UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

GEORGE F. HOFFMAN, JR. .	CASE NO. 99-61365
Debtor	Chapter 12

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

Presently before the Court are various contested matters arising out of the bankruptcy petition of George Hoffman, Jr. ("Debtor"), filed pursuant to Chapter 12 of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code") on March 18, 1999. By a motion dated March 24, 1999, Debtor seeks relief including, *inter alia*, the turnover of certain personal property seized prior to the petition date by creditor First Pioneer Farm Credit ("First Pioneer") as well as an order avoiding First Pioneer's security interest in such property pursuant to Code

§ 522(f). In a cross motion filed on March 30, 1999, First Pioneer seeks relief including an order dismissing Debtor's bankruptcy petition, an order enjoining Debtor from mining sand and gravel on real property of which it is the mortgagee and an order modifying the automatic stay of Code § 362 so as to allow it to take possession of whatever gravel and sand Debtor has already mined.

At a hearing on the cross motions, held on April 13, 1999, the Court concluded that the bulk of the issues described above could not be resolved without an evidentiary hearing, which has been scheduled for May 12, 1999. At the same time, the parties identified two discrete issues which, it was asserted, could be resolved on the pleadings as a matter of law. These are: (1) the question of whether First Pioneer is entitled to an order lifting the automatic stay with respect to that gravel and sand which has already been mined, and (2) whether Debtor is entitled to avoid First Pioneer's liens on certain cattle and farming equipment. Accordingly, while reserving judgment on the remainder of the cross motions pending the evidentiary hearing, the Court agreed to consider these two claims for relief as discrete submitted matters.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of these contested matters pursuant to 28 U.S.C. §§ 1334, 157(a), (b)(1), (2)(A), (B), (E), (G), and (K).

FACTUAL STATEMENT

On August 13, 1992, Debtor delivered a note to First Pioneer in the amount of $393,000.00, which was secured by a first mortgage on Debtor's dairy farm. On June 17, 1994, Debtor issued an additional note of $114,562.02 to First Pioneer, which was secured by a second mortgage on the dairy farm. As additional security for the second note, Debtor granted First Pioneer a security interest in various personal property, described by the financing statement as:

> All now existing and after acquired, equipment, farm products, crops, livestock, supplies, inventory, fixtures, accounts, consumer goods including but not limited to: cows and replacement youngstock of all ages and breeds, milk and milk proceeds, accounts receivables, purchased and raised feed and crop inventories, supplies, all dairy related fixtures and equipment, tillage and harvesting tools, tractors, office furniture and equipment, computers, printers, communications equipment, materials and supplies, [a]ll crops now planted or hereafter planted, grown or harvested at any time in the future and inventories, including but not limited to hay, corn and oats.

The personal property financing statement was filed with the Office of the County Clerk for the County of Otsego, New York, on June 20, 1994. The parties do not appear to dispute that this financing statement created a valid, first priority security interest in the personal property described. It is also undisputed that this security interest was a "nonpossessory, non purchase-money security interest" in the meaning of Code § 522(f)(1)(B).

Prior to filing for bankruptcy, Debtor defaulted on both notes. First Pioneer ultimately brought an action for replevin on the personal property secured by the second note pursuant to § 7102 of the New York Civil Practice Law and Rules ("CPLR") and on October 1, 1998, the New York Supreme Court, County of Otsego, issued an order of seizure, execution of which was however stayed by Debtor's subsequent filing of a petition for relief under Chapter 13 of the

Code. Following the Court's dismissal of Debtor's Chapter 13 petition, First Pioneer subsequently repossessed certain cattle and farm equipment pursuant to the order of seizure. No evidence has yet been presented regarding the value of this seized property.

It is also alleged that Debtor has permitted a contractor to mine sand and gravel from the mortgaged real property for use in various public construction projects. Based on the pleadings submitted to the Court, it also appears that at least some of the sand and gravel which has been extracted from the mine has not yet been transported off of Debtor's real property. By an injunction dated April 21, 1999, the Court ordered Debtor to segregate and account for any funds received on account of the mining operation. However, the Court refused First Pioneer's request for a preliminary injunction enjoining further mining or removal of the sand or gravel.

DISCUSSION

1. Debtor's motion to avoid liens on cattle and farming equipment

Code § 522(f) sets out a narrow set of circumstances under which a bankruptcy trustee or debtor in possession can avoid a perfected security interest in property of the estate. In order for Debtor to receive the benefit of this section, there are essentially three separate requirements that must be met. First, the lien must be of a type listed under Code § 522(f)(1). These include most judicial liens, *see* Code § 522(f)(1)(A); nonpossessory, non-purchase money security interests in animals that are held for the personal, family, or household use of the debtor, *see* Code § 522(f)(1)(B)(i); and nonpossessory, non purchase-money security interests in

"implements, professional books, or tools, of the trade of the debtor." *See* Code § 522(f)(1)(B)(ii).

