

**United States Bankruptcy Court
District of New Mexico**

Document Verification

Case Title: Clark Company, Inc.
Case Number: 00-16957
Chapter : 11
Judge Code: SA
First Meeting Location: Albuquerque
Reference Number: 11 - 00-16957 - SA

Document Information		
Number:	133	
Description:	Memorandum Opinion re: [125-1] Motion To Determine Controversy Regarding Distribution of Liquidation Proceeds. by Clark Company, Inc.	
Size:	9 pages (20k)	
Date Received:	01/22/2004 09:03:09 AM	Date Filed: 01/22/2004 Date Entered On Docket: 01/22/2004
Court Digital Signature		View History
91 86 e7 05 1a 51 be 5e 94 3e a3 d5 a1 81 9a ff 3c e3 1f ad ee 7f 8f 47 a0 1c 89 0b 6e a8 ff c5 a9 5c f3 20 78 d1 36 12 73 64 f4 b1 64 40 04 95 ef 73 12 82 fa 06 6a 25 1a 23 ef e8 66 86 95 0c f6 82 86 30 ff 82 b0 19 a3 67 34 42 91 b0 98 5a 78 a6 90 f0 e9 08 07 a6 e9 13 6c 21 4e 8d b9 34 da d7 6c 66 79 09 e3 0c bd 0f 78 ab 26 d8 b5 3e ea 8e 0e 31 1a 64 4e 93 c5 8c 06 09 5f 64 39 ef		
Filer Information		
Submitted By:	James E Burke	
Comments:	Memorandum Opinion	

Digital Signature: The Court's digital signature is a verifiable mathematical computation unique to this document and the Court's private encryption key. This signature assures that any change to the document can be detected.

Verification: This form is verification of the status of the document identified above as of *Wednesday, December 22, 2004*. If this form is attached to the document identified above, it serves as an endorsed copy of the document.

Note: Any date shown above is current as of the date of this verification. Users are urged to review the official court docket for a specific event to confirm information, such as entered on docket date for purposes of appeal. Any element of information on this form, except for the digital signature and the received date, is subject to change as changes may be entered on the Court's official docket.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
CLARK CO., INC.,
Debtor.

No. 11-00-16957 SA

MEMORANDUM OPINION

This matter is before the Court on the Debtor's Motion to Determine Controversy Regarding Distribution of Liquidation Proceeds (doc 125). Clark Co., Inc. ("Debtor") appears through its attorney Walter L. Reardon, Jr. Creditor Charles Haygood ("Haygood") appears through his attorney George D. Giddens. The parties submitted stipulated facts (doc 130) and briefs (docs 131, 132). Having reviewed the materials submitted, the Court issues this Memorandum Opinion. This is a core proceeding. 28 U.S.C. § 157(b)(2)(A) and (K).

The issue is whether the Debtor, as a debtor in possession exercising the powers of a trustee pursuant to § 1107(a), can use the trustee's § 544 strong arm powers to force Haygood, a junior secured creditor, to marshal in order to make a fund available for payment of unsecured claims. The Court concludes that neither the marshaling doctrine or the Code permit that result in this case.

Debtor owned real estate and personal property (equipment) subject to the cross collateralized liens of Wells Fargo. Creditor Haygood had a second lien on the real estate

from a recorded transcript of judgment but no lien on the personal property. Debtor liquidated its assets. The personal property was sold first and all proceeds were paid to Wells Fargo. Some time later the real property was sold, paying off the remainder of the Wells Fargo debt and leaving a sum that was substantial but not sufficient to pay Haygood's secured claim in full. The issue presented by the parties is whether Wells Fargo should be deemed to have collected from the real estate first, thereby, at Haygood's cost, freeing up some equity in the personal property that would be payable to Debtor's unsecured creditors.

FACTS

The parties stipulated to a set of facts, which are included in the following findings:

1. The liquidation of Debtor's assets has been completed.
2. The Wells Fargo equipment and real estate loans were cross-collateralized. Wells Fargo has been paid in full and, under any argument advanced by any party, remains fully paid.
3. DoveBid conducted an auction of Debtor's equipment that resulted in proceeds of \$136,661.07 to the estate. The sale report is attached to docket 126. The auction was

conducted on January 15, 2003 and all proceeds were distributed by February 25, 2003.

