

In the United States Bankruptcy Court
for the Northern District of Iowa
Western Division

TIM THOMSEN and
LUANN THOMSEN
Debtor(s).

Bankruptcy No. X90-01661S

Chapter 7
Contested No. 2157

**MEMORANDUM OF DECISION AND ORDER RE: OBJECTION TO EXEMPTION AND
MOTION TO AVOID LIEN**

Debtors claim farm machinery and equipment as exempt and seek to avoid a lien on the equipment held by Farmers Home Administration (FmHA). FmHA contends that liens on non-exempt property cannot be avoided and that because the equipment at issue is owned by a partnership, it is not exempt to the debtors. A hearing on these matters was held in Sioux City on January 24, 1991. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(K) and (O).

I.

FINDINGS OF FACT

On September 18, 1978, Tim Thomsen entered into a written partnership agreement with his father, Bernard Thomsen. The name given to the partnership was Thomsen Dairy Farm (TDF), a name which had previously been used by Bernard Thomsen in his farming operation. Before that, it had been used by Tim Thomsen's grandfather. Bernard Thomsen agreed "to contribute for the use of the partnership" his 80-acre farm and all farm equipment and livestock which he then owned. Tim Thomsen agreed to "contribute any interest, if any, that he may own in equipment or livestock." The partnership agreement also provided:

3. Any obligations against said farm real estate, equipment, or livestock shall be paid by the partnership as part of its cost of doing business and, to that extent, said payments shall be deemed and constitute rent to the owner of said items, whether it be first party [Bernard Thomsen] or second party [Timothy Thomsen].

The primary purpose in forming the partnership was to enable the borrowers to obtain FmHA financing for which they individually did not qualify. Thomsens believed that it would be easier to get an FmHA loan if they applied to FmHA as a partnership. The loan proceeds would be used to refinance Bernard Thomsen's agricultural debt to his bank. Tim had been working off the farm, but he also helped his father in the farming and he had been trying to work his way into his father's operation.

On September 16, 1978, at a special partnership meeting, the partners authorized an application to FmHA for a \$160,000.00 loan. Loan application papers were filed with FmHA's Spencer office by the partnership and the individual partners. These applications included three balance sheets. TDF listed among its property five tractors valued at \$14,750.00 and other farm machinery valued at \$14,300.00. Bernard Thomsen's personal loan application to FmHA listed one automobile valued at \$800.00. The debtors' balance sheet listed one automobile valued at \$200.00, one truck worth \$2,500.00 and two motorcycles valued at \$1,000.00. On December 29, 1978, FmHA loaned \$130,000.00 to TDF. The promissory note evidencing this loan was signed by Tim Thomsen and Bernard Thomsen, as partners, and by the partners and their spouses as individuals.

Also on December 29, 1978, TDF granted FmHA a security interest in crops, livestock and farm equipment. The security agreement was signed by Bernard and Timothy Thomsen and their wives. Between 1978 and 1990, TDF executed eight more security agreements for FmHA; the subsequent security agreements reflected changes in collateral. Each security agreement bore the signatures of Tim Thomsen and Bernard Thomsen "As Partners" and as individuals. Each security agreement specified that the parties to the agreement were TDF and FmHA.

Debtors maintain that the partnership never operated and never purchased equipment. From its creation, Bernard was apparently too seriously ill to contribute any labor, expertise or advice. Tim was doing all the work and making all decisions. Sometime in 1982, he told Don Pierce, the then FmHA county supervisor that he and his father were not operating as a partnership. He presented Pierce with a two-page lease agreement which had been entered into between Bernard and Berma Thomsen as lessors and Tim Thomsen as lessee. (Exhibit A) The lease covered Bernard's farmland, breeding livestock, machinery and equipment. Pierce rejected the notion that Tim and his father were not operating as a partnership and that another arrangement existed. Pierce said the partnership arrangement was operating satisfactorily, that everything was secured that way, and that FmHA did not want it changed. Tim felt trapped by the situation; he felt there was nothing he could do to change matters in light of FmHA's opposition. On at least two other occasions, he attempted to advise FmHA personnel that the dairy farm was not being operated by a partnership, but each time he was disregarded.

