

#S-8

signed 6-3-04

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In re:

**WILLIAM M. LAUFENBERG,
JOLYNN K. LAUFENBERG,**

DEBTORS.

**CASE NO. 03-12989-12
CHAPTER 12**

**ORDER GRANTING STAY RELIEF TO CREDITOR
METROPOLITAN LIFE INSURANCE COMPANY**

This matter is before the Court on the Metropolitan Life Insurance Company's motion for relief from the automatic stay and declaration that the codebtor stay does not apply to certain real property not owned by the debtors, and the objection filed by the owners of that property. Met Life appears by counsel Martin W. Bauer of Martin, Pringle, Oliver, Wallace & Bauer, L.L.P., of Wichita, Kansas. The objecting interested parties are relatives of debtor William Laufenberg: (1) his mother, Luella Laufenberg, and (2) his sister, Linda Gumpenberger and her husband.¹ These parties ("the Relatives") appear by counsel Garry L. Howard and Gene F. Anderson of Slape and Howard, Chartered, of Wichita, Kansas. The debtors have signed the stipulations of fact submitted in connection with this dispute, agreeing that Met Life can have stay relief, but have not filed a brief. The Court has reviewed the relevant materials and is now ready to rule.

¹The attorneys for the Relatives indicated in first paragraph of their brief that the debtor's brother, James Laufenberg, and James's wife were joining in the objection, although the other Relatives were the main affected parties. James and his wife have received a bankruptcy discharge of their obligation to Met Life, do not appear to have any ownership interest in the real property involved in this dispute, and are not mentioned again in the brief. Consequently, the Court does not consider them to be real-parties-in-interest to this dispute.

Met Life seeks stay relief so that it can foreclose on real property that the Relatives own and pledged to secure the debtors' obligation to Met Life. Because the debtors have waived the future lease rights they had in that real property, the Court concludes that the automatic stay imposed by 11 U.S.C.A. § 362(a) does not apply to the property. Because the debt to Met Life is not a consumer debt, the Relatives are not entitled to the protection of the codebtor stay imposed by § 1201(a). The relatives are asking the Court to apply the equitable doctrine of marshaling to defeat Met Life's motion for relief from the automatic stay. Under the circumstances of this case, the Court concludes that marshaling is not available to the Relatives.

FACTS

Debtor William Laufenberg and his brother James, joined by their wives, borrowed money from Met Life in 1995, signing a note for \$340,000. To help William and James get the loan, the Relatives pledged their real property, which the parties have called Tract A and Tract F, as collateral. Because they did not sign the note or any personal guarantees, the Relatives are not personally liable for the debt. Tract A is 80 acres which Luella owns, and Tract F is 160 acres on which Luella has a life estate and the Gumpenbergers have the remainder interest. William and James also pledged their own real property as collateral; this property included the debtors' homestead.² Nothing in the mortgage or the note

²The parties' stipulations give property descriptions labeled as tracts (a) through (f), but tract (e) appears to be included in tract (c), and tract (d) includes parts of two different sections. The debtors' amended plan also gives property descriptions labeled as a) through f), but its tracts d) and e) are the parts of sections grouped together as tract (d) in the stipulations. Paragraph 10 of the stipulations says part of an agreement attached as Exhibit G dealt with tracts (d) and (e), but the descriptions in the exhibit

requires Met Life to treat the Relatives' property any differently than the property William and James pledged.

Beginning in 1999, when William sued James, the family became embroiled in litigation in a Kansas state court. James and his wife filed a Chapter 7 bankruptcy case, and discharged their personal obligations on the Met Life debt. The trustee of their bankruptcy estate sold their interests in certain real estate to William. This included the land that James had pledged to Met Life, and the land, of course, remained subject to Met Life's mortgage. Later, the family settled the state court suit. Among other things, the settlement established additional terms for Luella's sale of certain real property to William, and the Relatives' lease of 640 acres of farmland, including Tracts A and F, to William on a cash-rent basis for five years or until Luella's death, whichever might occur last.³ The annual rent was \$16,000, but William was to pay real estate taxes attributable to Luella's interests in the properties out of the rent.

actually describe only the property labeled as tract (d) in the stipulations. The Court believes the parties probably intended to split their tract (d) description into tracts (d) and (e), and leave out the property labeled as tract (e) that is included in tract (c). This discrepancy has no impact on this decision, though, because the descriptions for the tracts the Court is calling Tracts A and F are consistent throughout the materials.

