SO ORDERED.

SIGNED this 06 day of December, 2005.

Dale L. Somers
Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

IN RE:	)	
	)	
RAFTER SEVEN RANCHES, L.P.	)	
	)	**Case No. 05-40483**
Debtor.	)	**Chapter 12**
	)	

MEMORANDUM AND ORDER DENYING WNL'S MOTION IN LIMINE

The matter before the Court is the Motion in Limine filed by WNL Investments, L.L.C. ("WNL"). WNL appears by Timothy H. Girard, Woner, Glenn, Reeder, Girard & Riordan, P.A. Debtor, Rafter Seven Ranches, L. P., appears by William E. Metcalf. There are no other appearances.

The motion in limine arises because of a dispute between the Debtor and WNL concerning their respective interests in real property. WNL asserts that it is the owner of three tracts of farm property located in Finney County which it contends it purchased from the Debtor and two related

trusts in October 2002. Each of the three transactions is evidenced by a warranty deed and an Agreement for Sale of Real Estate and Personal Property, Lease, and Option to Re-Purchase (hereafter Transfer Agreement). The Debtor contends that the October 2002 transactions were in fact loans from WNL to the owners/sellers secured by an equitable mortgage on the properties. Subsequent to the transactions, the Debtor contends it acquired by assignment the interest of the trusts in the real property and all related rights and obligations. That issue is not now before the Court. For the purpose of simplicity, however, in the remainder of this memorandum, the Court will disregard any distinction between the present rights and interests of the Debtor and the trusts and assume the assignment effectively divested the trusts and transferred to the Debtor all interests and obligations in issue.

The question of whether WNL is the owner of the tracks or the holder of a claim secured by equitable mortgages in the properties arises in four related matters set for trial in the near future: (1) The motion of WNL for relief from automatic stay, filed on April 14, 2005, to which the Debtor objected; (2) the Debtor's motion to assume leases and notice of assumption pursuant to 11 U.S.C. § 365 and Bankruptcy Rule 6006, filed May 6, 2005, to which WNL objected; (3) Debtor's Chapter 12 plan dated August 22, 2005, to which WNL objected; and (4) the Debtor's objection to claim of WNL filed on August 24, 2005.

WNL has filed a motion in limine by which it requests the Court, in the trial of the four foregoing matters, to prohibit Debtor's introduction of evidence to vary the terms of the warranty deeds and Transfer Agreements in support of its contention that WNL is not the owner of the real properties but is a mortgagee. WNL argues that the Transfer Agreements, the deeds, and a subsequent extension

agreement are unambiguous so that evidence which would vary the terms of the written agreements is not admissible. The Debtor contends that under Kansas law extrinsic evidence is admissible to establish that the deeds, although absolute on their faces, are in fact equitable mortgages. The Court is now ready to rule and denies the motion for the reasons stated below.

FACTUAL BACKGROUND.

An understanding of the factual circumstance is necessary to resolution of the motion.[1] The issue between the Debtor and WNL arises from three identical transactions concerning the sale of three tracts of farm land and personal property. One transaction is with the Debtor and the other two are with two trusts related to the Debtor, denoted as sellers. WNL, a Nebraska limited liability company, is denoted as the buyer. The Transfer Agreements were executed on October 22, 2002, when the tracts were the subject of a tax foreclosure action. Some aspects of the agreements appear inconsistent with the Debtor's theory of equitable mortgage. For example, each Transfer Agreement recites, "The Seller/Lessee acknowledges that this conveyance transaction is an absolute sale and conveyance of fee simple title of the property described in Paragraph 1 of this agreement." Warranty deeds were executed by the sellers conveying the properties to WNL, and the deeds were recorded. The Transfer Agreements provide that WNL is liable for real property taxes. However, the Transfer Agreements also include terms which are consistent with Debtor's theory. The sellers are granted leases of the real properties from October 2002 through December 31, 2005. The rent for 2002 and 2003 was deducted from the proceeds distributed to the sellers, and $8,300. in rent per tract per year was due

[1] The Court's recitation of the facts is intended as background and does not constitute findings of fact for purposes of determining the merits of any of the pending litigation.