Second, the collateral for which the debtor seeks to avoid a lien must be of a type that may be exempted under applicable law. *See* Code § 522(f)(1). Because New York has opted out of the federal bankruptcy scheme of Code § 522(d), the relevant exemptions in the present case are thus those that are set out by state law.

Third, the lien sought to be avoided must be such that it "impairs" an applicable exemption. The question of whether such impairment exists is a factual question, determined by a calculation involving the amount of the lien, the amount of all other liens on the property, the amount of the exemption, and the value that the debtor's interest in the property would have in the absence of any liens. *See* Code § 522(f)(2)(A).

Based on the rules described above, it is clear that the Court is not in a position to grant judgment to either party with respect to the farm equipment. While it is apparently undisputed that as "tools of trade" encumbered by a nonpossessory, non purchase-money security interest, this property passes the first step of the analysis, and that at least a portion of it would be exempt by operation of § 5205(a)(7) of the CPLR (McKinney's 1997), the Court is simply unable to perform the third step of the analysis under Code § 522(f)(2)(A), given the complete absence of any stipulation or proof regarding the value of the equipment. Accordingly, the Court will reserve judgment on this part of Debtor's motion pending the evidentiary hearing.

To the extent that Debtor seeks relief with respect to the cattle, his motion suffers from the same infirmity, as there has been no competent evidence received yet on the value that the Debtor's interest in the cattle would have in the absence of any liens. Yet the Court will

nevertheless consider as a matter of law First Pioneer's argument that, regardless of what value is determined for the cattle, Debtor is not entitled to relief because the lien on the cattle does not fit into any of the categories set out by Code § 522(f)(1), and that Debtor's argument thus fails the first step of the three-part test.

In his attempt to bring the cattle lien within the terms of Code § 522(f), Debtor has attempted to characterize it as a "judicial lien" within the meaning of Code § 522(f)(1)(A). Alternately, Debtor argues that the Court should treat the cattle as "implements" or "tools" within the meaning of Code § 522(f)(1)(B)(ii).

Debtor does not clearly indicate the basis for his claim that First Pioneer's security interest in the cattle is a judicial lien. However, under the Code, the judicial lien is a term of art, which is defined as any "lien *obtained* by judgment, levy, sequestration, or other legal or equitable process or proceeding." *See* Code § 101(37) (emphasis added). While First Pioneer's security interest in the cattle was admittedly the subject of at least one legal or equitable process, the Code determines the judicial nature of a lien with reference to how it was first obtained, not how it may have been enforced. In the present case, it is undisputed that the personal property security interest pursuant to which the cattle were seized was a consensual lien, which attached to the property prior to First Pioneer's judgment against Debtor and which would have remained attached even in the absence of such judgment. While Debtor's motion speaks of avoiding "the judicial lien of the Judgment and execution of First Pioneer on certain cattle executed upon by First Pioneer," and while Debtor's counsel argued at the hearing that the judgment of seizure itself "created a security interest," these descriptions are inaccurate. By its own terms, the state court order of seizure created no lien; indeed, such relief is not even available under CPLR §

7102, a section which instead merely allows for the seizure of specific property by one who already has an immediate right to possession of it. *See Spartan Built, Ltd. v. Modas Rest, Inc.*, 159 Misc.2d 530, 532, 605 N.Y.2d 635 636 (N.Y. Civ. Ct. 1993). Accordingly, the lien on Debtor's cattle is not of a sort that may be avoided through Code § 522(f)(1)(A).

Nor does the Court believe that the cattle are covered by the "equipment" or "tools of the trade" provisions of Code § 522(f)(1)(B)(ii). These terms are not defined in the Code, and while Debtor's interpretive argument would have some merit if this section were considered in isolation, it runs into insurmountable textual difficulties when it is read in comparison with the language of other provisions of the same section. For example, Code § 522(f)(1)(B)(i) allows certain liens to be avoided with respect to "animals . . . that are held primarily for the personal, family, or household use of the debtor." It appears that the purpose of this limitation would be to exclude commercial farm animals, which indeed would presumably be the only commonly-owned type of animal not held for personal, family, or household use. Yet this limitation becomes meaningless if commercial farm animals were nevertheless meant to be included as "equipment" under Code § 522(f)(1)(B)(ii). Likewise, Code § 522(f)(3) places a cap on the debtor's lien-avoidance power where the collateral in question includes "implements, . . . tools of the trade of the debtor . . . *or farm animals or crops of the debtor*." (emphasis added). It is clear that to the drafters of Code § 522(f)(3), at least, farm animals were not included in "equipment" or "tools of the trade." Absent overwhelming legislative history to the contrary (of which the Court finds none), the Court will not impart a different understanding of these terms to the drafters of Code § 522(f)(1). *See Meadows v. Farmers & Merchants National Bank of Stanley, Virginia (In re Meadows)*, 75 B.R. 357 (W.D. Va. 1987); *In re Smith*, 206 B.R. 186

(Bankr. N.D. Iowa 1996).

