FINANCING ISSUES

Before bankruptcy – state law lending rules:

O.C.G.A. § 11-9-322.1 (crop enabling loan)
O.C.G.A. § 11-9-334 (priority over mortgage)
O.C.G.A. § 11-9-502 (financing statement requirements)
O.C.G.A. § 11-9-306 (proceeds)
Prepetition perfection – see In re Coody, 59 B.R. 164 (Bankr. M.D. Ga. 1986).

After bankruptcy: 11 U.S.C. § 364
Fed. R. Bankr. P. 4001

A. Section 364(a) – unsecured credit. Ordinary course of business. Section 503(b)(1) administrative expense priority. No court permission required.

B. Section 364(b) – unsecured credit. Outside of ordinary course of business with court authorization. Section 503(b)(1) administrative expense priority is authorized.

C. Section 364(c) states:

(c) If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt—

(1) with priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title;

(2) secured by a lien on property of the estate that is not otherwise subject to a lien; or

(3) secured by a junior lien on property of the estate that is subject to a lien.

D. Section 364(d) states:

(d)(1) The court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if—

(A) the trustee is unable to obtain such credit otherwise; and

(B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.

(2) In any hearing under this subsection, the trustee has the burden of proof on the issue of adequate protection.

E. Section 364(e) states:

(e) The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in

good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.

F. Fed. R. Bankr. P. 4001(c) provides:

(c) OBTAINING CREDIT.

(1) *Motion; Service.*

(A) *Motion.* A motion for authority to obtain credit shall be made in accordance with Rule 9014 and shall be accompanied by a copy of the credit agreement and a proposed form of order.

(B) *Contents.* The motion shall consist of or (if the motion is more than five pages in length) begin with a concise statement of the relief requested, not to exceed five pages, that lists or summarizes, and sets out the location within the relevant documents of, all material provisions of the proposed credit agreement and form of order, including interest rate, maturity, events of default, liens, borrowing limits, and borrowing conditions. If the proposed credit agreement or form of order includes any of the provisions listed below, the concise statement shall also: briefly list or summarize each one; identify its specific location in the proposed agreement and form of order; and identify any such provision that is proposed to remain in effect if interim approval is granted, but final relief is denied, as provided under Rule 4001(c)(2). In addition, the motion shall describe the nature and extent of each provision listed below:

(i) a grant of priority or a lien on property of the estate under §364(c) or (d);

(ii) the providing of adequate protection or priority for a claim that arose before the commencement of the case, including the granting of a lien on property of the estate to secure the claim, or the use of property of the estate or credit obtained under §364 to make cash payments on account of the claim;

(iii) a determination of the validity, enforceability, priority, or amount of a claim that arose before the commencement of the case, or of any lien securing the claim;

(iv) a waiver or modification of Code provisions or applicable rules relating to the automatic stay;

(v) a waiver or modification of any entity's authority or right to file a plan, seek an extension of time in which the debtor has the exclusive right to file a plan, request the use of cash collateral under §363(c), or request authority to obtain credit under §364;

(vi) the establishment of deadlines for filing a plan of reorganization, for approval of a disclosure statement, for a hearing on confirmation, or for entry of a confirmation order;

(vii) a waiver or modification of the applicability of nonbankruptcy law relating to the perfection of a lien on property of the estate, or on the foreclosure or other enforcement of the lien;

(viii) a release, waiver, or limitation on any claim or other cause of action belonging to the estate or the trustee, including any modification of the statute of limitations or other deadline to commence an action;

(ix) the indemnification of any entity;

(x) a release, waiver, or limitation of any right under §506(c); or

(xi) the granting of a lien on any claim or cause of action arising under §§544,[1] 545, 547, 548, 549, 553(b), 723(a), or 724(a).

(C) *Service*. The motion shall be served on: (1) any committee elected under §705 or appointed under §1102 of the Code, or its authorized agent, or, if the case is a chapter 9 municipality case or a chapter 11 reorganization case and no committee of unsecured creditors has been appointed under §1102, on the creditors included on the list filed under Rule 1007(d); and (2) on any other entity that the court directs.

(2) *Hearing*. The court may commence a final hearing on a motion for authority to obtain credit no earlier than 14 days after service of the motion. If the motion so requests, the court may conduct a hearing before such 14-day period expires, but the court may authorize the obtaining of credit only to the extent necessary to avoid immediate and irreparable harm to the estate pending a final hearing.

(3) *Notice*. Notice of hearing pursuant to this subdivision shall be given to the parties on whom service of the motion is required by paragraph (1) of this subdivision and to such other entities as the court may direct.

(4) *Inapplicability in a Chapter 13 Case.* This subdivision (c) does not apply in a chapter 13 case.

G. Effect of section 552(b).

a. 11 U.S.C. § 552(a):

(a) Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

b. 11 U.S.C. § 552(b):

(b)(1) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, products, offspring, or profits of such property, then such security interest extends to such proceeds, products, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

c. Planting date. It seems to be settled law that section 552(a) cuts off a prepetition lender's prepetition security interest in crops planted after the bankruptcy filing date. In re Sheehan, 38 B.R. 859 (Bankr. S.D. 1984); In re Kruge, 35 B.R. 958 (Bankr. Kan. 1983); In re Lorenz, 57 B.R. 734 (Bankr. E.D. Ill. 1986). Likewise, if crops are planted prepetition they will attach to the prepetition security agreement, although valuation and "equities" issues may arise. Lorenz provides an example of this principle. There, it was asserted that the debtor used

prepetition crop proceeds, which were pledged to Lender A, to help produce post-petition crops financed by Lender B. The crops were planted after the petition date. The Court held that the prepetition security interest was cut off with regard to the crop planted after the petition date. Therefore, the question arose as to whether the "proceeds" exception would apply. The Court relied on the Illinois version UCC § 9-306, which defines proceeds as whatever is received in exchange for disposition of collateral. Section 522 did not apply, therefore, to post-petition proceeds because proceeds had to arise from the post-petition crop.

d. "Equities of the case." In re Lawrence, 41 B.R. 36 (Bankr. D. Minn. 1984) discusses "equities" in the case of milk production. The Court held that even if milk were proceeds of prepetition collateral, the equities required the termination or adjustment of the lien due to be expenditure of labor, feed, etc. A contrary decision was reached in In re Johnson, 47 B.R. 204 (Bankr. W.D. Wisc. 1985) where the Court held that equity was not appropriate due to an adequate remedy in law (adequate protection or use of cash collateral).

In Gray v. Bank of Early, 2018 U.S. Dist. Lexis 231210 (M.D. Ga. 2018), Bank of Early (BOE) held a prepetition security interest on crops for 2015 and subsequent years. Debtor filed for chapter 12 on May 7, 2016. Two to three weeks before the petition date, the debtor planted a corn crop. The parties stipulated that the security interest attached to the corn crop. The debtor alleged that he obtained $11,100.40 in funds post-petition from another creditor to bring the corn crop to maturity. The debtor also used $25,000.00 of his own money prepetition to plant the crop. The Court found that the security interest attached under the UCC because the crop was planted before the petition. The Bankruptcy Court held that the "equities" exception in section 552(b) not applicable as a matter of law to post-petition financing. The District Court reversed holding that a balancing of the equities should have been undertaken by the Bankruptcy Court. It

held that the exception was intended to apply where the trustee uses estate funds to increase the value of the collateral. The Court held that $25,000.00 in unencumbered funds used in the prepetition planting did not trigger the exception. However, the exception could apply to the post-petition expenditures, but the record was inadequate for the District Court to apply the balance test.

e. Program payments.

In Bracewell v. Kelley (In re Bracewell), 454 F.3d 1234 (11th Cir. 2006), the Eleventh Circuit held that a post-petition disaster program was not property of the bankruptcy estate because it was not in existence "as of the commencement of the case as required by 11 U.S.C. § 541(a). Followed Eighth, Fifth, and Ninth Circuits dissenters argued that the payments were "rooted" in prepetition conduct (prepetition crops).

In re Klaus, 247 B.R. 761 (Bankr. C.D. Ill. 2000), dealt with prepetition LDP payments. Secured creditor held security agreement and UCC covering "all entitlements and payments from and state or federal farm program . . . and general intangibles." The debtors argue LDPs acquired post-petition for prepetition crop program in existence prepetition and the debtor could have applied before bankruptcy. The debtor's right to apply prepetition was a sufficient property right for the security interest to attach. See also In re Lesmeister, 242 B.R. 920 (Bankr. N. Dak. 1999); In re Otto Farms, Inc., 247 B.R. 757 (Bankr. C.D. Ill. 2000).

Cases are in conflict as to whether program payments are substitutes for crops or general intangibles. The problem arises when the security agreement or financing statement only lists crops. See In re Schmaling, 783 F.2d 680 (7th Cir. 1985), relies on § 9-306 designation of proceeds. Proceeds under § 306 is something received by sale or exchange. PIK payments were not received upon sale or exchange and were not proceeds or crop substitutes.

For cases holding payments as substitute for crops see In re Judkins, 41 B.R. 369 (Bankr. D. Tenn. 1984) ("substitute for crops"); In re Kruse, 35 B.R. 958 (D. Kan. 1983) (PIK payment for planted crops were crop proceeds but PIK for crops not planted were general intangibles).

"General intangibles including government payments" is generally considered as adequate description. In re Otto Farms, 247 B.R. 757 (Bankr. S.D. Ill. 2000).

f. Cross-collateralization.

Cross-collateral clauses provide that the post-petition financing arrangement will cover the prepetition unsecured debt. Such would be the case where the farmer has a prepetition deficiency under an operating loan. See In re Texlon, 596 F.2d 1092 (2nd Cir. 1979); In re Vanguard Diversified, Inc., 31 B.R. 364 (Bankr. E.D. N.Y. 1983). These cases note that such arrangement are disfavored, but are available if the debtor will not survive without such arrangements, if no other loan is available and if such arrangement is in the interest of the creditor body.

H. Use of cash collateral.

11 U.S.C. § 363(a) provides:

(a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

11 U.S.C. § 363(c) provides:

(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, 1183, 1184, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

(3) Any hearing under paragraph (2)(B) of this subsection may be a preliminary hearing or may be consolidated with a hearing under subsection (e) of this section, but shall be scheduled in accordance with the needs of the debtor. If the hearing under paragraph (2)(B) of this subsection is a preliminary hearing, the court may authorize such use, sale, or lease only if there is a reasonable likelihood that the trustee will prevail at the final hearing under subsection (e) of this section. The court shall act promptly on any request for authorization under paragraph (2)(B) of this subsection.

