In the United States Bankruptcy Court

for the Northern District of Iowa

CHURDAN-HARCOURT SWINE
Debtor(s).

Bankruptcy No. X91-01767M
Chapter 11
Contested No. 1305 & 1331

MOTION TO AMEND FINDINGS CONCLUSIONS AND ORDER RE: MOTION TO USE CASH COLLATERAL and MOTION FOR RELIEF FROM STAY

In its order filed December 6, 1991, the court granted debtor's motion to use cash collateral arising from the sale of livestock. At the same time, the court denied Home State Bank's motion for relief from the stay but granted Bank adequate protection for its security interest in the livestock. On December 16, 1991, Bank filed a motion asking the court to amend its findings, conclusions and orders in regard to the two motions. A hearing on the post-trial motions was held January 14, 1992 in Mason City, Iowa. The court makes no new findings of fact.

Bank argues that debtor should be equitably estopped from claiming an interest in the livestock because evidence presented at trial allegedly shows that Kennedy and Miller never intended to hold the livestock in question individually and that their actions in obtaining the livestock loan from Bank constituted a fraudulent misrepresentation. Bank argues also that ownership of the livestock was previously decided by the default judgment entered in the state court action against Miller, Kennedy and N.I.P. Bank contends that principles of res judicata bar the partnership from claiming ownership of the livestock in the bankruptcy. Bank contends that by joining Miller and Kennedy in the state court action, Bank had properly joined the debtor partnership, and because ownership of the livestock by partnership was a defense to Bank's action for replevin, the prior judgment, even though by default, bars partnership from asserting its ownership position. Ownership of the livestock, Bank contends, is a predicate to the protection of the stay and to the use of the collateral. For the following reasons, this court will amend its conclusions of law, but will nevertheless deny Bank's request that the court's order be altered.

DISCUSSION

I. Equitable Estoppel

Bank has argued that debtor partnership should be equitably estopped from claiming an ownership interest in the cash collateral. In its prior ruling, this court held that equitable estoppel was inapplicable to the present case because there was no evidence that Kennedy or Miller had made a false representation or concealment of material fact when they originally executed the loan documents with bank. (Citing Merrifield v. Troutner, 269 N.W.2d 136, 137 (Iowa 1978)). Bank argues that this

holding was in error and that there was evidence that Kennedy and Miller did not intend to acquire or to maintain ownership of the livestock when they borrowed the money to purchase them.

The evidence does not persuade the court that Kennedy and Miller, at the time they obtained the loan, harbored an intention to transfer the livestock to a partnership in violation of their agreement. Bank's reliance on this court's statement "that Miller and Kennedy, at the time of purchase, had already determined to form a partnership" (previous opinion page 14) to show that the partnership decision had been reached prior to the original loan closing is unpersuasive. The loan closing took place February 22, 1990. The livestock was purchased sometime after that. Although it is not clear from the record exactly when purchase of the livestock took place, it is evident that this occurred after execution of the loan agreements. The court found that in the intervening period and based on the advice of their accountant, Miller and Kennedy agreed to establish a partnership. The evidence offered at trial did not suggest to the court an intention on the part of Kennedy and Miller to establish a partnership interest in the livestock prior to or at the time of the execution of the loan agreements.

Proving fraudulent misrepresentation in Iowa is no easy task. A plaintiff alleging such claim must overcome the presumption of fair dealing by individuals in the conduct of their ordinary business activities which is assumed under Iowa law. Hall v. Wright, 261 Iowa 758, 156 N.W.2d 661, 666 (1968); Wyckoff v. A & J Home Benevolent Ass'n. of Creston, Iowa, 254 Iowa 653, 119 N.W.2d 126, 129 (1962). In order to overcome this presumption, the Iowa courts have set a high standard of proof whereby plaintiff must establish its claim by a preponderance of evidence based on proof that is clear and convincing. Hall v. Wright, 156 N.W.2d at 669; Wyckoff, 119 N.W.2d at 129. Fraud is never presumed; it must be shown. Hatheway v. Hanson, 230 Iowa 386, 297 N.W. 824 (1941). The burden of proof in this case is on the party seeking to invoke the doctrine of equitable estoppel, Ames Trust & Sav. Bank v. Reichardt, 254 Iowa 1272, 121 N.W.2d 200, 204 (1963), and bank has not met its burden.

