

**UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA**

In the Matter of	:	Case No. 95-226-WH
	:	Chapter 13
STANLEY JOSEPH MESSERSCHMIDT,	:	
and MARY SUE MESSERSCHMIDT,	:	
	:	
Debtors.	:	

**ORDER--APPLICATION TO USE CASH COLLATERAL AND
OBJECTIONS TO CONFIRMATION OF PLAN**

On April 17, 1995 and April 19, 1995, Debtors' Application to Use Cash Collateral and the Objections to Confirmation of Debtors' Chapter 13 Plan came before this Court. Debtors, Stanley J. Messerschmidt and Mary Sue Messerschmidt, were represented by C. R. Hannan. The Chapter 13 Trustee, Albert C. Warford, was represented by Elizabeth E. Goodman. Creditor, Farm Services Cooperative of Harlan, Iowa, was represented by its attorney, John M. Bouslog. Creditor, Oakland State Bank, was represented by its attorney, Charles L. Smith. United States of America, on behalf of the Consolidated Farm Service Agency, was represented by Kevin R. Query. Creditor, Koch Agriculture, Inc., was represented by Warren R. Whitted. At the conclusion of the hearing, the Court took the matter under advisement under a briefing deadline. Post-trial briefs have been filed and the Court now considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(L) and (M). The Court, upon review of the pleadings, briefs, evidence and argument of counsel, now enters its findings of fact and conclusions of law pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. Oakland State Bank (“OSB”), has executed several promissory notes reflecting loans from OSB to Debtors. Such promissory notes are dated May 5, 1988 (\$130,000), August 9, 1990 (\$5,345), December 6, 1991 (\$10,000) and December 6, 1991 (\$7,500).

2. These promissory notes became due and delinquent and were called by OSB on or about February 22, 1992. On or about April 29, 1992, OSB sent Debtors several Notice to Cure letters. The Notices demanded payment. Subsequently, the notes were extended to February 1, 1993. The notes again became due and delinquent. A February 22, 1993 letter was sent declaring certain notes due. Thereafter, an agreement on May 27, 1993 was made which attempted to preserve OSB’s rights. The notes again became due and delinquent and were finally extended to December 10, 1994, at which time they again became due and delinquent. No further Notices to Cure were sent before litigation was commenced.

3. The obligations represented by the promissory notes were secured by certain property of Debtors pursuant to security agreements. These security agreements have been identified as OSB F, G, H & I. Of these four financing statements, only OSB-F purports to grant OSB a security interest in “all farm products including . . . all of the debtors’ crops both harvested and unharvested, including crops growing or to be grown and any crops stored or hereafter grown or stored . . .”

4. OSB-F was executed on May 5, 1988, and describes real property located in Pottawattamie County, Iowa. None of the land described in OSB-F was farmed by Debtors in 1994.

5. OSB attempted to perfect the security interest attained through OSB-F by filing financial statements reflected in the record as OSB-K and continuation statement OSB-M. These financing statements contain the same description of collateral and real estate as set forth in OSB-F. The real estate description had not been modified since 1988.

6. In the spring of 1993, OSB refused to continue financing Debtors' operations. Koch Agriculture Inc. ("Koch") provided 1993 production financing upon the basis of a security interest in the 1993 crop and the subordination of any OSB security interest to the interest of Koch. This 1993 loan was repaid following harvest of the 1993 crop.

7. Koch again financed Debtors' operations in 1994. This financing is evidenced by a security agreement ("K6") and a financing statement ("K7"). Both of these documents described "growing crops, crops to be grown and harvested crops wherever stored, now owned or hereafter acquired by the debtor . . . and the proceed (sic) and products therefrom." The financing statement was filed with the Secretary of State of Iowa on August 30, 1994.

8. On January 27, 1995, Debtors filed a voluntary petition for bankruptcy relief under Chapter 13 of the United States Bankruptcy Code.

9. On February 6, 1995, Debtors served a copy of their proposed Chapter 13 plan and notice setting bar date for objections thereto. According to the proposed plan, the only claims to be satisfied with payments with Chapter 13 Trustee are the priority tax claims owing to the Internal Revenue Service, the vehicle registration fees owing the Pottawattamie County Treasurer, the Trustee's statutory fees, Debtors' attorney fees, and 100 percent of the unsecured claims. The total payments required under the plan are as follows:

\$ 21,246.50	(plus \$5,719 interest) IRS secure
\$ 1,173.00	IRS priority
\$ 574.00	(plus interest) Pottawattamie County
\$ 4,000.00	Attorney fees
\$ 74,766.50	Unsecured claims
<u>\$ 11,282.32</u>	Trustee's fees
\$118,761.32	Total funds required for execution of plan

10. The plan provides that Debtors will pay the Chapter 13 Trustee the sum of \$100.00 to \$200.00 in monthly payments. The payments made under the plan, assuming \$200.00 per month payments to the Trustee for a period of five years, total \$12,000.00. To satisfy the debts it would require annual payments of \$21,352.26 over a period of five years.