(4) Except as provided in paragraph (2) of this subsection, the trustee shall segregate and account for any cash collateral in the trustee's possession, custody, or control.

Adequate protection of required 11 U.S.C. § 363(e).

I. Liquidation of assets.

A debtor may sell property of the estate to generate funds. Court permission is required if the sale is outside the ordinary course of business. 11 U.S.C. § 363. Section 363 provides with regard to sales free and clear:

(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

Chapter 12 afforded special tax treatment. 11 U.S.C. § 1232. Capital gains ordinarily treated as an expense of administration with highest priority, now treated as general unsecured. In effect, a farmer in Chapter 12 may liquidate assets with no capital gains tax (provided there is no distribution to unsecured creditors).

EXAMPLES

Situation 1

Farmer Brown has a $1,000,000.00 operating line with AgBank prior to bankruptcy. After collecting his 2019 crops, which were secured by the line, there is a deficiency of $500,000.00. Farmer Brown collected $100,000.00 of the 2019 crop proceeds in early 2020 and paid land rent for the 2020 crop. In April 2020, Farmer Brown files chapter 12. New Lender, in order to finance Farmer Brown, wants a first priority security interest in all crops and government benefits. AgBank claims that it should be compensated for the rent proceeds that went into the 2020 crop.

Situation 2

Farmer Brown files chapter 12 in May 2020. As a peanut planting deadline approaches, Lender advances $50,000.00 without Bankruptcy Court approval. The lender wishes to advance an additional 500,000.00 to be secured by 2020 crops and government payments. How does the Court deal with the initial, unauthorized $50,000.00 advance?

Situation 3

In 2019, prepetition lender takes an assignment of 2019, 2020, and 2021 crops for government payments to secure a multi-year credit line. Debtor executes a CCC form 36 assignment. Debtor files chapter 12 in March 2020. Can new lender take the 2020 government payments?

Situation 4

Lender does not get Bankruptcy Court approval to loan funds even though Farmer Brown has filed chapter 12. Lender advances crop money, takes a security agreement in crops, and files an otherwise appropriate UCC financing statement. What are the results?

Situation 5

Lender has 2019 deficiency of $400,000.00 and is undercollateralized by that amount. Debtor files Chapter 12. Lender is willing to make a new operating loan provided that $400,000.00 deficiency can be "rolled into" the new loan.

Situation 6

Farmer Brown files for chapter 12 in January 2020. Lender will advance $500,000.00 if secured by 2020 crops, crop insurance and government benefits. Farmer must pay $100,000.00 land rent within seven days. Fed. R. Bankr. P. 4001 states that a preliminary hearing on financing may be held on less than 15 days' notice, during which debtor can borrow only enough to prevent irreparable damage to estate. Lender does not want to lend $100,000.00 for rent and then risk being denied authority to lend the rest at a final hearing.

Situation 7

Farmer Brown cannot obtain financing. He has prepetition crop proceeds of $500,000.00, which are sufficient for his currently planned crop. The prepetition crops are pledged to AgBank.

Situation 8

Farmer Brown has a 200-acre farm tract that is unencumbered. It was inherited many years ago and has a very low tax basis. If he can sell it, he will have sufficient funds to operate the current year.

In re Coody

United States Bankruptcy Court for the Middle District of Georgia, Macon Division

March 25, 1986

Case No. 86-50433, Chapter 11

Reporter
59 B.R. 164 *; 1986 Bankr. LEXIS 6421 **; 1 U.C.C. Rep. Serv. 2d (Callaghan) 581

In the Matter of Rufus Bartlett COODY, Debtor

Core Terms

crops, grown, collateral, lot number, security agreement, security interest, financing statement, rented, perfected security interest, covering, proceeds, cotton, description of land, crop proceeds, perfected

Case Summary

Procedural Posture
Debtor filed a petition under Chapter 11 of the Bankruptcy Code and brought before the court a motion to use cash collateral for a debt owed to a bank in relation to a security agreement.

Overview
Debtor granted a bank a security interest in all crops grown on real estate described in a security agreement. The bank filed a financing statement to perfect the security agreement. The financing statement covered crops grown on land owned by debtor, crops grown on land rented by debtor, and crop proceeds. The court held that the bank's security agreement did not contain a sufficient description to have a security interest in the crops grown on rented land or the resulting proceeds because the security agreement contained no reference to or description of the rented land. The court held that bank did not sufficiently describe the crops grown on one lot; therefore, its security interest in those crops was not perfected. Without a reference, a third party would not be put on notice that crops grown on that lot and the resulting proceeds represented collateral in which the bank claimed a security interest. The court held that since debtor had the status of a hypothetical lien creditor, bank had no claim to cash proceeds from the rented land. The court held debtor demonstrated adequate protection to protect the bank's interest, and that debtor was authorized to use cash collateral.

Outcome
The motion to use cash collateral filed by debtor was granted. The court also directed the bank to endorse joint checks and authorized debtor to sell cotton upon which the bank had a security interest and to use the proceeds from the sale in accordance with the court's order.

LexisNexis® Headnotes

Business & Corporate Compliance > ... > Contracts Law > Standards of Performance > Creditors & Debtors

Commercial Law (UCC) > Secured Transactions (Article 9) > General Provisions > General Overview

Commercial Law (UCC) > Secured Transactions (Article 9) > General Overview

Commercial Law (UCC) > ... > Attachment, Effectiveness & Rights > Attachment & Effectiveness > General Overview

Commercial Law (UCC) > ... > Attachment, Effectiveness & Rights > Attachment & Effectiveness > Enforceability of Security Interests

Commercial Law (UCC) > ... > Attachment, Effectiveness & Rights > Attachment & Effectiveness > Security Interest Requirements

Commercial Law (UCC) > ... > Filing > Financing Statements > Requirements

Commercial Law (UCC) > Secured Transactions (Article 9) > Attachment, Effectiveness & Rights > General Overview

Commercial Law (UCC) > ... > Attachment, Effectiveness & Rights > Attachment & Effectiveness > Security Agreement Requirements

Contracts Law > ... > Secured Transactions > Attachment of Security Interests > General Overview

Business & Corporate Compliance > ... > Secured Transactions > Attachment of Security Interests > Enforceability

HN1[] **Standards of Performance, Creditors & Debtors**

Under Georgia law, a security interest is not enforceable against a debtor regarding the collateral and does not attach unless debtor has signed a security agreement which contains a description of the collateral and, when the security interest covers crops growing or to be grown, a description of the land concerned. *O.C.G.A. § 11-9-110* governs sufficiency of the description of land contained in a security agreement in that any description of land is sufficient if it reasonably identifies what is described. Several courts addressing the sufficiency issue of a description of growing crops under this section have upheld descriptions listing the name of the landowner, the approximate number of acres involved, the county, and the direction and distance of the land from a named town. Georgia courts have held that the description of collateral is sufficient if the key to the identity of the collateral is present.

Business & Corporate Compliance > ... > Methods of Perfection > Financing Statements > Requirements

Commercial Law (UCC) > ... > Filing > Financing Statements > General Overview

Commercial Law (UCC) > Secured Transactions (Article 9) > General Overview

Commercial Law (UCC) > ... > Methods of Perfection > Filing > General Overview

Commercial Law (UCC) > Secured Transactions (Article 9) > Attachment, Effectiveness & Rights > General Overview

Commercial Law (UCC) > ... > Attachment, Effectiveness & Rights > Attachment & Effectiveness > Security Agreement Requirements

HN2[] **Financing Statements, Requirements**

The description of the land in the security agreement cannot be enlarged by filing a financing statement in which the land is more broadly described in order to cover land not included in the security agreement.

Business & Corporate Compliance > ... > Contracts Law > Standards of Performance > Creditors & Debtors

Commercial Law (UCC) > ... > Filing > Financing Statements > Requirements

Contracts Law > ... > Perfections & Priorities > Perfection > General Overview

Commercial Law (UCC) > Secured Transactions (Article 9) > General Overview

Commercial Law (UCC) > ... > Perfection & Priority > Perfection > General Overview

Commercial Law (UCC) > ... > Perfection > Methods of Perfection > General Overview

Commercial Law (UCC) > ... > Methods of Perfection > Filing > General Overview

Commercial Law (UCC) > ... > Filing > Financing Statements > General Overview

Commercial Law (UCC) > Secured Transactions (Article 9) > Attachment, Effectiveness & Rights > General Overview

Contracts Law > ... > Secured Transactions > Perfections & Priorities > General Overview

Contracts Law > ... > Perfection > Methods of Perfection > General Overview

HN3[] **Standards of Performance, Creditors & Debtors**

In order for a security agreement to be properly perfected, *O.C.G.A. §§ 11-9-303(1)*, *11-9-302(1)* requires a creditor to file a financing statement covering his security interest. *O.C.G.A. § 11-9-402(5)* provides that a financing statement covering crops growing or to be grown must show that it covers this type of collateral, must recite that it is to be indexed in the real estate records, and the financing statement must contain a description of the real estate. *O.C.G.A. § 11-9-110* determines what type of description is sufficient to comply with *O.C.G.A. § 11-9-402(5)*.

Bankruptcy Law > ... > Examiners, Officers & Trustees > Duties & Functions > Capacities & Roles

Commercial Law (UCC) > Secured Transactions (Article 9) > Default

Contracts Law > ... > Perfections & Priorities > Perfection > General Overview

Bankruptcy Law > ... > Prepetition Transfers > Voidable Transfers > Lien Creditors & Purchasers

Bankruptcy Law > Reorganizations > Debtors in Possession > General Overview

Bankruptcy Law > ... > Reorganizations > Debtors in Possession > Powers & Rights

Contracts Law > ... > Secured Transactions > Perfections & Priorities > General Overview

Real Property Law > Bankruptcy > Secured Claims

HN4[] **Duties & Functions, Capacities & Roles**

Under *11 U.S.C.S. § 544(a)(1)* of the Bankruptcy Code, a trustee in bankruptcy is granted to the status of a hypothetical lien creditor who is deemed to have perfected his interest as of the date of the filing of the bankruptcy petition. In a Chapter 11 case in which no trustee has been appointed, *§ 1107(a) of the Bankruptcy Code* grants to a debtor, in his capacity as a debtor in possession under *§ 1101 of the Bankruptcy Code*, certain of the trustee's rights and powers, one of which is the status of a hypothetical lien creditor under *§ 544(a)(1)*. Under Georgia law, an unsecured creditor and an unperfected secured creditor are subordinate to the claim of a subsequent intervening lien creditor.

