

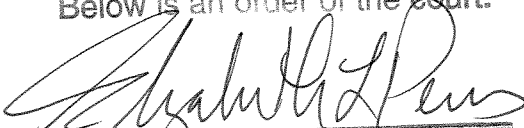
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Below is an order of the court.


U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)	Bankruptcy Case No.
)	01-42235-elp7
CARSTEN VON BORSTEL,)	
)	
Debtor.)	
_____)	
JIM O'HAGAN, as successor in)	Adversary No. 03-3523
interest to MICHAEL A.)	
GRASSMUECK, INC.,)	
)	
Plaintiff,)	
)	
v.)	RULING ON PHASE 1 OF TRIAL
)	
THEODORE VON BORSTEL,)	
)	
Defendant.)	
_____)	

Phase 1 of this adversary complaint came on for trial on
November 15, 16, and 20, 2006. Based on the evidence presented at
trial, the court enters the attached Ruling on Phase 1 of the Trial.

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cc: Joseph Field
Paul Bocci

O'Hagan v. Theodore Von Borstel
Adv. No. 03-3523

RULING ON PHASE 1 OF TRIAL, NOVEMBER 2006

This is the time set for the court to rule on Phase 1 of the trial of O'Hagan v. Theodore von Borstel, Adv. No. 03-3523. The complaint, as amended by the pretrial order lodged on November 16, 2006, seeks an accounting and dissolution of a partnership known as DVB & Sons (DVB), in which debtor was a partner, and avoidance of the alleged fraudulent conveyance of the personal property of DVB to defendant.

BACKGROUND

Debtor Carsten von Borstel filed a chapter 7 petition on December 10, 2001. The trustee filed an amended complaint against defendant, who is debtor's brother and business partner, requesting a partnership dissociation and accounting. Plaintiff is the successor-in-interest to trustee, having acquired the estate's interest in this litigation in exchange for \$10,000 plus 15% of any net recovery.

In the pretrial order, defendant admits that debtor and defendant were partners in DVB. The parties dispute the extent of debtor's partnership interest: plaintiff claims that it is 50%; defendant claims that, at the time of bankruptcy, debtor was only a nominal partner with a 5% interest.

DVB was formed in the mid-1970s when Donald von Borstel and one of his sons, debtor Carsten von Borstel, began jointly farming together. In 1979, DVB substantially expanded. Defendant Theodore von Borstel and another von Borstel brother, Wayne, became partners with their father and debtor, and the partnership purchased 5,000 acres, commonly referred to as the Bakeoven property. Wayne withdrew from the partnership in about 1983. In the middle of the 1980s, DVB filed Chapter 11. In 1986, at the end of the Chapter 11 bankruptcy, debtor stopped actively farming, but he continued as a partner.

In 1989, DVB filed Chapter 12 and confirmed a plan in 1991 pursuant to which DVB sold all of its real and personal property, consisting of the Bakeoven property, the Sherman County property, and machinery, to Don Phillips on an installment contract. The plan required the installment contract pursuant to which Phillips was to pay DVB the amounts due to creditors under the plan and DVB was to use the Phillips payments to pay the creditors.

As part of the Phillips transaction, but not disclosed or discussed in the Chapter 12 plan, Donald von Borstel deeded two parcels of property he owned individually to Phillips, the Home Place and the Pausch Place. In 1997, Phillips deeded those two parcels to defendant. Initially, plaintiff claimed in his opening statement that the conveyance of the two properties to defendant was a fraudulent conveyance. By closing argument, and

as part of the revised pretrial order that the court required to be submitted during trial, plaintiff claimed that defendant owns the two parcels for the partnership, which is the true owner of the Home Place and the Pausch Place.

DVB continued to operate after confirmation of the Chapter 12 plan through the lease back of property from Phillips, leasing of other property, and custom farming. Donald retired from active farming in the mid-1990s, and defendant remained the only active farmer in the DVB partnership.

According to DVB's tax returns, DVB continued some operations after debtor filed bankruptcy and after debtor's bankruptcy trustee filed the original complaint in this action.

ISSUES

1. What was the extent of debtor's interest in DVB on the date of his bankruptcy petition?
2. What were the assets of DVB as of the petition date? In particular:
 - a. What personal property did DVB own?
 - b. Did DVB fraudulently convey personal property to defendant?
 - c. What real property did DVB own?
 - d. What real property did DVB lease?
3. What rights, if any, does plaintiff have to funds generated by DVB after the date of debtor's bankruptcy petition?