³Paragraph 10 of the parties' stipulations states that the lease would last for five years or until the end of 2007. At oral argument, the Court pointed out that the state-court settlement agreement (which contains very few lease terms, but apparently the only ones that exist) actually provides that the lease will be for five years or until Luella Laufenberg dies, whichever occurs last. The attorneys all reviewed the agreement, attached to the stipulations as Exhibit G, and none of them argued thereafter that the term of the lease was correctly stated in the stipulations or that the settlement agreement was wrong about the lease term.

The required semi-annual payments were made on the Met Life mortgage until the September 1, 2002, payment came due. That payment was not made and, in December, Met Life declared the entire debt immediately due. The debtors also failed to make the payment that came due the following March 1. On March 12, 2003, Met Life filed a foreclosure action in a Kansas state court, seeking a judgment for about \$280,000, plus interest, attorney fees, and costs, and to foreclose on all the pledged real estate. The debtors filed a Chapter 12 bankruptcy petition three months later. In July 2003, Met Life filed a motion for relief from the automatic stay to allow it to proceed with its foreclosure suit, for a declaration that the stay did not protect the Relatives, and for adequate protection. The debtors and the Relatives objected.

Meanwhile, the debtors proposed a plan of reorganization. Under it, among other things, (1) they would pay Met Life all the principal they owed it, but over a longer period and at a lower interest rate than provided by Met Life's note, and (2) they would continue the lease with Luella under the terms of the state court settlement. However, the debtors made none of the payments called for by their plan. They now concede that they cannot reorganize without a reduction in their debt to Met Life. They filed an amended plan in March 2004, proposing to withdraw their objection to Met Life's request for stay relief with respect to Tracts A and F. The amended plan assumes that Met Life will be able to foreclose and sell the tracts for \$104,000. The debtors propose to keep all the land they own or are buying, and to assume all leases they have not previously rejected. The Relatives object to the amended plan.

The debtors have been able to resolve all objections to their amended plan except those made by the Relatives. They joined Met Life and the Relatives in stipulating to the facts the parties believe are relevant to their dispute, but only Met Life and the Relatives have filed briefs on the matter. In the stipulations, the debtors agreed to the termination of their leasehold interests in Tracts A and F after their final crop harvest in the 2004 calendar year, and William waived his right of first refusal on Tract F. In its brief, Met Life interprets the debtors' plan and stipulation to mean the debtors are going to assume the lease with Luella and pay the full cash rent it calls for, even after Met Life forecloses on Tracts A and F. In their brief, the Relatives interpret the plan and stipulation to mean the debtors are trying to assume part of their lease with Luella but reject the part covering Tracts A and F. At the last hearing on this dispute, the debtors' attorney informed the Court that the debtors intend to continue to pay the full cash rent called for under their lease with Luella even after Met Life forecloses on Tracts A and F, eliminating them from the lease.

DISCUSSION

Met Life contends that: (1) it is entitled to stay relief to allow it to foreclose on Tracts A and F now that the debtors have waived their interests in those tracts; and (2) the Relatives are not entitled to require Met Life to collect its debt from collateral that the debtors own before enforcing its lien on Tracts A and F. The Relatives respond that: (1) the debtors' leasehold interests are sufficient to make the automatic stay apply to Tracts A and F; (2) under their amended plan, the debtors are improperly assuming part of their lease with Luella and rejecting the part that applies to Tracts A and F; and (3) the Court

should apply the doctrine of marshaling to require Met Life to collect from the debtors' property before proceeding against their property.

1. The Automatic Stay No Longer Applies to Tracts A and F.

Under 11 U.S.C.A. § 362(a), the filing of a bankruptcy petition stays creditors from taking various kinds of action against the debtor or property of the bankruptcy estate.

