

UNITED STATES BANKRUPTCY COURT

DISTRICT OF SOUTH DAKOTA

ROOM 211

FEDERAL BUILDING AND U.S. POST OFFICE

225 SOUTH PIERRE STREET

PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT

BANKRUPTCY JUDGE

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VIA FACSIMILE TRANSFER

August 27, 2004

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Subject: *In re Larson Concrete Co.*,
Chapter 7; Bankr. No. 00-10053

Dear Trustee and Counsel:

The matter before the Court is Debtor's objection to Trustee William J. Pfeiffer's proposed distribution of sale assets. This is a core proceeding under 28 U.S.C. § 157(b)(2). This letter decision and accompanying order shall constitute the Court's findings and conclusions under Fed.Rs.Bankr.P. 7052 and 9014(c). As set forth below, Debtor's objection will be overruled.

Summary. Larson Concrete Company ("Debtor") filed a Chapter 11 petition in bankruptcy on March 22, 2000. The case was converted to Chapter 7 on May 1, 2001. William J. Pfeiffer was appointed as the Chapter 7 trustee.

On September 21, 2001, Trustee Pfeiffer filed a motion seeking authority to sell by auction the bankruptcy estate's personal property, which was located at Debtor's two business sites. In his sale motion, the Trustee stated that Dacotah Bank, with a claim of about \$145,906.83, was the only known

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secured creditor on both Debtor's real and personal property (excluding vehicles, which were unsecured), that the estimated value of the secured realty was \$200,000, and that the estimated value of the personalty was less than \$90,055.00. In the motion, Trustee Pfeiffer proposed to distribute general personalty proceeds first to administrative expenses and fiduciary taxes and second to Dacotah Bank. He proposed that the proceeds from the unsecured vehicles would go first to administrative costs and fiduciary taxes, then priority claims. Any balance from the vehicles would go to unsecured creditors.

One objection to the Trustee's personal property sale motion was filed by Terry Gaikowski, who wanted rent payments from the bankruptcy estate for personalty stored on his land. The objection was resolved by giving Gaikowski an administrative expense lien for reasonable storage fees.

The order granting the Trustee's personal property sale motion was entered October 5, 2001. It approved the Trustee's motion in all respects except as modified to recognize Gaikowski's administrative expense claim. The auction eventually grossed \$111,087.00 for the bankruptcy estate. After the auction, Trustee Pfeiffer sought court approval to pay both the auctioneer and Gaikowski. Both motions were granted without objection. Trustee Pfeiffer paid the auctioneer in full on November 21, 2002; he paid Dacotah Bank \$75,000 on November 28, 2001; and he paid Gaikowski in full on December 5, 2001.

On November 29, 2001, Trustee Pfeiffer filed a motion seeking approval to sell the bankruptcy estate's real property in Aberdeen, South Dakota, for \$165,000.¹ With the proceeds, he proposed to pay the real estate taxes, any transfer fees, and the several listed encumbrances, which included the balance of the mortgage held by Dacotah Bank, after paying the bank its personalty sale proceeds, and several judgment liens. Title insurance and closing costs were to be shared with the buyers. Based on the estimated sale costs and in light of the several secured claimants, Trustee Pfeiffer projected one judgment

¹ Before the case converted to Chapter 7, Debtor obtained approval to sell some real property in Redfield, South Dakota.

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holder, B&B Concrete, would not be paid in full and no proceeds would be available to pay unsecured creditors. No objections to Trustee Pfeiffer's real property sale motion were filed. The order approving the sale terms was entered January 3, 2002. The escrow company paid Dacotah Bank the balance of its mortgage before it turned over the sale proceeds of \$64,431.57 to Trustee Pfeiffer.

On January 18, 2002, Trustee Pfeiffer filed a motion to sell the estate's real property in Groton, South Dakota. The proposed purchaser was the City of Groton for \$1,250.00. While the proposed purchase price was low, the City also agreed to cancel all taxes and assessments it was due. Brown County, where the property was located, filed an objection on the grounds that the motion failed to provide for payment of taxes but later withdrew it after the objection was resolved with Trustee Pfeiffer. The order approving this sale provided for the payment of administrative costs, which dissipated all the proceeds. Real estate taxes and several judgment liens on the Groton property went unpaid.

