IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF: HARRY & LARRY MARONDE PARTNERSHIP, Debtor(s).	)	CASE NO. BK00-41338
AMERICAN LEASING, INC., Plaintiff, vs. HARRY & LARRY MARONDE PARTNERSHIP; HARRY MARONDE; LARRY MARONDE; AND YORK STATE BANK, Defendants.	)	A00-4067 CH. 12
IN THE MATTER OF: HARRY & RUTH MARONDE, Debtor(s).	)	CASE NO. BK00-41339
AMERICAN LEASING, INC., Plaintiff, vs. HARRY & LARRY MARONDE PARTNERSHIP; HARRY MARONDE, LARRY MARONDE, AND YORK STATE BANK, Defendants.	)	A00-4068 CH. 7

MEMORANDUM

Trial was held in Omaha, Nebraska, on the adversary complaint. William Klimisch appeared for American Leasing, Inc.,

and Ronald Eggers appeared for York State Bank. This memorandum contains findings of fact and conclusions of law required by Fed. R. Bankr. P. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(K).

Decision

Judgment will be entered in favor of York State Bank as to the proceeds of the market hogs and replacement sows, and in favor of American Leasing, Inc. as to the leased sows.

Issue

American Leasing and York State Bank hold competing claims to the proceeds of the sale of market hogs raised by the debtors and the sale of sows belonging to American Leasing. American Leasing leased sows to Harry Maronde and Larry Maronde, and was to be paid with a percentage of the offspring or the proceeds thereof. York State Bank holds a blanket security interest in all livestock owned by the Marondes. There are two issues to be decided. First, how much, if any, of the proceeds of the sale of sows is American Leasing entitled to? Second, which creditor has the prior perfected security interest in the market hogs sold? The dispute centers on whether the lease is a true lease or a disguised security agreement.

Background

Larry and Harry Maronde are row crop and hog farmers. York State Bank has been their lender since 1991. Loans were secured, in part, by a blanket lien on all of the Marondes' livestock. To perfect its interest, the bank filed financing statements with the Nebraska Secretary of State and the York County Clerk in 1991 and continued them thereafter. These financing statements named Larry Maronde and Harry Maronde as individuals. In January 1998, the bank first filed a financing statement naming "Harry G. Maronde and Larry A. Maronde, A Partnership."

The Marondes had sows of their own, but sought to expand their hog operation, so they entered into an agreement with American Leasing in November 1997 to lease female swine for breeding. The lease names Larry Maronde and Harry Maronde as lessees. American Leasing delivered 331 gilts to the Maronde farm between November 5, 1997 and March 16, 1998, so the

Marondes could farrow[1] approximately 55 litters at a time on a continuous rotation. The lease was expected to run for at least four but no more than five litters.

American Leasing filed a Nebraska Effective Financing Statement with the Nebraska Secretary of State in January 1997, and with the County Clerk in York County on November 12, 1997.

The terms of the lease agreement stated that the Marondes would pay American Leasing two isowean[2] pigs per litter per sow. However, the parties agreed that, rather than deliver two pigs per litter to American Leasing, the Marondes could simply finish the pigs to market weight and pay American Leasing for them when they were sold.

As part of that arrangement, American Leasing was named as a payee on checks whenever the Marondes sold hogs. In the early months of the lease between the parties, the hogs being sold by the Marondes were from their own herd, so American Leasing authorized the buyer to not put American Leasing's name on the checks. Later, when the hogs sold were offspring of American Leasing stock, the checks were made out to the Marondes and American Leasing. American Leasing endorsed and cashed the checks, keeping what it was owed and refunding the balance to the Marondes.

Eventually, American Leasing was no longer included on the checks. The Marondes told American Leasing this was because they were not selling many hogs. American Leasing later learned the debtors were in fact selling hogs, but under the partnership name instead of their individual names.

At the time American Leasing and the Marondes entered into the lease agreement, American Leasing had reviewed the Marondes' financial statement and was aware of an existing hog-related debt to York State Bank. The bank was informed of the lease agreement and of American Leasing's ownership of the sows. However, the bank considered all of the non-leased hogs to be covered by the bank's security interest. When American Leasing inquired of the Marondes about late payments on the lease, the Marondes often explained that the bank wanted payment on its

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[1]Produce a litter of piglets.