Because the debtors' lease with Luella is property of their estate and covers Tracts A and F, the stay applied to Met Life's state court foreclosure action. But the debtors have now agreed to relief from the automatic stay as to these tracts. The debtors apparently believe that they do not have an equity in the tracts and their lease rights in the tracts are not necessary to an effective reorganization, so Met Life is entitled to stay relief under § 362(d)(2) to allow it to foreclose on Tracts A and F. The Relatives do not appear to be arguing that their interests in Tracts A and F are protected by the codebtor stay imposed by § 1201(a), and they would not be covered by it because the debtors' obligation to Met Life is not a "consumer debt," that is, one incurred "primarily for a personal, family, or household purpose."⁴ Neither the automatic stay nor the codebtor stay now prevents Met Life from foreclosing on Tracts A and F.

2. The Debtors' Amended Plan Proposes to Assume the Lease with Luella in Full, Although the Debtors Recognize that Met Life's Foreclosure on Tracts A and F Will Eliminate those Tracts from the Lease.

⁴11 U.S.C.A. § 101(8).

The Relatives contend that the debtors are trying to reject the part of their lease with Luella that covers Tracts A and F, and assume the rest of the lease. The Court cannot agree. While it may be true that § 365(a) authorizes debtors to assume only the full extent of an unexpired lease and not to assume part and reject part,⁵ the Court is convinced that the debtors are proposing to assume all of their lease with Luella. The debtors' counsel informed the Court that under their plan, the debtors intend to continue to pay all the cash rent called for by the lease. By agreeing to waive their leasehold rights on Tracts A and F at the end of the current crop year, the debtors are merely acknowledging that Met Life's foreclosure and sale of the tracts will cut off the debtors' lease rights. The Relatives' argument would carry more weight if the lease involved crop-sharing rather than cash rent. Once the 240 acres of Tracts A and F are eliminated from the lease, the debtors will produce no crops from that land and the crop-share rent the Relatives would receive under the lease would be reduced. But with the debtors promising to pay the same cash rent for the reduced acreage, the Relatives' rent rights under the lease will not be reduced, making their assertion that the debtors are rejecting part of the lease unconvincing.

3. *The Relatives Are Not Entitled to Invoke the Equitable Remedy of Marshaling to Require Met Life to Collect its Debt From the Real Property the Debtors Own before Enforcing its Lien on Tracts A and F.*

⁵See *In re Valley View Shopping Center, L.P.*, 260 B.R. 10, 24-25 (Bankr. D. Kan. 2001).

Normally, the question of the application of the doctrine of marshaling would be more appropriate as an objection to a proposed plan than as an objection to stay relief. In this case, however, the contents of the debtors' amended plan make it appropriate to raise the issue at this time. The Relatives and Met Life agree that *Morris v. Jack B. Muir Irrevocable Trust (In re Muir)*⁶ accurately describes the equitable doctrine of marshaling that the Relatives ask the Court to apply here. In *Muir*, the court explained that marshaling is generally available when three circumstances coincide: “(1) [the] existence of two creditors with a common debtor; (2) the existence of two funds belonging to the debtor; and (3) the legal right of one creditor to satisfy his demand from either of the funds, while the other may resort to only one fund.”⁷ Some years ago, the United States Supreme Court explained the purpose of marshaling:

In considering the relevance of the doctrine here 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 involved and is applied only when it can be equitably fashioned as to all of the parties. Thus, state courts have refused to apply it where state-created homestead exemptions would be destroyed, [citation omitted]; or where the rights of insurance beneficiaries would be adversely affected, [citation omitted]; or where the rights of third parties having equal equity would be prejudiced, [citation omitted]; or where the ‘head of the household’ exemption was involved, [citations omitted]. Federal courts have likewise accepted this principle of the nonapplicability of the

⁶89 B.R. 157, 160-62 (Bankr.D.Kan. 1988).

