

**IN THE SUPREME COURT  
STATE OF NORTH DAKOTA**

Oliver-Mercer Electric Cooperative, Inc.,  
Plaintiff and Appellee,

vs.

Richard D. Davis, III, Michael P. Ossanna,  
Joseph Hauer and Berkley Strothman,  
Defendants.

Supreme Court No. 20030157

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Richard D. Davis, III, Joseph Hauer and  
Berkley Strothman, Defendants and  
Appellants

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Oliver-Mercer Electric Cooperative, Inc.,  
Plaintiff and Appellee,

vs.

AquaConcept Technologies, Inc.,  
Defendant and Appellant.

Supreme Court No. 20030158

**Brief of Appellants Richard D. Davis, III, Joseph Hauer, Berkley Strothman  
and AquaConcept Technologies, Inc.**

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Appeal from the District Court for Burleigh County, North Dakota,

Hon. Donald L. Jorgensen presiding

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## Table of Contents

Table of Authorities .....	ii
Issues Presented for Review .....	iv
Statement of the Case.....	v
1. Facts .....	1
2. Law & Argument .....	10
2.1. OME Elected the Remedy of Repossession and Sale Under the UCC.	10
2.2. Notice of the Various Sales.....	11
2.3. If Proper Notice Was Not Given, There is a Presumption That the Fair Market Value of the Property is Equal to the Debt.....	12
2.4. The Only Way to Overcome the Presumption is to Present Credible Evidence of the Fair Market Value of the Collateral on the Date of Repossession.....	14
2.5. The Trial Court’s Finding That All Aspects of the Sales Were Commercially Reasonable Was Clearly Erroneous .....	22
2.6. The Trial Court Erred In Denying the Request for Jury Trial .....	25
3. Conclusion .....	28

## Table of Authorities

### Cases

<i>Ace Parts &amp; Distributors, Inc. v. First Ntl. Bank of Atlanta</i> , 146 Ga.App. 4, 245 S.E.2d 314, 23 UCC Rep.Serv. 1370 (1978).....	15, 18, 19
<i>American State Bank v. Hewson</i> , 411 N.W.2d 57 (N.D. 1987).....	12, 22, 23
<i>Atlantic Coast Federal Credit Union v. Delk</i> , 526 S.E.2d 425 (Ga.App. 1999) .....	27
<i>Barker v. Horn</i> , 245 Ark. 315, 432 S.W.2d 21 (1968) .....	15, 17
<i>Borden v. Pope Jeep-Eagle</i> , 200 Ga. App. 176, 407 S.E.2d 128 (1991).....	23
<i>Dakota Bank &amp; Trust v. Reed</i> , 402 N.W.2d 887 (N.D. 1987) .....	11
<i>Enterprise Financial v. Georgia Nut &amp; Bolt</i> , 212 Ga. App.459 441 S.E.2d 908 (1994). 14, 15, 16, 23	
<i>Farmers Bank-Union Point v. Hubbard</i> , 247 Ga. 431, 276 S.E.2d 622, 30 UCC Rep.Serv. 1781 (1981).....	19, 20
<i>Farmers State Bank of Leeds v. Thompson</i> , 372 N.W.2d 862 (N.D. 1985).....	22
<i>FDIC V. Jahner</i> , 506 N.W.2d 57 (N.D. 1993).....	12
<i>First Nat. Bank v. Rivercliff Hardware</i> 161 Ga. App. 259, 260, 287 S.E.2d 701 (1982) 23	
<i>First National Bank of Bellevue v. Rose</i> , 188 Neb. 362, 196 N.W.2d 507.....	17
<i>General Electric Credit Corp. v. Richman</i> , 338 N.W.2d 814 (N.D. 1983) .....	26, 27
<i>Granite Equipment Leasing Corp. v. Marine Development</i> , 139 Ga.App. 778, 230 S.E.2d 43, 20 UCC Rep.Serv. 568 (1976).....	passim
<i>Hall v. Owen County State Bank</i> , 175 Ind.App. 150, 370 N.E.2d 918 (1977) .....	12, 13
<i>In re Thomas</i> , 12 UCC Rep. 578 (WD Va. 1973).....	15, 17
<i>In re Zsa Zsa Limited</i> , 11 UCC Rep. 1116, 1124 (SDNY 1972).....	17

<i>Lehman v. Coulter</i> , 40 N.D. 177, 168 N.W. 724 (1917).....	26
<i>Lindberg v. Williston Industrial Supply Corp.</i> , 411 N.W.2d 368 (ND 1987).....	12, 13
<i>Mercantile Bank v. B &amp; H Associated, Inc.</i> , 330 Ark. 315, 954 S.W.2d 226, Ark., (1997) .....	20
<i>Richard v. Fulton Ntl Bank</i> , 158 Ga. App. 595; 281 S.E.2d 338; (Ga.App. 1981); 32 U.C.C. Rep. Serv. (Callaghan) 1707.....	22
<i>State Bank of Burleigh County Trust Co. v. All-American Sub, Inc.</i> , 289 N.W.2d 772 (ND 1980).....	12
<i>State Bank of Towner v. Hansen</i> , 302 N.W.2d 760 (N.D. 1981).....	27
<i>Thrower v. Union Lincoln--Mercury, Inc.</i> , 282 Ark. 585, 670 S.W.2d 430 (1984) .....	25
<i>United States v. Conrad Publishing Co.</i> , 589 F.2d 949 (8 <sup>th</sup> Cir. 1978).....	22, 23
<i>Universal C.I.T. Credit Corp. v. Rone</i> , (1970), 248 Ark. 665, 453 S.W.2d 37 .....	12

**Statutes**

Section 41-09-125(3), N.D.C.C. ....	10
Section 41-09-20, N.D.C.C. ....	11
Section 41-09-47, N.D.C.C. ....	10
Section 41-09-50(3), N.D.C.C. ....	11, 22
Section 41-09-50, N.D.C.C. ....	11

**Constitutional Provisions**

Article I, Section 13 of the North Dakota Constitution .....	25
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### **Issues Presented for Review**

1. Whether the trial court erred in awarding a deficiency judgment against the defendants notwithstanding the fact that the creditor failed to establish the fair market value of collateral.
2. Whether the trial court's finding that collateral was disposed of in a commercially reasonable manner was clearly erroneous.
3. Whether the trial court erred in denying appellants' request for a jury trial.

## Statement of the Case

On May 8, 2001, Oliver-Mercer Electric Cooperative (OME) commenced this UCC Article 9 deficiency action against AquaConcept Technologies, Inc. (ACT) and guarantors. The defendants answered and counterclaimed for money damages, demanding a jury trial. On December 10, 2002, the court denied the demand for jury trial.