Trustee Pfeiffer filed a third real property sale motion on February 13, 2002, regarding some additional land in Brown County. In this sale motion, he proposed to pay in full from the proceeds certain real estate taxes, sale costs, and all judgment lien creditors with the exception of one, B&B Concrete, whose judgment lien would only be satisfied in part unless a higher bid was received. He did not project that any proceeds would remain to pay unsecured creditors. One party offered a higher bid. The property was sold for \$15,000.00 following a hearing on April 2, 2002. The sale order provided for payment of certain sale costs and the remaining encumbrances were transferred to the remaining sale proceeds.

Trustee Pfeiffer filed a fourth real property sale motion on May 31, 2002, wherein he proposed to sell two additional lots in Brown County for \$15,000.00. He proposed to pay from the proceeds sale costs, certain real estate taxes, and some of the judgments of record. He projected he would not receive sufficient proceeds to fully pay all judgments. No objections to this sale motion were filed and an order approving the sale

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was entered July 31, 2002.

Debtor never filed an objection to any of Trustee Pfeiffer's sale motions. Debtor never appealed any of the sale orders.

After several claims were litigated or otherwise resolved, Trustee Pfeiffer filed his Final Report and Proposed Distribution. He proposed to pay four judgment creditors in full and one judgment lien creditor, B&B Concrete, in part, and he proposed to pay the Chapter 7 administrative expenses in full. He proposed to prorate the balance of the funds among the three Chapter 11 administrative expense claimants as there were not sufficient funds to pay them in full. There were also no funds available to pay any of the unsecured claimants.

Debtor objected to Trustee Pfeiffer's proposed distribution. Its primary objection was that Trustee Pfeiffer should marshal the assets and distribute the proceeds differently so that priority claimants would be paid in full and unsecured creditors would be paid in part. Under Debtor's proposed distribution, the judgment lien creditors would not be paid in full and the balance due them would be treated as unsecured claims.

B&B Concrete responded to Debtor's objection. It argued that Trustee Pfeiffer's proposed distribution was in accord with the sale orders entered earlier.

The Court received briefs from interested parties. B&B Concrete reiterated what it had said in its response.

Debtor essentially restated its objection and it clarified that it wanted Trustee Pfeiffer to pay Dacotah Bank's secured claim first from the proceeds of Debtor's main plant real property (the \$165,000 sale) and then from the personal property proceeds. If applied in that manner, there would be remaining funds of \$71,539.91 to pay administrative expenses, priority expenses, and unsecured claims. Debtor further proposed that the judgment creditors be paid, only in part, from the \$27,830.47 net proceeds that Trustee Pfeiffer received from the sale of the other real estate. It argued that distributing proceeds in this manner would pay all administrative expenses

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and priority claims in full and that \$17,965.69 would be available to pay unsecured claim holders. Debtor relied on the Court's equitable power to order marshaling in this manner. Citing *Owens-Corning Fiberglas Corp. v. Center Wholesale, Inc. (In re Center Wholesale, Inc.)*, 759 F.2d 1440 (9th Cir. 1985),² which relied on California state law, for its argument that "[a] trustee should deny the request of a junior secured creditor for marshalling [sic] where the request for marshalling [sic] would prejudice the amount available for distribution to unsecured creditors." Debtor did not cite any South Dakota law regarding marshaling.

Trustee Pfeiffer noted a couple errors in Debtor's brief regarding some administrative expenses arising from the sale of Debtor's main plant realty. He also noted that he immediately paid Dacotah Bank its secured claim from the personal property sale to stop the accrual of interest; he did not make a specific marshaling decision. Trustee Pfeiffer did state, however, that he thought his proposed distribution was proper because it protected the judgment lien creditors, as compared to the priority tax creditor who had not filed a lien. He concluded that he would leave the distribution decision in the Court's discretion.

B&B Concrete filed a response. It argued Debtor did not have standing to object to the Trustee's proposed distribution because Debtor did not hold a pecuniary interest since no assets would revert to Debtor.

Discussion. For two reasons, Debtor's objection to Trustee Pfeiffer's proposed distribution will be overruled.

