

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
RYAN ROYCE RATHE and)
DEBRA LEE RATHE,) CASE NO. BK99-82149
) A99-8137
DEBTOR(S))
)
FIRST STATE BANK,) CH. 12
Plaintiff(s)) Filing No.
vs.)
)
RYAN ROYCE & DEBRA LEE RATHE,)
WILLIAM WARD, VIRGIL)
MCCLATCHEY, and DON KLEIN)
d/b/a MIDWEST LIVESTOCK)
COMMISSION,)
)
Defendant(s))

MEMORANDUM

Hearing was held on Adversary Complaint on November 29, 2000. Appearances: David Pederson as Attorney for Bank/plaintiff and George Vinton as Attorney for William Ward/defendant. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(K).

Trial was held on November 29, 2000. Thereafter, the parties were given the opportunity to submit supplemental briefs. All materials were submitted and the case was ready for a decision on December 14, 2000.

Background

The debtors borrowed money from the First State Bank ("Bank") and gave as collateral an interest in real estate, equipment and livestock. All of the collateral has now been liquidated, or, if it has not been liquidated, the Bank and the debtors have entered into agreements concerning continuing use and payment for real property and some equipment. The matter before the Court is between the Bank and William Ward.

Mr. Ward fed and cared for livestock owned by the debtors and believes he is entitled to payment for such services from the cash proceeds resulting from the liquidation of the livestock herd. The Bank, asserting its first lien, disagrees. All other parties have either settled or, in some other manner, have been removed as parties in this case.

Facts

1. The debtors borrowed money from the Bank and, among other things, gave, as collateral, a security interest in cattle.

2. The Bank refused to renew the debtors' operating loan for the year 1999.

3. The debtors informed the bank officer in charge of the loan, in early February, 1999, that they had no funds to purchase feed for the livestock, and that the livestock were in distressed condition and starving.

4. In February, 1999, the Bank conferred with a contact person at Farm Service Agency ("FSA"), the guarantor of the loan. The FSA contact and the Bank agreed that funds would be made available to the debtors for feed and care of the animals.

5. The Bank did pay for some veterinary service and for the delivery of some feed.

6. Mr. Ward, a neighbor of the debtors, was requested by the debtors to help care for and feed the livestock. From early March of 1999, through September of 1999, Mr. Ward provided feed and care for the livestock. When it became clear to Mr. Ward that the debtors' facilities were inadequate to properly provide for the animals, he moved them to a pasture which he had rented from another landowner. He made certain that they received veterinary services.

7. The Bank was made aware of Mr. Ward's involvement, and the services he was rendering, at least by mid April, 1999. Mr. Ward was invited to a farm mediation session between the Bank and the debtors in late April of 1999. At that session, the bank officer discussed with Mr. Ward the services that had been rendered and the expenses that had been

incurred. He informed Mr. Ward that funds were available for payment for feed and care of the animals.

8. At that late April, 1999, mediation session, the bank officer directed that the debtors once again take possession of and care for the animals. However, the bank officer had known since February, and continued to know both in late April, at the mediation session and later, that the debtors had insufficient funds to enable them to feed and care for the animals.

9. Even though the Bank had been informed that the debtors were unable to care for the animals, and even though the Bank directed the debtors to take possession of and care for the animals, the Bank took no action to replevin the animals. Even after the mediation session which Mr. Ward attended, the Bank did not direct Mr. Ward to stop providing care and did not take any action to take possession of the animals and liquidate the herd.

10. In early May of 1999, the bank officer prepared a "Plan of Liquidation" with two alternatives. The first alternative was to take possession of and liquidate the cattle immediately and the second alternative was to permit the cattle to be fed through the fall, gain weight and then be marketed in an orderly manner. The "Plan of Liquidation" showed that an immediate liquidation would cause a significant loss to the Bank, whereas the alternative of keeping the animals through the summer on grass, even after deducting approximately \$22,000.00 in feed and care expenses, would result in a significant gain to the Bank.

11. The Bank elected the second alternative and recommended that alternative to FSA.

12. Mr. Ward or his wife, on many occasions, consulted with the bank officer with regard to continuing care and the probability of payment for such care. Each and every time the bank officer informed Mr. or Mrs. Ward that funds were available for feed and care, and eventually told them that they should submit a statement therefor. The bank officer even provided language that the Wards should put in their statement. The bank officer then insisted that payment would only be made if the debtors agreed to the charges.

13. By September, 1999, the Wards had provided a written statement to the Bank and had submitted it to the debtors. The debtors informed the Bank that they did not agree with all of the expenses and the Bank, finally, in late September of 1999, informed the Wards that the Bank would not pay the expenses.

14. The Bank treated every other provider of service to the animals differently from the manner in which the Bank treated the Wards. For example, upon receipt of a statement from a feed supplier, the Bank made direct payment to the feed supplier. Upon receiving a statement from a veterinarian for services rendered to the animals prior to this "emergency" which arose in February of 1999, the Bank made direct payment to the veterinarian. With no written statement at all, the Bank made a \$3,000.00 payment to the owner of the land Mr. Ward had rented and upon which he placed the debtors' animals.

15. No officer of the Bank ever informed the Wards that they were acting as volunteers for providing feed and care for the animals. No officer of the Bank, until September of 1999, or later, informed the Wards that they would not be paid a reasonable amount for the services rendered.

16. The animals were eventually sold. The cost of sale was deducted from the gross cash proceeds, but still, the Wards were not and have not been paid.

17. The Wards claimed approximately \$22,000.00 for feed and services rendered from March through September of 1999. That amount is approximately the amount the Bank estimated it would cost to get the animals to market in the fall.

18. The Bank, on a continuing basis, led the Wards to believe that they would be paid for past services and, if they continued to care for the animals, they would be paid for future services.

19. Without such assurances, the Wards would not have spent their time, effort and money to care for the animals.

20. Bank officers, both in a written memorandum concerning telephone conversations, and in the "Plan of Liquidation" and cover letter to FSA, expressed in writing the Bank's agreement to pay for the reasonable cost of the care and feeding of the animals. Consistent with such writings,

the Bank did pay some suppliers of care and feeding and did pay some rent for land upon which the animals were grazing.

21. The Bank has a first lien, represented by a security interest in the animals and the proceeds thereof.

22. The Wards have an agister's lien properly filed prior to giving up possession of the animals for sale.

23. The services and feed provided to the animals benefitted the Bank by causing the value of the cattle to increase.

24. The conduct of the Bank in continuously leading the Wards to believe that they would be compensated at a reasonable rate for the services they rendered in caring for the cattle, harmed Mr. Ward and benefitted the Bank.

25. The reasonable value of the feed and care provided by Mr. Ward, as testified to by an expert witness, is approximately \$27,000.00.

Issues

1. Does the properly perfected security interest of the Bank take priority over the agister's lien, filed at a later date?

2. If the Bank's security interest takes priority, should its interest be equitably subordinated pursuant to 11 U.S.C. § 510(c)(1)?

Decision

1. The agister's lien takes priority over the earlier perfected security interest.

2. The Bank's interest in the cattle proceeds is subordinated, pursuant to 11 U.S.C. § 510(c)(1) to the interest of Mr. Ward in the amount of \$27,000.00.

Conclusions of Law and Discussion

The Agister's Lien Statute provides that one who contracts to provide feed and care for livestock in Nebraska has a first lien on the livestock for the feed and care as

long as the holder of any prior lien agrees in writing to the contract. Neb. Rev. Stat. § 54-201(1). In this case, both Exhibit 17 and Exhibit 18 are expressions of consent, in writing, by an authorized bank officer, to the services being provided by Mr. Ward with regard to the livestock owned by the debtors. Exhibit 17 is the previously referred to "Liquidation Plan" and cover letter to FSA. That document specifically refers to the need to pay for the cost of feed and care of the livestock.

Exhibit 18 is a writing prepared by a bank officer specifically indicating that the bank officer was aware of the claim by Mr. Ward for services rendered and, consistent with the bank officer's prior discussions with Mr. Ward, that funds would not be advanced to pay those expenses until Mr. Rathe agreed. This writing acknowledges, by negative implication, that the Bank agrees to pay the reasonable value of the services rendered, subject only to Mr. Rathe's agreement as to the amount. Although Mr. Rathe never did agree to the amount, such failure to agree does not negate the fact that the Bank knew that the services had been rendered and agreed to pay a reasonable amount for such services.

Both of the above-described writings satisfy the agister's lien statute requirement that the first lienholder agree in writing that an agister's lien would be paid, thereby boosting the agister's lien to first priority. See Washington County Bank v. Red Socks Stables, 221 Neb. 300, 376 N.W.2d 782 (1985).

Equitable Subordination

To obtain the benefit of the equitable subordination statute and thereby require that the Bank's interest in the proceeds of sale of the cattle be subordinated to the interest of Mr. Ward, to the extent of the reasonable value of the services, Mr. Ward must prove that the Bank's statements and actions amount to gross misconduct. First National Bank of Barnesville v. Rafoth (In re Baker & Getty Financial Services, Inc.), 974 F.2d 712 (6th Cir. 1992); Pacific Express, Inc. v. Pioneer Commercial Funding Corp. (In re Pacific Express, Inc.), 69 B.R. 112 (9th Cir. BAP 1986); Herzog v. Leighton Holdings, Ltd., 239 B.R. 497 (N.D. Ill. 1999); Computer Systems, Inc. v. Mylex Corp. (In re Northgate Computer Systems, Inc.), 240 B.R. 328 (Bankr. D. Minn. 1999); Bank of

New Richmond v. Production Credit Ass'n. of River Falls (In re Osborne), 42 B.R. 988 (W.D. Wis. 1984).

In Osborne, the Court applied equitable subordination to the interest of the Production Credit Association ("PCA") vis-a-vis General, a feed supplier. Osborne, 42 B.R. at 989. General had expressed great concern about the size of Osborne's account to PCA. PCA responded with "equivocation and outright misrepresentations" concerning whether or not the PCA would pay. Id. at 999. On several occasions over several months, General attempted to obtain payment from PCA. Each time PCA implied that payment would be made, but put a condition on the payment, such as the sale of cattle or obtaining signatures on certain documents. Eventually, it became clear that the PCA had no intention of paying.

