In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

GLENN STURM and MARLIES STURM Debtors.	Bankruptcy No. 95-51776XS Chapter 13
GLENN STURM and MARLIES STURM Plaintiffs vs. FARMERS STATE BANK; UNITED STATES OF AMERICA, on Behalf of its Agency, Consolidated Farm Service Agency; and CYRIL RENZE d/b/a Acre Assistance Company Defendants.	Adversary No. 96-5027XS

DECISION

The parties seek a determination of the priority of liens in the proceeds of debtors' pre-petition crop sales. Also before the court is a defendant's cross-claim for breach of contract and for conversion. Trial was held June 25-26, 1996 in Sioux City. Ronald F. Eich, Esq. appeared for plaintiffs Glenn and Marlies Sturm; Donna K. Webb, Esq. appeared for the United States on behalf of the Farm Service Agency; Colin J. McCullough, Esq. appeared for Farmers State Bank; and Michael P. Mallaney, Esq. appeared for Cyril Renze d/b/a Acre Assistance Company.

The court has jurisdiction of this matter under 28 U.S.C.

1334(b) and 157(a). The court's determination of the priority of liens is a core proceeding under 28 U.S.C. 157(b)(2)(K). The cross-claim is at best a related matter under 28 U.S.C. 157(a). The court will determine the cross-claim dispute and enter judgment as it has the consent of the parties given orally at trial. 28 U.S.C. 157(c)(2).

Findings and Conclusions

Glenn and Marlies Sturm, husband and wife, filed their voluntary petition under chapter 13 on September 18, 1995. They are farmers. At the time they filed, they held six checks which were the proceeds of pre-petition crop sales. These checks, assets of their bankruptcy estates, were issued on the following dates for the amounts shown:

Check No.	Date Issued	Amount
27997	12/24/94	$ 2,110.92

28172	2/10/95	11,105.68
28173	2/10/95	21,424.57
28189	2/17/95	4,104.68
28127	2/28/95	7,301.19
28433	5/25/95	8,923.33

Prior to 1992, Farmers State Bank, located in Lake View, Iowa, loaned operating money to the debtors. To secure its loans, Bank took a security interest in debtors' assets, including crops then owned and thereafter acquired. Bank did not loan money to Sturms for crop inputs in 1992.

Sturms borrowed the money to put in their 1992 crops from "Acre Assistance Company" (hereafter referred to as "ACRE"), an unincorporated farm lending business of Cyril Renze and perhaps his spouse. Sturms executed a Master Promissory Note to ACRE (Exhibit A) in the amount of $65,000. ACRE advanced money to Sturms during the crop year. ACRE also took a security interest in Sturms' crops, both those then owned and those thereafter acquired. (Exhibit B).

Bank and ACRE filed financing statements with the Iowa Secretary of State in order to perfect their liens. Bank's filing was prior in time. The parties do not dispute the perfections of the liens.

ACRE obtained Bank's execution of a "Subordination Agreement" for the 1992 crop year (Exhibit G). It stated:

Glenn Sturm + Marlies Sturm have entered into a loan agreement with ACRE Assistance Co. * * * to provide financing of crop inputs and rents for the 1992 crop year. ACRE Assistance Co. has taken a security interest in all 1992 crops and an assignment of all crop insurance. Farmers State Bank hereby subordinates its priority security interest in the 1992 crops to ACRE Assistance Co. to the extent of the advances made by ACRE Assistance Co. plus accrued interest on the master note dated April 25, 1992, and signed by Glenn L. Sturm and Marlies Sturm.

(Exhibit G.)

For Sturms' 1992 crop, ACRE made advances of $64,762.16 and charged fees and interest. Sturms sold at least some of their crops in the fall of 1992. Although they had paid back some of the loan by early March 1993, they still owed ACRE $25,418.24 (Exhibit 100). ACRE agreed to lend Sturms money for their inputs for the 1993 crop year. On March 2, 1993, Sturms executed another "Master Promissory Note" (Exhibit D). This time their credit limit was $52,000.00. At the same time, Glenn Sturm signed another security agreement granting ACRE an interest in crops (Exhibit E). The note stated also that it was secured by existing security documents (Exhibit D, page 2).