Bank argues also that the court erred by focusing on Kennedy and Miller's state of mind at the time of the execution of the loan documents. Bank acknowledges that the court was correct in holding that "a false representation or concealment of a material fact is a necessary element" of equitable estoppel. *See*, e.g., Walters v. Walters, 203 N.W.2d 376, 379 (Iowa 1973). However, Bank argues that "a fraudulent intention is not essential, nor is it necessary that the parties sought to be estopped should have had an actual intent to deceive or mislead." *Citing* 28 Am. Jur.2d "Estoppel and Waiver" § 41 (1966); Goodwin Tile & Brick Co. v. DeVries, 234 Iowa 566, 13 N.W.2d 310 (1944); and Afenson v. Banks, 180 Iowa 1066, 163 N.W. 608 (1917). Looking to the result of debtor's conduct rather than the intent thereof, bank states that it is enough to invoke equitable estoppel if a fraudulent effect would follow and that it "is not necessary or essential that a fraudulent purpose be present at the inception of" a given transaction." *Citing* 28 Am. Jur.2d "Estoppel and Waiver" § 43 (1966) and Goodwin Tile & Brick Co. The Iowa Supreme Court has
in some cases found it unnecessary for plaintiff or defendant to prove actual intent to commit fraud in order to prove fraudulent misrepresentation. Where a party has spoken with "reckless disregard" for the truth or veracity of his statements, no proof of fraudulent intent is necessary. That individual will be held liable for his statements. Beeck v. Aquaslide 'N' Dive Corp., 350 N.W.2d 149, 155 (Iowa 1984); Grefe v. Ross, 231 N.W.2d 863, 867 (Iowa 1975) ("a false statement innocently but mistakenly made will notestablish intent to defraud, but, when recklessly asserted, it will imply an intent to defraud.") Furthermore, silence which constitutes a "concealment of or failure to disclose a material fact" can constitute fraud in Iowa if done by a party under a duty to communicate the concealed fact. Cornell v. Wunschel, 408 N.W.2d 369, 374 (Iowa 1987); Lockard v. Carson, 287 N.W.2d 871, 876-77 (Iowa 1980).

The Iowa Supreme Court's ruling in Ames Trust & Sav. Bank v. Reichardt, 254 Iowa 1272, 121 N.W.2d 200 (1963) does not persuade the court to alter its ruling. That case does state that "equitable estoppel is based on fraudulent conduct or a fraudulent result." However, the Iowa Court also stated that, "one must knowingly take a position with intent that it be acted upon, and reliance thereon by another to his prejudice" must occur for the doctrine of equitable estoppel to apply. Ames Trust& Sav. Bank, 121 N.W.2d at 204. The court concluded "we have no such evidence [of fraudulent intent] in this case." *Id*. Neither is there such evidence in the present case.

Finally, bank contends that the court's refusal to equitably estop debtor is in conflict with the court's finding that Kennedy and Miller "should have known that the transfer violated the terms of the loan agreement and security agreements." (Opinion, page 15) Bank asserts that the agreement between Kennedy and Miller and the bank was a continuing agreement by its terms and that even a subsequent decision to transfer the livestock to the partnership was a decision which violated the terms of the prior written agreement. From this, the court understands Bank to argue that the two partners' decision, whenever made, entered into the transaction and made it fraudulent. Bank thus argues that the court should not simply have looked to the loan closing dates to determine the existence of fraud. Contrary to Bank's assertion, I believe that the timing of the partners' decision to transfer the livestock is important. What bank's argument portends is that a party which fails to live up to its agreements must be guilty of fraud. This view does not adequately recognize the difference between "fraud" and "breach of contract." The Iowa Court of Appeals has stated:

> 'Unless the present state of mind is misstated, there is no misrepresentation. When a promise is made in good faith, with the expectation of carrying it out, the fact that it subsequently is broken gives rise to no cause of action, either for deceit, orequitable relief. Otherwise any breach of contract would call for such a remedy. The mere breach of a promise is never enough in itself to establish the fraudulent intent. It may, however, be inferred from the circumstances, such as the defendant's insolvency or other reason to know that he cannot pay, or his repudiation of the promise soon after it is made, with no intervening change in the situation, or his failure even to attempt any performance, or his continued assurances after it is clear that he will not do so.' Prosser, The Law of Torts, § 109, pp. 730-731 (4th ed. 1971). Thus, when a promise is made by one individual in good faith with the expectation of carrying that promise out, the mere fact that the promise was not fulfilled does not, alone, constitute actionable fraud. For the breaking of such a promise to be actionable as fraud, the speaker must have had an existing intent not to perform at the time the promise was made. See Robinson, 412 N.W.2d at 565-66. Non-performance alone does not prove an intention not to perform. Otherwise every breach of contract would call for a fraud remedy. *Id*.