DISCUSSION

1. Extent of Debtor's Ownership Interest in DVB

Plaintiff claims that he has acquired a 50% interest in DVB by purchasing the bankruptcy estate's interest from the trustee. In the pretrial order, defendant contends that debtor was not a 50% partner in DVB at the time of debtor's bankruptcy petition, December 10, 2001. At the pretrial conference, defendant's counsel characterized debtor's interest as nominal, roughly 5%.

There is no signed partnership agreement between the partners that is in evidence. Exhibit 1 is a Partnership Agreement and Addendum that the parties never signed and that defendant testified he never saw until this litigation. I give it no weight.

Defendant's characterization of the ownership interests conflicts with the 1998-2005 tax returns that are in evidence as Exhibits 21-28 and which state on debtor's K-1s that debtor had profit, loss, and capital partnership shares of 50% each year.

The evidence offered by defendant to contradict debtor's 50% interest fails to do so. Much was made of a \$50,000 loan by the partnership to debtor that, according to the partnership's accountant, should be deducted from debtor's capital account, and the relative capital accounts establish the ownership percentages. The problem with this assertion is twofold. First, Exhibit I, the capital recap for debtor, starts in 1990 and

ignores that any true capital recap would have to have started at the beginning of the partnership. Second, and more important, notwithstanding that the alleged \$50,000 loan occurred in 1995, the tax returns in evidence for the years 1999-2005 made no adjustment in the percentage capital accounts of the two partners.

This is a case that involves, in its best light, what defendant's counsel characterized as less than adequate record-keeping by unsophisticated farmers and, in its worst light, individuals who are willing to describe facts in whatever way is advantageous to them at the moment.

I find that the partnership tax returns, which were prepared with information supplied by defendant, accurately capture debtor's and defendant's respective partnership interests. Debtor had a 50% capital interest in DVB at the time he filed bankruptcy.

2. Extent of Assets of DVB

Plaintiff claims that DVB has an interest in more than 7,000 acres of real property. He also claims that DVB fraudulently conveyed its personal property to defendant and that the conveyance should be avoided. I will address the real and personal property separately.

a. & b. Personal Property and Alleged Fraudulent Conveyance

On its tax returns for 1999-2004, DVB reported owning a fairly extensive list of personal property that it was depreciating. For example, in two lists on Statement 3, the 2001 return lists personal property acquired between 1974 and 2001, which cost approximately \$580,000. The same personal property continues to be listed on DVB's returns through 2004. In 2005, the lists disappear from the DVB return. In 2005, the DVB personal property suddenly shows up as defendant's personal property on his personal tax return, which is Exhibit 50 at pp. 27-29.

Defendant testified that he did not intend to change the ownership of the assets when he moved them from DVB's tax return to his own tax return in 2005. He intended that this court would determine ownership of the assets in this action.

Based on the tax returns through 2004 and defendant's testimony, I conclude that DVB owns the personal property identified on the DVB 2004 tax return and that DVB never transferred those assets to defendant, notwithstanding his instructions to the accountant to switch the depreciation claim from the partnership to his personal return. This may have been an awkward effort in furtherance of the dissolution of the partnership, since plaintiff in this action has sought a money judgment for his interest in the partnership rather than the

partnership assets themselves. Because the personal property was not transferred, there was no fraudulent transfer.

c. Real Property - Ownership Interests

Plaintiff claims that defendant took title in his own name to real property that was purchased with DVB funds, and that it is property of DVB despite the name on the title document.

Defendant responds that the real property was not purchased with DVB funds and is not DVB property.

ORS 67.060-67.065 governs when property is considered partnership property. ORS 67.065 provides:

(1) Property is partnership property if acquired in the name of:

(a) The partnership; or

(b) One or more partners with an indication in the instrument transferring title to the property of the person's capacity as a partner or of the existence of a partnership without an indication of the name of the partnership.

(2) Property is acquired in the name of the partnership by a transfer to:

(a) The partnership in its name; or

(b) One or more partners in their capacity as partners in the partnership, if the name of the partnership is indicated in the instrument transferring title to the property.

(3) It is a rebuttable presumption that property is partnership property if purchased with partnership assets, even if not acquired in the name of the partnership or of one or more partners with an indication in the instrument transferring title to the property of the person's capacity as a partner or of the existence of a partnership.

