UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
WILLIAM M. BARGER and RANDEE L. BARGER,	)	CASE NO. BK86-1341
	)	
DEBTORS.	)	A87-31
	)	
FIRST NATIONAL BANK OF McCOOK,	)	CH. 11
	)	
Plaintiff	)	
	)	
vs.	)	
	)	
WILLIAM M. BARGER and RANDEE L. BARGER,	)	
	)	
Defendants.	)	

MEMORANDUM

Trial of this adversary proceeding took place in North Platte, Nebraska, on April 20, 1988. After presentation of the evidence, the Court requested final post-trial briefs and written final argument. Those items have been filed with the Court and reviewed. Appearing on behalf of the plaintiff/bank was David Pederson of Murphy, Pederson, Piccolo & Pederson, P.O. Box 38, North Platte, Nebraska. Appearing on behalf of the defendants/debtors-in-possession, was William L. Needler, 220 So. State St., No. 1200, Chicago, Illinois. This memorandum constitutes the findings of fact and conclusions of law required by Bankr. R. 7052.

Facts

Mr. and Mrs. Barger are farmers in western Nebraska. They both work on the farm and participate both in the operation of the agricultural endeavor and in the record keeping for the farm unit.

Over several years, Mr. Barger has done business with the plaintiff/bank. He has executed numerous promissory notes and granted security interests in the farming assets to the bank. The bank has filed financing statements pursuant to Nebraska statutes in an attempt to perfect such security interests. In return for the execution of such documents the bank has financed the farm operation at least since 1980.

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DISTRICT OF NEBRASKA
AT ____ M
AUG 30 1988
Judith M. Napier
Clerk, U.S. Bankruptcy Court
By ____ Deputy

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Mrs. Barger has not signed any promissory notes or security documents and has not presented to the bank any financial statements which list her assets or liabilities. From the evidence, the Court finds that the bank did not ever request that she sign any such documents, but the Court also finds that the bank officers were aware throughout the years the banking relationship was in effect that she was an integral part of the operation.

In March of 1986 Mr. Barger and the bank came to an agreement concerning the farming operations. Mr. Barger and a bank officer on behalf of the bank executed an agreement which has been admitted into evidence as exhibit six entitled: "This agreement is between William Barger and the First National Bank of McCook, Nebraska." The exhibit states that William Barger on that date owed the bank a total of $228,600.00 plus accrued interest of $30,036.40. The agreement goes on to state that the bank would furnish farm operating capital for William Barger for 1986 in an amount not to exceed $80,000.00. Further, the bank agreed to provide an additional $12,000.00 as living expenses to William Barger for the year 1986 to be paid in the amount of $1,100.00 per month from and after the execution of the agreement.

In consideration of such operating funds being advanced, William Barger agreed to sell most of his cattle herd and his harvested pinto beans and milo on hand and apply the proceeds to the debt. The agreement contemplated a sale by April 1, 1986 and an application of proceeds of $115,900.00 to the debt. In addition, the agreement provided that the harvest value of 210 acres of growing winter wheat in the amount of $21,000.00 would be applied to the debt when the wheat crop was harvested and sold. Finally, the agreement apparently provided that the anticipated growing crops to be harvested in the fall of 1986 with a cash value at harvest in the amount of $70,750.00 would also be applied to the debt. However, those proceeds from the 1986 crop would first be applied to the operating loan and the family living loan.

Mr. Barger immediately received an advancement of living expenses and an advancement of operating funds pursuant to the terms of the agreement and pursuant to notes which he executed contemporaneously with the agreement. Then Mr. Barger used the operating funds advanced to purchase seed, fertilizer and other supplies for the 1986 crop season. From the execution of the agreement on March 27, 1986, until May 6, 1986, Mr. Barger received approximately $59,000.00. On May 6, 1986, Mr. and Mrs. Barger filed a joint petition for protection under Chapter 11 of the United States Bankruptcy Code. Shortly thereafter, Mr. Barger, as one of the debtors-in-possession, either directly or by his attorney informed the bank that he intended to complete the agreement with the bank if it intended to continue its part of the agreement.