for occupancy during years 2004 and 2005. During this 38 months, the lessees (Debtor and the trusts) retain many incidents of ownership, including the right to possession and use of the property for agricultural purposes, to make improvements, and to receive government payments. The lessees retained the duties to maintain the crop base, to repair and maintain water and irrigation systems, to control noxious weeds, to follow EPA guidelines when using chemicals, and to purchase hazard and liability insurance. The Transfer Agreements provide that the buyer, WNL, will not sell the property during the lease term. The sellers/lessees are granted options whereby they may purchase the real properties (but not the personal property) from WNL during the 38 months of the lease term. The three tracts may be listed, marketed, and sold by the lessees to a third party "as a part of the process of 'repurchasing.'" Although the consideration for each parcel was probably $50,000 or less in October 2002, the options to purchase are for $66,000 on or before December 31, 2003, $72,000 on or before December 31, 2004, and $78,000 on or before December 31, 2005. The Transfer Agreements provide that upon an uncured default in the payment of rent, WNL is entitled to immediate possession, without the need for foreclosure and with no redemption rights.

Although the Transfer Agreements include merger clauses, stating that the documents represent the "entire contract," the executed agreements are obviously incomplete. Paragraph 5, which was intended to provide for the allocation of the purchase price between the real estate, personal property, closing costs, and taxes, contains no amounts. The consideration received for the interests in real property is not known. Likewise, there is a dispute as to the value of the tracks in November 2002.

THE THEORY OF EQUITABLE MORTGAGE.

Kansas has long recognized that an absolute deed intended by the parties to be a mortgage will

be construed as an equitable mortgage. The law of Kansas regarding equitable mortgages was stated in 1986 to be as follows:

> Decisions of this court have long recognized the rule that where a deed, although absolute on its face, has been given to secure the payment of a debt the deed is to be considered an equitable mortgage rather than an absolute conveyance. . .. Where the circumstances disclose that such a deed was intended merely to serve as security for the indebtedness, principles of equity come into play and must be applied, and the debtor who executed the conveyance is entitled to a reconveyance of the land upon payment of his debt.[2]

To determine whether a transaction was a secured loan or a true sale, all of the circumstances must be examined to determine the parties' intent. In *Shamberger v. Shamberger*,[3] the appellate court affirmed a finding of equitable mortgage and stated the following rule:

> The form of an agreement by which security is given for the debt is unimportant. If the purpose and intention behind the transaction is to secure a debt, equity will consider the substance of the transaction and give effect to that purpose and intention. The court sitting in equity is not governed by the strict rules of law determining whether a mortgage has been created. The lien follows if the evidence discloses an intent to charge real property as a security for an obligation.[4]

Kansas law of equitable mortgages is consistent with that of other jurisdictions. An encyclopedia states the following rules regarding the issue as follows:

> In ascertaining whether an instrument is a mortgage, courts are guided more by the substance then by the form of the transaction. The fact that the instrument is in form a deed absolute does not

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[2] *Berger v. Bierschbach*, 201 Kan. 740, 743, 443 P.2d 186, 189 (1968).

[3] *Shamberger v. Shamberger*, 88 P.3d 807, 2004 WL 944016 (Kan. App. 2004), rev. denied Sept. 14, 2004.

[4] *Id.*, *quoting Fuqua v. Hanson*, 222 Kan. 653, syl. ¶ 1, 567 P.2d 862(1977).

> preclude the interpretation thereof as a mortgage. The interpretation of the instrument as a mortgage, or otherwise, presents a question to be decided from a consideration of the whole transaction, and not from any particular feature of it. The characterization of the transaction by the parties in the instrument is not conclusive, ...[5]
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> The ultimate and essential point to be determined in every case in which it is sought to have an instrument of transfer construed as a mortgage is the intention of the parties. To constitute a mortgage, there must be a purpose of the grantor to pledge his or her land for the payment of a sum of money or the performance of some other act.[6]
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> The doctrine that a conveyance, in essence a mortgage, shall operate as such irrespective of its form does not depend for application on the appearance of the face of the instrument of an intention that it operate by way of security and therefore as a mortgage. On the contrary, such an intention may be manifested by a separate instrument executed as part of the same transaction. In such a case, the two instruments are construed together and the conveyance held to constitute a mortgage. Thus, a deed will be regarded merely as a mortgage if at the time of its execution the parties enter into a separate writing in the nature of a defeasance or an agreement that the debtor-grantor may repurchase the property.[7]

