

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MINNESOTA

-----  
In re:

Chapter 11 Case

Tricord Systems, Inc.

Bky 02-82361  
Adv No. 03-4174

Debtor.

-----

James Bartholomew, as Trustee for the Liquidating  
Trust of Tricord Systems, Inc.

Plaintiff,

v.

General Electric Capital Corporation and  
Adaptec, Inc., a corporation,

**MEMORANDUM OF  
TRICORD SYSTEMS, INC.  
ON THE ISSUE OF DAMAGES  
OWED BY ADAPTEC**

Defendants.

-----

Pursuant to Judge Tunheim's Memorandum, Opinion and Order affirming in part and reversing in part this Court's Order dated January 23, 2004, Tricord Systems, Inc., by its counsel, respectfully submits the following points, authorities and argument on the issue of the amount of damages to assess against Adaptec on the subrogation theory.

**RELEVANT FACTS**

By way of factual background, the following facts have been stipulated to by the parties or were found by this Court after trial on the merits:

1. Prior to the commencement of its Chapter 11 bankruptcy cases, Tricord Systems, Inc. ("Tricord") and General Electric Capital Corporation ("General Electric") entered into Master Lease Agreement No. 6923229, together with various schedules, listings and addenda

thereto (collectively, the "Lease") for the lease of telephone equipment referred to in the Lease as the "System". (App 119-125).<sup>1</sup>

2. Tricord accepted the System under the terms of the Lease on June 28, 2001.

3. Except for \$1,910.14 paid by General Electric in July of 2003, General Electric applied payments made by Tricord to General Electric under the Lease as set forth in the Billing Schedule for Account in Exhibit 1 attached to the Joint Stipulation of Facts Which Are Not Disputed. (App. 17).

4. Also prior to the commencement of the Chapter 11 bankruptcy case (the "Case"), Tricord obtained the issuance by Wells Fargo, N.A. ("WFB"), of its Irrevocable Letter of Credit No. NZS284502 ("LOC") for the benefit of General Electric. (App. 58-61). Tricord posted \$194,000 in cash collateral with Wells Fargo to secure the Letter of Credit. (App. 84).

5. On or about August 19, 2002, WFB sent to General Electric and copied Tricord its Notice of Non-Renewal regarding the LOC as set forth in Exhibit 2 attached to the Joint Stipulation of Facts Which Are Not Disputed. General Electric received the Notice on or about August 19, 2003. (App. 18).

6. In October, 2002, Tricord negotiated and executed an Asset Purchase Agreement dated as of October 31, 2002, together with various exhibits, schedules, and Amendment One thereto (collectively, the "Asset Purchase Agreement") with defendant Adaptec, Inc. ("Adaptec") for the sale of various of Tricord's assets to Adaptec. (App. 19).

7. The Lease was listed as an "Assumed Contract" under the Asset Purchase Agreement. (App. 19).

---

<sup>1</sup> The Appendix has been previously filed with this Court.

8. Pursuant to the Asset Purchase Agreement, the Closing Date of the sale transaction contemplated in the Asset Purchase Agreement was scheduled to occur two days after this Court entered its order confirming the sale.

9. A hearing was convened before this Court on November 13, 2002, at which time this Court entered an Order approving, and authorizing Tricord to perform under, the Asset Purchase Agreement as set forth in Exhibit 3 attached to the Joint Stipulation of Facts Which Are Not Disputed. (App. 19-44).

10. Adaptec and Tricord closed the sale transaction contemplated in the Asset Purchase Agreement on November 15, 2002 ("Closing"). At the Closing, among other things, Adaptec paid the entire amount of the "Purchase Price" (as defined in the Asset Purchase Agreement) to Tricord, Tricord executed and delivered to Adaptec a Receipt for the Purchase Price. Adaptec delivered the Final Sub-Schedule 1.1.C identifying the "Assumed Contracts" as defined in the Asset Purchase Agreement, and Adaptec and Tricord mutually executed and delivered the Bill of Sale and the Assumption Agreement as set forth in Exhibit 4 to the Joint Stipulation of Facts Which Are Not Disputed. (App. 19-44).

11. Tricord's payments to General Electric, as applied on the Billing Schedule of Account, for the months of October 2002 and November 2002 were mailed by Tricord to General Electric after November 13, 2002.

12. Between August 19, 2002 and December 27, 2002, Tricord took no action to obtain a renewal of the LOC from WFB or to obtain a replacement LOC. Adaptec did not renew the LOC.

13. On or about November 13, 2002, WFB received General Electric's draw under the

LOC and made payment to General Electric.

14. Following the Closing, the telephone equipment which was the subject of the Lease, was delivered to the possession of Adaptec, which retains custody and control of that equipment.

15. On or about November 26, 2002, WFB filed a motion in the Case for a hearing on December 12, 2002, seeking relief from the automatic stay of 11 U.S.C. § 362.

16. Tricord did not object to WFB's motion and, accordingly, the Court granted WFB's motion on December 12, 2002 pursuant to an order as set forth in Exhibit 5 attached to the Joint Stipulation of Facts Which Are Not Disputed. (App. 56-57).

17. Wells Fargo applied \$198,530 of Tricord's cash collateral posted to satisfy the Letter of Credit indebtedness. (See trial transcript App. 84, line 7, App. 84-85, line 5).

**TRICORD IS ENTITLED TO ITS FULL LOSS FROM THE  
DRAW ON THE LETTER OF CREDIT  
INCLUDING INTEREST AND ATTORNEYS' FEES**

The limited issue on remand is how much Tricord is entitled to for damages on its subrogation theory which was affirmed by Judge Tunheim. The measure of damages for equitable subrogation is the full amount paid by the subrogee. In *National Garment Company v. New York, C & St.L.R. Co.*, 173 F.2d 32 (8<sup>th</sup> Cir. 1949), the court noted: "The rule is that in the absence of timely objection on the part of the defendant, the party suffering the loss may maintain an action for the recovery of the whole loss against the party primarily liable, although the plaintiff has been indemnified for part of his loss. . ." (Emphasis added).

Similarly, in *Standard Marine Ins. Co. v. Scottish Metropolitan Assurance Co.*, 39 F.2d 436 (6<sup>th</sup> Cir. 1930), the court held that, "Under the principles of subrogation as applied to the circumstances of this case, the appellee is entitled to be paid from the fund in controversy the full

amount which it paid to the insured. . ." (Emphasis added). In *National Surety Corp. v. United States*, 118 F.3d 1542 (Fed. Cir. 1997), the court ruled that subrogation permits the subrogee to be paid his entire damages in a construction contract dispute.

Similarly in *Zinman, et al. v. Shalala*, 67 F.3d 841 (9<sup>th</sup> Cir. 1995), the court held that the right of subrogation is equitable in nature and that a subrogated right holder may recover the full amount of loss which the third party beneficiary actually received from the subrogee's proceeds. See also *United States v. GCGISI*, 213 F. Supp. 616, 618 (D. Colo. 1962); *Colonial Penn Ins. Co. v. Ford*, 172 N.J. Super. 242, 411, A.2d 736, 737 (1979) (A subrogee is entitled to indemnity . . . to the extent of the money actually paid to discharge the obligation); *Maryland Casualty Co. v. Brown*, 321 F. Supp. 309, 312 (N.D. Ga. 1971); *Bituminous Fire & Marine Ins. Co. v. Culligan Fyrprotection, Inc.*, 437 N.E. 2d 1360, 1371 (Ind. App. 1982); *DeCespedes v. Prudence Mutual Casualty Co. of Chicago*, 193 So. 2d, 224, 227 (Fla. Dist. Ct. App. 1966).