(4) It is a rebuttable presumption that property acquired in the name of one or more partners, without an indication in the instrument transferring title to the property of the person's capacity as a partner or of the existence of a partnership and without use of partnership assets, is separate property, even if used for partnership purposes.

As the Oregon Supreme Court explained,

[A]ll property employed in a given partnership enterprise is not necessarily owned by the partnership and . . . the title to all or part so used may repose in one or more of the copartners as individuals, subject to the right of use only in the partnership.

Fenton v. State Indus. Accident Comm'n, 199 Or. 668, 672 (1953).

Therefore, the name on the title and the source of the funds used to purchase the property are factors in determining ownership of the property.

In addition, the intention of the parties is a factor in determining whether it is partnership property. Gorger v. Gorger, 276 Or. 267, 279 (1976) ("The courts are in substantial agreement with the proposition that the intention of the parties governs in determining what constitutes partnership property."). The court in Gorger relied on an earlier version of what became ORS 67.065, which provided that, "[u]nless the contrary intention appears, property acquired with partnership funds is partnership property" Former ORS 68.130(2). Although the language of the earlier statute relied on intent and the current version speaks in terms of presumption, the intention of the parties is still relevant evidence in determining whether the presumption described in ORS 67.065 is overcome.

Before discussing the individual properties, I want to comment on what plaintiff viewed as significant evidence of DVB's ownership: DVB's Safeco Insurance Policy for the period 8-31-04 to 8-31-05, identifying coverage for 7,185 acres. Exhibit J. I find that this policy is not particularly probative of what real estate, if any, DVB owned, because DVB is only one of five insureds, DVB operated as a lessee and, as such, would have had a need to maintain insurance, and the evidence was that DVB did not always update its insurance as the location of its farming activities changed.

(1) Home Place

The Home Place belonged to Donald and Jacqueline von Borstel until 1990, when they conveyed it to Phillips as part of the Chapter 12 transaction. Notwithstanding the fact that the conveyance was by land sale contract, debtor, who negotiated with Phillips on behalf of DVB, testified that the property was to be returned by Phillips if DVB and the von Borstels performed their obligations to him. Phillips, on page 37 of his deposition, denied the existence of such a side agreement.

Nonetheless, in 1997, Phillips quitclaimed the Home Place to defendant, and defendant executed a trust deed for the benefit of Phillips to secure an agreement to pay a cross-collateralized loan.

Plaintiff argues that the Home Place really belongs to DVB notwithstanding the fact that it has never been titled in DVB's name, because DVB paid some of the debt secured by the Home Place.

Although there are many odd aspects of the transaction between Phillips, DVB, and the von Borstels, I conclude that the Home Place never belonged, and does not currently belong, to DVB. I reach that conclusion based on the following. Donald and Jacqueline von Borstel owned the Home Place at the time DVB was formed. Although they pledged the Home Place as collateral for a series of loans to DVB, and later transferred it to Phillips to facilitate DVB's Chapter 12 plan, they never transferred the property to DVB. Essentially, they were partners who used personal assets to further the partnership's business. Putting their real estate up as collateral for the partnership's debts did not make the real estate partnership property. When Phillips conveyed the Home Place to defendant, it was his property and he had no obligation to convey it to DVB. Finally, the fact that DVB paid debt secured by the Home Place does not make the Home Place DVB property. The debts that were paid were DVB debts and DVB got the loan proceeds.

I want to comment on a few of the arguments plaintiff made regarding the Home Place. Plaintiff argues that the Chapter 12 bankruptcy plan treated the Home Place as DVB property. See

Exhibit A. While it is true that the Chapter 12 plan refers to Sherman County real property, the real property is not identified. There is no specific reference to the Home Place in the Chapter 12 plan. Furthermore, it is not clear whether the reference to Sherman Country property relates to an ownership interest or a leasehold interest in property. Even assuming the Sherman County property referenced in the Chapter 12 plan is the Home Place, its presence in the plan may be explained by its role as collateral for DVB loans that are being paid through the transaction referenced in the plan.

Plaintiff points to payment by DVB of property taxes to Sherman County, Exhibits 14, 64, 70, 71, and payments by DVB to the Farm Service Agency (FSA) and Farm Credit Services (FCS) totaling approximately \$200,000 after the Phillips transfer to defendant. Exhibits 72, 73. These payments would not be unusual, given that DVB used the property and the debt paid was debt incurred by DVB and secured by the property.

