



SO ORDERED.

SIGNED this 12 day of May, 2005.

Janice Miller Karlin

JANICE MILLER KARLIN
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In re:)
)
JERRY JOEL CRUZ and)
TERRI ANN CRUZ,) **Case No. 04-43119-13**
)
Debtors.)
_____)

**MEMORANDUM ORDER AND OPINION GRANTING DEBTORS' OBJECTION TO
CLAIM OF FARMERS STATE BANK AND OVERRULING DEBTORS'
OBJECTION TO CLAIM OF KAW VALLEY STATE BANK**

This matter is before the Court on Debtors' Objection to Claim Number 8, filed by Farmers State Bank, and Debtors' Objection to Claim Number 11 filed by Kaw Valley State Bank & Trust.¹

The Court heard evidence on this matter, and finds that Kaw Valley's lien in the John Deere tractor is superior to that of Farmers.

¹Docs. 34 and 68.

I. FINDINGS OF FACT

On June 13, 2002, Debtors entered into a Commercial Security Agreement (“Kaw Valley Agreement”) with Kaw Valley State Bank & Trust Company (“Kaw Valley”), in exchange for a loan from Kaw Valley. The Kaw Valley Agreement listed the “Debtor” as:

JERRY CRUZ JR. AND TERRI A. CRUZ
DBA ONE OF A KIND

Debtors signed the Kaw Valley Agreement in their own names, however, and not in any representative capacity for the entity “One of a Kind,” which the Court understands was a sole proprietorship.

In the Kaw Valley Agreement, Debtors gave Kaw Valley a security interest in all their accounts, inventory, equipment, instruments and chattel paper, documents, farm products and supplies, government payments and programs, investment property and deposit accounts. The Kaw Valley Agreement also contained an after-acquired property clause, giving Kaw Valley a security interest not only in the property Debtors owned as of June 13, 2002, but also any property described in the security agreement that Debtors obtained at any time in the future.²

Kaw Valley properly filed a financing statement with the Kansas Secretary of State in connection with the Kaw Valley Agreement. A records search with the Secretary of State would have revealed that (1) Kaw Valley filed the financing statement on June 18, 2002; (2) the borrowers in the transaction were

²The Kaw Valley Security Agreement indicates that “Debtor gives [Kaw Valley] a security interest in all of the Property described in this Agreement that Debtor owns or has sufficient rights in which to transfer an interest, now or in the future, wherever the Property is or will be located, and all proceeds and products of the Property.” (Emphasis added)

Jerry J. Cruz, Jr. and Terri Ann Cruz; and (3) that Kaw Valley was claiming a security interest in “All inventory, chattel paper, accounts, contract rights, inventory, equipment, general intangibles, furniture, fixtures, machinery and all other business assets; whether any of the foregoing is owned now or acquired later; all accessions, additions.”³ The financing statement filed with the Secretary of State’s office makes no mention of Debtors’ trade name.

In August or September 2004, Jerry Cruz received a 1968 John Deere tractor as a gift from his mother. After receiving the tractor, the Debtors took out a loan with Farmers State Bank (“Farmers”) and gave Farmers a security interest in the tractor as collateral for that loan. Debtors informed Farmers that the tractor was unencumbered. Farmers did not verify with the Kansas Secretary of State whether the tractor was encumbered; it instead decided the search was unnecessary given the relatively small amount of the loan. Farmers thus simply relied upon Debtors’ assertion that the tractor was unencumbered.

At the time Debtors entered into the Kaw Valley Agreement, they were engaged in a custom furniture making business known as “One of a Kind.” The furniture business was abandoned based on lack of profitability, and Debtors began a new business, a milling operation under the name of “Log N Logs.” The John Deere tractor was never used by Debtors in the operation of the furniture business, but was used in the milling operation. The fact that the tractor was used for business purposes is supported by the security agreement with Farmers, which states that “Borrower will use Collateral listed in this Security Agreement for: Business purposes.”

³The Court takes judicial notice that the cost for conducting such a search is \$20 per debtor name.

Debtors filed their Chapter 13 bankruptcy petition on November 5, 2004. Both Farmers and Kaw Valley filed proofs of claim, and both claimed a security interest in the John Deere tractor. Debtors have objected to both creditors' claims in an effort to determine which creditor holds the superior lien. Debtors do not contest the fact that both creditors' validly perfected a security interest, but understandably, wish to pay the value of the tractor to only one creditor through their Chapter 13 plan.

Neither Farmers nor Kaw Valley challenge that the other properly perfected their respective security interests. Thus, the only issue before the Court is whether the Kaw Valley Agreement entered into on June 13, 2002 created a security interest in the after-acquired 1968 John Deere tractor. If it did, Kaw Valley's interest is superior to that of Farmers, because it was filed first.

