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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	)	CHAPTER 11
AERO PLASTICS, INC.	)	CASE NO. 05-60451-MHM
Debtor	)	
AERO HOUSEWARES, LLC	)	CONTESTED MATTER
Movant	)	
v.	)	
INTERSTATE RESTORATION GROUP, INC.	)	
Respondent	)	

ORDER ON MOTIONS FOR SUMMARY JUDGMENT

This contested matter concerns competing claim to funds in an escrow account created in settlement of objections to the sale of substantially all of Debtor's assets. The parties have filed motions for summary judgment.

STATEMENT OF FACTS

Debtor was in the business of manufacturing plastic housewares products. Debtor's manufacturing facility is located at 237 Greenwood Court, McDonough, Henry County, Georgia (the "Factory"). Debtor occupied the Factory and the real property upon which it

is located (collectively, the "Property") under a sublease (the "Lease").[1] Prior to August, 2004, the Lease included an option to purchase the Property. On August 18, 2004, in exchange for $600,000 paid to Debtor, the Lease was amended to delete the purchase option.

On July 19, 2004, the Factory suffered significant damage due to a fire. From a list provided by Debtor's insurance company, Debtor employed Interstate Restoration Group, Inc. ("IRG") to provide services to restore the Factory.[2] Debtor and IRG entered into a written contract for the restoration services (the "Contract"). The Contract provided that Debtor would "make payment directly to [IRG] for the Work, whether or not such Work is covered by insurance...." Debtor was required to pay $75,000 upon execution of [the Contract]. Thereafter, IRG was to issue invoices weekly that were due upon receipt. The Contract provided that Debtor was required to furnish IRG with "evidence of Project funding" prior to the start of construction and thereafter as requested by IRG. The Contract also contained a provision that the Contract contained the entire agreement of the parties and could be modified only in writing.

IRG began work July 22, 2004 and completed work August 3, 2004. According to an affidavit from IRG's Chief Financial Officer, Thomas Reeve, when IRG's work was substantially completed, Mr. Reeve called Debtor's chief financial officer Andrew J. Rice

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[1] The sublessor is McDonough NI Industrial, LLC (the "Sublessor") by assignment of the sublease from FI Development Services, L.P. The lessor of the sublessor is the Henry County Development Authority (the "Lessor").

[2] IRG was not the only contractor employed to repair damages to the Factory.

to demand payment. The parties have submitted competing affidavits regarding the conversations between Mr. Reeve and Mr. Rice.

According to Mr. Reeve's affidavit, when he first began calling Mr. Rice, Mr. Rice told him Debtor had no funds to pay IRG but that Debtor would pay IRG from the insurance proceeds it expected to receive in August 2004. Based upon that representation, on August 12, 2004, IRG sent a final invoice for $250,000. When Mr. Reeve contacted Mr. Rice at about the time the final invoice was submitted, Mr. Rice confirmed that an insurance payment had been received by Debtor but represented that the insurance payment had been allocated for loss of income and not property damage and, thus, could not be used to pay IRG. In fact, it is now undisputed by the parties that Debtor received an insurance check in the amount of $400,000 August 12, 2004, allocated as $300,000 towards damage to Debtor's building and $100,000 toward damage to Debtor's personal property. The amount was more than sufficient to pay IRG in full.

Mr. Reeve's affidavit continues, setting forth that in October 2004, Mr. Rice acknowledged that another insurance payment had been received but that only $20,000 of that payment had been allocated for property damage. Debtor paid IRG $20,000. Again, it is now undisputed by the parties that Debtor, in fact, received an insurance check in the amount of $350,000 October 7, 2004, allocated as $50,000 towards damage to Debtor's building and $300,000 toward damage to Debtor's personal property. Debtor received another insurance check October 7, 2004, in the amount of $150,000, allocated toward

damage to Debtor's personal property. Then December 17, 2004, Debtor received an insurance check in the amount of $250,000 allocated toward Debtor's loss of income claim. Shortly after receiving the $20,000 payment from Debtor, on October 28, 2004, IRG recorded a mechanic's/materialmen's lien (the "IRG Lien"), claiming a lien in the amount of $250,675.86.

