UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re

SOUTHERN FABRICATORS, INC., et al.,

Debtor.

Case No. 02-25327-L
Chapter 11
(Jointly Administered)

Richard D. Maynard
and Bonita B. Maynard,

Plaintiffs,

v.

Adv. Proc. No. 02-0434

DZL, LLC,

Defendant.

ORDER ON CROSS MOTIONS FOR SUMMARY JUDGMENT AND MOTION TO STRIKE

THIS MATTER comes before the court on cross motions for summary judgment. The sole issue raised by the parties is whether the benefits of the plaintiffs' subordination to the liens and security interests of National Bank of Commerce ("NBC") may be enjoyed by the defendant, DZL, LLC ("DZL") as assignee of NBC. The plaintiffs claim that they are not bound by the Subordination Agreements because the agreements are not assignable. In addition to its motion for summary judgment, DZL has also filed a motion to strike portions of the affidavit submitted in support of the plaintiffs' motion for summary judgment. For the reasons set forth below, the motion of DZL to strike portions of the affidavit of Richard D. Maynard will be granted, the motion of DZL for summary judgment will be granted, and the motion of the plaintiffs for summary judgment will be denied. This is a core proceeding. 28 U.S.C. § 157(b)(2)(K).

I. FACTS

Certain of the background facts underlying these motions are not in dispute. On July 29, 2000, the Maynards and ARKO, Inc., one of the debtors in these jointly administered cases ("ARKO"), executed Subordination Agreements pursuant to which the Maynards and ARKO agreed to subordinate their indebtedness and security interests in the assets of ARKO to indebtedness and security interests held by NBC. The indebtedness owed to the Maynards arose out of an earlier purchase of assets by ARKO. On March 21, 2002, NBC sold certain of its loans to DZL and executed an Assignment of Notes and Deeds of Trust and Collateral Documents. The Assignment of Collateral Documents includes a reference to the Subordination Agreements. On May 21, 2002, this court entered an order approving the sale of the assets of ARKO to DZL but reserving for later determination the issue raised in this adversary proceeding.

The Subordination Agreements provide, at paragraph 9:

> This Agreement and all provisions herein are solely for the benefit of the parties hereto and no other parties (including Borrower) are intended to be benefitted in any way by this Agreement.

At paragraph 7 the Subordination Agreements provide:

> This Agreement shall remain in effect until all of the NBC Indebtedness has been paid and all instruments and agreements at any time evidencing or securing the whole or any part thereof have been terminated.

There is no dispute that the indebtedness owed to NBC has not been paid. The Maynards maintain that they agreed to subordinate their security interests and liens in the assets of ARKO to the security interests and liens of NBC and no one else.

II. STANDARD FOR GRANTING SUMMARY JUDGMENT

On a motion for summary judgment, the movant has the initial burden of showing the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325, 106 S. Ct. 2548, 2554, 91 L. Ed. 2d 265 (1986) ("the burden on the moving party may be discharged by 'showing' . . . that there is an absence of evidence to support the non-moving party's case"). Under Rule 56(e) of the Federal Rules of Civil Procedure, the burden shifts to the non-movant to "go beyond the pleadings and by . . . affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'" *Celotex Corp.*, 477 U.S. at 324. That burden is not discharged by "mere allegations or denials." FED. R. CIV. P. 56(e). All legitimate factual inferences must be made in favor of the non-movant. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255, 106 S. Ct. 2505, 2513, 91 L. Ed. 2d 202 (1986). Rule 56(c) mandates the entry of summary judgment "against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp.*, 477 U.S. at 322. Before finding that no genuine issue for trial exists, the court must first be satisfied that no reasonable trier of fact could find for the non-movant. *Matsushita Elec. Indus. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S. Ct. 1348, 1356, 89 L. Ed. 2d 538 (1986).

The filing of cross motions for summary judgment indicates the parties' essential agreement that there are no genuine issues of material fact and that the issues to be determined are ones of law. The essential dispute in this case is the appropriate interpretation of paragraph 9 of the

Subordination Agreements. The interpretation of a written agreement is a question of law, not of fact.

