UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	
LEE'S FAMOUS RECIPES, INC.,	CASE NO. 11-68463-BEM
Debtor.	CHAPTER 11
CUSTOMIZED DISTRIBUTION, LLC,	
Plaintiff,	ADVERSARY PROCEEDING NO. 11-5482-BEM
v.	
COASTAL BANK AND TRUST COMPANY and LEE'S FAMOUS RECIPES, INC.,	
Defendants.	

MEMORANDUM OPINION

A trial was held in this adversary proceeding on November 8, 2012. Through this proceeding, Plaintiff Customized Distribution, LLC ("CDI") seeks to marshal Debtor's assets by compelling Coastal Bank and Trust Company ("Coastal") to satisfy its secured claim against Debtor through payments received on certain promissory notes made by licensees of Debtor in favor of Debtor (the "Notes"), instead of satisfying part of its claim from sales proceeds of seven parcels of commercial property owned by Debtor (the "Real Estate Proceeds" and the "Real Estate," respectively). Coastal holds a first priority security interest in each of the Notes and the Real Estate, while CDI holds a

second priority security interest in the Real Estate. [Doc. No. 55, #s 5 & 10] Additionally, there are two junior lien holders on the Notes. *See infra.*

Debtor intervened in this proceeding and filed an Answer and Counterclaim. [Doc. No. 10] Debtor opposes marshaling and through its Counterclaim (i) sought an order determining that in the event the Real Estate Proceeds are insufficient to satisfy Coastal's lien, any claim asserted by CDI against Debtor would be classified as a general unsecured claim, and (ii) also objected to CDI's Proof of Claim based on a novation theory. CDI answered and denied Debtor's allegations. [Doc. No. 17]

This is a core proceeding under 28 U.S.C. § 157(b)(2)(K) and (O) and is within this Court's subject matter jurisdiction and all parties consent to the Court's entering a final order in this case.[1] After carefully considering the pleadings, the evidence presented and the applicable authorities, the Court enters the following findings of fact and conclusions of law in accordance with Fed. R. Bankr. P. 7052.

I. Findings of Fact

The parties stipulated to numerous facts prior to trial. [*See* Doc. No. 55] Those relevant to the Court's decision are set forth below in addition to all other relevant facts found by the Court.

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[1] Coastal originally filed a motion to dismiss this proceeding arguing, based on *Stern v. Marshall,* 131 S.Ct. 2594, 180 L. Ed. 475 (2011), that this Court did not have the authority to issue a final order in this case. [Doc. No. 5] Thereafter, in accordance with the Stipulation Regarding Application of Proceeds of Sale of Debtor's Real Estate and Participation of Coastal Bank in the Adversary Proceeding [Main Case Doc. No. 249] and the Court's order approving the same, [Main Case Doc. No. 257] Coastal does not object to this Court's entry of a final order in this Adversary Proceeding. Neither Debtor nor CDI have objected to the entry of a final order by this Court, and the Court will enter final judgment. However, if the District Court determines pursuant to the rationale set forth in *Stern* that this Court does not have the authority to enter a final judgment, then this Memorandum Opinion and Judgment entered shall constitute the Court's proposed findings of fact and conclusions of law to the District Court.

Debtor filed its petition for relief under Title 11, Chapter 11 on June 24, 2011 (the "Petition Date"). [Doc. No. 55, # 7] CDI filed this Adversary Proceeding on August 22, 2011. [Doc. No. 55, # 9] Since that time, Debtor sold the Real Estate and the parties to this proceeding stipulated that Coastal can apply the Real Estate Proceeds to its secured claim. [Main Case Doc. Nos. 249 & 257] The parties further stipulated that applied Real Estate Proceeds are not subject to disgorgement from Coastal; instead, if CDI is successful in this proceeding, CDI would be subrogated to Coastal's first priority lien on the Notes. [Main Case Doc. Nos. 249 & 257] Finally, the parties agreed that Coastal would answer the complaint, but would otherwise not participate in this proceeding. [Main Case Doc. Nos. 249 & 257]

