

IN THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF NEBRASKA

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OCT 1 1986

IN RE:

LAWRENCE JENSEN and RUTH
JENSEN,

Debtors.

FEDERAL DEPOSIT INSURANCE
CORPORATION, etc.,

Plaintiff,

v.

NEU CHEESE CO.,

Defendant.

IN RE:

LAWRENCE JENSEN and RUTH
JENSEN,

Debtors.

FEDERAL DEPOSIT INSURANCE
CORPORATION, etc.,

Plaintiff,

v.

NEU CHEESE CO.,

Defendant.

UNITED STATES BANKRUPTCY CLERK
FOR THE DISTRICT OF NEBRASKA
OMAHA

CV. 85-0-445

BK. 83-1816

ADV. 84-42

FILED	
DISTRICT OF NEBRASKA	
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SEP 30 1986	
William L. Olson, Clerk	
By	Deputy

CV. 85-0-470

BK. 83-1816

ADV. 84-42

Reversed 87:158

MEMORANDUM AND ORDER



This matter is before the Court on appeal from a final order of the Bankruptcy Court evidenced by a journal entry dated April 9, 1985, and a judgment dated April 10, 1985. At the conclusion of a hearing held on April 9, 1985, the United States Bankruptcy Judge for the District of Nebraska, David L. Crawford, held the Federal Deposit Insurance Corporation (FDIC) as receiver

and successor in interest of the Bank of Verdigre and Trust Company (Bank) should recover from the Neu Cheese Company the sum of \$63,368.71. On appeal, Neu Cheese argues Judge Crawford erroneously found the Bank held an interest in collateral, and its proceeds, which was sold to the Company by the debtors, Lawrence and Ruth Jensen.

On cross-appeal, the FDIC asserts Judge Crawford correctly found in its favor with respect to its security interest. The FDIC argues, however, that Judge Crawford applied the wrong statute of limitations in determining the amount owed. After careful consideration of the briefs submitted by the parties and the record on appeal, this Court finds the Bankruptcy Court's order should be affirmed.

The underlying facts pertinent to these appeals are undisputed and were stipulated to by the parties prior to the Bankruptcy Court ruling. Neu Cheese is a dairy located in Hartington, Nebraska, which purchases milk from farmers within an eighty-mile radius of Hartington and manufactures it into specialty cheeses. The FDIC is the receiver of the Bank by virtue of an order of the District Court of Knox County, Nebraska. The Bank was located in Verdigre, Nebraska, forty miles west of Hartington. Lawrence Jensen, bankrupt, was a dairy farmer who was engaged in farming operations. During the last few years of his operations, he sold his milk to Neu Cheese. He was a loan customer of the Bank continuously from 1964 through 1983, and throughout this period, the Bank knew him to be engaged in the dairy business.

From 1964 through January of 1980, Lawrence Jensen owed the bank amounts varying from zero in 1977 to \$180,150.30. On October 19, 1984, Mr. Jensen filed bankruptcy owing the Bank \$174,816.70. The Bank has received \$22,583.56 from the sale of livestock and machinery and expects to recover another \$20,889.79 from the Trustee for Ruth Jensen on her guarantee of the indebtedness of Lawrence Jensen, leaving a balance of \$131,343.35.

To secure his indebtedness, Mr. Jensen executed and delivered to the Bank security agreements which granted the Bank a security interest in all farm products. The security agreements specifically provided for a security interest in all the debtors' milk cows, the milk produced therefrom and the proceeds from the sale of the milk. Financing statements or continuation statements evidencing the security agreements were duly recorded in the proper offices of various county clerks. Accordingly, the Bank held a properly perfected security interest in the milk, a farm product, produced by Lawrence Jensen. From January 4, 1980, through January 4, 1984, Lawrence Jensen sold, to Neu Cheese, milk in which the Bank had a properly perfected security interest. Neu Cheese paid for the milk with checks made payable solely to the debtor. Mr. Jensen deposited most of those checks in his checking account at the Bank. He never applied the checks from Neu Cheese directly to his indebtedness to the Bank.

Neu Cheese did not determine at any time whether there existed any financing statements or security interests in Jensen's milk. The Bank did not request an assignment of the

milk proceeds from the debtor at any time during its relationship with Mr. Jensen, nor did the Bank object to any sale or purchase of such milk. Additionally, no written documents exist between the Bank, Neu Cheese and Lawrence Jensen authorizing the disposition of the milk free of the Bank's security interest.