Mr. Rice, in his affidavit, avers he has no memory that he told Mr. Reeve that IRG would be paid when Debtor received insurance proceeds. Mr. Rice states he referred Mr. Reeve's calls to Debtor's CEO, Jeffrey Goldberg. Mr. Goldberg has testified that IRG had no "lien rights, liens asserted, security interests, or anything" in the insurance proceeds that he was aware of. Therefore, neither Mr. Rice nor Mr. Goldberg have expressly denied the conversations represented by Mr. Reeve.

Debtor filed its Chapter 11 bankruptcy petition January 6, 2005. After a considerable series of developments and disputatious hearings with Debtor's primary lenders, creditors and potential purchasers, on July 26, 2005, Debtor filed a motion to sell substantially all its assets to Aero Housewares, LLC ("Aero"), whose CEO is Jeffrey Goldberg. The terms of the sale included a provision that Debtor would assume and assign the Lease to Aero. The terms of the sale also included transfer of Debtor's insurance claims and right to receive insurance proceeds. IRG objected to the sale, as did the Lessor and Sublessor of the Property. The Lessor and Sublessor resisted the sale until IRG's Lien was removed as a cloud upon title to the real property.

This court determined that the immediate sale of Debtor's assets to Aero was in the best interests of the estate, as any substantial delay in the transfer would likely force Debtor to discontinue operations, which would severely impact the value of the assets (*see* Order Approving Sale, entered August 26, 2005, dkt. No. 298). Upon the court's suggestion, the parties agreed to create an escrow fund of $290,000 (the "Escrow Fund"),[3] to which all IRG's claims would attach, including the IRG Lien. IRG agreed to withdraw or cancel its mechanic's materialmen's lien recorded in the records of Henry County, Georgia, and allow that lien claim to attach to the proceeds reserved in the Escrow Fund.

IRG asserts essentially two theories of recovery: First, it asserts that the insurance proceeds, up to the amount of IRG's unpaid claim, never became property of the estate because those proceeds were assigned to IRG by Debtor and Debtor's "conversion" of the insurance proceeds gave rise to a constructive trust for the benefit of IRG. Second, and alternatively, IRG asserts the IRG Lien attached to Debtor's leasehold, which has value at least equal to the amount of IRG's claim.

Aero[4] contends that IRG is not entitled to recover under either theory but instead holds simply an unsecured claim against Debtor's estate. Aero contends both a lack of

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[3] A subsequent agreement among Debtor, Aero, and the Creditors' Committee provides that, to the extent that Aero recovers all or any portion of the Escrow Fund, Aero will pay to Debtor's estate funds sufficient to discharge certain prepetition tax claims against the Property and shall also pay the U.S. Trustee fees for the third quarter of 2005. Any balance of the Escrow Fund recovered by Aero will be retained by Aero. The motion to approve that agreement (filed September 9, 2005, dkt. No. 303) was approved by order entered October 20, 2005 (dkt. No. 335).

[4] Interestingly, Aero Housewares, LLC, the purchaser of Debtor's assets, is represented by the same law firm that represents Debtor.

factual basis and parol-evidence-rule preclusion from finding an effective assignment of the insurance proceeds. Additionally, Aero contends that the assertion of a constructive trust is unsupported by any identifiable *res*. With respect to the IRG Lien, Aero contends that it could not attach to the insurance proceeds because Debtor's senior secured creditor's security interest extended to general intangibles, which would include the insurance proceeds and any unpaid insurance benefits, and, as the senior secured creditor's claim was undersecured, no value existed to which the IRG Lien could attach. Aero asserts that, under Georgia law, the IRG Lien attached only to the leasehold, not to the real property itself. Finally, Aero argues that, as of the date of sale of Debtor's assets, the Lease was of inconsequential value and thus, under 11 U.S.C. §506, the IRG Lien is unsecured.

In response to Aero's argument regarding the value of the leasehold, IRG asserts that the relevant date for valuation should be the date the lien attached, i.e. the date IRG began the repairs to the Factory. Alternatively, IRG asserts that, contrary to Debtor's contention, the Lease had substantial value at the time of the sale. Both parties agree that an evidentiary hearing would be required to determine the value of the Lease.