On March 29, 1993, Bank executed another subordination agreement. Bank lent no money for crops in 1993. The agreement stated:

Glenn and Marlies Sturm, Breda, Iowa Have entered into a loan agreement with ACRE Assistance Company to provide financing for crop inputs and rents for the 1993 crop year. ACRE Assistance Company has taken a security interest in all 1993 crops. Farmers State Bank, Lake View, Iowa has a priority security interest in said crops. Farmers State Bank hereby subordinates its priority security

interest in the 1993 crop to ACRE Assistance Company to the interest (sic) of the outstanding balance of his loan and any accrued interest. The undersigned warrants and agrees that should it receive payment from the proceeds of the sale or other form of liquidation of the collateral that it will promptly remit to Lender the proceeds of such sale to the extent called for under this agreement.

(Exhibit H). The agreement's fourth sentence was no doubt intended in part to read "to the extent of" not "to the interest of." Both this agreement and the one for 1992 were prepared by ACRE.

During the course of the 1993 crop year, ACRE advanced approximately $54,298.15 to Sturms. ACRE also charged fees and interest. According to ACRE's records, Sturms' debt from 1992 advances and interest was paid in full by December 20, 1993 (Exhibit 100). By the end of 1993, Sturms owed ACRE $55,352.79 for 1993 advances. By the date of bankruptcy, the debt was $66,199.47.[(1)]

In 1992, ACRE was not Sturms' only lender. Sturms borrowed approximately $31,000.00 from the Commodity Credit Corporation (CCC), the predecessor of the United States Farm Service Agency. Sturms pledged 19,630 bushels of 1992 corn as collateral for their farm storage loan, loan no. 252 (Exhibit 2). In taking their security interest in that much of the 1992 crop, CCC obtained lien waivers from Bank and ACRE (Exhibit 5). Each waiver stated in part:

The undersigned [Bank or ACRE] is the holder of a lien on the commodity identified above [corn and beans]. In order for [Sturms] to pledge such commodity as collateral for a Commodity Credit Corporation ("CCC") price support loan or to sell such commodity to CCC in accordance with a CCC purchase agreement, with respect to CCC only, the undersigned waives all interest in, and title to, such commodity.

(Exhibit 5.)

In August 1993, Glenn Sturm decided to participate in the CCC reserve program (Exhibit 6). He signed a Reserve Loan Agreement on September 30, 1993 (Exhibit 11) and transferred 10,924 bushels of 1992 corn into the reserve loan program. The corn was transferred from the bushels he had pledged to CCC in November 1992 (Exhibits 12 and 2). Sturms signed a note and security agreement (loan no. 750) as part of the reserve program loan (Exhibit 12).

On two occasions, Sturms redeemed corn from the storage loan: 2,500 bushels in March 1993 and 6,206 bushels of ear corn in April 1994. The April redemption was financed by a loan from his mother-in-law. In May 1994, Sturms redeemed 4,797 bushels of corn from the reserve loan, leaving a balance of 6,127 in the program as collateral. However, when a CCC representative inspected in August 1994, the corn which should have remained in the reserve program had been removed from the specified bin.

Glenn Sturm had removed the shelled corn in reserve from the bin without authorization. He had intended to replace it by using the 6,206 bushels of ear corn he had redeemed in April. He had that corn shelled, and it was subsequently sold. The proceeds are represented by check no. 28433 in the amount of $8,923.33. Sturms say the check is proceeds of FSA (CCC) collateral.

Sturms sold grain in late 1992, throughout 1993, and in the early part of 1994 (Exhibits A-3; A-14; A-15; A-16; A-22 and

A-30). The bulk of the documentary evidence showing sales is bank deposit tickets, copies of checks to Sturm, and some settlement sheets. According to Glenn Sturm, all proceeds of grain sales were deposited in his account at the bank. By the time Sturms filed bankruptcy, only the six checks in dispute had not been negotiated by Sturms. After filing, the parties agreed that the checks would be deposited in Sturms' attorney's trust account.

Lien Priority as to Five Checks

Five of the checks (all but no. 28433) total $46,047.04. Glenn Sturm says that three of these checks (nos. 27997, 28172 and 28173), totaling $34,641.17, are from the sales of 1994 crop. He says no. 28189 and no. 28127, totaling $11,405.87, are proceeds of 1993 crop. Bank is willing to have the court accept his testi- mony. The result would be that Bank would have the first lien in $34,641.17, and ACRE would have the first lien in $11,405.87.

ACRE disagrees. It, of course, wants the two checks, but it contends that at least part of the three checks represents proceeds of 1993 crop in which it holds a priority interest under the subordination agreement. ACRE argues that the court should not rely on Sturm's testimony as he is not a credible witness. It is pointed out that Sturm admitted selling CCC corn out of trust and that he admitted lying to his banker in July 1994 about the amount of crop on hand. At that time, Sturm told the banker that he had 10,000 bushels of corn and 3,500 bushels of beans, all from 1993. Despite ACRE's contention that Sturm is not credible, it uses the latter figures as its starting point in calculating that the three disputed checks include proceeds of 1993 crops.

Bank counters that Sturm's testimony is the best evidence as to the year of the crops, but it says that if the court does not believe Sturm, then the court must decide as to the crop year source of all five checks, not just the three. Bank says it concedes two checks to ACRE only under the circumstance that the court also believes Sturm's testimony as to the three from which Bank would benefit.

I agree with ACRE that Glenn Sturm is not a credible witness. Because of his demeanor and because of the substantial number of significant facts that he could not recall about his operation, I find his testimony nearly useless regarding the critical issues of this case. Also, I agree that he has reason to favor the Bank. ACRE has only its interest in crops. Regardless of the outcome here, ACRE will have an unsecured claim in the case. Bank, on the other hand, to secure its claim, has a security interest in debtors' home as well as their crops. It would be understandable that Sturm would be more cooperative in getting Bank paid than in getting ACRE paid.

How then do I decide the crop year source of the checks? Based on the evidence submitted, I cannot. Sturm remembers too little about his crop operation to permit reconstruction of two crop years of harvest, storage and sales. His production and sale records are incomplete. There are no records in evidence showing sales of 1994 crop. Documents in evidence show sales that must be 1992 crop and that must be 1993 crop, but it is not possible to determine with accuracy whether some sales in 1993 were sales of prior year's crop or of the 1993 crop. In short, the credible evidence does not permit me to determine what proportion of the disputed checks represent 1993 and 1994 crop sales.

It is ironic that ACRE's counsel would point me in the direction of calculation based on Sturm's "lie" to the Bank. But as I do not believe Sturm's testimony in general, I also do not believe it as to this event. Even Sturm says it was not the truth.

It is undisputed, or certainly not strongly disputed, that the five checks represent 1993 and 1994 crops. There is no doubt that between ACRE and Bank, they are entitled to all of the proceeds. It is just that I

cannot determine how much is 1993 crop proceeds and how much is 1994 crop proceeds. Bank has a security interest in the crops from both years, and despite ACRE's counsel's misspeaking in his closing argument, ACRE does too. Bank's interest is prior in 1994 and ACRE's interest is prior in 1993 by virtue of the subordination agreement.

Both parties have perfected security interests in identifiable cash proceeds under Iowa Code 554.9306 (4)(a)-(c). I conclude this is so despite the fact that the parties cannot show from what year's crops the checks proceeded. If it were concluded that the checks were not identifiable cash proceeds because the particular years of each bushel of crop could not be identified, then the creditors would lose their interests in the proceeds to the benefit of the debtors and the unsecured creditors. I find no equity in that, as it is undisputed that these checks represent crop in which both creditors have interests. The priority problem does not turn this dispute into a perfection dispute.