Recently, in *American National Fire Ins. Co.*, as subrogee of *Tabacalera Contreras Cigar Co. v. Yellow Freight Systems, Inc.*, 325 F. 3d 924 (7<sup>th</sup> Cir. 2003), the court held, "It is the general rule in subrogation that the subrogee is to be reimbursed only to the extent of the amounts paid in discharge of the obligation assumed by the subrogee." *Id.* at 936, citing *Milan v. Kausch*, 194 F.2d 263, 265 (6<sup>th</sup> Cir. 1952); *Lexington Ins. Co. v. Baltimore Gas & Electric Co.*, 979 F. Supp. 360, 362 (D. Md. 1997); *Utica Mutual Ins. Co. v. Denwat Corp.*, 778 F.Supp. 592, 594 (D. Conn. 1991) (Holding that traditional principles of subrogation provide for indemnification of the subrogee's actual loss).

These cases comport with well settled Minnesota common law of subrogation. In *In re: Bukowski*, 109 B.R. 932 (B.K. D. Minn. 1990), Judge Dreher summarized Minnesota law of

subrogation, holding, *inter alia*, that, "It is settled Minnesota law that subrogation rights relate back to the time of the agreement giving rise to those rights." *Id.* at 934. Similarly, in *In re: Wefelmeyer Construction Co.*, 1997 B.K. Lexis 77 (Bk. E.D. Mo. 1997), the court noted, in the context of satisfaction of a guarantee agreement and promissory note, "A guarantor who pays the debt of the principal debtor receives an equitable assignment of the debt and is thereby entitled to all the rights, remedies, and securities which were available to the creditor to obtain payment from the principal debtor." *Id.* at 8. (Copy attached to Affidavit of Scott A. Johnson).

The undisputed testimony from Keith Thorndyke at trial confirms that \$198,530 was lost by Tricord Systems on November 15, 2002, when Wells Fargo Bank applied that amount from the cash collateral which had been posted by Tricord Systems to satisfy the Letter of Credit indebtedness payable to GE Capital. (App. 84). That amount is therefore the correct measure of damages.

In fact, that dollar amount of loss is the minimum that could be assessed in this case in light of the ruling on appeal by Judge Tunheim. On appeal, Judge Tunheim held that GE Capital was authorized under its Lease Agreement to draw on the Letter of Credit for the full amount contained therein. Therefore, under the law of the case doctrine, it has been determined on appeal that GE Capital was entitled to at least the \$198,530 seized from Wells Fargo. Adaptec therefore cannot legally argue that Tricord's damage was any less than that amount as that issue cannot now be re-litigated following remand. See *Bethea v. Levi Strauss & Co.*, 916 F.2d 453, 456 (8<sup>th</sup> Cir. 1990); *Little Earth of United Tribes, Inc. v. U.S. Department of Housing & Urban Development*, 807 F.2d 1433, 1441 (1986) (The law of the case doctrine prevents re-litigation of issues decided in earlier proceedings in the same case, barring reconsideration of such issues).

In addition to the principal amount due, Tricord is entitled to pre-judgment interest at 4% per annum pursuant to Minn. Stat. § 549.09, as this Court previously ruled. A two year calculation of interest from November 15, 2002 at 4% would yield \$16,907.04 in interest.

In addition to the foregoing, the law is well settled that a subrogee who has incurred attorneys' fees may recover such fees following his loss if the underlying contract which was satisfied gives the right to attorneys' fees. The Bankruptcy Appellate Panel for the Eighth Circuit ruled in a case strikingly similar to this that a surety may "enforce the rights of a creditor beneficiary only to the extent necessary to obtain reimbursement for the amount which the surety has actually paid". *In re: Maurer v. Maurer*, 256 B.R. 495 (8<sup>th</sup> Cir. BAP 2000). The Court further held that the Bankruptcy Court's refusal to award the subrogee attorney's fees when such fees were recoverable under the contract which the subrogee had satisfied, was error, holding that attorney's fees are recoverable if the underlying contract, paid off by the subrogee, permits such fees. *Id.* at 503, citing *Ruckman & Hanson, Inc. v. Contracting & Material Company*, 328 F. 2d 744 (7<sup>th</sup> Cir. 1964); *Monarch Ins. Co. of Ohio v. Siegel*, 634 F. Supp. 1252, 1262 (N.D. Ind. 1986).

The underlying contract in this case permitted GE Capital recovery of attorney's fees in enforcing its rights under the Lease Agreement. Paragraph 20 , of the Master Lease provided that "Lessee shall pay Lessor, on demand, all costs and expenses, including reasonable attorney's fees and collection fees, incurred by Lessor in enforcing the terms and conditions of a lease or in protecting Lessor's rights and interests in a lease or a system."

As the Affidavit of Scott A. Johnson with annexed time and billing statements confirm, Tricord Systems has incurred \$43,636.71 through the time of the most recent hearing in

attorney's fees and costs. It is anticipated that at least another \$5,000 will be incurred during the pendency of the continued appeals. The attorney's fees incurred by Tricord are reasonable under the circumstances. This case has involved pretrial motion practice, active discovery, trial on the merits, post trial motion practice, and a first round of appeals to the United States District Court. Fees in the amount of \$40,000 to \$45,000 are modest in light of the time intensive nature of this litigation.

### CONCLUSION

Tricord Systems should be compensated in the amount of \$198,530, plus two years of interest totaling \$16,907.04, plus attorney's fees and costs totaling \$43,636.71. The total amount of damages to which Tricord is entitled is therefore \$259,073.75.

Dated: October 29, 2004

JOHNSON LAW GROUP LLP

s/ Scott A. Johnson

Scott A. Johnson (#124606)

Todd M. Johnson (#52061)

10801 Wayzata Boulevard, Suite 120

Minnetonka, MN 55305

(952)525-1224

ATTORNEYS FOR PLAINTIFF

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MINNESOTA

-----  
In re:

Chapter 11 Case

Tricord Systems, Inc.

Bky 02-82361  
Adv No. 03-4174

Debtor.

-----

James Bartholomew, as Trustee for the Liquidating  
Trust of Tricord Systems, Inc.

Plaintiff,

v.

**AFFIDAVIT OF  
SCOTT A. JOHNSON**

General Electric Capital Corporation and  
Adaptec, Inc., a corporation,

Defendants.

-----

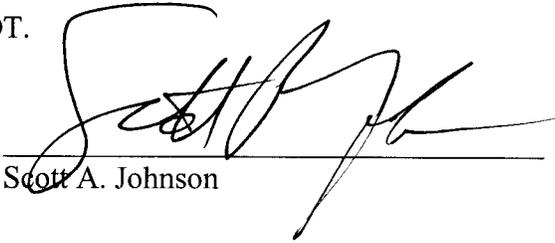
STATE OF MINNESOTA    )  
                                  )ss.  
COUNTY OF HENNEPIN

I, Scott A. Johnson, being first duly sworn on oath depose and state:

1. I am counsel for Tricord Systems, Inc. Attached hereto as Exhibit A is a true and accurate copy of the billing statement reflecting the time expended and the costs incurred on behalf of our client throughout the course of this litigation.

2. Attached hereto as Exhibit B is a true and accurate copy of *In re: Wefelmeyer Construction Co.*, 1997 B.K. Lexis 77 (Bk. E.D. Mo. 1997)

FURTHER YOUR AFFIANT SAYETH NOT.

  
\_\_\_\_\_  
Scott A. Johnson

Subscribed and sworn to before me this  
29<sup>th</sup> day of October, 2004.