DISCUSSION

Constructive Trust

IRG asserts a constructive trust in the insurance proceeds paid to Debtor. The Georgia Code, O.C.G.A. §53-12-93 defines a constructive trust:

> A constructive trust is a trust implied whenever the circumstances are such that the person holding legal title to property, either from fraud or otherwise, cannot enjoy the beneficial interest in the property without violating some established principle of equity.

Georgia case law has further explained what appear to be the somewhat murky principles for imposition of a constructive trust:

> "Trusts are implied -- 1. Whenever the legal title is in one person, but the beneficial interest, either from the payment of the purchase money or other circumstances, is either wholly or partially in another. 2. Where, from any fraud, one person obtains the title to property which rightly belongs to another. 3. Where from the nature of the transaction it is manifest that it was the intention of the parties that the person taking the legal title should have no beneficial interest." Code, § 108-106. Thus it will be seen that implied trusts arise under varying circumstances. Such trusts are divided into two categories; resulting trusts and constructive trusts, and sometimes it is exceedingly difficult to differentiate between the two; but ordinarily distinctions are unnecessary since both are implied trusts and are governed by the same rules. Generally trusts arising under the first and third classifications in the cited Code section are resulting trusts, while those arising under the second classification are constructive trusts.

Hancock v. Hancock, 205 Ga 684, 689 (1949).

> "Constructive or implied trusts are such as are raised by equity in respect of property which has been acquired by fraud, or where, though acquired originally without fraud, it is against equity that it should be retained by him who holds it." ...As against a trustee *ex maleficio*, the person injured is entitled to recover the property wrongfully obtained or in equity subject it and its income to such a trust; and if the trust property cannot be traced, the fact that an action might have been brought at law for damages or that the plaintiff may in his suit to establish the trust also seek a money judgment for the proceeds of the trust property, will not divest equity of jurisdiction.

(Citations omitted). *Bateman v. Patterson*, 212 Ga. 284 (1956). Thus, it appears that the beneficiary of a constructive trust must be able to assert an identifiable beneficial interest in the relevant property, which, in this proceeding, would be the insurance proceeds.

IRG's argument that it is beneficiary of a constructive trust depends upon a finding that an assignment of the insurance proceeds occurred or upon fraud. If such an assignment occurred, giving IRG an identifiable interest in the insurance proceeds, then that equity would create a constructive (implied) trust.

IRG asserts that after its work for Debtor was substantially completed, Debtor made an "effective assignment" of the insurance proceeds to pay IRG's fees. The facts asserted to support the assignment are that Debtor orally, through Mr. Rice's conversations with Mr. Reeve, promised payment from the proceeds it expected to receive from its insurance carrier. Mr. Reeve made no allegations that Mr. Rice or any other agent of Debtor expressly, in writing or orally, assigned or promised to assign the insurance payments to IRG. IRG did not communicate with the insurance company until after Debtor filed its Chapter 11 petition January 6, 2005. In July before commencing the work or after having completed the work covered by the $75,000 advance, IRG could have contacted the insurance company, with whom it had a relationship, to find out the anticipated dates and amounts of payments; IRG could have requested that checks be made payable jointly to Debtor and IRG; if Debtor had refused, then IRG could have requested a written assignment of benefits, either initially in the written contract or later by amendment when Debtor indicated it would be able to pay IRG from the insurance proceeds.

Although Debtor's lies to IRG about the insurance proceeds satisfy the misrepresentation prong necessary to find fraud, none of those false representations took

place until after IRG's work was completed. IRG cannot assert, therefore, that it undertook the work in reliance on Debtor's promises of payment when Debtor received the insurance proceeds. The conversations between Mr. Reeve and Mr. Rice or Mr. Goldberg, without more, are insufficient to establish an effective assignment of the insurance proceeds. The conversations described by Mr. Reeve establish that IRG demanded payment and Debtor responded that it had no money but expected to be receiving some money from its insurance company and would pay IRG at that time. Such a conversation does not establish an assignment or the promise of an assignment. It is merely a logical and reasonable response to a collection call. IRG chose not to avail itself of any of the means by which it could have protected itself. A written assignment would have sufficed.

