

**UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa**

In re: : **Case No. 01-01776-CH**
: :
DAVID L. WEILER and : **Chapter 11**
EDNA Z. WEILER, : :
: :
Debtors. : :
: :
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MIDWESTONE BANK & TRUST, : **Adv. No. 01-20105**
f/k/a : :
MAHASKA STATE BANK, : :
: :
Plaintiff, : :
v. : :
DAVID L. WEILER, et al., : :
: :
Defendants. : :
: :
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OFFICIAL UNSECURED : :
CREDITOR'S COMMITTEE, : :
: :
v. : **Adv. No. 02-20045**
: :
COMMERCIAL FEDERAL BANK, : :
et al., : :
: :
Defendants. : :
: :
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**ORDER--COMPLAINT TO AVOID TRANSFERS OF DEBTORS' INTEREST IN
PROCEEDS FROM THE SALE OF CATTLE**

The trials of the above consolidated adversary proceedings came on for hearing on May 10, 2004. The following appearances were entered: Mark D. Walz and

LeGrand W. Smith for the respective plaintiffs, Mahaska State Bank and Official Unsecured Creditor's Committee; Lynn Wickham Hartman and Wythe Willey for the defendants Bloomfield Livestock Market, Inc., Ron Schooley, David Schooley, and Schooley Farms; and August B. Landis for the defendant Commercial Federal Bank. At the conclusion of the trial on May 14, 2004, the court took the matters under advisement on a briefing schedule. Post-hearing briefs have been received, and the court considers the matters fully submitted.

The court has jurisdiction of these matters pursuant to 28 U.S.C. §§ 157(b)(1) & 1334 and order of the United States District Court for the Southern District of Iowa. These are core proceedings pursuant to 28 U.S.C. § 157(b)(2)(F) & (K). Upon review of the pleadings, evidence, briefs, and arguments of counsel, the court now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

POCEDURAL HISTORY OF DEBTORS' CHAPTER 11 CASE AND PLEADINGS

1. David L. Weiler and Edna Z. Weiler (hereinafter collectively Debtors) filed a voluntary chapter 11 petition on April 12, 2001.
2. Debtors filed their schedules and statement of financial affairs on April 27, 2001. As relevant herein, on Schedule B – Personal Property, Debtors stated that they did not have a property interest in any animals; on Schedule C – Property Claimed as Exempt, Debtors did not schedule any animals as exempt; and on Schedule G – Executory Contracts and Unexpired Leases, Debtors scheduled a “Custom Feeding Contract” with Schooley Farms - c/o Bloomfield Livestock Market.
3. On Schedule A – Real Property, as amended, Debtors scheduled two tracts of real property, a 90 acre farm in Pennsylvania, and a 920 acre tract encompassing their

homestead and feedlot, located in Davis County, Iowa, locally known as 22912 Ice Avenue, Bloomfield, Iowa 52537.

4. On their Statement of Financial Affairs in response to item 14, Property held for another person, Debtors stated that they were holding 473 head of cattle for Schooley Farms at 22912 Ice Ave., Bloomfield, IA 52737, Debtors' home address.

5. On April 15, 2002, the United States Trustee appointed an official, unsecured creditors' committee in the Weiler chapter 11 case.

6. Mahaska State Bank (hereinafter MSB) filed adversary proceeding number 01-20105 on August 23, 2001, naming David L. Weiler, Edna Z. Weiler, Commercial Federal Bank, Bloomfield Livestock Market, Inc., Ron Schooley, David Schooley, and Schooley Farms as defendants.

7. MSB's complaint requested relief based on eight separate counts. Count I alleged that MSB held a perfected security interest in certain cattle placed in Debtors' feedlot and asked the court to determine that its security interest in the cattle is superior to any claims by the defendants. Count II alleged that the defendants converted MSB's interest in the cattle, and requested damages. Count III requested the court to impose a constructive trust in MSB's favor on the proceeds from the sale of the cattle. Count IV asked for a determination that the transfer of the cattle and the sale proceeds constituted avoidable pre-petition preferential transfers under 11 U.S.C. § 547. Count V sought a determination that the sale of cattle after the bankruptcy filing constitutes an avoidable post-petition transfer of property of the estate under 11 U.S.C. § 549. Count VI alleged violations of the automatic stay provisions of 11 U.S.C. § 362. Count VII requested a

determination of priority of its security interest in equipment. Count VIII requested a marshalling of assets.

8. The court adjudicated Counts IV, V, and VI of MSB's complaint by order entered on May 27, 2003. Counts I, II, III, VII, and VIII remain before the court.

9. Debtors filed adversary proceeding 02-20045 on March 14, 2002, naming Bloomfield Livestock Market, Inc., Ron Schooley, David Schooley, and Schooley Farms as defendants (hereinafter the Weiler Complaint).

10. The Weiler Complaint prayed for relief in three counts. Count I contained an allegation of conversion and requested an accounting and turnover of the fair market value of silage and corn fed to 473 head of cattle post-petition pursuant to 11 U.S.C. §§ 542 (a) or 543(b); Count II asked for a declaration that the post-petition transfer of 473 head of cattle was an avoidable transfer pursuant to 11 U.S.C. § 549; and Count III requested a determination that the transfer of the cattle and corn and silage was an avoidable transfer under 11 U.S.C. § 547.

11. Without objection, the court confirmed Debtors' Second Amended and Substituted Plan of Reorganization on October 1, 2002. This plan provided that the Official Unsecured Creditors' Committee (hereinafter OUCC) was to be substituted as the plaintiff in adversary proceeding 02-20045.

12. On December 5, 2002, the court granted OUCC's motion to substitute itself as the plaintiff in adversary proceeding 02-20045 and substituted OUCC as the party plaintiff in that adversary proceeding.