A. Claims Against the Notes and Real Estate

1. Coastal's Claim

Coastal was Debtor's lender pre-petition. [Doc. No. 55, # 10] As of the Petition Date, Debtor was indebted to Coastal in the approximate amount of (i) $867,000 under a loan evidenced by a promissory note dated October 30, 2008 (the "Coastal Note"), in the original principal amount of $5,350,000, plus (ii) $270,000 on account of Debtor's guaranty of an affiliate's obligations. [Doc. No. 55, #s 10 & 12] The Real Estate and the Notes secure this debt. [Doc. No. 55, # 10] Coastal filed Proof of Claim No. 18, asserting secured claims in the total aggregate amount of $1,166,602.03, plus accruing interest, legal fees, expenses, and other amounts, as of the date the claim was filed. [Ex. 2]

As of the date of the trial, Debtor had sold six of the seven parcels of Real Estate and paid Coastal's debt down to $242,880.40, exclusive of attorneys' fees and other charges that Coastal may be entitled to. [Doc. No. 55, #s 38, 39 & 41] The net sales proceeds from the sale of the seventh and final property in the amount of $213,403.75 had not yet been applied to Coastal's debt.[2] [Doc. No. 55, # 41] When the proceeds from the sale of the final parcel of Real Estate are applied to Coastal's debt, the remaining balance is $29,476.65. Counsel for Coastal informed Debtor that it has incurred attorneys' fees in excess of $196,000, which it will seek to recover as part of its secured claim. [Doc. No. 55, # 42] When these legal fees are added to the outstanding balance, Coastal's claim is $225,476.65.

2. CDI's Claim

CDI was a supplier to one of Debtor's affiliates. [Doc. No. 55, # 5] Debtor guaranteed certain of its affiliate's obligations to CDI under a guaranty dated April, 2006 ("Guaranty 1"), and a subsequent extension and amendment of guaranty dated July 22, 2009 ("Guaranty 2"). [Doc. No. 55, # 20] The debt arising under Guaranty 2 is also evidenced by a promissory note dated July 22, 2009 ("Note 1"), as amended on April 22, 2010 ("Note 2"), executed by Debtor's affiliate Famous Recipe Company Operations, LLC ("FRCO") as maker, and CDI. [Doc. No. 55, # 21] Note 1 and Note 2 are secured by a second priority security interest in the Real Estate. [Doc. No. 55, # 22] CDI filed Proof of Claim No. 2 in the amount of $1,159,653.84, asserting that Debtor is obligated

[2] The sale of the final Real Estate property closed on November 15, 2012.

under one or more guaranties and related promissory notes with respect to sales to FRCO. [Ex. 1]

3. Tsern Claims

John F. Tsern ("Tsern") directly or indirectly filed four proofs of claim, asserting over $1,000,000 in claims against Debtor. [Exs. 3 - 6] Debtor filed an adversary proceeding against Tsern.[3] The parties settled the adversary proceeding and the Court approved the settlement. [Main Case Doc. No. 307] The settlement provides in pertinent part that Proof of Claim No. 33 is

> allowed as a secured claim against the Debtor's estate in the amount of $400,000 and will have the same priority and be secured by the same collateral as provided in the documents attached or referred to in such proof of claim. That is, the claim will be senior in priority to all other claims, except for, and junior only to, the secured claim of Coastal Bank & Trust, with regard to the collateral securing Claim No. 33 . . . .

[Main Case Doc. No. 307].

4. Sysco Claim

Sysco Atlanta, LLC and Sysco Memphis, LLC (together, as "Sysco") filed Proof of Claim No. 30, asserting a secured claim in the amount of $407,989, as of the Petition Date. [Doc. No. 55, # 28] Debtor filed an adversary proceeding against Sysco.[4] The parties settled the adversary proceeding and the Court approved the settlement. [Main Case Doc. No. 241] The settlement provides in pertinent part that Proof of Claim No. 30 is secured to the extent of $40,000 (the "Sysco Secured Claim"). [Doc. No. 55, # 31]

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[3] *Lee's Famous Recipes, Inc. v. John Tsern*, AP Docket No. 12-5170-BEM.
[4] *Lee's Famous Recipes, Inc. v. Sysco Atlanta, LLC*, AP Docket No. 12-5181-BEM.

B. Lien Summary

The parties below hold secured interests in the following property of Debtor:

- Notes
  - Coastal – First Priority Security Interest
  - Tsern – Second Priority Security Interest
  - Sysco – Third Priority Security Interest
- Real Estate
  - Coastal – First Priority Security Interest
  - CDI – Second Priority Security Interest

CDI seeks to compel Coastal to satisfy its secured claim from the Notes so that CDI will be secured to the extent of the Real Estate Proceeds while Debtor objects to CDI's claim and seeks entry of an order that CDI's claim is unsecured. Initially the Court will determine if marshaling is appropriate in this case.

II. Conclusions of Law

A. CDI's Marshaling Claim

1. Marshaling, generally

The doctrine of marshaling provides that, "a creditor having two funds to satisfy his debt may not, by his application of them to his demand, defeat another creditor, who may resort to only one of the funds." *Meyer v. United States*, 375 U.S. 233, 236, 84 S. Ct. 318, 321, 11 L. Ed. 2d 293 (1963) (citation omitted); *see also Motley v. Adventure Parks Grp., LLC (In re Adventure Parks Grp., LLC)*, 2007 WL 2331076

(Bankr. M.D. Ga. 2007) (*citing McDonald v. First Nat'l Bank of Athens (In re Harrold's Hatchery & Poultry Farms, Inc.),* 17 B.R. 712, 715-16 (Bankr. M.D. Ga. 1982)); *In re Maddox,* 84 B.R. 251, 257 (Bankr. N.D. Ga. 1987). Marshaling "is founded . . . in equity, being designed to promote fair dealing and justice. Its 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." *Meyer,* 375 U.S. at 238. "The equity of marshaling may be enforced either by injunction against the paramount creditor, or by subrogation in favor of the junior creditor." *In re Harrold's,* 17 B.R. at 716 (*citing* Whitney, *The Law of Modern Commercial Practices* (2d ed. 1965)); *Farmers & Merchs. Bank v. Gibson,* 7 B.R. 437, 439 (Bankr. N.D. Fla. 1980), *vacated for other reasons, Peacock v. Gibson,* 81 B.R. 79 (N.D. Fla. 1981). "Bankruptcy courts, as courts of equity, have the power to marshal a debtor's assets in appropriate situations to secure an equitable distribution of funds to creditors of the debtor." *In re Maddox,* 84 B.R. at 257.

2. Georgia Law

In the absence of a state statute to the contrary, state law determines property rights. *See, e.g., Raleigh v. Ill. Dep't of Revenue,* 530 U.S. 15, 20 (2000); *Butner v. United States,* 440 U.S. 48, 54 (1979). Marshaling is one such property right. *See, e.g., Meyer,* 375 US at 237-39. Georgia law provides for marshaling at O.C.G.A. § 18-2-2 which states, "[a]s among themselves, creditors shall so prosecute their own rights as not to jeopardize unnecessarily the rights of others; hence, a creditor having a lien on two funds of the debtor, equally accessible to him, will be compelled to pursue the one on which other creditors have no lien."

In addition, the Georgia Supreme Court held, when considering whether marshaling was equitable where both funds were subject to junior liens, that "[i]n the eye of equity, all creditors are equally meritorious, and therefore, equity, if left to itself, makes no discriminations among creditors, but puts them all on the same footing. [Plaintiff], then, and these younger judgment creditors, must be permitted to stand on the same footing with respect to the Boykin *fi fa* [the senior creditor with security in two funds] which is older than his mortgage, and older than their judgments." *Semmes v. Boykin*, 27 Ga. 47, 53 (1859). Thus, the senior creditor could not apply her full claim to the fund subject to the plaintiff's lien. *See also* Pomeroy's *Equity Jurisprudence & Equitable Remedies § 2290* ("The right to marshaling being a mere equity and not a lien, it is generally held that it is subject to displacement and defeat by subsequently acquired liens upon the funds."); *53 Am. Jur. 2d Marshaling Assets § 16* ("Some courts, however, take the view that priority in time does not give rise to a superior equity and thus do not allow marshaling in favor of one junior lienor to the detriment of another. In such a case, the junior lienors are required to bear the burden in due proportion to the value of the fund or property to which each has a claim.").

3. Analysis

CDI and Debtor agree that there are at least three elements necessary for imposition of marshaling. These three elements are: "1) that the creditors are creditors of the same debtor, 2) that there are two funds belonging to that debtor, and 3) that one of the creditors has the right to resort to both funds." *In re Hale,* 141 B.R. 225 (Bankr. N.D. Fla. 1992) (*citing Farmers & Merchs. Bank*, 7 B.R. at 439; Am.Jur.2d, Marshaling Assets

§ 9); *In re Adventure Parks Grp., LLC*, 2007 WL 2331076 *n.1. Debtor asserts that, in addition, courts may apply marshaling only when marshaling will not 1) impair the senior lien holder's right to complete satisfaction; or 2) cause injustice to third parties. S*ee, e.g., In re Hale*, 141 B.R. at 226; *Hennessey Capital SE, LLC v. David (In re Miller Eng'g, Inc.),* 398 B.R. 473, 488-89 (Bankr. S.D. Fla. 2008). CDI disagrees that these additional considerations are elements of marshaling but does acknowledge that the Court should consider them when deciding if marshaling is appropriate. [Doc. No. 56] The parties agree that the three threshold elements for marshaling are satisfied. [Doc. No. 53, pg. 31] And regardless of the labels attached to the elements and/or concerns, the Court must consider the impact marshaling will have on Coastal's rights and on certain third parties in making a decision whether marshaling is appropriate.

a. Impact of Marshaling on Coastal

Subrogation "is the substitution of one person in the place of another with reference to a lawful claim or right." *See Rinn v. First Union Nat'l. Bank of Md.*, 176 B.R. 401, 407 (D. Md. 1995). In other words, the party subrogated steps into the shoes of the other creditor and "acquires all rights, securities and remedies the creditor has against the debtor and is regarded as one and the same with the creditor whom he succeeds." Bruce H. White & William L. Medford, *Equitable Subrogation: The Saving Grace for Unperfected Lenders?*, Am. Bankr. Inst. J., July/August 2005, at 38 (citing *Rinn*, 176 B.R. 401). Thus, if CDI is successful in forcing marshaling, it will have a first priority lien against the Notes after Coastal's claim is fully paid.

CDI argues that the lien holders on the Notes are so over secured that even if collections on the Notes decline Coastal, Tsern, Sysco and CDI's marshaling claim of $693,721.11 will be paid in full. CDI points to Debtor's estimate that the collectible balance on the Notes is $1,386,950, which exceeds the secured claims of Coastal, Tsern, Sysco and CDI's marshaling claim by $27,752.29.[5] CDI points further to the fact that Debtor has collected and currently holds $837,503 from the Notes which further assures that all parties will be paid.