First and foremost, Trustee Pfeiffer's proposed distribution is in accord with the sale motions. Trustee Pfeiffer

² In its subsequent decision on appeal after remand, the Court of Appeals for the Ninth Circuit no longer gives Debtor's position much support. See *Owens-Corning Fiberglas Corp. v. Center Wholesale, Inc. (In re Center Wholesale, Inc.)*, 788 F.2d 541 (9th Cir. 1986).

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specifically stated in his personal property sale motion that he intended to use the proceeds of this property (excluding the vehicles) to pay Dacotah Bank, who held the only known encumbrance. No one objected. Debtor's objection to that distribution is now untimely.

Second, the Trustee's method of satisfying the Dacotah Bank's secured claim -- by applying the personal property proceeds first and the real property proceeds next -- was equitable. It comported with the federal doctrine of marshaling,³ which provides:

[I]f a senior lien holder has a lien that extends to two funds or two potential funds, and a junior lien holder has recourse to only one of those funds, the senior lien holder may be required to exhaust the fund to which only it has access before proceeding against the fund that is also available to the junior lien holder. *Meyer v. United States*, 375 U.S. 233, 236, 84 S.Ct. 318, 321, 11 L.Ed.2d 293 (1963); *C.T. Dev. Corp. v. Barnes (In re Oxford Dev., Ltd.)*, 67 F.3d 683, 687 (8th Cir.1995); *Berman v. Green (In re Jack Green's Fashions for Men Big and Tall, Inc.)*, 597 F.2d 130, 132-33 (8th Cir.1979). The doctrine of marshaling is designed to promote fair dealing and justice and is applied when it can be equitably fashioned as to all parties. *Meyer*, 375 U.S. at 237, 84 S.Ct. 318; *Oxford Dev., Ltd.*, 67 F.3d at 686-87.

Bankruptcy courts may apply the doctrine in proper cases where it is equitable to do so. *Oxford Dev., Ltd.*, 67 F.3d at 687; *Jack Green's Fashions for Men*

³ A review of *C.T. Development Corp. v. Barnes (In re Oxford Development, Ltd.)*, 67 F.3d 683, (8th Cir. 1995), indicates that the federal marshaling doctrine should be applied in this case because the sale of the secured property and the distribution of proceeds by the Chapter 7 Trustee is governed by federal bankruptcy law. The result, however, would be the same under federal or state law.

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Big and Tall, Inc., 597 F.2d at 133. The court must balance the equities to determine whether marshaling is equitable in any given situation. *Oxford Dev., Ltd.*, 67 F.3d at 687. Marshaling is not appropriate where it will cause prejudice. *Whitaker Corp., Juster Steel Div. v. St. Cloud Nat'l Bank & Trust (In re St. Cloud Tool & Die Co.)*, 533 F.2d 387, 391 (8th Cir.1976).

Ramette v. United States (In re Bame), 279 B.R. 833, 837 (B.A.P. 2002). Here, requiring Trustee Pfeiffer to distribute the assets in the manner proposed by Debtor may be more advantageous to priority and general unsecured creditors, but it would be unfair to judgment lien creditors, who would receive less on their secured claim than under the Trustee's proposed distribution. The federal doctrine of marshaling directs that marshaling not prejudice a secured claim. Junior liens should be preserved when possible. See *JaKS Farm Custom Forage Harvesting, L.L.C. v. Anderson (In re Anderson)*, 305 B.R. 861, 866-67 (B.A.P. 8th Cir. 2004); *In re Borges*, 184 B.R. 874, 878-81 (Bankr. D. Conn. 1995)(doctrine of marshaling cannot be sought by debtor to the detriment of a junior security holder); *In re Robert E. Derecktor of Rhode Island, Inc.*, 150 B.R. 296, (Bankr. D.R.I. 1993)(doctrine of marshaling cannot be used to defeat junior lien in order to increase return for unsecured creditors).

The Trustee's distribution under his Final Report also comports with S.D.C.L. § 44-3-1, which governs the marshaling of securities among lien holders, and with S.D.C.L. § 54-1-5, which governs the marshaling of funds. Neither statute requires Trustee Pfeiffer to marshal if doing so would prejudice the judgment lien creditors.

An order overruling Debtor's objection to Trustee Pfeiffer's Final Report and Proposed Distribution will be entered.

Sincerely,

/s/ Irvin N. Hoyt

Irvin N. Hoyt
Bankruptcy Judge

INH:sh

CC: case file (docket original; serve parties in interest)