Thus, in 1982 and thereafter, all loan documents with FmHA continued to recognize the operation of the partnership and its ownership of livestock and equipment. In subsequent promissory notes used to reschedule debt or advance new funds, the partnership was shown as a borrower. The security agreements executed annually from 1983 through 1990 listed livestock, machinery and equipment and stated that such property was property of the partnership.

On February 4, 1988, TDF received a \$10,000.00 operating loan from FmHA. TDF also obtained FmHA rescheduling of a \$20,000.00 loan originally received from FmHA in 1987. The promissory notes reflecting these transactions were signed by Tim Thomsen and Bernard Thomsen as individuals and as partners of TDF. The loan proceeds were disbursed to TDF.

In 1988, a nationwide FmHA directive required all local FmHA offices to update and to bolster, if necessary, their security interests concerning outstanding partnership loans. This directive resulted in FmHA's requesting Bernard Thomsen to convey his 80-acre Clay County farm to the partnership. At the same time, the debtors were seeking revised terms on TDF's indebtedness to FmHA. In conjunction with these events, FmHA presented Tim Thomsen with two options: under the first, Bernard Thomsen would convey his farm land to Tim, and Tim would take over entirely the partnership operation and debt; under the second, Bernard would deed the farm to the partnership. Because conveyance of the farm would potentially have caused adverse tax consequences to Bernard Thomsen and because of the debtors' financial inability to purchase the farm, these options were rejected. FmHA personnel in Spencer subsequently sought and received approval from the FmHA state office to waive the requirement that Bernard Thomsen convey his farm to TDF. As a result, the existing FmHA-TDF relationship, originally begun in 1978, continued.

On April 10, 1989, FmHA rescheduled the \$10,000.00 operating loan obtained in 1988 and again reamortized the \$20,000.00 loan. FmHA also reamortized TDF's initial \$130,000.00 loan. The promissory notes representing these transactions were signed by Tim Thomsen and Bernard Thomsen, both as individuals and as partners of TDF.

On January 28, 1990, TDF and the partners completed three "Application For . . . Services" forms as part of workout negotiations begun with FmHA. The application completed on behalf of TDF listed farm equipment with a value of \$20,435.00. The application was signed by Tim Thomsen "for Thomsen Dairy Farm." The application of Bernard and Berma Thomsen disclosed no farm assets. The application of Timothy and LuAnn Thomsen disclosed no farm assets.

A "farm and home plan" completed by TDF on March 20, 1990 lists farm equipment owned by TDF with a value of \$24,030.00. The plan was signed "Thomsen Dairy Farm Tim Thomsen." The farm implements and equipment claimed as exempt by debtors were acquired during or before 1988.

Documentary evidence introduced at trial shows that Tim Thomsen had business dealings with the U. S. Department of Agriculture in his own name. Some of these dealings related to the farm owned by his father. (Debtors' Exhibits N

through V).

The partnership never filed a partnership tax return. Tim Thomsen's personal tax returns, from at least 1981 forward, reported income or loss from farming. Schedules attached to the return disclosed Farm Income and Expenses (Schedule F), Computation of Self-Employment Tax (Schedule SE), Computation of Investment Credit (Form 3468), Schedule of Depreciation and Amortization (Form 4562), and a computation for fuel tax credit (Form 4136). The depreciation schedule for the 1982 tax year showed five items of machinery and equipment, all acquired in 1982. Each subsequent year's depreciation schedule added newly acquired equipment. Prior to 1982, Tim Thomsen described himself as a "laborer" on his tax returns. (Exhibits H, I and J).