In this particular adversary proceeding, the FDIC contends that Neu Cheese wrongfully converted the milk by assuming and exercising dominion and ownership over the milk without the authority of the Bank. The FDIC contends that the applicable statute of limitations in this case is found at Neb.Rev.Stat. §25-207(2), which provides for a four-year limitation period. Neu Cheese on the other hand, argues the statute of limitations is governed by Neb.Rev.Stat. § 25-205(2), as amended, which provides for an eighteen-month statute. The parties agreed that if the four-year statute is applicable, net milk proceeds paid to Jensen totalled \$198,453.91, and if the eighteen-month period is applicable, the net proceeds equaled \$63,368.71.

At the conclusion of the hearing below, Judge Crawford found for the FDIC in the amount of \$63,368.71. He held that Neu Cheese purchased the milk subject to the Bank's security interest. While Neu Cheese may not have had actual notice of the Bank's security interest, it was on constructive notice of the interest held by the Bank due to the properly filed financing and continuation statements. Additionally, he found no evidence in the record supporting Neu Cheese's argument that the Bank waived

its security interest in the collateral. Finally, Judge Crawford applied the eighteen-month statute of limitations in awarding the money damages.

On appeal, Neu Cheese argues that the Bankruptcy Court erred in finding no waiver. The company contends the Bank waived its security interest in the collateral through its course of dealing with Mr. Jensen. The FDIC, on the other hand, asserts Judge Crawford properly ruled on the liability issue, but applied the wrong statute of limitations in assessing damages.

Before this Court addresses the merit of the appeals, it is prudent to state the general standard of review that guides the Court in matters such as this. On appeal, a district court is not bound by the Bankruptcy Judge's conclusions of law; however, the Bankruptcy Judge's findings of fact are entitled to stand unless clearly erroneous. In re American Beef Packers, Inc., 457 F.Supp. 313, 314 (D.Neb. 1978); see also Bankruptcy Rule of Procedure 8013.

With this standard in mind, this Court must first determine whether the Bankruptcy Court erred in finding that no waiver of the Bank's security interest occurred. The Court notes, and the parties, concede the security agreements required that Mr. Jensen obtain from the Bank written consent for any sale or disposition of the milk. Furthermore, the parties agreed no written consent was given. Neu Cheese argues, however, the Bank could and did impliedly waive the requirement of written consent and thus its security interest in the collateral when Mr. Jensen was allowed to sell his milk over the years without written

consent. Furthermore, the Company asserts the Bank was fully aware of the sales because the debtor deposited most of the proceeds in his account with the Bank.

Neu Cheese relies upon Section 9-306(2) of the Nebraska Uniform Commercial Code in arguing that a waiver occurred.

Section 9-306(2) (Reissue 1980) reads:

Except where this article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

The Nebraska Supreme Court has interpreted the "or otherwise" term to mean that a secured party can waive written consent, and thus its security interest, through its course of dealing with the debtor. *State Bank v. Scoular-Bishop Grain Co.*, 217 Neb. 379, 349 N.W.2d 912 (1984)(Scoular-Bishop I). In a second case involving the Scoular-Bishop Grain Company, the State Supreme Court held:

Waiver has been defined as a voluntary and intentional relinquishment or abandonment or a known existing legal right, advantage, benefit, claim, or privilege, which except for such waiver, the party would have enjoyed; the voluntary abandonment or surrender, by a capable person, or a right known by him to exist, with the intent that such right shall be surrendered and such person forever deprived of its benefit; or such conduct as warrants an inference of the relinquishment of such rights; or the intentional doing of an act inconsistent with claiming it.

Five Points Bank v. Scoular-Bishop Grain Co., 217 Neb. 677, 681, 350 N.W.2d 549, 552 (1984)(Scoular-Bishop II). In both cases, the court held that an implied waiver through a course of dealing should be found with extreme hesitancy and must be shown by clear and convincing evidence.

With this standard of proof in mind, Judge Crawford ruled Neu Cheese had failed to produce evidence sufficient to establish a waiver on the part of the Bank. This Court does not conclude that such a finding was clearly erroneous. Upon review of the record, it appears the Bank knew or should have known that Mr. Jensen was selling his milk without written approval. Over the course of their relationship, approximately five hundred checks drawn in payment for his milk were delivered to the debtor, who in turn deposited the checks in his account with the Bank. The record also indicates the Bank raised no objection to the sales. Mere acquiescence, however, is insufficient to establish waiver. Scoular-Bishop I, 349 N.W.2d at 217. Neu Cheese was required to prove through clear and convincing evidence that the course of dealing between Mr. Jensen and the Bank amounted to a voluntary and intentional relinquishment by the secured party of a known and existing right. Id. Judge Crawford held the Company failed to meet its burden and this Court does not conclude his holding was clearly in error.

