

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)
)
MBA POULTRY, L.L.C.,) CASE NO. BK00-40122
)
Debtor(s).) CH. 7

ORDER

Trial was held in Lincoln, Nebraska, on January 6, 2006, on issues remanded from the Eighth Circuit Court of Appeals. Gerald Laughlin and Tom Cohen appeared for Dapec, Inc.; Emmett Childers appeared for The Money Store Commercial Mortgage, Inc.; Gregg Stratman appeared for the United States Small Business Administration; and Kevin Siebert appeared for Bird Watchers, L.L.C.

The debtor was a poultry processor and had a plant in Tecumseh, Nebraska. The debtor's purchase and remodeling of that plant gave rise to the matters at issue here, which primarily deal with competing security interests in the plant property, including fixtures.

The debtor obtained financing from The Money Store Commercial Mortgage, Inc. ("TMS"), when it purchased the plant in 1998, and gave TMS deeds of trust to secure the notes. The debtor obtained additional financing from Heller Financial, Inc. ("Heller"), with all of the debtor's personal property as collateral. In late 1998, the debtor borrowed money from the Nebraska Economic Development Corporation, in exchange for a deed of trust, to pay off one of the TMS notes. That note and the deed of trust securing it were then assigned to the Small Business Administration ("SBA").

As part of the plant renovations, the debtor installed a system to air-chill the chicken carcasses for processing. The air-chill system involved a room-sized stainless steel framework supporting a 1,820-foot overhead chain conveyor which circulated hanging carcasses through refrigerated areas. The debtor purchased the system from Dapec, Inc. ("Dapec"), giving the company a security interest in all goods and fixtures purchased from it, and Dapec filed a construction lien. TMS subordinated its interest in the real estate to Dapec's fixture interest.

After the bankruptcy case was filed, the court gave Heller a super-priority security interest in the debtor's personal property and authorized the sale of the plant. Heller assigned its claim to

Bird Watchers, L.L.C. ("Bird Watchers"), which purchased all of the debtor's real and personal property at the bankruptcy auction. The sale was approved, but further hearing was necessary to determine priority among the various secured creditors. The bankruptcy court ruled against Dapec on the priority of its construction lien, determining that the TMS/SBA security interest is superior to Dapec's construction lien. The bankruptcy court also held that the City of Tecumseh's lien for sewer and water charges was superior to all but the county's lien for real estate taxes. The court further ruled that Johnson County's lien, if any, for personal property taxes was superior to Bird Watchers' security interest. Finally, the bankruptcy court ruled against Dapec on its argument that the steel framework of the air-chill system¹ (hereafter known as "the superstructure") was a fixture and was covered by Dapec's security interest in goods and fixtures, so Dapec did not receive any of the proceeds from the sale of the real property.

The sale of the real property generated total proceeds of \$2,479,109.47. Those funds were distributed as follows:

Johnson County	\$56,676.55
City of Tecumseh	\$63,824.63
American National Bank	\$534,199.27
The Money Store	\$881,675.69
SBA	\$942,733.33
TOTAL	<u>\$2,479,109.47</u>

On appeal, the Eighth Circuit affirmed the rulings regarding the personal property taxes and the priority of Dapec's construction lien. It reversed the decision on the water and sewer lien and the decision regarding the superstructure. The appellate court remanded the case for a determination of the priority between the security interests held by Dapec and SBA in the superstructure, and between Dapec's construction lien and the water and sewer lien. Dapec, Inc. v. Small Bus. Admin. (In re MBA Poultry, L.L.C.), 291 F.3d 528 (8th Cir. 2002). To determine the rights of Dapec and SBA concerning the Dapec fixture filing, the components of the fixture, that is, of the superstructure, must be determined, and the contributory value of the superstructure to the sale of the real property plus fixture must be calculated.

¹The components of the conveyance system had previously been found to be personal property.

The City of Tecumseh subsequently disgorged the \$63,824.63 that had been distributed to it and disclaimed any further interest in those proceeds. The funds are held by the Clerk of the Bankruptcy Court, and as of April 25, 2006, the balance was \$64,724.40.

The issues of the value of the superstructure and the priority of security interests in it, as well as the issue of competing rights to the money returned by the City of Tecumseh and the issue of whether Bird Watchers is entitled to recover the amount it paid to release a personal property tax lien, were tried and are now ready for decision.

The parties agree on the following relevant facts:

1. The recorded instruments on the debtor's property were filed in the following order:
 - a. TMS deed of trust, June 17, 1998
 - b. TMS deed of trust, June 17, 1998
 - c. American National Bank deed of trust, June 17, 1998
 - d. Notice of commencement of construction pertaining to Dapec's project, June 17, 1998
 - e. Heller Financial financing statement, August 14, 1998
 - f. Dapec UCC financing statements, November 13, 1998
 - g. SBA deed of trust, December 16, 1998
 - h. Dapec construction lien, January 22, 1999
 - i. Assignment of TMS deed of trust to SBA, April 1, 1999.
2. These recorded filings created valid security interests in or liens upon the debtor's real property, subject to disputes over priority.
3. Dapec's security interest relates to an original debt of at least \$709,000, of which \$63,824 has been paid.
4. The debtor's real and personal property was sold on June 5, 2000. Bird Watchers was the winning bidder for the real and personal property, purchasing it to operate an air-chilled chicken processing plant.
5. After the sale, Bird Watchers paid \$130,789.35 to Johnson County for unpaid personal property taxes.
6. Dapec faxed to the debtor on April 30 and May 7, 1998, the price quotations which formed the basis for the May

15, 1998, contract between the parties to build the air-chill system.

7. The bankruptcy court ruled on July 19, 2000, that the City of Tecumseh's lien for water and sewer charges was superior to all claims other than the county's claims for real estate taxes. Dapec filed the only appeal of that ruling.
8. The SBA loan was made pursuant to the SBA 504 loan program described in 15 U.S.C. §§ 695 *et seq.* and 13 C.F.R. 120.800 *et seq.*
9. TMS was the interim lender on the 504 loan to the debtor.
10. The SBA funded the 504 loan and the proceeds paid off TMS's interim note, which was secured by a recorded deed of trust.
11. TMS assigned the interim note and deed of trust to SBA, and SBA recorded the assignment.
12. TMS executed two subordination agreements to Dapec on September 30, 1998.
13. SBA received \$942,733 from the proceeds of the sale of the debtor's property.

I. Discussion

A. Superstructure

In the context of establishing a valuation for the superstructure, much of the evidence at trial centered on whether certain components of the air-chill system which are attached to the superstructure, namely the drive gear motors and the frequency converter, are part of the fixture. Dapec believes they are, while SBA argues that the opinion of the Court of Appeals describes the parameters of the superstructure as a fixture. A careful reading of that opinion, however, indicates that the circuit court was not deciding the scope of the superstructure. It was simply determining that the superstructure was a fixture and in doing so, described how the superstructure was affixed to the real property. The Eighth Circuit opinion itself is not a basis for ruling that anything not described in that opinion is personal property and not part of the superstructure.

Instead, the evidence presented at trial indicates that the

frequency converter and the drive gear motors are fixtures. To determine whether an item constitutes a fixture, the court follows Nebraska law in looking at three factors: (1) actual annexation to the realty, or something appurtenant thereto, (2) appropriation to the use or purpose of that part of the realty with which it is connected, and (3) the intention of the party making the annexation to make the article a permanent accession to the freehold. Bank of Valley v. U.S. Nat'l Bank, 341 N.W.2d 592, 594-95 (Neb. 1983) The third factor is generally regarded as the most important factor when determining whether an article is a fixture. The other two factors, annexation and appropriation to the use of the realty, have value primarily as evidence of such intention. Id.

Here, Dapec's senior service technician, who oversaw the installation of the debtor's air-chill system, testified about building the superstructure, including installation of the condensers and, of particular import here, the motors and frequency converter. He said that the motors are large and are each attached above a main drive gear box, bolted down with six bolts. Each gear box was fabricated as one unit and is welded into the superstructure. The gear boxes, motors, and connection to the frequency converter cost nearly \$102,000. The frequency converter, which cost \$35,000, is the control panel and was described as "the brain" of the air-chill system. It controls each of the 18 motors and causes them to function together, adjusting the speed of the line and shutting it down if a problem develops. The frequency converter was custom-designed for the debtor's operation, and the Dapec technician testified that it could not be removed and used elsewhere. Unlike the example given at trial of a furnace thermostat, which is not a fixture, the frequency converter cannot be replaced with something off the shelf. It is a specialized control mechanism designed and built for this system.

As described by Dapec's witness, and as shown in the plant photographs placed into evidence, the motors and the frequency converter are annexed to the superstructure fixture. They are an integral part of the air-chill system, as the motors and control panel are necessary to operate the chain conveyor to move the carcasses. The motors and frequency converter do not appear to be removable without damage to the superstructure, nor would they have nearly as much value apart from the superstructure. As cable television "house drops," T-V Transmission, Inc. v. Pawnee County Bd. of Equalization, 338 N.W.2d 752 (Neb. 1983), bolted-down irrigation pumps and motors, Cook v. Beermann 271 N.W.2d 459 (Neb. 1978), and opera chairs specially designed for the building and screwed to the floor, Oliver v. Lansing, 80 N.W. 829 (Neb. 1899), are considered to be fixtures under Nebraska law, so should the 18 drive gear motors and the frequency converter.

Having found the disputed items to be part of the fixture, the next question is the value of the superstructure. The value suggested by Dapec's appraiser is more reasonable and reliable than the value suggested by SBA's appraiser. The SBA appraiser depreciated the superstructure and the building by 55 percent of the original cost as of the time of the real estate sale, because the superstructure is attached to the building and the building's age is more than half of its useful life. This approach does not take into account the separate useful life of the superstructure. The SBA's appraiser testified that it is appropriate to depreciate the entire plant - building and superstructure - together. However, this logic is contrary to the approach used by appraisers in valuing a residential property. In that situation, the age of a furnace or the age of the roof, for example, would be considered separately, because those parts of a house generally need to be replaced during the life of the house. I understand there are differences between appraising residential and non-residential properties, but the point of the example is that not all parts of a building depreciate at the same rate. The superstructure was constructed more recently and of different material than the building, and cannot be said to be depreciating at the same rate as the building.

Both parties' experts agree that the value of the superstructure with the 18 drive gear motors and frequency converter, before depreciation, is \$411,589. Dapec's expert suggests a replacement cost less actual physical depreciation of 15 percent (one and one-half years of a 10-year life), resulting in a value of \$350,000. SBA's expert estimates the replacement value of the superstructure without the motors and frequency converter and depreciates the total by 55 percent, resulting in a value of \$125,000. SBA's position on replacement cost also excludes expenditures for labor. The replacement cost should include labor. A pile of stainless steel beams and tubing will not do the owner any good until skilled workers assemble it into a superstructure.

I find Dapec's estimation of the superstructure's contributory value to the real estate for purposes of determining the superstructure's proportionate share of the sale price to be supported by the facts and more reliable than the estimation offered by the SBA.

- B. Priority as between Dapec and SBA in the funds repaid by the City of Tecumseh

The Eighth Circuit Court of Appeals ruled that the City of Tecumseh's lien for water and sewer charges may or may not have priority over Dapec's construction lien. It also ruled that the

security interests of TMS and the SBA are superior to Dapec's construction lien. This creates a dispute regarding the parties' rights to the \$63,824.63 returned by the City of Tecumseh after conceding that its lien was unperfected. TMS argues that it is an oversecured creditor and therefore entitled to recover attorneys' fees and costs under 11 U.S.C. § 506(b).

As noted above, TMS held the first deed of trust on the property. The property sold for more than \$2.4 million. TMS had a claim of \$881,675.69 at the time of the distribution of the sale proceeds in July 2000. Since that time, it has incurred more than \$40,000 in attorneys' fees for the appeals and subsequent litigation.

Dapec objects to TMS's request. Dapec wants TMS to be bound by the terms of a June 2000 proposed order regarding distribution of sale proceeds, which was agreed to by all parties but Dapec. That proposed order would have authorized distribution of the proceeds to the first four lien creditors, including TMS, "in full satisfaction of their claim or interest in the proceeds received from the sale of the real estate," and upon payment, each creditor's claim or interest in the proceeds "shall be considered fully paid and discharged."

That proposed order was not entered. The court ruled on the fixture and construction lien priority issues, and then entered an order authorizing distribution of the sale proceeds consistently with those orders, as long as the City of Tecumseh consented and sufficient funds were withheld to protect the parties' interests pending a ruling on the priority of Tecumseh's lien for water and sewer charges.

The bankruptcy court subsequently ruled that Tecumseh's lien was superior to all but the county's claim for real estate taxes. Funds were distributed, but after the Court of Appeals remanded the matter of the water and sewer lien, Tecumseh repaid the money. Those funds in essence went back into the pot of money to be distributed among the creditors; they were not relinquished to or otherwise earmarked for payment to Dapec.

Under § 506(b), TMS is entitled to recover its reasonable costs and fees because its claim was oversecured. The reasonableness of those fees and costs will be determined after consideration of TMS's most recent application for compensation and objections, if any.

C. Bird Watchers' payment of real estate taxes

When the debtor's real and personal property was sold, Bird Watchers submitted a credit bid equal to its first lien of \$2,329,386.37 for the personal property and a high bid of \$2,470,000 for the real property. It then bid \$4,800,000 for the real and personal property as a package, which was accepted and the sale confirmed.

As of the petition date, the debtor owed Johnson County more than \$100,000 in real and personal property taxes. The real estate taxes were paid from the sale proceeds, but the personal property taxes were not. However, it appears that Johnson County did not receive notice of motions filed early in the case and was unable to object to the treatment of its claims. Upon a post-sale motion by Johnson County, the court ruled that Johnson County's personal property tax lien, if any, was deemed to have continued and to be enforceable under Nebraska law, and was superior to Bird Watchers' U.C.C. security interest from Heller. That decision was affirmed by the Eighth Circuit Court of Appeals. Bird Watchers, L.L.C. v. Johnson County, Nebraska (In re MBA Poultry, L.L.C.), 295 F.3d 886 (8th Cir. 2002).

At some point, Bird Watchers paid the taxes and now asserts that it is entitled to recover that amount from the estate because it did not receive the full payment of its claim. Because the financing statement filed by Heller to evidence its security interest in fixtures and equipment preceded Dapec's U.C.C. filing, Bird Watchers believes it has a superior claim to a portion of the proceeds relating to the superstructure.

The final order authorizing the debtor to use cash collateral, incur post-petition debt and provide security to Bird Watchers' predecessor-in-interest, Heller Financial, states that:

Upon the sale of all of the Equipment, . . . Dapec shall be entitled to assert (or continue to assert) its Dapec liens and the claims underlying them against the estate (but not against [Heller] and not, unless and until [Heller's pre- and post-petition debt] is indefeasibly and finally paid in full, against the [pre- and post-petition collateral, including equipment and fixtures]).

¶ 4(b) at 9 (Fils. #37 & #294).

Bird Watchers argues that, although it received payment in full of its claim upon confirmation of the sale, because it subsequently paid \$130,789.35 in property taxes, its claim has not been "indefeasibly and finally paid in full."

The order confirming the sale of the property to Bird Watchers approved the sale free and clear of all liens, claims and encumbrances. Only later was Johnson County found to have a personal property tax lien with priority over Bird Watchers' interest. If Bird Watchers is not reimbursed for the amount of personal property taxes it paid, then it did not receive the property free and clear of liens, contrary to a court order. Bird Watchers is therefore entitled to recover \$130,789.35 from Dapec.

II. Conclusion

For the reasons stated above, I find that the motors and frequency converter are part of the fixture. The value of the superstructure at the time of sale was \$350,000. The SBA has acknowledged that it will be required to pay that amount into the estate for distribution to Dapec. Bird Watchers is entitled to recover \$130,789.35 from Dapec for payment of the debtor's personal property taxes. TMS, as an oversecured creditor, is entitled to recover its reasonable costs and attorney fees. It has filed a renewed application for compensation at Filing #338; the objection deadline is June 5, 2006. A hearing will be set if necessary, and the matter will be ruled on in due course.

The following chart illustrates a proposed distribution of the sale proceeds based on the findings above. It treats the proceeds, including the \$900 of interest earned on the funds repaid by the City of Tecumseh, as having all been put back into the pot for redistribution as if the priorities as now determined had been in place at the time of the sale.

		Balance
Available proceeds, including subsequent interest on amount disgorged by City of Tecumseh		\$2,480,009.47
Johnson County (real estate taxes)	\$56,676.55	\$2,423,332.92
Johnson County (personal property taxes)/Bird Watchers	\$130,789.35	\$2,292,543.57
Dapec fixture lien (\$350,000 less the \$130,789.35 in personal property taxes paid by Bird Watchers)	\$219,210.65	\$2,073,332.92

The Money Store, including for the sake of these calculations a round number of \$45,000 for fees and costs	\$926,675.69	\$1,146,657.23
American National Bank	\$534,199.27	\$612,457.96
SBA	\$592,733.33	\$19,724.63
Dapec's construction lien	\$295,176.00	\$0.00

To accomplish this distribution, SBA should pay \$350,000 into the registry of the court. The Clerk will then have \$414,724.40, plus subsequent accrued interest, to distribute as follows: \$130,789.35 to Bird Watchers, \$219,210.65 to Dapec on its fixture filing, an amount to be determined to TMS for its attorney fees, and the balance to Dapec on its construction lien. No money needs to change hands until an order is entered on TMS's request for compensation, final judgment has been determined, and all appeal times have run.

Because SBA is required to disgorge funds as a result of this ruling, it asserts that TMS's lien should be equitably subordinated because it assigned to the SBA a deed of trust that it had subordinated to Dapec. This is a contractual dispute between two creditors and does not involve the bankruptcy estate, so the parties will litigate it outside the bankruptcy court.

This is not a final order for appeal purposes. Judgment will be entered on the matters encompassed in this order after ruling is made on TMS's renewed application for compensation.

DATED: May 23, 2006

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:
Gerald Laughlin
Tom Cohen
Emmett Childers
Gregg Stratman
Kevin Siebert
United States Trustee