Although the lawyer for the bank and the lawyer for the debtors and Mr. Barger were aware that any postposition advances by the bank under the operating agreement would not be treated as a secured loan without permission of the Court under Section 364 of the Bankruptcy Code, the lawyer for the debtors did not file the appropriate motion which would have brought the matter before the Court. However, even though the motion had not been filed, the bank continued to advance funds relying upon the representations by Mr. Barger and his counsel that such a request would be made and that he intended to live up to the terms of the agreement.

The bank paid out fully under the terms of the agreement by approximately August of 1986 and it was at about that time that Mr. Barger directly informed the bank that the debtors would not ask for Court approval of the loan, nor would they make any payment pursuant to the agreement.

The bank then filed a motion requesting the Court to authorize a secured loan, to which both debtors objected. The Court did not approve the motion and directed that an adversary proceeding be filed to clarify the matter. This adversary proceeding was then filed which requests a determination of the status of the bank's liens in the 1986 crop, in the ASCS payments for the year 1986 and in the equipment owned by the debtors.

The parties have stipulated that the $34,504.39 advanced postposition is at least an administrative expense allowable under Section 503 of the Code. However, the bank strenuously argues that not only are the prepetition advances secured by the assets of the debtors but that the postposition advances should be treated as secured also because of the representations of Mr. Barger which led the bank to continue funding according to the agreement even though the debtors eventually refused to obtain the appropriate Court authority for such funding on a secured basis.

The debtors respond to the bank's claims in several ways. First, the debtors claim that Mrs. Barger owns one-half of all of the assets of the farming operation and that the bank has no security agreement with her, no perfected security interest in her assets and if somehow this Court should find that she had permitted her husband to grant a security interest in her assets prepetition, the powers of the debtor-in-possession under Section 544 of the Bankruptcy Code would permit the avoidance of such an unperfected security interest. Second, the debtors claim that the bank does not have a perfected security interest in government payments under the ASCS programs by virtue of the language in the security agreements or financing statements and, further, if there is a perfected security interest in such payments, the bank has waived any claim to the security interest by its failure to assert any claim to government payments over the years and its acknowledgment that any ASCS payments would be used to make

payments to other secured creditors, including Farmers Home Administration and Federal Land Bank. Third, the debtors claim that some of the crops which were grown in the farming operation were raised on rented land and that the bank did not have legal descriptions of such land in either the security agreements or financing statements and therefore, under the Uniform Commercial Code, the bank does not have a security interest in those growing crops.

These contentions will be dealt with in order.

1. Ownership interest of Mrs. Barger and whether or not she granted a security interest to the bank.

From the testimony of bank officers as well as from the testimony of Mrs. Barger, it is clear to this Court that the bank has known for many years that she was a participating person in the farm operation and that she had some type of an ownership interest in that farm operation. The Court further finds from her testimony that her interest is that of a one-half owner in all of the operations and all of the assets of the business which were owned or used in the operation of the business prior to March 27, 1986. The bank loaned the money for many years to Mr. Barger. The bank did not ever request her to sign any loan documentation or security instruments. The bank was aware of her interest and yet failed to ask her to complete any paperwork. This case is different from previous cases decided by this Court. In those cases the female member of the farming operation had failed to let the bank know either her activities as a part of the operating entity or her interest in the assets. In this case the bank was or should have been aware that Mrs. Barger had an ownership interest in the assets and should have taken a security interest in those assets. It failed to protect itself, and this Court will not infer that the bank has any security interest, perfected or unperfected, in her assets. This conclusion, however, does not end the matter with regard to the 1986 crop and its proceeds which will be discussed below in Part 3.

With this factual conclusion, the Court finds it unnecessary to discuss the issue of lien avoidance under Section 544 of the Bankruptcy Code. Therefore, the Court determines that the bank had a security interest in one-half of the value of the cattle, one-half of the value of the growing crop and one-half of the value of machinery and equipment on the bankruptcy petition date, May 6, 1986. The value of the property subject to the lien includes $69,339.00 which is one-half of the total value of the growing wheat, cattle, machinery and cattle proceeds on hand on the petition date.