  
\_\_\_\_\_  
Notary Public



# **EXHIBIT A**

Invoice submitted to:  
Tricord Liquidating Trust  
ATTN: James Bartholomew  
Lighthouse Management Group, Inc.  
P.O. Box 2057  
Stillwater MN 55032

October 29, 2004

Invoice #11994

Professional services

	<u>Hrs/Rate</u>
1/14/03 SAJ litigation	2.00
Analyze documents	240.00/hr
5/19/03 SAJ litigation	4.50
Research, e-mail client, conference with TMJ	210.00/hr
5/30/03 SAJ litigation	3.50
Conference with client; research	210.00/hr
6/3/03 SAJ litigation	2.00
Draft complaint	210.00/hr
6/4/03 CKM litigation	0.40
Review client documents; pull documents for complaint	100.00/hr

	<u>Hrs/Rate</u>
6/4/03 SAJ litigation	2.00
Revise complaint	210.00/hr
6/5/03 SAJ litigation	0.50
Revise complaint	210.00/hr
6/6/03 SAJ litigation	2.00
Go to court	210.00/hr
6/10/03 SAJ litigation	0.40
Strategy conference with McDonald	210.00/hr
6/24/03 SAJ litigation	2.00
Finalize complaint and telephone conference with McGowan	210.00/hr
6/25/03 SAJ litigation	2.00
Research for motion	210.00/hr
6/27/03 SAJ litigation	0.60
Legal research and fax expert	210.00/hr
7/16/03 SAJ litigation	0.40
Telephone conference with potential expert witness	210.00/hr
7/30/03 SAJ litigation	0.40
Telephone conference with counsel re: settlement	210.00/hr
8/20/03 SAJ litigation	2.00
Settlement conference	210.00/hr
8/21/03 SAJ litigation	2.00
Analyze new defenses	210.00/hr
8/25/03 CKM litigation	0.30
Serve Amended Complaint	100.00/hr

		<u>Hrs/Rate</u>
8/25/03	SAJ litigation	1.00
	Amend complaint	210.00/hr
8/26/03	SAJ litigation	1.20
	Telephone conference with possible expert	210.00/hr
8/27/03	SAJ litigation	0.40
	E-mail Bohl	210.00/hr
8/28/03	CKM litigation	0.60
	File Amended Complaint with bankruptcy court via electronic filing process	100.00/hr
	SAJ litigation	1.50
	Prepare document discovery	210.00/hr
8/29/03	CKM litigation	0.30
	Serve interrogatories and request for production of documents	100.00/hr
	SAJ litigation	0.60
	Telephone conference with counsel re: answers	210.00/hr
9/8/03	SAJ litigation	0.40
	Telephone conference with consultant	210.00/hr
9/9/03	SAJ litigation	2.00
	Work with expert	210.00/hr
9/10/03	SAJ litigation	2.00
	Review discovery and telephone conference with client	210.00/hr
9/11/03	SAJ litigation	2.50
	Work up discovery	210.00/hr

		<u>Hrs/Rate</u>
9/12/03	SAJ litigation Research case law	2.50 210.00/hr
9/18/03	SAJ litigation Retrieve Kishel decision	0.80 210.00/hr
9/23/03	SAJ litigation View demand/jury	0.35 210.00/hr
9/25/03	SAJ litigation Work on discovery	2.00 210.00/hr
10/4/03	SAJ litigation Line up witnesses	1.00 210.00/hr
10/6/03	SAJ litigation Work on discovery issues	2.20 210.00/hr
10/8/03	SAJ litigation Work on discovery responses	1.50 210.00/hr
10/9/03	SAJ litigation Work on discovery	1.20 210.00/hr
10/15/03	SAJ litigation Research for jury issue	3.50 210.00/hr
10/16/03	SAJ litigation Work on jury motion	3.00 210.00/hr
10/21/03	SAJ litigation Telephone conference re: discovery	0.40 210.00/hr
10/27/03	SAJ litigation Review lease	0.40 210.00/hr
11/4/03	SAJ litigation Research subrogation	2.00 210.00/hr

		<u>Hrs/Rate</u>
12/1/03	SAJ litigation	3.00
	Work on summary judgment motion	210.00/hr
12/2/03	SAJ litigation	0.80
	Proof motion for summary judgment	210.00/hr
12/8/03	SAJ litigation	3.00
	Work on discovery	240.00/hr
	SAJ litigation	3.00
	Work on discovery	240.00/hr
12/18/03	CKM litigation	1.20
	Serve and file summary judgment motion	120.00/hr
12/22/03	SAJ litigation	6.00
	Brief summary judgment	240.00/hr
12/23/03	SAJ litigation	4.00
	Brief summary judgment	240.00/hr
1/5/04	SAJ litigation	2.20
	Prepare for argument	240.00/hr
1/6/04	SAJ litigation	8.00
	Prepare for hearing and attend summary judgment hearing; work on trial brief	240.00/hr
1/7/04	SAJ litigation	2.50
	Trial preparation	240.00/hr
1/8/04	SAJ litigation	6.50
	Trial preparation	240.00/hr
1/12/04	SAJ litigation	12.00
	Trial preparation	240.00/hr

		<u>Hrs/Rate</u>
1/13/04	SAJ litigation	4.50
	Trial preparation	240.00/hr
1/19/04	CKM litigation	1.20
	Serve and file motion to withdraw rule 7036 admissions	120.00/hr
1/28/04	SAJ litigation	2.00
	Hearing on Rule 36	240.00/hr
2/5/04	SAJ litigation	0.40
	Research rule	240.00/hr
2/10/04	SAJ litigation	2.50
	Work on post trial briefs	240.00/hr
2/11/04	SAJ litigation	2.20
	Work on brief	240.00/hr
2/13/04	SAJ litigation	1.00
	Serve pleadings	240.00/hr
2/18/04	SAJ litigation	1.00
	Attend hearing re: post trial matters	240.00/hr
3/3/04	SAJ litigation	0.60
	Prepare designation of record	240.00/hr
3/4/04	SAJ litigation	1.50
	Appeal documents	240.00/hr
3/5/04	SAJ litigation	0.80
	Work on appeal designation	240.00/hr
3/6/04	SAJ litigation	3.20
	Brief appeal	240.00/hr
3/8/04	SAJ litigation	2.20
	Work on brief	240.00/hr

	<u>Hrs/Rate</u>
3/9/04 SAJ litigation Finish brief	0.40 240.00/hr
3/31/04 SAJ litigation Negotiate briefing schedule	0.60 240.00/hr
4/5/04 SAJ litigation Work on brief	0.80 240.00/hr
4/6/04 SAJ litigation Work on brief	2.00 240.00/hr
4/8/04 SAJ litigation Work on brief	3.20 240.00/hr
4/9/04 CKM litigation Compile, serve and file appeal brief and appendix	2.40 120.00/hr
4/30/04 SAJ litigation Work on brief	1.20 240.00/hr
5/6/04 SAJ litigation Work on appeal brief	4.00 240.00/hr
5/9/04 SAJ litigation Work on reply brief	4.00 240.00/hr
5/10/04 SAJ litigation Revise brief	0.80 240.00/hr
5/11/04 SAJ litigation Work on appeal brief	1.20 240.00/hr
5/12/04 SAJ litigation Work on reply brief	2.00 240.00/hr
10/13/04 SAJ litigation Research damages; telephone conference with Hobblitt re: status	4.80 240.00/hr

	<u>Hrs/Rate</u>	
10/14/04 SAJ litigation	3.20	
Research indemnity issues; telephone conference with client re: same	240.00/hr	
SAJ litigation	0.45	
Telephone conference with Bohl re: settlement; telephone conference with Hoblitt re: same	240.00/hr	
10/15/04 SAJ litigation	1.20	
Telephone conference with client, outline damages and research	240.00/hr	
10/20/04 SAJ litigation	0.90	
Outline damage argument	240.00/hr	
10/21/04 SAJ litigation	3.00	
Prepare brief on damages	240.00/hr	
SAJ litigation	3.80	
Work on brief; telephone conference with client re: status; telephone conference with Ratelle re: settlement	240.00/hr	
10/22/04 SAJ litigation	2.00	
Review and amend brief on damages	240.00/hr	
SAJ litigation	2.00	
Revise brief	240.00/hr	
11/4/04 SAJ litigation	3.00	
Prepare for and attend hearing	240.00/hr	
	<hr/>	<u>Amount</u>
For professional services rendered	182.60	\$41,207.50