13. Pursuant to order of this court, the OUCC filed its Amended and Substituted Adversary Complaint on February 26, 2003. (hereinafter the OUCC

complaint) It was at this time that Commercial Federal Bank (hereinafter CFB) was added as a party defendant in Adversary Proceeding 02-20045.

14. The OUCC complaint contained four counts. Count I asked the court to avoid any liens that defendants have in the identified cattle pursuant to 11 U.S.C. §§ 544 and 550(a). Count II seeks a determination that the pre-petition transfer of cattle to the defendants and the payment of the proceeds to CFB are avoidable preferential transfers pursuant to 11 U.S.C. § 547(b). Count III asks the court to avoid the post-petition transfer of the cattle pursuant to 11 U.S.C. § 549. Count IV requests a determination that the post-petition transfer of the cattle was made in violation of the automatic stay provisions of 11 U.S.C. § 362.

15. The two adversary proceedings were consolidated for purposes of trial and discovery by order entered on October 21, 2003.

FACTS

16. Debtors are husband and wife, and engaged in farming and cattle feeding operations located in Davis County, Iowa. The majority of the crops that they raise are used in their cattle feeding operation. Debtors moved with their immediate family to Iowa from Pennsylvania in the fall of 1988.

17. Plaintiff MidWestOne Bank was formerly known as Mahaska State Bank and has offices in Oskaloosa, Iowa.

18. Bloomfield Livestock Market, Inc., (hereinafter BLMI) is an Iowa corporation incorporated in 1975 doing business in Bloomfield, Iowa.

19. BMLI operates a livestock auction business, selling cattle on a commission basis. It also conducted a feeder cattle business in which it purchased cattle

and placed them at various feedlots for feeding, including the feedlot owned and operated by Debtors. BMLI maintained its own set of books, and its finances were kept separate from that of its officers, directors, and shareholders.

20. Ronald E. Schooley and David P. Schooley are the officers, directors, and sole shareholders of BLMI. Ronald is the president of the corporation and handles the cattle end of the business. David is the vice president and handles the record keeping and finances of the business.

21. Schooley Farms is not a separate legal entity, corporation or partnership, but an entity under which BLMI did business for many years. BLMI used Schooley Farms as a trade name for fat cattle receipts.

22. Commercial Federal Bank was formerly known as the Iowa Bank and Trust and the Liberty Bank and Trust. It has a branch bank in Bloomfield, Iowa.

23. BMLI and David Weiler entered into business relations as early as 1988 or 1989. At that time, Debtors began custom feeding cattle for BLMI pursuant to oral agreements. On August 1, 1996, Debtors and BMLI entered into the only written custom feeding agreement between the parties. (Exh S-1). Under this agreement, BLMI placed its cattle in Debtors' feedlot to be fattened. BMLI retained ownership of the cattle and paid Debtors based on the amount of weight gained by each animal. Debtors received a portion of the net profit upon sale of the animals. These cattle were sold in early 1997. Customarily the feeding agreements by and between Debtors and BMLI were oral.

24. On March 6, 1997, Debtors granted MSB a mortgage on their 920-acre farm located in Davis County, which secured credit in the amount of \$750,000.00.

25. On June 23, 1997, Debtors executed an agricultural security agreement with MSB, which gave MSB a blanket security interest in Debtors' assets. This security agreement included all farm products, crops, and all livestock owned, used or produced by Debtors.

26. MSB filed a UCC-1 on July 9, 1997.

27. In 1997, Debtors purchased their own cattle for feeding and sale. These purchases were financed through MSB. In 1998, Debtors resumed custom feeding for BMLI under an oral agreement. Approximately half of the 1998 cattle were placed there by BMLI and half were purchased by Debtors through financing obtained from MSB.

28. Debtors had the capacity to place a total of 1,600 head of cattle on their feedlot in Iowa at one time.

29. In 1999, BMLI purchased and placed 960 head of cattle on Debtors' feedlot for feeding (hereinafter the 1999 Cattle). In 2000, BMLI purchased and placed 1924 head of cattle on Debtors' feedlot for feeding (hereinafter the 2000 Cattle).

30. The terms of Debtors' cattle feeding arrangement with BMLI in 1999 and 2000 was as follows. BMLI purchased cattle with financing obtained from CFB. BMLI placed the cattle in Debtors' feedlot. Debtors fed and cared for the cattle. When BMLI sold the cattle, Debtors received the amount in excess of BMLI's costs for the cattle. This amount was determined as the slaughter sale price minus the price that BMLI paid for the cattle plus interest on the purchase money that BMLI had borrowed. While the cattle were in Debtors' care, Debtors were responsible for any death loss.

31. Ronald and David Schooley, as officers of BMLI, contracted with IBP for the sale of the finished cattle. Sale contract arrangements were never conducted between Debtors and IBP. Ronald Schooley, as an officer of BMLI, purchased the cattle,

sometimes with David Weiler's input; he arranged for the delivery of the cattle to the various feedlots; including Debtors' feedlot; he monitored the progress of the cattle on a weekly, and sometimes more often, basis; he determined when animals were ready for market; he negotiated the sale of the cattle; arranged for the shipping of the cattle to market; he sorted the cattle for sale, sometimes with help of David Weiler or members of his family; and he helped load the cattle onto the trucks. Cattle were placed on Debtors' feedlot and shipped for market at times when David Weiler was not present.

32. Over the course of their business relationship, BLMI would advance sums of money to Debtors against the payment that they would receive for feeding out the cattle. BLMI would offset these advances against the amount that it owed Debtors for the custom feeding. On occasion, the amount advanced exceeded the amount owed to Debtors, resulting in a balance carried forward to the next group of cattle. BMLI maintained a ledger regarding the indebtedness owed with respect to the 1999 and 2000 Cattle. As of the end of the year 2000, Debtors were carrying forward approximately \$140,000.00 of debt from prior years.

33. The delivery of the 2000 Cattle to the Weiler feedlot was evidenced by a buyer's bill (where the source of the cattle was a private seller), or a buyer's invoice (where the source of the cattle was through the BLMI Auction).

34. BLMI recorded the placement of the cattle on various feedlots on the buyer's bills and buyer's invoices by placing the feeder's name on those bills and invoices. The cattle placed on Debtors' feedlot were shown on the bills and invoices by placing the name "David Weiler" thereon.

35. The movement of cattle through Debtors' feedlot was continuous throughout the year. Cattle were being loaded and unloaded regularly. Approximately 60 groups of cattle were being moved in and out of Debtors' feedlot during 1999 and 2000. Debtors relied upon the records maintained by Ron Schooley to determine the movement of the cattle. Debtors did not keep independent records.

36. Each buyer's invoice issued in connection with the placement of the 2000 Cattle on the Weiler feed lot provided as follows:

The purchaser of livestock listed above agrees that the title of said livestock shall be retained by Bloomfield Livestock Mkt., Inc. until check or draft is paid.

37. David Weiler did not produce these bills and invoices to MSB for information or filing. MSB's loan policy required proper identification by sex, weight, brand, and location of animals for purchase money livestock loans. This provision was not enforced until November 2000 at which time MSB required Debtors to produce invoices for further cattle notes and advances.

38. The cattle placed in the Weiler feedlot by BLMI had ear tags, which identified the cattle as BMLI cattle and were separated from any cattle owned by Debtors, which had separate ear tags, and were in separate pens.

39. The vast majority of the 2000 Cattle were located at the Debtors' 920-acre farm and feedlot in Davis County, Iowa. The balance were located at Debtors' Pennsylvania farm.

40. The purchase price for all of the 2000 Cattle placed on the Weiler farm by BLMI was financed through CFB.

41. The 2000 Cattle, when they were ready for market, were sold by BLMI to IBP, Inc. The proceeds were deposited into a BLMI account at CFB. BLMI used these monies to reduce BLMI's indebtedness to CFB on those cattle. Neither Ron Schooley, David Schooley, nor Schooley Farms received any of these funds.

42. The cattle were sold to IBP in the name of Schooley Farms. This was done at the insistence of IBP because, at the time, IBP did not want to issue checks directly to sale barns.

43. The 1999 Cattle were sold partly in BLMI's name and partly in Debtors' name. This was done solely for tax purposes to benefit Debtors in showing cattle sales on their tax returns. This was done at the suggestion of Debtors' tax consultant. All of the proceeds went to BMLI.

44. Debtors took care of the cattle while they were on their feedlot; they provided the feed and husbandry.

45. Representatives of MSB inspected the cattle located on Debtors' feedlot in 2000 on two occasions. During these inspections, numbers of cattle were approximated; David Weiler represented that he owned the cattle. The MSB representatives did not note, examine, or inquire about ear tags on the cattle. During these visits the representatives never inquired of Debtors if they were custom feeding livestock for anyone.

46. On December 29, 2000, Debtors sold \$29,115.72 worth of cattle, and in 2001, Debtors sold 75 head of the 2000 Cattle, all of which were located in Pennsylvania. Debtors retained all of the proceeds from the sale of these cattle.

47. MSB had a loan commitment to Debtors in the amount of \$1,910,700.00 by January 20, 1998. This exceeded its internal lending limit of \$1,500,000.00. By April 20, 1999, this loan commitment had risen to \$1,985,500.00. By October 17, 2000, this loan commitment had risen to \$2,201,000.00, which exceeded the internal lending limit at the time of a cumulative \$1,900,000.00 per borrower.

48. Commencing in March 2000, and ending in July 2000, MSB advanced almost \$618,700.00 to Debtors for the purchase of cattle.

49. MSB first learned of BMLI's interest in the cattle on March 27, 2001. Prior to this time, there had been no communication between the Schooleys, BLMI, and/or CFB on the one hand, and MSB on the other, regarding BLMI feeding cattle on Debtors' farm.

50. MSB knew prior to the year 1999 that Debtors custom fed cattle for BMLI.

51. BMLI did not file a UCC-1 financing statement identifying its claim of ownership of the 1999 Cattle or 2000 Cattle in the possession of Debtors.

52. BMLI did not post any signs at the Weiler feedlot advising that BMLI owned cattle on the premises.

53. On March 30, 2001, MSB filed a petition for replevin of personal property in Davis County, Iowa. It sought, as relevant herein, a determination of the ownership of cattle and other personal property in the possession of David and Edna Weiler. Hearing on MSB's prayer for possession of the cattle and personal property was scheduled for April 13, 2001.

54. As noted above, when Debtors filed their chapter 11 petition on April 12, 2001, they did not schedule any property interest in animals or exempt any animals from the bankruptcy estate. They stated that they had an executory custom feeding contract with Schooley Farms - c/o Bloomfield Livestock Market. They also stated that they were in possession of 473 head of cattle that belonged to Schooley Farms.

55. David Weiler, in a deposition on June 22, 2001, testified under oath as follows: "I didn't buy any of these cattle. Bloomfield was buying them and setting them there. I don't know if you're aware of that or not." (Deposition, June 22, 2001, p. 44, ll. 16 - 19)

56. Debtors provided to MSB tax returns for the years 1998 and 1999 which showed 1999 sales of livestock totaling \$2,110,406.00 in Iowa and 1998 sales of livestock totaling \$1,247,659.00 in Iowa.

57. In 1999, Debtors provided MSB financial statements that showed that the cattle located on their property was owned by them. This was the first time that Debtors represented an ownership interest in cattle on a financial statement. A financial statement provided by Debtors to MSB on November 28, 2000, and January 10, 2001, represented over \$1,000,000.00 worth of cattle located in Iowa.

58. Debtors were indebted to BMLI at the end of 1999 in excess of \$130,000.00, which was carried forward by BMLI into 2000. Debtors did not show this debt on any of their financial statements.

59. Debtors have never claimed ownership of the 2000 Cattle in any of their reorganization documents.

60. The following are customary practices in the cattle feeding industry: ownership of cattle is shown by the use of ear tags; it is uncommon for the cattle owner to employ the use of a UCC filing when placing cattle in custom feed lots; cattle owners provide bills of sale to feedlot operators for information purposes only; cattle owners decide when and at what price cattle are sold; the custom feedlot operator is responsible for the identification of the cattle while on the custom feedlot premises; and payments are made to the seller of cattle within 24 hours of the transfer of ownership.

DISCUSSION

MSB commenced its adversary proceeding seeking to recover funds loaned to Debtors and secured by a blanket security interest in personal property. MSB claims that its security interest extended to the 1999 Cattle and the 2000 Cattle that Debtors were feeding for the slaughter market. Counts IV, V, and VI of the complaint were dismissed on motion for summary judgment based in part on MSB's lack of standing to pursue these Counts. Counts I, II, III, VII, and VIII remained for trial.

Debtors, as debtors in possession, commenced its adversary proceeding seeking recovery for post-petition transfers and alleged stay violations. Debtors confirmed chapter 11 plan ceded its claims to the OUCC, of which MSB was the dominant member. Upon motion and hearing, the OUCC was substituted as plaintiff in this adversary proceeding, and it promptly filed a motion to amend the complaint. The court granted the motion, and the OUCC filed an amended complaint which essentially eliminated a claim for post-petition feed supplied to the remaining 2000 Cattle, and resurrected the previously dismissed counts ostensibly for the benefit of the bankruptcy estate. Counts I, II, III, and IV of the complaint as amended by the OUCC remained for trial.

Parenthetically, the court notes that the confirmed chapter 11 plan provides for the 100% payment over time of all the unsecured claims. These claims do not receive interest or compensation for attorney fees. Consequently, MSB seeks to avoid having a portion of its claim treated as unsecured and seeks recovery under the terms of its security agreement with Debtors.

MSB and the OUCC claim that Debtors owned the 1999 Cattle and 2000 Cattle. They allege that Weiler purchased the cattle through the BLMI sale barn, and that Ronald Schooley was order-buying cattle for Debtors. They acknowledge that Debtors owed BLMI based on money loaned and the purchase price of cattle bought through the sale barn. However, they claim that BLMI and the Schooleys are unsecured or that any lien that they might have is avoidable. MSB claims that it holds a prior, perfected security interest in the 1999 Cattle and 2000 Cattle. MSB and the OUCC claim that BLMI, Ronald and David Schooley, and ultimately CFB received avoidable preferential transfers of the sale proceeds from the cattle. Further, MSB claims that BLMI and the Schooley brothers converted their security interest by selling the cattle and keeping the proceeds for their own use. The OUCC claims that BLMI and the Schooleys violated the automatic stay by selling the 473 head of cattle post-petition. Both plaintiffs argue that the post-petition sale should be avoided.

Alternatively, MSB argues that even if Debtors did not own the animals, they had sufficient rights in the 1999 Cattle and 2000 Cattle to allow MSB's security interest to attach to the cattle. MSB further argues that BLMI should be estopped from presenting its claim of ownership based on its actions and dealings with Debtors and its failure to put MSB on notice of its ownership interest. Finally, MSB argues that the court should consider BLMI's relationship with Debtors to be one of consignment, and find that BLMI failed to protect its interest in the cattle thereby allowing MSB's security interest priority. MSB also requests a finding that BLMI

is the alter ego of David and Ronald Schooley, and allow it to seek recovery from them personally.

Each of the defendants disputes the Debtors' claim of ownership in the 1999 Cattle and 2000 Cattle. They contend that Debtors had no interest in the cattle whatsoever. BLMI owned the cattle outright, and Debtors were custom feeding the cattle for them. The defendants dispute the assertion that the arrangement was a consignment and maintain that it constituted a bailment. They argue MSB has not set forth facts sufficient to warrant estoppel. Finally, the Schooleys argue that they have observed the corporate formalities and treated BLMI as a separate entity. They deny that BLMI is their alter ego.

Motion in limine

As a preliminary matter, on April 29, 2004, MSB filed a motion in limine seeking to exclude testimony by James J. Willrett (hereinafter Willret). Defendants identified Willret on their witness list as an expert witness. MSB seeks to exclude Willret's testimony as "patently flawed," "unreliable," "irrelevant," and inadmissible under Fed. R. Evid. 702. The court disagrees and for the following reasons will deny the motion.

The Federal Rules of Evidence provide for expert testimony as follows:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, expertise, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

Fed. R. Evid. 702.

The Eight Circuit has explained the use of expert testimony thusly:

The Federal Rules of Evidence "grant expert witnesses testimonial latitude unavailable to other witnesses on the 'assumption that the expert's opinion will have a reliable basis in the knowledge and experience of his discipline.'" *Kumho Tire Co. v. Carmichael*, 526

U.S. 137, 148, 119 S.Ct. 1167, 143 L.Ed.2d 238 (1999) (quoting *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579, 592, 113 S.Ct. 2786, 125 L.Ed.2d 469 (1993)). "[W]here such testimony's factual basis, data, principles, methods, or their application are called sufficiently into question ... the trial judge must determine whether the testimony has 'a reliable basis in the knowledge and experience of [the relevant] discipline.'" *Id.* at 149, 119 S.Ct. 1167 (quoting *Daubert*, 509 U.S. at 592, 113 S.Ct. 2786) (alteration in original). A district court's determination of the reliability of a proposed expert's testimony is reviewed under an abuse-of-discretion standard. *Id.* at 158, 119 S.Ct. 1167.