Counsel: **[**1]** Rufus Bartlett Coody, Debtor, is represented by Jerome L. Kaplan, James P. Smith, and Wesley J. Boyer.

Bank of Dooly is represented by John Carswell Pridgen.

Judges: Robert F. Hershner, Jr., Chief United States Bankruptcy Judge.

Opinion by: HERSHNER, JR.

Opinion

[*164] MEMORANDUM OPINION AND ORDER

On March 10, 1986, Rufus Bartlett Coody, Debtor, filed a petition under Chapter 11 of the Bankruptcy Code. Before the Court is the "Motion to Use Cash Collateral" that was filed by Debtor on March 11, 1986. The motion came on for hearing on March 18, 1986, and the Court, having considered the evidence presented and the arguments of counsel, now publishes its opinion.

[*165] The initial issue for the Court's determination is whether under the security agreement executed on February 15, 1985, the Bank of Dooly has a properly perfected security interest in certain crops and crop proceeds under Georgia law. Under the security agreement, Debtor granted to the Bank of Dooly a security interest in "all crops grown on real estate shown on exhibit A." Exhibit A identifies and specifically

describes three tracts of land, which includes Land Lot Numbers 172, 180, 181, 203, and 204. The financing **[**2]** statement filed on February 15, 1985, to perfect this security agreement states that the financing statement covers crops grown on land owned by Debtor, crops grown on land rented by Debtor, and crop proceeds. The financing statement lists the following land lot numbers as lots owned by Debtor -- Land Lot Numbers 180, 181, 203, and 204; and the following land lot numbers as lots rented by Debtor -- Land Lot Numbers 139, 140, 166, 168, 169, 179, 188, 198, 199, 200, 201, 202, and 218. Debtor asserts that the Bank of Dooly does not have a properly perfected security interest in the crops Debtor grew on rented land because the security agreement does not specifically cover those crops.

HN1[↑] Under Georgia law, a security interest is not enforceable against a debtor with respect to the collateral and does not attach unless "the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown, a description of the land concerned; . . . ." *O.C.G.A. § 11-9-203(1)(a)* (Michie 1982). *See United States v. Big Z Warehouse, 311 F. Supp. 283, 286 (S.D. Ga. 1970)* ("security agreements covering crops **[**3]** must contain 'a description of the land concerned.'"); *In re Couch, 5 U.C.C. Rep. Serv. 255, 257 (Bankr. M.D. Ga. 1968)*. *Georgia Code section 11-9-110* [1] governs the sufficiency of the description of land contained in a security agreement. Under this section, any description of land is sufficient if it reasonably identifies what is described. *O.C.G.A. § 11-9-110* (Michie 1982). Several courts addressing the issue of the sufficiency of a description of growing crops under this section have upheld descriptions listing the name of the landowner, the approximate number of acres involved, the county, and the direction and distance of the land from a named town. *First National Bank of Franklin County, Tennessee v. Smith, 447 So.2d 705, 707 (Ala. 1984)* (citing *United States v. Newcomb, 682 F.2d 758 (8th Cir. 1982)*; *United States v. Oakley, 483 F. Supp. 762 (E.D. Ark. 1980)*; *United States v. Smith, 22 U.C.C. Rep. Serv. 502 (D. N.D. Miss. 1977)*; *United States v. Big Z Warehouse, 311 F. Supp. 283 (S.D. Ga. 1970)*). Georgia courts have held that the description of the collateral is sufficient if the key to the identity of the collateral is present. *In re A & T Kwik-n-Handi,* **[**4]** *Inc., 12 U.C.C. Rep. Serv. 765, 766 (Bankr. M.D. Ga. 1973)*; *Yancey Brothers Co. v. Dehco, Inc., 108 Ga. App. 875, 877, 134 S.E.2d 828, 830 (1964)*; *United States v. Big Z Warehouse, 311 F. Supp. at 286*.

This Court finds that the Bank of Dooly's security agreement does not contain a sufficient description under Georgia law in order for the Bank of Dooly to have a security interest in the crops grown on the rented land and the resulting crop proceeds. The security agreement contains absolutely no reference to or description of the rented land on which the crops were grown. The failure to include such a description leads the Court to conclude that no security interest in the crops grown on the rented land was ever created. *See* 8 R. Anderson, *Uniform Commercial Code § 9-203*:30 (3d ed. 1985). *HN2*[↑] The description of the land in the security agreement cannot be enlarged by filing a financing statement in which the land is more broadly described in order to cover land **[**5]** not included in the security agreement. *Id. See also Tri-County Livestock Auction Co. v. Bank of Madison, 228 Ga. 325, 329, 185 S.E.2d 393, 396 (1971)*. Under the security agreement, the Bank of Dooly took a security interest in only the crops grown on the land listed **[*166]** in Exhibit A, which includes Land Lot Numbers 172, 180, 181, 203, and 204, and the crop proceeds from that land.

The Court now must determine if the Bank of Dooly properly perfected its security interest in the crops grown on Land Lot Numbers 172, 180, 181, 203, and 204. *HN3*[↑] In order for a security agreement to be properly perfected, Georgia law requires a creditor to file a financing statement covering his security interest. *O.C.G.A. §§ 11-9-303(1)*, *11-9-302(1)* (Michie 1982). *See Tidwell v. Bethlehem Steel Corp. (In re Georgia Steel, Inc.),* 56 Bankr. 509, 515 (Bankr. M.D. Ga.1985). *Section 11-9-402(5) of the Georgia Code* provides that "[a] financing statement covering crops growing or to be grown . . . . must show that it covers this type of collateral, must recite that it is to be indexed in the real estate records, and the financing statement must contain a description of the real estate." *O.C.G.A. **[**6]** § 11-9-402(5)* (Michie Supp. 1985). *Section 11-9-110 of the Georgia Code* determines what type of description is sufficient to comply with *section 11-9-402(5)*.

The Court finds that the financing statement filed by the Bank of Dooly sufficiently describes the crops grown on Land Lot Numbers 180, 181, 203, and 204 for the Bank of Dooly to have a properly perfected security interest in those crops and the proceeds from those crops. The Court, however, finds that the Bank of Dooly did not sufficiently describe the crops grown on Land Lot

[1] *O.C.G.A. § 11-9-110* (Michie 1982).

Number 172; therefore, its security interest in the crops grown on that land lot was not perfected. As previously noted, the financing statement covered only Land Lot Numbers 180, 181, 203, and 204. No reference was made to crops grown on Land Lot Number 172. Without a reference to Land Lot Number 172, a third party would not be put on notice that the crops grown on that land lot and the resulting crop proceeds represent collateral in which the Bank of Dooly claims a security interest. *Goodman v. Schenck (In re Swafford Furniture Co. of College Park, Inc.)*, 10 Bankr. 293, 295 (Bankr. N.D. Ga. 1981); *Thomas Ford Tractor, Inc. v. North Georgia Production [**7] Credit Association, 153 Ga. App. 820, 822, 266 S.E.2d 571, 572-73 (1980)*. *See generally* J. White & R. Summers, *Uniform Commercial Code* § 23-16, at 964 (2d ed. 1980). The Court concludes that the Bank of Dooly has a perfected security interest in the crops grown on Land Lot Numbers 180, 181, 203, and 204, but the Bank of Dooly has only an unperfected security interest in the crops grown on Land Lot Number 172.

Having concluded that the Bank of Dooly has no security interest in the crops grown on the rented land and an unperfected security interest in the crops grown on Land Lot Number 172, the Court must now decide how the Bankruptcy Code applies in this situation. *Section 544(a)(1) of the Bankruptcy Code* ***HN4***[↑] grants to a trustee in bankruptcy the status of a hypothetical lien creditor who is deemed to have perfected his interest as of the date of the filing of the bankruptcy petition. *11 U.S.C.A. § 544(a)(1) (West Supp. 1985)*. In a Chapter 11 case, such as this, in which no trustee has been appointed, *section 1107(a) of the Bankruptcy Code* [2] grants to a debtor, in his capacity as a debtor in possession under *section 1101 of the Bankruptcy Code*, [3] certain of the trustee's **[**8]** rights and powers, one of which is the status of a hypothetical lien creditor under *section 544(a)(1)*. *See Tinsley & Groom v. West Kentucky Production Credit Association (In re Tinsley & Groom), 49 Bankr. 85, 92* nn.1-2, *12 Bankr. Ct. Dec. 1368, 1371* nn.1-2 (Bankr. W.D. Ky. 1984); *Cash Register Systems, Inc. v. Munsey Corp. (In re Munsey Corp.), 10 Bankr. 864, 866, 7 Bankr. Ct. Dec. 674, 675 (Bankr. E.D. Penn. 1981)*; ***cf. Rechnitzer v. Boyd (In re Executive Growth Investments, Inc.), 40 Bankr. 417, 420, 11 Bankr. Ct. Dec. 1239, 1241 (Bankr. C.D. Cal. 1984)***. In this case, Debtor has the status of a hypothetical lien creditor. Under Georgia law, an unsecured creditor and an unperfected secured creditor are subordinate to the **[*167]** claim of a subsequent intervening lien creditor. [4] The Bank of Dooly thus has no claim to the $42,900 in cash proceeds from the rented land.

[9]** Debtor does not dispute that the Bank of Dooly has a validly perfected security interest in the $39,000 in proceeds attributable to crops grown on land owned by Debtor. Under *section 363 of the Bankruptcy Code*, [5] Debtor may not use this $39,000 in cash collateral unless the Bank of Dooly consents or Debtor has demonstrated that the Bank of Dooly's security interest is adequately protected. The Court notes that some of the collateral involved herein is in the form of bales of cotton, but the Court will consider them as if they were cash collateral because as soon as the bales are sold, the proceeds will be cash collateral.

As adequate protection, Debtor proposes to give the Bank of Dooly a first lien on the cotton and peanut crops that Debtor will shortly plant, and also proposes assignment of a $10,000 Agricultural Stabilization and Conservation Service (ASCS) set aside payment. Debtor also proposes to assign his crop insurance to the Bank of Dooly. The question **[**10]** presented is whether this is sufficient adequate protection for $39,000 in cash collateral so that the Court may authorize its use. Debtor needs the use of the cash collateral to plan his 1986 cotton, peanut, and silage crops. Because the cotton and peanut crops generate income for Debtor, and the silage is needed to feed Debtor's dairy cattle, the Court is persuaded that the three crops are necessary for Debtor to have a chance to reorganize under Chapter 11 of the Bankruptcy Code.