## Additional charges:

			<u>Amount</u>
12/9/93	JLG disbursements	1	15.00
	Facsimile	15.00	
7/3/03	JLG disbursements	1	150.00
	Summons and Complaint filing fee	150.00	
8/21/03	JLG disbursements	1	6.50
	Parking at settlement conference	6.50	
8/25/03	JLG disbursements	1	52.00
	Facsimile	52.00	
8/28/03	JLG disbursements	1	12.50
	Copies month of August	12.50	
9/10/03	JLG disbursements	1	365.00
	Payment to Transtech	365.00	
9/12/03	JLG disbursements	1	21.00
	Facsimile	21.00	
10/1/03	JLG disbursements	1	14.00
	Copies month of September	14.00	
10/8/03	JLG disbursements	1	18.00
	Facsimile	18.00	
10/10/03	JLG disbursements	1	40.00
	Witness fee for Keith Thorndyke	40.00	
10/22/03	JLG disbursements	1	6.00
	Facsimile	6.00	
12/17/03	JLG disbursements	1	16.75
	On Time Delivery (from Thorndyke)	16.75	

			<u>Amount</u>
1/13/04	SAJ disbursements	1	8.50
	Parking	8.50	
1/16/04	JLG disbursements	1	15.00
	On Time Delivery (Gray Plant firm)	15.00	
	JLG disbursements	1	35.00
	On Time Delivery (Fabyanske firm)	35.00	
1/19/04	JLG disbursements	1	19.80
	On Time Delivery	19.80	
1/28/04	JLG disbursements	1	5.00
	Parking for hearing	5.00	
2/3/04	JLG disbursements	1	171.00
	Copies of January court transcripts	171.00	
	JLG disbursements	1	178.25
	Copies months of December and January	178.25	
2/27/04	JLG disbursements	1	255.00
	Appeal filing fee	255.00	
	JLG disbursements	1	26.00
	Facsimile	26.00	
3/1/04	JLG disbursements	1	6.00
	February copies	6.00	
3/31/04	JLG disbursements	1	71.75
	March copies	71.75	
4/8/04	JLG disbursements	1	72.00
	Facsimile	72.00	

		<u>Amount</u>
4/8/04 JLG disbursements	1	31.98
On Time Delivery (US District Court)	31.98	
4/12/04 JLG disbursements	1	12.90
On Time Delivery (US District Court)	12.90	
5/5/04 JLG disbursements	1	655.25
Copies month of April	655.25	
5/13/04 JLG disbursements	1	13.03
On Time Delivery (US District Court)	13.03	
7/13/04 JLG disbursements	1	136.00
US Bankruptcy Court (copy of appeal)	136.00	
Total costs		<u>\$2,429.21</u>
Total amount of this bill		<u>\$43,636.71</u>
Balance due		<u><u>\$43,636.71</u></u>

## **EXHIBIT B**

Source: [Legal > / . . . / > 8th Circuit - US Court of Appeals, District & Bankruptcy Cases, Combined](#)   
 Terms: **name(wefelmeyer construction)** ([Edit Search](#))

*1997 Bankr. LEXIS 77, \*; 30 Bankr. Ct. Dec. 323*

In re **WEFELMEYER CONSTRUCTION CO.**, Debtor, LESLIE A. DAVIS, TRUSTEE, Plaintiff, v. EARL WALKER, MYRTLE WALKER, E. C. WEFELMEYER and EILEEN WEFELMEYER, Defendants.

Adv. No. 94-4344-172, Case No. 93-44251-172, CHAPTER 7 PROCEEDING

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION

*1997 Bankr. LEXIS 77; 30 Bankr. Ct. Dec. 323*

January 14, 1997, Decided

**CORE TERMS:** reimbursement, setoff, guarantor, marshaling, prepetition, offset, postpetition, collateral, equitable, deed of trust, commencement, subrogation, guaranty, partnership, holder, certificate of deposit, bankruptcy case, principal debtor, codebtor, lessor, adversary proceeding, doctrine of subrogation, unsecured claim, proof of claim, receivable, mutuality, pledged, right to payment, eliminated, jointly

**COUNSEL:** [\*1] Office of United States Trustee, St. Louis, MO.

Scott A. Greenberg, Attorney for Plaintiff/Trustee, Clayton, MO.

Joseph J. Trad, Duane L. Coleman, Attorneys for Earl Walker, St. Louis, MO. William Foote, Attorney for E. C. Wefelmeyer, St. Louis, MO.

**JUDGES:** JAMES J. BARTA, Chief U.S. Bankruptcy Judge

**OPINIONBY:** JAMES J. BARTA

**OPINION: MEMORANDUM**

At Saint Louis, in this District, this 14th day of January, 1997.

This matter concerns the Amended Adversary Complaint filed on January 3, 1995, by Leslie A. Davis, Chapter 7 Trustee ("Plaintiff"), against Earl Walker and Myrtle Walker and E. C. Wefelmeyer and Eileen Wefelmeyer ("Defendants"). The Plaintiff has requested a judgment against the Defendants in the amount of \$ 250,000.00 based on an obligation described by Wefelmeyer Construction Co. ("Debtor") as a note receivable. The Wefelmeyer Defendants filed an answer that denied the substantive allegations in the Amended Complaint. The Walker Defendants filed an answer, affirmative defenses and a counterclaim for reimbursement in the amount of \$ 277,818.74.

On October 21, 1994, Earl E. Walker filed a proof of claim designated as Number 49. The Trustee filed an objection to this proof [\*2] of claim. On October 28, 1994, Earl Walker filed a second proof of claim designated as Number 57, in the amount of \$ 250,000.00 as a secured claim, and \$ 27,818.74 as a general unsecured claim based on a right of reimbursement for the payment of the Debtor's promissory note in the amount of \$ 277,818.74. The Trustee filed an objection to Proof of Claim Number 57. Both objections were subsequently withdrawn when the Parties agreed to submit the issues to the Court on the pleadings and brief oral argument in this Adversary Proceeding. The facts necessary for this determination are, in general, not

disputed by the Parties.

This Court has jurisdiction over the parties and this matter pursuant to 28 U.S.C. §§ 151, 157, and 1334, and Rule 29 of the Local Rules of the United States District Court for the Eastern District of Missouri. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B). The Bankruptcy Petition was filed on August 9, 1993.

For several years prior to the commencement of this case, Earl Walker and E.C. Wefelmeyer had been associated in business ventures including W&W Partnership, a Missouri general partnership, and Shaw Park Place Limited Partnership. Wefelmeyer [\*3] was also a ninety percent shareholder of the Debtor, and its Secretary.

In December 1987, the Defendants obtained a personal signature loan from Commerce Bank ("Bank") in the amount of \$ 250,000.00. The proceeds were used to satisfy certain amounts owed to the Debtor by Shaw Park Place Limited Partnership, W&W Partnership, and E. C. Wefelmeyer. The Debtor immediately used the \$ 250,000.00 to guaranty the Defendants' loan from Commerce Bank by purchasing a \$ 250,000.00 certificate of deposit which was pledged to the Bank as collateral. In 1990, the Debtor's certificate of deposit was liquidated, and the proceeds were used to extinguish the Defendants' obligation to Commerce. The Trustee has requested a judgment against the Defendants in the amount of \$ 250,000.00 for reimbursement of the amount paid by the Debtor to fulfill the Defendants' personal obligations.

On or about June 1, 1992, prior to the commencement of this case, the Defendants personally guaranteed any indebtedness of the Debtor to Commerce Bank. **Exhibits "A" through "D" to Earl and Myrtle Walker's Answer to First Amended Complaint**, filed February 3, 1995. Thereafter, on May 3, 1993, the Debtor borrowed \$ 294,600.00 [\*4] from Commerce Bank and executed a promissory note in like amount. **Exhibit "D", supra**. Three months later on August 9, 1993, the Debtor filed a voluntary Petition under Chapter 7 of the Bankruptcy Code.

The Debtor had defaulted under the terms of the note to the Bank. On or about September 27, 1993, Earl E. and Myrtle Walker ("Walkers") paid \$ 277,818.74 in response to Commerce Bank's demand pursuant to the guaranty. The Walkers paid Commerce Bank the full amount of principal and interest due under the Debtor's note and were assigned the bank's collateral for the loan, a deed of trust on the Wefelmeyer's house.