Irons v. Community State Bank, 461 N.W.2d 849, 853-54 (Iowa Ct. App. 1990) (emphasis added). The court sees no inconsistency between its finding of fact that the two partners "should have known that the transfer [of livestock] violated the terms of the loan agreement and security agreements" with bank and the court's refusal to equitably estop debtor from claiming an interest in the livestock. Kennedy and Miller's actions constitute a breach of their contract with Bank. It was a failure to live up to their promise to maintain ownership of the livestock. But this breach of contract without more does not constitute fraud, nor does it call for a fraud remedy such as equitable estoppel.

Bank's further argument, that it was warranted in seeking to estop debtor, does little more than rehash the court's findings of fact and conclusions of law in its prior opinion. As debtor's counsel has pointed out, motions to amend findings are generally intended to correct manifest errors of law or fact or to present recently discovered evidence and are not to be used as a vehicle for obtaining rehearing or

relitigation of old matters. American Train Dispatchers Ass'n. v.Norfolk & Western Ry. Co., 627 F.Supp. 941, 947 (N.D. Ind. 1985); Evans, Inc. v. Tiffany & Co., 416 F.Supp. 224, 244 (N.D. Ill. 1976).

II. Res Judicata

Bank claims that debtor is barred by the doctrine of res judicata from now asserting its ownership interest in the livestock because it did not raise its ownership interest in the prior state court replevin action. In its previous opinion, this court rejected bank's claim preclusion argument determining that the prior state court replevin action would not be a bar to the partnership's assertion of ownership because the partnership, as a "separate entity" had not been joined in the action. The court stated that "a judgment against the individuals that compose a partnership is not a judgment against the partnership." *Citing* Bankers Trust Co. v. Knee, 222 Iowa 988, 270 N.W. 438, 441 (1936) (previous opinion page 17). The court also held that because of the timing of the transfer and judgment, the partnership was not in privity with Kennedy and Miller so as to permit the application of claim preclusion to the partnership.

Upon further reflection, the court must reject its prior conclusion that "a judgment against the individuals that compose a partnership is not a judgment against the partnership." This statement by the Iowa Supreme Court was based on the principal that a partnership under Iowa law was "a legal entity, known and recognized by the law." Bankers Trust Co., 270 N.W. at 441. This statement, also known as the "separate entity" theory of partnerships, as Bank asserts, was done away with when Iowa adopted and codified the Uniform Partnership Act in 1971. Carlson v.Carlson, 346 N.W.2d 525, 526 (Iowa 1984). Iowa R.Civ. P. 4 states that "[a]ctions may be brought by or against the partnerships as such; or against any or all partners with or without joining the firm." Thus, under Iowa law, it is unnecessary to join a partnership at law to obtain a binding judgment against the partnership when any or all partners have been sued. To the extent that this court's previous decision was not in accord with this statement of the law, it is amended.

For the following reasons, the court still rejects Bank's claim preclusion (res judicata) argument. The distinction between "claim preclusion" and "issue preclusion" is important to this determination. In Iowa, the doctrine of "claim preclusion" provides that "[a]n adjudication in a former suit between the same parties on the same claim is final as to all matters which could have been presented to the court for determination." Israel v. Farmers Mut. Ins. Ass'n. of Iowa, 339 N.W.2d 143, 146 (Iowa 1983). These matters include defenses. Matter of Sinnard, 91 B.R. 850, 852 (Bankr. N.D. Iowa 1988). Under the doctrine, a claim or defense would be barred, if it could have been but was not asserted in the prior suit. *Id*. This is so even if the prior adjudication was a default judgment. Lynch v. Lynch, 205 Iowa 407, 94 N.W.2d 105, 108-09 (1959).