Debtor's testimony is that he expects a $49,000 profit from his 1986 cotton and peanut crops. He bases this estimate upon prior crop yields and the fact that irrigation is available this year to avoid the drought problems that he suffered last year. The undisputed testimony is that Debtor will participate in the government price support program, which will give added protection for the crops. Debtor also has agreed

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[2] *11 U.S.C.A. § 1107(a) (West Supp. 1985)*.

[3] *11 U.S.C.A. § 1101 (West 1979)*.

[4] *See Nicholson v. First Investment Co., 705 F.2d 410, 413 (11th Cir. 1983)*; *United States Fidelity & Guaranty Co. v. Leach (In re Merts Equipment Co.), 438 F. Supp. 295, 298 (M.D. Ga. 1977)*; *O.C.G.A. § 11-9-301(1)(b), (3)* (Michie 1982).

[5] *11 U.S.C.A. § 363* (West 1979 & Supp. 1985).

to assign his crop insurance to the Bank of Dooly and estimates that if he suffered a total loss on his crops, he would receive $141,800 in insurance proceeds.

Debtor has agreed to assign the $10,000 ASCS payment to the Bank of Dooly. While there may be some risk involved, it is relatively **[**11]** certain that the payment will be made to Debtor and thus through the assignment to the Bank of Dooly.

The Court is persuaded that Debtor has demonstrated that his offer of adequate protection is more than enough to protect the interest of the Bank of Dooly, and that Debtor, therefore, should be authorized to use the $39,000 in cash collateral. While the Court is unable to determine from the evidence what part of the cash collateral is attributable to Land Lot Number 172, the fact that the Bank of Dooly does not have a validly perfected security interest in the crops grown on that land lot leads to the conclusion that the Bank of Dooly may not have a valid claim to all of the $39,000 which the Court has considered as cash collateral.

Accordingly; it is

ORDERED that the Motion to Use Cash Collateral filed by Rufus Bartlett Coody, Debtor, on March 11, 1986, is granted; and it is further

ORDERED that the Bank of Dooly is hereby directed to endorse the joint checks which are made out to it and Debtor in order to comply with this order of the Court; and it is further

ORDERED that Debtor is authorized to sell the bales of cotton upon which the Bank of Dooly has a security interest and **[**12]** to use the proceeds from the sale in accordance with this order; and it is further

[*168] ORDERED that Debtor strictly comply with the terms of the adequate protection which he has offered to the Bank of Dooly.

ROBERT F. HERSHNER, JR., Chief United States Bankruptcy Judge

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End of Document

In re Lorenz

United States Bankruptcy Court for the Northern District of Illinois, Eastern Division

February 21, 1986, Decided

No. 85 B 907

Reporter
57 B.R. 734 *; 1986 Bankr. LEXIS 6640 **

In re Anthony Peter LORENZ, Joseph Andrew Lorenz, and Robert Dean Lorenz, a Partnership, d/b/a Lorenz Brothers Farm, Debtors

Core Terms

crop, proceeds, security interest, security agreement, collateral, pre-petition, harvested, commencement of the case, post-petition

Case Summary

Procedural Posture

Plaintiff bank moved to terminate or modify the automatic stay under *11 U.S.C.S. § 362* and to prevent the use of certain cash collateral under *11 U.S.C.S. § 363* after defendant partnership declared Chapter 11 bankruptcy.

Overview

After defendant debtor declared Chapter 11 bankruptcy, plaintiff bank moved to terminate or modify the automatic stay under *11 U.S.C.S. § 362* and to prevent debtor's use of certain cash collateral under *11 U.S.C.S. § 363*. The court said that in as much as defendant incurred new debt to buy, seed, and lease lands for the crop, the proceeds of that crop were not generated by pre-petition collateral. The court ordered plaintiff to turn over proceeds of crop to defendant to pay administrative and operating expenses because plaintiff's security interest did not encompass cash proceeds generated by the crop, which was planted and harvested after debtor filed for bankruptcy. Consequently, the proceeds of the crop were not cash collateral as defined in *§ 363(a)*.

Outcome

The court ordered plaintiff to give crop proceeds to defendant to pay administrative and operating expenses because plaintiff's security interest did not include cash proceeds from the crop, which was harvested after debtor filed Chapter 11 petition, and so the proceeds of the crop were not cash collateral.

LexisNexis® Headnotes

Bankruptcy Law > ... > Bankruptcy > Estate Property > Defenses

HN1[] **Estate Property, Defenses**

See *11 U.S.C.S. § 552*.

Bankruptcy Law > ... > Bankruptcy > Estate Property > Defenses

Contracts Law > ... > Secured Transactions > Application & Construction > General Overview

Contracts Law > Types of Commercial Transactions > Secured Transactions > General

Overview

HN2[] **Estate Property, Defenses**

Once a bankruptcy petition is filed, *11 U.S.C.S. § 552* abrogates the effect of all pre-petition security interests in subsequently acquired property except those security interests in proceeds to the extent recognized by applicable state law.

Commercial Law (UCC) > General Provisions (Article 1) > Definitions & Interpretation > General Overview

Commercial Law (UCC) > ... > Subject Matter > Definitions > General Overview

Commercial Law (UCC) > Secured Transactions (Article 9) > General Overview

Commercial Law (UCC) > ... > Definitions & General Concepts > Definitions > General Overview

Commercial Law (UCC) > ... > Definitions > Collateral > General Overview

Commercial Law (UCC) > ... > Definitions & General Concepts > Definitions > Proceeds

Commercial Law (UCC) > ... > Perfection > Methods of Perfection > Proceeds From Collateral

HN3[] **General Provisions (Article 1), Definitions & Interpretation**

Section 9-306(1) of the Illinois Commercial Code defines proceeds to include whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Ill. Rev. Stat. ch. 26, para. 9-306(1).

Commercial Law (UCC) > Secured Transactions (Article 9) > Attachment, Effectiveness & Rights > General Overview

Commercial Law (UCC) > Secured Transactions (Article 9) > General Overview

Commercial Law (UCC) > ... > Definitions & General Concepts > Definitions > Proceeds

Commercial Law (UCC) > ... > Attachment, Effectiveness & Rights > Attachment & Effectiveness > Proceeds From Collateral

Commercial Law (UCC) > ... > Perfection > Methods of Perfection > Proceeds From Collateral

Contracts Law > Types of Commercial Transactions > Secured Transactions > General Overview

HN4[] **Secured Transactions (Article 9), Attachment, Effectiveness & Rights**

Unless the parties otherwise agree, a security agreement gives the secured party the rights to proceeds provided by section 9-306. Ill. Rev. Stat. ch. 26 para. 9-203(3). Thus, the absence of the word proceeds in the security agreement does not preclude the extension of a security agreement to cover proceeds of a secured party's collateral.

Business & Corporate Compliance > ... > Secured Transactions > Attachment of Security Interests > After Acquired Property & Future Advances

Commercial Law (UCC) > ... > Attachment, Effectiveness & Rights > Attachment & Effectiveness > After Acquired Property & Future Advances

Commercial Law (UCC) > ... > Definitions & General Concepts > Definitions > Proceeds

Business & Corporate Compliance > ... > Contracts Law > Standards of Performance > Creditors & Debtors

Contracts Law > Types of Commercial Transactions > Secured Transactions > General Overview

HN5[] **Attachment of Security Interests, After Acquired Property & Future Advances**

Under *11 U.S.C.S. § 552 (a)* after-acquired property is not subject to any liens created by a pre-petition security agreement. Thus, the proceeds of that after-acquired property, are not subject to the Bank's security interest. The exception to *section 552(a)*, set forth in subsection (b), refers to proceeds generated by pre-petition

collateral, not to proceeds of after-acquired property. Proceeds of collateral may be held to be secured by a pre-petition security interest only if the collateral which produces the proceeds was acquired by the debtor pre-petition.

Counsel: **[**1]** Nancy West Stoecker, Truemper, Ward, Hollingsworth & Wotjecki, for Debtors.

Douglas J. Lipke, Lord, Bissell & Brook, for First National Bank of Joliet.

Judges: Eisen, Chief Bankruptcy Judge.

Opinion by: EISEN

Opinion

[*734] MEMORANDUM AND ORDER

ROBERT L. EISEN, Chief Bankruptcy Judge

This matter comes to be heard on the motion of First National Bank of Joliet ("Bank") to terminate or modify the automatic stay pursuant to *11 U.S.C. § 362* and to prevent the use of certain cash collateral pursuant to *11 U.S.C. § 363*. On January **[*735]** 22, 1985, Anthony Peter Lorenz, Joseph Andrew Lorenz, and Robert Dean Lorenz, a partnership d/b/a Lorenz Brothers Farm ("debtor"), filed its petition for relief under Chapter 11 of the Bankruptcy Code and has continued to operate its business and conduct its affairs as a debtor in possession. Prior thereto, on August 7, 1984, the debtor had executed four agricultural notes with a total principal balance of $795,000. As security therefor, the debtor executed certain security agreements granting the Bank a security interest, inter alia, in the following:

> All crops, growing or to be grown, annual or perennial, including but not limited to corn **[**2]** and soybeans on all farms as described in Exhibit A attached and all products thereof and all accounts arising therefrom.

Presently at issue is whether the Bank has a security interest in the 1985 crop which was harvested post-petition by the debtor in possession and whether the cash received from the sale of the 1985 crop is cash collateral which the Bank can preclude the debtor from using to pay operating and administrative expenses. The proceeds from the 1985 crop are currently being held by the Bank pursuant to an order entered nunc pro tunc October 14, 1985.

The Bank maintains that at least a portion of the proceeds of the 1984 crop were used to buy seed, rent farm land and plant and harvest the post-petition crop. Thus, the Bank contends that the 1985 crop constitutes proceeds of the Bank's collateral to which the Bank's security interest in pre-petition crops extends pursuant to *11 U.S.C. § 552(b)*. In its response, the debtor initially contends that the security agreement executed by the parties does not by its language extend a security interest in crop proceeds to the Bank nor is the cash currently being held by the Bank a product of the crops or an account arising **[**3]** therefrom as those terms are defined under the Uniform Commercial Code. Further, the debtor states that the schedules filed with its petition indicate that the debtor had no cash, bank accounts, crops, seeds or any other personal property not specifically listed, remaining after the 1984 crop was harvested and the proceeds therefrom paid to various creditors. Rather, the debtor asserts it incurred additional post-petition unsecured debt in leasing land, planting and harvesting the 1985 crop, and transporting crop and grain for sale. In addition, the debtor argues that no identifiable proceeds from the sale of the 1984 crop are in existence to which a security interest would continue to attach pursuant to § 9-306(2) of the Illinois Commercial Code, Ill. Rev. Stat. ch. 26 para. 9-306(2).