Plaintiff points to FSA records that he says show a side deal between debtor and Phillips. Exhibit 74, authenticated by Exhibit 92. As discussed earlier, there is divergent testimony as to whether such a side deal existed. Even if it did, it does not establish that DVB has a right to the property, which did not belong to DVB at the time it was transferred to Phillips.

(2) Pausch Place

Donald von Borstel inherited the Pausch Place. He transferred it to Phillips around the same time as he transferred the Home Place as part of the Chapter 12 plan transaction. Phillips later deeded both the Home Place and the Pausch Place to defendant in 1997. Defendant testified that he thought he got the Pausch Place from Donald, not from Phillips. In fact, there was a 1997 quit claim deed from Donald to defendant.

The uncontradicted testimony is that Donald inherited the Pauch Place and that it was unencumbered. The fact that he conveyed it to Phillips in 1990, who later conveyed it to defendant, did not turn the Pausch Place into DVB's property.

Although I find the von Borstels, and particularly debtor, to be less than forthright witnesses, I believe the testimony that the Pausch Place and the Home Place were Donald's property, and that he agreed to use the two properties to secure financing for DVB without relinquishing whatever rights to ownership could be retained. As evidenced by the quitclaim deeds from Donald to defendant in 1997, Exhibits 57-63, Donald wanted the Pausch Place and the Home Place conveyed to defendant, rather than being returned to him when Phillips was ready to convey them in 1997.

I conclude that DVB has no interest in the Pausch place.

(3) John Larsall Property

Defendant farmed the John Larsall property from 1982-1986 when the property went into the Conservation Reserve Program

(CRP). The evidence did not establish that DVB ever had any ownership interest in the John Larsall property.

(4) Bakeoven Property

The uncontradicted evidence established that Phillips bought the Bakeoven property from DVB and continues to own it to this day. The contention that DVB owns some interest in the Bakeoven property borders on the frivolous.

(5) Rita Place and Ashly Place

Likewise, there is no credible evidence that DVB has any ownership interest in either of these properties.

d. Real Property - Leasehold Interests

DVB's 2002, 2003, and, to a lesser extent, 2004 tax returns show substantial farming-type expenses, such as custom hire, chemicals, fertilizers, freight and trucking, gasoline, insurance, and repairs and maintenance, that are typically associated with farm operations. Yet, DVB has not identified what property DVB had leasehold interests in nor the terms of those leaseholds.

To the extent that DVB had leaseholds or other possessory rights in property that have value, those must be accounted for in the winding up of the partnership. DVB must produce such evidence during Phase 2 of the trial.

3. Plaintiff's Rights, if any, to Funds Generated by DVB after the Date of Debtor's Bankruptcy

DVB continued in business after debtor filed bankruptcy, although there is a dispute about the extent of the operation and the amounts generated by it. As is evident from the 2002-2005 DVB tax returns, DVB sold farm products it produced, had custom hire (machine work) income, agricultural program payments, and other income such as insurance proceeds and seed and expense reimbursements.

The parties dispute what rights, if any, plaintiff has to income generated after the date of debtor's bankruptcy and how much that income was. Plaintiff contends that he is entitled to 50% of the DVB income after the date of bankruptcy.

Plaintiff hired an accountant, Virginia Anderson, who laboriously constructed an accounting for the years 2001-2006 using information gleaned from the DVB and individual partners' tax returns, bank records, bankruptcy court documents and records from Mid Columbia Producers, Inc., a corporation that bought product from DVB and the individual von Borstels. Anderson concluded that DVB's tax returns for 2001-2005 substantially understate DVB's income. Her analysis assumes that plaintiff is a substitute partner for debtor and that he is entitled to 50% of the income generated by DVB after the date of bankruptcy.¹

¹ Because, as I discuss later, I find Anderson's assumption that plaintiff acquired the right to 50% of any income DVB generated post-bankruptcy erroneous, I do not review her income analysis in detail.

Defendant did not offer an accounting. Instead, he offered to have the property owned by DVB on December 10, 2001 valued as of that date, to have debtor's share of the value of the DVB assets determined by the court, and to give defendant an opportunity to buy plaintiff out. Defendant contends that the only consequence of his failure to buy out debtor's share should be "an *in rem* judgment against partnership assets." Pretrial Order, ¶ 10.iii., p. 6.

