

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Western Division

In re:)	
	)	Bankr. Case No. 92-50211
GOLDEN HILLS RESORT, INC.,)	
	)	Chapter 11
Debtor.)	
	)	Adversary No. 92-5012
)	
GOLDEN HILLS RESORT, INC.,)	
	)	MEMORANDUM OF INTERLOCUTORY
	)	DECISION RE:
Plaintiff,	)	DETERMINATION OF
v.	)	SECURED INTEREST OF HOMESTAKE
	)	MINING COMPANY IN CERTAIN
HOMESTAKE MINING COMPANY,	)	ESTATE PROPERTY
	)	ACQUIRED POST-PETITION
Defendant.)	
)	

The matter before the Court is Plaintiff-Debtor Golden Hills Resort, Inc.'s, complaint to determine the validity, priority, and extent of Defendant Homestake Mining Company's interest, if any, in certain post-petition receipts of Debtor. This is a core proceeding under 28 U.S.C. § 157(b). This decision and accompanying Order shall constitute Findings and Conclusions as required by F.R.Bankr.P. 7052.

I.

On October 1, 1988, Golden Hills Inn, Inc.,¹ gave a Second Mortgage and Security Agreement ["Second Mortgage"] to Westpac Banking Corporation, Defendant Homestake Mining Company's assignor, as part of a financing plan involving economic development bonds

¹ The parties to this adversary have failed to explain how and when Debtor Golden Hills Resort, Inc., assumed this obligation of Golden Hills Inn, Inc.

for a hotel and convention center complex. The Second Mortgage covered certain real property, improvements, fixtures, and proceeds therefrom. In addition, the Second Mortgage contained the following provision:

Assignment of Rents; Foreclosure. As further security for its obligation under the Reimbursement Agreement, the Borrower hereby assigns to the Bank **all of the rents, revenues, issues, earnings, income, products and profits** of the Trust Estate, such assignment to become effective upon the occurrence of an Event of Default and the filing of a suit or other commencement of judicial proceedings to enforce the rights of the Bank under this Second Mortgage and Security Agreement, . . . ; provided however, that the Borrower shall not be denied the right to possession of the Facilities if such denial would be contrary to South Dakota law. Whenever all that is to the Bank under the Reimbursement Agreement interest thereon under the terms of the Reimbursement Agreement shall have been paid and all Events of Default cured or waived, the Bank shall surrender possession of the Facilities and the rents, revenues, issues, earnings, income, products and profits to Borrower, its successors or assigns; the same right of possession, however, to exist upon any subsequent Event of Default.

[Emphasis added.]

The Second Mortgage was filed with the Lawrence County, South Dakota register of deeds on October 25, 1988. On February 21, 1989, Westpac filed a state-approved financing statement with the South Dakota Secretary of State.²

² Exhibit A of the financing statement described the secured collateral as follows:

Debtor's interest in and to all building material, plants and fixtures of every kind and nature whatsoever on the real estate described below or in any building now or hereafter located on such real property and any other tangible personal property now owned or hereafter acquired by Debtor and affixed to or attached to such real estate[no "." in original]

All machinery, apparatus, fittings, equipment,

Debtor filed a Chapter 11 petition on August 10, 1992. According to Debtor, the petition triggered a default on the revenue bonds.³ The default resulted in a call on a letter of credit given by Westpac. Homestake eventually paid under its guarantee of the letter of credit and took Westpac's Second Mortgage on August 28, 1992 under an assignment. The assignment of mortgage was recorded with the Lawrence County Register of Deeds on September 19, 1992.

Debtor filed a complaint on November 5, 1992 that asks the Court to determine the validity, priority, and extent of Homestake's interest, if any, in post-petition rents and profits and for a determination of the value of Homestake's secured claim. Homestake answered and counterclaimed on November 27, 1992. Homestake states it has a secured interest in Debtor's post-petition rents and profits and it agrees with Debtor that Homestake's secured interest should be valued by the Court. In its counterclaim, Homestake argues that the automatic stay

chattels and articles of personal property acquired with the proceeds of the \$3,700,000 Economic Development Revenue Bonds (Golden Hills Inn Project), Series 1986 issued by the City of Lead, South Dakota, and now or hereafter located in, on, or about the real estate described [sic] below, and all repairs, additions, accessions, alterations, renewals and replacements thereto and all substitutions therefor and all cash and noncash proceeds therefrom.

³ The Second Mortgage adopted the definition of "an event of default" provided in the Reimbursement Agreement. The Court does not have a copy of the Reimbursement Agreement nor sufficient facts to determine whether an event of default has actually occurred. At least at this stage of this proceeding, Debtor agrees an event of default has occurred.

precluded Homestake from taking further action and that this adversary is the judicial proceeding through which Homestake wants to enforce the Second Mortgage. Homestake stated that the "value of the collateral securing [Homestake's] claim is equal to or greater than the amount of the debt."

With the consent of both parties, a trial was held December 1, 1992 on the initial legal question of whether Homestake has a post-petition secured interest in Debtor's hotel revenues under the Assignment of Rents provision.⁴ Valuation questions raised by the Complaint and Counterclaim were delayed pending resolution of the legal question. Both parties offered oral argument and filed briefs.

Debtor filed a reply to Homestake's Counterclaim on December 10, 1992. Debtor stated the Counterclaim was insufficient under 11 U.S.C. §546(b) to perfect any interest Homestake might have in Debtor's post-petition income. Debtor further claimed that under 11 U.S.C. § 544 it could avoid any interest that Homestake had in Debtor's post-petition revenues because inter alia Homestake had not perfected any interest in those revenues as of the petition date.

⁴ Neither party argues that the secured interest in "proceeds" given in section 2.1(e) on page 5 of the Second Mortgage created a secured interest in hotel receipts. The Court assumes that the parties acknowledge the definition of "proceeds" in S.D.C.L. 57A-9-306, which does not encompass general business receipts.

Debtor filed a reply brief on December 21, 1992. Homestake filed its reply brief on December 23, 1992. On December 23, 1992 Homestake filed a motion to strike a portion of Debtor's reply brief. That motion was denied by Order entered January 4, 1993 and the matter was taken under advisement.

II.

Section 552(b) states that a pre-petition secured interest in property of the debtor may extend to the rents and profits of that secured property acquired by the bankruptcy estate post-petition if the security agreement and applicable non bankruptcy law so provide, unless the court orders otherwise "based on the equities of the case." State law usually determines whether a security interest in property was acquired **pre**-petition. Butner v. United States, 440 U.S. 48, 55 (1979); see also United States v. Landmark Park and Associates, 795 F.2d 683 (8th Cir. 1986). Section 546(b) and applicable state law will determine whether a security interest may be perfected **post**-petition so as to defeat any lien avoidance powers that the debtor-in-possession (DIP) acquires in bankruptcy.

Two questions must be answered before the Court can determine whether Homestake has a perfected security interest in post-petition "rents, revenues, issues, earnings, income, products and profits of the Trust Estate" [hereinafter "rents"] as provided in the Second Mortgage and 11 U.S.C. § 552(b).⁵

⁵ While the parties have framed the issue in a slightly different fashion, the ultimate question is whether the post-petition rents are cash collateral whose use is restricted by 11

First, did Homestake acquire a pre-petition security interest in rents?

If the security interest given in a mortgage is an absolute assignment, it is effective on the day of its creation. In re Princeton Overlook Joint Venture, 143 B.R. 625, 630-31 (Bankr. D.N.J. 1992). If the security interest is a pledge conditioned on the happening of a future event, the interest does not vest until the occurrence of the precipitating event. Id.; see also In re 641 Associates, Ltd., 140 B.R. 619, 628 (Bankr. E.D. Pa. 1992); In re Harbour Town Associates, Ltd., 99 B.R. 823, 824-25 (Bankr. M.D. Tenn. 1989).

The pertinent clause in the Second Mortgage states that the assignment of rents is "to become **effective upon the occurrence of an Event of Default and the filing of a suit or other commencement of judicial proceedings** to enforce the rights of the Bank under the Second Mortgage and Security Agreement[.]" In other words, two events -- default and enforcement of the Second Mortgage -- conditioned when the security interest in rents becomes effective. Debtor admits that a default occurred. However, Homestake did not commence a judicial proceeding to enforce its rights under the Second Mortgage before Debtor filed bankruptcy. Since a precipitating condition remained, the assignment was not absolute. Therefore, Homestake did not acquire a secured interest in rents

U.S.C. § 363. In re Jefferson Business Center Associates, 135 B.R. 676, 681 (Bankr. D. Colo. 1992).

pre-petition and was precluded from perfecting that interest pre-petition.

