

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF

ORIN ABENDROTH and
MARTHA ABENDROTH,

DEBTORS

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CASE NO. BK85-258

MEMORANDUM OPINION

This matter came on for hearing on July 29, 1986, on the debtor's objections to the claims of the Federal Land Bank of Omaha and of the Citizens Bank of Bancroft, Nebraska. A combined hearing on both objections was held. Appearing on behalf of the debtor was David Hahn of the Hahn Law Offices, Lincoln, Nebraska. Appearing on behalf of the Federal Land Bank of Omaha was Terrence Michael of Baird, Holm, McEachen, Pederson, Hamann, and Strasheim, Omaha, Nebraska. Appearing on behalf of the Citizens Bank of Bancroft, Nebraska, were John Green and Mitchell Pirnie of Nelson & Harding, Omaha, Nebraska.

Findings of Fact

A. The Citizens Bank of Bancroft, Nebraska, was the holder of a claim against Orin and Martha Abendroth (the "debtors") in the approximate amount of \$126,790.99. This claim was secured by a mortgage on approximately 130 acres of farm land located in Cuming County, Nebraska, and a security interest in the debtors' farm equipment. Prior to the filing of a Chapter 11 petition by the debtors on February 5, 1985, the Citizens Bank initiated in the District Court of Cuming County, Nebraska, a mortgage foreclosure action and a replevin action with regard to the aforementioned secured property. Both actions were filed on September 28, 1984, four months before the debtors filed their Chapter 11 petition. On October 31, 1984, the Cuming County District Court entered an order in replevin, and subsequently the Citizens Bank obtained possession of the collateral pursuant to the order. On November 5, 1984, the debtors filed a motion to remove the action to the United States District Court for the District of Nebraska. On motion of the Citizens Bank the United States District Court remanded the case to the Cuming County District Court, indicating in its order that the case had been improvidently removed. On April 23, 1985, this Court sustained the motion of the Citizens Bank for relief from the stay that had been imposed both with regard to the real property and the farm equipment and personal property of the debtor. On June 3 and June

5, 1985, the debtors filed a motion to compel, a motion to strike, and a motion for protection and due process with the Cuming County District Court. On July 11, the Cuming County District Court entered a judgment of replevin in favor of the Citizens Bank against the debtors, as well as a decree of foreclosure. On July 31, 1985, debtors filed a motion to vacate with the Cuming County District Court, and on August 21, 1985, the debtors filed a motion for summary judgment. On August 30, 1985, Citizens Bank filed a motion to strike, and on September 5, the District Court of Cuming County granted the motion to strike and denied the debtors' motion to vacate and set aside judgment. On September 13, 1985, notice of sale was given to the debtors and other parties, and on September 26, 1985, a sale of the personal property of the debtors was held. On September 24, 1985, the real property subject to the mortgage of Citizens Bank was sold at a sheriff's sale. Citizens Bank was the highest bidder at the sheriff's sale with a bid of \$26,500, which sale was confirmed by the District Court of Cuming County, Nebraska, on October 10, 1985. After application of the net proceeds received from the sale of the real property and personal property of the debtors, the Citizens Bank seeks to be adjudged the holder of an unsecured claim in this case in the approximate amount of \$91,772.18. The debtor has filed an objection to this claim on the grounds that the Citizens Bank, by holding the personal property collateral for an extended period of time, constructively elected to keep the collateral in full satisfaction of the debt, or in the alternative, that the Citizens Bank did not hold and prepare the collateral for sale in a commercially reasonable manner.

B. On January 28, 1978, the debtors entered into a promissory note and loan agreement with the Federal Land Bank of Omaha, which note was secured by a first real estate mortgage on 80 acres of farm land located in Cuming County, Nebraska, and a possessory lien on Federal Land Bank stock. As of February 5, 1985, the date of the debtors' filing of a Chapter 11 petition, the amount owed by the debtors to the Federal Land Bank was \$79,423.80, which sum included interest and reflected credit given for the Federal Land Bank stock. On May 27, 1985, this Court granted the Federal Land Bank relief from the stay. The Federal Land Bank did not elect to initiate foreclosure proceedings, however. The Citizens Bank of Bancroft, Nebraska, also held, subject to the first lien of the Federal Land Bank, a mortgage on the aforementioned real property. The Citizens Bank foreclosed on the real property, and the property was sold at public auction on September 24, 1985. Having purchased the property, the Citizens Bank then executed and delivered to the Federal Land Bank a quitclaim deed to the 80 acres on which the Federal Land Bank held a first lien. On March 13, 1986, the Federal Land Bank entered into a purchase agreement with a third party providing that the property would be sold for \$810 per acre, or a total price of \$64,800. The Federal Land Bank incurred expenses in the sale of the land of \$3,432.29, leaving net proceeds of \$61,367.71. After application of the net sale price to the debt owed by the debtors to the Federal Land Bank, the Federal Land Bank seeks to be

adjudged the holder of an unsecured claim in this case in the amount of \$18,056.09. The debtor objects to the claim of the Federal Land Bank on the grounds that by declining to initiate a foreclosure action or accelerate its loan, the Federal Land Bank can claim no deficiency. Further, the debtor claims that the Federal Land Bank cannot obtain a deficiency because the title taken by the quitclaim deed merged with the mortgage interest. The debtor also objects on the ground that the Federal Land Bank waived any claim to a deficiency by transferring its rights in the property to a third party without the consent or approval of the debtors or the trustee. Finally, the debtors contend that the fair market value of the subject property was equal to or greater than the amount of the Federal Land Bank's claim.

