



**IT IS ORDERED as set forth below:**

**Date: March 29, 2010**

*James E. Massey*

James E. Massey  
U.S. Bankruptcy Court Judge

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF GEORGIA  
ATLANTA DIVISION

\_\_\_\_\_  
IN RE:

CASE NO. 08-84255

Value Family Properties - West Atlanta, LLC,

CHAPTER 11

Debtor.

JUDGE MASSEY

\_\_\_\_\_  
Value Family Properties - West Atlanta, LLC,

Movant,

v.

CONTESTED MATTER

James Harrison,

Respondent.  
\_\_\_\_\_

ORDER GRANTING OBJECTION TO CLAIM

James Harrison filed proof of claim no. 2 in this case, asserting that he holds an unsecured claim for \$7,500.00 against Debtor arising out of Debtor's failure to pay interest in that amount pursuant to a Subscription Agreement dated August 17, 2005, a copy of which is attached to his proof of claim. Under the Subscription Agreement, Mr. Harrison and Debtor, along with an

affiliate, Family Value Homes - West Atlanta, L.L.C., agreed that as an “Investor,” he “desired[d] to share in the profits from the purchase and sale of the Park [a mobile home park that Debtor and an affiliate planned to purchase] and the purchase and lease and/or sale of the Homes [mobile homes that Debtor and its affiliate planned to acquire and install in the mobile home park]. The Subscription Agreement does not state the amount of his investment. It provides, however, that “[f]or each investment of \$1,000,000, an Investor shall be credited with a fourteen (14%) percent equity interest in VFP and VHF.” (VFP is the acronym used for the Debtor, and VHF is the acronym used for Family Value Homes - West Atlanta, L.L.C.) Mr. Harrison bases his claim on a further provision in the Subscription Agreement promising him that “Investors shall receive interest-only payments of Ten Percent (10%) per annum on their investment in VFP and VFH which shall be paid monthly.” Finally, the Subscription Agreement provides that “[u]pon the sale or refinance of the VFP and or VFH, the Investors shall receive the return of their capital investment in the respective entity as allocated by the Managing Member, any accrued and unpaid interest and such Members (sic) undistributed share of profits, including any allocable share of funds remaining from the sale of refinancing of VFP or VFH.”

Mr. Harrison thus bought a security, representing in the Subscription Agreement that he was a “sophisticated investor,” who qualified as an “‘accredited investor’ as that term is defined in Section 501 of Regulation D promulgated under the Securities Act of 1933.”

The Debtor, acting as debtor-in-possession, objects to the claim on the ground that “Claim No. 2 is based on an equity investment made by Claimant in the Debtor, and therefore cannot be an allowed unsecured claim.”

Mr. Harrison filed a response in which he asserts that he received interest payments from the Debtor until January 15, 2008 and that he sold his equity interest in the Debtor in July 2008. He further contends that at the time of that transfer and as a result of the Debtor's default, he is owed \$7,500.00. He argues that "Claimant's claim is not for damages arising from a sale of securities or for any other of the matters which give rise to subordination. 11 U.S.C. § 510. Claimant simply became a creditor of Debtor the moment he transferred his membership interest."

In objecting to the claim on the ground that it is "based on an equity investment" and "cannot be allowed unsecured claim," Debtor is in effect asserting, as Mr. Harrison's response points out, that the claim should be subordinated to general unsecured claims pursuant to section 510(b) of the Bankruptcy Code.

Section 510(b) of the Bankruptcy Code provides:

(b) For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

The word "claim" means a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, *unmatured*, disputed, undisputed, legal, equitable, secured, or unsecured ." (Emphasis added.) Contrary to Mr. Harrison's assertion that his claim arose at the time he sold his equity position in 2008, he had an unmatured claim for interest against Debtor under the Subscription Agreement at the time he made his investment in 2005. His right to payment of interest matured periodically as each month passed thereafter. His

right to payment of accrued interest was not created by the sale. His contention that the sale of the security somehow isolated or divorced his claim from the security for purposes of section 510(b) is therefore without merit.

Mr. Harrison's claim is rooted in and arises from his purchase of a security at the instant of the purchase and that subjects his claim to section 510(b). *In re Med Diversified, Inc.*, 461 F.3d 251 (2<sup>nd</sup> Cir. 2006). In that case, a former officer of the debtor and the debtor entered into an agreement upon the termination of Rombro's employment pursuant to which the debtor agreed to issue at a future date shares of its common stock in exchange for shares of stock of another company owned by Rombro. The debtor breached the agreement and later filed bankruptcy. Rombro filed a proof of claim for his alleged damages to which the bankruptcy trustee objected. The bankruptcy court ruled for the trustee, and the district court affirmed. The Court of Appeals summarized the decision of the bankruptcy court as follows:

In a well-reasoned, unpublished decision dated February 23, 2005, the bankruptcy court (Bernstein, Bankr. J.) granted summary judgment to the trustee and subordinated Claim 661. Judge Bernstein determined, in accordance with case law broadly construing section 510(b), that "the claim need not flow directly from the securities transaction, but can be viewed as 'arising from' the transaction if the transaction is part of the causal link leading to the injury," quoting *In re PT-1 Communications*, 304 B.R. 601, 608 (Bankr.E.D.N.Y.2004). The court concluded that because Rombro's claim was based on the debtor's alleged failure to issue Rombro shares of its stock as required by the termination agreement, there was a causal link between the securities transaction and the injury. Consequently, pursuant to section 510(b), the bankruptcy court subordinated Rombro's claim and deemed it to have "the same priority as the debtor's common stock for purposes of distribution under the [bankruptcy] Plan."

*Id.* at 254.

The Second Circuit affirmed, stating:

[W]e conform our interpretation of the statute to require subordination here only if Rombro (1) took on the risk and return expectations of a shareholder, rather than a creditor, or (2) seeks to recover a contribution to the equity pool presumably relied upon

by creditors in deciding whether to extend credit to the debtor. We conclude that Rombro took on the risk and return expectations of a shareholder when he agreed to exchange securities in PrimeRx and employment claims for the shares of the debtor, and that his resulting claim for damages therefore must be subordinated.

...

In reaching this conclusion, we are influenced by what appears to be the uniform determination of courts presented with similar claims that those who conclude the bargain to become investors or shareholders should be treated as such. Thus, as the Ninth Circuit explained when subordinating claims of individuals who allegedly did not receive the shares they were due and never had an opportunity to share in the benefits of ownership, “[e]ven if an investor never receives her promised shares, she entered into the investment with greater financial expectations than the creditor. The creditor can only recoup her investment; the investor expects to participate in firm profits.” *In re Betacom*, 240 F.3d at 830. Likewise, the Third Circuit concluded that claims of individuals who were unable to sell shares they were allegedly due because the shares were not registered should be subordinated. *In re Telegroup*, 281 F.3d at 136.

*Id.* at 256-257.

Under the Subscription Agreement, Mr. Harrison had no right to the return of his capital investment until a sale or refinancing took place. He bargained for periodic payments of interest but not interest payable on a loan. Instead, he “took on the risk and return expectations of a shareholder” when, as a sophisticated investor, he bought an equity position in Debtor that included a promised return in the form of interest and of a share of profits. A causal link exists between the purchase of the equity investment and the breach of promise of Debtor to pay interest on that investment - there would have been no claim had Mr. Harrison not purchased the equity investment.

For these reasons, Debtor’s objection to the claim of Mr. Harrison is GRANTED to the extent that his claim is subordinated the claims of general unsecured creditors pursuant to 11 U.S.C. § 510(b).

\*\*\*END OF ORDER\*\*\*