On December 17-18, 2002, a bench trial was held. On February 19, 2003, the court issued a Memorandum Opinion, ruling OME was entitled to a deficiency, ordered all remaining collateral be liquidated within 180 days, and ordered OME to make application for final judgment subsequent thereto. On April 4, 2003, judgments were entered consistent with the Memorandum Opinion. On June 4, 2003, defendants filed notices of appeal with respect to the April 4, 2003 judgments.

On August 13, 2003, the court entered an order granting final judgment, and final judgments were entered August 22, 2003. On September 16, 2003, defendants filed notices of appeal with respect to the August, 2003 judgments.

## 1. Facts

In the early 1990's, the concept of a fish farm was conceived as an economic development project designed to take advantage of by-products of a power plant. Trial Transcript (T.) at 130. A group of individuals formed Fish 'N Dakota (FND) in order to give life to the project and construct a fish farm. T. at 284. Subsequently, FND began looking for a buyer for the farm. T. at 285.

In 1995, Ron Boyko sought to acquire the farm, but could not obtain financing. T. at 171:3-24. Under a contract to purchase the farm, Boyko operated the facility until a disease wiped out approximately \$300,000 worth of fish. T. at 173:20-174:3. Boyko vacated the premises in mid-1996. T. at 167:8-15.

In 1998, AquaConcept Technologies, Inc (ACT) began negotiations to acquire the farm. During that time, an update of a previous appraisal on the farm was done by Bill Knudson. On January 15, 1998, Knudson issued an updated appraisal indicating the facility had a value of approximately \$3,300,000. Appendix at 108.<sup>1</sup> The discussions with all interested parties at that time did not focus on the fair market value of the property, but rather satisfying the amount owed against the property. T. at 287:10-288:23. All interested parties, including Oliver-Mercer Electric Coop (OME) and ACT, worked together to compile a list of creditors and the amount owed such creditor. *Id.*

The plan included a principal of FND paying some of the debts owed and ACT assuming the remaining debt. T. at 60-63. The plan also included principals of ACT,

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<sup>1</sup> The entire appraisal, which consisted of the original appraisal done in 1995 and supplemented in 1998, was admitted at trial as Exhibit 86. Since the entire appraisal is extremely voluminous, only the 1998 supplement is reproduced in the appendix.

Richard Davis III, Joseph Hauer, Berkley Strothman, and Michael Ossanna, signing personal guaranties for \$290,000; and Hauer, Strothman, and Ossanna guaranteeing the guaranty of Davis. Appendix at 40. The plan further included ACT being entitled to certain credits and ACT seeking abatement of real estate taxes. All parties were aware of the plan prior to ACT acquiring the facility. T. at 65:16-66:14.

On January 20, 1999, ACT acquired the facility through various documents, including a Bill of Sale (Appendix at 141) for certain assets owned by Cooperative Developments, a wholly owned subsidiary of OME; a Bill of Sale from FND; and various leases and other documents. The acquisition was funded by a \$1,800,000 loan from OME to ACT. No purchase agreement was entered into showing a purchase price of \$1,800,000 because, among other things, that was never intended to be the purchase price. T. at 288:3-8. The \$1,800,000 was arrived at by adding up the debts of the facility, plus some cash that ACT was to use for operations. T. at 287:7-288:23. It is obvious by looking at the appraisal amount and the amount borrowed to acquire the facility, ACT principals felt they were acquiring the facility for an extremely favorable bargain price.

Davis testified that within a month of the date of acquisition, he, Bill Keller and Tim Trana, then employees of ACT, spent approximately two weeks going through the facility making a detailed record of all assets and determining the value of such assets. T. at 290-294; T. at 334:5-335:20; T at 336:15-25. This information was needed so that the insurance underwriter could issue coverage appropriate for the facility. At the conclusion of their work, they determined the assets to be worth in excess of \$2,800,000. T. at 294:6-7. ACT acquired insurance based upon such valuation. T. at 307-308.

Consistent with the plan to acquire the facility, approximately a month after ACT acquired the facility, it applied for a real estate tax abatement for the years 1997 and 1998. T. at 356:10-14; Appendix at 102. In its application, ACT requested Mercer County to reduce the “true and full value” [see section 57-02-01(5), N.D.C.C.] of property taxable under chapter 57-02, N.D.C.C. for 1997 and 1998 from \$2,510,980 to \$524,969. *Id.* Davis testified as to the abatement application:

Q. All right. So would you acknowledge that the property less the real property which you didn't own, had a fair market value at that time of 513,989?

A. Absolutely not.

Q. All right. Isn't that what you swore to?

A. No, sir.

Q. What -- how do you explain the difference?

A. We took an aggressive approach at requesting a tax abatement on the property. Aggressive from the standpoint that we knew when we submitted this abatement, there might be some questions about the value of the abatement. We submitted every piece of information we had, including the appraisal, which is so noted in there, and let the commissioners, you know, draw their own conclusions from it. We told them everything. If they had chosen, sir, to look at that appraisal which was submitted and said, we don't accept this, you're showing a fair market value by your appraisal at 300,000 dollars, they could have denied the abatement.

T. at 360:16-361:9. Davis further testified:

Q. And you -- did you tell them that -- well, let me ask it this way. What did you tell them with respect to that abatement proceeding?

A. That we were requesting an abatement based on a calculation provided by Mr. Clement that showed the value of -- the land value of the bubble, and that we were requesting a consideration from the assumed value of 2.5 million to an abated value of approximately 524,000 that was --

Q. Did they ask you any questions with regard to the abatement or was it just rubber stamped?

A. There was limited discussion, but I think we all knew going into that that there was an inclination, desire, if you will, to approve the abatement.

Q. And that's consistent with all of the parties at the onset of ACT purchasing the property working together, is that true?

A. I believe so, yes, sir.

T. at 404:23-405:14. The commission which considered the application made the following minutes:

After a lengthy discussion a motion was made by Murray to approve granting the refund of taxes for the 1997 year . . . [and] 1998 year. The total true and full value shall be \$524,969 beginning for the tax year 1999; **His decision was based upon keeping the business in operation which he feels will grow and benefit the county.** . . . The motion carried.

Appendix at 167 (last paragraph).

Don Clement, ACT's accountant, testified that the true and full value shown on the application was arrived at by subtracting from the \$1,800,000 loan amount all the pre-January 20, 1999 debt that was going to be paid from the loan proceeds. T. at 70:6-10.

After ACT acquired the facility, it made improvements to the facility. T. at 371:22-372:3. It also experienced cash flow problems. T. at 82:19-23, T. at 79:19-80:22, T. at 337:7-24. Efforts to acquire additional financing with OME failed and OME, with the consent of ACT, took possession and control of the facility on January 20, 2000. T. at 338. OME ran the facility through Cooperative Developments, an entity wholly owned by OME. T. at 26:2-15. Since there is no legal significance to such arrangement as it pertains to this litigation, for ease of understanding defendants will refer to the operator as OME.