Additionally, the Contract contained specific provisions about payment: The Contract provided that Debtor would "make payment directly to [IRG] for the Work, whether or not such Work is covered by insurance...." That clause evidences the clear intention of IRG that it did *not* wish to rely on the insurance for payment. Thus, a post-Contract assignment of insurance benefits would have constituted a modification of the Contract. The parol evidence rule, O.C.G.A. §13-2-22,[5] prohibits proof of oral modification of an unambiguous written contract. Additionally, IRG's inquiries about payment could have appropriately been viewed by Debtor as nothing more that IRG's exercise of its right under the Contract to seek "evidence of Project funding." As in *In re*

[5] "Parol evidence is inadmissible to add to, take from, or vary a written contract."

Markair, Inc., 172 B.R. 638, 642 (BAP 9th 1994), IRG "has not established that it is entitled to treatment different than any other creditor that extended credit to the debtor, other than the superficial appeal of the existence of the *res*."

The IRG Lien

The parties do not dispute that IRG has a valid mechanic's/materialman's lien upon Debtor's leasehold. The IRG Lien, however, does not extend to the interests of the Lessor and the Sublessor in the real property. *D&N Electric, Inc. v. Underground Festival, Inc.*, 202 Ga. App. 435 (1991); O.C.G.A. §44-14-361. Therefore, the issues regarding the IRG Lien focus on valuation.

Despite IRG's resistance to "bankruptcy-based" arguments, the issues surrounding the IRG Lien are subject to 11 U.S.C. §506. IRG holds a claim, within the definition set forth in 11 U.S.C. §101(5), that arose before Debtor filed its bankruptcy petition. That claim is secured by the IRG Lien, which was also filed prepetition. The property securing the IRG Lien is Debtor's leasehold interest under the Lease. Under §506(a), the amount of IRG's claim that is allowable as secured is equal to no more than the value of the leasehold. To the extent that the value of the leasehold is less than the amount of IRG's claim, that amount is an unsecured claim.

The parties dispute the effective date for valuation of the Debtor's leasehold interest. IRG asserts that the leasehold should be valued as of the date the lien arose, *i.e.* the date IRG began work on repairing the fire damage to the Factory. IRG argues that this

prepetition date is appropriate because Debtor transferred a valuable feature of the Lease, the option to purchase, after the IRG Lien attached.

> Section 506(a) contains a clear statement concerning the time of valuation:
>
> Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

The appropriate date for valuation is the date of the approval of the sale of Debtor's assets. *U.S. v. Booth Tow Services, Inc.*, 64 B.R. 539 (W.D. Mo. 1985).

Although the parties suggest that a further hearing is required to determine the value of the leasehold, no further hearing appears to be necessary. The undersigned presided over the hearings on Debtor's motion to sell its assets and, thus, has an understanding of the terms of the sale and the value of the assets. The purchase price of Debtor's assets was $11,500,000. An integral part of the sale of Debtor's assets was the assumption and assignment of the Lease. The sale would not have occurred without assignment of the Lease. Debtor argues that the Lease had no equity and no intrinsic value, but within the context of the sale to the purchaser approved, the Lease had substantial value and that value can be measured by no less than the cost, at the time of the sale, to accomplish the repairs of the damage cause to the leasehold by the fire. Based upon the repair cost incurred approximately a year prior to the sale, the value of the leasehold was, at the time of sale, at least equal to the $290,000 escrowed by Debtor. It is undisputed that as of March 31, 2006, IRG's claim was $265,051.79. All that remains is the calculation of

accrued interest since that date. If the parties are unable to agree to the calculation of that amount, they may file an appropriate motion. Accordingly, it is hereby

ORDERED that IRG's claim is secured in the amount of $265,051.79, plus interest accrued since March 31, 2006, up to an amount not to exceed $290,000, to be paid from the Escrow Fund.

IT IS SO ORDERED, this the 27th day of September, 2006.

MARGARET H. MURPHY
UNITED STATES BANKRUPTCY JUDGE