[2]Isowean pigs are early-weaned pigs less than 21 days old.

note, so some of the proceeds from hog sales were going to the bank instead of to American Leasing.

In the fall of 1998, the debtors suffered significant set-backs related to the health of their swine herd. Two contagious diseases causing high mortality rates in young pigs – transmissible gastroenteritis (TGE) and porcine reproductive and respiratory syndrome virus (PRRS) – were diagnosed in the herd. As a result, fewer litters were born and fewer pigs from the litters that were born survived to or beyond weaning. In addition, 80 of the leased sows died. The Marondes intended to replace those 80, and did replace some of them, with gilts which would otherwise have been sold as butcher hogs. The gilts included offspring of the American Leasing sows as well as of the Marondes' home-raised sows.

American Leasing's owner made bi-monthly visits to the Maronde farm to check on the leased sows. On each of those visits, he took an inventory of the livestock. American Leasing was short 99 leased sows when it repossessed the animals from the debtors. This number represents the 80 that died and 19 others that were sold with the proceeds put into escrow.

American Leasing apparently believes it should have received 200 sows, or the proceeds thereof, when it repossessed the sows. It took and sold 101 head, and considers 99 missing. Other leased sows were culled during the course of the lease, which may explain the discrepancy between the original number of leased sows and the number American Leasing expected at the end of the lease. After the filing of these bankruptcy cases, American Leasing retrieved some (101 head) of the leased sows from the debtors and sold them. The remaining sows and pigs were sold and the proceeds of $44,000 are presently held in a trust account at the bank pending the outcome of this lawsuit.

Discussion

The dispute involves two distinct groups of livestock, one being the leased sows and the other being the sows and pigs sold by the bank. American Leasing is claiming that it should be compensated from the escrowed proceeds the value of 80 replacement sows for the 80 leased sows that died. American Leasing is also making a claim against the escrowed proceeds for payment for the pigs owed to American Leasing as rental for the leased sows.

The determination of whether an agreement constitutes a security agreement or a lease is a question of state law. Nebraska U.C.C. § 1-201(37) provides a road map for making such a determination. That section states:

> "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The term also includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to article 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under section 2-401 is not a "security interest", but a buyer may also acquire a "security interest" by complying with article 9. Except as otherwise provided in section 2-505, the right of a seller or lessor of goods under article 2 or 2A to retain or acquire possession of the goods is not a "security interest", but a seller or lessor may also acquire a "security interest" by complying with article 9. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (section 2-401) is limited in effect to a reservation of a "security interest".
>
> Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and
>
> (a) the original term of the lease is equal to or greater than the remaining economic life of the goods,
>
> (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,
>
> (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
>
> (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

> A transaction does not create a security interest merely because it provides that
>
> (a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,
>
> (b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,
>
> (c) the lessee has an option to renew the lease or to become the owner of the goods,
>
> (d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or
>
> (e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.
>
> For purposes of this subsection (37):
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> * * *
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> (y) "Reasonably predictable" and "remaining economic life of the goods" are to be determined with reference to the facts and circumstances at the time the transaction is entered into;
>
> * * *

Neb. U.C.C. § 1-201(37) (Michie 2000).

Under U.C.C. § 1-201(37), a lease creates a security interest if (1) the lessee does not have the right to terminate the lease and is obligated to make payments for the full lease term, and (2) one of the four conditions enumerated as the first set (a) through (d) is met. In re Super Feeders, Inc., 236 B.R. 267, 270 (Bankr. D. Neb. 1999).

In the present case, it appears that the lease between the parties operates as a true lease as to the breeding stock provided by American Leasing, but as a security agreement as to the isowean pigs due as rental payment for the sows after each farrowing. Because the plaintiff's security interest was not properly perfected, the plaintiff's claim to proceeds of the

sale of the pigs is not valid. Moreover, because the bank's perfected security interest covered all of the Marondes' non-leased hogs, the bank also has superior rights to the 80 replacement sows.