11. The nine secured obligations referenced by Debtors at paragraph 2 of the plan are to be paid by Debtors directly. These payments to be paid directly to secured creditors are as follows:

\$ 1,000.00 per year	Citizen State Bank (car obligation)
\$ 1,200.00 per year	Citizen State Bank (car obligation)
\$ 1,500.00 per year	Stemple Implement (tractor obligation)
\$ 16,950.00	Ronnie Eggers note payoff
\$ 4,000.00	Farm Services Coop (grain storage)
\$ 7,629.29 per year	Koch Services (1994 crop input)
\$ 1,500.00	Stewart Messerschmidt (interest in drill)
\$ 7,436.90 per year	Oakland State Bank (7 year reamortization)
\$ 8,234.00 per year	Glenda Palmer (farm property)
<u>\$ 6,252.96 per year</u>	Rommel Reedy (home contract \$431.00 per month plus \$1,080.00 per year)

Total \$55,703.15 for year No. 1 and \$33,253.15 thereafter

12. At the time of the filing of the petition, Debtors farmed about 500 acres. In 1992, they lost a large rented farm and both took jobs off the farm. Mr. Messerschmidt is employed at Eaton Corporation in Red Oak as a forklift driver making in excess of \$13.00 per hour. He estimates his annual earnings at \$26,000.00 exclusive of overtime, which is currently available at the rate of about \$300.00 per month. Mrs. Messerschmidt is a home health aid and has an income of about \$12,000.00 annually. She also has overtime at around \$100.00 per month.

13. Debtors presented evidence at trial that their anticipated income in 1995 is as follows:

Off farm	\$ 38,000.00
Brick farm	\$ 25,537.50
Springer farm	\$ 48,500.00
Messerschmidt farm	\$ 19,435.00
Custom work	\$ 19,000.00
Sale of 5 bulls	\$ 6,250.00
Sale of 15 calves	<u>\$ 7,500.00</u>
Total	\$164,222.50

14. Debtors anticipate annual expenses totaling \$92,000 for crop expenses and \$31,724.16 for family living expenses.

15. Debtors also have 1994 crop or proceeds remaining as follows:

Government payment	\$ 5,700.00
Hancock E/C	\$ 5,578.54
Bartlett E/C	\$ 1,846.31
ASCS payment	\$ 43,959.54
Coop payment	\$ 44,756.11
Brick beans	\$ 9,882.00
Brick corn	<u>\$ 9,400.00</u>
Total	\$121,122.50

This total, less an ASCS payment of \$7,805.54, an ASCS payment of \$36,804.22, and payment of a storage obligation to the Coop of approximately \$4,000.00, leaves approximately \$72,512.00 remaining. Debtors then propose to pay Koch the total amount due.

16. Debtors sold livestock to pay the 1995 crop insurance payment. Debtors did not seek permission to sell the cattle from the secured creditor, OSB. The livestock which was sold was not breeding stock and consisted of livestock which Debtors customarily sold during past farming operations.

17. Koch has agreed to lend Debtors \$51,600.00 for the 1995 crop expenses conditioned upon the satisfaction of the outstanding 1994 loan and the granting of a super priority lien on the 1995 crop.

DISCUSSION

Cash Collateral

Debtors have filed an Application to Use Cash Collateral. Debtors propose that the Court allow them to sell the remaining grain from the 1994 crops and use the proceeds to pay off the debt to Koch. In exchange, Koch will finance Debtors for the 1995 season upon the granting of a super priority lien on the 1995 crops. OSB objects to this application arguing that it has a security interest in the 1994 crops which has priority over any such security interest claimed by Koch. OSB argues that its interest is not adequately protected. OSB also contends that Debtors have failed to adequately demonstrate the need to use cash collateral. USA and Farm Services Cooperative withdrew their respective objections provided that the payments were made to ASCS and to Farm Services Cooperative for storage.

Under Iowa law, a security interest does not attach to growing crops unless the debtor has signed a security agreement containing a description of the land concerned. Iowa Code § 554.9203(1)(a) (1993). Such security interest is perfected only if the financing statement includes a description of the real estate concerned. Iowa Code § 554.9402(1). Pursuant to Iowa Code § 554.9110, a description of real estate “is sufficient whether or not it is specific if it reasonably identifies what is described.” The Iowa Supreme Court has held that such a security interest fails to attach if the description is “seriously misleading.” First National Bank in Creston v. Francis, 342 N.W.2d 468 (Iowa 1984).