It is thus clear that by its very nature, the lien on the cattle is not vulnerable to avoidance under any of the subsections of Code § 522(f). Accordingly, the Court finds that Debtor's motion in this respect must be denied as a matter of law.

2. First Pioneer's motion to lift the automatic stay on the mined gravel

As a general matter, the relief of an order lifting the automatic stay is available only to a creditor that holds a perfected first-priority security interest in the property in question. *See In re Hunt's River Pier Assocs.*, 143 B.R. 36, 50 (Bankr E.D. Pa. 1992). In urging the Court to allow it to take possession of the mined gravel and sand that is still on Debtor's property, First Pioneer appears to make two alternate arguments: first, that the gravel and sand are still part of the real property, and thus subject to its mortgage interests; and in the alternative, that the gravel and sand are covered by its perfected security interest in Debtor's after-acquired personal property.

The issue of whether a commercially useful mineral is realty or personalty is frequently a difficult question under the Uniform Commercial Code (UCC). Arguably the leading judicial discussion of this matter is the opinion of the Supreme Court of Kentucky in the case of *Texas American Energy Corp. v. Citizens Fidelity Banks*, 55 U.C.C. Rep.Serv.2d 184, 736 S.W.2d 25 (1987). In *Texas American*, a commercial supplier of natural gas had extracted the gas from fields in Texas and piped it to Kentucky, where the surplus gas was injected into a natrual underground reservoir for storage. This raised the problem, however, of whether the stored gas

could be secured by an Article 9 security agreement, or whether it instead had become part of the real property and thus could be encumbered only by a mortgage. In holding that the gas remained personalty, the *Texas American* court stated that the determinative issue was whether the gas had been "captured" but not returned to its natural environment, adopting by analogy the doctrines of common law applicable to the capture and ownership of wild animals. Thus, to the extent that the gas was stored in an underground reservoir where its escape could be prevented and its quantity could be defined with certainty, it did not become part of the real property. *Id.* at 189.

The Court believes that this logic applies equally to the facts of this much-simpler case. To the extent that the sand and gravel has been "captured" through mining, it is no longer part of the property secured by First Pioneer's mortgage. This is true even if the sand and gravel have not left the boundaries of Debtor's property, and it is true regardless of the manner in which they are presently stored. Accordingly, the Court must next determine whether a security interest has attached to the sand and gravel by virtue of First Pioneer's financing statement for Debtor's after-acquired personal property.

While the plain language of the financing statement would seem to cover all personal property acquired by Debtor, including the sand and gravel mined from his real property, this financing statement is only valid to the extent that it complies with the substantive requirements of the UCC. Of particular importance is UCC § 9-402(3), which requires a financing statement to contain a particularized description of any minerals to be mined, as well as UCC § 9402(5), which requires that a financing statement covering mineral rights "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 sufficient for its identification and must

show the name of a record owner." The purpose of this section, of course, is to place other creditors on clear notice of the asserted security interest in mineral royalties. *See Lewiston Bottled Gas Co. v. Key Bank of Maine*, 601 A.2d 91 (Me. 1992) (discussing parallel provision dealing with fixtures). First Pioneer's UCC-1 statement plainly does not do this; instead, it appears from the exhibits submitted by First Pioneer that its UCC-1 statements left blank a box for mineral interests. The security interest which First Pioneer asserts here is precisely the type of hidden lien that Article 9 was meant to prevent, and the Court thus cannot conclude that the omission was a harmless error which may be disregarded pursuant to UCC § 9-402(8). Accordingly, the Court finds that First Pioneer does not have a perfected security interest in the mined gravel and sand, and that it is not presently entitled to an order of relief from the automatic stay with respect to that property.[1]

Based on the foregoing,

Debtor's motion to avoid First Pioneer's security interest with respect to any cattle pursuant to Code § 522(f), is hereby DENIED;

First Pioneer's motion for relief from the automatic stay with respect to any gravel or sand actually mined from Debtor's real property is hereby DENIED; and

The Court's judgment on the remaining portions of Debtor's motion and First Pioneer's cross motion, pending an evidentiary hearing, is RESERVED.

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[1] In the absence of an evidentiary hearing, the Court does not now address First Pioneer's argument that the unmined minerals form part of its collateral, and that Debtor's authorization of mining constituted an act of conversion. This ruling is accordingly without prejudice to First Pioneer's pending motion to enjon future mining entirely, and it is also without prejudice to that part of First Pioneer's motion which seeks a rollover or replacement lien in the mined gravel or sand, based on a the alleged reduction in the value of the real property due to the mining operation.

IT IS SO ORDERED.

Dated at Utica, New York

this 11th day of May 1999

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge