UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re: Keith L. Barickman and Cheryl A. Barickman, Debtors.	**Bky. No. 97-36797** **Chapter 7 Case**
Mark C. Halverson, Trustee, Plaintiff, v. First Farmers and Merchants National Bank of Fairmont, Minnesota, and Truman Farmers Elevator Company and Colonial Pacific Leasing Corporation, Defendants.	**Adv. No. 99-3026** **Memorandum Order**

This matter is before the Court on several motions. The parties seek a determination of their relative rights to farm equipment and auction proceeds from the sale of other farm equipment. The Defendants in this adversary all filed claims in the main bankruptcy case asserting rights to equipment used by the Debtors in their farming operation. The Trustee seeks a determination that, under Minnesota law, certain agreements labeled as leases, in favor of Defendants Truman Farmers Elevator Company and Colonial Pacific Leasing Corporation, are in fact avoidable improperly perfected security agreements. He seeks to preserve the secured position of Truman, however, as against Defendant First Farmers & Merchants National Bank (First Farmers), alleging that First Farmers had actual knowledge of the security interest, which, according to the Trustee, is prior and superior to First Farmers' interest. First Farmers seeks summary judgment that any claim of the Trustee is inferior to First Farmers' interest.

This matter for the "determination of the validity, extent, or priority of liens" is a core proceeding under 28 U.S.C. s 157 (k). Appearances at hearings on the motions, June 30 and July 15, 1999, are noted on the record. Based on the files and arguments of counsel, the

Court makes the following **ORDER** pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I. Facts

The Debtors, Keith L. and Cheryl A. Barickman filed a voluntary petition for Chapter 7 Bankruptcy on October 14, 1997. It is undisputed that they farmed and resided in Watonwan County, Minnesota for the entire time relevant to determining the respective rights of all parties to this adversary proceeding. The Debtors held an auction on August 12, 1997, of certain farm equipment prior to filing their voluntary petition. The proceeds of that sale[1] were distributed to secured parties. Some of the equipment was not sold, but remains in the possession of Defendant Truman farmers Elevator.

The Trustee, Mark C. Halverson, commenced this adversary proceeding on January 19, 1999, regarding both the remaining equipment and proceeds from the sales, to: have certain prepetition transactions determined as secured transactions rather than leases; to avoid the liens so determined; to preserve one of the avoided liens in favor of the estate; and, to have priority of claims and interests determined regarding the collateral. The transactions are described below.

The 1994 Financing Statement

John Deere and the Debtors entered into a transaction in 1994 described as a lease by the Debtors from Deere of certain equipment. In connection with that transaction, Deere filed an informational financing statement in Martin County on April 15, 1994. Four pieces of equipment are listed in the informational financing statement: a John Deere 9500 Combine, serial # H09500x635224; a John Deere 930 Platform, serial # H00930F651611; a John Deere

[1]Not all equipment offered for sale met the minimum bid requirements of the various secured parties. Unsold equipment was surrendered to the secured parties after the auction.

893corn Head, serial #H00893X655720; and a John Deere Trailer, serial #2650[2]. The informational filing notes the secured party as John Deere Credit Inc. of West Des Moines, Iowa, as lessor to the lessee Debtors.[3] John Deere's interests were assigned to Truman Farm Elevator Co. (Truman). These four pieces of equipment were offered for sale at the August 12 auction but the bid price ($112,250) was unacceptable to Truman, which took possession of the equipment after the August 12 auction.

The 1994 filing states "The above described property is owned by the Secured Party and/or its Assignee and is leased to the Debtor. This statement is filed to give notice of Secured Party's (and/or its Assignee) title of said property."

The lease from Deere Credit correctly lists the Debtors' county of residence as Watonwan County. By its terms the lease began March 31, 1994 and concludes March 30, 2000. The Debtors were to make semi-annual lease payments of $11,821.78 plus applicable use tax of $295.54. The lease contains an "option purchase price" of $47,499.30, which allowed the lessee to purchase the equipment at the end of the lease "provided Lessee is not in default under any provision of this Lease Agreement or any Schedule[.]" The Trustee claims that the transaction was an improperly perfected secured transaction, not a lease.