> This determination of the intention of the parties is generally treated as a question of law because the words of the contract are definite and undisputed, and in deciding the legal effect of the words, there is no genuine factual issue left for a jury to decide.

Planters Gin Company v. Federal Compress & Warehouse Co., Inc. 78 S.W.3d 885, 890 (Tenn. 2002).

III. DISCUSSION

The Maynards contend that the language of paragraph 9 of the Subordination Agreements prevents the assignment of the agreements for the following reasons: (1) the agreements provide that they are solely for the benefit of the parties and no one else; (2) Uniform Commercial Code Comment to Revised Article 9-339 (previously Article 9-316) prohibits a non-party from enforcing a subordination agreement; (3) the RESTATEMENT (SECOND) OF CONTRACTS § 317(2) prohibits an assignment of the Subordination Agreements because assignment would "materially increase" the risk to junior creditors; and (4) the Subordination Agreements are contracts coupled with liabilities and a relationship of personal credit and confidence, and thus are not assignable.

DZL counters that the Maynards have mistaken an inurement clause, intended to prevent third-party beneficiary claims, from an anti-assignment clause. DZL asserts that it does not seek to assert the rights of a non-party to the Subordination Agreements, but those of a party. It asserts that

as the result of the assignment of the Subordination Agreements to it by NBC, DZL stepped into the shoes of NBC and is now a party to the agreements.

A. As a General Rule, All Contracts are Assignable

As a general rule, contract rights are assignable except for certain narrow exceptions. *See* RESTATEMENT (SECOND) CONTRACTS § 317(2) which provides:

> (2) A contractual right can be assigned unless
>
> (a) the substitution of a right of the assignee for the right of the assignor would materially change the duty of the obligor, or materially increase the burden or risk imposed on him by his contract, or materially impair his chance of obtaining return performance, or materially reduce its value to him, or
>
> (b) the assignment is forbidden by statutes or is otherwise inoperative on grounds of public policy, or
>
> (c) assignment is validly precluded by contract.

Even in the absence of language binding a contract upon the parties, "their heirs and assigns," contract rights are generally assignable unless the assignment would materially affect the obligor's rights or burdens. *Williamson County Broadcasting Co., Inc. v. Intermedia Partners*, 987 S.W.2d 550, 553 (Tenn. Ct. App. 1998), citing *Petry v. Cosmopolitan Spa Intern., Inc.,* 641 S.W.2d 202 (Tenn. App.1982) (applying the RESTATEMENT (SECOND) OF CONTRACTS § 317(2) (1981)); *see also Jackson v. Moskovitz Agency, Inc.*, 672 S.W.2d 400 (Tenn. 1984) (In the absence of a provision prohibiting assignment, property rights are both assignable and transferable).

B. The Subordination Agreements Do Not Expressly Prohibit Assignment

The Maynards argue that the Subordination Agreements themselves prohibit assignment at paragraph 9. That paragraph provides that the agreement is intended solely for the benefit of the parties and is not intended to benefit non-parties. It does not mention or prohibit the possibility of assignment. The language of paragraph 9 is intended to prevent any inference of the granting of rights to non-parties to the agreements. It does not prevent substituted parties from exercising rights obtained by assignment. "One of the general principles of the law of assignments is that the assignee 'steps into the shoes of the assignor' with regard to the matters covered by the assignment. . . . Thus, an assignment does not extinguish the underlying contract, but rather it transfers the assignor's contract rights against the other contracting party to the assignee who succeeds to the assignor's rights under the underlying contract." *SunTrust Bank, Nashville v. Johnson,* 46 S.W.3d 216, 226 (Tenn. Ct. App. 2000) (internal citations omitted).

Once NBC's interests under the Subordination Agreements were assigned to DZL, DZL was substituted as a party for NBC. DZL is the only party that can enforce the rights granted under the Subordination Agreements. NBC no longer has those rights. Thus, DZL is not a stranger to the agreements, but is a party.