4. The auction proceeds were applied to the loans of Wells Fargo as follows:
 - a. \$3,806.58 legal expense
 - b. \$1,841.14 real estate appraisal
 - c. \$1,849.26 environmental cleanup cost
 - d. \$34,659.17 payoff of equipment loan
 - e. \$94,504.92 balance applied to real estate loan.
5. The sale of Debtor's real estate closed on March 7, 2003. A copy of the closing statement is attached to docket 126.
6. According to the closing statement, the gross amount due seller was \$685,000.00, applied as follows:
 - a. \$57,607.83 in closing costs
 - b. \$1,500.00 in cleanup costs
 - c. \$1,010.64 in property taxes
 - d. \$279,256.99 to pay Wells Fargo's claim in full
 - e. \$345,624.54 balance applied to the secured claim of Haygood on his transcript of judgment.
7. The payment to Haygood left him with an unsecured claim of \$803,040.76.
8. A dispute has arisen between Haygood and the Debtor regarding application of the proceeds.
9. The dispute is outlined in the Motion to Determine Controversy and involves the method of application or allocation of proceeds to Wells Fargo's loans. For the

purpose of this motion, Debtor does not take issue with the collection costs applied by Wells Fargo on the sale of the equipment. The amount in dispute is the \$94,504.92 from the proceeds of the equipment sale applied to the Wells Fargo real estate loan.

10. The issue is whether up to \$94,504.92 should be available for distribution to unsecured creditors which includes the unsecured claim of Charles Haygood which has a balance of \$803,040.76.
11. By virtue of the size of his unsecured claim, Haygood would receive about 85% of any distribution to unsecured creditors.¹

CONCLUSIONS OF LAW

¹ The Liquidation Committee received a refund of \$15,853.93 from NC Venture, LP, a secured creditor, based upon an overpayment by DoveBid. These funds are presently in Mr. Reardon's trust account. Had the auctioneer not overpaid NC Venture, LP, an additional \$15,883.93 would have been paid to Wells Fargo and applied to the Wells Fargo real estate loan. The members of the Liquidation Committee, Mr. Haygood and Mr. Clark, have reached an agreement to withhold distribution of the funds received from NC Venture and \$15,000.00 of the funds received from the proceeds of sale of the real estate until the Court determines the controversy regarding the marshaling of liens issue. The parties attached two spreadsheets showing the effect of marshaling on the distribution to the unsecured creditors. These spreadsheets attached to the stipulated facts assume that the \$15,000.00 has been applied to the remaining claim of Haygood.

1. New Mexico law recognizes the doctrine of marshaling of assets. Seasons, Inc. v. Atwell, 86 N.M. 751, 755, 527 P.2d 792, 796 (1974):

Marshaling is an equitable principle under which assets of a debtor are arranged to protect the rights of two or more competing creditors. It is also referred to as the two-funds doctrine and is often applied in situations where one creditor has a claim to two or more funds, and another has a claim upon one of the funds only, the one having a claim upon two funds being required to look first to the fund to which he has the exclusive right. Its purpose is to protect junior lienholders.

(Citations omitted.) Marshaling is applied only when it can be equitably fashioned as to all of the parties. Meyer v. United States, 375 U.S. 233, 237 (1963).

2. Wells Fargo had cross collateralizing liens on both the equipment and real estate.

3. Haygood had a lien only on the real estate by virtue of his transcript of judgment. This lien is second in priority, behind Wells Fargo.

4. The Court concludes that Debtor should not be able to use § 544 as if it were a secured creditor at least where, as here, the requested marshaling would result in a more senior secured creditor being paid less than that more senior secured creditor would otherwise receive.

5. Although there are some cases that permit this type of marshaling, e.g., In re Wilmot Mining Co., 167 B.R. 806, 812

(Bankr. W.D. Pa. 1994)(allowing trustee to prevent previously secured junior creditor from marshaling assets solely for its benefit), the Court agrees with the reasoning of Canal Nat'l Bank v. Larry's Equipment Service, Inc. (In re Larry's Equipment Service), 23 B.R. 132, 134 (Bankr. D. Me. 1982):

Marshaling is not equitable if applied for the benefit of a trustee to the detriment of a secured and properly perfected junior lien creditor. To permit marshaling in the manner sought by the trustee, in this case, would frustrate the objective of the Bankruptcy Code and conflict with the doctrine itself by prejudicing the rights of a superior class of creditors.