Debtor questions the certainty of CDI's assertion that all of the secured parties would be paid in full. Debtor argues that were it to cease operations and be unable to provide service and support to which the licensees are entitled under the licensee agreements, the Notes "would be in grave jeopardy of ever being collected . . . ." [Doc. No. 53, pg. 106] Further, Charles Cooper, Debtor's president, testified that he believes that the performing notes will continue to decline. [Doc. No. 53, pg. 107]

The potential for declining collections from the Notes is supported by an analysis of the collections on the Notes since 2008. From October 1, 2008, through October 8, 2012, Debtor collected $7,654,862, consisting of $5,421,094 of principal and $2,231,781 of interest on the Notes. [Doc. No. 55, # 40] This averages out to $159,476.29 in Note collections per month.[6] Between the Petition Date and September, 2012, Debtor collected $2,112,163.10 in principal and interest on the Notes. [Ex. 41, pg. 12] This averages out to $140,810.87 in collections on the Notes per month

[5] $1,386,950 - ($225,476.65 + $400,000 + $40,000 + $693,721.11) = $27,752.29
[6] $7,654,862 / 48 mos = $159,476.29

("Historical Monthly Collection").[7] Mr. Cooper testified that Debtor collected $837,503 in principal and $177,717 in interest from the Notes over the first nine months of 2012. [Doc. 53, pg. 34; Ex. 41] That is, on average, $112,802.22 per month in principal and interest payments ("2012 Average Monthly Collection").[8] Finally, Debtor's Monthly Operating Report for September, 2012, evidences that Debtor collected $73,390.47 in August, 2012 and $72,830.77 in September, 2012 in principal and interest on the Notes, for a two month average of $73,110.62 ("Current Monthly Collection").[9] [Ex. 41, pg. 12]

Assuming Debtor continues to collect the Notes in amounts equal to the Current Monthly Collection amount, Coastal's claim, including the current estimate of attorney's fees, will be paid in just over three months.[10] Debtor currently holds $837,503 in collections from the Notes. [Ex. 41, pg. 9; Doc. No. 53, pg. 123] Coastal is the assignee of all of Debtor's right, title and interest in the Notes such that the funds collected are subject to Coastal's claims, and in the ordinary course, would be paid to Coastal if Debtor's case converts or Debtor otherwise ceases operating during the four months it will take to pay Coastal's claim. [*See* Ex. 40] Because of the significant amount of Notes collections Debtor is holding and the short time it will take to pay Coastal's claim in full, the Court finds that marshaling in favor of CDI does not impair Coastal's right to a full satisfaction of its claim, the decreasing Notes collections notwithstanding.

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[7] $2,112,163.10 / 15 mos = $140,810.87
[8] ($837,503 + $177,717) / 9 mos = $112,802.22
[9] ($73,390.47 + $72,830.77) / 2 mos = $73,110.62
[10] $225,476.65 / $73,110.62 = 3.08 mos

b. Impact of Marshaling on Third Parties

The final factor that the Court must consider in determining whether marshaling is equitable in this case is whether marshaling in favor of CDI will be unjust to third parties. Debtor argues that these third parties include unsecured creditors of Debtor. CDI argues to the contrary, stating, "marshaling . . . will always work a detriment to unsecured creditors because marshaling, by its very nature, is utilized to force payment of a junior secured claim that would otherwise be rendered unsecured." [Doc. No. 56, pg. 8] The Court agrees with CDI's logic and holds that unsecured creditors are not third parties that must be considered in determining whether marshaling is appropriate. *See also In re Talmo*, 192 B.R. 272 (Bankr. S.D. Fla. 1996) (noting that if preventing adverse impact on unsecured creditors was an element of the marshaling test then the doctrine could rarely be applied).

Although unsecured creditors are not third parties that the Court must consider in weighing the equities of marshaling, the impact on other lien holders must be considered. *See Semmes,* 27 Ga. at 53; *see also Topcon Instrument Corp. of Am. v. W. Coast Optical Instruments (In re W. Coast Optical Instruments, Inc.)*, 177 B.R. 720, 722 (M.D. Fla. 1992) ("Injury to persons other than the senior lien holder is generally relevant only where the third person has a right or equity superior or equal to that of the person requesting marshaling."); *see also In re Miller Eng'g, Inc,* 398 B.R. at 489 (noting the need to consider the affect of marshaling on all creditors' with liens on Debtors' assets). In *Semmes*, the Court held that the senior creditor must apply its claim proportionally against each fund to insure that all lien holders were treated equally. Such apportionment

insures equal treatment of junior creditors because it divides the risk of shortfall between all junior creditors in a manner that is consistent with their expectations as junior creditors, that is, in an amount equal to the senior creditor's claim against each fund. Consequently, in order to evaluate whether marshaling is unfair to Tsern and Sysco the Court must apportion Coastal's claim. *See Semmes*, 27 Ga. at 52 – 53.

The Real Estate constitutes 23.77% of the total collateral available to pay Coastal's claim.[11] Coastal's claim at the time this proceeding was filed was $1,166,602.03. [Ex. 3] So, the amount of Coastal's claim that should be allocated to the Real Estate Proceeds is $277,301.30,[12] which leaves $416,419.81[13] available to pay CDI's secured claim. Obviously, payments to Tsern and Sysco will be delayed if CDI is subrogated to Coastal's claim. The question is how long the delay is and is it long enough to cause marshaling to be unfair to Tsern and Sysco.

If CDI, as subrogree, is paid $416,419.81 after Coastal's claim of $225,476.65 is paid, and if the Notes continue to be paid at the 2012 Average Monthly Collection amount, Tsern would have to wait an additional 3.7 months to begin receiving payments from the Notes.[14] If the Notes pay at a rate equal to the Currently Monthly Collection amount then Tsern would have to wait an additional 5.7 months[15] after Coastal is paid to begin receiving payments from the Notes. Conversely, if CDI is not subrogated to Coastal's claims then Tsern would begin receiving payments from the Notes as soon as

[11] $693,721.11 / ($1,386,950 + $837,503 + $693,721.11) = 23.77% = Real Estate Proceeds / Total Collateral Securing Coastal's Claim = Proportion of Real Estate Proceeds that make up Total Collateral
[12] $1,166,602.03 x 23.77% = $277,301.30
[13] $693,721.11 – $277,301.30 = $416,419.81
[14] $416,419.81 / $112,802.22 = 3.69 mos
[15] $416,419.81 / $73,110.62 = 5.7 mos

Coastal's claim is paid, that is in two or four months depending on whether collections are at the 2012 Average Monthly Collection or Current Monthly Collection averages.[16] Assuming payments at the Currently Monthly Collection amount, Tsern would begin receiving some payment from the Notes in month four. If, however, CDI steps into Coastal's shoes, Tsern will not begin receiving Note payments for six or nine months.[17] Assuming continued payments at either the 2012 Average or the Currently Monthly Average, Sysco would begin receiving Notes payments in month seven or ten.

The evidence presented shows that collections have been declining, that Debtor's president believes this decline will continue and that $73,110.62 on average was collected on the Notes between August and September, 2012. While the reduced amounts collected in August and September, 2012 may not continue, it is also possible that Debtor's estimate of the amount that will be collected from the Notes is overly optimistic.[18] The evidence presented did not include a projected liquidation value of the Notes, but was limited to Mr. Cooper's statement that if Debtor ceases operations the Notes may not be collected at all. Consequently, the Court does not know the likely minimum amount that will be collected on the Notes. Thus the Court cannot, with any degree of confidence determine how much will be paid on the Notes.

Because of this uncertainty and the uncertainty inherent in the Chapter 11 process, there is risk of nonpayment such that it is not possible to definitely state that

[16] Months to pay off Coastal using 2012 Average Monthly Collection: $225,476.65 / $112,802.22 = 2; Months to pay off Coastal using Current Monthly Collection: $225,476.65 / $73,110.62 = 3.08
[17] Months to pay off CDI and Coastal using 2012 Average Monthly Collection: 2 + 3.69 = 5.69; Months to pay off CDI and Coastal using Current Monthly Collection: 3.08 + 5.7 = 8.78
[18] For Debtor to collect the $1,386,950 estimated, the average monthly collection would have to be $77,052.78 = $1,386,950 / 18 mos.