In their counterclaim, the Walkers have requested a judgment declaring that (a) they have a valid claim for reimbursement in the amount of \$ 277,818.74; (b) they have a right to set off any amount owed by them to the Debtor against their claim for reimbursement from the Debtor; and (c) that the right of set off gives rise to a secured claim in their favor. Although payment pursuant to the guaranty occurred postpetition, the Walkers contend that a claim for reimbursement that becomes fixed postpetition is treated under 11 U.S.C. § 502(e)(2) as a prepetition claim. If [\*5] the Walkers are ultimately found to be liable to the Debtor, the Walkers seek to exercise their right under Section 553 to offset the amount owed by them to the Debtor against their claim for reimbursement from the Debtor.

The Trustee has opposed the Walkers' position on the grounds that the claim for reimbursement arose postpetition and that a postpetition claim may not be set off against a prepetition debt because of the absence of mutuality of obligation. The Trustee has also urged that the Court deny the right of setoff on equitable grounds in that the doctrine of subrogation requires the Walkers to reduce their claim by the value of the deed of trust and any other collateral assigned to them by Commerce Bank

#### **WALKER'S CLAIM**

Sections 101(5)(A) n1 and 101(10)(A) n2 of Title 11 provide that a guarantor is a creditor of the debtor, because a guarantor has a contingent right to payment. **In re Friendship Child Development Center, Inc.**, 164 Bankr. 625, 626 (Bankr. D. Minn. 1992); **In the Matter of Midwestern Companies, Inc.**, 102 Bankr. 169, 171 (W.D. Mo. 1989). The Walkers, as guarantors, were the holders of a contingent claim as of the date of the bankruptcy petition. [\*6] However, upon their postpetition payment of the obligation, the claim became fixed. **Friendship Child**, 164 Bankr. at 627-28.

----- Footnotes -----

n1 Section 101(5)(A) defines "claim" as "right to payment, whether or not such right is reduced to judgement, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured." 11 U.S.C. § 101(5)(A).

n2 Section 101(10)(A) defines "creditor" as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." 11 U.S.C. § 101(10)(A).

----- End Footnotes-----

Bankruptcy Code Sections 502(e) and 509 are to be consulted in the analysis of the rights of guarantors against the Debtor's bankruptcy estate. **Friendship Child**, 164 Bankr. at 626-27.

The combined effect of Sections 502(e)(1)(B) and (e)(2) is to allow a codebtor's claim for reimbursement or contribution only to the extent that he has paid the debtor's creditor. Alternatively, Section 502(e)(1)(C) disallows a codebtor's claim for reimbursement [\*7] to the extent the codebtor has also asserted a right of subrogation under Section 509. Therefore, this statutory scheme provides a guarantor or other codebtor with the opportunity to elect either a claim for reimbursement or contribution, or a claim for subrogation. **See Collier on Bankruptcy**, P 509.03 at 509-10, 11 (15th Ed. 1996). This choice allows the guarantor to pursue the most advantageous strategy to satisfy its claim, and also protects the debtor's estate from making multiple payments on a single claim. **Friendship Child**, 164 Bankr. at 628 n.4; **See** 3 L. King, **Collier on Bankruptcy**, P 502.05 at 502-86 (15th ed. 1996). In this matter, the Walkers have asserted a claim for reimbursement under Section 502(e) based on Missouri law. **Amended Proof of Claim, Exhibit "A"**. Pursuant to Section 502(a), the claim is deemed allowed, unless a party in interest objects.

Under Missouri law, payment by a guarantor of the debt of the principal debtor implies a promise of reimbursement based upon equitable principles. **In re Jamison's Estate**, 202 S.W.2d 879, 883 (Mo. 1947); **Gibson v. Harl**, 857 S.W.2d 260, 268 (Mo. Ct. App. 1993). [\*8] The equity of subrogation attaches immediately to enforce the right to reimbursement as a matter of law. The recovery by the guarantor need not be based on a contractual relationship, formal assignment of the debt, or subrogation agreement. **Gibson**, 857 S.W.2d at 268. A guarantor who pays the debt of the principal debtor receives an equitable assignment of the debt and is thereby entitled to "all the rights, remedies and securities which were available to the creditor to obtain payment" from the principal debtor. **Id.** Thus, a guarantor "who is required to pay a note secured by collateral acquires title to the note, which is not discharged by the payment, and becomes owner of the collateral." **Id.** The Walkers, as guarantors, became owners of the collateral and the right to payment from the Debtor immediately upon their payment of the Debtor's obligation to Commerce Bank. Therefore, under Missouri law, the Walkers hold a claim against the Debtor for reimbursement.

Under Bankruptcy law, the claim for reimbursement is to be determined, allowed or disallowed

as if it had become fixed before the date of the filing of the petition. **11 U.S.C. § 502(e)(2) [\*9]** . The only objections to the Walkers' claim for reimbursement have been withdrawn by the Trustee. Therefore, the Walkers' amended proof of claim No. 57 is deemed allowed in the Bankruptcy case as a prepetition claim in the amount paid by them to Commerce Bank.

### **DEBTOR'S CLAIM**

In the Amended Complaint, the Trustee seeks to hold the individual Defendants jointly and severally liable for the \$ 250,000.00 that had been paid by the Debtor in 1990 to satisfy their personal obligations to Commerce Bank. In 1987, the Debtor had guaranteed the Defendants' loan by purchasing a \$ 250,000.00 certificate of deposit which was pledged to Commerce as collateral for the Defendants' loan. Prior to the commencement of this case, the Debtor's certificate of deposit was liquidated and the proceeds were used to satisfy the Defendants' obligation to Commerce. The function of a pledge is to secure indebtedness and, on default implies the power of sale in the pledge of the property pledged. **Gibson, 857 S.W.2d at 268.** The corporate Debtor was not liable for payment of the Defendants' debts to the Bank. Nonetheless, the Debtor's assets were pledged and eventually applied to pay the Defendants' [\*10] personal debt. Th record has not shown that the Debtor received any value in return for this use of its assets. There is no indication of any corporate action that authorized this distribution. There is no indication that the pledge and payment were a distribution of capital to E. C. Wefelmeyer. Nothing in this record supports the contention that the Debtor was authorized to voluntarily pay the Walkers' personal obligation to the Bank. **See Frago v. Sage, 737 S.W.2d 482, 483 (Mo.App. 1987)**(in general, subrogation does not extend to one who voluntarily discharges the debt of another).

In 1989, the Debtor carried the \$ 250,000.00 certificate of deposit on its books as an asset. After payment of the Defendants' debt, the \$ 250,000.00 was carried as a liability. The Court has determined that in fact, the payment of the Defendants' debt gave rise to a Debtor's claim against the Defendants in the amount of \$ 250,000.00. This determination is further supported by a review of the Debtor's business records and its Schedules and Statement of Affairs which identify and acknowledge the existence of a \$ 250,000.00 receivable. For example, the Debtor's Schedule B lists a \$ 250,000.00 Note [\*11] Receivable from W&W Partnership. The Debtor's December 31, 1990 balance sheet reflects a \$ 250,000.00 "Notes receivable - affiliated entity." The Debtor's December 31, 1991 balance sheet reflects a \$ 250,000 "Notes receivable - officer." Although the obligor was not specifically identified in each instance, and a written note has not been produced, the Court record, the Debtor's records and other documents submitted here clearly recognize that \$ 250,000.00 was due to the corporation from Walker, Wefelmeyer, and/or one of the entities with which they were associated. Under the circumstances, the Court finds and concludes that the Plaintiff is entitled to a judgment on this complaint against the Defendants in the amount of \$ 250,000.00.

### **SETOFF**

The Walkers have asserted that they have a right to offset any amount that may be determined to be owed by them to the Debtor against their claim for reimbursement.

Section 553(a) of the Bankruptcy Code protects a right of setoff as follows:

Except as otherwise provided in this section . . . , this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement [\*12] of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case...

**11 U.S.C. § 553(a).**

To establish a right of setoff, the Walkers must demonstrate that:

1. The Debtor owes a debt to the Walkers, and that the debt arose prior to the commencement of the bankruptcy case.
2. The Walkers have a claim against the Debtor which arose prior to the commencement of the bankruptcy case.
3. The debt and the claim are mutual obligations.