The debtor concedes that if the 1985 crop had been in existence on the date of filing, then the Bank would be entitled to assert a lien on the proceeds of the 1985 crop. However, because the 1985 crop was planted and the seed therefore purchased post-petition, the debtor maintains that the Bank has not demonstrated its entitlement to a security interest in the crops harvested in 1985.

DISCUSSION

[4]** *HN1*[↑] *Section 552 of the Bankruptcy Code* provides as follows:

> (a) Except as provided in subsection (b) of this section, property acquired by the estate or by the

debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

(b) Except as provided in section 363, 506(c), 522, 544, 545, 547 and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, product, offspring, rents or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

[*736] 11 U.S.C. § 552. HN2[↑] Once a bankruptcy petition is filed, section 552 "abrogates the **[**5]** effect of all pre-petition security interests in subsequently acquired property except those security interests in proceeds to the extent recognized by applicable state law." In re Trans-Texas Petroleum Corp., 33 B.R. 67, 69 (Bankr. N.D. Tex. 1983). HN3[↑] Section 9-306(1) of the Illinois Commercial Code defines "proceeds" to include "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." Ill. Rev. Stat. ch. 26, para. 9-306(1). HN4[↑] Unless the parties otherwise agree, a security agreement gives the secured party the rights to proceeds provided by section 9-306. Ill. Rev. Stat. ch. 26 para. 9-203(3). Thus, the absence of the word "proceeds" in the security agreement does not preclude the extension of a security agreement to cover proceeds of a secured party's collateral, as the debtor contends.

However, the court is not confronted here with the question of who has rights in *proceeds* acquired by a debtor's estate post-petition from the disposition of property acquired pre-petition, a situation addressed by section 552(b). Rather, this is a case of HN5[↑] after-acquired *property*, i.e., the 1985 crop which section 552(a) expressly provides is **[**6]** not subject to any liens created by a pre-petition security agreement. *See* In re Sheehan, 38 B.R. 859, 863 (Bankr. D.S.D. 1984). Thus, the proceeds of that after-acquired property, i.e., the cash received from 1985 crop, are not subject to the Bank's security interest. The exception to section 552(a), set forth in subsection (b), refers to proceeds generated by pre-petition collateral, not to proceeds of after-acquired property. *See* In re Texas Tri-Collar, Inc., 29 Bankr. 724, 8 CBC 2d 970 (W.D.La. 1983). Proceeds of collateral may be held to be secured by a pre-petition security interest only if the collateral which produces the proceeds was acquired by the debtor pre-petition. Matter of Gross-Feibel Company, Inc., 21 Bankr. 648, 6 CBC 2d 1239, 1241 (Bankr. S.D. Ohio 1982). In the case *sub judice*, the debtor has stated that the cash proceeds from the sale of the 1984 crop were no longer in existence as of the date of filing. Inasmuch as the debtor incurred new debt to purchase the seed and lease lands to generate the 1985 crop, the proceeds of that crop were not generated by pre-petition collateral.

The court concludes that this matter is governed by section 552(a). **[**7]** Therefore, the court holds that the Bank's security interest does not encompass cash proceeds generated by the 1985 crop which was planted and harvested after the filing of debtor's chapter 11 petition. Consequently, the proceeds of the 1985 crop are not "cash collateral" as defined in section 363(a) of the Code. [1]

IT IS THEREFORE ORDERED that the Bank turn over the proceeds of the 1985 crop to the debtor for the payment of administrative and operating expenses.

End of Document

[1] The Bank also argues that because farm equipment in which it has a security interest was used to harvest and plant the 1985 crop, the 1985 crop is a "product" of that collateral. The court finds this argument without merit under the express terms of the security agreement and the provisions of the Illinois Commercial Code. *See, e.g.,* Ill. Rev. Stat. ch. 26 para. 9-109(3).

Gray v. Bank of Early

United States District Court for the Middle District of Georgia, Albany Division

September 20, 2018, Decided; September 20, 2018, Filed

CASE NO.: 1:17-CV-098 (LJA)

Reporter
2018 U.S. Dist. LEXIS 231210 *; 2018 WL 9415069

DAN MARK GRAY, Appellant, v. BANK OF EARLY, Appellee.

Core Terms

Crop, proceeds, collateral, security interest, Corn, bankruptcy court, post-petition, security agreement, expenditures, perfected, prepetition, funds, expended, financing statement, perfected security interest, financing, unsecured creditor, matter of law, debtor in possession, bankrupt estate, balancing, commencement of the case, farming, parties, notice, rights, ACRES, grown, secured party, attaches

Counsel: [*1] For DAN MARK GRAY, Appellant: KENNETH W. REVELL, LEAD ATTORNEY, Albany, GA.

For BANK OF EARLY, Appellee: DAVID ALLEN GARLAND, LEAD ATTORNEY, ALBANY, GA; STEPHAN A RAY, LEAD ATTORNEY, ALBANY, GA.

Judges: LESLIE J. ABRAMS, UNITED STATES DISTRICT JUDGE.

Opinion by: LESLIE J. ABRAMS

Opinion

ORDER

Before the Court is an appeal from an order of the United States Bankruptcy Court for the Middle District of Georgia denying Appellant Debtor Dan Mark Gray's (Gray) motion to receive post-petition proceeds, free from the secured creditor's security interest, from the sale of a certain crop as the debtor in possession. (Doc. 1.) Gray contends that the Bankruptcy Court erred in finding: (1) that the proceeds from the sale of the debtor's 2016 Corn Crop were subject to Appellee Creditor Bank of Early's (BOE) security interest; and (2) that the Bankruptcy Court could not, as a matter of law, apply the "equities of the case" exception pursuant to *11 U.S.C. § 552(b)(1)* to limit BOE's rights to said proceeds. (Doc. 10 at 2.) For the reasons set forth below, the Bankruptcy Court's decision is **AFFIRMED in part** and **REVERSED in part** and **REMANDED**.

FACTUAL AND PROCEDURAL BACKGROUND

On May 7, 2016 (Petition Date), Gray filed a Petition for relief under Chapter 12 **[*2]** of the United States Bankruptcy Code. (Doc. 10 at 2.) Prior to the Petition Date, Gray executed two separate promissory notes in favor of BOE. (Doc. 12 at 1.) The first note (Note 4483) was a renewal note for outstanding balances due from Gray's 2014 crop production loan with a principal amount of $236,360.42. (*Id.*) The second note (Note 13209), Gray's 2015 crop production loan, had a principal amount of $900,000.00. (*Id.* at 1-2.) With each note, Gray executed both an Agricultural Loan Agreement and Agricultural Security Agreement. (*Id.* at 2.) While Note 13209 was primarily to cover Gray's 2015 crop production, the Agricultural Security Agreement attached to Note 13209 (Security Agreement 13209) purported to secure both the 2015 crop and beyond. (Doc. 10 at 4; Doc. 12 at 2.)

On May 18, 2015, BOE filed a UCC-1 financing statement (UCC-1) in the real estate records of the Clerk of the Superior Court of Miller County, Georgia, at Deed Book 237, pages 105-108. (Doc. 12 at 2.) The

UCC-1 contained the following collateral description:

> ALL FARM PRODUCTS INCLUDING ALL 2015 CROPS, ANNUAL OR PERENNIAL, AND ALL PRODUCTS OF THE CROPS, ALL FEED, ALL SEED, FERTILIZER, PROCEEDS AND OTHER SUPPLIES USED OR PRODUCED **[*3]** IN DEBTOR'S FARMING OPERATION, INCLUDING BUT NOT LIMITED TO 403.35 ACRES OF CORN, 83.01 ACRES OF GRAN SOURHUM [sic], 10.89 ACRES OF OATS, 253.83 ACRES OF PEANUTS, 101.63 ACRES OF SOYBEANS AND 164.6 ACRES OF WHEAT GROWING OR TO BE GROWN ON LANDS OWNED, LEASED OR RENTED BY DEBTOR LOCATED IN THOSE LOTS LISTED ON THE EXHIBIT "B" ATTACHED HERETO AND MADE A PART HEREOF.

(Doc. 10 at 6; Doc. 12 at 2.)

In April 2016, about two to three weeks before the Petition Date, Gray planted approximately fifty acres of seed corn on leased land in Miller County, Georgia (2016 Corn Crop). (Doc. 10 at 2; Doc. 12 at 3.) Gray allegedly purchased the seed corn using funds derived from a sublease to a third-party farmer. (Doc. 10 at 2.) Sometime before the Petition Date the 2016 Corn Crop sprouted, but it was not harvested until after the Petition Date. (Doc. 12 at 3.) Gray alleges that he obtained $11,100.40 in post-petition financing from another creditor in the ordinary course of his farming, which he used in bringing the 2016 Corn Crop to maturity and harvest. (Doc. 10 at 3.) These post-petition funds are required to be paid back within one year through bankruptcy estate-generated farm income. (*Id.*) Gray subsequently **[*4]** sold the harvested 2016 Corn Crop to Flint Hills Resources Grain, LLC (Flint Hills) for $41,729.97 (2016 Corn Crop Proceeds).

On October 10, 2016, Gray filed a Motion for Comfort Order Directing that Postpetition Proceeds be Paid to Debtor in Possession and for Determination that Proceeds are not Subject to Lien. (Doc. 1 at 23.) Therein, Gray sought to have the 2016 Corn Crop Proceeds paid to him as the debtor in possession, arguing that BOE did not have a perfected security interest in the proceeds, and, even if it did, the bankruptcy court should reduce its interest under 11 U.S.C. § 552(b)(1)'s "equities of the case" exception. (*Id.*) Hearings were held on both issues on March 10 and May 12, 2017, respectively. On May 15, 2017, the Bankruptcy Court denied Gray's Motion for Comfort Order. The Bankruptcy Court held that BOE held a perfected security interest in the 2016 Corn Crop Proceeds. (*Id.* at 24.) Additionally, the Bankruptcy Court concluded that § 552(b)(2)'s "equities of the case" exception was inapplicable because Gray did not expend unencumbered post-petition assets of the bankruptcy estate to grow and bring the 2016 Corn Crop to harvest. (*Id.*)

Gray appealed the Bankruptcy Court's Order Denying Debtor's Motion for **[*5]** Comfort Order on May 30, 2017. (Doc. 1.) On appeal Gray raises the following issues: (1) whether the Bankruptcy Court erred in finding that BOE had a perfected security interest in the 2016 Corn Crop Proceeds; and (2) whether the Bankruptcy Court erred in finding that it was prohibited as a matter of law from applying the "equities of the case" exception in 11 U.S.C. § 552(b)(1) to reduce BOE's security interest in the 2016 Corn Crop Proceeds. Neither party disputes the sufficiency of the underlying security agreement or the accuracy of the language as set forth in UCC-1. Instead, the parties disagree over whether the language in UCC-1 is sufficient to perfect BOE's interest in the 2016 Corn Crop and its proceeds. (Doc. 10 at 4-5; Doc. 12 at 2-3; Doc. 13 at 5.) Moreover, neither party disputes that if the BOE did not have a perfected security interest in the 2016 Corn Crop Proceeds, then the BOE would have no claim to the proceeds. (*See* Doc. 13.)