The debtors filed their chapter 7 bankruptcy on September 26, 1990. Each debtor has claimed a \$10,000.00 exemption in farm equipment pursuant to Iowa Code § 627.6(11)(A). On October 24, 1990, FmHA filed its objection to the debtors' claims of exemption. FmHA contends that the farm equipment cannot be claimed as exempt by the debtors because it is partnership property owned by TDF. The debtors argue that the partnership with Bernard Thomsen terminated prior to their acquiring the equipment and that the equipment was never partnership property. There is no documentary evidence substantiating the purchases of the equipment by debtors.

I.

DISCUSSION

The court must decide whether the farm machinery and equipment claimed as exempt by Thomsens is property of the TDF partnership. If it is, it may not be claimed as exempt by the debtors to the detriment of a partnership creditor. Iowa Code § 544.25(2)(c). See also Jensen v. Wiersma, 185 Iowa 551, 170 N.W. 780 (1919). In conjunction with this issue, the court is called upon to decide whether debtors are estopped from denying the partnership's ownership of the property.

The law of estoppel is applicable to disputes arising under Iowa's Uniform Partnership law. Iowa Code § 544.4(2). A succinct discussion of the nature of equitable estoppel is provided by the Iowa Supreme Court:

Equitable estoppel is based on the concept that one who has made certain representations should not thereafter be permitted to change his or her position to the prejudice of one who has relied thereon. (Citations omitted.) It may be utilized when otherwise injustice would result. (Citation omitted.) The elements of equitable estoppel are well established: (1) a false representation or concealment of material fact; (2) lack of knowledge of the true facts on the part of the actor; (3) intention that it be acted upon; and (4) reliance thereon by the party to whom made, to his prejudice and injury. (Citations omitted.) Equitable estoppel may not be established if any one of these elements is lacking. (Citation omitted.)

Fernandez v. Iowa Dept. of Human Services, 375 N.W.2d 701, 708 (Iowa 1985).

"[T]he doctrine of equitable estoppel is designed to prevent fraud and injustice and may come into play whenever a party cannot in good conscience gainsay his prior acts or assertions." DeWall v. Prentice, 224 N.W.2d 428, 431 (Iowa 1974). FmHA must prove the elements of equitable estoppel by clear, convincing and satisfactory evidence. Anita Valley, Inc. v. Bingley, 279 N.W.2d 37, 41 (Iowa 1979).

Having considered the evidence and the law, the court concludes that equitably the debtors should be estopped from establishing that the machinery and equipment are not partnership property.

Bernard and Tim Thomsen formed their partnership in September, 1978 in order to obtain agricultural financing which otherwise would have been unavailable to them. The written partnership agreement did not effectuate a transfer of each partner's farming assets to the partnership. Although paragraph 2 of the partnership agreement is ambiguous in this regard, paragraph 3 makes clear that the partners retained ownership of the described assets. The partnership was to pay rent to the owners. It is unlikely that the partnership intended to pay rent on items of property which it owned.

But although the partnership agreement did not itself transfer individually owned assets to the partnership, it also did not prevent such transfers. There is nothing in the agreement which precluded Bernard or Tim from transferring machinery and equipment to the partnership at any time after the formation of the partnership. Despite the agreement's indication that the partners would retain ownership of their individual assets, the partners and the partnership represented to FmHA in the loan applications that the machinery and equipment was owned by the partnership. At least through part of 1982, there was no contrary representation to FmHA about the continued vitality of the partnership or about the ownership of its necessary equipment.