**U.S. through ASCS v. Gerth, 991 F.2d 1428, 1431 (8th Cir. 1991); In re Jones Truck Lines, Inc., 196 Bankr. 123, 127 (Bankr. W.D.Ark. 1996).**

The first element requires the Court to determine whether the Walkers owe a prepetition debt to the Debtor. As discussed above, when the Debtor paid \$ 250,000.00 from its assets to satisfy the Walkers' and the other Defendants' personal obligation to Commerce Bank, the Debtor acquired the right to claim reimbursement from the Walkers and the other Defendants. Clearly, this debt arose prior to the commencement of the Debtor's bankruptcy case.

Similarly, the Walkers are the holders of a valid, prepetition [\*13] claim for reimbursement from the Debtor. A claim that is determined and allowed or disallowed as a prepetition claim under Section 502(e)(2) is also treated as a prepetition claim for purposes of Section 553. **See In the Matter of Corland Corp., 967 F.2d 1069, 1077-78 (5th Cir. 1992); In re Denby Stores, Inc., 86 Bankr. 768, 778 n.9 (Bankr. S.D.N.Y. 1988)**(stating "[a] claim for reimbursement should also be deemed pre-petition notwithstanding that the payment was made subsequent to bankruptcy"). Pursuant to Section 502(e)(2), the Court has determined that the Walkers' claim against the Debtor "arose" prepetition for purposes of Section 553. The final element requires that the Court determine whether the Walkers' reimbursement claim and the Debtor's claim against the Walkers are mutual obligations.

The Trustee relies on **In the Matter of Waller, 28 Bankr. 850 (Bankr. W.D.Mo. 1983)**, as a basis for finding a lack of mutuality of obligations. **Trustee's Reply**, p.3. **Waller**, however, was decided under Sections 57i and 68a of the former Bankruptcy Act which required a surety or guarantor to file a claim in the name of the creditor. **Waller [\*14]** , 28 Bankr. at 855. Under Section 57i, the guarantor was not regarded as a creditor of the bankrupt and the element of mutuality of obligation was lacking, unless the guarantor paid the creditor prior to the bankruptcy filing. **Id.** Section 502(e) of the current Bankruptcy Code substantially changed the rights of a guarantor as compared to Section 57i, n3 and for this reason, Waller's holding is not determinative in this case. Additionally, in **Waller** the guarantor had not paid the creditor in full, and therefore, setoff was denied to prevent a double recovery from the estate. **Waller**, 28 Bankr. at 854-55. As noted above, the Walkers paid the Debtor's obligation to Commerce in full, and under Sections 502(e)(1)(B) and (e)(2) the Walkers' postpetition payment pursuant to the guaranty is treated as a prepetition claim for reimbursement.

----- Footnotes -----

n3 See 4 L. King, Collier on Bankruptcy, P 502.05 at 502-89 (15th ed. 1996).

----- End Footnotes-----

The Trustee also relies upon **In re Public Service Co. of New Hampshire** [\*15], 884 F.2d 11 (1st Cir. 1989) to challenge the mutuality of obligation requirement. **Trustee's Reply**, p.3. In the **Public Service Co.** case the court refused to allow a setoff because an executory contract, which had not been rejected or breached by the debtor, was not yet a matured claim. **Public Service Co.**, 884 F.2d at 15. The matter being considered here is distinguishable because, by law, the Walkers' claim for reimbursement became enforceable when it was paid by the Walkers.

Other courts have held that two debts may be mutual obligations when one is based on a claim for subrogation under Section 509(a) that resulted from a postpetition payment on a guaranty. **Corland**, 967 F.2d at 1077, **Jones**, 196 Bankr. at 127, **Denby**, 86 Bankr. at 778-79. "Mutuality is evident because the surety's claim for reimbursement and the debtor's debt are owing between the same parties." 4 L. King, **Collier on Bankruptcy**, P 553.04[5] at 553-32 (15th ed. 1996). For purposes of setoff under Section 553(a), the court has determined that a similar conclusion is appropriate when, as here, one of the claims is for reimbursement pursuant to Section [\*16] 502(e)(2). Generally, mutuality will exist when the debts are in the same right and between the same parties standing in the same capacity. **In re Rinehart**, 76 Bankr. 746, 750 (Bankr. D.S.D. 1987).

In the circumstances presented in this case, for purposes of Section 553, the debts owed to each other by the Debtor and by the Walkers are mutual debts. **Gibson**, 857 S.W.2d at 270. Therefore, under Missouri law, the Walkers enjoy a right to offset the debt owed by them to the Debtor against their claim for reimbursement against the Debtor.

The determination that a right of setoff is available in particular circumstances does not necessarily include a determination that the full amount of the debts are to be included in the setoff calculation. In the matter being considered here, the Court must determine the extent to which the setoff is available to the Walkers. **Denby**, 86 Bankr. at 779.

## **SUBROGATION AND EQUITABLE MARSHALING**

As noted above, the Walkers have asserted a right to offset any amount they may owe to the Debtor as a result of the Trustee's action to collect the note receivable (\$ 250,000.00), against the entire amount of their payment under the [\*17] guaranty (\$ 277,818.74). The Trustee as Plaintiff here has contended that if a right of setoff exists, it must be limited or denied under the doctrine of subrogation. Specifically, the Plaintiff has argued that the amount of the debt that may be subject to set off should be reduced by the value of the lien of the deed of trust on the Wefelmeyer real estate. The Walkers acquired the deed of trust and other documents as part of the postpetition transaction that included payment of the Debtor's obligation to Commerce Bank.

The Walkers have responded to the Plaintiff's request to limit the amount of the setoff, by characterizing the action as an attempt to invoke the doctrine of marshaling which the Walkers contend is not applicable in this case. If the Walkers are required to satisfy their claim first from any equity in the Wefelmeyer property, the value of the Debtor's estate may be increased for the benefit of the holders of allowed unsecured claims.

The Plaintiff's argument in support of limiting the amount of the setoff through the application of the doctrine of subrogation is based in part on an earlier New York Bankruptcy Court decision in the matter of **In re Denby Stores, [\*18] Inc.**, 86 Bankr. 768 (Bankr. SDNY 1988). In ruling on a Chapter 7 Trustee's motion for partial summary judgment in an adversary proceeding, the Court determined that a guarantor had paid a debtor's lessor after the commencement of the Bankruptcy case. The Court also concluded that the guarantor had asserted a timely claim for subrogation based on Section 509 of the Bankruptcy Code. **Id.** At 773. The Court then determined that the amount of setoff available to the guarantor/subrogee

was limited to the maximum amount that the lessor would have been entitled to recover from the debtor's estate under the Bankruptcy Code. The claim of a lessor for damages resulting from the termination of a lease of real property is limited by the provisions of Section 502(b)(6). The **Denby** Court held that the guarantor's claim based on subrogation was subject to the limitations of Section 502(b)(6), resulting in an amount that was less than the amount paid under the guaranty. **Id.** at 780-781.

In the matter being considered here, the Walkers as guarantors have elected to pursue a direct claim for reimbursement rather than as the subrogee of the Commerce Bank claim. The Walkers' [\*19] Amended Proof of Claim filed on October 28, 1994, indicates that the right to payment is based on a claim for reimbursement. The Court finds and concludes that the amended claim for reimbursement was filed under Section 501(a), and is determined and allowed under Sections 502(e)(2) and 502(a). Consistent with Section 509(b)(1)(A), the Walkers are not subrogated to the rights of Commerce Bank to the extent that the claim for reimbursement has been allowed. It then follows that the **Denby** limitation on setoff based on subrogation under Section 509 is not applicable here. Furthermore, the record in this matter has not suggested that the claim of Commerce Bank would have been limited in the Bankruptcy case by any statutory provision, as the lessor's claim in **Denby** was limited by Section 502(b)(6).