The doctrine of collateral estoppel "prevents parties to a prior action in which judgment has been entered from relitigating in a subsequent action issues raised and resolved in the previous action." Hunter v. City of Des Moines, 300 N.W.2d 121, 123 (Iowa 1981). A condition for the application of the doctrine is that the issue sought to be precluded be actually litigated in the prior action. Israel v. Farmers Mut. Ins. Ass'n. of Iowa, 339 N.W.2d at 146; Lynch v. Lynch, 94 N.W.2d at 108.

Bank's claim against Kennedy and Miller, or the partnership, in the state court proceeding was its "right to possession." Bank's claim would have been based on its loan documents, the default of the borrowers and presumably upon Iowa Code § 554.9503. The latter Code section gives Bank, unless otherwise agreed, the right to possession of collateral upon the default of the debtor. Bank now argues that any claim by the partnership that it owned the livestock was a defense to its action. The court

disagrees. An "issue" has been defined as "a single, certain and material point arising out of the allegations and contentions of the parties." Overseas Motors, Inc.v. Import Motors Ltd , Inc., 375 F.Supp. 499, 518 n. 66a (E.D. Mich. 1974), *citing* Paine &Williams Co. v. Baldwin Rubber Co., 113 F.2d 840, 843 (6th Cir. 1940). The court in Overseas Motors went on to state that the issue "may concern only the existence or non-existence of certain facts, or it may concern the legal significance of those facts. (citation omitted). If the issues are
'merely evidentiary', they need only deal with the same past events to be considered identical. However, if they concern the legal significance of those facts, the legal standards to be applied must also be identical; different legal standards as applied to the same set of facts create different issues. (citation omitted)." *Id*.

Ownership of the livestock, in and of itself, was not a defense[(1)] to be asserted by the partnership. wnership by the partnership, standing alone, was nothing more than an evidentiary fact, and perhaps not a material one. Partnership does not now contend that its taking title to the livestock somehow cut off Bank's security interest. That, arguably, would be a defense. Or, had Bank claimed ownership or title, the partnership might have raised as a defense that title was in itself or a third person. In the state court proceeding, Bank claimed a security interest in the livestock. Had partnership appeared and claimed title or ownership, it could not on that fact alone have prevailed. Some further fact or issue in conjunction with title would have been necessary to present a defense. Ownership of the livestock was an issue not subject to preclusion in the bankruptcy contested matters because it was not actually litigated in state court.

CONCLUSION

Bank's motion to amend conclusions should be granted in part and denied in part as set out herein. The motion to amend findings should be denied. The motion to amend the order of December 6, 1991 should be denied.

This decision does not prevent Bank from seeking a further determination of partnership's interest in the livestock. This decision only determines Bank has a colorable claim to a protectible interest. Although no reported decision exists to this court's knowledge which determines whether an order authorizing the use of cash collateral is interlocutory or final either for purposes of 28 U.S.C. § 158 or Fed. R.Bankr. P. 7054, one commentator has suggested that such orders are usually considered interlocutory because of the expedited nature of the cash collateral hearing which gives little time for the parties or for the court to make decisions about the use of cash collateral. Stripp, Balancing of Interests in Orders Authorizing the Use of Cash Collateral inChapter 11, 21 Seton Hall L.Rev. 562, 586-88 (1991). One court has held that due to "the priority and summary nature of the adequate protection proceedings" matters concerning the validity, priority and extent of liens "are usually segregated and heard separately." Greives v. Bank of Western Indiana (In re Greives), 81 B.R. 912, 960 (Bankr. N.D. Ind. 1987). Fed. R.Bankr. P. 7001(2) requires that an adversary proceeding be instituted to determine the validity, priority or extent of a lien or other interest in property. Due to the urgency of a debtor's need for cash, complex questions are best left to a separate hearing with full opportunity for discovery. The adequate protection previously provided by this court will, in the meantime, serve to protect Bank's interest.

ORDER

IT IS ORDERED that Bank's motion to amend its conclusions of law is granted in part and denied in part as set out herein; its motion to amend findings is denied.

IT IS ORDERED that Bank's motion to amend the order of December 6, 1991, which granted debtor's motion to use cash collateral and which denied Bank's motion for relief from stay, is denied.

SO ORDERED ON THIS 29th DAY OF JANUARY, 1992.

William L. Edmonds
Bankruptcy Judge

1. Counterclaims in replevin actions are prohibited. Iowa Code § 643.2.