Before focusing on the specific disputes, I want to focus on the legal consequences when a partner files bankruptcy, because the consequences have a bearing on the rights of the bankruptcy trustee of the debtor partner. Plaintiff stands in the shoes of the bankruptcy trustee and has no greater rights than the trustee had.

Under Oregon law, the act of filing a bankruptcy dissociates a partner from the partnership. ORS 67.220. Debtor's bankruptcy petition dissociated him from the partnership, resulting in a single remaining partner, defendant. According to ORS 67.290, "A partnership is dissolved, and its business must be wound up, only upon the occurrence of any of the following events: . . . (7) There are no longer two or more partners carrying on as co-owners the business of the partnership for profit." Because of debtor's dissociation, DVB dissolved by operation of law as of the bankruptcy petition filing date, December 10, 2001. Once a

partnership is dissolved, "[e]ach partner is entitled to a settlement of all partnership accounts upon winding up the partnership business." ORS 67.315(2).

Based upon the evidence, I conclude that plaintiff is entitled to 50% of the value of the partnership assets² on December 10, 2001, plus compensation for the delay in payment as discussed below. The partnership assets consist of the following:

1. Personal property identified on the partnership return in 2004, and any additional personal property acquired with partnership assets.
2. Leasehold interests and rights to government payments in existence on the date of debtor's bankruptcy or acquired thereafter using assets of the partnership. In Phase 2 of the trial, these assets need to be identified and valued. Defendant will have the burden of demonstrating what the leasehold interests are and what rights to CRP payments defendant had on the date of bankruptcy. The burden will be on defendant to prove, by competent evidence what farming operations DVB conducted in 2002-2004 and the extent, if any, to which those operations did not involve use of partnership assets. Mere

² Based on Exhibit 37, it appears that DVB paid off on October 29, 2003 an obligation to FCS in the original amount of \$44,752.06. Normally an accounting would deduct debt from the value of the assets. No party has advocated that this should be done here, so I have not considered it.

denial and self-serving testimony will not be acceptable in view of the fact that DVB's tax returns for the pertinent years contain farming type expenses, but little or no crop income.

With respect to plaintiff's claim for prejudgment interest, the case of Jones v. Dorsey, 193 Or. App. 688 (2004), is instructive. In awarding prejudgment interest in a partnership accounting action, the court stated:

Ordinarily, interest is not chargeable in an accounting by one partner to another. However, there is an exception to that general rule; a "court may, in its discretion, add interest to the share owed by a partner guilty of a fiduciary breach * * *." Here, plaintiff pleaded and proved [that the defendant breached his fiduciary duties.] Accordingly, the trial court had discretion to award plaintiff prejudgment interest on the accounting claim, if the other requirements for such an award were satisfied.

[T]he fact that the amount owed cannot be ascertained without resolving complex issues of fact does not bar a determination that the defendant owed sums certain at a date certain. A prejudgment interest award is especially appropriate where, as here, the complexity in ascertaining the amount owed is attributable, in part, to inadequate recordkeeping by the defendant.

Jones, 193 Or. App. at 692-93 (citations omitted).

Because of defendant's lengthy delay in winding up the partnership, his use of partnership assets in the interim, and his incomplete record keeping, plaintiff is entitled to compensation equal to the greater of the following:

1. Interest on one-half the value of the assets at 9% per annum from April 1, 2002. I selected this date because defendant reasonably could have wound up the partnership in three to four

months, and it is reasonable that pre-judgment interest, at the statutory rate under Oregon law, should apply after that period expired.

Or:

2. One-half of the net custom hire income generated using DVB equipment plus one-half the net proceeds from any leaseholds and government payments. Defendant continued to use DVB property for non-winding up activities. That was an improper use of partnership property. If such use generated more than prejudgment interest would yield, plaintiff should be given the benefit of one-half the income to prevent unjust enrichment of defendant, who used partnership assets to generate income that he kept rather than promptly winding up the partnership as he was obligated to do.

This court will assume that all the custom hire income and payments by Pat Powell for services fall in this category unless defendant puts on competent evidence during Phase 2 of the trial that the payments by Pat Powell are strictly for labor by defendant and defendant alone.

CONCLUSION

The court will wait until the conclusion of Phase 2 of the trial to decide whether plaintiff should be entitled to a money judgment against defendant because of defendant's use of partnership assets for the last several years and his delay in

winding up the partnership, or the judgment should be fashioned as an *in rem* judgment against the partnership as requested by defendant.