II. CONCLUSIONS OF LAW

Farmers makes two arguments why Kaw Valley's Agreement did not provide it a security interest in the John Deere tractor. First, Farmers argues that the Kaw Valley Agreement did not cover after-acquired property, since it was undisputed that Debtors did not own the tractor at the time the Kaw Valley Agreement was signed. Although Kaw Valley's witness at trial was unable to point to the after-acquired property clause in its own Agreement, the security agreement was introduced as evidence. It clearly contains an after-acquired property clause. The inability of the witness to find the appropriate language containing the after-acquired property clause does not negate the clear evidence that such a clause existed.

The second argument raised by Farmers is that there is no evidence the tractor was used for business purposes, and therefore the Kaw Valley Agreement did not apply to that piece of equipment. The Court disagrees. The testimony from Ms. Cruz clearly established that the tractor was used in their business, rather than at their home, to move logs for the milling business. At the time Debtors entered into

the Kaw Valley Agreement, they were operating under the trade name of One of a Kind, rather than Log N Logs, the trade name they used after acquiring the tractor. However, the Court finds that the change of trade names does not render the security agreement between Kaw Valley and Debtors ineffective.

The Kaw Valley Agreement was between Kaw Valley and Debtors as individuals, as One of Kind was not a formal business entity. In addition, the financing statement filed by Kaw Valley listed each of Debtors' names, not One of a Kind, so Farmers could not have been misled, in any way, as to Kaw Valley's security agreement based upon the UCC filing with the Kansas Secretary of State. In fact, the use of Debtors' trade name in the financing statement filed by Kaw Valley was neither necessary, nor would it have been sufficient if filed without including Debtors' individual names.⁴ In addition, the security agreement between Farmers and Debtors also indicates that the tractor was to be used for business purposes. The evidence presented at trial clearly demonstrates that this tractor was used in the business and that it was covered by the Kaw Valley Agreement.

Farmers also contends that because they relied upon Debtors' assertions that the tractor was unencumbered, it should prevail in this matter. The Court need not make a finding at this time whether Debtors were simply mistaken when they informed Farmers that the tractor was unencumbered, or if they intentionally misled Farmers, because that finding is immaterial in determining the relative priorities between Kaw Valley and Farmers. What is relevant is that Kaw Valley did nothing to mislead Farmers.

Kaw Valley properly filed a financing statement with the Kansas Secretary of State. That financing statement clearly informed Farmers of Kaw Valley's interest. Unfortunately for Farmers, it chose to simply

⁴See K.S.A. 84-9-503.

accept Debtors' expressed belief regarding the tractor's status rather than pay the small fee required to have the Secretary of State conduct a records check. A major purpose for centralized filing is to allow a potential lender to determine for itself if another lender claims an interest, without having to rely on an unsophisticated, misinformed or dishonest debtor.⁵ Farmers' decision not to avail itself of this procedure is now fatal to its claim.

III. CONCLUSION

For the reasons stated above, the Court finds that Kaw Valley's perfected security interest in Debtors' 1968 John Deere tractor has priority over Farmers' claim in that tractor. Furthermore, the Court ruled from the bench, after the trial, that the tractor is valued at \$7,000 and that the remainder of Kaw Valley's collateral is worth less than its debt.⁶ As a result, Farmers' claim is thus totally unsecured, as there is no equity available for its claim. Debtors' objection to Farmers' claim is thus sustained on that basis. Because the Court has found that Kaw Valley does have a secured interest in the tractor, the Court overrules Debtors' objection to Kaw Valley's claim to that extent. Kaw Valley's claim is allowed as secured to the value of all its collateral, and is allowed as unsecured for any remaining balance.

⁵*Cf. Kruckenberg v. First National Bank of Medicine Lodge (In re Kruckenberg)*, 160 B.R. 663, 671 (D. Kan. 1993). It is entirely conceivable that an unsophisticated borrower would not understand that a loan document entered into two years before his or her acquisition of property could result in that later acquired property being encumbered. The only Debtor who testified, Ms. Cruz, impressed the Court as such an unsophisticated borrower; the Court did not get the impression that she and her husband knew the property was encumbered and simply tried to fool Farmers. Debtors knew they had just acquired the tractor at the time they approached Farmers for the loan, and Ms. Cruz's testimony that she did not realize the legal implication of an after-acquired clause was credible.

⁶At the trial, the Court announced its finding regarding valuation and requested Debtors' counsel submit the order. As of the date of this opinion, that order has not been submitted to the Court for review.

IT IS, THEREFORE, BY THIS COURT ORDERED that Debtors' Objection to Claim Number 8 filed by Farmers State Bank (Doc. 34) is sustained, and that Debtors' Objection to Claim Number 11 filed by Kaw Valley State Bank & Trust (Doc. 68) is denied to the extent it objected to Kaw Valley State Bank & Trust's claim to a security interest in the Debtor's 1968 John Deere tractor.

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