The 1995 Financing Statement

First Farmers & Merchants National Bank of Fairmont, Minnesota (First Farmers), filed a claim in this bankruptcy case of $105,056.88 for amounts due and owing on three different promissory notes. The promissory notes were secured by a security agreement and UCC

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[2]The Trustee argued that the Martin County filing may have included a blanket security interest in the equipment of the Debtors, but has provided no basis for such a claim. The face of the filing makes no reference to any additional forms or schedules, and the copies of the filing provided to the court, as well as the lease which is the basis if the filing, provide no factual basis to support the Trustee's claim.

[3]The lease was not attached to the UCC filed in Martin County. (June 1, 1999 Affidavit of James A. Rubenstein).

financing statement in Watonwan County on August 10, 1995, covering all equipment and general intangibles. Based on that filing, First Farmers claims an interest in the proceeds from the sale of the following equipment, sold by the Debtors at auction on August 12, 1997:

John Deere 8640 tractor	$38,000
John Deere 4430 tractor	$15,400
John Deere 9600 field cultivator	$ 9,600
John Deere 610 chisel plow	$ 4,000
John Deere 213 tandem disk	$ 3,600
Total	$71,000
auction expenses	($ 4,473)
Proceeds	$66,627

First Farmers holds[4] the $66,627 in sales proceeds[5] pending the outcome of this adversary proceeding. The Trustee claims that the 1994 transaction with Deere resulted in Deere obtaining a blanket security interest in all of the Debtors' equipment, including the equipment later sold by First Farmers. Additionally, the Trustee claims that, although Deere improperly perfected its interest and the Trustee is entitled to avoid it under 11 U.S.C. § 544, the Trustee can effectively preserve the lien against First Farmers under 11 U.S.C. § 551 because First Farmers had actual knowledge of Deere's interest when First Farmers later acquired an interest in the same collateral.

The 1997 Financing Statement

The Debtors entered into a transaction described as a lease with Timmerman Leasing, Inc. on May 21, 1997. The arrangement required the debtors to make 36 monthly payments of $1,447.30 and states "Lessee acquires no ownership rights in the equipment, and has no

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[4]First Farmers received relief from the automatic stay on January 19 , 1999 to pursue its remedies as a secured creditor.

[5]It appears from the 2nd Amended Statement of Financial Affairs filed by the Debtors on February 10, 1998, that over 380 lots were sold at the auction, yielding gross proceeds of $197,845. These proceeds, minus the costs associated with the auction, were apparently distributed to various secured parties. Of those proceeds, only the net proceeds of $67,077.99 held by First Farmers are apparently claimed by the Trustee.

option to purchase same." (Timmerman Lease, #13).

Defendant Colonial Pacific Leasing (Colonial) subsequently took an assignment of Timmerman's interest in the transaction and filed a financing Statement with the Minnesota Secretary of State on June 12, 1997, disclosing the assignment. The filing lists the Debtors as lessees for two pieces of equipment: a 1990 John Deere model 7300 Planter, serial # B-200848; and, a 1978 John Deere Model 4440 tractor, serial # RW440H006976. This equipment was also offered at the August 12, 1997 auction, but remained unsold after final bids of $19,500 for the planter and $29,500 for the tractor[6]. The Trustee claims that the transaction was an improperly perfected secured transaction, not a lease.

II. Analysis

The 1994 Agreement

The Trustee claims that the 1994 agreement with Deere reflects an improperly perfected secured transaction, not a lease. The Minnesota Supreme Court has observed that "[i]t is the clear policy of Article 9 of the code to look to the substance, rather than the form , of an agreement to determine whether or not it is a security agreement." James Talcott, Inc. v. Franklin National Bank of Minneapolis, 194 NW.2d 775 at 779 (Minn. 1972).

In determining the economic reality of this agreement, the Court is guided by Minn. Stat. Sec. 336.1-201(37), which states:

> Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and
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> (a) the original term of the lease is equal to or greater than the remaining economic life of the goods,
>
> (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of

[6]Truman Farm Elevator Co. apparently took possession of this equipment after the auction.

> the goods,
> (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
> (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A transaction does not create a security interest merely because it provides that

> (a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,
> (b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,
> (c) the lessee has an option to renew the lease or to become the owner of the goods,
> (d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or
> (e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

Minn. Stat. Sec. 336.1-201(37).

To establish the 1994 agreement was a security agreement, the Trustee must first show that the "consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee[.]" Id. If the payment obligations under the lease continue after the termination of the lease by the Debtors, then (a), (b), (c), or (d), must be present for the Court to find a security agreement.

