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Minn. Stat. § 480A.08, subd. 3 (2010).*

**STATE OF MINNESOTA
IN COURT OF APPEALS
A11-1738**

Jorday, Inc., et al.,
Appellants,

vs.

David E. Burggraff and Donna J. Burggraff, as Trustees of the
David E. Burggraff and Donna J. Burggraff
Revocable Trust Deed, dated September 25, 2003,
David Burggraff and Donna Burggraff, as individuals,
Defendants,

Frandsen Bank and Trust f/k/a Northern National Bank,
Respondent.

**Filed May 21, 2012
Reversed and remanded
Connolly, Judge**

Crow Wing County District Court
File No. 18-CV-10-4340

Michael L. Jorgenson, Charlson & Jorgenson, P.A., Thief River Falls, Minnesota (for appellants)

David E. Burggraff, Donna J. Burggraff, Brainerd, Minnesota (pro se defendants)

John B. Person, Breen & Person, Ltd., Brainerd, Minnesota (for respondent Frandsen Bank)

Considered and decided by Stauber, Presiding Judge; Worke, Judge; and
Connolly, Judge.

UNPUBLISHED OPINION

CONNOLLY, Judge

In this dispute regarding conflicting priority interests in personal property under the Uniform Commercial Code (UCC), appellants challenge the district court's ruling that respondent had a superior priority interest. Because the district court erred in ruling that respondent had a perfected interest in the personal property, we reverse and remand to the district court for further proceedings relating to the foreclosure on appellants' security interest.

FACTS

Appellant Jorday Inc. is a Minnesota corporation and appellants Darcy and Jodi Harbott are its shareholders. Jorday Inc. owned an amusement park, known as "Kart Kountry" near Brainerd, Minnesota. The amusement park owned various assets, including the real estate on which the park was located, along with personal property used by the park. Pursuant to the terms of a purchase agreement dated November 26, 2005, Jorday Inc. sold Kart Kountry to defendants David E. and Donna J. Burggraff as Trustees of the David E. Burggraff and Donna J. Burggraff Revocable Trust, dated September 25, 2003 (the trust).¹ As part of the sale, Jorday Inc. provided the Burggraffs with a warranty deed to the real estate and a bill of sale for all of the personal property associated with the business.

¹ The Burggraffs did not respond to the complaint or file briefs in this case, either in their individual capacities, or in their capacities as trustees.

At the time of closing, the trustees were unable to pay the full \$1,000,000 purchase price. Instead, the trustees paid \$30,000 in earnest money, \$370,000 at closing, and executed and personally guaranteed a promissory note for \$600,000 in favor of Jorday Inc. The promissory note contained an acceleration clause in the event of a default. To secure payment of the promissory note, the trustees executed a mortgage in favor of Jorday Inc. encumbering the amusement park's real property.²

As additional security for the promissory note, the trustees executed a security agreement on January 3, 2006, granting Jorday Inc. a security interest in the personal property of the amusement park. On January 4, 2006, Jorday Inc. submitted a UCC Financing Statement to the Office of the Minnesota Secretary of State. Jorday Inc. concedes that the UCC statement was not accepted by the Secretary of State. Jorday Inc. later learned of the error and re-filed on June 30, 2010 to perfect their interest.

After purchasing the amusement park, the Burggraffs formed two entities: (1) Vacationland Family Enterprises LLC (LLC); and (2) Vacationland Family Fun Park Inc. (Corporation). According to the Burggraffs' accountant, the intent was that the Corporation would own the equipment and personal property, while the LLC would own the real estate and lease it to the Corporation. The accountant further testified that the Burggraff trust owns the shares of the Corporation. Both Mr. Burggraff and the accountant testified that the land was never formally conveyed from the Burggraffs' trust

² The mortgage was recorded and subsequently assigned as collateral to appellants Glenn and Diane Erlandson, who joined Jorday Inc. in this mortgage foreclosure action to preserve their collateral. Jorday Inc. did not, however, relinquish ownership of the mortgage in their assignment to the Erlandsons.

to the LLC, nor was the personal property formally conveyed from the Burggraffs' trust to the Corporation. However, the Burggraffs' 2006 income tax returns referenced a transfer of personal property to the Corporation, and, since 2006, the personal property was depreciated on the Corporation's tax returns. Finally, the accountant testified that before an entity files articles of organization, it is common for assets to be transferred to a trust or to an individual until the business is formed, and that in such cases, there is not typically a bill of sale when the assets are transferred from the trust or individual to the business.

After executing the purchase agreement with Jorday Inc., the Burggraffs approached respondent Frandsen Bank to obtain loans. The bank subsequently loaned the Burggraffs \$460,000. As security for the loans, the Burggraffs executed a mortgage in favor of the bank on the amusement park's real estate. The bank acknowledges that the mortgage was inferior to Jorday Inc.'s mortgage. As additional security, the LLC and the Corporation executed security agreements in favor of the bank, granting the bank a security interest in all equipment, inventory, and assets of the LLC and the Corporation.