Smith v. Rasmussen, 249 F.3d 755, 758 (8th Cir. 2001).

In these proceedings, the defendants offered Willret's testimony to explain the customs and practices in the cattle feeding industry. Willret was also to provide his opinion as to whether BLMI's custom feeding agreement with Debtors was common within the cattle feeding industry. Further, Willret was to explain the practice of filing UCC financing statements by cattle owners and the posting of notices at custom feedlots.

Willret has been engaged in the cattle business for over twenty years. He received a bachelor of science degree in agricultural economics from the University of Illinois. After receiving his degree he returned to the family farm in Malta, Illinois. Willret has a cow-calf operation and currently feeds between 5000 and 6000 head of cattle each year. Through J. Willret farms, he places between 2000-2400 head of cattle with feedlots for custom feeding each year. Willret has extensive experience with a number of cattlemen's associations and served on committees and as an officer in many of these organizations.

Accordingly, the court finds that Willret has extensive knowledge of the livestock industry in general and custom cattle feeding in particular. The court also finds that his opinion has a reliable basis in knowledge and experience in this discipline. His testimony is helpful in understanding the customs and norms in the custom cattle feeding industry and will help the court in its duty as trier of fact. Therefore, the court will deny MSB's motion in limine to exclude Willret's testimony.

Ownership of the 1999 Cattle and 2000 Cattle

The threshold issue in resolving all the matters before the court is to determine who actually owned the cattle in question. Upon review of the documentary evidence and the testimony presented, the court finds that BLMI owned the 1999 Cattle and the 2000 Cattle. The court bases its finding on a number of facts.

In their schedules, sworn under oath as correct to the best of their knowledge, Debtors did not claim a property interest in any livestock. They stated that they were in possession of property of others, that being the remaining 473 head of the 2000 Cattle. Debtors identified Schooley Farms as the owner of the livestock. They also stated that they had an executory custom feeding contract with Schooley Farms c/o BLMI. In fact, Debtors have never claimed a property interest in cattle in any of their bankruptcy documents. Further, in a deposition taken on June 22, 2001, David Weiler specifically stated that he did not buy any of the cattle in question. He stated that BLMI purchased the cattle and placed them in his feedlot.

After viewing David Weiler's demeanor and hearing his testimony at trial, the court finds him to be a less than credible witness insofar as his testimony concerned his ownership interest in the 1999 and 2000 Cattle. The court also bases this determination on the fact that on several occasions his testimony at trial conflicted with statements that he provided in deposition testimony. Accordingly, the court gives little weight to David Weiler's testimony where it conflicts with testimony provided by other witnesses, in particular that of Ronald and David Schooley.

As to the viewing the demeanor and hearing the testimony of Ronald and David Schooley, the court finds them both to be credible witnesses. Each responded to questions

from the various counsels with candor and without attempting to dissemble. Ronald Schooley in particular was candid to the point of bluntness. Accordingly, the court gives much weight to their testimony.

David Schooley testified as to the business activities of BLMI, and its operation of the sale barn. He testified concerning BLMI's custom feeding relationship with Debtors, and how the corporation tracked the livestock placed in the Debtors' feedlot. He explained how BLMI loaned money to Debtors as advances against the money that Debtors would receive under the custom feeding contract. David Schooley testified that BLMI purchased and owned the 1999 and 2000 Cattle. He presented and explained the documentary evidence consisting of ledger entry and sale bills for the cattle. Finally, he testified that Ronald Schooley handled the purchasing and marketing of cattle for BLMI.

Ronald Schooley also testified that BLMI owned the 1999 and 2000 Cattle. He explained his role in purchasing and monitoring the progress of the cattle. He also explained the method and reasons concerning the method of selling the slaughter animals to IBP.

Most notably, Ron Schooley testified that David Weiler approached him in 2001 and stated to him that he done something wrong; that he had borrowed money against BLMI's cattle. MSB did not call David Weiler to rebut this testimony.

Finally, David Yahnke, a representative of CFB, who provided financing to BLMI provided testimony explaining the documentation concerning CFB's financing of BLMI's purchase of the 1999 and 2000 Cattle. CFB documented its security interest in the 1999 and 2000 Cattle with buyer invoices, descriptions of the livestock, and sales receipts when the cattle were sold for slaughter.

The evidence presented shows that BLMI purchased and owned the 1999 and 2000 Cattle. Accordingly, the court finds that Debtors did not have any ownership interest in the cattle.

Attachment of MSB's Security Interest to the 1999 Cattle and 2000 Cattle

MSB argues that even if Debtors were not owners of the 1999 and 2000 Cattle, its security interest attached to the animals pursuant to the Uniform Commercial Code. Iowa's version of the UCC in effect at the time provides the conditions under which a security interest attaches and becomes enforceable against collateral. The statute provides in relevant part:

- a. the collateral is in the possession of the debtor...
- b. value has been given; and
- c. the debtor has rights in the collateral.

Iowa Code § 554.923(1).

The parties do not dispute that MSB had a security agreement with Debtors and that they filed a valid UCC-1 financing statement. Likewise, there is no dispute that the cattle were in the possession of Debtors, and that MSB had given value in the form of funds loaned. At issue is whether Debtors had sufficient right in the 1999 and 2000 Cattle for MSB's security interest to attach.