In this case, it is clear that the security agreement and financing statement incorrectly describe the real estate upon which the 1994 crops were grown. In fact, such documents describe an altogether different piece of property as the description was never updated. The incorrect description does not serve to put third parties on notice as to encumbrances and is “seriously misleading.” Therefore, this Court finds that OSB had no perfected security interest in the 1994 growing crops.

Moreover, the Court finds that Koch correctly executed a security agreement and filed a financing statement which perfected its security interest in the 1994 growing crops. Although, OSB attempts to argue that the security agreement is defective because certain attachments were allegedly corrected only in August 1994, this Court finds that testimony adequately explains the discrepancies and shall be given weight absent some proof of OSB’s allegations. Such proof has not been produced. Therefore, this Court finds that Koch has a perfected security interest which attached when the crops were still growing.

Although, OSB concedes that the real estate description was incorrect, OSB maintains that its security interest became perfected upon the harvesting of the 1994 crops. OSB argues that it has this security interest in the severed crops by virtue of its security agreement and financing statement which purport to cover “all farm products.”

In support of this argument, OSB cites In re Roberts, 38 B.R. 128 (Bankr.D.Kansas 1984). In Roberts, the financing statement failed to include a description of real estate, however, a security interest had been granted in “farm products.” The court found that despite the failure to include a property description, the creditor had a security interest in the harvested crops which were no longer “growing

crops” but instead were included within “another subcategory of farm products.” Id. at 133. Other cases have adopted this approach. See also United States v. Smith, 832 F.2d 774 (2nd Cir. 1987); Bank of Cresbard v. Lindhorst Farms, Inc., 78 B.R. 1002 (D.S.D.1987).

In contrast, the Bankruptcy Court of the Northern District of Iowa, while distinguishing the case on its facts, has expressed “serious reservations” about the holding in the Roberts case and the cases which adopt its reasoning. In re Waters, 90 B.R. 946, 965 (Bankr.N.D.Iowa 1988). In Waters, Judge Melloy reasoned that real estate descriptions are required to put third parties on notice of encumbrances. Id. Because all growing crops eventually become severed crops, he questioned why legal descriptions are required if they eventually become unnecessary. Id.

This Court is unable to find any Iowa cases which address the issue of harvested crops as discussed in the Roberts line of cases. However, the Iowa Supreme Court has found that an error in a legal description resulted in the failure of a creditor to perfect a security interest in crops. First National Bank in Creston v. Francis, 342 N.W.2d 468 (Iowa 1984). While the Iowa Supreme Court did not directly address the issue of whether the security interest attached upon severing of the crops, it is interesting that the crops at issue in the Francis case had already been harvested and sold prior to the action. Id.; see also Waters, 90 B.R. at 966.

This Court has many of the same reservations with the Roberts line of cases as those expressed in Waters. OSB refused to provide financing for the 1994 crop. Debtors were forced to find other means to plant that year’s crops. They did so in obtaining

financing from Koch. However, even assuming that OSB has a security interest that attached at the time of the severance of the crops, this security interest is junior to the prior interest of Koch. Moreover, the evidence shows that the obligation owed to OSB is fully secured by other property, regardless of any interest in the 1994 crops and proceeds.

OSB argues that even if Koch has a valid security agreement, it cannot take priority over OSB's subsequent interest pursuant to Iowa Code § 554.9312(2). Under that section, the value given by Koch must be given more than six months after OSB's obligation was overdue. OSB argues that the obligations owed to OSB were not due until December 10, 1993 less than six months before the Koch financing.

Assuming arguendo that OSB has a security interest that arose at the time of severance, OSB's interest would not qualify as an "earlier perfected interest" in the 1994 crops pursuant to Iowa Code § 554.9312(2). Moreover, even if the interest of OSB was an "earlier perfected interest," the Court finds that the obligations owed to OSB were overdue more than six months prior to the value given by Koch. On April 29, 1992, OSB sent Debtors several Notice to Cure letters. The Notices demanded payment. An agreement of May 27, 1993 was made which attempted to preserve OSB's rights. Finally, a February 22, 1993 letter declares certain notes due. No further Notices to Cure were sent before litigation was commenced. OSB refused to commit future financing. The Court finds that the obligations owed to OSB were overdue in 1992 when the Notices to Cure were sent. This is clearly more than six months before the agreement was executed with Koch.

The Court finds that Debtors have adequately demonstrated a need to use cash collateral in order to obtain financing for the 1995 crops. Therefore, Debtors may proceed to use the proceeds from the 1994 crops as requested which includes payments to ASCS, Farm Services Cooperative, and Koch.