The indicia of an equitable mortgage transaction include the property having value greatly exceeding the consideration transferred, continued possession of the property by the seller, and periodic payments of money regarded as interest.[8]

The Court notes that the equitable mortgage doctrine, applicable to real property transactions, is similar to the familiar UCC Article 9 question of whether a lease of personal property was intended

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[5] 54A Am. Jur.2d *Mortgages* §102.

[6] *Id.* at §103.

[7] *Id.* at §104.

[8] *Id.* at §§125, 130, and 131.

as a true lease or as an installment sale. In this circumstance, "what is in economic reality an installment sale of personal property is sometimes dressed up as a lease for tax and accounting reasons." [9] A lease format may be selected because the lessor may wish to avoid the filing requirements of Article 9 or the foreclosure rules following default.[10]

EXTRINSIC EVIDENCE.

Since at least 1871, the Kansas Supreme Court has held that parol evidence is admissible in support of the contention that a deed, absolute on its face, is a mortgage.[11] The court's most recent pronouncement on the issue is as follows:

> Despite the consistency of our decisions adhering to the equitable principles to which we have referred [that a deed absolute on its face may in fact constitute an equitable mortgage], the defendant insists that the terms of his deed are clear and unambiguous and that the deed conveyed full title. Thus, argues Mr. Bierschbach, the court erred in admitting oral testimony tending to vary or contradict terms of the deed. We did not agree. It has been held repeatedly by this court that parol evidence is admissible to establish that a conveyance, absolute in form, was given for the purpose of securing an indebtedness, and is hence is but a mortgage.[12]

The law of Kansas is in keeping with the general rule that "[i]n the absence of a statutory provision to the contrary, parol evidence is admissible to show that a deed in form absolute is in fact a mortgage, even though the claim for relief is not based on special equitable grounds and even though no foundation

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[9] 1 Clark, The Law of Secured Transactions under the Uniform Commercial Code ¶ 1.05 (Rev. Ed. 2005).

[10] *Id.*

[11] *Moore v. Wade*, 8 Kan. 380 (1871).

[12] *Berger v. Bierschbach*, 201 Kan. at 743, 443 P.2d at 189.

for the parol evidence has been laid by the introduction of testimony not resting in parol."[13] The rationale for the rule is stated to be:

> The doctrine of the unrestricted admissibility of parol evidence to show an absolute conveyance to be a mortgage comes into collision with the rule of positive law forbidding oral testimony to be heard in contradiction of the written definition of the transaction made by the parties. The violation of this rule is sustained on the theory that a person who accepts a conveyance with the understanding that it is to operate merely as a security for the payment of a debt owed to him or her by the grantor is chargeable with a constructive or quasi fraud if he or she subsequently denies the existence of such understanding, and that a court in prevention of the fraud may therefore enforce the instrument according to the contract of the parties. The breach of the rule mentioned is also defended on the ground that the parol evidence does in fact contradict the written contract of the parties, but that it serves to establish an independent equity, to show the actual object of the transaction, to prove the real consideration of the conveyance, to show the fact of a loan, to explain an ambiguity, or to show a additional feature of the transaction.[14]

There appears to be less unanimity about the admissibility of parol evidence when the transaction involves both a deed and a separate written instrument.

> Many decisions support the view that if an absolute conveyance of land is based upon or accompanied by a written agreement which affirmatively shows on its face that a mortgage was not intended, parol evidence is inadmissible to show the contrary, especially where the agreement contains an express declaration relative to such intention. Under this rule, parol evidence is inadmissible where the written memorandum or agreement is not ambiguous, or obscure so as to require extrinsic evidence in explanation. . ..
>
> On the other hand, there are cases which support the proposition that a deed absolute in terms may be shown by parol

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[13] 54A Am. Jur.2d *Mortgages* § 113.