2. The ASCS payments.

The various security agreements and financing statements signed by Mr. Barger granted the bank a security interest in, variously, accounts, contracts rights and general intangibles. Government payments payable through ASCS programs have been determined by other Courts to fall under those general categories. One exception to such findings concerns generic certificates which this Court has found in Matter of Lehl, 79 B.R. 880 (Bankr. D. Neb. 1987), to be not subject to Uniform Commercial Code security interest under state law by virtue of the plain language of the federal regulations governing the issuance of such certificates. Therefore, the Court concludes that one-half of the government program payments, whether for the 1986 program or for prior years' programs, are subject to the security interest of the bank, less any payments which were made by virtue of generic certificates. To the extent Mr. Barger's share of such payments were used in the production of the 1986 crop, the lien of the bank attaches to the 1986 crop and its proceeds.

With regard to the "waiver defense," this Court rejects such a defense. There is no evidence in this record that the bank waived its claim to a security interest in the ASCS payments. It is true that the bank, believing it was secured by a perfected security interest in all of the assets of the farming operation, permitted the use of government payments for payment on the mortgage loans to Farmers Home Administration and Federal Land Bank. However, it is also true that as soon as it became clear to the bank that the debtors would not be required to pay such payments over to Farmers Home Administration and the Federal Land Bank, it reasserted its interest in those payments and requested that the payments be delivered to the bank. The bank's granting permission to use such payments to keep other creditors current is not sufficient factually to permit this Court to find that the bank actually waived its claim to such payments.

3. The secured position of the bank with regard to funds advanced pursuant to the operating agreement from March 27, 1986 to May 6, 1986.

Mr. Barger borrowed the money pursuant to the operating agreement of March 1986. Mr. Barger granted the security interest in collateral pursuant to that operating agreement. This Court concludes that Mr. Barger became the owner of the funds which were borrowed from the bank and that no ownership interest of his wife attached to those funds. There is no evidence in the record that he made a gift of the funds he obtained from the bank in 1986 or that he used those funds for any purpose other than the purchase of supplies, power, repairs and other such purchases, all of which were necessary for planting the 1986 crop, plus $12,000 he used for living expenses. The bank had a valid security interest in all such supplies, farm products and proceeds of such supplies and

farm products. Mr. Barger, whether by design or by accident, did not plant the 1986 crop until after he had received $59,000.00 from the bank for input costs and had filed bankruptcy. Therefore, the bank's security interest arguably does not extend to the 1986 growing crops. This is because Section 552 of the Bankruptcy Code has been interpreted numerous times to cut off security interests in after acquired property. See Bird v. Plains State Bank, 86 B.R. 660 (Bankr. D. Kan. 1988), and cases cited therein. The debtors argue that the crops, being planted after the petition date, are after acquired property and are not the product of the collateral in which the creditor had a security interest. The debtors further argue that even if a security interest extends to the postposition crops, there can be no perfected security interest in crops which were grown on land for which the bank failed to list a legal description in the financing statement.

The Court finds that the bank does have a security interest in the proceeds of the 1986 crop which was planted after May 6, 1986. That security interest is perfected to the extent of the $59,000.00 in advances made prepetition. The bank had a perfected security interest in supplies, farm products and proceeds. The bank loaned Mr. Barger money for the 1986 operating year. Prior to the petition date, Mr. Barger had in his possession supplies, including seed and fertilizer and other chemicals. Postpetition he used those supplies, including seed, fertilizer and other chemicals to produce the crop. The crop was harvested and thus became a farm product during 1986. There is nothing in the Uniform Commercial Code which prohibits a prepetition security interest in seed and supplies from continuing to be a valid security interest in the resulting farm products and the proceeds of the farm products. In addition, there is nothing in the Bankruptcy Code which prohibits such continued perfection. Section 552(b) of the Bankruptcy Code specifically authorizes the postposition continuation of a perfected security interest in the proceeds and the product of prepetition collateral as long as the appropriate language is contained in the security documents. In this case the security documents contained the appropriate language, and the lien passes through from the prepetition collateral to the postposition proceeds and products.

The debtors argue that any prepetition security interest is lost with regard to crops planted postposition and specifically with regard to growing crops which are grown on land which is not adequately described in the financing statement. This Court could conceive of circumstances under which it could agree with the debtors. However, this creditor not only has a prepetition lien in crops or growing crops but has a lien in supplies, including seed, products and proceeds. The fact that the crops were planted postposition and that the bank did not have the appropriate legal description on certain documents does not destroy its perfected

security interest in the product and proceeds of prepetition collateral. See Matter of Sekutera, 62 B.R. 387 (Bankr. D. Neb. 1986).

