In the United States Bankruptcy Court

for the Northern District of Iowa

BOCKES BROTHERS FARMS INC. Bankruptcy No. 93-60881KW
Debtor(s). Chapter 11

ORDER RE: PROPOSED STIPULATION

On August 27, 1993, the above-captioned matter came on for hearing pursuant to assignment. Debtor appeared by Attorney Thomas Fiegen; Creditor First Bank of Fargo and First American Bank appeared by Attorney Michael Vestle; Farmland Financial Services appeared by Attorney Rod Kubat; and the Unsecured Creditors appeared by Attorney Tom McCuskey.

The matter before the Court is a proposed stipulation presented to the Court by Debtor and Creditor Phelps Implement Tire and Auto Corp. The stipulation proposes that Debtor be allowed to purchase a John Deere 7000 planter from Phelps. This proposed stipulation is objected to by Farmland as well as by the Unsecured Creditors Committee. The record establishes that Phelps Implement sold two 16-row John Deere Model 7200 planters to Debtors pre-bankruptcy. Mr. Roger Bockes was a personal guarantor on a portion of the sales price of these two planters. In the purchase of these planters, Phelps Implement had a security interest and a first lien. Farmland Services had a second lien.

The Debtor defaulted on its payments, pre-bankruptcy, and both planters were repossessed. Prior to the filing of this bankruptcy petition, both planters were placed on the lot at Phelps Implement and one of the two planters was sold to a third party. When this third party purchased this John Deere Model 7200 planter, he traded in, as part of the transaction, a John Deere Model 7000 planter, which is the machine in dispute in this case.

After the filing of the bankruptcy petition, a demand for turnover was made against Phelps Implement under 11 U.S.C. § 543. The demand sought turnover of both the remaining unsold John Deere 7200 planter as well as the John Deere 7000 planter which had been the subject of the trade-in. Phelps Implement complied with the turnover demand and, since that time, the Debtor has had the use of both planters.

The stipulation, entered into between Phelps and Bockes Brothers, proposes that Phelps will sell to Bockes Brothers the John Deere Model 7000 under certain conditions set forth in the stipulation including a cash down payment, a cash payment at the end of the 1993 crop season, and the remainder to be paid under the proposed plan of reorganization.

The proposed stipulation was filed July 12, 1993 and an objection was filed by Farmland on July 27, 1993. Farmland asserts that it had a security interest in both of the Model 7200 planters. Farmland claims that it continues to have a security interest, not only in the remaining 7200 planter which was returned, but also the 7000 planter which was given to Phelps as a result of the trade-in on the second 7200 planter. In its objection, Farmland asserts that its security interest in the 7000 planter is prior to and superior to the interests of Phelps. However, at hearing, Farmland conceded that it would have a second lien which is not superior to Phelps on either planter.

Phelps and Bockes take the position that as long as both Model 7200 planters remained on Phelps' lot for resale, they were subject to turnover by the Trustee. However, as the one 7200 planter was sold before the filing of the petition, Farmland loses its security interest on this item of machinery. When the 7200 planter was sold, this planter was turned into partial cash as well as the John Deere 7000. It is both Phelps' and Debtor's assertion that Farmland has no security interest in this 7000 planter as it was proceeds of the sale.

Farmland, however, takes the position that Debtor retained rights in this 7000 planter after the sale and therefore,

Farmland retains its secondary security position in this planter. It is the position of Farmland that its security interest on the sold 7200 planter must now be placed on the 7000 planter. Farmland denies that its lien was lost in the sale process. Creditor Phelps and Debtor disagree and assert that this series of transactions is such that Farmland's lien was lost and further assert that the new proposed stipulation would constitute a new sale post-petition free of Farmland's prior security interest.

Farmland asserts that this is not a post-petition sale but rather a procedure in which all of the significant events occurred pre-petition and Farmland retains its security position and a chance to recover against this collateral in the future. Attorney McCuskey, on behalf of the Unsecured Creditors, objects to the proposed stipulation. The unsecured creditors do not want Farmland to have a secondary security interest on this collateral. Obviously, if Creditor Phelps is paid off and there is any liquidity left in this collateral, it would go to the Unsecured Creditors if Farmland does not have any secondary

lien. However, if Farmland is correct and the lien is recognized, the residue of any sale would go to Farmland and the Unsecured Creditors would not receive any of these proceeds.

In its simplest terms, the issue presented is whether Farmland retains a security interest in the proceeds of Creditor Phelps' sale of the 7200 planter. Article 9 of the Uniform Commercial Code governs secured transactions. Iowa Code SS 554.9101 et seq.; U.C.C. §§9-101 et seq. Article 9 authorizes disposition of collateral after a default. Iowa Code § 554.9504. Sec. 554.9504(4) states:

When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto.

Notification of a sale must be sent to any other secured party, such as Farmland, from whom the foreclosing secured party, such as Phelps, has received written notice of a claim of an interest in the collateral. Iowa Code § 554.9504(3). Farmland has not contested the validity of the sale or of notice so the Court concludes notice of Phelps' sale of the 7200 planter is not at issue. Both Phelps' and Farmland's security interests in the sold 7200 planter were discharged by the sale pursuant to sec. 554.9504(4) .

Farmland argues that Iowa Code sec. 554.9306(2) allows its security interest to continue in the 7000 planter as identifiable proceeds resulting from Phelps' sale of the 7200 planter. However, sec. 554.9306(2) applies to proceeds from an unauthorized sale of collateral and is not applicable here because Phelps' sale was not the type of unauthorized sale contemplated in this section. Disposition of proceeds from a sale after repossession of collateral is governed by sec. 554.9504 and not sec. 554.9306(2).

