UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF TENNESSEE

IN RE:

WASHINGTON MANUFACTURING COMPANY; WASHINGTON INDUSTRIES, INC., and KSA, INC.,	Case Nos.	388-01467-WHB 388-01468 388-01469
Debtors.		Chapter 11 Jointly Administered Judge William Houston Brown

RONALD R. PETERSON, Trustee in bankruptcy for Debtors as successor to Timothy F. Finley,

Plaintiff,

v. Adversary Proceeding No. 3:89-0392

HAMBLETON HILL INDUSTRIES, INC.; WILLIAM R. MOORE DEVELOPMENT, INC.; E & W BUILDING VENTURE; FRANCIS J. CIANCIOLA, JR., AND GEORGE M. KLEPPER, III, TRUSTEES FOR SOVRAN BANK/MEMPHIS; and JOHN W. STAPP, IV, TRUSTEE FOR BM ENTERPRISES, LTD. and CARNATION PROPERTIES CORPORATION,

Defendants.

MEMORANDUM OPINION ON TRUSTEE'S MOTION
FOR ENTRY OF FINAL JUDGMENT

The Chapter 11 Trustee for the joint debtors ("debtor") has moved for the entry of a final judgment pursuant to Federal Rule of Bankruptcy Procedure 9021. The Trustee's motion comes after an unpublished decision by the United States Court of Appeals for the Sixth Circuit that reversed this Court's January 18, 1991, decision and remanded the proceeding to this Court. Ronald

R. Peterson, Trustee v. Hambleton Hill Industries, Inc., et al., No. 91-6183, slip opinion (6th Cir. September 8, 1992) (per curiam). No further appeals are pending and entry of a final judgment appears to be appropriate.

The Court conducted a telephonic hearing on the Trustee's motion, with counsel for the parties participating. No further proof was offered, and the issues were presented to the Court upon the motion, response, memoranda, trial record, and argument of counsel. The following issues are presented:

1. The amount of the judgment to be entered in favor of the Trustee;
2. The defendants against whom monetary judgment shall be entered;
3. The Trustee's entitlement to prejudgment interest;
4. The Trustee's entitlement to an equitable lien against the William R. Moore building that takes priority over any interests held by the Trustees for the Sovran Bank; and
5. The "insider" defendants' entitlement in this adversary proceeding to a credit for any alleged fault of James McElroy, under those defendants' "comparative" fault theory.

These issues are a part of this core proceeding in which this Court has entered a prior decision and the District Court and Court of Appeals have entered decisions remanding this proceeding to this Court. No one has asserted lack of authority for this Court to enter a final judgment.

DISCUSSION

MONETARY DAMAGES AGAINST INSIDER DEFENDANTS

The Trustee seeks a judgment for monetary damages of $945,559.36, plus prejudgment interest from October 16, 1987, against the "insider" defendants Hambleton Hill Industries, Inc.

("HHI") and E & W Building Venture ("E & W"). This is the amount that the Trustee claims to have been lost by the debtor as a result of E & W's purchase from Washington Manufacturing Company and E & W's turnaround sale of the Ely & Walker Building in Memphis, Tennessee. This building was sold by E & W to Mr. Pitts, a third party. See Court's January 18, 1991, findings of fact number 59. The Trustee also seeks a lien against the William R. Moore Building in Memphis, Tennessee to the extent profits were used by the insider defendants to purchase the Moore Building.

The Court has been referred to the August 9 & 10, 1990, trial record, including exhibits, for the determination of the amount of damages.[1] As the Trustee pointed out in his memorandum, the larger component of damages is calculable from the closing statements for the sales to the insider defendants and to the Pitts purchaser. The total net proceeds paid by the Pitts purchaser was $4,941,588.16. See Defendants' Ex. 42. Assuming the Pitts purchaser had purchased directly from the debtor, the debtor would have incurred cost of a title insurance policy, $5,930.00. See Defendants' Ex. 21. Thus, the debtor would have received a net of $4,935,658.16 had the debtor sold directly to Pitts. The debtor actually received $4,135,932.12 from E & W. Defendants' Ex. 21. The difference of $799,726.04 is the loss suffered by the debtor or the amount the debtor should have benefitted from the Pitts purchase.