The Court found PCA's conduct was inequitable. It was aware of General's concern and continued to reassure General concerning the probability of payment. The Court found that PCA's conduct rose to a level of gross or egregious misconduct. That standard was satisfied by "misrepresentation whereby other creditors were deceived to their damage." The repeated misrepresentations induced General to continue to sell feed to preserve the cattle. The misrepresentations directly injured General. Similar factual findings were made in other cases, not dealing with cattle. See Murphy v. Nunes (In re Terrific Seafoods, Inc.), 197 B.R. 724 (Bankr. Mass. 1996); Figgie Acceptance Corp. v. Abatement Systems, Inc. (In re 5000 Skelly Corp.), 142 B.R. 442 (Bankr. N.D. Okla. 1992); Slefco v. First National Bank of Stuttgart (In re Slefco), 107 B.R. 628 (Bankr. E.D. Ark. 1989).

In this case, the bank officer testified that he had been told that the cattle were in poor condition and on the verge of starvation. He employed the services of an expert witness to verify that fact. An internal memo of the Bank stated that it was crucial to get feed to the cattle before they went out of condition whether the debtors provided the feed or the Bank employed someone else to do it. There was no question in the mind of the bank officer concerning whether the debtors could provide feed or care for the cattle.

The Bank had available emergency funds for feed and care of the cattle, but the bank officer stated that, strictly speaking, those funds were supposed to be advanced as part of a liquidation plan. Nonetheless, the Bank took the position

that it had to get feed to the cattle without a liquidation plan and it did so, paying certain suppliers for the feed.

The Bank, over a several week period, advanced funds for the care and feed of the cattle not knowing if the funds would be covered as emergency funds by the FSA guaranty.

Mr. Ward did not know anything about the requirements put upon the Bank by the FSA guaranty concerning emergency funds. He only knew that he was encouraged to continue to feed and care for the cattle and was told that there were funds available.

It is clear from the deposition of the bank officer that the Bank was aware that Mr. Ward was involved in helping with the cattle from late February or early March of 1999.

All of the evidence leads to the conclusion that the Bank acted with deliberate intent to get Mr. Ward to continue to care for the cattle although one or more of the Bank's officers had no intention of paying for the services.

In May, the Bank estimated that it would cost a little over \$21,000.00 to get the cattle from May until liquidation. Since the Bank knew that the debtors could not provide care and feed for the cattle between May and fall liquidation, one can only conclude that the Bank knew that Mr. Ward would provide the services, knew what it would cost and yet determined at some point in time that Mr. Ward would not be paid.

There is no evidence in the record that the Bank officer was acting outside of his authority or in excess of his authority when he made representations to Mr. Ward and Mrs. Ward that funds were available and subject only to certain contingencies.

The Bank's conduct in this case is egregious and amounts to gross misconduct. The Bank intentionally misled Mr. Ward. He fed and cared for the cattle based on the understanding from representations by a bank officer that funds were available to repay him for feed and care. He had no reason to volunteer to care for and feed collateral of the Bank for free. He was stuck with the animals because Mr. Rathe had no ability to care for them and the Bank took no action to replevin them.

The Bank should not be permitted to now stand on its Uniform Commercial Code perfected security interest to claim the gross proceeds from the cattle, especially when the Bank deceived Mr. Ward and induced him to continue to provide feed and services which increased the value of the cattle throughout the spring, summer and early fall of 1999.

The interest of the Bank is, therefore, equitably subordinated pursuant to 11 U.S.C. § 520(c)(1) to the interest of Mr. Ward, to the extent of \$27,000.00, the reasonable value of the services rendered.

Separate journal entry to be filed.

DATED: February 14, 2001

BY THE COURT:

/s/Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

Copies faxed by the Court to:

10 PEDERSON, DAVID
121 VINTON, GEORGE
4 LYDICK, RICHARD
98 POTTER, P. STEPHEN

Copies mailed by the Court to:

United States Trustee

Movant (*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

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d/b/a MIDWEST LIVESTOCK)
COMMISSION,)
Defendant(s))

CASE NO. BK99-82149
A99-8137

CH. 12
Filing No.

JOURNAL ENTRY

DATE: February 14, 2001
HEARING DATE: November
29, 2000

Before a United States Bankruptcy Judge for the District of
Nebraska regarding Adversary Complaint.

APPEARANCES

David Pederson, Attorney for Bank/plaintiff
George Vinton, Attorney for Ward/defendant

IT IS ORDERED:

The interest of the bank is subordinated to the interest
of Mr. Ward to the extent of \$27,000.00 of the cattle
proceeds. Judgment is entered in favor of William Ward and
against First State Bank in the amount of \$27,000.00. See
Memorandum entered this date.

BY THE COURT:

/s/Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

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121 VINTON, GEORGE
4 LYDICK, RICHARD
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