STANDARD OF REVIEW

Pursuant to 28 U.S.C. § 158(a), the Court has jurisdiction to hear this appeal. In reviewing the decisions of the bankruptcy court, the district court functions as an appellate court. *In re JLJ Inc.*, 988 F.2d 1112, 1116 (11th Cir. 1993). As such, the district court is not authorized to make independent factual findings. **[*6]** *In re Sublett*, 895 F.2d 1381, 1384 (11th Cir. 1990). The district court must accept the bankruptcy court's findings of fact, unless the findings are clearly erroneous. *In re JLJ Inc.*, 988 F.2d at 1116. Where the bankruptcy court's factual findings are ambiguous or silent about an outcome determinative factual question, the district court must remand the case to the bankruptcy court to make the necessary factual findings. *Id.* (citing *In re Cornelison*, 901 F.2d 1073, 1075 (11th Cir. 1990)). The bankruptcy court's legal conclusions, however, are reviewed *de novo*. *In re Goerg*, 930 F.2d 1563, 1566 (11th Cir. 1991). Here, the parties contest only the legal conclusions drawn by the Bankruptcy Court. Accordingly, this Court must review the Bankruptcy Court's legal determinations *de novo*.

DISCUSSION

Gray contends that, as the debtor in possession in his Chapter 12 bankruptcy case, he is entitled to the proceeds from the sale of the 2016 Corn Crop. Under the "strong arm" powers of *11 U.S.C. § 544(a)*, the debtor in possession has all "the rights and powers of a hypothetical perfected judgment lien creditor," entitling said debtor to priority over an unperfected secured creditor's interest in collateral. *Old W. Annuity & Life Ins. Co. v. Apollo Grp., 605 F.3d 856, 863 (11th Cir. 2010)*. Thus, Gray raises two issues on appeal: (1) whether BOE's filing of its UCC-1 properly perfected its security interest in Gray's 2016 Corn Crop and its proceeds; and (2) if the UCC-1 did properly **[*7]** perfect BOE's security interest, whether the bankruptcy court was prohibited, as a matter of law, from applying the "equities of the case" exception set forth in *11 U.S.C. § 552(b)(1)* to reduce BOE's claim to cash proceeds of the 2016 Corn Crop. (Doc. 10 at 1.) Upon *de novo* review and accepting the Bankruptcy Court's findings of fact, the Court holds that, while BOE had a perfected security interest, the Bankruptcy Court erred in holding that it was prohibited from considering the "equities of the case" exception.

I. BOE's Security Interest in the 2016 Corn Crop and its Proceeds

Gray does not dispute that BOE has a valid security agreement covering the 2016 Corn Crop and its proceeds. Rather, Gray contends that BOE failed to properly perfect that security interest, giving Gray priority to the proceeds under *§ 544(a)*. Whether a secured creditor properly perfected its' security interest is governed by state law. *See Butner v. United States, 440 U.S. 48, 55, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979)*. "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.*; *see also In re Codrington, 691 F.3d 1336, 1339 (11th Cir. 2012), certified question answered* ***[*8]*** *sub nom. Wells Fargo Bank, N.A. v. Gordon, 292 Ga. 474, 749 S.E.2d 368 (Ga. 2013)* (looking to state law to determine the rights of a hypothetical bona fide purchaser to set aside a security deed).

Pursuant to *Ga. Code Ann. § 11-9-301(1)* and *§ 11-9-302*, Georgia's adopted version of Article 9 controls the present inquiry because Gray is located in Georgia and the 2016 Corn Crop was grown in Georgia. Thus, the Court must review Georgia law to determine whether BOE properly perfected its interest in the 2016 Corn Crop and its proceeds.

A. The 2016 Corn Crop

Ga. Code Ann. § 11-9-308(a) provides that "a security interest is perfected if it has *attached* and all of the applicable requirements for perfection . . . have been satisfied. A security interest is *perfected* when it attaches if the applicable requirements are satisfied before the security agreement attaches." (emphasis added). "A financing statement may be filed before a security agreement is made or a security interest otherwise attaches." *Id. § 11-9-502(d)*. "A security interest attaches to collateral when it becomes enforceable against the debtor . . . . [A] security interest is enforceable against the debtor . . . only if: (1) Value has been given; (2) The debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and (3) . . . The **[*9]** debtor has authenticated a security agreement...." *Id. § 11-9-203(a)-(b)*; *Sw. Georgia Prod. Credit Ass'n v. James, 180 Ga. App. 795, 350 S.E.2d 786, 788 (Ga. Ct. App. 1986)* (holding that security interest in the subject pea crop attached at the time the crop was planted). Here, there was a valid security agreement, which contained sufficient language to cover the 2016 Corn Crop. (Doc. 10 at 4-5.) Moreover, value was previously given, and Gray had rights in the crops because they were planted and sprouted prior to the Petition Date. (Doc. 12 at 3.)

In order to perfect a security interest in crops under Georgia law, a secured creditor must also file a financing statement. *Ga. Code Ann. § 11-9-310(a)* (West 2018). A financing statement, or UCC-1, covering a security interest in growing crops is sufficient only if it is filed with the clerk of any superior court in Georgia. *Id. § 11-9-501(a)*. Additionally, it must provide the following: (1) the name of the debtor; (2) the name of the secured party or their representative; (3) a description of the collateral; (4) an indication that it covers growing crops; (5) an indication that it is filed in the real property records; and (6) a description of the real property where the crops are growing. *Id. § 11-9-502(a)-(b)*. With regards to BOE's UCC-1, the sole issue argued by Gray is whether the description of the collateral **[*10]** was sufficient.

As the parties agree that the description of the collateral

in the security agreement was sufficient to grant BOE a security interest in the 2016 Corn Crop and its proceeds, the question before the Court is whether the UCC-1 was sufficient to put a third party on inquiry notice that the collateral could be covered by a security interest. "A financing statement is designed to notify third parties . . . that there may be an enforceable security interest in the property of the debtor." *Kubota Tractor Corp. v. Citizens & S. Nat. Bank, 198 Ga. App. 830, 403 S.E.2d 218, 222 (Ga. Ct. App. 1991)* (internal quotations omitted); *Goodin v. S. Atl. Prod. Credit Ass'n, 201 Ga. App. 35, 410 S.E.2d 159, 160 (Ga. Ct. App. 1991)* (holding that description was sufficient because it would have put a "person of ordinary business prudence" on notice of creditor's lien on collateral). Furthermore, "[a] financing statement need not provide an interested person with all the information he needs to understand a secured transaction but only with the information that such a transaction has taken place and that the particulars thereof may be obtained from the named security party at the address shown." *Kubota Tractor Corp., 403 S.E.2d at 223*.

Pursuant to *Ga. Code Ann. § 11-9-504*, a financing statement's description of collateral is sufficient if it "reasonably identifies" the described collateral. *Ga. Code Ann. §§ 11-9-504, 11-9-108(a)* (West 2018). A description reasonably identifies collateral **[*11]** if it identifies the subject property by specific listing, category, Article 9-defined collateral classifications, or any other method making the collateral "objectively determinable." *Id. § 11-9-108(b)*. Thus, unlike a collateral description in a security agreement, "it is not wholly necessary that the physical description appearing of record [in a financing statement] be sufficient in itself to identify the property;" however, "it must raise a warning flag, as it were, providing a key to the identity of the property." *Peoples Bank of Bartow Cty. v. Nw. Georgia Bank, 139 Ga. App. 264, 228 S.E.2d 181, 183-84 (Ga. Ct. App. 1976)*.

The UCC-1 identifies the collateral as "*all farm products* including all 2015 crops, annual or perennial, and all products of the crops, ... proceeds and other supplies used or produced in debtor's farming operation . . . ." (Doc. 10 at 6) (emphasis added.) The UCC-1 description identifies categories of collateral such as "crops" and Article 9 defined collateral classifications such as "farm products." Georgia's version of Article 9 defines "farm products" as goods involved in the debtor's farming operations, including "[c]rops grown, growing, or to be grown . . . ." *Ga. Code Ann. § 11-9-102(35)(A)* (West 2018). The inclusion of the Article 9 classification is sufficient to put a party of ordinary business prudence **[*12]** on notice that another party might have a security interest in crops grown, growing, or to be grown on the identified plot of land. Such a reasonably prudent business person would then consult the security agreement setting forth a more particularized description of the collateral—in this case, the 2016 Corn Crop. Beyond the use of the statutorily defined term "farm products," the UCC-1 also includes a description of the crops and area of land, and it explicitly states that BOE has an interest in the crops "growing or to be grown" on the lots identified in Exhibit "B." (Doc. 10 at 6; Doc. 12 at 2.)