Further the Trustee seeks rental payments of $145,833.32 that the Trustee says should have been paid by the E & W Building's lessee to the debtor rather than to the insider defendants for the July, August and September, 1987 lease periods. Defendants' Ex. 12; Hill testimony at p. 398.

The insider defendants in their memorandum argue that some of this Court's findings and conclusions are undisturbed by the Court of Appeals decision and that the debtor's estate has not

[1] It should be noted that the Trustee does not seek actual recovery of the Ely & Walker Building.

suffered any loss. These defendants rely upon this Court's examination of the two transactions involving the Ely & Walker Building and the Moore Building as a total transaction. See Court's findings of fact 57, 58 and 65. As to the lost rents, the insider defendants argue that the Trustee fails to consider the cost of operation of the E & W Building and the savings to the debtor from ridding itself of this building's ownership.

It is correct that this Court originally analyzed the E & W Building and Moore Building transactions from a totality effect standpoint. However, that perspective has been altered by the Court of Appeals decision that held the E & W transaction to be unfair and invalid under Tenn. Code Ann. §48-1-808(b) and (c) and §48-1-816(a)(1) and (3). This Court must now look at the economic effect on the debtor resulting from the invalid sale to the insider defendants, and it appears clear that the debtor lost the benefit of the increased sales price paid by the Pitts purchaser. Thus, the amount of monetary loss of $799,726.04 should be awarded to the Trustee against the two insider defendants HHI and E & W. As to the Trustee's claim for lost rents, this Court concludes, from all of the facts and circumstances, that the Trustee is not entitled to this monetary damage. In order to award damages for lost rents, the insider defendants would be entitled to a credit for their cost of operation of the E & W Building, and the Trustee's demand fails to take into account the debtor's savings from shifting ownership and operation costs to E & W. The monetary damages against the insider defendants, before prejudgment interest, should be limited to the lost sale profits, which takes into account the net amount the debtor should have received had a direct sale occurred from the debtor to the ultimate Pitts purchaser.

The insider defendants raise an interesting but meritless argument that the Tennessee Supreme Court's recent decision in McIntyre v. Balentine, 833 S.W. 2d 52 (Tenn. 1992) dictates that

"comparative fault" has been adopted in Tennessee, and that these defendants are entitled to benefit from the fault of James McElroy, an attorney who testified at trial but was not a party to this litigation. In essence, the insider defendants claim that they should only pay their "share" of the Trustee's damages. See insider defendants' memorandum, pp. 3-5. The Court is intrigued but not persuaded by this argument. McIntyre v. Balentine was a negligence case and this is not. Fault was not an issue in this proceeding. If the insider defendants have or had a cause of action against Mr. McElroy, they have or had other forums within which to bring those actions. This Court will not apply McIntyre v. Balentine to a cause of action under Tenn. Code Ann. §48-1-816(a).

As to the Trustee's demand for prejudgment interest, the decision of the Court of Appeals and the total facts and circumstances seem to demand that this Court award prejudgment interest. The Court of Appeals stated that the insiders acted with "less than good faith" in failing to disclose the higher Pitts offer to the debtor's disinterested directors. Further, that Court stated that the sale to the insider defendants was not fair to the debtor corporation and that the debtor did not receive adequate consideration. The awarding of prejudgment interest is discretionary but there are compelling reasons for such an award here. The insider defendants have had the use of the money that should have gone to the debtor. See, e.g., In re Chattanooga Wholesale Antiques, Inc., 930 F. 2d 458 (6th Cir. 1991). The Court will award prejudgment interest on the $799,726.04 monetary damages from October 16, 1987, at the Tennessee maximum statutory rate of ten percent (10%). Tenn. Code Ann. §47-14-123.

LIEN AGAINST MOORE BUILDING

The Trustee points out that the insider defendants used $535,000.00 of the proceeds from the E & W Building sale to pass through HHI's wholly-owned subsidiary, William R. Moore Development, Inc., to purchase the Moore Building in Memphis, Tennessee. Plaintiff's Ex. 21 and Transcript pp. 346, 349, 396-7. The Trustee seeks an equitable lien against the Moore Building in the amount of $535,000.00 and this relief is appropriate;[2] however, there is a difficult problem of priority of this lien.

On November 14, 1989, the Trustee recorded in the office of the Shelby County Register of Deeds a certified Abstract and Notice of Lis Pendens on the Moore Building. Plaintiff's Ex. 15. The deed of trust on the Moore Building securing Sovran Bank/Memphis ("Sovran") was recorded in that same office on November 17, 1989. Plaintiff's Ex. 16. As to the defendant John W. Stapp, IV, Trustee for BM Enterprises, Ltd. and Carnation Properties Corporation, a default was entered by the Clerk of this Court on August 9, 1990. Thus, as to this defendant the Trustee's equitable lien takes priority. However, the Trustee for Sovran disputes that the Trustee's lien takes priority over Sovran's lien and memoranda have been submitted on this issue.

The crux of the dispute is whether the Trustee's Abstract and Notice of Lis Pendens contained sufficient notice of the Trustee's complaint that was amended after the recording of the lis pendens to add the state law cause of action for an avoidable self-interested transaction. This appears to be an issue of first impression under Tennessee law. The Court has found no reported cases in Tennessee that determine how much information regarding the theory of a complaint must be included in the notice of lis pendens to fulfill statutory requirements. Briefly, the essential facts necessary to this inquiry are that the Trustee sued the insider defendants in an original complaint that

[2] See, e.g., In re Bell & Beckwith, 70 B.R. 725 (Bankr. N.D Ohio 1987).

alleged that the sale to E & W was a voidable fraudulent conveyance. This complaint prayed for a setting aside of the conveyance of the Moore Building and for a lien against the Moore Building to the extent that the proceeds of the E & W sale were used to purchase the Moore Building. The Trustee's recorded lis pendens notice stated:

> Plaintiff [Trustee] in this action seeks to set aside as a fraudulent conveyance the transfer of certain real estate from Washington Manufacturing Company to William R. Moore Development, Inc. The real estate in dispute is known as the William R. Moore Building [location described]. Plaintiff also seeks to impose a lien against the William R. Moore Building in excess of $900,000.00 to secure plaintiff's recovery of the proceeds of an earlier fraudulent conveyance that plaintiff alleges were used to acquire the William R. Moore Building.

The notice of lis pendens did not contain any reference to a self-interested transaction under Tenn. Code Ann. §48-1-816. On November 17, 1989, the deed of trust on the Moore Building to Sovran was recorded. On May 24, 1990, the Trustee filed an amended complaint repeating the fraudulent conveyance allegation but adding a state law self-interested transaction count. The District Court and Circuit Court opinions held that the sale of the E & W Building was void as a self-interested transaction rather than as a fraudulent conveyance. Sovran, therefore, asserts that the Trustee's amended cause of action, upon which the Trustee prevailed, can not relate back, for priority purposes, to the recording of the notice of lis pendens, which made reference only to fraudulent conveyances.

Tenn. Code Ann. §20-3-101 provides, in pertinent part:

> When any person, in any court of record, by declaration, petition, bill or cross bill, shall seek to fix a lien lis pendens on real estate, or any interest therein, situated in the county of suit, in furtherance of the setting aside of a fraudulent conveyance, of subjection of property under return of nulla bona, tracing a trust fund, enforcing an equitable vendor's lien, or otherwise, he shall file for record in the register's

> office of the county an abstract, certified by the clerk, containing the names of the parties to such suit, a description of the real estate affected, its ownership, and a brief statement of the nature and amount of the lien sought to be fixed.

Tenn. Code Ann. §20-3-101(a) (emphasis added).

Unfortunately, there is no Tennessee case law that interprets what the "brief statement of the nature" of the lien must include. Nor is there legislative history that explains what the Tennessee Legislature meant by this phrase.

The Trustee cites only one case in favor of its interpretation of the statute, Pedro v. Kipp, 735 P. 2d 651 (Or. Ct. App. 1987). The Trustee's reliance on this case is misleading. Although the case does stand for the proposition of relation back of the lien lis pendens to the date of the first complaint or amendment stating the cause of action, the property involved, and the parties, the only basis ever asserted for the lien in either the original or amended complaints was the fraudulent conveyance of the property. Id. at 652-54. The Pedro case, therefore, does not answer the issue raised by Sovran, that is, the necessary amount of specificity of the theory of the lien required in the notice of lis pendens.

Sovran concedes that "an amendment to a complaint after the recording of a lien lis pendens, which does not alter the basic cause of action, will relate back to the original recording." Defendants' Response at 6. It also asserts, however, that the introduction of the self-interested transaction allegation is a separate cause of action, and any lien that is created by the Trustee prevailing on that cause of action only relates back to the first time that cause of action is asserted, in this case the filing of the amended complaint after the recordation of Sovran's deed of trust. Sovran cites as authority 54 C.J.S. §22, Board of Transportation v. Royster, 251 S.E. 2d 921 (N.C. Ct. App. 1979); 5303 Realty Corp. v. O & Y Equity Corp., 476 N.E. 2d 276 (N.Y. 1984); and Hulen v.

Chilcoat, 113 N.W. 122 (Neb. 1907). The C.J.S. citation directly supports Sovran's proposition that a new cause of action does not allow the lien to relate back to the original notice of lis pendens. The Royster case, however, does not add support to Sovran's argument. Regarding lis pendens, Royster stands for the proposition that:

> It is clear that under Article 9, Chapter 136, General Statutes of North Carolina, a single condemnation proceeding may include more than one tract of land, and that the proceeding may be amended to include additional land provided that the additional land is described in the complaint and declaration of taking and in the land records of the county through a memorandum of action as required by G.S. 136-104 . . . .

Royster, 251 S.E. 2d at 294.

Therefore, the Royster case deals with the question of the property to which the lis pendens applies, not the theory of the asserted lien.

Similarly, the 5303 Realty Corp. case does not deal with the cause of action asserted, but with the underlying property. In that case, the plaintiff contracted with the defendant to purchase the stock of the corporation that was created for the sole purpose of holding title to the specific real property. 476 N.E. 2d at 278. The defendant allegedly breached the contract and the plaintiff sued for specific performance of the sale of the stock. Id. In addition, the plaintiff filed a "notice of lis pendency" (New York's statutory enactment of common law lis pendens) against the real property held by the corporate entity. Id. The New York Court of Appeals vacated the notice of pendency because the underlying cause of action was not a question of the ownership of the property, but of the ownership of the stock. Id. at 282. Clearly, this case does not support Sovran's position regarding relation back of new causes of action for lien.

The Hulen case was not available to this Court for analysis.

Sovran also asserts that to allow the Trustee's lien lis pendens to relate back to the date of the original recordation would constitute an unconstitutional taking of property if due process requirements are not met. Sovran relies on Trus Joist Corp. v. Treetop Assoc., Inc., 477 A. 2d 817 (N.J. 1984). In that case, the Court defined three requirements to allow relation back of new matters to the originally filed lis pendens: (1) the parties must be the same (2) the affected property must be the same, and (3) the "general purpose and subject of the suit" must be the same. Id. at 822. That Court held that the first requirement was not met because the bankruptcy trustee of Treetop who actually prevailed on the fraudulent conveyance issue was representing parties other than Trus Joist. Id. The Court also stated that the trustee was representing claims of those parties against Treetop other than the claim of Trus Joist. Id. Because the first and third requirements listed above were not met, the trustee's claim on the property could not relate back to the date the lis pendens was filed by Trus Joist. Id. It is clear from the context of the case that the third requirement failed because new monetary claims of creditors of Treetop were being represented by the trustee. The underlying theory of the case, however, remained fraudulent conveyance. Therefore, it seems that the Trus Joist case does not lend convincing support to Sovran in the instant case, which argues that this Trustee would fail the third requirement for relation back of new matters to the original filing of the lis pendens.

Although not argued by Sovran, a recent case decided by the United States Supreme Court calls into question the constitutionality of statutes similar to the Tennessee statute authorizing the filing of lis pendens. In Connecticut v. Doehr, 111 S. Ct. 2105 (1991), the Court ruled that a state statute allowing prejudgment attachment of real estate without prior notice or hearing and without requiring a showing of exigent circumstances failed to satisfy due process requirements. Id. at 2116.

