

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
EASTERN DIVISION

IN RE:

MOTEL 22 OF DECATUR COUNTY, INC.,
d/b/a HOLLADAY SCOTTISH INN,
d/b/a APPLE ANNIE'S RESTAURANTS,
and d/b/a CASEY'S DELI JUNCTION,

BK #92-10509-WHB
Chapter 11

Debtor.

MOTEL 22 OF DECATUR COUNTY, INC.,

Plaintiff,

v.

Adversary Proceeding
No. 92-0983

SUE DRAKE,

Defendant.

MEMORANDUM OPINION AND ORDER ON COMPLAINT
OBJECTING TO SECURED CLAIM OF SUE DRAKE AND
SEEKING A DETERMINATION AS TO THE EXTENT AND VALIDITY
OF SUE DRAKE'S CLAIM AND SECURITY

This adversary proceeding was tried on June 23, 1993. The complaint filed by the debtor Motel 22 of Decatur County, Inc. ("Motel 22") seeks a determination of various issues, including a determination that the debtor is not liable to Sue Drake for any amount and that the Sue Drake note has been paid in full and that the claim of Sue Drake should be disallowed with her deed of trust ordered released and that judgment be entered against Sue Drake for an alleged overpayment of approximately \$24,000.00. These issues address the allowance of the filed secured claim of Sue Drake (Tr. Ex. 9) and involve the determination of the extent, validity, and priority of an alleged lien. Therefore, the adversary proceeding is core pursuant to 28 U.S.C. §157(b)(2)(B) and (K). The following contains findings of fact and conclusions of law pursuant to F.R.B.P. 7052.

The parties stipulated to certain facts and nine trial exhibits referred to in the stipulation filed with the Court on June 23, 1993. Those stipulated facts are incorporated herein as findings of fact of the Court based upon the stipulations of the parties. See Stipulation of Facts and Exhibits 1 through 9. In addition to the stipulated facts and exhibits, the Court received testimony and additional trial exhibits. The Court has reviewed the testimony and the trial exhibits and has considered all of the facts and circumstances in reaching its additional findings of fact and conclusions of law. The Court also has considered the credibility and demeanor of witnesses.

There is no dispute that a corporation known as JGM Corporation ("JGM") was formerly the owner and operator of the motel property currently owned by Motel 22 and that JGM executed a promissory note to Sue Drake, which note was secured by a deed of trust securing a first mortgage on a portion of the motel property. Tr. Exs. 1 and 2. The dispute that exists between these parties began to arise when JGM sold the motel real property to Motel 22. Tr. Ex. 3. Motel 22 financed the purchase of this property with a loan from Central State Bank, and a Loan And Disbursement Agreement was entered into between Central State Bank and Motel 22. Tr. Ex. 4. Sue Drake was not a party to that Loan And Disbursement Agreement nor was she a party to any negotiations between Central State Bank, Motel 22, its present owners Mr. and Mrs. Jack McCormick, or the former principal in the ownership of the motel property, Jimmy G. Melton. The Loan And Disbursement Agreement contains certain instructions as to how Central State Bank and Motel 22 agreed upon disbursement of loan proceeds. Unfortunately, Mr. Melton and Ms. Drake were not signatories on that agreement, and the agreement itself contains language that the Court finds to be vague, in that the agreement provides that the balance of the loan proceeds, after payment of specified amounts, would "either be paid on the Sue Drake note or used to purchase gasoline to go into the tanks located on the real property." Tr. Ex. 4. The testimony was clear that Motel 22 did not utilize loan proceeds to purchase actual gasoline.

This would seem to indicate that the balance should be paid on the Sue Drake note; however, unfortunately, the agreement left unspecified as to how the balance of the loan proceeds would be applied to

the Sue Drake note. In fact, Sue Drake did not wish her loan to be prepaid in part but rather she wanted to continue to receive monthly payments as set out in her note with JGM.

For reasons that served the personal interest of Jimmy Melton, Mr. Melton picked up a check for \$46,292.53 drawn on the escrow account of the closing attorney and, through his agent, obtained the special endorsement of Sue Drake added to the back of the check. See Tr. Ex. 7.