The lease allows: "Provided Lessee is not in default under any provision of this Lease, Lessee may request that this Lease be terminated prior to the expiration of the term of this

lease with respect to the equipment . . . Lessor and Lessee will use reasonable efforts to arrange for a sale to a third party." (Lease at #2). The Trustee concedes that "the agreement provides that the Lessee may cancel the agreement at any time upon notice to Lessor so long as the Lessee is not in default." (Trustee's Memorandum of Law, June 4, 1999, p. 3.). The Trustee argues that regardless of such a cancellation, the lessee must continue to make lease payments.

Under this agreement, the lessees were required to continue making the lease payments until a third-party sale was consummated. Even after the third party sale was completed, the lessees were liable for paying the difference between the net sale price and the "termination value"[7] specified in the lease. The lessees were obligated to pay the present value of all outstanding lease payments, unless the equipment sold for a value greater than the discounted value of the lease payments added to the residual value calculated under the lease. The first prong of § 336.1-201(37) is arguably met. However, none of the other criteria are.

The Trustee argues that the "Option to Purchase" clause of the agreement meets the second prong of the § 336.1-201(37) analysis because "the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement." Minn. Stat. § 336.1-201(37)(d). Under the lease signed by the Debtors, lease payments of $12,117.32[8] were due every six months, for a total paid under the lease of $145,407.84. After completing these lease payments, the lessees had

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[7]According to the lease, # 18, termination value is calculated by discounting the remaining lease payments and adding a residual value for the equipment. There is no information in the record about what payments were outstanding under the lease. Nor was any information provided about calculating the residual value of the leased equipment. The only information available to the Court about the equipment's value at the end of the leases is the auction bids received on August 12, 1997.

[8]Including use tax of $296.64.

the option to purchase the equipment for a price of $47,449.30. This amount is considerably more than "the nominal consideration of $1" in Chemlease Worldwide Inc. v. Brace, Inc. cited by the Trustee. Chemlease Worldwide Inc. v. Brace, Inc., 338 N.W.2d 428 at 432 (Minn. 1983).

The Trustee posits that because the purchase price of $47,449.30 is considerably less than the lease payments of $145,407.84, the purchase option amount is nominal. The Court disagrees. The Trustee seems to rely on the Code's provision that "Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised." Minn. Stat. § 336.1-201(37). But under this agreement, the only cost to the lessees if they chose not to exercise the purchase option is the cost of returning the equipment to the lessor.

In determining whether $47,449.30 is nominal, the Court compares the residual value of the equipment with the option purchase price[9]. At the August 12, 1997 auction, $112,250 was bid for three of the four pieces of the equipment at issue. Assuming that the Debtors made all lease payments due on before the filing of their bankruptcy petition, there were still five payments, totaling $59,108.90[10] due under the original lease. Adding the lease's option purchase price of $47,499.30 to the amount of the remaining payments equals $106,608.20. While the option purchase price seems to approximate the residual value of the equipment, it is not a nominal amount. The March 31, 1994 agreement is a lease.

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[9]There was no evidence presented that would allow the court to determine the expected residual value at the time the agreement was made.

[10]For the purposes of this analysis the court has not attempted to calculate the present value of these payments.

The 1997 Agreement

The Trustee also challenges the agreement between Timmerman Leasing Inc. (later assigned to Colonial Pacific Leasing) and the Debtors.[11] According to the language of this agreement, "THIS LEASE IS NOT CANCELABLE OR TERMINABLE BY LESSEE." (Timmerman Lease, #6). The Trustee argues correctly that the first prong of the § 336.1-201(37) analysis is met for this contract.

Additionally, the Trustee argues that, "(c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement[.]" Minn. Stat. § 336.1-201(37)(c). The Trustee points to #14 in the agreement which states:

> At the expiration of the Lease, . . . At Lessor's option, this Lease may be continued on a month-to-month basis until 30 days after Lessee returns the Equipment to the Lessor. In the event the lease is so continued, Lessee shall pay to the Lessor rentals in the same periodic amounts indicated under "Amount of Each Payment," above. (Timmerman Lease, #14).

The Debtors agreed to make 36 monthly payments of $1,447.30, for a total of $ 52,102.80 under the terms and conditions of the agreement.

The Trustee's argument fails for two reasons. Under § 336.1-201(37)(c), the option to renew must be available to the lessee. Under the language of this agreement, the right of renewal belongs exclusively to the lessor, now Colonial Pacific.

Nor is the renewal clause "for no additional consideration or nominal additional

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[11]Colonial Pacific Leasing Corporation agrees that the Court has jurisdiction to adjudicate the nature of the May 1997 agreement, but seeks to have the Trustee's motion seeking adjudication of this matter struck for alleged procedural defects. At the July 15, 1999 hearing before this Court, the Trustee suggested that any procedural failures could be traced to Colonial's failure to respond to pleadings served at the address provided by Colonial's own legal department in the Debtors' Chapter 7 case. A review of the record shows that the service address used by the Trustee is the same as that provided in Colonial's December 18, 1997 Proof of Claim in the Debtors' Chapter 7 Case. Colonial's failure to offer a response to the Trustee's argument is treated by the Court as a waiver of Colonial's motion. The Court's disposition of the Trustee's motion moots any claim of prejudice made by Colonial.

consideration[.]" Minn. Stat. § 336.1-201(37)(c). An example of "nominal additional consideration" can be found in Acme Industries, Inc. v. National Cash Register Corp., 1975 WL 22808 (Kansas 1975), where a renewal clause allowed an annual payment equal to the previous monthly payment amount under the lease. That is not the case here. Instead of diminishing, the monthly payments made under a renewal are identical to the monthly payments under the terms of the lease. Determining the remaining economic life of these assets[12] is unnecessary because the additional consideration paid under a renewal is identical to consideration paid under the lease. The agreement does not meet the second prong under § 336.1-201(37)(c). The 1997 agreement between Timmerman Leasing and the Debtors is a true lease.

First Farmers' Summary Judgment Motion and Trustee's Motion for Leave to Amend Complaint

Defendant First Farmers seeks summary judgment against the Plaintiff Trustee, arguing that because it holds a valid, perfected, and unavoidable security interest in all of the property disputed in this adversary proceeding, the Trustee's suit is futile.

Rule 56 of the Federal Rules of Civil Procedure is incorporated into the Federal Rules of Bankruptcy Procedure as Rule 7056 which states: "A party against whom a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, . . . move with or without supporting affidavits for a summary judgment in the party's favor as to all or any part thereof." FR Bankr. P. 7056. Summary judgment is appropriate where "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." Id. "In making this determination, the function of the presiding court is not to weigh evidence and to make credibility determinations, or to attempt to determine the truth of the matter, but is, rather,

[12]At the August 12, 1997 auction the John Deere tractor and planter in dispute were unsold with final bids of $29,500 and $19,500 respectively.

solely 'to determine whether there is a genuine issue for trial." Reis v. Wintz Properties (In re Wintz Companies), 230 B.R. 848 at 857 (8th Cir. BAP (Minn.) 1999), quoting Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250 (1986). " Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." Id. at 858, quoting Celotex, at 322, 106 S.Ct. at 2552.

The Trustee does not dispute that First Farmers holds a valid security interest in all of the Debtors' equipment and general intangibles worth $105,056.88 as of August 5, 1998. Nor does the Trustee dispute that First Farmers' security interest was properly perfected by filing a financing statement in Watonwan County on August 10, 1995. The Trustee's argument against First Farmers is one of priority, and is premised on a hoped for finding that the April 15, 1994 Deere financing statement is part of an improperly perfected blanket security interest avoidable by the Trustee under 11 U.S.C. § 544, not informational filings related to valid leases. The Trustee seeks to preserve for the estate, under 11 U.S.C. § 551, what he claims to be the prior improperly perfected blanket security interest of Deere, trumping First Farmers' later acquired interest on the theory that First Farmers had actual knowledge of the earlier unperfected blanket security interest at the time of the transaction.[13]

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[13]Even if the Court determined that the agreement was a secured transaction, it seems unlikely that the Trustee could succeed. There has been no credible evidence offered that First Farmers had actual knowledge of any blanket security interest of Deere. For a complete analysis, see, Carvell v. Bank One, Lafayette, N.A. (In re Carvell), 222 B.R. 178 (1st Cir. B.A.P. 1998):