In order to overcome the presumption that all contracts are assignable, an agreement must contain language clearly prohibiting or preventing assignment. There is no language in the Subordination Agreements that may be read as a prohibition on assignment.

The Maynards rely heavily upon the unreported decision of *First Interstate Credit v. Phillips*, 1994 WL 65021 (Tenn. Ct. App. 1994), in support of their assertion that the Subordination

Agreements prohibit assignment. The facts of that case, however, are clearly distinguishable from those of this case. *First Interstate Credit* determined that the following language effectively prevented assignment of a subordination agreement:

> In the event that at any time or for any reason you [the secured party] cease to have your above-mentioned security interest in said specific items, our subordination of lien as provided herein shall thereupon immediately cease and be terminated and any security interest which you may have in the above-captioned's goods, other than those described in Schedule A, shall be subordinate to our security interest. No person other than you and us shall have any right, benefit, priority or interest under or because of the existence of this Letter Agreement.

First Interstate Credit, 1994 WL 65021, at *2. In its discussion, the Tennessee appellate court noted that "Tennessee courts have adopted the general principle that contract rights are freely assignable." *Id*. at *4, citing *Jackson v. Moskovitz Agency, Inc.,* 672 S.W.2d 400, 403 (Tenn. 1984); *Perry v. Cosmopolitan Spa Int'l, Inc.*, 641 S.W.2d 202, 203 (Tenn. App. 1982). The court further noted that "[a] subordination agreement is an ordinary contract and is governed by ordinary rules of construction." *First Interstate Credit*, 1994 WL 65021, at *4. And further, "'The cardinal rule for interpretation of contracts is to ascertain the intention of the parties and to give effect to that intention consistent with legal principles.'" *Id*. quoting *Park Place Center Enterprises, Inc. v. Park Place Mall Associates*, *L.P.*, 836 S.W.2d 113, 116 (Tenn. Ct. App. 1992).

In *First Interstate*, the language of the agreement provided that should the secured party cease to have a security interest in specified equipment, the subordination agreement would terminate. Thus, the court concluded that "although there was no specific sentence stating 'This subordination agreement cannot be assigned,' the language resulted in the same effect." *Id*. The

language made clear that in the event that the secured party's interest ceased, the subordination agreement was terminated.

The facts in the present case are quite different. Not only do the Subordination Agreements not contain express language prohibiting assignment, but they expressly do provide that the "Agreement shall remain in effect until all of the NBC Indebtedness has been paid." This language contemplates the survival of the Subordination Agreements until all the NBC Indebtedness (a defined term in the Subordination Agreements) is paid. As stated earlier, it is conceded that the NBC Indebtedness has not been paid.

The Maynards seek to supplement the unambiguous language of the Subordination Agreements with the affidavit of Mr. Maynard containing statements made by a certain Wyatt Isbell concerning ARKO's efforts to obtain refinancing of its obligations to NBC, and Mr. Maynard's own thoughts with respect to the Subordination Agreements. DZL has appropriately filed a motion to strike those portions of Mr. Maynard's affidavit that are offered as parol evidence to vary the terms of the written Subordination Agreements. The parol evidence rule provides that "contracting parties cannot use extraneous evidence to alter, vary, or qualify the plain meaning of an unambiguous written contract." *Hillard v. Franklin*, 41 S.W.3d 106, 112 (Tenn. Ct. App. 2000). The motion of DZL to strike paragraphs 7, 8, 10, 11, 12, 15, and 17 of the affidavit of Mr. Maynard will be granted.

C. The Uniform Commercial Code Does Not Prohibit Assignment of Subordination Agreements

The Maynards argue that assignment of the Subordination Agreements is prohibited by the Uniform Commercial Code. The Uniform Commercial Code does not prohibit the assignment of

the Subordination Agreements, rather Tennessee Code Annotated § 47-9-339 (previously TENN. CODE ANN. § 47-9-316) merely authorizes a person entitled to priority to subordinate its claim by agreement. This in fact is what the Maynards did, subordinated their first priority lien upon the assets of ARKO to a lien securing the new loan extended by NBC. Official Comment 2 to that section is equally unavailing. It provides:

> The preceding section deals elaborately with questions of priority. The section makes it clear that a person entitled to priority may effectively agree to subordinate its claim. Only the person entitled to priority may make such an agreement: a person's rights cannot be adversely affected by an agreement to which the person is not a party.

The comment reiterates the ability of a person entitled to priority to subordinate its position by agreement. It makes clear that this change in priority can only be accomplished by the agreement of the person entitled to priority, not by a third party (such as a new lender). Both the UCC section and the comment to it are concerned with the consensual subordination of a priority lien; neither is concerned with the assignability of a subordination agreement.

D. The Assignment of the Subordination Agreements Did Not Materially Increase the Risk to Junior Creditors

The Maynards further argue that the assignment of the Subordination Agreements is prohibited because assignment would "materially increase" the risk to the junior creditors (Maynards and ARKO, Inc.). As support for their position, the Maynards rely upon the following passage from CORBIN ON CONTRACTS:

> [A] party to a contract cannot by any process called assignment change in any material way the performance to be rendered by the other party. He has power to substitute a new party as holder of the

> right he has no power to change the performance that the right requires. . . .
>
> It is on this ground that a surety is discharged if the creditor discharges the principal debtor or grants him a binding extension of time to pay the debt.

4 CORBIN ON CONTRACTS § 868, pp. 468-69 (1951).

The Maynards' argument must fail on the strength of the very passage on which they rely. The risks they claim will "materially increase" are no more than those that arise from the rights granted to NBC in the original agreements. The Maynards point to no change in the performance expected of them under the agreements. The assignments contemplate a substitution of a new party as holder of the rights under the Subordination Agreements. The Maynards do not assert that DZL has attempted to subordinate the Maynards' liens to new advances. As DZL points out in its Reply Brief, the effect of the assignment of the Subordination Agreements is to cap the obligation to which the Maynards' lien is subordinate. *See* DZL's Brief In Opposition to the Maynards' Motion for Summary Judgment and in Support of DZL's Motion for Summary Judgment, December 18, 2002, pp. 4-5.

E. The Subordination Agreements Do Not Involve Personal Credit and Confidence Such as Would Prevent Their Assignment

Because the effect of the assignment of the Subordination Agreements is to cap the obligation to which the Maynards' lien is subordinate, the Maynards' assertion that the Subordination Agreements involve relationships of personal credit and confidence is equally unfounded. The Subordination Agreements merely establish the relative priorities of liens. No

additional performance was expected from NBC under the agreements before they were assigned to DZL, and upon assignment, DZL obtained the right to exercise the remedies provided by the agreements, but not the right to further subordinate the liens of the Maynards by making new advances to ARKO. *See Western Auto Supply Company v. Brazoport Bank of Texas,* 840 S.W.2d 157, 159 (Tex. Ct. App. 1992) (Future indebtedness stipulations apply only to those debts that were reasonably within the contemplation of the parties at the time the debt instrument was made.) The Maynards have failed to show how they have in any way been adversely affected by the assignment of the Subordination Agreements to DZL. Rather, it seems that the Maynards seek to obtain a windfall by avoiding the effect of the Subordination Agreements. This they will not be permitted to do.

IV. CONCLUSION

For the foregoing reasons, Defendant's Motion to Strike Portions of Affidavit Submitted in Support of Plaintiffs' Motion for Summary Judgment is **GRANTED**; Defendant's Motion for Summary Judgment is **GRANTED**; and Plaintiffs' Motion for Summary Judgment is **DENIED**.

IT IS SO ORDERED.

BY THE COURT,

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JENNIE D. LATTA
United States Bankruptcy Judge

Date: April 3, 2003

cc: Debtor
Debtor's Attorney
Plaintiffs
Plaintiffs' Attorney
Defendant
Defendant's Attorney