Motel 22 argues that Sue Drake received the check and by her endorsement she accepted the check as payment on her note. Further, Motel 22 argues that her special endorsement transferring the check to JGM with no credit being given to her note did not benefit Motel 22 and was at least a negligent act on Sue Drake's part, so as to equitably prevent her from contending that she should not apply that check as credit to her note.

Of course, as a part of the purchase by Motel 22 of the motel property from JGM, Motel 22 agreed to assume the balance on the Sue Drake note. See Tr. Ex. 8. Motel 22's owners and principals now testify that they did not intend to assume the entire estimated balance of \$90,000.00 on the note but rather the balance less a credit for \$46,292.53, representing the amount of the check introduced as Tr. Ex. 7. The Court certainly can understand the McCormicks' testimony and arguments, and in looking back at the transaction, it is obvious that the McCormicks did not intend to pay the Sue Drake note twice. However, due to a combination of errors, some induced by the actions of Mr. Melton and some by inexperience, confusion or negligence on the part of Motel 22 and its principals, Motel 22 and its principals entered into a separate Assumption And Hold Harmless Agreement introduced as Tr. Ex. 8. That agreement specifically stated that Motel 22 and its principals assumed the balance due on the Sue Drake note, and the agreement referred to the \$1,200.00 monthly payments and the "estimated current outstanding principal balance of \$90,000.00" and the agreement held JGM Corporation harmless from any loss in the event of nonpayment of the note. The Court has heard the testimony of the McCormicks that they did not understand the Assumption And Hold Harmless Agreement to mean that they had assumed an actual balance of \$90,000.00. In other words, the McCormicks now testify that they understood that agreement to mean an assumption of the \$90,000.00 approximate

balance less any credit for the \$46,292.53 check payable to Ms. Drake from the closing attorney's escrow account. There are several problems with the McCormicks' present understanding of the assumption agreement. First, the agreement speaks for itself and while the agreement does have some vagueness in its reference to an estimated principal balance of \$90,000.00, it is difficult for the Court to accept the McCormicks' version that an estimated \$90,000.00 balance was in fact less than one-half of that amount. To say the least, a poor estimate was made by the McCormicks when they signed the assumption agreement. Moreover, the Court is not satisfied that there is sufficient vagueness in the assumption agreement to justify oral testimony that alters the assumption agreement. In addition, the testimony from Mr. McCormick was that he must have signed the undated assumption agreement at the same time as he signed other closing papers in March of 1987. On March 10, 1987, the McCormicks purchased personal property from JGM Corporation and JOB Corporation for \$167,000.00 recited in a bill of sale. Tr. Ex. 10. In contrast, the check to Ms. Drake is dated January 12, 1987, a date shortly after execution of the loan and disbursement agreement between Central State Bank and Motel 22 concerning the transfer of the real estate. The McCormicks and Motel 22 knew or certainly should have known that Ms. Drake's credit on the note should have been given prior to or simultaneously with the March, 1987, closing. Moreover, Mr. McCormick testified that he had been told by Mr. Melton that if Mr. Melton did not receive the near \$47,000.00 represented by the Sue Drake check that the McCormicks would have to pay an additional \$47,000.00 for purchase of the personalty. In fact, the bill of sale recites that the McCormicks would pay \$47,000.00 in cash. Tr. Ex. 10. How could the McCormicks assume that a credit would be given on the \$90,000.00 estimated balance of the Sue Drake note and yet pay \$47,000.00 additional money to Mr. Melton that was only justified in the event Melton did not receive the Sue Drake funds? The McCormicks should have known from their dealings with Mr. Melton that he could not be relied upon and they should have verified the status of the Drake note with Bill Martin, the bank, and/or Ms. Drake.