Clayton Hoffman, manager of OME, testified that at the time of repossession, OME did not conduct an inventory of all collateral nor did OME make any attempt to value the collateral. T. at 132:15-133:8. Hoffman testified that OME did obtain insurance on the facility in the amount of \$1,850,000, which represented the approximate amount owed to OME at the time. T. at 152:15-153:3. Having made no effort to value the property, it appears the amount of insurance was based not on fair market value of the property, but rather solely on the amount owed OME.

Leonard Sliwoski, an appraiser, was engaged by OME in April, 2002 [T. at 248:8], in order to “render an opinion as to whether that business was a going concern at or about the time the business transferred from ACT to Oliver-Mercer Electric or OME, and that would have been at or about 14 January of 2000.” T. at 227:10-14. Sliwoski testified that the facility did not have going concern value. T. at 232:12-16. He also challenged the methodology Knudson used in his appraisal. T. at 241-244. Sliwoski never made any determination as to the value of the collateral. T. at 248:9-16.

Davis testified that the fair market value of the collateral on the date of repossession, January 20, 2000, was \$2,200,000. T. at 312-317. There was no other evidence presented as to the actual fair market value of the property on the date of repossession.

Subsequent to taking possession, OME continued to operate the facility. OME hired Boyko to market fish and sell the facility. The agreement is approximately four sentences long with the only provision relating to the sale being:

OME will pay 3% of the selling Price of the Fish Farm if Boyko Inc brings a legitimate Buyer.

Appendix at 149. While Boyko testified that he made a number of phone calls and sent some faxes, he was unable to corroborate such testimony through production of fax logs, timeslips, or any other written evidence to verify exactly with whom he communicated and what exactly was communicated. T. at 210:2-21, T. at 212:11-13. Boyko testified:

- Q. At the deposition do you recall me asking you for a copy of phone logs?  
A. Correct.  
Q. You didn't have them then, did you?  
A. We do have some phone logs, but we do not have -- we never kept track of which numbers they -- who we called. also, you asked for postage. We did not keep track of that, either.

Q. Did you -- so you didn't keep track of who you called?  
A. No.  
Q. Did you keep track of who you mailed things to?  
A. No, we do not.  
Q. Did you keep copies of things that you mailed to people?  
A. Yes, it was the sale bill that we mailed out.  
Q. The sale bill?  
A. And also -- also that sheet that I -- excuse me, I had shown you that with all the inventory list on, is what we mailed out.

T. at 210:9-211:3. He also testified that probably 20 percent of the communications he made were not completed due to disconnected numbers, out-of-date addresses, and various other reasons. T. at 196:7-15. Boyko also testified that he had no previous experience in selling such a facility. T. at 169:6-13, T. at 214:18-20.

OME also entered into listing agreements with Stroup Realty in Hazen, North Dakota and Davis Brokerage, LLC of Bismarck. T. at 100:7-101:12. See Also Appendix at 143 and 147. There is no evidence that OME made any effort to see what these entities were doing in an effort to sell the property. There is no evidence that Stroup Realty made any effort to sell the facility. There is some evidence that Davis Brokerage made an effort, but Davis, a principal in Davis Brokerage, also testified that Davis Brokerage was created more as a way for ACT to stay in touch with what was happening with the farm. T. at 339:5-25. In fact, Hoffman testified that OME did not pay anything out of pocket to any of the three entities to market the fish farm, except Boyko, which included payment for clean up and to dismantle the fish farm. T. at 150:1-15. Davis also testified that ACT, at the time of repossession and subsequent thereto, had hopes of regaining possession of the facility. T. at 339; 380:11-13.

Hoffman testified that approximately ninety days after OME took possession of the farm, the power to the facility went out. T. at 103:9-23. When a large backup

generator failed to start, OME employees determined that the generator would not turn over because the batteries were dead. T. at 108:5-20. OME employees attempted to jump start the generator. Matthew Schwarz, an expert in the field, testified that the OME employee hooked the jumper cables wrong and shorted the system, dashing any hope of getting the generator started. See Schwarz deposition page 31:2-22. Admitted into evidence as Exhibit 90. T. at 164:3-7. Over 900,000 fish died due to lack of oxygen. Appendix at 150.

Between the date of repossession and the power outage, OME made little effort to sell the facility. Subsequent to the fish kill, the job of selling the facility became significantly more difficult. Boyko testified that he contacted some wholesalers who he thought may be interested in purchasing the facility, yet he did not have a record of exactly who was contacted, what was provided to them, how information was provided to them (*e.g.*, whether it looked professional-well laid out on good quality paper, well-drafted language, nicely typed, good quality pictures of the facility), or any other evidence of exactly what efforts he made to sell the facility. T. at 180; 210-212. No written material of Boyko purportedly provided to potential buyers was admitted into evidence other than the sale bill for the auction that took place on July 21, 2001 (Appendix at 151).

Hoffman testified that sometime in the first part of June, 2001, OME decided it would hold an auction to sell the remaining collateral. T. at 122:24-123:7. There was also evidence through Boyko and Davis that certain companies concentrate in selling specialized equipment, yet OME made little attempt to analyze whether the hiring of such professionals would be beneficial. T. at 197:16-19; T. at 346:23-247:2. Boyko, who had

never organized an auction sale before, hired auctioneer Jim Riedemann. Riedemann was the only auctioneer they could find in the area that was available on the date selected for the auction. T. at 197:9-12. There is no evidence of Riedemann's experience in the auction business, particularly in selling specialized equipment. There is no evidence of when the auction sale flyer (Appendix at 151) was created. The auction was set for July 21, 2001. *Id.* The flyer was published in the Bismarck Tribune and Mandan Finder on July 19, just two days before the sale. Appendix at 152-153. The flyers were also placed around local businesses. T. at 216:3-12. Boyko testified that some were faxed to potential buyers, but he had no record of who such potential buyers were or when they were notified of the sale, but it was probably a couple weeks prior to the auction. T. at 215:13-216:2.

OME did not give notice of the sale to any defendant. T. at 151:25-151:12. Davis testified that he was made aware of the sale by an acquaintance faxing him a copy of the flyer. T. at 340:24-341:5. A few days before the sale, Davis contacted Hauer and Strothman and informed them of the scheduled sale. T. at 400:1-13.

On cross-examination, Boyko testified that approximately 98 people were present at the auction sale; however they left quite rapidly once they realized the equipment was so specialized. T. at 203:10-13. It was apparent that if there were efforts made to attract suitable buyers for the specialized collateral, such efforts failed. Riedemann was never called to testify. Davis testified as to the auction:

Mr. Riedemann, as far as an auctioneer, if I was buying a lawn tractor or a refrigerator, I would have felt that he did a fine job. But as far as any reference to the nature of the equipment that was being purchased, a description of the equipment, potential use for the equipment, none of that was demonstrated. In fact, some of the items that had significant value or true value were not for auction. There were signs on them saying, not for sale. And those type of things.