⁷89 B.R. at 160 (citing *In re Francis Constr. Co., Inc.*, 54 B.R. 12 (Bankr. S.C. 1985)).

doctrine where, as here, one of the funds is exempt under state law. [Citations omitted].⁸

One difficulty in giving a marshaling remedy to the Relatives is immediately apparent — the two sources of payment (“funds”) that the Relatives suggest are available to Met Life here are (1) Tracts A and F, and (2) Tracts B through E; but the debtors do not own Tracts A and F. In *In re Beach*,⁹ the district court affirmed the bankruptcy court’s refusal to let Chapter 12 debtors require their secured creditor, over its objection, to marshal its claim against their co-tenants’ undivided interests in property that served as its collateral. The court mainly relied on the fact the debtors did not own their co-tenants’ interests to reject the marshaling argument.¹⁰

Another problem with the Relatives’ marshaling request is that they are not creditors with claims against the debtors that are secured by one of the two funds involved in their request. Instead, they are more like debtors of Met Life than competing secured creditors, because their property is liable for the Met Life debt, even though they are not personally liable. In a sense, they might be thought to have an even stronger claim to a marshaling remedy because they are not holders of a mere lien against Tracts A and F that secures a debt, they *own* the property. Since they are not personally liable on the Met Life debt, the Relatives suggest their situation is similar to the one that led the *Muir* court to grant

⁸*Meyer v. United States*, 375 U.S. 233, 237-38 (1963).

⁹*In re Beach*, 169 B.R. 201, 203-06 (D.Kan. 1994).

¹⁰169 B.R. at 204-05.

marshaling, namely, that the debtor in *Muir* was only secondarily liable as a guarantor on the debt involved there.¹¹ The Court cannot agree. In *Muir*, the reason the court granted marshaling for the debtors was that the inherent equities of a loan guarantee agreement (absent a specific provision to the contrary) require the creditor to exhaust its legal recourse against the primary obligor before compelling the guarantor to satisfy the obligation.¹² Here, however, the Relatives' agreement with Met Life made their property serve as collateral on an equal footing with the property that William and James pledged. Now, they are asking the Court to alter that agreement and make their property only secondarily liable for the Met Life debt, an arrangement they could have insisted on when they agreed to pledge their property.¹³ They have not suggested that the debtors engaged in any inequitable conduct that would justify making an exception to the common debtor requirement for marshaling.¹⁴

Kansas law does provide another type of marshaling protection. In *The Frick Co. v. Ketels*,¹⁵ the Kansas Supreme Court ruled that a debtor who had given a mortgage on his

¹¹See 89 B.R. at 162.

¹²89 B.R. at 162.

¹³*Cf. DuPage Lumber and Home Improvement Co. v. Georgia-Pacific Corp.*, 34 B.R. 737, 744-45 (N.D. Ill. 1983) (creditor who agreed to subordinate its lien on certain property was denied marshaling in part because creditor could have insisted on additional security from parties against whom it sought to require superior creditor to marshal).

¹⁴See *Muir*, 89 B.R. at 161-62.

¹⁵42 Kan. 527 (1889); see also *In re Estate of Dahn*, 204 Kan. 535, 543 (1970) (recognizing the continued validity of *Ketels*).

homestead and other nonexempt realty had the right to require the creditor to foreclose on the nonexempt realty before it enforced the homestead mortgage, even though another creditor had a judgment lien on the nonexempt realty. But the Relatives have not alleged that Tract A or Tract F qualifies as a homestead for any of them. This marshaling remedy, therefore, is not available to them.

Had the debtors not filed for bankruptcy, the Relatives might be able to convince a state court that the equitable doctrine of marshaling should be applied to their benefit. At the very least, they would have a strong argument that the state court should direct Met Life to conduct its foreclosure sales in the following order, and only to the extent necessary to pay it in full: first, sell the debtors' nonexempt tracts, then sell Tracts A and F, and finally, sell the debtors' exempt homestead. Based on the materials submitted to this Court, it appears to be fairly likely that Met Life's debt would be satisfied without selling one or perhaps either of the tracts the Relatives own. In such a foreclosure suit, the state court would not have to consider the impact that marshaling might have on the debtors' creditors who were not parties to the suit.