Tsern and Sysco will be paid. This risk is, present, however, whether CDI is subrogated to Coastal's claim or not. To say it another way, the extent of the risk may increase because of the additional amounts that must be funded from the Note payments, but the underlying risk of nonpayment is present regardless of marshaling. Thus, the question is whether the delay caused by the payment to CDI from the Notes increases the risk of nonpayment enough to cause marshaling to be unfair to Tsern and Sysco.

The Court concludes that payment of $416,419.81 to CDI is not unfair to Tsern and Sysco because the allocation of Coastal's claim results in a delay in payment to Tsern and Sysco that is equivalent to that which would be present if Coastal were paid its proportionate share of the Note fund prior to payment to Tsern and Sysco. Allocating Coastal's claim to each of the funds accounts for the fact that Coastal's claim is senior to Tsern and Sysco, and Coastal will be paid, in any case, in full prior to any payment to Tsern, Sysco or CDI. Consequently, paying CDI's marshaling claim in an amount equal to Coastal's proportional claim against the Notes does not affect the risk of nonpayment to Tsern and Sysco, rather it is the same risk that would be present if Coastal were paid its proportional claim from the Notes rather than paying a subrogated claim to CDI. Because payment of a claim equal to the amount of Real Estate Proceeds that would be available to CDI comports with each of the junior lien holder's reasonable expectations

as junior lien holders, marshaling is not unfair to Tsern and Sysco.[19] Further, even if there is some slight delay in payment to Tsern and Sysco, their claims are sufficiently collateralized so that any such delay will not appreciably increase the risk of nonpayment. This is because all secured claims including CDI's marshaling claim will arguably be paid in full within ten months, leaving approximately eight months of payments to be made and thereby providing protection from nonpayment. *See infra* at notes 14 - 17. In addition to the estimated future payment on the Notes, Debtor currently holds $837,503 in Notes collections. This fund is sufficient to pay both Coastal and CDI in full with $195,606.54 remaining.[20] Given the substantial equity cushion in the Notes fund and the apportionment of Coastal's claim which allocates the risk of nonpayment in a manner consistent with Tsern and Sysco's junior lien position, the Court holds that marshaling $416,419.81 of the Notes fund to be paid to CDI as subrogee of Coastal is not unfair to Tsern and Sysco.

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[19] Equitable subrogation is analogous to marshaling and is thus, instructive. Equitable subrogation applies "[w]here one advances money to pay off an encumbrance on realty either at the instance of the owner of the property or the holder of the encumbrance, either upon the express understanding or under circumstances under which an understanding will be implied that the advance made is to be secured by the senior lien on the property, in the event the new security is for any reason not a first lien on the property, the holder of the security, if not chargeable with culpable or inexcusable neglect, will be subrogated to the rights of the prior encumbrancer under the security held by him, unless the superior or equal equity of others would be prejudiced thereby; knowledge of the existence of an intervening encumbrance will not alone prevent the person advancing the money to pay off the senior encumbrance from claiming the right of subrogation where the exercise of such right will not in any substantial way prejudice the rights of the intervening encumbrance." *Davis v. Johnson,* 241 Ga. 436, 438 (1978); *see also Byers v. McGuire Props., Inc.,* 285 Ga. 530 (2009). It is generally held that a junior lienholder cannot be prejudiced by equitable subrogation when a senior security deed is of record when the junior lien is obtained because the junior lienor's position remains unchanged. *See,Byers,* 285 Ga. 530; *Davis,* 241 Ga. 436; *Hayes v. EMC Mortg. Corp.,* 296 Ga. App. 709, 712 (2009).