In Maxi Sales Co. v. Critiques, Inc., 796 F.2d 1293 (10th Cir. 1986), a creditor made an argument which mirrors Farmland's present argument. It asserted that U.C.C. sec. 9-504, rather than sec. 9-306(2), governed disposition of proceeds from a liquidation sale by a receiver occurring while the creditor's foreclosure proceedings were pending. Id. at 1297. The debtor had filed bankruptcy after the sale but prior to distribution of the sale proceeds. Id. at 1295. The court concluded that had foreclosure been complete and the proceeds distributed, U.C.C. sec. 9-504 would have been applicable rather than sec. 9-306. Id. at 1297. This Court also concludes that sec. 554.9504 applies to Phelps' sale of the 7200 planter because foreclosure was complete prior to filing bankruptcy. Thus, Farmland's security interest in the sold 7200 planter was discharged by the sale.

Farmland argues that it and Bockes have the right to redeem both the remaining 7200 planter and the 7000 planter for turnover to the bankruptcy estate under 11 U.S.C. § 543. Thus, Farmland argues, its security interest would continue in both pieces of equipment. A Chapter 11 estate includes property of the debtor which has been seized by a creditor prior to filing of the petition. United States v. Whiting Pools, Inc., 462 U.S. 198, 207, 103 S. Ct. 2309, 2315 (1983) (considering property seized by I.R.S.). Similar to the remedies of private secured creditors, the I.R.S may sell property at a tax sale. I_dd. at 212, 103 S. Ct. at 2317. Until sale of the seized property, it remains property of the debtor and is subject to turnover. Id.

A debtor's right to redeem collateral under Iowa Code sec. 554.9506 applies "at any time before the secured party has

disposed of collateral". As noted in Whiting Pools, turnover of collateral is only appropriate prior to its disposition by the foreclosing creditor. Proceeds of property sold pre-petition are not property of the estate. In re Davis, 40 B.R. 934, 936 (Bankr. D.S.D. 1984). There is no post-sale redemption of personal property under U.C.C. sec. 9-506. Id. at 937. A debtor's property repossessed but not disposed of is property of the estate. Id. After the property is brought back into the estate, the creditor's lien continues, entitling the creditor to adequate protection. Id.

The 7200 planter which Phelps had repossessed but had not sold pre-petition is subject to turnover. It is property of the bankruptcy estate. Both Phelps' and Farmland's security interests continue in that collateral. They are both entitled to adequate protection.

As to the 7200 planter sold pre-petition, both Phelps' and Farmland's liens were discharged by the sale. They do not retain a security interest in the 7000 planter which Phelps' received in trade from a third party. Sec. 554.9504(1) provides that, after deduction of reasonable expenses, proceeds from the sale shall be applied in satisfaction of Phelps' secured indebtedness. If, as Farmland asserts, Phelps received some amount of cash plus the $16,000 value trade-in 7000 planter, those amounts must be applied in satisfaction of the prepetition debt. The pre-petition debt appears from Bockes' schedules to total $23,000.

Farmland characterizes Phelps' proposed stipulation as an attempt at cross-collateralization. Cross-collateralization has been disapproved. In re Saybrook Mfg. Co., 963 F.2d 1490, 1496 (11th Cir. 1992). Enhancement of a creditor's position by postpetition financing arrangements securing both pre- and post-petition debt is contrary to the Bankruptcy Code's fundamental priority scheme. Id. at 1495. The question remains whether Phelps' proposed stipulation regarding the 7000 planter enhances its position in violation of the Code.

The Court concludes that the Proposed Stipulation must be rejected. In essence, the stipulation ignores Farmland's prepetition security interest and provides for payment of $23,739.12. This amount is suspiciously similar to the $23,000 scheduled as Phelps' total claim, part of which should have been satisfied by the 7200 planter sale. The stipulation would grant Phelps a security interest in both the 7200 and 7000 planters which appears to cross-collateralize pre- and post-petition debt with pre- and post-petition property. This arrangement could enhance its position as a pre-petition creditor.

Phelps already has a senior security interest in the 7200 planter to the extent of the pre-petition debt remaining after application of the proceeds of the sale of the other 7200 planter in partial satisfaction. Farmland has a junior security interest in the remaining 7200 planter. Both creditors are entitled to adequate protection. The Stipulation does appear to offer adequate protection in the form of payments, maintenance, insurance, etc.

Phelps and Bockes may enter into a post-petition transaction on motion under 11 U.S.C. § 364 regarding the 7000 planter. In this case, such a transaction would entail obtaining secured debt of approximately $16,000 (apparent value of the 7000 planter) secured by the 7000 planter. The 7200 planter would not be security for the post-petition debt because it appears to be fully encumbered by Phelps' and Farmland's prepetition interests. Farmland would have no involvement with this post-petition transaction. The fact that Phelps acquired the 7000 planter as trade-in on sale of Bockes' 7200 planter is irrelevant.

WHEREFORE, the Proposed Stipulation for Purchase of John Deere 7000 Planter from Phelps Implement Tire and Auto Corp., and For Other Purposes is REJECTED.

FURTHER, the 7200 planter is property of the estate. Farmland retains its junior security interest in the 7200 planter. Phelps retains its security interest in the 7200 planter to the extent it was not satisfied by proceeds of the sale of the other 7200 planter under Iowa Code sec. 554.9504(1).

FURTHER, Phelps and Farmland are entitled to adequate protection regarding the 7200 planter.

FURTHER, the 7000 planter is not property of the estate. Farmland has no interest in the 7000 planter. Phelps and Bockes may present a motion under 11 U.S.C. § 364 to obtain credit as necessary to the extent that Bockes wishes to continue to use the 7000 planter.

SO ORDERED this 16TH day of September, 1993.

PAUL J. KILBURG

Paul J. Kilburg
U.S. Bankruptcy Judge