The bank's representative testified that the Burggraffs represented to the bank that the assets they had purchased from Jorday Inc. had been conveyed to the LLC and the Corporation and that the bank was provided the Corporation's tax documents and relied on them in making the loan. The Corporation's 2006 income tax return showed an asset transfer from the Burggraffs' revocable trust to the Corporation. The 2009 Tax Assets Detail for the Corporation listed 91 personal property items reported to be owned by the Corporation, and that list encompassed the personal property at issue. The bank then

performed a UCC search which showed no prior UCC liens for either the LLC or the Corporation. The bank filed with the Minnesota Secretary of State's Office UCC financing statements on the equipment, inventory, and assets of the LLC and the Corporation.

In February 2010, the Burggraffs, as trustees and in their individual capacity, defaulted on the Promissory Note to Jorday Inc. Jorday Inc. then elected to accelerate the payments and declared the entire unpaid amount immediately due. Appellants then initiated this action to foreclose on the mortgage, recover the personal property used as collateral, and obtain a money judgment against the Burggraffs. The Burggraffs did not answer the complaint, but the bank answered, claiming a superior security interest in the personal property of the amusement park.

A bench trial was held on April 12, 2011. The district court granted appellants' prayer for relief, except as it related to the amusement park's personal property. The district court held that "the tax records demonstrate that [the Corporation] acquired possession and control over the personal property from Defendant Trustees and accordingly, it had the power to transfer rights to Frandsen Bank." Thus, the district court held that the bank's security interest in the personal property was superior to Jorday Inc.'s security interest. This appeal follows.

DECISION

In an appeal from a bench trial, this court gives great deference to the district court's findings of fact and does not set them aside unless clearly erroneous. *Porch v. Gen. Motors Acceptance Corp.*, 642 N.W.2d 473, 477 (Minn. App. 2002), *review denied*

(Minn. June 26, 2002). However, we do not defer to the district court on purely legal issues. *Id.* “When reviewing mixed questions of law and fact, we correct erroneous applications of law, but accord the [district] court discretion in its ultimate conclusions and review such conclusions under an abuse of discretion standard.” *Id.* (alteration in original) (quotations and citations omitted).

The central issue in this case is whether the LLC or the Corporation had sufficient rights in the personal property of the amusement park under Minn. Stat. § 336.9-203(b) (2006) to grant the bank a valid security interest. If they had sufficient rights to grant a security interest, the bank was the first creditor to properly perfect its security interest in the personal property of the amusement park. The bank perfected its security interest in the personal property of the LLC on March 21, 2006 and perfected its security interest in the personal property of the Corporation on July 30, 2008. Jorday Inc. did not properly file and perfect its security interest in the personal property of the amusement park until June 30, 2010. However, if the LLC or the Corporation did not have sufficient rights, then the bank did not have a valid security interest and Jorday Inc. would prevail despite its later filing.

“Minnesota has adopted article 9 of the Uniform Commercial Code to regulate secured transactions.” *State Bank of Young America v. Wagener*, 479 N.W.2d 92, 94 (Minn. App. 1992), *review denied* (Minn. Mar. 10, 1992). “Article 9 of the Code is an attempt to bring simplicity and certainty to the law of secured transactions through a system of written agreements and recorded notice.” *Wabasso State Bank v. Caldwell Packing Co.*, 251 N.W.2d 321, 325 (Minn. 1976). Under Minnesota law, “a financing

statement must be filed to perfect all security interests” Minn. Stat. § 336.9-310(a) (2006). Where perfected security interests conflict, they are ranked according to priority in time of filing or perfection. Minn. Stat. § 336.9-322(a)(1) (2006). Where two creditors claim a security interest in the same personal property, the first to file has priority. Minn. Stat. § 336.9-322(a)(1) (2006).

“[A] security interest is enforceable against the debtor and third parties with respect to the collateral only if: (1) value has been given; (2) the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and (3) . . . the debtor has authenticated a security agreement that provides a description of the collateral” Minn. Stat. § 336.9-203(b). Appellants do not dispute that the bank gave value for the collateral or that there was a security agreement that provided a description of the collateral. They do, however, dispute that the LLC or the Corporation had rights in the collateral sufficient to give the bank a security interest. Without a conveyance from the trust to the LCC or the Corporation, appellants argue that those entities never had control of the collateral, and could not give the bank a valid security interest.

To determine whether there has been a valid security agreement, courts look to the substance of the transaction, rather than the form. *James Talcott, Inc. v. Franklin Nat’l Bank*, 292 Minn. 277, 282-83, 194 N.W.2d 775, 779 (1972). Minnesota law does not require that the debtor have title to, or ownership of, the collateral before a security interest may attach; it only requires that the debtor have “rights in the collateral or the power to transfer rights in the collateral.” Minn. Stat. § 336.9-203(b)(2); *see also State Bank of Young Am. v. Vidmar Iron Works, Inc.*, 292 N.W.2d 244, 249 (Minn. 1980)

(holding that a metal-goods fabricating shop that finished goods out of raw materials for owner of the raw materials had a right in the goods to the extent of the amount due under the fabrication contract sufficient to allow the bank's security interest to attach); *James Talcott, Inc.*, 292 Minn. at 285, 194 N.W.2d at 781 (holding that a security interest could attach to property purportedly leased by the debtor); *Border State Bank of Greenbush v. Bagley Livestock Exch., Inc.*, 690 N.W.2d 326, 333 (Minn. App. 2004), (holding that whether the bank's security interest in calves attached did not depend on whether the debtor had ownership interest in the calves, but on whether the debtor had rights in the cattle under the cattle-sharing agreement between the debtor and cattle owner), *review denied* (Minn. Feb. 23, 2005). Thus, even if the LLC or the Corporation did not have legal title to the personal property of the amusement park, those entities could grant the bank a valid security interest if the entities had sufficient rights in the collateral.

The district court erred in concluding that the Corporation had sufficient rights in the personal property of the amusement park to grant the bank a valid security interest. While the district court found that “the tax records demonstrate that [the Corporation] acquired possession and control over the personal property from Defendant Trustees,” possession is an insufficient right in collateral from which to grant a security interest. *See Bagley Livestock*, 690 N.W.2d at 333 (holding that, to grant a security interest, the debtor must have more than mere possession). Moreover, neither entity had ownership rights in the property. The evidence is undisputed that, at the time the amusement park was sold by Jorday Inc., it was sold to the Burggraffs as trustees. While the Burggraffs individually are the shareholders and officers of the Corporation

and the owner-members of the LLC, owners are legally separate from LLCs and corporate entities. *See, e.g., West Bend Mut. Ins. Co. v. Allstate Ins. Co.*, 776 N.W.2d 693, 706 (Minn. 2009) (“[A] corporation is a separate legal entity from its owners and shareholders”); *Equity Trust Co. Custodian ex rel. Eisenmenger IRA v. Cole*, 766 N.W.2d 334, 339 (Minn. App. 2009) (stating that courts may pierce the corporate veil of a corporation or an LLC if the business entity is found to be an alter ego for the principals). The security agreements negotiated by the bank were with the LLC and the Corporation; not with the Burggraffs as trustees. Neither the Burggraffs nor their accountant could point to any conveyance or document of conveyance transferring the personal property of the amusement park, held by the Burggraffs as trustees, to the Corporation or LLC. There is no evidence that the personal property of the amusement park was ever formally transferred or conveyed to the debtor LLC or debtor Corporation.

We acknowledge that there was evidence presented at trial that showed that the personal property was listed on the Corporation’s tax returns and the district court relied on this evidence and the accountant’s testimony in determining that the Corporation had rights in the personal property of the amusement park and that the bank’s security interest was enforceable. As a matter of law, this is insufficient. The bank was in the best position to protect its interest by requiring proof of ownership by the LLC or the Corporation of the property it sought to encumber with a security interest. In fact, when conducting its UCC search, the bank searched not only for the debtor name of the LLC and the Corporation, but also for the Burggraffs as trustees, demonstrating that the bank was aware of the trust’s existence.

Moreover, there is no evidence in the record that the LLC or the Corporation had other rights in the personal property of the amusement park sufficient to grant the bank a valid security interest. Unlike the situations in *Vidmar Iron Works, Inc.*, 292 N.W.2d 244, and *Bagley Livestock*, 690 N.W.2d 326, the bank did not add indivisible value to the collateral. There was no evidence at trial that the bank loans were used to make improvements to the personal property so that any such improvements became comingled with the personal property and gave the bank rights in that property. Instead, this case is very similar to a United States Bankruptcy Court case, in which the court determined that the debtor corporation did not have rights in the modular, non-fixture building property sufficient to grant the creditor a security interest where the individual officers and owners of the debtor corporation who purchased the property never formally conveyed the property to the corporation. *In re Hot Shots Burgers & Fries, Inc. v. Fas Fax Corp.*, 169 B.R. 920, 925 (E.D. Ark. 1994).

Therefore, we reverse the district court's decision on the issue of priority interests in the personal property of the amusement park because there was insufficient evidence as a matter of law to conclude that the LLC or the Corporation owned the property. Based on the record, the personal property of the amusement park is owned by the Burggraffs as trustees, and the LLC and the Corporation could not grant the bank a valid security interest because they had no rights in the property. Appellant Jorday Inc. was therefore the first to file and perfect its security interest in the personal property of the amusement park when it filed on June 30, 2010. We remand to the district court so that

Jorday Inc. can foreclose on all of the personal property items for which it filed a UCC statement.³

Reversed and remanded.

³ Jorday Inc. perfected its security interest on the personal property listed in the 2010 UCC Financing Statement with Schedule 1 attached contained in Trial Exhibit 14. To the extent that the amusement park has personal property that is not listed on Jorday Inc.'s UCC statement, the bank likely has a valid prior security interest in that property.