I had thought that perhaps this case could, under these circumstances, be decided by determining who had the burden of proof as to its interest and then determining the outcome by whether the burden had been met. I conclude, however, that it would be unfair to place the burden on either claimant. Each ought to have some burden to prove the priority of its interest. See 11 U.S.C. 363(o)(2). But the burden is not greater for one than the other. Neither could prove by preponderance that the checks in question were subject to its prior interest. Both are blameless, and I do not believe that either should be penalized for the Sturms' poor memory or records. Neither has a greater access to the information pertinent to the dispute. Neither claim is disfavored. And importantly, neither claim, as it relates to a particular year, represents a party desiring a change from the normal situation or status quo. I conclude it would be inequitable to determine this dispute based on one party being saddled with the ultimate but unmet burden.

During closing argument, I asked counsel to tell me whether they thought Iowa Code 554.9315 applied. Neither argued that it did. I find that it cannot be applied literally. The section states:

1. If a security interest in goods was perfected and subsequently the goods or a part thereof have become part of a product or mass, the security interest continues in the product or mass if

a. the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass; or

b. a financing statement covering the original goods also covers the product into which the goods have been manufactured, processed or assembled.

In a case to which paragraph "*b*" applies, no separate security interest in that part of the original goods which has been manufactured, processed or assembled into the product may be claimed under section 554.9314.

2. When under subsection 1 more than one security interest attaches to the product or mass, they rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.

As I say, I cannot apply this section literally because, as is required by 554.9315(2), I do not have sufficient information as to the "cost of the goods to which each interest originally attached" so as to determine the ratio. It is arguable that

554.9315 does not even apply to a situation such as this one.

Nonetheless, I choose to apply this section by analogy because to do so both liberally construes the Uniform Commercial Code, including its remedies, and does equity to both parties. As I cannot determine the ratio based on the cost of 1993 crop and the cost of 1994 crop, I will use the creditors' claims at filing.

I calculate that as of September 18, 1995, Bank was owed $74,602.26 on its claims (Exhibit Z). On the same date, I find that ACRE was owed $66,199.47. ACRE may claim more, and from an examination of Exhibits A-34 and 100, I have no doubt it does. But my reading of the 1993 Master Promissory Note leads me to conclude that ACRE has incorrectly calculated interest by compounding it after January 15, 1994. Its agreement with Sturms entitled it to simple interest on the amount due as of January 15, 1994, and that amount could include interest. But the agreement gives ACRE no right to compound interest each time it decides to calculate the interest due to any arbitrary date. This it has done, but I will not perpetuate the error in deciding this case.

The two debts together total $140,801.73. ACRE's claim amounts to 47 per cent of this total; Bank's claim amounts to 53 per cent. ACRE's first priority security interest in the five checks which total $46,047.04 will be limited to $21,642.11, and Bank's first priority security interest will be limited to $24,404.93.

The Check for 1992 Corn

The sixth check, no. 28433, is in the amount of $8,923.33. All parties agree it is the proceeds of the sale of 1992 corn. FSA claims it as its collateral for the remaining balance of the reserve note. Sturm and Bank do not contest FSA's claim, but ACRE does.

FSA says the check is its collateral because Glenn Sturm intended it to be so. Sturm sold the corn securing the reserve loan without authorization. He redeemed 6,206 bushels of ear corn from FSA on the storage loan in April 1994. He removed it from the bin where it was stored and had it shelled. He said he did so with the intent of substituting it for the corn sold out of trust. The redeemed corn was never delivered to FSA. Instead, it was sold, and check no. 28433 represents the proceeds.

FSA says that the effect of Sturm's redemption of the ear corn was to estop FSA from enforcing a lien which at all times remained against the crop. It argues that when Sturm decided to use the corn to replace the FSA collateral sold without permission, Sturm was prevented from raising the estoppel and that FSA is now free to enforce its always-present lien.