The **language** of the Second Mortgage controlled when Homestake's secured interest in rents became effective. Thus, this case is distinguished from those cases in which the assignment of rents was effective and perfected pre-petition although the assignment was not enforced pre-petition. See, e.g., In re Foxhill Place Associates, 119 B.R. 708 (Bankr. W.D. Mo. 1990); In re Carley Capital Group, 128 B.R. 652 (Bankr. W.D. Wis. 1991); and Capital Realty Investor Tax Exempt Fund Limited Partnership v. Greenhaven Village Apartments of Burnsville Phase II Limited Partnership (In re Greenhaven Village Apartments of Burnsville Phase II Limited Partnership), 100 B.R. 465 (Bankr. D. Minn. 1989); but see Northwestern National Life Insurance Co. v. Metro Square (In re Metro Square), 106 B.R. 584 (D. Minn. 1989) (non absolute assignment of rents may be perfected by filing of mortgage). Further, the facts of this case distinguish it from those cases in which the applicable state law provided that an assignment of rents was not perfected pre-petition because the interest had not been enforced pre-petition. See, e.g., Saline State Bank v. Mahloch, 834 F.2d 690 (8th Cir. 1987).

The Assignment of Rents provision can be read in harmony with state law which allows for the continued collection of assigned rents from default, to foreclosure, and through the mortgage redemption period. S.D.C.L. 21-47-17; Aetna Life Insurance Co. v.

McElvain, 363 N.W.2d 186, 191 (S.D. 1985). The mortgagee, as drafter, by the language and effective date chosen, insured that it could employ S.D.C.L. 21-47-17.

The conclusion that the security interest in rents did not become effective or vest until default and enforcement of the Second Mortgage is consistent with other terms in the Second Mortgage. Article V., Miscellaneous, Section 5.4, Use of Facilities, states that the mortgagor "shall have the **unencumbered** right to the use of the Facilities [defined in the Second Mortgage as the land and improvements] in the ordinary course of its business" until default and enforcement [emphasis added]. Further, the prospective language governing the secured interest in rents is in sharp contrast to the Second Mortgage clause that created the present secured interest and lien on the Facilities. There, the Second Mortgage states the mortgagor "does hereby . . . mortgage, convey, grant, assign, transfer, pledge, set over and confirm unto the [mortgagee] . . . and grant a lien and security interest in, the Facilities[.]" Had the mortgagor intended a similar present transfer of a secured interest in rents, the granting clause could have so stated. Other clauses in the Second Mortgage also acknowledge that a present lien has been given on the Facilities without mention of a present lien on rents. For example, page eight of the Second Mortgage states that a lien on the Facilities was "created and vested" by the Second Mortgage. A vested secured interest in rents was not similarly recognized. Finally, Article

III, REPRESENTATIONS, COVENANTS, PERMITTED ENCUMBRANCES, was drafted to insure that the mortgagor had good title to the land and improvements and that the mortgagor promised to keep that title clear except as to certain specified or described encumbrances. This segment of the Second Mortgage also did not acknowledge or protect a present lien interest of the mortgagee in rents.

Second, may Homestake perfect their interest in rents post-petition?

Section 546(b) states:

The rights and powers of a trustee [to avoid liens] under sections 544, 545, and 549 of this title are subject to any generally applicable law that permits perfection of an interest in property to be effective against an entity that acquires rights in such property **before the date of such perfection**. If such law requires seizure of such property or commencement of an action to accomplish such perfection, and such property has not been seized or such action has not been commenced before the date of the filing of the petition, such interest in such property shall be perfected by notice within the time fixed by such law for such seizure and commencement.

[Emphasis added.] To utilize the opportunity under this section to perfect a secured interest post-petition, the creditor must show not only that state law allows the creditor to perfect his interest against an intervening lien holder or purchaser but also that the perfection would relate back to a time pre-petition. Virginia Beach Federal Savings and Loan Association v. Wood, 901 F.2d 849, 852 (10th Cir. 1990) (citing In re Casbeer, 793 F.2d 1436, 1442-43 (5th Cir. 1986)); In re Rancourt, 123 B.R. 143, 149 (Bankr. D.N.H. 1991) (in dicta; cases cited therein); In re Westport-Sandpiper Associates, 116 B.R. 355, 358-59 (Bankr. D. Conn. 1990); Drummond

v. Farm Credit Bank of Spokane (In re Kurth Ranch), 110 B.R. 501, 507 (Bankr. D. Mont. 1990); and Harbour Town Associates, 99 B.R. at 825-26.