T. at 346:3-10.

With no inventory having been previously taken, the property was assembled in rows so a truck could be driven up and down the rows, and auctioned to the highest bidder. Boyko held back some items when he felt the highest bid was insufficient. T. at 203:20-204:9.

On May 8, 2001, OME commenced these actions against ACT and the guarantors. The case proceeded to trial on December 17, 2002. The trial court determined that OME did not comply with the notice provisions of Chapter 41-09. Appendix at 86-87 (sections 26 and 340). The court concluded:

[11]. That upon the failure of OME to give mandated notice of sale to ACT and defendants Davis, Strothman, Hauer, and Ossanna, it is the burden of OME to prove that the sale of ACT property resulted in the fair and reasonable value of the property being credited to ACT's debts. State Bank of Burleigh County Trust Co. v. All American Sub, Inc., 289 N.W. 2d 772 (N.D. 1980).

12. That the efforts of OME in preserving the ongoing business when voluntarily surrendered by ACT, to include the continued employment of all ACT employees at said fish farm; securing appropriate insurance coverage; engaging three separate agencies or entities to market said fish farm business; accessing other fish farm producers as potential purchasers of specialized equipment; inviting by public advertisement bids for existing buildings; advertising and conducting of public auction at which time OME employed minimum bid levels to ensure sale for reasonable value; and the continuing efforts of OME to preserve residual assets in its possession and available for sale, establish that said efforts to date have been achieved in a commercially reasonable manner; that OME obtained fair and reasonable value for the ACT property sold, to date. That there remains personal property for sale and in the possession of OME, but that the sale of all residual personal property and prior sales of ACT assets, appear to have a fair market value less than the debt against it.

The court ordered OME to dispose of the remaining collateral and thereafter apply for final judgment. Appendix at 68. OME subsequently sold the remaining collateral,

netting approximately \$30,000 [August 11, 2003 Transcript at 22:12], and applied for a final judgment.

On August 22, 2003, the court entered a deficiency judgment against ACT in the amount of \$884,761.76, such being the amount due in principal and interest after applying the sales proceeds. Appendix 91. The court also entered judgment against the guarantors in amounts not to exceed:

Davis .....	\$290,000
Ossanna .....	\$386,667
Hauer.....	\$386,667
Strothman.....	\$386,667

Appendix at 93. This appeal followed.

## **2. Law & Argument**

### **2.1. OME Elected the Remedy of Repossession and Sale Under the UCC.**

Section 41-09-47<sup>2</sup> of the North Dakota Century Code sets forth the procedure in the event a debtor is in default under a security agreement. Specifically, that section states:

When a debtor is in default under a security agreement, a secured party has the rights and remedies provided in this part and except as limited by subsection 3 those provided in the security agreement. The secured party may reduce the secured party's claim to judgment, foreclose, or otherwise enforce the security interest by any available judicial procedure. . . . A secured party in possession has the rights, remedies, and duties provided in section 41-09-20. The rights and remedies referred to in this section are cumulative.

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<sup>2</sup> While Chapter 41-09 was amended by the 2001 Legislature, the law of this case is governed by the pre-2001 amendments. See NDCC § 41-09-125(3) [“This chapter does not affect an action, case, or proceeding commenced before July 1, 2001”]. This case was commenced prior to July 1, 2001.

After default, the debtor has the rights and remedies provided in this part, those provided in the security agreement, and those provided in section 41-09-20.

In *Dakota Bank & Trust v. Reed*, 402 N.W.2d 887 (N.D. 1987), this court pointed out that there are two basic methods available to a creditor upon default: "First, he can seize the goods subject to his security interest and either keep them in satisfaction of the debt or resell them and apply the proceeds to the debt. . . . Alternatively, the creditor can ignore his security interest and obtain a judgment on the underlying obligation and proceed by execution and levy." 402 N.W.2d at 890. This is an action under the first method. Accordingly, Section 41-09-20 (Rights and duties when collateral is in secured party's possession) and 41-09-50 (Secured party's right to dispose of collateral after default-Effect of disposition) become key statutes in resolving this case.

## **2.2. Notice of the Various Sales**

Section 41-09-50(3) provides:

Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale.

The trial court found that proper notice was not given. Such finding is not an issue in this appeal.

### **2.3. If Proper Notice Was Not Given, There is a Presumption That the Fair Market Value of the Property is Equal to the Debt**

If all of the defendants were not given proper notice, there is a presumption that the fair market value of the property is equal the debt. *American State Bank v. Hewson*, 411 N.W.2d 57 (N.D. 1987); *State Bank of Burleigh County Trust Co. v. All-American Sub, Inc.*, 289 N.W.2d 772 (ND 1980); *FDIC V. Jahner*, 506 N.W.2d 57, 62 (N.D. 1993). In this case, since proper notice was not given, there is a presumption that the fair market value of the collateral was equal to the debt.

In *Lindberg v. Williston Industrial Supply Corp.*, 411 N.W.2d 368 (ND 1987), this court succinctly summarized the law applicable in cases such as the present one:

If the collateral is disposed of without prior notice to the debtor, the creditor cannot obtain a deficiency judgment unless it meets its burden of overcoming the **presumption that the collateral had a fair market value at least equal to the amount of the indebtedness**. Upon overcoming such presumption the secured creditor will only be allowed to recover a deficiency for the lesser of: (a) the difference between the indebtedness and the fair market value of the collateral sold, or (b) the difference between the indebtedness and the actual amount received upon sale of the collateral. In this regard, the secured creditor cannot overcome the presumption by merely introducing evidence of the value received from the disposition of the collateral....

In *Hall v. Owen County State Bank*, 175 Ind.App. 150, 370 N.E.2d 918 (1977), the Indiana Court of Appeals stated:

'... when a secured creditor disposes of collateral without proper notice under IC 1971, 26-1-9-504(3), he must then prove, in his action for a deficiency judgment, that the reasonable value of the collateral at the time of the sale was less than the amount of the debt.

'In meeting the burden outlined above, the creditor may not merely rely on the value which he received from the repossession sale. We agree with the Arkansas Supreme Court that "it is only where the sale is conducted according to the requirements of the code that the amount received or bid at a sale of collateral is evidence of its true value in an action to recover a deficiency." *Universal C.I.T. Credit Corp. v. Rone*, (1970), 248 Ark. 665, 669, 453 S.W.2d 37, 39-40.

'Furthermore, the secured party may not rely solely on testimony of his credit manager or his other employees as to their opinions of the fair value of the collateral. Instead, the creditor must introduce other additional credible objective evidence of value.' 370 N.E.2d at 928.

We agree with this reasoning of the Indiana Court of Appeals. Accordingly, in order to meet its burden in this regard, Towner must introduce credible evidence of the fair market value of the collateral other than the price received for it and other than the opinions of its own agents or employees." [Citations omitted.]

411 N.W.2d 368, 374. These cases make it clear that the creditor has the burden to establish the fair market value of the collateral. The formula for computing a deficiency, if any deficiency exists, requires it. Without establishing fair market value, it is mathematically impossible to determine whether a deficiency exists and, if one exists, the amount of such deficiency. Mathematically, the formula is:

IF Debt - FMV of Collateral < Debt - Sales Proceeds THEN  
Debt-FMV of Collateral = Deficiency; OTHERWISE  
Debt - Sales Proceeds = Deficiency

In this case, the debt (including interest up to the time of trial) was \$2,346,422.30 (total debt less ACT interest payments made). Appendix at 100. The sales proceeds, including amounts recouped by OME from insurance, total \$1,403,954.91. Since no inventory of collateral was taken and no value placed on the collateral, there was no finding as to the fair market value of the collateral. Ignoring the presumption for a moment, application of the mathematical formula to this case makes it clear that the court disregarded the presumption:

IF \$2,346,422.30 - ??? < \$2,346,422.30 - 1,403,954.91 THEN  
\$2,346,422.30 - ??? = ???; OTHERWISE  
\$2,346,422.30-1,403,954.91 = \$942,467.38

The formula was not followed. In order to determine whether a deficiency exists, it is essential to make a determination as to fair market value of the property. That is why the presumption exists. If a creditor does not meet the burden of proving fair market value, the law presumes a number: the amount of the debt. Using the presumption, the formula in this case is expressed:

$$\text{IF } \$2,346,422.30 - \$2,346,422.30 < \$2,346,422.30 - 1,403,954.91 \text{ THEN} \\ \$2,346,422.30 - \$2,346,422.30 = \$0.00$$

The deficiency is zero. Since OME failed to establish the fair market value of the collateral during its case-in-chief, the fair market value is presumed to be equal to the debt for purposes of determining whether a deficiency exists. Accordingly, the decision of the trial court decision awarding a deficiency should be reversed and the claim for a deficiency denied.

#### **2.4. The Only Way to Overcome the Presumption is to Present Credible Evidence of the Fair Market Value of the Collateral on the Date of Repossession.**

While there is no North Dakota case law which indicates the point in time when fair market value is to be determined, other jurisdictions hold when a debtor challenges the commercial reasonableness of the sale of collateral, the creditor must show the value of the collateral at the time of repossession and the value of the collateral does not equal the value of the debt. *See Enterprise Financial v. Georgia Nut & Bolt*, 212 Ga. App.459 441 S.E.2d 908 (1994). *Granite Equipment Leasing Corp. v. Marine Development*, 139 Ga.App. 778, 230 S.E.2d 43, 20 UCC Rep.Serv. 568 (1976); *Ace Parts & Distributors, Inc. v. First Ntl. Bank of Atlanta*, 146 Ga.App. 4, 245 S.E.2d 314, 23 UCC Rep.Serv.

1370 (1978); *In re Thomas*, 12 UCC Rep. 578 (WD Va. 1973); *Barker v. Horn*, 245 Ark. 315, 432 S.W.2d 21 (1968).

In *Georgia Nut*, Enterprise made several loans to Georgia Nut and acquired a security interest in its inventory, accounts receivable, equipment and machinery. Walter Hendricks and Richard Hendricks, principals in Georgia Nut, personally guaranteed the loans. Georgia Nut defaulted on the loans and Enterprise repossessed the collateral and sold it. Enterprise then brought suit against Georgia Nut and the two guarantors for the amount of the deficiency. Prior to the sale, the principal and interest owed on the loan was \$330,000.00 Enterprise sold the collateral for \$195,000.

At trial, the president of Enterprise testified that the keys to Georgia Nut's facility were turned over to Enterprise on April 17, 1989, and that Enterprise took possession of the collateral on that date. Enterprise hired several former employees of Georgia Nut to conduct an inventory. One such employee almost immediately also started a similar business and evidence showed he sold some of what was Georgia Nut's collateral and no accounting was made of such sales. No prior notice of such sales were given to Georgia Nut nor the guarantors. The same individual eventually purchased the Georgia Nut collateral for \$195,000.

The trial court found that the sale of the collateral was not commercially reasonable, thus precluding Enterprise from obtaining a deficiency judgment. Enterprise appealed.

On appeal, the appellate court stated the law governing the case:

Where the commercial reasonableness of a sale is challenged by the debtor, the party holding the security interest has the burden of proving that the terms of the sale were commercially reasonable and the resold price was the fair and reasonable value of the collateral. The secured party must also prove the value of the collateral **at the time of**

**repossession** and the value of the goods does not equal the value of the debt. When a creditor . . . conducts a commercially unreasonable sale, a rebuttable presumption is created that the value of the collateral is equal to the indebtedness. The creditor may rebut the presumption by introducing (1) evidence of the fair and reasonable value of the secured property, and (2) evidence that the value of the collateral was less than the debt. If the creditor rebuts the presumption, he may maintain an action against the debtor or guarantor for the deficiency (the difference between the fair and reasonable value of the collateral and the amount of the debt). If the creditor conducts a commercially unreasonable sale and does not rebut the presumption..., he loses the right to recover the deficiency against the debtor and guarantor. **Proof of the value of the collateral is required to be the value at the time of repossession.**

441 S.E.2d at 910. [Emphasis added]. The court stated that the record establishes that Enterprise allowed an interested third party to sell Georgia Nut's collateral as its own during the time that this third party was preparing a physical inventory of Georgia Nut's assets and prior to the date of the appraisal based upon that inventory. The court further stated, "While we recognize that conducting an inventory of nuts and bolts might take some time to complete, we do not believe that allowing the party conducting the inventory to sell such inventory as its own without any accounting thereof is commercially reasonable." The court held Enterprise thus did not establish the value of the collateral at the time of repossession and therefore was not entitled to any deficiency. *Id.* at 911.

In *Granite*, the trial court found as a matter of fact that the appellee defaulted on its contract with a balance due of \$6,383.19, that the appellant repossessed the equipment and sold it at a private sale for \$1,100 after advertising, making telephone inquiries to prospective buyers and receiving a bid of \$150 (which was eventually withdrawn), and that the subsequent buyer of the equipment shortly resold it for \$1,900. The trial court found the price terms of the sale to be commercially unreasonable and denied a deficiency judgment.

On appeal, the Georgia Court of Appeals set forth the law to apply:

[I]n order for the secured party to first meet its burden of proving every aspect of the sale to be commercially reasonable, it must establish affirmatively that the 'terms' of the sale were commercially reasonable; this includes a burden to show that the resale price was the fair and reasonable value of the collateral. *First National Bank of Bellevue v. Rose*, 188 Neb. 362, 196 N.W.2d 507. The burden is on the secured party to prove the value of the collateral **at the time of repossession** and that such value does not equal the debt; failure to so prove results in a presumption that the value was at least the amount of the debt. *In re Thomas*, 12 UCC Rep. 578 (W.D.Va.1973); *Barker v. Horn*, 245 Ark. 315, 432 S.W.2d 21.

139 Ga.App at 779 [emphasis added]. In analyzing the case, the court stated:

The only witness for the appellant testified that she had no expertise in the value of the repossessed equipment and that she had been told it had only 'junk value.' '**Although testimony heard was that the (collateral) was junk, there was no showing of valuation in the nature of an appraisal by a third party . . .**' *In re Thomas*, 12 UCC Rep. 578, 580. The appellant was offered \$150 for the equipment but sold it for \$1,100. 'Unless (the purchaser) was itself a junk dealer, the (collateral) must, we assume, have had some value (to the purchaser) other than mere junk value.' *In re Thomas*, 12 UCC 578, 581. Mr. Atkins, to whom the equipment was sold, was no junk dealer; indeed, he resold it within a very short time at a substantial profit for himself. It is therefore clear that the equipment had more than mere junk value, **but what that value was is unclear because the appellant never established it.** [Emphasis added].

In concluding the creditor did not meet its burden, the court stated:

Under the contract the equipment had a value in excess of \$6,000 but was sold for only \$1,100. 'A wide discrepancy between the sale price and the value of collateral signals a need for close scrutiny, . . . even though a seemingly low return is usually not dispositive on the question of commercial reasonableness.' *In re Zsa Zsa Limited*, 11 UCC Rep. 1116, 1124 (SDNY 1972). Having closely scrutinized this sale of repossessed equipment, we find a wide discrepancy between the sale price and the value of such collateral (presumed to equal the amount of the debt in the absence of proof otherwise) **coupled with the appellant's failure to prove the value at the time of repossession**, and that such value does not equal the debt. The appellant has nowhere shown that the resale price was the fair and reasonable value of the collateral, has therefore failed to show that the price term of the resale was commercially reasonable and thus cannot recover a deficiency. The trial judge's finding that this sale was not commercially reasonable for failure to establish the price term to be commercially reasonable was correct under the evidence. [Emphasis added].

*Id.* At 780. Thus the court concluded that a wide discrepancy between the sale price and the value of the collateral, coupled with the creditor's failure to prove the value of collateral at the time of repossession, precludes a deficiency judgment.

In this case, there was very wide discrepancy between the sale price and the value of the collateral, presumed to equal the amount of the debt in the absence of proof otherwise. But even more importantly, OME failed to prove the value of the collateral at the time of repossession or any other point in time. March 20, 2003 Addendum to Memorandum Decision, Appendix at 95 ["No inventory of assets no valuation of collateral was prepared by either plaintiffs [sic] or defendants at the time of relinquishment"]. The trial court never made a finding as to the value of the collateral because it was not presented with evidence to establish a value. Such constituted a fatal flaw in its quest to rebut the presumption that the fair market value of the collateral was equal to the debt. That being the case, the trial court erred in awarding a deficiency to OME.

In *Ace*, the bank brought suit on a note by the corporate debtor, Ace Parts, and two individual guarantors. The note was secured by inventory of Ace, an auto parts store. The bank had reduced the amount demanded in order to credit the proceeds of the sale of the collateral which the bank had repossessed, and the suit thus became one for a deficiency judgment. Defendants appealed from a judgment in favor of the bank, asserting the bank did not dispose of the collateral in a commercially reasonable manner as required by UCC § 109A-9 504(3), the result being that recovery of a deficiency

judgment was barred. It was contended that the bank failed to prove the value of the collateral at the time of repossession or that its resale price was fair and reasonable.

In affirming the deficiency judgment against the defendants, the court stated:

We find no merit in these arguments. The voluminous record reveals that the collateral consisted of thousands upon thousands of automobile parts, **each of which had to be individually inventoried, evaluated and priced. There was evidence that the total of all these items was approximately \$39,000 at the time of repossession;** that they were stored in the bank's warehouse at no charge to defendants; that bids were solicited from 150 auto parts dealers; that there were approximately one dozen inquiries; that five bids were submitted; and that the collateral was sold to the highest bidder for \$15,000. We find nothing in all this to demand a finding of commercial unreasonableness.

245 Ga.App. 315 [emphasis added]. Ace is distinguishable in that the creditor clearly fulfilled its obligation to inventory and value the collateral prior to disposing of it.

In *Farmers Bank-Union Point v. Hubbard*, 247 Ga. 431, 276 S.E.2d 622, 30 UCC Rep.Serv. 1781 (1981), the bank brought suit for deficiency judgment following its foreclosure of personal property. The property, a tractor and trailer pledged as collateral on a note, had been sold by the bank at public sale after advertisement and notice, and brought \$15,000. The case was then tried before a jury which returned a verdict finding value of the tractor and trailer to be \$18,000 and the plaintiff bank due a balance of \$7,369.75. The Court of Appeals held:

The right of a secured party to dispose of collateral after default, and the effect of disposition, is governed by Code § 109A-9-504, which requires that the disposition of such property be commercially reasonable. It is well settled that the burden of proof on this issue rests with the secured party, that this includes a burden to show that the terms of sale are commercially reasonable, **and that one of the terms which must be so proved is that the resale price was the fair and reasonable value of the collateral. Where there is no evidence of such fair and reasonable value this burden has not been carried.** Failure to establish that the fair and reasonable value of the property does not equal the debt results in a presumption that the value of the property disposed of is at least equal to the debt, from which it follows that no deficiency judgment can be obtained.

247 Ga. 431 [emphasis added]. The Court of Appeals found further that the sale price at the public foreclosure sale (\$15,000) was not evidence of the fair and reasonable value of the collateral, that the bank had failed to prove the fair and reasonable value of the collateral, and that the trial court therefore had erred in denying the defendant's motion for directed verdict and motion for judgment *nov. Id.*

In *Mercantile Bank v. B & H Associated, Inc.*, 330 Ark. 315, 954 S.W.2d 226, Ark., (1997), the debtors owned an in-house processing system designed to handle the accounting needs of banks. The debtors sold a copy of the system to a company. Under the sales contract, the parties agreed that if one went into bankruptcy or had a judgment entered against them, that it would sell its interest to the other for a certain amount. Later, the creditor made a loan to the debtors secured by the system. The debtors defaulted, and the creditor took possession of the system. At a private sale, the creditor sold the system to the company for the amount specified in the sales contract between the company and the debtors. The creditor then sought a deficiency judgment, but the debtors claimed that the creditor's sale was not commercially reasonable. The creditor's witness, Tim Gibson, who sold licenses for computer software systems, stated that he was unable to place a value on the Uni-Banc System. In the opinion of the bank's witness, "there was no way to determine whether the system was worth \$25,000.00, \$1,000.00, \$500,000.00, or \$1,000,000.00." The jury found the sale was not commercially reasonable and rendered a verdict in favor of the debtor. In affirming the denial of creditor's motion for new trial/judgment *nov*, the appellate court stated there was substantial evidence in the record that reflects the creditor did not identify potential buyers and made no reasonable effort to

determine the fair market value of the asset; and there was evidence to show the asset was worth well in excess \$400,000 when the debt was only \$150,000.

At the conclusion of OME's case, there was no evidence of fair market value of the collateral at the time of repossession. Sliwoski's testimony did nothing more than beg the question: How much is the collateral worth? OME relies upon the tax abatement application as evidence of value on the date of repossession. It is clear the abatement had nothing to do with the overall value of the facility. The starting point of the abatement calculation was \$1,800,000, the amount of the loan from OME to ACT. The loan amount was arrived at by taking the debts incurred with respect to the facility-no matter who incurred them- and adding in some dollars for working capital. There is no correlation whatsoever between the value of the collateral and the loan amount. Accordingly, any attempt to use the abatement application as evidence of collateral value should stop right there. Going forward in the analysis, however, the "full and true value" for purposes of the tax abatement, was arrived at by subtracting from the \$1,800,000 all the other debt, including debts of FND. There is simply no logic in the math. While there is certainly no evidence that ACT acted in bad faith, it is clear on close examination of the worksheet their analysis in coming up with a value is simply illogical. Even if the math was logical, the application is no evidence of the value of the collateral on the date of repossession.

Having failed to meet its burden of establishing the value of the collateral on the date of repossession, or at any point in time, as a matter of law OME is not entitled to a deficiency judgment.

## **2.5. The Trial Court's Finding That All Aspects of the Sales Were Commercially Reasonable Was Clearly Erroneous**

OME has the burden to prove that every aspect of the disposition, including the method, manner, time, place, and terms of each sale was commercially reasonable. N.D.C.C. § 41-09-50(3) (1999). *See also American State Bank v. Hewson*, 411 N.W.2d 57 (N.D. 1987). Whether a sale of collateral was conducted in a commercially reasonable manner is essentially a factual question. *United States v. Conrad Publishing Co.*, 589 F.2d 949 (8<sup>th</sup> Cir. 1978) [sale of printing equipment collateral by a secured party was not in a commercially reasonable manner where no genuine effort was made to reach the potential market for the printing equipment, the time between the selection of an auctioneer and the sale date was too short for an effective advertising effort, the advertising that was done was unreasonably limited in scope, there was no technical assistance furnished the auctioneer concerning the highly sophisticated nature of the equipment, and there was a great disparity between the estimated value and the sale price of the equipment].

For OME to meet its burden of providing every aspect of the sale of the collateral to be commercially reasonable, it must affirmatively establish that the resale price was the fair and reasonable value of the collateral. *Hewson, supra*. Accordingly, in order to meet its burden in this regard, OME must introduce credible evidence of the fair market value of the collateral other than the price received for it and other than the opinions of its own agents or employees. *Farmers State Bank of Leeds v. Thompson*, 372 N.W.2d 862 (N.D. 1985); *Richard v. Fulton Ntl Bank*, 158 Ga. App. 595; 281 S.E.2d 338; (Ga.App. 1981); 32 U.C.C. Rep. Serv. (Callaghan) 1707; *Borden v. Pope Jeep-Eagle*, 200 Ga. App.

176, 407 S.E.2d 128 (1991); *Enterprise Financial Corporation v. Georgia Nut & Bolt Company*, 212 Ga. App.459 441 S.E.2d 908 (1994); *Granite Equipment Leasing Corp. v. Marine Dev. Corp.*, 139 Ga. App. 778, 230 S.E.2d 43 (1976) [cited with approval in *American State Bank v. Hewson*, 411 N.W.2d 57 (N.D. 1987) for the proposition that the creditor has the burden of showing the resale price was the fair and reasonable value of the collateral.; *First Nat. Bank v. Rivercliff Hardware* 161 Ga. App. 259, 260, 287 S.E.2d 701 (1982). As discussed at length in the previous section, that OME did not do.

Factors to consider in determining whether a sale was commercially reasonable include: whether a genuine effort was made to reach the potential market for the specialized equipment; whether the time between the selection of an auctioneer and the sale date was too short for an effective advertising effort; whether the advertising that was done was unreasonably limited in scope; whether there was technical assistance furnished the auctioneer concerning the highly sophisticated nature of the equipment. *United States v. Conrad Publishing Co.*, 589 F.2d 949 (8<sup>th</sup> Cir. 1978). OME failed on all counts. The trial court made the following findings with respect to making a determination that the sales were commercially reasonable:

- The continued employment of all ACT employees
- Securing appropriate insurance coverage
- Engaging three separate agencies or entities to market the fish farm business
- Accessing other fish farm producers as potential purchasers of specialized equipment
- Inviting by public advertisement bids for existing buildings

- Advertising and conducting of public auction at which time OME employed minimum bid levels to ensure sale for reasonable value

- OME continued efforts post-trial to preserve residual assets in its possession

In this case, there was no genuine effort to reach the market for this specialized equipment. Boyko testified he contacted some people. Notwithstanding the fact the collateral was arguably worth between \$1,000,000 to \$3,300,000, OME did not keep any records of contacts made. That is especially important in a case like this where much of the collateral is specialized equipment worth in the millions of dollars. On cross-examination, Boyko testified that approximately 98 people were present at the auction sale; however they left quite rapidly once they realized the equipment was so specialized. It was apparent that if there were efforts made to attract suitable buyers for the specialized collateral, such efforts failed. Because OME did not keep records, no one can tell whether the advertising was aimed at realistic bidders. To meet its burden, OME needed to keep detailed records of the time, place, manner, and method of its efforts to sell the property.

In June, 2001, OME made the decision to auction the remaining collateral. Boyko, who had never organized an auction sale before, hired auctioneer Jim Riedemann. Riedemann was the only auctioneer they could find in the area that was available on the date selected for the auction. There is no evidence of Riedemann's experience in the auction business, particularly in selling specialized equipment. There is no evidence of when the auction sale flyer (Appendix 151) was created. The auction was set for July 21, 2001. The flyer was published in the Bismarck Tribune and Mandan Finder on July 19, just two days before the sale. The flyers were also placed around local businesses. Boyko

testified that some were faxed to potential buyers, but he had no record of who such potential buyers were or when they were notified of the sale, but it was probably a couple weeks prior to the auction. Advertising an auction two days before it is to take place is not reasonable. There must also be some evidence that the auctioneer was qualified and was able to effectively sell specialized equipment. Having no beginning collateral inventory to work with and no determination as to value with respect to such collateral makes it impossible to determine whether the many sales which took place were conducted in a commercially reasonable manner. When determining whether the sale of a collateral was handled in a commercially reasonable manner, a major consideration is the determination of the fair market value of the collateral. *Thrower v. Union Lincoln--Mercury, Inc.*, 282 Ark. 585, 670 S.W.2d 430 (1984). Consistent with what a creditor must prove under *Conrad*, along with the failure of OME to establish the fair market value of the collateral, the trial court's finding that every aspect of the disposition of the collateral was commercially reasonable is clearly erroneous.

## **2.6. The Trial Court Erred In Denying the Request for Jury Trial**

Article I, Section 13 of the North Dakota Constitution provides that “[t]he right of trial by jury shall be secured to all, and remain inviolate. OME brought these actions seeking a deficiency (money judgment). The complaints were signed on or about May 8, 2001. The defendants counterclaimed for money damages, alleging, *inter alia*, breach of fiduciary duty and negligence. On December 2, 2002, OME sought to supplement the pleadings to add language authorizing OME to sell the remaining collateral. On December 10, 2002, the pre-trial conference, the court granted OME's motion to supplement the pleadings and denied defendants' request for a jury trial. Specifically, the

court, relying upon *General Electric Credit Corp. v. Richman*, 338 N.W.2d 814 (N.D. 1983), ruled that this was an action to foreclose a security agreement and was therefore an action in equity, precluding the right to a jury. Appendix at 66.

Prior to bringing this action, OME disposed of almost the entire facility, realizing over \$1,400,000. Subsequent to trial, OME sold the remaining collateral and netted less than \$30,000.

Where a complaint prays for both legal and equitable relief but only legal relief is warranted by the facts pleaded, it is error to deny a defendant's demand for trial by jury. *General Elec. Credit Corp. v. Richman*, 338 N.W.2d 814, 818 (N.D. 1983). A defendant whose answer in an equitable action to foreclose a chattel mortgage admits all of the allegations and pleads a counterclaim for the recovery of money only cannot be denied a jury trial. *Lehman v. Coulter*, 40 N.D. 177, 168 N.W. 724 (1917).

The distinction between law and equity is still important in determining whether or not one has a right to a jury trial. *Richman, supra*. In view of the high regard with which our society views the right to a jury trial, the one against whom an action is brought may not be deprived of the right to a jury trial unless the party seeking to avoid a jury trial clearly and unambiguously shows that he is seeking an equitable remedy and that he is clearly entitled to it if he proves the facts as alleged in his complaint. *Id.*

In *Richman*, the the debtors' note was secured by a chattel mortgage. The creditor filed an action on the note and sought possession of the collateral. The trial court struck the debtors' jury trial demand, ruling that it was a foreclosure action, and entered judgment for the creditor. On appeal, the court reversed the foreclosure and interest awards, remanded for hearing on the interest award, and affirmed the remainder of the

judgment. The court found that the complaint did not unambiguously seek equitable relief and that it could be construed as seeking damages and recovery of specific personal property, and the demand for a jury trial was proper. The trial court erred in denying a jury trial and in granting foreclosure, the court held, when the creditor did not clearly request or prove that it was clearly entitled to foreclosure. Nevertheless, the court found that denial of a jury trial did not prejudice the debtors because the evidence established that they were in default on their payments. Thus, there was no question of fact for a jury to determine. With respect to the jury trial issue, the court stated:

We have examined the complaint filed in the instant case and we conclude that General Electric in its complaint did not clearly and unambiguously show that it was seeking the equitable remedy of foreclosure. While the complaint can be construed to be one seeking foreclosure of a chattel mortgage, it can as easily be construed to be one for money damages and for recovery of specific personal property, for which Chapter 32-07, N.D.C.C., provides a right of trial by jury. Speculation that one remedy, foreclosure, is sought, rather than money damages or recovery of personal property, is not enough upon which to deny the Richmans the right to trial by jury. The speculation could have been entirely eliminated by a motion to amend the complaint to explicitly pray for foreclosure if that were General Electric's desire. We hold that the trial court erred in denying the Richmans' demand for a trial by jury. The trial court also erred in granting a foreclosure of the chattel mortgage when General Electric neither clearly prayed for it nor proved it was clearly entitled to foreclosure.

338 N.W.2d at 818-819. In this case, there are many factual issues in dispute, the most important being whether OME overcame the presumption with respect to the fair market value of the property being equal the debt and whether all aspects of the sales were commercially reasonable. These are proper factual issues for the jury to decide.

Many of the Article 9 cases reviewed were tried to a jury with there being no issue of the same on appeal. *See e.g., State Bank of Towner v. Hansen*, 302 N.W.2d 760 (N.D. 1981); *Atlantic Coast Federal Credit Union v. Delk*, 526 S.E.2d 425 (Ga.App. 1999) [To recover a deficiency, a creditor bears the burden of proving commercial

reasonableness to rebut the presumption that the value of the collateral is equal to the indebtedness, by presenting evidence of the fair and reasonable value of the collateral. This burden may not be satisfied without establishing affirmatively that the terms of the sale were commercially reasonable. This is normally an issue for the jury].

The trial court erred in denying the demand for a jury trial. Such constitutes reversible error entitling defendants to a new trial, in front of a jury.

### **3. Conclusion**

The trial court erred as a matter of law in not denying a deficiency when OME failed to introduce sufficient evidence to overcome the presumption that the fair market value of the property was equal the debt. The decision of the trial court awarding a deficiency should be reversed and the claim for deficiency denied.

The trial court's finding that all aspects of the sales were commercially reasonable was clearly erroneous. The decision of the trial court should be reversed and the claim for deficiency denied.

If the court does not reverse on the previous two issues, the case should be remanded back for a jury trial.

Dated this November 10, 2003.

Respectfully Submitted,

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## Certificate of Service

On November 10, 2003, a true and correct copy of

-Brief of Appellants Richard D. Davis, III, Joseph Hauer, Berkley Strothman and AquaConcept Technologies, Inc. [File Name: 8032 Supreme Court Brief; Format: PDF]

- Appellants' Appendix [File Name: 8032 Supreme Court Appendix; Format: PDF]

was emailed to Gregory Lange at [hazenlaw@westriv.com](mailto:hazenlaw@westriv.com) which email address is published in the supreme court's online directory.

/s/ Michael L Wagner

Michael L Wagner (ID 04615)