I disagree that such is the effect of the redemption, the FSA documents and Sturm's intent. FSA agrees that when Sturm redeemed the ear corn, he was free to do with it what he desired. Redemption had been accomplished by payment to FSA of an amount sufficient for Sturm to regain the use of the corn. FSA has pointed to no statute or federal regulation which supports the proposition that its lien remained against the redeemed corn and that FSA was merely estopped from enforcing it. Indeed, the Department of Agriculture's regulation describes the process as a "release" of the commodity as collateral. 7 C.F.R. 1421.20(a). I conclude that the legal effect of the redemption was to allow Sturm to obtain the redeemed corn free and clear of FSA's lien.

Moreover, FSA's lien did not reattach because of Sturm's sale of other collateral without permission and his intent to replace it with the ear corn. The Farm Storage (Reserve) Note and Security Agreement (Exhibit 12) states:

The producer hereby sells, assigns, and mortgages to CCC as collateral for the payment of this Note all of the commodity described in this Note, together with all authorized replacements, substitutions, additions, and accessions thereto, which is stored in the bins or storage structures specified in this Note (even though a larger quantity than the quantity shown in the item above entitled "Total Loan Quantity" is stored in such structure).

(Exhibit 12).

I read the above to require replacements or substitutions of collateral to be authorized. This sounds of a formal, advance-permission procedure, not merely a debtor's intent to substitute or replace if he has sold the collateral without FSA's knowledge. Further, I find no evidence that the 6,206 bushels of ear corn redeemed from loan no. 252 (Exhibit 10) and removed from the sealed bins were subsequently stored in the bins where the collateral for reserve loan no. 750 was stored.

Last, I find Sturm's private intent irrelevant. The attachment of a security interest requires, among other things, that the collateral be in the possession of the secured party pursuant to an agreement or that the debtor has signed a security agreement containing a description of the collateral. Iowa Code 554.9203(1)(a). The Storage Note and Security Agreement (Exhibit 12) does not describe the shelled corn, the proceeds of which are now at issue. It describes 10,924 bushels of other corn stored in specific bins. As the redeemed corn was not covered by the original agreement (Exhibit 12) and as there was no authorization that the corn be placed in the bins as replacement or substituted collateral, I conclude it was not covered by FSA's security interest. Accordingly, check no. 28433 in the amount of $8,923.33 is not proceeds of FSA's collateral.

FSA says that if such would be the result, the check is the proceeds of no creditor's collateral, and the check should inure to the benefit of the unsecured creditors. I do not agree.

The lien waivers signed by ACRE and Bank state that they waived each of their liens "with respect to CCC only" (Exhibit 5). This language is ambiguous. "Waiver" in the legal sense denotes complete relinquishment. In waiving "with respect to CCC only," perhaps the creditors intended only to subordinate their liens to CCC, not to waive them outright. I am not sure it matters. Certainly when Sturm redeemed the grain from FSA, this language would at least permit each creditor's security interest in farm products to reattach, and the liens would reattach in the order of their original priority, subject to any subordination agreement.

Bank had a prior lien in 1992 crops and their proceeds. ACRE had a junior lien. Bank, however, had agreed to subordinate its lien to ACRE's lien to the extent of ACRE's advances for 1992 crop inputs. As I have found that ACRE was fully paid for 1992 advances to Sturms for such inputs, the subordination does not help ACRE. It does not allow ACRE to take a priority position in 1992 crop proceeds for 1993 debt. I do not construe the subordination agreements so broadly. ACRE's security documents do provide it with a security interest in 1992 crop proceeds for 1993 debt. Therefore, I conclude that as to check no. 28433, in the amount of $8,923.33, Bank has a security interest prior to the security interest of ACRE.

ACRE's Cross Claims for Conversion

ACRE makes two conversion claims against Bank. ACRE also contends that the acts constituting conversion were breaches of the 1993 subordination agreement signed by Bank (Exhibit H). The agreement stated that should bank "receive payment from the proceeds of the sale or other form of liquidation of the collateral" that it would remit the proceeds to ACRE "to the extent called for under [the] agreement." Id.