As noted above, the FDIC cross-appealed from the Bankruptcy Court's determination of the applicable statute of limitation. The Bankruptcy Court ruled that the applicable statute of limitation was the eighteen-month period provided in

Section 25-205(2), R.R.S., as amended. The FDIC argues the correct statute of limitation is the four-year period set forth in Section 25-207, R.R.S., as amended. The pertinent portions of the statutory sections read:

25-205. Actions on written contracts, foreign judgments. (1) Except as provided in subsection (2) of this section, an action upon a specialty, or any agreement, contract, or promise in writing, or foreign judgment, can only be brought within five years * * *.

(2) An action to recover collateral (a) the possession and ownership of which a debtor has in any manner transferred to another person and (b) which was used as security for payment pursuant to an agreement, contract, or promise in writing which covers farm products, as described in Section 9-109, Uniform Commercial Code, or farm products which become inventory of a person engaged in farming, shall be brought within eighteen months from the date possession and ownership of such collateral was transferred.

25-207. Actions for trespass, conversion, other torts; fraud; exceptions. The following actions can only be brought within four years: (1) An action for trespass upon real property; (2) an action for taking, detaining or injuring personal property, including actions for the specific recovery of personal property * * *.

The FDIC sets forth three reasons in support of its argument that the Bankruptcy Court erred. First, it claims Section 25-205(2) applies only to contract actions. This is a tort action for a conversion and is specifically covered by Section 25-207. Next, the former statute only applies to actions for recovery or replevin of collateral. The present action is

one for damages resulting from the unlawful conversion, rather than an action for replevin of the converted collateral.

Finally, the legislative history of Section 25-205(2) indicates the section was intended only to apply to actions for the recovery of possession of farm products. It does not apply to suits for damages.

Section 25-205(2) became effective July 1, 1983. To date, the Nebraska Supreme Court has not decided any case wherein the statute was applied. Accordingly, this Court will look to the legislative history proceeding the enactment of the statute. As noted by the FDIC in its brief, the section was adopted out of a concern for the "double jeopardy" problem that buyers of farm products are exposed to due to the interplay between Sections 9-306 and 9-307 of the U.C.C. As was held above, a purchaser of collateral takes subject to any security interest which may exist in that collateral. If the security interest is not relinquished through waiver, a purchaser of the goods can be held responsible for the debt owed to the secured party, even though the purchaser paid in full for the goods. Section 9-307(1) limits the burden imposed on such a purchaser. A buyer in the ordinary course of business (see U.C.C. § 1-201(9)) takes free of a security interest created by a seller even though the security interest is perfected and even though the buyer knows of its existence. This exception to Section 9-306(2), however, does not apply to a person buying farm products from a person engaged in farming operations.

On March 3, 1983, the Banking, Commerce and Insurance Committee to the Nebraska Legislature held a hearing on both LB 117 (a proposed amendment to Section 9-307(1)) and LB 343 (a proposed amendment to Section 25-205(2)). The "double jeopardy" problem was a major focus of the hearing. Representatives of the agricultural industry supported the elimination of the § 9-307 farm products exception by relating stories about purchasers of farm products being subjected to claims, long after the purchase, for conversion of collateral and double payment. (March 3, 1983, hearing, Tr. 4, 6, 13, 15, 17-19, 21-22). The Nebraska Bankers Association, while opposing eliminating of the farm products exception, supported the shortening of the statute of limitations relating to such actions from five years to two years. (March 3, 1983, hearing, Tr. 28, 41):

Mr. Brandt [General Counsel and Lobbyist
for Nebraska Bankers Association]:
" * * * We have agreed to * * * the
lowering the statute of limitations.
That's in the amendments to 343."

Ultimately, the Nebraska Legislature enacted Section 25-205(2) as a compromise between totally eliminating the farm products exception and lowering the statute of limitations to two years. The eighteen-month period of limitation was, in effect, a compromise between the two-year period agreed to by the Nebraska Bankers Association and the one-year limitation discussed by the Legislature. (See March 3, 1983, hearing, Tr. 43).


Upon review of the legislative history, it appears Judge Crawford was correct in ruling that the eighteen-month statute of limitations applied to the FDIC's claim against Neu

Cheese. The Court believes Section 25-205(2) was intended to apply to all actions brought by a secured party against purchasers of farm products to recover their security interest in the collateral, including both replevin and conversion actions. Many farm products are perishable and replevin after thirty or sixty days would be a fruitless action. As is the case here, a suit in replevin to recover milk would be futile because the property would spoil before a court could address the merits of the claim. Thus, the amendment to Section 25-205(2) would be rendered meaningless if it were not also applied to actions for conversion of farm products. Accordingly,

IT IS HEREBY ORDERED that the Bankruptcy Court's ruling against Neu Cheese in the amount of \$63,368.71 is affirmed.

DATED this 30th day of September, 1986.

BY THE COURT:

A handwritten signature in cursive script, appearing to read "Lyle E. Strom", is written over a horizontal line.

LYLE E. STROM
UNITED STATES DISTRICT JUDGE