At least one court has considered the possibility that subrogation under Section 509 is distinguishable from the concept of equitable subrogation that has been developed through case law. **In re Leedy Mortgage Co.**, 111 Bankr. 488, 492 (Bankr. E.D.Pa. 1990). Neither Party here has suggested any basis upon which the Walkers' right of setoff should be limited by way of [\*20] equitable subrogation (if such a doctrine exists independently of Section 509 in a bankruptcy case). **See Feldhahn v. Feldhahn**, 929 F.2d 1351 n.4 (8th Cir. 1991); **In re Carley Capital Group**, 118 Bankr. 982, 989 (Bankr. W.D.Wis. 1990); **In re Spirtos**, 103 Bankr. 240, 244 (Bankr. C.D.Cal. 1989). Based on the record submitted here, the Court finds and concludes that no such basis exists in this matter. Therefore, the Walkers' right of setoff is not eliminated or limited by the doctrine of subrogation. However, in the circumstances presented here, the Court must consider whether the doctrine of marshaling of **assets** should operate to compel the Walkers to first proceed against collateral other than the Debtor's assets.

In considering the relevance of the doctrine ... it is well to remember that marshaling is not bottomed on the law of contracts or liens. It is founded instead 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. It deals with the rights of all who have an interest in the property [\*21] involved and is applied only when it can be equitably fashioned as to all of the parties.

**Meyer v. United States**, 375 U.S. 233, 237, 84 S. Ct. 318, 321, 11 L. Ed. 2d 293 (1963).

In a bankruptcy case, a request to require marshaling of assets usually involves a consideration of at least two areas which may provide the basis for equitable relief. **See In re Oxford Development, Ltd.**, 67 F.3d 683, 686 (8th Cir. 1995). The circumstances in this case have suggested that the Court consider equitable marshaling under Missouri law, and equitable marshaling under federal bankruptcy law. **Id.** At 686.

Although there may be circumstances that support a different conclusion, as a general principle, under the Missouri doctrine, marshaling may not be invoked by unsecured creditors. It is a remedy that is available to the holder of a junior mortgage. **Eisenhart v. Schreimann**, 889 S.W.2d 887, 892 (Mo.App.Ct. 1994) reh'g denied 1994, transfer denied 1995 citing **State**

**ex rel. Fields v. Cryts**, 87 Mo. App. 440 (1901). As the holder of a prepetition judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial [\*22] lien, a Chapter 7 trustee enjoys standing to invoke marshaling under Missouri law. **See** 11 U.S.C. Section 544. Under Missouri law, equity will require marshaling when a creditor has a lien on two funds, and another creditor has a lien on only one of these funds. **Oxford** at 686.

The federal doctrine of equitable marshaling "rests upon the principle 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. U.S.**, 375 U.S. 233, 236, 84 S. Ct. 318, 320, 11 L. Ed. 2d 293 (1963). The specific requirements necessary for the application of the federal doctrine are: (a) that the two lienors are creditors of the same debtor; (b) that there are two funds belonging to the common debtor; and (c) that only one of the lienors has a right to resort to both funds. **In re Oransky**, 75 Bankr. 541, 543 (Bankr. E.D.Mo. 1987). In such circumstances, equity will require that the first creditor look to the property which cannot be reached by the second creditor, but only if this can be accomplished without prejudice to the first creditor or to third parties. [\*23] **Id.**

As a general rule, equitable marshaling under either the Federal or the Missouri doctrine may be imposed only when the first creditor may look to two properties of the same debtor. **Oransky**, 75 Bankr. at 543. It has been held that the requirement that the two properties be held by the common debtor is not met where the officers of a corporation personally guaranty a corporate note, because the collateral securing the personal guarantee is not the property of the debtor corporation. **In re Leviton Construction Co.**, 122 Bankr. 530, 532 (Bankr. S.D. Ohio 1991); **In re Mel-O-Gold, Inc.**, 88 Bankr. 205, 208 (Bankr. S.D. Iowa 1988); **See In the Matter of Clary House**, 11 Bankr. 462, 466 (Bankr. W.D. Mo. 1981). Therefore, the doctrine of marshaling does not normally require the secured creditor to exhaust his remedy against the guarantor before proceeding against the principal debtor.

In the matter being considered here, Wefelmeyer Construction Company (the Chapter 7 Debtor) is the common debtor as between the Walkers and the Plaintiff. However, the Debtor has only one fund (its assets) that is available to both the Walkers and to the Plaintiff [\*24] as a source of payment. The Walkers, however, also have access to the value of the lien of the deed of trust which had been transferred to them when the debt to Commerce Bank was paid. The deed of trust is a separate fund that is not available to the Plaintiff, and is not property of the Debtor. Therefore, the Court finds and concludes that the Debtor's assets and the Wefelmeyer deed of trust are not two funds of the common debtor between the Walkers and the Plaintiff. In the absence of special circumstances, the doctrine of marshaling will not apply in this case.

Several courts have recognized that equitable marshaling may be available even in the absence of a common debtor. In general, these exceptions to the common debtor requirement are based on the existence of special circumstances, such as the ability to pierce the corporate veil. **See In re Muir**, 89 Bankr. 157, 161 (Bankr. D. Kan. 1988); **In Re Tampa Chain Company, Inc.**, 53 Bankr. 772, 778 (Bankr. S.D.N.Y. 1985); **In re Jack Green's Fashions for Men Big and Tall, Inc.**, 597 F.2d 130, 132, 133 (8th Cir. 1979). The Court has determined that special circumstances exist in this case.

The Plaintiff's [\*25] claim against the Walkers and the other Defendants is based on his successful prosecution of a complaint to recover the value of a prepetition debt that resulted from a transfer of the Debtor's assets. These assets were used to satisfy the personal debt of the Walkers and the other Defendants including the Wefelmeyers and a Walker/Wefelmeyer partnership. The Court has concluded from the record here that E.C. Wefelmeyer exercised a great deal of control over the Debtor and its assets. The Debtor listed the transfer of its assets as a receivable, but no supporting documentation has been submitted in this matter. The Court has determined further that the Walkers and the Wefelmeyers were closely associated

with each other in the operation of the businesses which included Wefelmeyer Construction Company, the Debtor. Neither the Debtor's books and records, nor the Debtor's bankruptcy Schedules and Statement of Affairs identified the Debtor's claim against the Walkers for their personal liability based on the Debtor's payment of their personal debt.

The Walkers' claim against the Debtor is based on their postpetition payment of the Debtor's debt under a personal guaranty. The record presented [\*26] to the Court does not support a determination that the debt owed to the Debtor by the Walkers was incurred for the purpose of obtaining a right of setoff against the Debtor. **See Section 553(a)(3)**. However, in these circumstances, to permit the offset to occur without regard to the value of other collateral available to the Walkers is to sanction an inequity on the Debtor's other creditors. It must be noted that the prepetition transfer of the Debtor's assets was caused by and created a benefit for the Walkers and the Wefelmeyers. As a result of the Walkers' postpetition payment, the Debtor's obligation to the Bank, an unsecured claim against the Bankruptcy estate, has been paid in full; the prepetition contingent unsecured claim of a nondebtor guarantor of the Debtor's obligation has been converted to a claim at least partially secured by a right of setoff; and the general creditors' anticipation of a pro rata distribution as a result of the Plaintiff's judgment in this matter, is eliminated. The combination of these activities compels the Court to find and conclude that the Wefelmeyers and their business associates, the Walkers, engaged in a pattern of inequitable conduct [\*27] with respect to the prepetition use of the Debtor's assets which, but for the payment of the Defendants' debt, should have been available for general creditors. The remedy for such conduct in these circumstances is to apply the doctrine of equitable marshaling and require that the Walkers account for the value of the Wefelmeyer deed of trust, before their debt owing to the Debtor is offset against their claim for reimbursement against the Debtor.