In 1982, Tim Thomsen desired to terminate the partnership arrangement with his father because of the inability of his father to participate in a substantial way in the farming operation. Tim tried to tell FmHA that the partnership had been dissolved. He substantiated the dissolution of the partnership by delivering to FmHA a copy of a lease agreement between Tim and his parents. From his parents, Tim would lease farmland, breeding livestock, machinery, equipment and the milking facility. The agreement evinces the partners' intent to dissolve the partnership with Tim continuing the operation on his own. Iowa Code § 544.29. FmHA rejected this change in relationship between Tim and his father and between the partners and FmHA. FmHA had the right to refuse to do business with Bernard and Tim unless the business relationship was transacted through a partnership. However, FmHA could not force Bernard and Tim to remain as partners or to continue the partnership business. Tim and Bernard, therefore, retained the final voice as to the continuation of the partnership. As between themselves, it appears that Tim and Bernard considered the partnership terminated. Tim conducted the operation of the farm, paid rent to his father under the lease agreement, and for tax purposes treated the farming operation as his business both as to income and deductions. Deductions included depreciation of farming equipment on tax returns beginning in 1982. But as between the Thomsens and FmHA, the documentation of all subsequent business transactions indicates that the farm operation continued as a partnership. Furthermore, there is no evidence that the partners attempted to wind up partnership affairs pursuant to Iowa Code § 544.30. Neither partner made an effort to liquidate any partnership assets in order to pay partnership creditors. In any liquidation, partnership creditors would have had first claim on such assets. Iowa Code § 544.40(2)(a). After 1982, security agreements given to FmHA continued to state that livestock and specific machinery and equipment were property of the partnership. The partners executed these security agreements individually and as partners. Promissory notes used to restructure pre-1982 debt were executed in the name of the partnership. These renewals of pre-existing debt conflict with intention of the partners to dissolve and terminate the partnership. Moreover, the transaction constitutes reliance by the FmHA on the continued existence of the partnership. Although Tim may have believed that after 1982 he was acquiring machinery and equipment in his own name, he acquiesced to signing security agreements representing to FmHA that the machinery and equipment were partnership property. Tim's testimony showed that he felt powerless to force FmHA to accede to the changed relationship. The benefit to him of such acquiescence was the continued loan services of FmHA.

In 1988, FmHA was willing to recognize Tim prospectively as the sole proprietor of the farm operation. Such recognition was conditioned on the transfer of the farm ground from Bernard to Tim. Because of potentially adverse tax consequences, this proposal was rejected by Bernard's letter to FmHA. Government Exhibit 17. The elder Thomsen closed his letter by stating that "[I]t would be to FmHA's and our benefit to continue on as we have been at this time." In January of 1990, the partnership, Bernard and Berma, and Timothy and LuAnn, filed applications with FmHA which continued to indicate that livestock, machinery and equipment were owned by the partnership.

Because Tim and Bernard were no longer operating the dairy farm as a partnership, the notes, security agreements, applications for services and farm and home plan falsely represented to FmHA the continued operation of the farm by TDF and its continued ownership and acquisition of business assets. These representations were made by Thomsens to preserve the lender-borrower relationship with FmHA. Thomsens intended that FmHA rely upon the representations. Despite Tim's effort to notify FmHA that the partnership had been dissolved, it was not unreasonable for FmHA to believe that the partnership continued. FmHA had made clear it wanted the continuation of the partnership operation, and it appeared that Bernard and Tim had acquiesced in that demand. FmHA relied on the loan documents provided to it in continuing to restructure and renew the partnership loans. If now the court were to find that the machinery and equipment were owned by the debtors, FmHA's lien would be prejudiced by debtors' right to avoid under 11 U.S.C. § 522(f). FmHA has established by clear and convincing evidence the elements necessary to establish equitable estoppel.

The court finds and concludes that the machinery and equipment claimed as exempt by the debtors is property of the

Thomsen Dairy Farms partnership and that FmHA has a perfected security interest in such property. As a result, the debtors may not claim such property exempt from partnership creditors. Iowa Code § 544.25(2)(c). The objection of FmHA to the claims of exemption must, therefore, be sustained. Because the machinery and equipment are not exempt from the claim of FmHA, the debtors may not utilize § 522(f) of the Bankruptcy Code to avoid FmHA's lien.

Accordingly,

IT IS ORDERED that judgment shall enter as follows: the objection of Farmers Home Administration to debtors' claims of exemption in farm machinery and equipment is sustained; debtors' motion to avoid the lien of Farmers Home Administration in farm machinery and equipment is denied.

SO ORDERED ON THIS 22nd DAY OF MARCH, 1991.

William L. Edmonds
Chief Bankruptcy Judge