Objections to Confirmation of the Chapter 13 Plan

Debtors seek confirmation of their Chapter 13 Plan pursuant to § 1325. Trustee objects to confirmation on the grounds that the plan is not feasible and that Debtors' proposal to make payments directly to secured creditors violates § 1325 (a)(3), (5), and (6). Trustee also objects pursuant to the disposable income test of § 1325(b) and under general equitable principles. Farm Services Cooperative joined in this objection and OSB objects to the treatment of its secured claim.

According to the evidence produced, Debtors have on hand approximately \$121,122.50 remaining from the 1994 crop and proceeds thereof. Debtors have been granted conditional permission to use this cash collateral for payments to ASCS and Farm Services Cooperative leaving a balance of \$72,512.00. Debtors will then repay Koch's 1994 input loan of \$38,950.00 to obtain financing of the 1995 crop. Debtors also intend to make a payment to OSB, Ronnie Eggers, and Glenda Palmer. This leaves \$3460.00 available to pay the Chapter 13 Trustee.

Debtors propose to make direct payments as follows: two obligations for automobiles to Citizens State Bank, a tractor obligation to Stemple Implement, a debt owed to Stewart Messerschmidt, and a 7 year reamortization of an obligation to OSB.

Debtors propose payments under the Plan as follows: the IRS for secured and priority debt, Pottawattamie County, attorney fees, unsecured claims, and trustee fees.

Debtors also provided income projections for 1995. Debtors anticipate total income of \$164,222.50 including off-farm employment, the operation of three farms, custom farming work, and sale of livestock. Projected input costs are in the amount of \$92,000.00. Koch has agreed to lend Debtors \$51,600.00 for 1995 crop expenses. Expenses for tax obligations are not included.

Although the Bankruptcy Code does not expressly prohibit direct payment to secured creditors, the feasibility test of § 1325(a)(6) limits the extent to which a Debtor can make such direct payments. In re Carson, 85 B.R. 460 (Bankr.S.D, Ohio 1988). The proposal of direct payments also presents a classification of claims problem. This difference in method of payment of claims must withstand the unfair discrimination standard of § 1322(b)(1). Separate classification of fully secured claims for direct payment is generally permitted, but separate classification of unsecured or undersecured claims is usually refused by the courts. K. Lundin, Chapter 13 Bankruptcy § 4.71 (2nd Ed. 1994) (citations omitted).

The Court has concerns as to feasibility if Debtors are allowed to make the proposed direct payments. Defaults on the Plan would be difficult to monitor if the Trustee does not serve as a disbursing agent. There would be little assurance of an efficient means of enforcement of the Plan. Additionally, the Court notes that it has some concerns with Debtors' sale of livestock and use of the proceeds without involvement of the Chapter 13 Trustee or the Court. The Court also has concerns with allowing

obligations secured by personal property to be paid directly such as the payments to Citizens State Bank and Stemple Implement.

The Court finds that there are also problems with classification in the Plan. Debtors propose to make direct payments to Citizens State Bank which has an undersecured claim. Further, Debtors propose to pay Stewart Messerschmidt directly. The Court finds that the evidence reveals that the debt owed to Stewart Messerschmidt is not a valid secured claim, but an unsecured claim. The payments to Citizens State Bank and Stewart Messerschmidt clearly violate the unfair discrimination standard of § 1322(b)(1).

The direct payments to Koch, ASCS, and Farm Services Cooperative for storage have been authorized in the cash collateral portion of this order. However, the Court finds that the direct payment of OSB violates the Code. OSB objects to the treatment of its claim under the proposed Plan. The Plan seeks to reamortize the secured claim of OSB for a period of seven years. The term of the plan is five years and the Plan may not provide for payments to a secured creditor which extend beyond the term of the Plan unless the debt by its own terms extends beyond the life of the Plan. In re Dinsmore, 141 B.R. 499 (Bankr. W.D. Mich. 1992). The obligation owed to OSB is past-due.

Debtors work ethic is certainly commendable. However, in accordance with the above discussion, the proposed Chapter 13 Plan can not be confirmed.

ORDER

IT IS THEREFORE ORDERED that Debtors' Application to Use Cash Collateral is granted and Debtors are permitted to use the 1994 crop and proceeds therefrom to make the proposed payments to ASCS, Farm Services Cooperative, and Koch. OSB shall cooperate to whatever extent necessary to carry out this order.

IT IS FURTHER ORDERED that the objections to the proposed Chapter 13 Plan are sustained.

Dated this _____ day of May, 1995.

RUSSELL J. HILL, CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT