

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

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IN RE:

MIKE ROSE OIL CO., L.P.,  
a/k/a MIKE ROSE OIL COMPANY, L.P.,

BK #90-23604-WHB

Debtor.

TRAVELERS INDEMNITY COMPANY and  
MIKE ROSE OIL COMPANY, L.P.,

Plaintiffs,

v.

Adversary Proceeding  
No. 91-0006

JOE B. HUDDLESTON, Commissioner  
of Revenue of the State of Tennessee;  
and THE TENNESSEE DEPARTMENT OF  
REVENUE,

Defendants.

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**MEMORANDUM OPINION AND ORDER  
OF TRAVELERS INDEMNITY COMPANY'S  
MOTION FOR SUMMARY JUDGMENT**

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Travelers Indemnity Company ("Travelers") filed its complaint in this adversary proceeding seeking a declaratory judgment under 28 U.S.C. §2201 as to the parties' rights and obligations pursuant to a petroleum tax bond issued by Travelers in favor of the state of Tennessee Department of Revenue ("Department"). There is no dispute as to material facts and the issues presented are questions of law, which have been briefed and argued by counsel and which are ripe for summary judgment. Federal Rule of Civil Procedure 56(c), made applicable by Bankruptcy Rule 7056 provides, in pertinent part:

The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any

material fact and that the moving party is entitled to a judgment as a matter of law.<sup>1</sup>

The issues presented affect the claims made against this Chapter 11 estate; therefore, this proceeding is core under 28 U.S.C. §157(b)(2)(O). Furthermore, the parties voluntarily submitted to this Court's jurisdiction, and an order was entered denying Travelers' motion for preliminary injunction against the Department in which order the Attorney General for the State of Tennessee consented to "abide by the orders of this Court, including, but not limited to, any orders directing the Defendants to pay or refund any sums that this Court may later determine are due to Plaintiff Travelers." See Order entered February 28, 1991.

The following represents findings of fact and conclusions of law pursuant to Bankruptcy Rules 7052 and 7056.

#### **FINDINGS OF FACT**

1. Travelers originally filed its complaint for declaratory judgment on January 10, 1991, which complaint was amended on April 29, 1991, to add the debtor as a plaintiff and to seek injunctive relief.

2. Travelers is a Connecticut corporation, authorized to do business in Tennessee, and Travelers is engaged in the business of providing surety and other bonds.

3. The debtor is a Tennessee limited partnership, with a confirmed liquidating Chapter 11 plan in this Court.

4. Prior to the Chapter 11 filing, the debtor was engaged in the business of operating convenience stores which sold gasoline in Western Tennessee.

5. The selling of gasoline and other petroleum products exposes the seller to liability for certain petroleum taxes under applicable Tennessee statutes. See Tennessee Code Annotated §§67-3-603-604, 67-3-801-820, 67-3-903-904.

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<sup>1</sup> For a thorough discussion of the "new era" of summary judgment, see In re Suburban Motor Freight, Inc., 124 B.R. 984, 991 (Bankr. S.D. Ohio 1990).

6. To facilitate the sale of petroleum products, the prebankruptcy debtor was required by Tennessee Code Annotated §67-3-104 to post a bond in favor of the Department and its Petroleum Tax Division, as a guaranty for payment of any petroleum taxes, interest and penalties which might be assessed against the debtor by the Department.

7. On May 24, 1988, Travelers issued a petroleum tax bond, number 974G1881-119, in favor of the Commissioner of Revenue as obligee. Ex. A to Amended Complaint. The maximum penal sum of this bond was \$86,000.00.

8. In order to induce Travelers to issue the bond, the debtor and others executed an indemnity agreement in favor of Travelers. Ex. B to Amended Complaint. The indemnity agreement, among other things, provided that the indemnitors would reimburse Travelers for any losses sustained by payment on the bond.

9. On April 26, 1989, a rider to the bond was issued by Travelers, raising the maximum penal sum to \$153,000.00, which amount was again increased by a November 30, 1989 rider to \$214,000.00. Ex. C to Amended Complaint.

10. The debtor filed a voluntary Chapter 11 petition on April 24, 1990, and as of that date petroleum taxes were due the Department for March and April, 1990.

11. The Department filed a proof of claim on August 13, 1990, for \$207,112.48. An amended proof of claim was filed November 8, 1990, reducing the claim to \$175,003.13. The amended claim consisted of prepetition taxes of \$170,655.37, prepetition interest of \$135.65 and prepetition penalties of \$4,347.76.

12. Travelers, on December 18, 1990, executed a written agreement with the debtor and its indemnitors, under which Travelers agreed to pay the Department's claim of \$175,003.13. Ex. E to Amended Complaint.

13. The Department made demand on Travelers for payment of \$214,000.00, the full penal sum of the bond.

14. After a hearing on Travelers' motion to preliminarily enjoin the Department from levying on Travelers' assets, the injunction was denied and Travelers paid the Department \$214,000.00, with the Department agreeing to refund any of that sum if so ordered by this Court. See Order entered February 28, 1991.

15. The bond at issue is evidenced by a contract executed by Mike Rose d/b/a Mike Rose Oil Company, L.P., as principal and the Travelers Indemnity Company as surety "for the use and benefit of the State of Tennessee, in the just and penal sum of [\$214,000.00] for which payment we bind ourselves . . . jointly and severally."

In pertinent part, the bond contract further provides:

NOW, THEREFORE, if the said principal shall well and truly comply with all of the requirements of Tennessee Code Annotated, Title 67, Chapter 3 and the rules issued thereunder, and particularly shall promptly and properly account for and pay all gasoline taxes, all motor vehicle fuel use taxes, all liquified gas taxes, and all special taxes on petroleum products, together with interest and penalties thereon that accrue against the said principal under the provisions of the said law, and all moneys coming into his hands which are due from him to the State of Tennessee, as the said law provides, then this obligation shall be null and void, otherwise it shall be in full force and effect.

It is thereby agreed and understood by the said principal and surety on this bond that:

(1) Action may be maintained on this bond against the said surety without making the said principal a party thereto, the same being a joint and several obligation; and

(2) The said surety shall have the right to terminate the liability upon giving to the commissioner sixty (60) days notice by registered mail of intention to so terminate, but shall remain liable for all sums due under the provisions of this bond which relate to any taxable periods occurring on and after the effective date hereof and continuing up to and including the effective date of such termination of liability; and

(3) This bond is continuous and shall remain in full force and effect until such time as either the said principal or the said surety requests that liability be terminated and the request shall be granted in the manner set out in the paragraph directly preceding this paragraph; and

(4) If at any time after the execution of this bond the surety thereon shall become insolvent, the commissioner may require the execution of a new bond with good and solvent surety in the same manner and with the same penalty as this bond and it shall be subject to the approval of the commissioner; and

(5) The purpose of the parties in executing this bond is to comply with the requirements of Tennessee Code Annotated Section 67-3-104, and the terms and conditions set forth in such statute shall be considered in determining the legal effect of this contract.

This bond is signed by the debtor and Linda Messinger, attorney-in-fact for Travelers.

### **THEORIES OF PARTIES**

As discussed above, pursuant to these provisions, Travelers admits that it is liable to the Department for the taxes, penalties, and interest which the debtor owed on the date the petition was filed. However, because the debtor is not liable for postpetition interest and penalties accruing on prepetition taxes, it is Travelers' position that it is likewise not liable for such. See 11 U.S.C. §502(b)(2); see also e.g., In re Robert Melvin Conner, unpublished opinion, J. Donald, p. 6 slip opin. (Bankr. W.D. Tenn. 1989), citing In re Patco Photo Corp., 82 B.R. 192, 197 (Bankr. E.D. N.Y. 1988) (holding, inter alia, that interest on prepetition taxes is compensation entitled to same priority treatment as taxes but that prepetition penalties are punitive and are treated as a general unsecured claim). Travelers argues that under both bankruptcy and surety law, the maximum liability of Travelers to the Department is \$175,003.13 and that Travelers is subrogated to the Department's rights to any distribution to be made by the debtor under the plan for petroleum taxes, interest and penalties. Travelers asserts its bond liability is limited to the same amount as the debtor would be liable under bankruptcy law, and this would be limited to the prepetition tax, interest and penalty claim of \$175,003.13. Travelers seeks a refund of \$38,996.87 from the Department. The Department, on the other hand, asserts that Travelers' liability on the bond is independent of any maximum liability to which the debtor is limited, and the Department asserts that Travelers' bond liability extends to both pre- and postpetition interest and penalties until it reaches the bond maximum of \$214,000.00.

### **CONCLUSIONS OF LAW**

A suretyship is defined as a contractual arrangement, "whereby for consideration, one person or entity obligates himself to satisfy the debts of another, [the principal] in case of a default." In re Microwave Products of America, Inc., 118 B.R. 566, 570 (Bankr. W.D. Tenn. 1990). The law governing such arrangements is generally the law of the situs of the contract. Id. This bond refers to Tennessee law, which clearly governs here. Accordingly, Judge Bernice Bouie Donald observed that

[t]he general rule is that the suretyship liability is the same as that of the principal, and cannot be greater than that of the principal, either as to amount or as to the burdensome character of the conditions. However, the obligations of the principal and surety do not have to be equal . . .

The liability of the surety is measured by the terms of his contract . . . [and] the loss or damage directly resulting from [the principal's] default.

Id. (citations omitted); see also, In re Lexington Housing Authority v. Continental Casualty Co., 210 F. Supp. 732 (W.D. Tenn. 1962); In re Darwin's Estate, 503 S.W. 2d 511 (Tenn. 1973). A surety includes a guarantor. Tennessee Code Annotated §47-1-201(40).

From these authorities, it is clear that although a surety's liability is generally the same as that of its principal, its liability includes, to the extent allowed by the suretyship contract, loss or damages directly resulting from the principal's default. This rule is consistent with Tennessee cases which hold that a surety is liable, to the extent of the penal sum of the bond, for punitive damages awarded against its principal and which directly result from the principal's default. See e.g., Gaston v. Gibson, 328 F. Supp. 3 (E.D. Tenn. 1969); see also Tennessee Code Annotated §25-1-102. However, a surety's liability may not exceed the penal sum of the bond. State ex. rel. McCormack v. National Bond & Mortg. Co., 26 Tenn. App. 125, 168 S.W. 2d 488 (Tenn. App. 1943). Given these precepts, the Department contends that notwithstanding the limit on the debtor's liability in this case, the liability of Travelers pursuant to the terms of its bond is for the full amount of the bond, because this amount constitutes losses directly resulting from the debtor's [principal's] default.

As set forth above, the bond provides that the debtor and Travelers are jointly and severally liable for the payment of petroleum taxes, interest and penalties due the Department up to the penal amount of the bond.

Consequently, it may be concluded that the terms of the bond contract render Travelers liable for all unpaid taxes, penalties, and interest upon the debtor's default to the extent of the penal sum of the bond. As such, if the only issue before the Court was one of contractual construction, it could be concluded that Travelers is liable for the amount of the unpaid taxes, penalties, and interest up to \$214,000.00.

However, although the surety's liability is measured by the terms of its contract and the loss or damages directly resulting from the principal's default, it remains dependent in the first instance on the principal's liability. In re Microwave Products of America, Inc., 118 B.R. at 570. Accordingly, defenses available to a principal are generally available to its surety. Rhode Island Hospital Trust National Bank v. Ohio Casualty Ins. Co., 789 F. 2d 74, 78 (1st Cir. 1986). Therefore, it is incumbent upon the Court to additionally consider the debtor's defenses to the Department's claim and examine their availability to Travelers in order to determine the extent of Travelers' liability. As noted above, there is no dispute as to the debtor's default and thus the existence of Travelers' liability. The dispute concerns the extent of that liability. In the bankruptcy context under circumstances such as exist here, a debtor's estate is ordinarily not liable for interest and penalties which accrue postpetition on a prepetition tax claim. See 11 U.S.C. §502(b)(2), §507(a)(7)(G); In re Boston and Maine Corp., 719 F. 2d 493, 496 (1st Cir. 1983), cert den., 466 U.S. 938, 104 S. Ct. 1913, 80 L. Ed. 2d 461 (1984); In re Snider Farms, Inc., 83 B.R. 977, 988 (Bankr. N.D. Ind. 1988); E.E.O.C. v. Rath Packing Co., 787 F. 2d 318, 327 (8th Cir. 1986), cert. den., 479 U.S. 910, 107 S. Ct. 307, 93 L. Ed. 2d 282 (1986). Cf. U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989). Indeed, in this proceeding, the Department has amended its proof of claim to reflect a claim only for the amount of tax, penalties and interest due prepetition. Ex. D to Amended Complaint. Thus, there is no dispute here as to the availability of the bankruptcy laws as a defense for the debtor nor as to the resulting extent of the debtor's liability. Rather, the issue becomes whether these bankruptcy defenses may be raised by the surety.

Although a surety may generally raise the defenses available to its principal, this is not the case where such defenses are personal to the debtor or arise by operation of law. Rhode Island Hospital Trust National

Bank v. Ohio Casualty, 789 F. 2d at 78-79. The defenses asserted here by the surety fall into both categories.

Generally, the protections encompassed in the bankruptcy laws are for the benefit of those who avail themselves of the bankruptcy court's jurisdiction by filing petitions for relief. The debtor's bankruptcy protections do not apply to the property interests of parties other than the bankruptcy debtor. See, In re Lockard, 884 F. 2d 1171 (9th Cir. 1989); U.S. v. Huckabee Auto Co., 783 F. 2d 1546 (11th Cir. 1986); Browning Seed, Inc. v. Bayles, 812 F. 2d 999 (5th Cir. 1987). Debtor relief under bankruptcy is personal to the debtor. This is true even when the nondebtor is a surety which will be given a claim for indemnification against the estate. In re Northeast Glass, Inc., 112 B.R. 475, 477 (Bankr. D. Mass. 1990). Consequently, the surety's obligation to pay upon the debtor's default is unaffected by the debtor's filing a petition in bankruptcy. In re Woerner, 19 B.R. 708, 711 (Bankr. D. Kan. 1982) (citing 11 U.S.C. §524(e) which provides: "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.")

Moreover, inasmuch as the tolling of postpetition interest and penalties on unsecured prepetition tax claims is peculiarly a creature of bankruptcy law, it may be said to arise by operation of law.

Therefore, it may be concluded that the bankruptcy defenses available to the debtor for purposes of this proceeding are not available to its surety.

The plaintiff Travelers contends that a conclusion such as has been made here contravenes bankruptcy law in that the debtor ultimately will be liable for the amount paid to the state on the bond because of an indemnity agreement with the plaintiff. However, §509(a) of the Bankruptcy Code contemplates that a codebtor surety may be subrogated to the rights of a creditor to the extent of any payment made by the surety to the creditor. In re Northeast Glass, Inc., 112 B.R. at 477. Therefore, the debtor's liability pursuant to an indemnification agreement cannot be said to automatically contravene bankruptcy law. It should be noted that the subrogated status afforded a surety under §509(a) does not mandate a priority status even where the creditor to which payment is made is entitled to such. 11 U.S.C. §507(d); In re Tentex Marine, Inc., 83 B.R. 530, 536 (Bankr. W.D. Tenn. 1988); In re Woerner, 19 B.R. at 711-712. In the instant proceeding, the parties

have agreed, notwithstanding §507(d), that Travelers will be paid \$175,003.13 or the amount of the Department's claim against the estate as a priority claim in the debtor's confirmed Chapter 11 plan. In addition, the debtor has executed a document postpetition styled "Affirmation of Liability for Taxes Due the State of Tennessee and Consent for Surety to Pay Claim" wherein the debtor acknowledged its liability to the Department for its prepetition claim and agreed to Travelers' payment of that amount. Ex. E to Amended Complaint. Subsequently, Travelers filed an amended proof of claim for priority and unsecured claims in the amount of \$226,555.00. The debtor has objected to this proof of claim by an objection to Travelers' motion for summary judgment in this proceeding.

As discussed above, the Bankruptcy Code provides for the subrogation of a surety's claim for payments made on behalf of a debtor to the claim of the paid creditor. However, the Code also mandates that the provisions of a confirmed plan are binding upon the debtor and "any creditor." 11 U.S.C. §1141(a). Consequently, it may be concluded that the provisions of the confirmed plan are binding on Travelers. Thus, absent a postconfirmation modification of the plan, Travelers must abide by its terms. See, e.g., In re White Farm Equipment, 38 B.R. 718 (D.C. Ohio 1984); Paul v. Monts, 906 F. 2d 1468 (10th Cir. 1990).

From the above findings and conclusions, **IT IS HEREBY ORDERED** that the Motion for Summary Judgment filed by Travelers Indemnity Company is denied and the Tennessee Department of Revenue is entitled to retain the full penal amount of the bond.<sup>2</sup> Judgment will be entered for the Defendants. Any further objections to the amount of Travelers' or the Department's claims against the debtor will be heard upon the filing of written objections to those claims.

**SO ORDERED** this 17<sup>th</sup> day of June, 1991.

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<sup>2</sup> Although the Tennessee Department of Revenue did not move for summary judgment, where, as in this proceeding, there are no disputed issues of material facts, the issues of law may be decided summarily. Here, there is nothing left to try as to the amount owed by Travelers to the Department. See generally Street v. J.C. Bradford & Co., 886 F. 2d 1472, 1477 (6th Cir. 1989) ("[T]he test for deciding a motion for summary judgment is the same as that for a directed verdict motion.")

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WILLIAM HOUSTON BROWN  
UNITED STATES BANKRUPTCY JUDGE

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