Issues

A. With regard to the objection to the claim of the Citizens Bank of Bancroft, Nebraska:

1. By retaining the farm equipment and personal property collateral for an extended period of time prior to its sale, did the Citizens Bank elect to keep the collateral in full satisfaction of this debt pursuant to Uniform Commercial Code §9-505(2)?

2. In the event that the Court finds that the Citizens Bank did not elect to keep the collateral in full satisfaction of this debt, was the collateral cared for and prepared for sale in a commercially reasonable manner?

3. If the collateral was not held and prepared for sale in a commercially reasonable manner, is the debtor entitled to damages and thereby an adjustment of the amount of the claim of the Citizens Bank?

B. With regard to the claim of the Federal Land Bank:

1. By obtaining title to the subject property without initiating a foreclosure action or accelerating its loan, did the Federal Land Bank waive its right to any claim other than for the amount of the past-due installments and accrued interest?

2. Did the Federal Land Bank's taking of title to the subject property by quitclaim deed operate to trigger the application of the equitable doctrine of merger, thus barring the Federal Land Bank from claiming a deficiency after sale of the property?

3. Did the Federal Land Bank waive its right to a deficiency by transferring its rights in the subject property to a third party without the consent or the approval of the debtors or the trustee?

4. Was the fair market value of the subject property greater than or equal to the debt owed the Federal Land Bank, thus barring the Federal Land Bank from claiming any deficiency?

Decision

The unsecured claim of the Citizens Bank in the approximate amount of \$91,772.18 is allowed. The unsecured claim of the Federal Land Bank of Omaha will be allowed if it is determined in a separate hearing on the valuation of the property that the property's fair market value on March 13, 1986, the date it was sold by the Federal Land Bank, was less than the amount of the Federal Land Bank's claim.

Conclusions of Law and Discussion

"Section 502. Allowance of claims or interests:

"(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

"(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount except to the extent that--

"(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;"

A. With regard to the objection of the claim of the Citizens Bank of Bancroft, Nebraska:

1. The Uniform Commercial Code §9-505(2) states:

In any other case involving consumer goods or any other collateral, a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor if he has not signed after default a statement renouncing or modifying his rights under this subsection. In the case of consumer goods no other notice need be given. In other cases notice shall be sent to any other secured party from whom the secured party has received (before sending his

notice to the debtor or before the debtors renunciation of his rights) written notice of a claim of an interest in the collateral. If the secured party received objection in writing from a person entitled to receive notification within twenty-one days after the notice was sent, the secured party must dispose of the collateral under §9-504. In the absence of such written objection, the secured party may retain the collateral in satisfaction of the debtor's obligation.

There is no evidence before this Court that the Citizens Bank gave the debtors notice of their intent to keep the farm equipment and personal property collateral in full satisfaction of the debt as required by this section of the statute. However, the debtors contend that the Citizens Bank constructively elected to so keep the collateral by holding it for an extended period of time prior to the date of its sale, that period being from the first week of November of 1984 until September 26, 1985. The debtors' cite a 1985 Nebraska Supreme Court case, Schmode's, Inc. v. Wilkinson, 219 Neb. 209, 361 N.W.2d 557 (1985), in support of their proposition. Schmode's, however, is clearly distinguishable from the instant case. In Schmode's, the debtors defaulted on a loan contract and shortly thereafter delivered the collateral, a truck and trailer, to the creditor. The creditor restored the collateral and leased it out over a period of three years before finally selling it. The court found that the creditor had constructively elected to retain the collateral in full satisfaction of the debt. In the instant case, the Citizens Bank obtained the collateral under an order of replevin. It is clear from the record that the delay in the sale of the collateral occurred not because the Citizens Bank was using the collateral or unnecessarily delaying the sale procedures but because the debtors filed numerous legal actions following the order in replevin, including their petition in bankruptcy, which delayed the final judgment in the replevin action until July 11, 1985. Debtors filed two more motions, a motion to vacate and a motion for summary judgment following the judgment in replevin, further delaying any sale until September 5 when the District Court of Cuming County denied those motions. The sale was held twenty-one days after the September 5th order. The debtors cannot avail themselves of the court system and then turn around and ask this Court to penalize the Citizens Bank for retaining the collateral during the pendency of the actions filed by the debtors themselves. In fact, the Nebraska statute contemplates a return of property taken under an order in replevin when judgment is rendered against the plaintiff. See Nebraska Revised Statutes §25-1098 (Reissue 1985). Therefore, the Citizens Bank had the right to actual possession but had no right to sell the property prior to the final judgment in the replevin action. This Court finds that the Citizens Bank did not unnecessarily delay the sale of the collateral and thereby constructively elect to keep the said collateral in full satisfaction of the debt.