4. Postpetition Advances.

None of the above discussion, however, saves the bank's claim that it also should be treated as secured with regard to the postposition advances. When bankruptcy is filed, Section 364 permits a debtor-in-possession to borrow money on a secured basis only with permission of the Court. Therefore, advances made postposition are not covered by a prepetition security interest. The bank argues that it would inequitable to prohibit it from being treated as secured under the circumstances of this case with regard to postposition advances. The evidence is clear that the bank was misled by Mr. Barger into continuing to advance monies pursuant to a prepetition agreement upon the good faith belief that the debtor would perform. He promised to approach the Bankruptcy Court and request to be permitted to borrow on a secured basis to insure that the farming operations would be successful during the 1986 farm year. The evidence is clear that Mr. Barger needed the additional $34,000.00 from the bank postposition in order to operate the farm business during the crop year 1986.

The debtors suggest that there is nothing in the Bankruptcy Code which would permit this Court to grant some type of "equitable lien" under these circumstances and that the bank should simply stand in line after secured creditors and before unsecured creditors with a priority administrative expense claim. This Court finds that the Bankruptcy Court does have the power to grant such an equitable lien under the circumstances as shown by the evidence in this case. In a recent bankruptcy decision on facts very similar to those at issue here, the Bankruptcy Court for the Southern District of Ohio determined that an entity which had loaned funds postposition for production of postposition crops would be granted an equitable lien upon net proceeds of the crops. See In re Smith, 72 B.R. 344 (Bankr. S.D. Ohio 1987). In that case the postposition advances were necessary for production of the crops, the parties intended that a lien would be granted to the creditor, the advances would not have been made had the creditor realized it would not be granted the lien. All of the appropriate documents enabling the creditor to obtain the lien were executed, but no Court approval was sought. The Court stated:

> This is not a case where the debtor has attempted to grant a lien to a creditor on previously unencumbered property at the expense of the general creditors. The fundamental fact is that Ohio Grain's loan did not just preserve the bankruptcy stay, but in fact "created" a portion of that estate. To allow Ohio Grain no recovery

from the 1986 crops would result in a creation of a "windfall" for the other creditors.

Smith, 72 B.R. at 351.

The Smith Court allowed, on a nunc pro tunc basis, a security interest to attach to the proceeds of the debtor's postposition 1986 crop.

In this case, the facts are even more favorable to the bank. This debtor, Mr. Barger, misled the bank officers who, either through ignorance or a naive belief that this debtor would live up to his promises, continued to advance funds pursuant to its prepetition agreement even though the debtor delayed and eventually reneged upon his promise to seek Court approval. The postposition advances were necessary for the creation of the crop and such advances would not have been made but for the affirmative representations of the debtor that he would proceed appropriately in the Bankruptcy Court. As in Smith cited above, it would be inequitable to prohibit the bank from obtaining its lien solely to grant the unsecured creditors a windfall. Therefore, this Court finds that the bank does have a security interest in the proceeds of the 1986 crop which was planted after May 6, 1986 to the extent of the postposition advances.

In conclusion, the Court finds:

(1) Mrs. Barger owns one-half of all assets acquired prior to March 27, 1986 and the bank is unsecured as to her one-half interest.

(2) The bank has a valid security interest in Mr. Barger's one-half interest in the prepetition and postposition ASCS payments and, to the extent Mr. Barger's government payments were used in the production of the 1986 crop, the bank's security interest follows such investment and attaches to the proceeds of the crop.

(3) The bank has a lien on the 1986 crop proceeds to the extent of the prepetition advances of $59,000.

(4) The bank has a lien on the 1986 crop proceeds to the extent of the postposition advances and, in addition, an administrative claim under Section 503 for the postposition advances which exceed the value of the proceeds from the 1986 crop.

Separate Journal Entry shall issue.

DATED: August 27, 1988

BY THE COURT:

Timothy J. Mahoney
Chief Judge