[20] $837,503 – ($225,476.65 + $416,419.81) = $195,606.54

c. Impact on Debtor

The Court must also consider the impact of marshaling on Debtor, as a party with an interest in the property to be marshaled. *See Meyer,* 375 U.S. at 237 ("[Marshaling] 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." (Emphasis added)); *see also Mulherin v. Porter,* 58 S.E. 60, 61 (Ga. Ct. App. 1907) (holding that marshaling will not be applied to work an injustice on the debtor).

Debtor seems to argue that prejudice to unsecured creditors is prejudice to it; however, the Court has already determined that impairment of the potential dividend to unsecured creditors does not affect the equities in determining if marshaling is appropriate. Debtor does not otherwise argue impact to it but does argue that any marshaling claim in favor of CDI should be reduced by the amounts Debtor spent to maintain the Real Estate. It does not appear that, absent marshaling, Debtor seeks to impose these costs on its secured creditors and the rationale for these costs, that one seeking equity must do equity, is thereby undercut. Accordingly, the Court finds that allowing CDI a marshaling claim of $416,419.81 does not unfairly impact Debtor.

Finally, Debtor argues that CDI has unclean hands because prior to the Petition Date, CDI and Debtor were unable to agree upon terms for CDI to release its lien in the Real Estate to allow for potential sales. No evidence of bad faith was presented and the Court does not believe that the inability to negotiate a prepetition release of liens makes it inequitable to allow CDI's marshaling claim. Consequently, the Court finds that

CDI is entitled to be subrogated to Coastal's rights in the Notes to the extent of $416,419.81.

B. Analysis of Counterclaim

Debtor filed a counterclaim against CDI seeking a determination of the extent, validity and priority of CDI's lien and objecting to CDI's proof of claim based on the theory that a subsequent note between CDI and Debtor's affiliate was a novation that discharged Debtor's obligations, if any.

1. Extent, Validity & Priority of CDI's lien

At trial and in Debtor's post-trial brief, Debtor stipulated that the three threshold elements necessary for marshaling were met, in particular, that CDI had a second priority security interest in the Real Estate. [*See* Doc. No. 53, pgs. 30-31; Doc. No. 57; Doc. No. 55, # 22] Thus, it appears that Count 1 of Debtor's counterclaim is moot.

In addition, seven deeds to secure debt were entered into evidence and show CDI held recorded security deeds on the Real Estate. [*See* Exs. 7 - 13] No evidence was introduced questioning the validity or priority of these deeds. Accordingly, the Court finds that CDI has a valid, perfected second position lien in the Real Estate.

2. Objection to CDI's claim

Similarly, it appears that Debtor has chosen not to prosecute its objection to CDI's proof of claim. The only evidence presented at trial regarding the validity of CDI's claim was the testimony of William Bartels, vice-president of finance at CDI, who testified that at no point did Debtor or Debtor's affiliate (which was the primary borrower

on the promissory notes) object to the basis of its claim against Debtor and Debtor's affiliate. [Doc. No. 53, pg. 57]

Accordingly, Debtor's objection to claim is OVERRULED.

III. Conclusion

The parties stipulated that the threshold elements of a marshaling claim were present here, thus the issues remaining were whether allowance of a marshaling claim in favor of CDI would impair Coastal's right to full satisfaction or be unfair to Debtor or junior lien holders. Because of the substantial Notes collections held by Debtor and apportionment of Coastal's claim among the Real Estate and Notes funds that reflects the junior lien holders' reasonable expectations regarding the risk of nonpayment, the Court holds that marshaling is not unfair to the junior lien holders. Debtor did not point to any unfairness to it and the Court concludes that CDI is entitled to be subrogated to Coastal's rights to the extent of $416,419.81.

A separate judgment in accordance with this memorandum opinion will be entered.

IT IS SO ORDERED, this 24th day of January, 2013.

BARBARA ELLIS-MONRO
UNITED STATES BANKRUPTCY JUDGE

Distribution List

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