While the Court did not find Mr. Melton to be a credible witness nor can the Court find that his testimony adds any significant instructive benefit to this confusion, and while the Court can understand the

McCormicks and Ms. Drake being confused if not misled by Mr. Melton, as between the McCormicks, Motel 22 and Sue Drake, the Court finds it inconsistent for Motel 22 to now contend that it expected a credit on the Sue Drake note, which it had assumed in a separate assumption agreement, when it did not follow through on some minimal investigation to determine if the Sue Drake note had been reduced out of the January, 1987, loan proceeds, and continued to pay the \$1,200.00 monthly payments on the Sue Drake note through August, 1991. Based upon all of the proof, the Court finds that Motel 22, through its principals, certainly knew by August, 1987, that the escrow check had not been applied to the Sue Drake note. They should have known by March, 1987. These findings are made based upon the testimony of the closing attorney, Mr. Martin, and the President of Central State Bank, Mr. Woods. These findings are also consistent with the only interpretation of all of the facts and circumstances that make sense of the confusion existing between these parties.

While the Court is sympathetic to the McCormicks' argument that they are being required to double, if not triple, pay on the Sue Drake note, any blame for that rests not with Ms. Drake's actions but with the actions of Mr. Melton and either confusion or inaction on the part of the McCormicks.

From a strict reading of the documents, the Court can not make a finding that Motel 22 and/or its principals were misled by Sue Drake, with whom they had no direct dealings other than to continue to make monthly payments. As a matter of law, the Court can not conclude that the endorsement on the escrow check by Sue Drake was an acceptance by her of the check for payment on her note, when her testimony and other proof in the proceeding contravenes such a conclusion.

CONCLUSION

Viewed from an equitable analysis, it would appear that each of these parties bears some responsibility. If Sue Drake was negligent in endorsing the escrow check without further inquiry on her part, so were Motel 22 and its principals negligent in not directly contacting Sue Drake, the closing attorney, and/or the President of the bank to verify what had happened with the Sue Drake check before the McCormicks entered into a further closing in March, 1987, with the source of so much confusion, Mr.

Melton. From all of the facts and circumstances, the Court believes that the McCormicks were so interested in extricating Mr. Melton from their lives that they overlooked the inquiry into what had happened to Sue Drake's note and any credit that could have been given on that note. The reality is that the ultimate finding is that the McCormicks, rather than Sue Drake, had it within their control to make the closing of any transactions with Mr. Melton dependent upon satisfaction of the Sue Drake note, direct payment by the bank or escrow agent to Sue Drake, or proof that Sue Drake's note had been credited with partial payment.

Because of the negligence on both parties' part and the predominant negligence being on the part of Motel 22 and its principals, an equity court must leave the parties where they are rather than improve the position of one over another. That is, the Sue Drake note and its related deed of trust remain as a secured claim against a portion of the Motel 22 property and no credit for the escrow check, Ex. 7, will be given to that note.

However, as a result of the negligence of Sue Drake in endorsing the escrow check without further inquiry, the Court concludes that it would be equitable to allow her secured claim only in the amount of the principal balance outstanding on the note, without credit for the escrow check, plus accrued interest at the contractual rate of ten percent (10%). No claim for late fees or other charges other than contractual interest and principal will be allowed. Specifically, Sue Drake will be required to bear her own attorney's fees and costs of this litigation.

IT IS THEREFORE ORDERED that the Court determines that Motel 22 of Decatur County, Inc. did assume the obligations under the Sue Drake note and deed of trust and remains liable to Sue Drake for the outstanding principal balance, plus accrued interest at the contractual rate, and that no credit shall be given on the note for the escrow check marked as Tr. Ex. 7;

That the Sue Drake note and its deed of trust remain enforceable obligations under applicable state law;

That the Sue Drake claim is allowed as a secured claim in the amount specified above but that each party shall be responsible for their own attorney's fees and costs related to this litigation; and

That the plaintiff's request for a judgment against Sue Drake in the amount of an alleged overpayment of the note is denied.

SO ORDERED this 28th day of June, 1992.

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

cc:

Mr. David M. Dunlap
Humphreys, Dunlap, Wellford,
Acuff & Staton
Attorneys for Plaintiff
165 Madison Avenue
Suite 2200
Memphis, Tennessee 38103

Ms. Rayna Hardee Bomar
Hardee & Martin
Attorney for Defendant
213 E. Lafayette Street
Jackson, Tennessee 38103