[14] *Id.* at § 114.

> evidence to have been intended as a mortgage, although the deed is based upon or accompanied by and memorandum or written agreement. In this connection, it has been held that parol evidence that the absolute deed was intended as a mortgage may be received where the memorandum or agreement is not thereby contradicted. Indeed, the cases show a decided liberality in admitting parol evidence of a purpose to mortgage where the written memorandum or agreement is silent, uncertain, ambiguous, or defective and incomplete. Some cases go further and hold that parol evidence is admissible to show that the absolute deed was intended as a mortgage even though the accompanying memorandum or agreement is precise and complete, and negates the purpose to mortgage and even the circumstance that the memorandum in direct terms negates the purpose to mortgage is not regarded as barring the evidence. It has also been held that even though a clear and complete memorandum showing the purpose of a contemporaneous conveyance will bar inconsistent parol evidence of a purpose to mortgage, a mere declaration in the memorandum that a mortgage is not intended will not bar the evidence if by reason of uncertainty and ambiguity in the memorandum as a whole the evidence is otherwise admissible.[15]

Kansas follows the rule of liberal admission of parol evidence. In the *Berger*[16] case, the court affirmed a trial court's finding that a warranty deed given by the plaintiffs to the defendant was an equitable mortgage. For years the Bergers had farmed land in Harvey County which they wished to purchase from an estate for the sum of $60,000. They were able to obtain conventional financing for $40,000 of the purchase price. The remaining $20,000 was paid through $4,000 cash of the Berger's and $16,000 in cash from a friend, Bierschbach. As a part of the transaction, two documents were executed, which, taken together, provided that Bierschbach should furnish $16,000 to apply to the purchase price and the Bergers $4,000; and the Bergers would deed the land to Bierschbach, in return

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[15] *Id.* at § 117.

[16] *Berger v. Bierschbach*, 201 Kan. at 740, 443 P.2d at 186.

for which they were granted an option for 14 months to repurchase the farm for $16,000, plus 6% interest and any taxes that might be due, plus the assumption of the $40,000 mortgage, which both Bergers and Bierschbach had signed. The sale closed, and the Bergers delivered their deed to Bierschbach. After several extensions of the option to purchase, the Bergers made arrangements to refinance the debt and pay off Bierschbach. When advised of this circumstance, Bierschbach refused to convey the property. Suit was filed by the Bergers seeking a declaration that the deed was a mortgage. The trial court entered judgment for the plaintiffs. On appeal, Bierschbach claimed that court erred when admitting oral testimony tending to vary or contradict the terms of the deed. The court rejected this argument, stating that it has long been the law of Kansas that parol evidence is admissible to establish that a deed, absolute in form, was given for the purpose of securing an indebtedness. Bierschbach likewise sought to invoke the parol evidence rule in relation to the written option agreement and its extension. The court again rejected this position, finding that the option agreement was executed as part of the transaction in which Bierschbach put up $16,000 and was given a deed. The court therefore held that the "rule which permits parol evidence to establish a deed as an equitable mortgage was just as applicable to the option agreement as to the deed itself."[17]

WNL argues that extrinsic evidence should not be admitted in this case because the Transfer Agreement is unambiguous and because, unlike the historic Kansas cases adopting the equitable mortgage doctrine, this is a commercial transaction, not a transaction between family members or social acquaintances. WNL's primary case authority is *Albers v. Nelson.* [18]

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[17] *Id.*, 201 Kan. at 744, 443 P.2d at 190.

[18] *Albers v. Nelson*, 248 Kan. 575, 809 P.2d 1194 (1991).