ACRE says that Bank breached the agreement to remit and converted ACRE's collateral when it accepted payment from Sturms out of 1993 crops. These payments were made on December 31, 1993 in the amount of $3,200.00 and on January 6, 1994 in the amount of $2,180.10. Bank admits it accepted the payments in violation of the agreement and says that it has tendered repayment. The tender was not accepted because of the parties' inability to resolve ACRE's other conversion claim. The court concludes that Bank is liable to ACRE in the sum of $5,380.10.

ACRE also makes claim against the Bank for all sums that passed through Sturms' account at the Bank the source of which was 1993 crop sales. ACRE says Bank is liable to it regardless of whether the Bank got the money or whether Sturms used the money for entirely other purposes. ACRE contends that this result is required by a fair reading of the 1993 subordination agreement. I do not construe the agreement to have such legal effect. The agreement requires Bank's remittance to ACRE of 1993 crop sales proceeds if Bank "receives payment" from the proceeds. A clear and reasonable reading of the agreement is that Bank's loans cannot be paid from 1993 crop before ACRE's input loans are paid in full. If that happened, Bank would give the money back.

ACRE argues that the provision means that Bank is obligated to monitor the Sturms' checking account at the Bank and take whatever money is deposited in it from 1993 crop sales (apparently with or without Sturms' permission) and give it to ACRE. I find such a reading of the contract to be extreme. Such a reading may have been somewhat more supportable if the agreement had indicated Bank would remit funds to ACRE if it had "receive[d] payment OF the proceeds." It did not. Even had it, ACRE's interpretation gives a tortured ready to "payment."

Moreover, I do not agree that the nature of the banking business supports ACRE's argument. ACRE contends that when a depositor makes a deposit in an account at a bank, the money is the bank's and the deposit creates merely a debt from the bank to depositor. I think this is a generally correct view of the depositor-bank relationship. But it is not the relationship which determines this issue. It is the language of the subordination agreement. Bank's contract with its depositor requires Bank to repay the depositor according to Bank's rules and regulations. Johnson v. Stamets (In re Estate of Stamets), 260 Iowa 93, 148 N.W.2d 468, 471 (1967). The subordination agreement gives no explicit right of Bank to breach its contract with Sturms by sending all 1993 crop proceeds deposits to ACRE. And while Bank might agree to the subordination, the court is offered no motive why Bank would agree to daily monitor Sturms' account to become the collection agency for ACRE. ACRE's reading of the subordination agreement is not supported by its language or by common sense. ACRE has cited the court no legal authority to support its interpretation. I conclude that Bank is not liable to ACRE for conversion or breach of contract on this theory.

ORDER

IT IS ORDERED that judgment shall enter as follows:

that to the extent of $24,404.93 the security interest of Farmers State Bank in grain proceeds check nos. 27997, 28172, 28173, 28189 and 28127 is prior and superior to the security interest of Cyril Renze d/b/a ACRE Assistance Company;

that to the extent of $21,642.11 the security interest of Cyril Renze d/b/a ACRE Assistance Company in the same checks is prior and superior to the security interest of Farmers State Bank;

that the security interest of Farmers State Bank in grain proceeds check no. 28433 in the amount of $8,923.33 is prior and superior to the security interest of ACRE Assistance Company;

that the United States of America on behalf of the Consolidated Farm Service Agency has no security interest in any of the grain proceeds checks listed above;

that Cyril Renze d/b/a ACRE Assistance Company shall recover from Farmers State Bank the sum of $5,380.10.

SO ORDERED THIS 3rd DAY OF SEPTEMBER 1996.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order and a judgment by U.S. mail to: Ronald Eich, Colin McCullough, Robert Peters, U.S. Attorney, Michael Mallaney, and U.S. Trustee.

1. See discussion page 12.