2. The debtor also contends that the Citizens Bank did not hold and prepare the collateral for sale in a commercially reasonable manner. The determination of the reasonableness of the sale is an issue for the trier of fact. Evidence presented at the hearing does not convince this Court that the value of the collateral declined due to neglect on the part of the Citizens Bank while the collateral was in its possession. Therefore, this Court finds that the collateral was cared for and prepared for sale in a commercially reasonable manner. Having reached the foregoing conclusion, it is unnecessary to reach the issue of damages.

Section 502(b)(1) does not apply to bar the claim of the Citizens Bank.

B. With regard to the objection to the claim of the Federal Land Bank of Omaha:

1. This Court finds nothing in Nebraska law that requires the holder of a first lien to take any affirmative action to foreclose or accelerate its loan upon the initiation of foreclosure proceedings by a junior lienor. When the junior lienor in the instant case foreclosed, the property was sold at a sheriff's sale subject to the lien of the Federal Land Bank, thereby preserving the Federal Land Bank's interest. The mortgage instrument executed by the debtors to the Federal Land Bank on January 28, 1977, states in Paragraph 7 that in the event of default, "mortgagee may immediately foreclose this mortgage or pursue any other available legal remedy." (Respondent's Exhibit 1). There is also nothing in Nebraska law which prevents the mortgagee from purchasing the interest of the holder of the sheriff's deed to the property once it has been sold at sheriff's sale and the sale has been confirmed by the court. Wyatt-Bullard Lumber Co. v. Bourke, 55 Neb. 9, 75 N.W. 241 (1898). Therefore, the Federal Land Bank did not, by obtaining the property by quitclaim deed from the Citizens Bank, waive its right to any claim arising out of the mortgage agreement with the debtors other than one for the amount of past-due installments. It did not waive its right to claim a deficiency.

2. The debtors also contend that when the Federal Land Bank obtained title to the subject property by a quitclaim deed from the Citizens Bank of Bancroft, Nebraska, the two titles merged and thus extinguished the debt owed the Federal Land Bank. It is a well established principle of Nebraska law that when a mortgagee acquires the equity of redemption, where there is no expression of the mortgagee's intention to merge the two estates, no merger will be presumed. In fact, it will be presumed that the mortgagee intended to do that which would prove most advantageous to itself. Wyatt-Bullard Lumber Co. v. Bourke, 55 Neb. 9, 75 N.W. 241 (1898). In the instant case, the Federal Land Bank has expressed no intention to merge the titles and cannot be presumed to have

intended such a merger. Therefore, it must be presumed that the Federal Land Bank intended to preserve all of its rights, including the right to claim a deficiency.

3. The debtors further contend that the Federal Land Bank waived its right to claim a deficiency by conveying subject property to a third party without the consent of the debtors or the trustee in bankruptcy. However, when the Citizens Bank of Bancroft, Nebraska, foreclosed its mortgage, and the property, including that on which the Federal Land Bank held a first lien, was sold at a sheriff's sale, said sale being confirmed by the Court, all of the debtors' rights in the subject property were conveyed to the Citizens Bank, which in turn conveyed them to the Federal Land Bank. Thus, the Federal Land Bank, as holder of the fee, was not required to obtain the consent of the debtors or the trustee in order to convey it to a third party because neither the debtors nor the trustee had any interest remaining in the property. See §25-2145 Nebraska Revised Statutes (Reissue 1985).

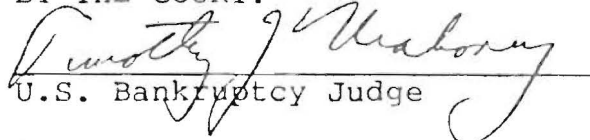
4. Finally, the debtors contend that the fair market value of the subject property was equal to or greater than the amount of the debt owed the Federal Land Bank, thus barring the Federal Land Bank from seeking a deficiency from the debtors. The Federal Land Bank sold the subject property for a total sale price of \$64,800. Expenses of the sale totaled \$3,432.29, leaving net proceeds of \$61,367.71. After application of the net proceeds to the debt, the Federal Land Bank claims a deficiency of \$18,056.09. This Court believes that sufficient evidence as to the fair market value of the subject property has not been presented and so reserves judgment as to how much of a deficiency, if any, the Federal Land Bank may claim until a hearing may be held on the valuation of the said property.

Section 502(b)(1) does not apply to bar the claim of the Federal Land Bank of Omaha if it is determined that the fair market value of the Federal Land Bank's collateral was less on the date of its sale than the amount of the debt owed to the Federal Land Bank.

Separate journal entry shall be filed overruling objections to claim of the Bank and setting for evidentiary hearing the question of fair market value of the land on date of sale by the Federal Land Bank.

DATED: December 31, 1986.

BY THE COURT:


U.S. Bankruptcy Judge

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