Chapter 554 of the Iowa Code (the UCC) does not define what constitutes rights in collateral, and as late as 1998, the Iowa Supreme Court had not addressed the issue.

Schultz v. Security National Bank, 583 N.W.2d 886, 889 (Iowa 1998).¹ In that case, the

¹ Schultz involved a vehicle that had been provided as partial compensation to a pitcher of a softball team. The vehicle was titled in his wife's name. The team owner financed the purchase of the vehicle through a bank, gave a security interest to the bank, and made payments on the loan. When her husband was killed in an accident while a passenger in a car driven by another of the team's pitchers, the wife filed a wrongful death suit against the owner of the car. The team owner took umbrage with the suit and ultimately ceased to make payments on the vehicle. The bank repossessed the vehicle, and the wife commenced a suit alleging, among other things, conversion. The court submitted special interrogatories to

Iowa Supreme Court quoted the following:

The basic reason for requiring rights in the collateral is not difficult to grasp. The Article 9 security interest is by nature a consensual interest. It arises because the debtor has consented to its existence. But the consent must be manifested with respect to assets, which the debtor has some right to control. A stranger cannot create a security interest in assets which the stranger does not own or appropriately control. Giving such a power to a stranger would interfere with the rights of the person entitled to control the property. The debtor must have some authority over the assets in order to create an interest in them. The concept of rights in the collateral is rooted in authority over the collateral.

Id. Quoting 1 Peter F. Coogan et al., Secured Transactions Under the Uniform Commercial Code § 2B-8 (U.C.C.Serv.(MB) 1998). However, the Iowa Court gave no further guidance on the question of what constituted sufficient rights in collateral to allow a security interest to attach. Rather, it simply stated that the plaintiff failed to establish such rights in the collateral as a matter of law.

A number of other courts have decided cases with facts somewhat similar to the case before this court; similar at least to the extent that they involve secured creditors, debtors, and third parties who claim ownership interests in livestock and dispute the validity of the creditors' security interests. Generally speaking, those courts that held that the debtor in possession of the livestock had sufficient interest in the livestock for the creditor's security interest to attach have done so based in part on contract provisions between the debtor and the third party and in part on the conduct of the parties. See e.g. American Bank & Trust v. Shaull, 678 N.W.2d 779, 790 (S.D. 2004) (Bred cow agreement provided that debtor and third party had rights in and to the calves and their proceeds and shared equally in the profit or loss; as such they were in a joint venture

jury asking whether the team owner had any ownership rights in the vehicle and the value of the vehicle at the time it was repossessed. The jury found that the team owner had no rights in the vehicle, and the court entered judgment against the bank in the amount that the jury found as the vehicle's value. Schultz, 583 N.W.2d at 887.

relationship. Debtor therefore had an “equitable” interest in the cows.); Pleasant View Farms Inc. v. Ness, 455 N.W.2d 602, 604 (S.D. 1990) (agreement provided that debtor was to keep the entire 1986 calf crop and compensate third party out of the calf crop for any death loss to the original herd); American Nat. Bank v. Joy (In re Joy), 169 B.R. 931, 936 (Bankr. Neb. 1994) (hogs under the agreement were already on the premises, having been raised or previously purchased by the debtor, and the agreement gave the debtor complete control over the hogs with the discretion over the manner, place, and time of sale).

Courts that have held that a creditor’s security interest did not find that the debtor did not gain sufficient rights in the livestock from their agreement. Those courts not only look to the agreement but to the intent of the parties. See e.g. Union State Bank v. Cook (In re Cook Angus Ranch), 63 B.R. 789 (Bankr. D.N.D. 1986) (brother’s cattle on family ranch not covered by blanket security interest, no intent to give authority to encumber cattle); State Bank of Young America v. Wagener, 479 N.W.2d 92, 95 (Minn. Ct. App. 1992) (debtor did not have sufficient rights in hogs placed in debtor’s feedlot for security interest to attach where parties intended that ownership remain with the original owner); Nat. Livestock Credit Corp. v. First State Bank of Harrah, 503 P.2d 1283 (Okla. Ct. App. 1972) (creditor’s security interest did not attach to cattle that debtor purchased for another and fed in debtor’s feedlot).

In Rohweder v. Aberdeen Production Credit Assoc., 765 F.2d 109 (8th Cir. 1985),² the Eight Circuit Court considered the issue in the context of a cattle share

² MSB argues that Rohweder lacks vitality after the Eighth Circuit’s decision in Stover v. Fulkerson (In re Bruening), 113 F.3d 838, 841 (8th Cir. 1997) wherein the court stated that “Rohweder, then, for our purposes, merely stands for the unexceptional proposition that factual disputes are to be resolved by the trier of facts.” However, in that case, the circuit court was reviewing a bankruptcy court's factual finding

agreement. In that case, Production Credit Association (PCA) had a security agreement covering after acquired property of the debtor. The debtor and Rohweder entered into an agreement whereby the debtor would breed, calve, pasture, and provide care for Rohweder's cattle in exchange for forty percent of the calf crop. Rohweder retained ownership of the cows and received the remaining calves. Id. at 110. PCA claimed a security interest in the cattle based on its agreement with the debtor. Rohweder contended that the debtor held the cattle under a bailment and did not have sufficient rights in the livestock for the security interest to attach. In reversing the district court's directed verdict, the Eighth Circuit noted that security interest does not attach to property that is subject to a bailment and held that Rohweder had presented sufficient evidence to support the conclusion that the arrangement was a bailment. Therefore, it was proper to present the issue to the trier of fact. Id. at 112-113. Upon remand, the court stressed that the crucial element in determining whether the debtor had rights in the cattle or a bailment was created, was the parties' intent. Id. at 113.

