UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
RICHARD AND EUNICE MAHLOCH,	)	CASE NO. BK82-2072
DENNIS MAHLOCH,	)	82-2073
	)	
DEBTORS	)	

MEMORANDUM AND ORDER

This matter comes on for hearing upon the application of Saline State Bank for the sequestration of the rents and profits from certain real estate owned by the debtors Richard and Eunice Mahloch and Dennis Mahloch in two separate Chapter 11 proceedings. The Bank is the holder of claims: the aggregate amount in the Richard and Eunice Mahloch case being $943,840.78 plus interest in the amount of $145,602.48, plus additional interest from and after December 22, 1982, at the rate of $458.81 per day, and in the estate of Dennis Mahloch, an aggregate claim amount of $897,455.32 plus interest in the amount of $141,783.79, plus additional interest from and after December 22, 1982, at the rate of $436.26 per day. The claims of the Bank arise in the main from real estate mortgages and an assignment of land contract. The Saline State Bank also holds a security interest in the debtors' 1982 crops and a partial assignment of each of the debtor's claims in additional bankruptcy estates. Each of the security documents at issue here contains provision for assignment of rents and profits to the Bank upon default by the obligor. The operative language of those documents states,

> Provided further, that upon such default the Mortgagee, or a receiver appointed by the court, may at his option and without regard to the adequacy of the security, enter upon and take possession of the Property and collect the rents, issues and profits therefrom and apply them first to the cost of collection and operation of the Property and then upon the indebtedness secured by the Mortgage; said rents, issues and profits being hereby assigned to the Mortgagee as further security for the payment of the indebtedness secured hereby.

At issue here is whether the language contained in the security agreement purporting to create a valid assignment of rents and profits, is sufficient to allow the Saline State Bank to prevail in its application to sequester rents and profits from all the real estate encumbered by its liens and to apply those rents and profits to the indebtedness secured by the mortgage.

Before this Court can reach this ultimate issue, it first must resolve whether to apply federal or state law in making that decision. The controversy centers around 11 U.S. Code §552(b) which provides in essence that if a pre-petition security agreement extends to proceeds, rents, or profits derived from that property, the security interest will attach to those proceeds, rents and profits acquired post-petition, but only to the extent provided by the security document and by the applicable non-bankruptcy law.

According to Butner vs. U.S., 440 U.S. 48 (1979), the right to rents and profits realized by mortgaged property is to be determined by the laws of the state in which the property is located. Therefore, the laws of the State of Nebraska are to be applied when interpreting the terms of the security documents.

There is no significant dispute among the parties that pursuant to Nebraska state law, rents and profits may be validly assigned, such assignment creating an equitable lien in favor of the mortgagee upon default by the mortgagor, this, from a long line of cases, beginning with Penn Mutual Life Insurance Company vs. Katz, 139 Neb. 501 (1941). The dispute in the instant case centers around a perceived conflict between the language of the operative document and caselaw interpreting the validity of such assignment within certain Nebraska State statutory requirements. The debtors-in-possession and the First National Bank of Chicago, a secured creditor in both estates, argue that the debtors, not the Saline State Bank, are entitled to receive and hold rents and profits realized from the realty in question despite express terms to the contrary in the security documents.

Caselaw in Nebraska, Huston vs. Canfield, 57 Neb. 345 (1899), indicates that so long as the mortgagor is in possession of the property, he may collect and use for his own benefit the rents and profits derived from the mortgaged property. Until that possession is interrupted either by conveyance or by foreclosure, the mortgagor rather than holder of the mortgage is entitled to those proceeds. The Huston case required that steps be taken pursuant to Nebraska law to secure the appointment of a receiver. The fact that no receiver had been appointed was sufficient to render the rents and profits property of the mortgagor and to prevent their application toward the debt owed on the mortgage. [See also Prudential Insurance Co. of America v. Farm Insurance Co. 243 N.W. 843 (Neb. 1899)].

In accord is the 5th Circuit decision In re Village Properties, Ltd., 723 F.2d 441 (5th Cir. 1984) interpreting an assignment of rents provision under a deed of trust. There, too, state law required the mortgagee take affirmative steps after default before he could reach his interest in rents. In this state, the appointment of a receiver is the mandated affirmative step.

Nebraska Statue §25-1081 (Reissue 1979) deals with the appointment of receivers. Under that statutory section, a receiver may be appointed under a variety of circumstances. Applicable here is sub-paragraph 2. Under those provisions, a receiver may be appointed ". . .in an action for the foreclosure of a mortgage, when the mortgaged property is in danger of being lost, removed, or materially injured, or is probably insufficient to discharge the mortgage debt." §25-1081 R.R.S. 1943. It follows, then, that the only means by which the Saline State Bank may make any claim to the rents and profits is by initiation of a foreclosure action and by appointment of a receiver. Neither of these steps was taken pre-petition. Accordingly, it is

ORDERED that the application for sequestration is hereby denied.

DATED: May 25th, 1984.

BY THE COURT:

David L. Crampton

U.S. Bankruptcy Judge

Copies to:

Timothy Haight, Attorney, 1500 Woodmen Tower, Omaha, NE 68102

Joseph Badami, Attorney, 1241 N, Rm. 402, Lincoln, NE 68508

Gregory Searson, Attorney, The Omaha Building, 1650 Farnam Street, Omaha, NE 68102