While Gray would like the Court to construe the phrase "including all 2015 crops" to limit the interest to only 2015 crops, such a construction is not appropriate. Gray cites *In re Robert Bogetti & Sons, 162 B.R. 289 (Bankr. E.D. Cal. 1993)*, to support this argument. (Doc. 10 at 6.) A proper reading of *Bogetti*, however, prohibits the use of the more general description of collateral in the financing statement to modify the more specific description of the collateral found in the security agreement. *162 B.R. at 295-97*. The *Bogetti* court explained that it would be inappropriate to allow the financing statement to modify the security agreement because the purpose of the security **[*13]** agreement is to "describ[e] the property in which the debtor has conveyed a security interest to the creditor . . . [that is] to establish whether a security interest in fact exists and its scope or extent," where as the "financing statement is not designed to define or create contractual rights and is merely a notice and perfection tool." *Id. at 295*. While *Bogetti* construes California law, the underlying principles are present in Georgia law as well. *Pers. Thrift Plan of Perry, Inc. v. Georgia Power Co., 242 Ga. 388, 249 S.E.2d 72, 74 (Ga. 1978)* (noting that a financing statement, unlike a security agreement, is meant to give notice); *see also Planned Furniture Promotions, Inc. v. Benjamin S. Youngblood, Inc., 374 F. Supp. 2d 1227, 1236 (M.D. Ga. 2005)* (interpreting Georgia's Article 9 and noting that "[i]n a financing statement, as opposed to a security agreement, collateral need only be reasonably identified."). Moreover, as the *Bogetti* court noted, jurisdictions have "liberally construed less than clear granting language in a financing statement to create a security interest where there is no formal security agreement between the parties." *In re Robert Bogetti & Sons, 162 B.R. at 297*. Such is not the case here as both parties acknowledge that there is a valid security agreement that adequately defines the security interest to include the 2016 Corn Crop. Therefore, as the UCC-1's collateral description

was sufficient to put a third party of ordinary **[*14]** business prudence on notice of BOE's security interest, BOE has a perfected security interest in the 2016 Corn Crop.

B. 2016 Corn Crop Proceeds

Having established that BOE has a perfected security interest in the 2016 Corn Crop, the issue remains whether the security interest attached to the proceeds of that corn crop. Under Ga. Code Ann. § 11-9-315(a), "[a] security interest continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien [] and . . . attaches to any identifiable *proceeds* of collateral." (West 2018) (emphasis added) (punctuation omitted). Proceeds include anything acquired from that sale, lease, license, exchange, or other disposition of the collateral. *Id.* § 11-9-102(63)(A). Once attached, a security interest in proceeds is perfected if "the security interest in the original collateral was perfected," and remains perfected if the proceeds are "identifiable cash proceeds." *Id.* § 11-9-315(c)-(d)(2).

Here, the original collateral—the 2016 Corn Crop—was sold to Flint Hills for $41,729.97.[1] (Doc. 12 at 3.) The cash value is clearly identifiable cash proceeds from the sale of the corn crops; and, since **[*15]** there is no indication that BOE authorized the sale, its security interest would automatically attach to the identifiable cash collateral. As noted above, the 2016 Corn Crop was properly perfected, so the identifiable cash proceeds are as well. Thus, BOE has a perfected security interest in the cash proceeds from the sale of the 2016 Corn Crop.

Gray, nevertheless, contends that "proceeds" are limited to those resulting from "supplies" and "does not create a blanket security interest on all future farm proceeds unrelated" to those supplies. (Doc. 10 at 7.) Under Georgia law, a secured party only needs a perfected security interest in the initial collateral to remain perfected and secured in identifiable cash collateral proceeds. *See* Ga. Code Ann. § 11-9-315 (West 2018). BOE has a perfected security interest in the proceeds of the sale of the 2016 Corn Crop; and it would, therefore, have priority over Gray as debtor in possession to said proceeds.

II. Applicability of the "Equities of the Case" Exception of *11 U.S.C. § 552(b)(1)*

Even if BOE has a perfected security interest in the 2016 Corn Crop and its proceeds, Gray argues that the Bankruptcy Court should have applied the "equities of the case" exception in 11 U.S.C. § 552(b)(1) to reduce BOE's **[*16]** interest. (Doc. 10 at 9.) In general, property acquired by either the debtor or the bankruptcy estate post-petition is not subject to any prepetition lien. 11 U.S.C. § 552(a). The single exception to this rule is provided in § 552(b):

> Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, products, offspring, or profits of such property, then such security interest extends to such proceeds, products, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, *except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.*

11 U.S.C. § 552(b)(1) (emphasis added). The final clause of that provision provides an exception to the exception: Based on the equities of the case, the bankruptcy court may adjust a prepetition security interest in post-petition proceeds. *Id.*

Gray argues that the Bankruptcy Court erred in holding that **[*17]** the "equities of the case" exception did not apply to reduce a prepetition secured creditor's interest in post-petition proceeds for expenditures made with prepetition assets or post-petition financing. Specifically,

[1] The record is noticeably silent as to whether the 2016 Corn Crop was purchased as growing crops or after being harvested. This might have some effect on the initial identity of the "proceeds" and whether they remained continuously perfected before becoming identifiable cash proceeds. *See* Bank of Dawson v. Worth Gin Co., 295 Ga. App. 256, 671 S.E.2d 279, 281 n.6 (Ga. Ct. App. 2008) (discussing potential effect of whether crop sold while growing or after being harvested would be covered under financing statement). Neither party raised this issue, and both parties have assumed the "proceeds" were the identifiable cash value of the crop's sale. Accordingly, the Court does not address this issue and accepts the parties' representations.

the Bankruptcy Court held: (1) that "any prepetition expenditures by [the debtor]. . . does not . . . allow the Court to utilize the equities . . . exception to set aside . . . the bank's lien," (Doc. 14, May 12, 2017 Hearing Tr. at 86:17-22); and (2) "that the equities of the case exception does not apply" when the debtor expends post-petition, encumbered assets to improve the secured creditor's subject collateral. (Doc. 14, May 12, 2017 Hearing Tr. at 88:24-25.)

At the outset, the Court notes that these issues are a matter of first impression for the Eleventh Circuit. *See In re Diamond Mfg. Co., Inc.*, No. 85-40555, 1995 WL 17004722, at *2 (Bankr. S.D. Ga. Feb. 17, 1995) (noting the lack of Eleventh Circuit precedent). And, while there is generally a scarcity of authority on the issue in our sister circuits, those few circuits who have addressed it have agreed on its limited applicability. *In re Endresen, 548 B.R. 258, 274 (B.A.P. 9th Cir. 2016), appeal dismissed* (July 1, 2016) ("Although 'equities of the case' is not defined in the Code, at least five courts of appeal have assigned a nearly identical meaning to *[§ 552(b)(1)]*."); *see, **[*18]** e.g., In re Tower Air, Inc., 397 F.3d 191, 205 (3d Cir. 2005); In re Cross Baking Co., Inc., 818 F.2d 1027, 1033 (1st Cir. 1987); J. Catton Farms, Inc. v. First Nat. Bank of Chicago, 779 F.2d 1242, 1246 (7th Cir. 1985); Matter of Vill. Properties, Ltd., 723 F.2d 441, 444 (5th Cir. 1984); see also United Virginia Bank v. Slab Fork Coal Co., 784 F.2d 1188, 1191 (4th Cir. 1986)*. These courts held that the "equities of the case" exception in *§ 552(b)(1)* typically applies to prevent a secured creditor from receiving a windfall when the value of its collateral is increased by the expenditure of estate funds, which would otherwise be used to pay unsecured creditors. In *Matter of Village Properties, Ltd.*, the Fifth Circuit stated: "[The] legislative history regarding *[§ 552(b)(1)]* indicates its purpose was to cover cases where an expenditure of the estate's funds increases the value of the collateral." *723 F.2d at 444*. Likewise, in *In re Cross Baking Co., Inc.*, the First Circuit explained that *§ 552(b)(1)* was created to address "the situation where raw materials, for example, are converted into inventory, or inventory into accounts, at some expense to the estate, thus depleting the fund available for general unsecured creditors, but is limited to the benefit inuring to the secured party thereby." *818 F.2d at 1033* (internal quotations omitted). Put more succinctly, "The equity exception is meant for the case where the trustee or debtor in possession uses other assets of the bankruptcy estate (assets that would otherwise go to the general creditors) to increase the value of the collateral." *J. Catton Farms, Inc., 779 F.2d at 1246*. With this **[*19]** foundation, we address Gray's two arguments in turn.

A. Debtor's Prepetition Expenditures

The Bankruptcy Court held that, as a matter of law, prepetition expenditures used to produce proceeds cannot be grounds for utilizing the equities of the case exception. The Bankruptcy Court relied almost exclusively on the Third Circuit's opinion in *In re Tower Air, Inc., 397 F.3d 191 (3d Cir. 2005)*, and the underlying bankruptcy court opinion to reach this decision, *In re Tower Air, Inc., 268 B.R. 404 (Bankr. D. Del. 2001), aff'd, 2003 U.S. Dist. LEXIS 10108, 2003 WL 21398007 (D. Del. June 16, 2003), aff'd, 397 F.3d 191 (3d Cir. 2005)*. (Doc. 14, May 12, 2017 Hearing Tr. at 85:22-86:22.) Gray argues that, rather than finding that the exception did not apply as a matter of law, the Bankruptcy Court in *In re Tower Air, Inc.* conducted a balancing of the equities but held that the bankruptcy trustee did not make the requisite showing to apply the exception. *See In re Tower Air, Inc., 268 B.R. at 408* (stating that "[i]n balancing the equities between the parties" the prerequisite showing for the exception was not made). While the Third Circuit affirmed the bankruptcy court's holding, it explained that the equity exception simply did not apply there because the repairs to the original collateral were made prepetition. *In re Tower Air, Inc., 397 F.3d at 205*. Likewise, the "equities of the case" exception does not apply here to the extent that Gray expended prepetition assets **[*20]** to generate the proceeds.

Under *§ 552(a)*, "property acquired by the estate or by the debtor *after the commencement* of the case is not subject to any lien resulting from any security agreement entered into by the debtor *before the commencement* of the case." *11 U.S.C. § 552(a)* (emphasis added). *Section 552(b)(1)* distinguishes between prepetition encumbered collateral and its proceeds "acquired *by the estate after the commencement* of the case." *11 U.S.C. § 552(b)(1)* (emphasis added). The commencement of a bankruptcy case begins with the filing of a bankruptcy petition. *11 U.S.C. §§ 541, 1207*. Upon filing, the debtor's financial universe is frozen, an automatic stay is imposed, and "all legal or equitable interests of the debtor in property as of the commencement of the case" is gathered into the bankruptcy estate. *11 U.S.C. § 541(a)(1)*. *Section 552(b)(1)* only allows the bankruptcy court to exercise its powers to cut off security interests once a bankruptcy case is actually instituted. Security interests outside of bankruptcy do not even come into the purview of the

court. *See* 11 U.S.C. § 541(a)(1). Simply put, prepetition expenses of the debtor cannot be the basis for the bankruptcy court to exercise its powers under 552(b)(1) because those actions were taken before the court had jurisdiction over such matters.