Because the debtors have sought bankruptcy protection, though, this Court must consider the impact of marshaling on the interests of another group, the debtors' general unsecured creditors. In their bankruptcy schedules, the debtors listed over \$170,000 in unsecured claims, and their amended plan indicates that some of their secured creditors are undersecured, so portions of their claims are unsecured as well. Assuming the unsecured claims are allowed in amounts close to those stated by the debtors, well over \$200,000 will

be distributed to unsecured creditors if the debtors' plan is confirmed and successfully completed. The marshaling the Relatives seek would reduce the value of the debtors' nonexempt assets, reducing the liquidation value of their bankruptcy estate and harming the unsecured creditors by reducing the amount the debtors would have to pay them through their plan. The record indicates that Tracts A and F are worth \$104,000, but even if Met Life does not recover that much by foreclosing on the tracts after receiving stay relief, the proceeds of the tracts should still reduce its secured claim substantially. The Court concludes that it cannot fashion a marshaling remedy for the Relatives that would be equitable to the debtors' unsecured creditors.

Although marshaling is not available to them, the Relatives are not completely without remedies, including some that might allow them to keep Tracts A and F. They can negotiate with Met Life to try to arrange financing that would allow them to pay it what it would otherwise receive by foreclosing on the tracts. If the tracts are sold to someone else through foreclosure, they will have a redemption period during which they can try to obtain financing elsewhere to redeem the tracts. They can also assert a claim against the debtors' bankruptcy estate for any loss they suffer as a result of Met Life's efforts to collect from Tracts A and F. If that claim is allowed and the debtors' plan is confirmed, the Relatives will participate in distributions made to general unsecured creditors.

The Court is not without sympathy for the position the Relatives find themselves in. However, the Court cannot rewrite the debtors' plan. Ultimately, the Court is convinced the Relatives cannot require Met Life to marshal its collateral. The marshaling remedy

protects one creditor from another creditor to whom the debtor gave additional collateral, without harming the latter, who will simply collect from its other collateral. The Relatives could have insisted when they pledged their property that the agreement make their property serve as collateral for Met Life only to the extent Met Life was unable to collect its debt from the debtors and their property. But they did not. Assuming there are two “funds” from which Met Life can collect, one being Tracts A and F, from which the Relatives can also “recover,” and the second being the debtors’ real estate, from which only Met Life can recover, the second fund is currently frozen while the debtors try to reorganize under Chapter 12. Because the debtors’ bankruptcy case is preventing Met Life from collecting its debt from the debtors’ property, granting the Relatives’ marshaling request would harm Met Life by delaying the partial satisfaction of its debt through the foreclosure and sale of Tracts A and F. Refusing the marshaling remedy the Relatives want here also furthers the general bankruptcy policy of favoring bankruptcy reorganizations under Chapters 11, 12, and 13 over liquidations under Chapter 7.¹⁶ Clearly, the debtors have determined that allowing Met Life to foreclose on Tracts A and F is the best way for them to proceed with their Chapter 12 reorganization.

CONCLUSION

¹⁶*See In re Beeman*, 224 B.R. 420, 425-26 (Bankr. W.D. Mo. 1998) (granting Chapter 11 reorganized debtor’s marshaling request for junior creditor to be paid before senior oversecured creditor from proceeds of land that was security for both creditors, and rejecting as “impracticable and infeasible” senior creditor’s suggestion that debtor should be required to sell other parcels of land before one on which junior creditor also had lien).

For these reasons, the Court concludes that Met Life is entitled to stay relief to allow it to proceed to foreclose on Tracts A and F, so its motion is hereby granted to that extent. The Relatives' request for marshaling is denied.

IT IS SO ORDERED.

Dated this _____ day of June, 2004.

DALE L. SOMERS
BANKRUPTCY JUDGE

CERTIFICATE OF SERVICE

The undersigned hereby certifies that true and correct copies of the above **ORDER GRANTING STAY RELIEF TO CREDITOR METROPOLITAN LIFE INSURANCE COMPANY** were mailed via regular U.S. mail, postage prepaid, on the _____ day of June, 2004, to the following:

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