The terms of the lease agreement provide that the Marondes were to bear the financial responsibility for the leased sows. They were to pay all veterinary expenses for the animals, as well as compensate for any loss of or damage to the animals (other than loss arising due to wind or fire) by supplying the plaintiff with three feeder pigs for each sow lost or injured. See Lease Agreement at ¶¶ 4 and 9 (Ex. 3). The record is not entirely clear on this point, but there is no dispute that the Marondes did not reimburse or intend to reimburse American Leasing 240 pigs for the 80 sows that died. It does not appear that the 80 were replaced with 80 other sows or gilts, either.

The terms of the lease also permit the Marondes to terminate the lease after the third litter by returning the same number of sows as were originally leased. See Lease at ¶ 12. The sows were to weigh a minimum of 400 pounds and were to be delivered to a location in the lessee's area. If any sow weighed less than 400 pounds, the lessee was to pay the difference in value as compared to the top market price in Omaha on the day of termination. This suggests that the plaintiff would sell the sows upon termination of the lease rather than take possession of them for future breeding.

The lease permits American Leasing to terminate the lease and take possession of all leased livestock and the offspring to which it is entitled upon default or upon the lessee's failure to provide proper care for the animals. See Lease at ¶¶ 11 and 14.

Nothing in the lease agreement indicates that the Marondes could have purchased the sows at the end of the lease term or renewed the agreement. The length of the lease term covers the production of four to five litters per sow. American Leasing argues that because the sows sold in November 2000 for an average price of $152.92 per head, they were still within their economic life. However, they appear to have been sold for slaughter, at an average weight of 522 pounds. The only testimony at trial regarding the economic life of female breeding swine was from the bank officer, who testified that after a sow farrows four or five litters, her size becomes a factor, as she is likely to outgrow the physical facilities and

is more prone to cause mortality in the litter by accidentally laying on piglets. Therefore, the evidence indicates that there was little, if any, economic life available in the sows as breeding stock at the end of the stated lease term.

The Super Feeders test, supra, finds a security agreement instead of a lease if the lessee cannot terminate the lease and if either (i) the length of the lease is for the full economic life of the goods or (ii) the lessee can renew the lease or purchase the goods for little or no additional money at the end of the lease. In this case, although the lease was for essentially the full economic life of the sows, the Marondes had the right to terminate the lease after three litters if they so desired. Therefore, the agreement at issue does not constitute a security agreement as a matter of law as to the sows.

The record is clear that 19 of the missing 99 sows belonging to American Leasing were sold by the Marondes and the proceeds placed into the escrow account at issue here. Those proceeds clearly should be turned over to the plaintiff.

Of the 80 sows alleged by American Leasing to be serving as replacements for the original American Leasing stock that died, it is difficult to determine how many were sold and the proceeds placed in the escrow account. The difficulty lies in the absence of a specific designation of replacement sows by the Marondes. Even Mr. Maronde was not sure which animals in the herd were intended to be replacement animals for American Leasing. If Mr. Maronde did not identify specific gilts or sows as replacement animals for the American Leasing sows that died, the bank would have no way to distinguish “replacement leased sows” from “owned sows” in its collateral records. However, as discussed below, this does not really matter. Because the replacement sows were from the litters born to the leased and home-raised sows, the bank’s perfected security interest attached ahead of American Leasing’s unperfected interest.

The plaintiff bears the burden of proving how many of the sows sold were American Leasing’s property. Nothing in the record establishes which sows were replacement animals, and evidently neither the debtors, the plaintiff, nor the bank was ever sure specifically which sows, other than the sows delivered at the beginning of the lease, belonged to American Leasing. Other than the 19 head referred to above, the plaintiff has failed to meet its burden as to its allegation that the bank holds proceeds from the sale of sows belonging to American

Leasing.

Although the lease agreement is clearly a lease as to the original sows, the agreement attempted to create a security interest in favor of American Leasing as to the isowean piglets owed it as lease payments for the sows. However, that interest was not properly perfected.