A review of the **[*21]** legislative history supports the conclusion that the provision was meant to apply when funds from the bankruptcy estate are expended to generate post-petition proceeds of that collateral. Prior to filing the petition, the bankruptcy estate does not exist. Therefore, any prepetition expenditures, even those purportedly increasing the value of collateral, are not expenditures of the estate but of the debtor alone. 124 Cong. Rec. H 11,097-98 (daily ed. Sept. 28, 1978) ("[Section 552(b)(1)] allows the court to consider the equities in each case. In the course of such consideration the court may evaluate any expenditures by *the estate* relating to proceeds and any related improvement in position of the secured party." (emphasis added)); 124 Cong. Rec. S 17,414 (daily ed. Oct. 6, 1978); H. Rep. No. 95-595, 95th Cong., 1st Sess. 376-77 (1977) ("[The equities of the case exception] is designed to cover the situation where *the estate* expends funds that result in an increase in the value of collateral." (emphasis added)); *see also* Sen. Rep. No. 95-989, 95th Cong., 2d Sess. 91 (1978), U.S. Code Cong. & Admin. News 1978, pp. 5963, 6332-33, 5787, 5877. Moreover, courts interpreting § 552(b)(1) have used language that buttresses **[*22]** this conclusion. Interpreting the exception in the context of post-petition expenditures of the bankruptcy estate, courts have held that: "The equity exception is meant for the case where the trustee or debtor in possession uses other assets of *the bankrupt estate* (assets that would otherwise go to the general creditors) to increase the value of the collateral." J. Catton Farms, Inc., 779 F.2d at 1246 (emphasis added); *see also* In re Cross Baking Co., Inc., 818 F.2d at 1033 ("We can only conclude from our reading of these reports that the 'equities of the case' proviso is a legislative attempt to address those instances where expenditures of *the estate* enhance the value of proceeds . . . ." (emphasis added)); In re Tower Air, Inc., 397 F.3d at 205 ("Section 552(b) is normally relevant . . . to prevent a secured creditor from reaping benefits from collateral that has appreciated in value as a result of the trustee's/debtor-in-possession's use of other assets of *the estate*." (emphasis added) (internal quotation omitted)). Thus, assets of the bankruptcy estate must be expended to trigger the application of § 552(b)(1).

In the case at bar, Gray expended $25,000[2] in personal funds obtained from a prepetition sublease to buy and plant the 2016 Corn Crop seed before filing his bankruptcy petition. (Doc. 10 at 2.) Even though the expense **[*23]** was a mere two to three weeks before the May 7, 2016 petition filing, it was nevertheless a prepetition expenditure. Thus, the funds were not property of the estate, and the exception is not applicable. Gray further argues that had the $25,000 not been used to improve BOE's collateral it would have been property of the estate available for the benefit of the unsecured creditors. (Doc. 10 at 9.) Gray is correct in so far as any pool of unencumbered cash in existence at the petition date becomes property of the estate, yet this fact alone does not trigger the equity exception in § 552(b)(1). Discussed in greater detail below, Gray's expenditure of $25,000 was not used to produce post-petition proceeds; rather, it was used to buy the original collateral. The equity exception is inapplicable to such an expenditure. The fact that the expended funds would have otherwise gone to the unsecured creditors does not change this. Finally, Gray argues that denying his claim to said proceeds would unjustly enrich BOE. Notwithstanding the inapplicability of the exception, the Court notes that BOE is severely undersecured; and the proceeds, thus, would not constitute a windfall. (Doc. 12 at 18.)

Moreover, § 552(b)(1) does **[*24]** not apply where the expenditure did not increase the value of the collateral. The Seventh Circuit illustrated this point in *J. Catton Farms, Inc.*:

> Suppose a creditor had a security interest in raw materials worth $1 million, and the debtor invested $100,000 to turn those raw materials into a finished product which he then sold for $1.5 million. The proceeds of this sale (after deducting wages and other administrative expenses) would be added to the secured creditor's collateral unless the court decided that it would be inequitable to do so—as well it might be, since the general creditors were in effect responsible for much or all of the increase in

[2] BOE spends a significant portion of its brief challenging this figure's accuracy. (Doc. 12 at 19-20.) The Bankruptcy Court made no specific finding of fact as to whether the whole amount or less was expended to purchase and plant the 2016 Corn Crop. Regardless, the Bankruptcy Court did not rely on that fact in its ultimate disposition. Likewise, whether the whole amount or less was used is not controlling on our conclusion, so the Court shall assume without deciding that the whole $25,000 was used for the prepetition purchase and planting of the 2016 Corn Crop seed.

> the value of the proceeds over the original collateral.

779 F.2d at 1247. As the court held, the exception applies when the debtor expends funds to create the proceeds and increase its value beyond what the original collateral was worth. *Id.*

Here, Gray did not expend any funds to increase the value of proceeds. Before filing his Chapter 12 petition, Gray used $25,000, unencumbered cash, to purchase and plant the seeds. (Doc. 10 at 2.) In the hypothetical example above, Gray has simply used his unencumbered cash to purchase the raw materials in which BOE had **[*25]** a secured interest, rather than expending that cash to create a finished product—*i.e.*, proceeds. He has merely procured original collateral subject to BOE's original security interest. The language and intent of § 552(b)(1) do not speak to this factual scenario. Therefore, because Gray used the $25,000 to purchase the crop seeds, not create the proceeds, even if it were applicable, the facts in this case do not support application of the exception.

B. Debtor in Possession's Post-Petition Expenditures

The Bankruptcy Court held that the exception also did not apply to the post-petition financing because there was no direct detriment to the unsecured creditors. (Doc. 10 at 13.) The Bankruptcy Court explained that, "actual expenditures are needed, because the incurring of debt alone does not seem to trigger the prejudice to unsecured creditors that's required . . . [The prejudice must be a] direct detriment, . . . basically, out of the pockets of the unsecured creditors." (Doc. 14 at 87:4-11.) Thus, the Bankruptcy Court held that the exception does not apply absent a direct detriment to the unsecured creditors. *Id.*

While not explicitly defining the scope of the "equities of the case" exception, § 552(b)(1) empowers **[*26]** the court to "not apply a pre-petition security interest to post-petition proceeds," United Virginia Bank, 784 F.2d at 1191. The section, however, "is not a general grant of equitable power" to rearrange security interests. In re Cross Baking Co., Inc., 818 F.2d at 1033. Courts interpreting § 552(b)(1)'s scope have generally relied on the legislative intent. *See, e.g.*, J. Catton Farms, Inc., 779 F.2d at 1246; In re Cross Baking Co., Inc., 818 F.2d at 1033; In re Tower Air, Inc., 397 F.3d at 205. The legislative intent, however, also is vague on this issue. There appears to be no mandatory authority or evidence to suggest that, as a matter of law, expenditure of post-petition financing would render § 552(b)(1) inapplicable. The cases and legislative history only require that funds otherwise going to unsecured creditors be spent in improving the secured creditor's collateral. *See, e.g.*, In re Tower Air, Inc., 397 F.3d at 205; In re Cross Baking Co., Inc., 818 F.2d at 1033; J. Catton Farms, Inc., 779 F.2d at 1246.

Most courts considering this issue conducted a balancing of equities to determine whether a security interest in post-petition proceeds should be reduced. For example, in *In re Photo Promotion Assocs., Inc.*, the Chapter 7 Trustee obtained post-petition financing to complete and collect on the debtor's outstanding photography contract orders. 61 B.R. 936, 938 (Bankr. S.D.N.Y. 1986). The secured creditor in that case had a lien on all accounts receivable. *Id.* Despite the fact that the Trustee expended post-petition financed assets of the estate, the court conducted **[*27]** a balancing of the equities under § 552(b)(1), and it found that it would be inequitable to permit the creditor to retain the entirety of the proceeds of the photo accounts since their incomplete value would have been nominal. *Id.* at 939; *see also* In re Laurel Hill Paper Co., 393 B.R. 89, 92-93 (Bankr. M.D.N.C. 2008) (noting that "[t]he cases involving section 552(b)(1) appear to place the most weight on whether a debtor expended unencumbered funds of the estate, at the expense of the unsecured creditors, to enhance the value of the collateral," and finding that the equities did not weigh in debtor in possession's favor since post-petition financing was used to increase the proceeds' value); In re Muma Servs., Inc., 322 B.R. 541, 558-59 (Bankr. D. Del. 2005) (holding that, in balancing the equities, a creditor's security interest in proceeds under § 552(b)(1) should not be reduced since post-petition financed assets were used as opposed to assets of the estate).

The Bankruptcy Court erred in finding, as a matter of law, that the exception did not apply to post-petition financing. The Bankruptcy Court should have conducted a balancing of the equities to determine whether to apply the exception and, if applicable, to what extent. As the Fourth Circuit held in *United Virginia Bank*, "In this case, the record does not reflect adequately the various equitable considerations **[*28]** which may bear on this question, and in any event such a determination should more properly be made in the first instance by the Bankruptcy Court." 784 F.2d at 1191. Therefore, the case should be remanded to the Bankruptcy Court to conduct a balancing of the equities as to whether BOE's

interest should be reduced in light of Gray's expenditure of post-petition financing. *See In re JLJ Inc., 988 F.2d at 1116*. ("If the bankruptcy court is silent or ambiguous as to an outcome determinative factual question, the case must be remanded to the bankruptcy court for the necessary factual findings.").

CONCLUSION

For the foregoing reasons, the Court hereby **AFFIRMS in part** and **REVERSES in part** and **REMANDS** the Bankruptcy Court's order. More specifically, the Bankruptcy Court's Order finding that BOE had a perfected security interest in the 2016 Corn Crop and its proceeds and finding that the "equities of the case" exception in *§ 552(b)(1)* does not, as a matter of law, apply to a debtor's use of prepetition funds to improve collateral is **AFFIRMED**. The Bankruptcy Court's finding that, as a matter of law, the "equities of the case" exception of *§ 552(b)(1)* does not apply to debtor expending post-petition financing estate funds, however, is **REVERSED and REMANDED** for further **[*29]** proceedings consistent with this Order.

SO ORDERED, this 20th day of September, 2018.

/s/ Leslie J. Abrams

LESLIE J. ABRAMS, JUDGE

UNITED STATES DISTRICT COURT

JUDGMENT

Pursuant to this Court's Order dated September 20, 2018, and for the reasons stated therein, the Bankruptcy court's decision is AFFIRMED in part and REVERSED in part and REMANDED.

JUDGMENT is hereby entered in favor of Appellant.

This 20th day of September, 2018.

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