In this case BLMI argues that Debtors held the 1999 Cattle and the 2000 Cattle subject to a bailment. In Iowa,

A bailment occurs when personal property has been delivered by one person, the bailor, to another, the bailee, for a specific purpose beneficial to the bailee or the bailor, or both, with the understanding the property will be returned to the bailor after the purpose has been accomplished. Farmers Butter & Dairy Coop. v. Farm Bureau Mut. Ins. Co., 196 N.W.2d 533, 538 (Iowa 1972). Generally, a bailment is based on an expressed or implied agreement. Id. However, it can also arise by operation of law when justice requires. See 8A Am.Jur.2d Bailments § 8 (1997). Thus, when a person comes into lawful possession of personal property of another without an underlying agreement, the possessor may become a constructive

that the arrangement was an actual sale and not a bailment. Therefore, the procedure posture was different and the burden on the appellant to prevail was significant as he would have to show that the lower court's finding was clearly erroneous. The circuit panel recognized that Rohweder had a stronger factual basis for a finding of a bailment, and he was therefore afforded the opportunity to present the issue to the trier of fact.

bailee. Id. Once a bailment is established, the law imposes specific duties upon bailees to care for the bailor's property while it is in their possession. The degree of care required to be exercised by a bailee depends upon the type of bailment.

Khan v. Heritage Property Management, 584 N.W.2d 725, 729-30 (Iowa Ct. App. 1998).

Iowa courts recognize three types, bailments for the sole benefit of the bailor, bailments for the sole benefit of the bailee, and bailments for the mutual benefit of both parties. Id. at 730 n. 3.

In these proceedings, the court finds that BLMI has demonstrated that its arrangement with Debtors was a bailment for the mutual benefit of the parties. BMLI's main business is the operation of its sale barn and providing a market for livestock producers. When it purchases cattle it advances its business goals; however, it must dispose of the purchased livestock without taking a loss in the process. To accomplish this goal, BLMI engages cattle feeders such as Debtors to "background" and "feed out" or "fatten" the cattle that it purchases with the ultimate destination for the cattle being sent to IBP.

The court finds that BLMI delivered the 1999 Cattle and 2000 Cattle to Debtors for the specific purpose of feeding the cattle to market weight. This delivery was made with the understanding that these cattle, so placed, would be returned to BLMI when the cattle reached market weight and were ready for slaughter. The decision of when they were to be returned and ultimately sold for slaughter lay entirely with BLMI and its representative Ronald Schooley. This bailment mutually benefited the parties. BLMI enhanced its auction sales by providing an outlet to cattle producers and received sales commissions. Debtors were able to market their crops and labor through the feedlot operation, receiving compensation from BLMI when the cattle were sold.

Therefore, since the arrangement between BLMI and Debtors was that of a bailment for the mutual benefit of the parties, Debtors did not have sufficient rights in the 1999 Cattle and 2000 Cattle to encumber them with a security interest. See Rohweder, 765 F.2d at 112. Accordingly, MSB's security interest did not attach to the cattle, and Counts I, II, and III will be dismissed.

Equitable Estoppel

MSB also argues that BLMI should be estopped from claiming a property interest in the 1999 Cattle and the 2000 Cattle. It contends that BLMI clothed Debtors with the appearance of ownership of the cattle, and thereby allowing Debtors to mislead MSB as to their ability to grant a security interest in the cattle. MSB argues that it is an innocent victim, and BLMI should not be allowed to profit at its expense. MSB asks the court to find that it is inequitable to allow BLMI to assert its property interest in the cattle, and Debtors' possession, caretaking, and appearance of control over the cattle constitute rights in the collateral sufficient to permit MSB's security interest to attach.

In general, to succeed on a claim of estoppel, the claimant must demonstrate 1) a false representation by the party to be estopped; 2) that the party had the intent to induce the claimant to act on the misrepresentation; 3) the claimant's lack of knowledge or inability to obtain the true facts; and 4) the claimant's reliance on the misrepresentation to his detriment. Rutten v. United States, 299 F.3d 993, 995 (8th Cir. 2002). Mere silence will not give rise to an estoppel. However, if a party has a duty to speak and his failure to do so leads to the prejudice of the claimant, the party may be estopped. 31 C.J.S.

Estoppel and Waiver § 99.³

³ The South Dakota Supreme Court in Shaul refers to what it calls estoppel by negligence and cites Black's Law Dictionary 571 (7th ed. 1999) for its definition. MSB does not specifically identify its argument as

The court does not find that BLMI should be estopped from asserting its property interest in the cattle. BLMI did not misrepresent its ownership interest in the cattle and did not intentionally induce MSB to take any action. Nor did BLMI remain silent when it was under a duty to speak. The only time that MSB actually questioned BLMI about the cattle, David Schooley informed MSB's representative of BLMI's ownership interest. The statutes in place at the time this bailment took place did not require the filing of a UCC statement. To the extent that MSB was the victim of a misrepresentation, David Weiler made the misrepresentation by stating that he owned the cattle in his feedlot.

Further, the court finds that MSB had the ability to obtain the true facts. Debtors' feedlot is on the outer edge of what would be considered MSB's market area at the time. It would have been prudent for its representatives to speak with local residents and businesses concerning Debtors' operation. MSB had the ability to investigate Debtors' operation and reputation. MSB also knew, prior to loaning money to Debtors in 1997, that they had been engaged in the custom feeding of cattle.