> Section 551 of the Bankruptcy Code states that there is "preserved for the benefit of the estate" any transfer avoided under the estate representative's various avoidance powers, including the representative's powers under section 544(a), the so-called "strong arm clause." 11 U.S.C. § 551 (1994). This appeal presents the question whether such preservation grants the estate priority over other liens even though under state law the other liens have priority over the avoided lien. We hold it does not. Id.
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> . . .
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> Section 551 does not change this. It merely states that a lien avoided under section 544

The Court has already held above that the Deere transaction was a lease, not a security interest, and the Trustee has suggested no additional basis for avoiding the security interest of First Farmers. Based on the Court's determination, "[t]he moving party is 'entitled to a judgment as a matter of law' because the nonmoving party has failed to make a sufficient showing on an essential element of [his] case with respect to which [he] has the burden of proof." Celotex Corp. v. Catrett, 106 S.Ct. 2548 at 2552 (1986).

Summary judgment must be granted the Defendant First Farmers and Merchants National Bank of Fairmont as between the Trustee and First Farmers. The estate has no interest in any of the proceeds from the sale of certain equipment formerly owned by the Debtors in the amount of $66,627 plus accrued interest, presently in possession of First Farmers.

(and the other enumerated sections) is "preserved for the benefit of the estate...." Preservation is just that. It simply puts the estate in the shoes of the creditor whose lien is avoided. It does nothing to enhance (or detract from) the rights of that creditor viz-a-viz other creditors. This is the holding of all decisions to which we have been directed. (citations omitted) Id. at 180.

. . .

Section 551 therefore accomplishes nothing for the bankruptcy estate in circumstances such as those here. This case is quite different from, for example, the case where a perfected lien is avoided as a preference and there are other perfected liens which are junior to the avoided lien. In that situation, without preservation of the avoided lien, avoidance benefits only the junior lienors. That would be a windfall for them because it gives them a benefit they could not obtain outside of bankruptcy. Id.

III. Disposition

Based on the foregoing, **IT IS HEREBY ORDERED THAT**:

1. The March 31, 1994 agreement between John Deere Credit as Lessor, and the Debtors, as lessees, assigned to Truman Farm Elevator Co., is a true lease, not a disguised security agreement.

2. The May 21, 1997 agreement between Timmerman Leasing Inc. as Lessor, and the Debtors, as lessees, assigned to Colonial Pacific Leasing, is a true lease, not a disguised security agreement.

3. Summary judgment is granted Defendant First Farmers and Merchants National Bank of Fairmont. The bankruptcy estate has no interest in the proceeds from the sale of certain equipment formerly owned by the Debtors in the amount of $66,627 plus accrued interest, presently held by First Farmers.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: September 29, 1999.

By the Court:

/e/ Dennis D. O'Brien
Dennis D. O'Brien
Chief U.S. Bankruptcy Judge

NOTICE OF ELECTRONIC ENTRY AND FILING ORDER OR JUDGMENT
Filed and Docket Entry made on 9/29/99
Patrick G. De Wane, By DLR

38E

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

I, Doretta Raymond, hereby certify: That I am the Judicial Assistant for Chief Judge Dennis D. O'Brien of the United States Bankruptcy Court for the Third Division of the District of Minnesota, at St. Paul, Minnesota; that on September 29, 1999, true and correct copies of the annexed **ORDER** were placed by me in individually stamped official envelopes; that said envelopes were addressed individually to each of the persons, corporations, and firms at their last-known addresses appearing hereinafter; that said envelopes were sealed and on the day aforementioned were placed in the United States mails at St. Paul, Minnesota, to:

U. S. TRUSTEE
1015 U. S. COURTHOUSE
300 SO. 4th street
MINNEAPOLIS, MN 55415

STEPHEN BEHM, ESQ.
PO BOX 3544
MANKATO, MN 56002

Mark C. Halverson, Esq.
P.O. Box 3544
Mankato, Mn 56001

ANDREA HAUSER, ESQ.
6600 FRANCE AVENUE, SOUTH, STE 600
MINNEAPOLIS, MN 55435

JAMES A. WILSON, ESQ.
P. O. BOX 271
FAIRMONT, MN 56031

JAMES RUBENSTEIN, ESQ.
MOSS & BARNETT,PA
4800 NORWEST CENTER
MINNEAPOLIS, MN 55402-4129

and this certificate is made by me.

/e/Doretta Raymond

Filed On September 29, 1999

Patrick G. De Wane, Clerk
By dlr , Judicial Assistant