One effect of the Court's order requiring marshaling is likely to be a reduction in the amount of the Walkers' debt that can be subject to set off. This result is not inconsistent with the law in this Circuit. The application of setoff under Section 553 is within the discretion of the court and is exercised under the court's general equitable powers. **Photo Mechanical Services, Inc.**, 179 Bankr. 604, 616 (Bankr. D. Minn. 1995). A limitation on the application of a right of setoff which does not create new substantive rights for the parties and which is otherwise consistent with provisions of the Bankruptcy Code is a valid exercise of the Bankruptcy Court's equitable powers. **See In re NWFx, Inc.**, 864 F.2d 593, 596 (8th Cir. [\*28] 1989).

Every setoff by its very nature is a preference. Yet Section 553 allows the bankruptcy court to recognize setoffs in certain situations where there is mutuality of debt. Even so, a bankruptcy court may disallow an otherwise proper Section 553 setoff if there are compelling reasons for not allowing such a preference.

**Id. at 595.**

Generally, setoff has been limited or denied in situations where illegal or fraudulent conduct, or a breach of a fiduciary duty was present. **In re Blanton**, 105 Bankr. 321, 337-38 (Bankr. E.D.Va. 1989). The Defendants' inequitable conduct described above is a sufficient basis to require marshaling of assets here before determining the amount that is subject to set off.

A party is discharged from liability on a note by payment as well as by cancellation. The cancellation of mutual indebtedness by setoff serves to discharge liability on a note as if the note had been paid in full. **Gibson**, 857 S.W.2d at 271. When the Debtor's assets were used to pay \$ 250,000.00 to Commerce Bank on behalf of the Defendants, the Debtor obtained the right to collect on the Defendants' note to Commerce. The offset of that portion of [\*29] the Walkers' debt owing to the Debtor as a result of the Plaintiff's judgment in this case against a portion of the Walkers' claim for reimbursement serves to cancel that portion of the Walkers'

obligation under the note and judgment as if paid with money. As a result, the Plaintiff's interest in the note and judgment is reduced or eliminated by that portion, and the Plaintiff may seek to collect from all Defendants only that amount that is unsatisfied by the setoff.

A separate Order will be entered.

JAMES J. BARTA

Chief U.S. Bankruptcy Judge

**ORDER**

At Saint Louis, in this District, this 14th day of January, 1997.

On consideration of the record as a whole, and consistent with the determinations in the memorandum entered in this matter,

**IT IS ORDERED** that this Adversary Proceeding is concluded; and that this is the final order of the Bankruptcy Court in this matter; and that on the First Amended Adversary Complaint of Leslie A. Davis, Trustee ("Plaintiff"), judgment is entered in favor of the Plaintiff and against Earl Walker and Myrtle Walker and E. C. Wefelmeyer and Eileen Wefelmeyer ("Defendants"), jointly and severally; and that as and for said judgment, Defendants [**\*30**] are to pay said Plaintiff the amount of \$ 250,000.00 plus interest, attorneys fees and costs related to prosecution of this action.

**IT IS FURTHER ORDERED** that with respect to the Counterclaim on behalf of Earl Walker and Myrtle Walker ("Walkers"), judgment is entered in part in favor of the Walkers and against the Plaintiff, and in part in favor of the Plaintiff and against the Walkers; and

That Proof of Claim No. 49 on behalf of Earl Walker is not allowed as having been amended; and

That Proof of Claim No. 57 on behalf of Earl Walker is allowed in the amount of \$ 277,818.74, as a prepetition claim for reimbursement against the estate of Wefelmeyer Construction Co., Inc. ("Debtor"); and

That the Walkers' request to offset their obligation on the judgment entered in this matter in favor of the Trustee against their claim for reimbursement against the Debtor is granted in part as set out herein; and

That the Plaintiff's request to require the Walkers to marshal assets is granted; and that prior to any setoff or distribution from the bankruptcy estate, the Walkers are to reduce the amount of their claim for reimbursement by an amount equal to the value of the deed of trust [**\*31**] on the real property owned by E.C. Wefelmeyer and Eileen Wefelmeyer; and that said reduced amount is allowed as a secured claim not greater than the amount of the Plaintiff's judgment in this Adversary Proceeding; and that any portion of said reduced amount that is not subject to offset is allowed as a general unsecured claim; and that any amount of the Plaintiff's judgment in this proceeding that is not set off shall be enforceable by the Plaintiff against all Defendants jointly and severally; and

That not later than ten (10) days after the date of this Order, Counsel for the Parties are to meet and agree upon a procedure by which they may determine the amount of the Walkers' claim that is subject to offset; and

That all other requests in this matter are denied.

JAMES J. BARTA

Chief U.S. Bankruptcy Judge

Source: [Legal](#) > / . . . / > **8th Circuit - US Court of Appeals, District & Bankruptcy Cases, Combined** 

Terms: **name(wefelmeyer construction)** ([Edit Search](#))

View: Full

Date/Time: Friday, October 29, 2004 - 11:57 AM EDT

\* Signal Legend:

-  - Warning: Negative treatment is indicated
-  - Caution: Possible negative treatment
-  - Positive treatment is indicated
-  - Citing Refs. With Analysis Available
-  - Citation information available

\* Click on any *Shepard's* signal to *Shepardize*® that case.

[About LexisNexis](#) | [Terms and Conditions](#)

Copyright © 2004 LexisNexis, a division of Reed Elsevier Inc. All rights reserved.



UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MINNESOTA

-----  
In re:

Chapter 11 Case

Tricord Systems, Inc.

Bky 02-82361  
Adv No. 03-4174

Debtor.

-----  
James Bartholomew, as Trustee for the Liquidating  
Trust of Tricord Systems, Inc.

Plaintiff,

v.

**ORDER**

General Electric Capital Corporation and  
Adaptec, Inc., a corporation,

Defendants.

-----  
At Minneapolis in said District this 3rd day of November, 2004, this matter came before the Court on remand from the District Court to determine the amount of damages Tricord Systems, Inc. is entitled to on its subrogation theory against Adaptec. The Court, having reviewed the briefs of counsel, heard the argument, reviewed the file, and being satisfied that Tricord is entitled to its full loss, plus interest and attorney's fees, IT IS HEREBY ORDERED:

1. Judgment shall be entered against Adaptec and in favor of Tricord in the amount of \$259,073.75 on its subrogation theory.

Dated: \_\_\_\_\_

\_\_\_\_\_  
The Honorable Robert J. Kressel  
Judge of Bankruptcy Court



**JOHNSON LAW GROUP LLP**  
Attorneys at Law

10801 Wayzata Boulevard, Suite 120  
Minnetonka, Minnesota 55305  
Telephone: 952/525-1224 • Fax: 952/525-1300

**VIA MESSENGER**  
October 29, 2004

United States Bankruptcy Court  
ATTN: Clerk of Court  
U.S. Courthouse  
300 South Fourth Street  
Suite 301  
Minneapolis, MN 55415

RE: In re: Tricord Systems, Inc. and James Bartholomew v. General Electric  
Capital Corporation and Adaptec, Inc.  
Bky No. 02-82361  
Adv No. 03-4174

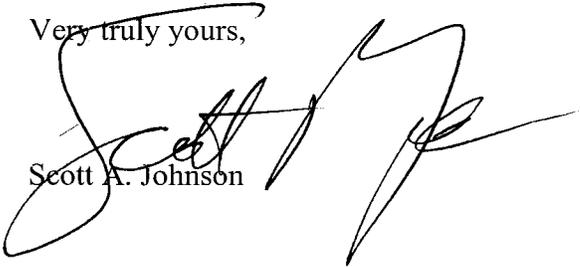
Dear Clerk of Court:

My assistant, Cheryl Moum, telephoned your office today requesting a paper filing. Our scanner has broken and our technical support person is unable to come to our office today to do repairs. She was given permission to file the following in paper format with regard to the above matter:

1. Memorandum of Tricord Systems, Inc. on the Issue of Damages Owed by Adaptec;
2. Affidavit of Scott A. Johnson;
3. Proposed Order; and
4. Affidavit of Service.

Thank you for your assistance in this matter.

Very truly yours,

  
Scott A. Johnson

SAJ/ckm  
encs.