Finally, MSB did not follow its own internal procedures for making loans, and tracking the collateral. MSB offered no evidence at trial of the purchase of cattle, identification of cattle in which they claimed a security interest, sale of those cattle, and the disposition of the sale proceeds. The court acknowledges that BLMI's method of tracking the cattle could be misleading to a creditor, because it used its buyer bills and buyer invoices forms to identify the destination where the livestock were to be placed. Although the court believes Ronald and David Schooley's testimony that they did not intend to deceive anyone, this method could give the impression that the named farmer or

one of estoppel by negligence and does not cite any authority for this premise. Based on the lack of argument and corroborating authorities in the Eight Circuit or by Iowa Courts, this court chooses to discuss this issue based on the well-settled analysis.

feedlot operator had purchased the livestock. However, since MSB could not show that it ever required or received these documents from Debtors, the court cannot find that it was misled or relied upon the documents to its detriment.

The court has also considered MSB's argument that BLMI violated the Packers and Stockyard Act. However, the court does not consider the argument relevant in the context of determining whether BLMI should be estopped from claiming ownership of the cattle in question. Whether BLMI violated the Act is the question for another forum. The evidence before this court shows that BLMI purchased cattle at fair market price and placed the cattle on different farms and feedlots.

Deemed Sale or Return

MSB argues that even if Debtors did not have sufficient rights in the cattle for their interest to attach pursuant to Iowa Code § 544.9203(1), its security interest would attach because the delivery of the cattle should be deemed a sale to Debtors under Iowa Code 554.2326. That statute which addresses consignment sales and secret liens provides in relevant part:

3. Where goods are delivered to a person for sale and such person maintains a place of business at which that person deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to the claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as "on consignment" or "on memorandum". However, this subsection is not applicable if the person making delivery
 - a. complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or
 - b. establishes that the person conducting the business is generally known by creditors of the person conducting the business to be substantially engaged in selling the goods of others, or
 - c. complies with the filing provisions of the Article on Secured Transactions (Article 9).

Iowa Code § 554.2326 (2000).

The court determines that Iowa Code § 554.2326, as in effect at the time of the transactions, is inapplicable in these proceedings. As stated above, BLMI delivered the 1999 and 2000 Cattle to Debtors subject to a mutually beneficial bailment. The cattle were not delivered for sale. Debtors' duty under the bailment was to feed and care for the cattle to market weight. At that time, Debtors would return the cattle to BLMI and the bailment would cease. BLMI, through its representative Ronald Schooley, then sold the cattle to IBP. The court places no significance to the fact that some of the sales checks from IBP were made to the order of David Weiler with the balance made to Schooley Farms. For the purposes of this proceeding, BLMI presented testimony evidence from Ronald Schooley, David Schooley, and Jim Beatie, buyer for IBP providing credible explanations for the manner in which the checks were drafted.

Further, even if the statute were applicable, the court has found that MSB knew that Debtors were engaged in the business of custom feeding cattle at their farm near Bloomfield, Iowa. As such, BLMI has demonstrated a valid defense under Iowa Code § 554.2326(3)(b).

Accordingly, the court finds that delivery of the 1999 Cattle and 2000 Cattle to Debtors' feedlot should not be deemed a sale or consignment. Therefore, MSB's security interest did not attach to the cattle.

Priority in Farm Equipment

Count VII of MSB's complaint asks for a determination that its lien has priority over CFB's claim of a purchase money security interest in certain identified equipment consisting of a 2000 Roto Grind – 1090 Rotary Tub Grinder s/n 1646090; a 1994 MF

1183 cornhead – 8 row s/n 2739-120090; 1995 Westfield Auger MK 100-61/71; and a 1990 IHC V-ripper s/n 12100004001875. Although the parties did not address this issue in their post-trial briefs, evidence presented at trial supports MSB’s contention that CFB did not provide purchase money for this equipment. Debtors had purchased and taken possession of the equipment more than twenty days prior to the filing of CFB’s financing statement, and the funds advanced on the promissory note were not used to purchase the equipment.

Accordingly, the court finds that MSB’s perfected security interest in the above-identified equipment is prior and superior to that of CFB.

Marshalling of Assets

Count VIII of MSB’s complaint is cast in the alternative to Count VII. The court has found in its favor on Count VII rendering Count VIII moot.

Schooleys as Alter Egos of BLMI

At trial, MSB moved to amend its complaint to ask the court to pierce the corporate veil of BLMI, and hold Ronald and David Schooley personally liable for any claims against it. The court has considered the evidence presented and finds that BLMI has maintained a distinct corporate identity. It observes the corporate formalities and keeps separate accounts and books. Notwithstanding Ronald Schooley’s blunt concession that he did not understand the distinction, the court determines that MSB has not shown that BLMI is the alter ego of Ronald and/or David Schooley.

Finally, the court has considered all the other arguments presented by the OUCC and MSB, and finds them to be without merit.

ORDER

IT IS THEREFORE ACCORDINGLY ORDERED as follows:

1) That the defendants, David L. Weiler, Edna Z. Weiler, Commercial Federal Bank, Bloomfield Livestock Market, Inc., Ron Schooley, David Schooley, and Schooley Farms, shall have judgment against the plaintiff, MidWestOne Bank & Trust, f/k/a Mahaska State Bank, dismissing Counts I, II, III, and VIII, of the complaint in adversary proceeding No. 01-20105.

2) That the plaintiff, MidWestOne Bank & Trust, f/k/a Mahaska State Bank, shall have judgment on Count VII of the complaint in adversary proceeding No. 01-20105, against the defendants declaring that said plaintiff has a superior security interest in the equipment as described in the above order.

3) That the defendants, Commercial Federal Bank, Bloomfield Livestock Market, Inc., Ron Schooley, David Schooley, and Schooley Farms, shall have judgment against the plaintiff, Official Unsecured Creditors Committee, dismissing the complaint in adversary proceeding No. 02-20045.

4) That each party shall pay their own costs incurred in the course of these proceedings.

Dated: _____, 2004.

RUSSELL J. HILL, JUDGE
U.S. BANKRUPTCY COURT