The legislative history states the purpose of § 546(b) "is to protect, in spite of the surprise intervention of [the] bankruptcy petition, those whom state law protects by allowing them to perfect their liens or interests as of an effective date that is earlier than the date of the petition." H.R.Rep. No. 95-595, 95th Cong., 1st Sess. 371 (1978);, U.S.Code Cong. & Admin. News 1978, p. 5787 (cited in Kurth Ranch, 110 B.R. at 507 (cites therein)). The Senate Report further states,

The rights granted to a creditor under [§ 546(b)] prevail over the [debtor-in-possession] only if the transferee has perfected the transfer in accordance with applicable law, and that the perfection relates back to a date that is before the commencement of the case.

S.Rept. No. 989, 95th Cong., 2d Sess. 86 (1978); accord H.Rept. No. 595, 95th Cong., 1st Sess. 371 (1977), U.S.Code Cong. & Admin.News 1978, pp.5787, 5872,6327 (cited in Harbour Town Associates, 99 B.R. at 826).

The logic of the decisions cited above and their reliance on legislative history are sound. This Court agrees that the state law on which a creditor relies under § 546(b) to perfect a security interest post-petition must provide that the perfection relates back to a time pre-petition.

Homestake has not identified any applicable state law that would allow Homestake to perfect its interest in rents such that the perfection would relate back to a time pre-petition and thereby

defeat the lien avoidance powers of the DIP. Consequently, the requirements of § 546(b) for post-petition perfection of a secured interest have not been met. Whether rents are an interest in real property that must be perfected by recording the mortgage with the county register of deeds or whether rents are an interest in personalty that must be perfected by filing a financing statement with the Secretary of State need not be answered⁶ -- Homestake has not identified a state law governing perfection of either type of interest that would allow the perfection to relate back to a time pre-petition under § 546(b). Westport-Sandpiper Associates, 116 B.R. at 358-59. Compare S.D.C.L. 57A-9-301(2) ("If the secured party files with respect to a purchase money security interest before or within twenty days after the debtor receives possession of the collateral, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and time of filing.").

In summary, Homestake did not acquire a vested secured interest in rents pre-petition because the assignment was not absolute and one of the two conditional events did not occur pre-petition. Further, Homestake's interest in rents cannot vest and be perfected post-petition under § 546(b) because Homestake has failed to identify any state law that allows Homestake to perfect its interest such that the perfection relates back to a time pre-

⁶ The Court also does not need to decide whether the assignment of rents clause in the Second Mortgage encompassed daily business receipts (room revenues, etc.).

petition and defeats the rights of the DIP as an intervening judicial lien holder or bona fide purchaser. Consequently, Debtor's post-petition rents are not cash collateral under §§ 363(a) and 552(b). An appropriate order will be entered.

The Court will schedule a status hearing regarding remaining issues by a separate order.

Dated this ____ day of March, 1993.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By _____
Deputy

(SEAL)

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Western Division

In re:)	
	)	Bankr. Case No. 92-50211
GOLDEN HILLS RESORT, INC.,)	
	)	Chapter 11
Debtor.)	
	)	Adversary No. 92-5012
)	
GOLDEN HILLS RESORT, INC.,)	
	)	INTERLOCUTORY
Plaintiff,	)	ORDER DETERMINING SECURED
v.	)	INTEREST OF HOMESTAKE
	)	MINING COMPANY IN CERTAIN
HOMESTAKE MINING COMPANY,	)	ESTATE PROPERTY ACQUIRED
	)	POST-PETITION
Defendant.)	
)	

In compliance with and recognition of the Memorandum of Decision Re: Determination of Secured Interest of Homestake Mining Company in Certain Estate Property Acquired Post-Petition entered this day and

IT APPEARING that Homestake Mining Company's interest in "rents, revenues, issues, earnings, income, products and profits of the Trust Estate," as that interest is set forth and more fully described in section 2.4 of the Second Mortgage and Security Agreement dated October 1, 1988, did not vest and therefore was not perfected pre-petition; and

IT FURTHER APPEARING that Homestake Mining Company's interest in "rents, revenues, issues, earnings, income, products and profits of the Trust Estate," as that interest is set forth and more fully described in section 2.4 of the Second Mortgage and Security Agreement dated October 1, 1988, may not be perfected post-petition under 11 U.S.C. § 546(b) and any applicable state law;

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that Homestake Mining Company does not have a secured interest in Debtor's post-petition "rents, revenues, issues, earnings, income, products and profits of the Trust Estate," as that interest is set forth and more fully described in section 2.4 of the Second Mortgage and Security Agreement dated October 1, 1988.

Dated this ____ day of March, 1993.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By _____
Deputy

(SEAL)