By the terms of the lease, American Leasing retained title and ownership of the leased sows and "all replacements, offsprings or additions thereto . . . until such time as the litters are divided and [American Leasing] paid pursuant to [¶ 3 of the agreement] at which time the remaining portion of the litter shall become the property of the Lessees." Lease at ¶ 5. To protect its interest, it filed a Nebraska Effective Financing Statement (EFS-1) with the county clerk a few days after delivering the sows to the Marondes. Mr. Larry Rupiper, president of American Leasing, testified that his company has not filed a UCC-1 form in Nebraska in the last eight or nine years, relying instead on the EFS-1 filing.

First, the U.C.C. specifically limits a seller's ability to reserve title once the seller has surrendered possession to a purchaser and dictates that even when title is reserved, the effect of such a reservation is the retention of a security interest. Neb. U.C.C. § 2-401; Maryott v. Oconto Cattle Co., 259 Neb. 41, 48, 607 N.W.2d 820, 825-26 (2000).

Second, the security interest must be properly perfected. Filing an EFS does not accomplish that. The EFS is the document by which the federal Food Security Act ("FSA") protects buyers of farm products in the ordinary course of business. The FSA does nothing to alter U.C.C. requirements for perfecting a lien or security interest. In other words,

> the only persons entitled to protection under the FSA are those who are strictly buyers in the ordinary course of business. Thus, it has been held that where a party is acting as a creditor or junior lienholder, that party cannot claim protection as a buyer in the ordinary course of business under the FSA. . . . Furthermore, it is clear that the FSA is not meant to preempt or interfere with other provisions of the U.C.C. regarding the creation, perfection, and priority of security interests.

Battle Creek State Bank v. Preusker, 253 Neb. 502, 509, 571 N.W.2d 294, 299-300 (1997) (citations omitted).

That proposition is clearly applicable here. American Leasing is not a buyer of farm products in this situation. Rather, it is a creditor. As such, it was subject to the same U.C.C. requirements as the bank regarding the creation, perfection, and priority of security interests. The bank's properly filed and continued financing statements perfect its security interest in all of the Marondes' livestock, including the offspring of the leased sows, and that perfected security interest is superior to American Leasing's interest in the animals. To the extent plaintiff argues that the bank did not obtain a security interest in the partnership's livestock until after the Marondes entered into the lease with American Leasing, and prior to that time had security interests only in the assets of the Marondes as individuals, the argument is unavailing. Regardless of when the bank filed a financing statement in the name of the partnership, the fact remains that the bank filed one while American Leasing did not. The bank thereby perfected its interest while American Leasing did not, and American Leasing cannot support a priority argument on that ground.

Separate judgment will be entered in favor of the bank as to the proceeds of the market hogs and replacement sows, and in favor of American Leasing as to the proceeds of 19 of the leased sows. That amount is $2,905.48, which represents 19 head at $152.92 per head.

DATED: August 22, 2002

BY THE COURT:

/s/Timothy J. Mahoney
Chief Judge

Notice given by the Court to:
*William Klimisch
Ronald Eggers
W. Eric Wood
Richard Lydick
U.S. Trustee

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

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FOR THE DISTRICT OF NEBRASKA

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AMERICAN LEASING, INC., Plaintiff, vs. HARRY & LARRY MARONDE PARTNERSHIP; HARRY MARONDE; LARRY MARONDE; AND YORK STATE BANK, Defendants.	)	A00-4067 CH. 12
IN THE MATTER OF: HARRY & RUTH MARONDE, Debtor(s).	)	CASE NO. BK00-41339
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JUDGMENT

Trial was held in Omaha, Nebraska, on the adversary complaint. William Klimisch appeared for American Leasing, Inc., and Ronald Eggers appeared for York State Bank.

Judgment is hereby entered in favor of York State Bank as to the proceeds of the market hogs and replacement sows. York State Bank holds a prior perfected security interest in the hogs owned by the Marondes and the proceeds therefrom.

Judgment is hereby entered in favor of American Leasing, Inc. for $2,905.48 representing the escrowed proceeds of the 19 American Leasing sows sold.

See Memorandum entered this date.

DATED: August 22, 2002

BY THE COURT:

/s/Timothy J. Mahoney
Chief Judge

Notice given by the Court to:
*William Klimisch
Ronald Eggers
W. Eric Wood
Richard Lydick
U.S. Trustee

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