

A LOAN GONE BAD: THE STATUTE OF LIMITATIONS DOES NOT BAR FORECLOSURE, AND SUBROGATION APPLIES ONLY WHEN THE SURETY DISCHARGES THE ENTIRE UNDERLYING OBLIGATION

***RABO AGRIFINANCE INC. V. TERRA XXI, LTD.*, NO. 08-10143, 2009 WL 3003670 (5TH CIR. SEPT. 22, 2009)**

Highlight

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In *Rabo Agrifinance Inc. v. Terra XXI, Ltd.*, the appellants, Terra and “the Viegel entities,” appealed the district court’s ruling allowing their equipment to be sold at foreclosure and awarding attorney’s fees to the plaintiffs.¹ Between 1997 and 1999 the appellee, Rabo Agrifinance, loaned the appellants approximately \$1.8 million to conduct farm operations.² As collateral, Rabo Agrifinance held a second lien on 5,600 acres of real property (the property was encumbered by a first lien of over \$3 million), a second lien on irrigation equipment, and a first lien on additional farming equipment.³ In 1999, the appellants defaulted on the irrigation equipment debt.⁴ Diversified Financial Services, which had acquired the debt, sued in state court and received a \$550,000 judgment against the Viegel entities.⁵ In November 2003, appellee, Ag Acceptance, acquired the \$550,000 judgment from Diversified.⁶

In late 2000, the appellants filed for bankruptcy protection.⁷ As part of the bankruptcy proceedings, the appellees agreed to reduce the debts to \$1.5 million.⁸ Regardless, the appellants defaulted on the reduced loans.⁹ Ag Acceptance foreclosed on the 5,600 acres, and

¹ *Rabo Agrifinance Inc. v. Terra XXI, Ltd.*, No. 08-10143, 2009 WL 3003670, at *1 (5th Cir. Sept. 22, 2009).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

because of the sizable first lien, they purchased the property at the foreclosure sale for \$20,000 and credited it against the amount owed.¹⁰ In September 2005, Rabo Agrifinance sued to collect the deficiency (Deficiency Suit).¹¹ Based on diversity, the case was moved to federal court.¹² In June 2006, Robert Viegel paid \$551,052.2 to satisfy the judgment for the first lien on the irrigation equipment.¹³ He then filed a right to contribution from the other defendants and assigned his rights to Terra Partners.¹⁴ In February 2007, the appellees amended the pleading seeking a declaratory judgment and seeking to foreclose on the irrigation system and other farm equipment.¹⁵ The Viegel entities claimed that collection was barred by the following limitations: Terra owned some of the equipment, some items were personal property, and because of Robert Viegel's assignment, Terra "was subrogated to the first lien interest in the irrigation equipment."¹⁶

The Viegel entities also separately defaulted on the \$3 million debt (secured by the 5,600 acres) to First Ag Credit.¹⁷ In 2004, Rabo Agrifinance acquired this debt from First Ag Credit and followed with a suit that resulted in a \$3.8 million judgment.¹⁸ In an attempt to collect, Rabo Agrifinance filed a suit for quiet title, attempted to foreclose on 960 acres, and claimed certain transfers were fraudulent (Transfer Suit).¹⁹ The court held back-to-back trials for the two cases and used evidence from both cases to find that the foreclosure was valid in the transfer suit and that the appellees could foreclose on the equipment in the Deficiency Suit.²⁰ Additionally, the court awarded the plaintiffs attorney's fees in both cases.²¹ The appellants argue that the statute of limitations barred collection of the underlying debt thus barring the foreclosure sale.²² They also argue that even if the

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.* at *2.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *See id.*

²¹ *See id.*

²² *See id.* at *3.

foreclosure was permissible, Terra should be subrogated to a superior lien position with the equipment and that recovery of attorney's fees should be barred.²³

Rabo Agrifinance filed the Deficiency Suit one day before the statute of limitations ran. The appellants, however, argue that the statute of limitations barred the Deficiency Suit because Rabo Agrifinance did not own the debt when they filed the suit, and they "failed to exercise diligence in effecting service of process."²⁴ The court pointed out that any attack against the validity of the Deficiency Suit judgment is barred by collateral estoppel.²⁵ Additionally, the court determined the debt had been transferred back to Rabo Agrifinance giving them ownership at the time the deficiency suit was filed.²⁶ Because the appellants failed to show how the district court's holding was clearly erroneous, the appellate court followed the district court's opinion, finding that the appellees used "the degree of diligence that an ordinarily prudent person would have used" in serving process in this situation.²⁷

The court then addressed the appellant's contention that Terra should be subrogated to the first lien on the irrigation equipment, because Robert Viegel assigned his subrogation rights to Terra.²⁸ The appellees contend that if Terra is given subrogation on the first lien, Rabo Agrifinance will be unable to collect on the second lien.²⁹ Texas recognizes "three sources of subrogation rights: equitable, contractual, and statutory."³⁰ Terra relied on the latter, basing their claim on § 43.004 Tex. Civ. Prac. & Rem. Code: "A surety who pays on a judgment . . . is subrogated to all of the judgment creditor's rights under the judgment."³¹ But, the court discusses a partial payment exception to subrogation that applies when a security covers multiple loans and only some are discharged by the surety's payment.³² "The surety must discharge the entire underlying obligation before achieving subrogation," meaning that all of Rabo

²³ *See id.* at *4, *6.

²⁴ *Id.* at *3.

²⁵ *See id.*

²⁶ *See id.* at *4.

²⁷ *Id.*

²⁸ *Id.*

²⁹ *See id.*

³⁰ *Id.* at *5.

³¹ *Id.*

³² *See id.*

Agrifinance's debts must be paid before Terra's interest can become subrogated to the first lien.³³ Lastly, the court awarded attorneys fees based on the debt contracts between Terra and Rabo Agrifinance.³⁴ The court also explained that at the district court, the appellants challenged only the reasonableness of the attorney's fees thereby waiving their right to challenge the absolute right to attorney's fees.³⁵

The court used collateral estoppel to quickly dispel the contention of who owned the debt, essentially saying that it did not matter who owned the debt because the validity of the Deficiency Suit was already litigated.³⁶ Even though the appellants were not served with process until after the limitation period, the court asserted that the appellees used due diligence in service of process.³⁷ This allows lenders to file a suit at the last minute, and even if service of process is not served before the expiration of the limitation period, the suit is still valid. Although the statute regarding subrogation is straight forward, the court points out a common law exception and explains its relevance to the situation at hand.³⁸ This decision protects lenders in full dispelling any notions that subrogation prejudices second lien holders. While the factual situation may be new, the court applies already established law to better protect lenders who are seeking payment from creditors.

³³ *Id.*

³⁴ *Id.* at *6.

³⁵ *See id.*

³⁶ *See id.* at *4.

³⁷ *See id.*

³⁸ *See id.* at *5.