As to the first argument, the Court acknowledges that the Debtor has not contended that Transfer Agreements are ambiguous. However, the Court has not located any authority indicating that ambiguity is a necessary prerequisite for the consideration of extrinsic evidence when the doctrine of equitable mortgage is relied upon. Rather, when the assertion is that of an equitable mortgage, the Kansas courts have liberally admitted extrinsic evidence without regard to the presence or absence of ambiguity in the deed and related transaction documents. It is an exception to the customary application of the parol evidence rule. Moreover, notwithstanding the position of the Debtor, the Court finds that it can not determine the purpose or the economic substance of the transactions without consideration of extrinsic evidence. The incomplete Transfer Agreements are susceptible to the interpretations urged by both the Debtor and WNL.

Second, contrary to WNL's position, the Court does not find that the *Albers* case stands for the proposition that the modern rule is that parol evidence is not admissible when a deed is accompanied by unambiguous related documents. *Albers* was an ejectment action in which plaintiffs, Albers and Luther, sought to recover possession of real estate sold to them by defendants Nelsons. Nelsons owned two tracts of land in Saline County, and their creditor foreclosed upon the real estate and equipment. Shortly before the redemption period was to expire, the Nelsons met with Albers and Luther to discuss financing the redemption. Nelsons contended they reached an agreement whereby Albers and Luther would lend them $109,579.08 to redeem the property from foreclosure and the Nelsons would secure the loan by transferring title to Albers and Luther. The redemption was made, and an agreement and warranty deed executed. The agreement provided Nelsons conveyed absolute title to the real estate and equipment to Albers and Luther. Nelsons remained in possession and were

to pay $300 monthly for the rent of the house and outbuilding. Nelsons also had a right to repurchase the real estate and farm machinery for $119,579.08 at 12.25% interest on or before one year from the transaction. In the event of default of the rental payments or failure to purchase the property within that year, the Nelsons agreed to peacefully vacate the premises. Albers and Luther, the purchasers, were entitled to all rents, profits, government payments and other income produced by the real estate. The contract stated that the transfer was absolute "and not for the purposes of security."

The Nelsons failed to purchase the property by the date provided, Albers and Luther filed an action. The Nelsons claimed the transaction was a mortgage and was not intended as an outright sale with the option to purchase. After the completion of discovery, Albers and Luther filed a motion for summary judgment which the district court granted, finding the written agreement was clear and unambiguous and not based on fraud or misrepresentation. The decision was affirmed on appeal. The parol evidence rule now before the Court was not considered. The Nelsons litigated the case upon a theory of fraudulent misrepresentation based upon their belief that the agreement was for a loan rather than the sale of real estate and farm machinery. The court affirmed the district court's finding that there was insufficient evidence to support a claim of fraud. As to the claim that there was no meeting of the minds, the court affirmed the finding that the Nelsons' mistake was unilateral and insufficient to void the contract. The court did not address the exception to the parol evidence rule on which the Debtor relies. Because some of the facts in *Albers* are somewhat similar to this case, the case may support WNL's position on the merits, but it is of no assistance on the parol evidence question.

The Court further rejects the contention that extrinsic evidence is not admissible because the matter before the Court is a formal commercial transaction, rather than an agreement between family

members or friends. It is true that most, if not all reported Kansas cases, arose in noncommercial situations. However, the Court does not view this circumstance as determinative. As stated above, even though the transaction is commercial and the Transfer Agreements extensive, the Court cannot determine the economic substance of the transactions from the documents alone.

In this case, the Court therefore finds that extrinsic evidence is admissible in support of the Debtor's position that the transactions created an equitable mortgage. Kansas liberally allows extrinsic evidence when a deed was granted under circumstances where the economic substance of the transaction may have been a loan secured by a mortgage. Further the Court finds, even though the Debtor does not so argue, that the Transfer Agreements are neither complete nor unambiguous. The consideration for the transferor of the real estate is not stated. Insufficiency of consideration for a sale is one of the indicia of an equitable mortgage. The Court also notes that some the terms of the Transfer Agreements are fully compatible with the Debtor's view of the transaction, which is not clearly or unambiguously excluded by the terms of the Transfer Agreements. The Court expressly notes, however, that this rationale for the admission of extrinsic evidence does not constitute a finding an equitable mortgage was intended. Any conclusion in this regard must await consideration of all of the evidence.

BE IT SO ORDERED.

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