That is, the Court finds that the type of marshaling suggested by the Debtor in this case would improperly prejudice Haygood who holds a lien senior to the Debtor and junior only to Wells Fargo's lien. Simply put, marshaling in this instance would provide a fund to pay unsecured claims by permanently reducing Haygood's recovery on Haygood's perfected secured claim and leaving Haygood with a larger unsecured claim. See also Federal Land Bank of Columbia v. Tidwell (In re McElwaney), 40 B.R. 66, 70-71 (Bankr. M.D. Ga. 1984)(allowing trustee to invoke marshaling would frustrate the Code's policy by enriching unsecured creditors over secured creditors); Murdock v. Security State Bank of Harlem (In re Murdock), 134 B.R. 417, 423 (Bankr. D. Mont. 1991)(trustee cannot defeat a perfected junior lien by marshaling).

6. No one has argued that Haygood's claim should be equitably subordinated, see § 510(c), so that there is no basis for a reordering of the Code priorities for payment of claims.

"Outside bankruptcy, secured creditors hold a position superior to unsecured creditors. Under the Bankruptcy Code, the secured claims in a Chapter 7 case are recognized first."

In re McElwaney, 40 B.R. at 70.² This reasoning would be applicable whether the debtor-in-possession/trustee is treated as a secured creditor by virtue of the strong-arm powers (§ 544) or simply as an unsecured creditor. The fact that Haygood would receive about 85% of any distribution on unsecured claims does not justify an otherwise improper taking of his property or constitute a de minimis reduction of his interest.

7. [Marshaling's] purpose is to prevent the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security. It deals with the rights of all who have an interest in the property involved and is applied only when it can be equitably fashioned as to all of the parties.

Meyer v. United States, 375 U.S. at 237. There has been no arbitrary action by either senior lienholder, particularly

² The chapter 7 payment priorities are equally applicable in this chapter 11 case.

Haygood. And even though the unsecured creditors are not receiving the additional funds, they have suffered no legal prejudice because they, having not bargained for any security, have no equity equal to Haygood's. In re Robert E. Derecktor of Rhode Island, Inc., 150 B.R. 296, 299-301 (Bankr. D.R.I. 1993). Accord, In re Gibson Group, Inc., 151 B.R. 133, 135 (Bankr. S.D. Ohio 1993) ("It is not appropriate for a party, asserting a valid security interest to be defeated in its expectations by a creditor, or creditors, having no such interest," following Ohio law). Indeed, if anything, Haygood would presumably be entitled to require Wells Fargo to marshal if it had not done so already. Id.

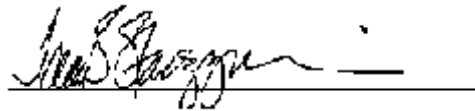
8. Given the foregoing analysis, the Court need not address the issue of whether a trustee even has standing to raise the marshaling argument. See Moses Lachman, Marshaling Assets in Bankruptcy: Recent Innovations in the Doctrine, 6 Cardozo Law Review 671, 675-77 (1985) (suggesting that trustee as representative of unsecured creditors does not have standing to raise marshaling argument).

CONCLUSION

For purposes of the bankruptcy case, therefore, Wells Fargo should be deemed to have been paid the full proceeds of the personal property with the remainder of its debt satisfied

by the real estate proceeds. Haygood's transcript of judgment should then be paid the remaining net proceeds from the real property, including the \$30,883.93 currently held in Mr. Reardon's trust account.

Haygood's counsel shall submit an order in conformity with this Opinion within ten days.



Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that on January 22, 2004, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered, or mailed to the listed counsel and parties.

Walter L Reardon, Jr
3733 Eubank Blvd NE
Albuquerque, NM 87111-3536

George D Giddens, Jr
10400 Academy Rd NE Ste 350
Albuquerque, NM 87111-1229