The facts are relatively simple. A man named DiGiovanni brought suit against Doehr for assault and battery. At the same time, pursuant to Connecticut law, DiGiovanni applied to the Connecticut Superior Court for an attachment in the amount of $75,000.00 on Doehr's home. Id. at 2109. The statute allowing prejudgment attachment of real property only required "verification by oath of the plaintiff or of some competent affiant, that there is probable cause to sustain the validity of the plaintiff's claims." Id. Upon DiGiovanni's filing of such an affidavit, the state court ordered the sheriff to attach Doehr's home to the amount of $75,000.00. Id. Although the statute allowed a post-attachment hearing to allow the property owner to answer the attachment, Doehr instead brought suit in the United States District Court against DiGiovanni alleging that the Connecticut statute was unconstitutional under the Due Process Clause of the Fourteenth Amendment. Id. at 2110. The District Court upheld the statute. The Second Circuit Court of Appeals reversed the District Court and held the statute unconstitutional. The Supreme Court unanimously affirmed the Court of Appeals. Id.

The Court examined three factors in reaching its decision: (1) consideration of the private interest that will be affected by the prejudgment measure; (2) an examination of the risk of erroneous deprivation through the procedures under attack, and the probable value of additional or alternative safeguards; and (3) principal attention to the interest of the party seeking the prejudgment remedy. Id. at 2111-2113. The Court found that the interests affected are significant for a property owner like Doehr. The effects of attachment include clouds on title, inability to sell property, inability to secure a loan on the property, and other similar problems. Id. at 2113. Even though these effects are not "a complete, physical, or permanent deprivation of real property" they are still sufficient to warrant due process protection. Id.

Turning to the second factor of the inquiry, the Court held that there is too high a risk of erroneous deprivation allowed by the state statute. The Court stated:

> [p]ermitting a court to authorize attachment merely because the plaintiff believes the defendant is liable, or because the plaintiff can make out a facially valid complaint, would permit the deprivation of the defendant's property when the claim would fail to convince a jury, when it rested on factual allegations that were sufficient to state a cause of action but which the defendant would dispute, or in the case of a mere good-faith standard, even when the complaint failed to state a claim upon which relief could be granted.

Id. at 2114.

Turning to the third factor, the Court stated that DiGiovanni's interests in favor of the attachment were too minimal to allow the burdening of Doehr's property rights without a hearing to determine the likelihood of recovery. Id. at 2115. DiGiovanni's only interest was to ensure the availability of assets to satisfy his judgment if he prevailed on the merits of his action. Id. No exigent circumstances existed because there were no allegations that Doehr was about to transfer or encumber his real estate. Id. Given the burden created on the rights of the property owner by the prejudgment attachment, the real possibility of erroneous deprivation of those rights, and the minimal interests of the party favoring the attachment, the Court held the Connecticut statute unconstitutional.

An analogy of the Tennessee statute authorizing lis pendens to the Connecticut real property attachment statute is suggested. Although technically the lis pendens statute is designed only to give notice of the pendency of litigation affecting the underlying property, it is undeniable that the same effects on the property owner will be likely to occur. The Tennessee lis pendens statute does not even have the safeguards that were built into the Connecticut statute. In the Connecticut statute, the burden on the property owner's rights could only be created after an examination of the verified

complaint, albeit minimal, by a judge. After the attachment was made, the property owner had the opportunity to have a post-attachment hearing. Under the Tennessee lis pendens statute, there is no judicial review prior to the hearing on the merits of the complaint. These statutory burdens are created merely upon the presentation of a document naming the parties, the property, and the nature of the alleged lien to the clerk maintaining the county real property records. There is no opportunity for a post-filing hearing. The interests of the parties asserting the prejudgment attachment or the lien lis pendens are also similar.

This Court is not required to rule upon the constitutionality of the Tennessee statute. It would not be appropriate to do so as the state of Tennessee is not a party and has no notice of this proceeding. However, the federal constitutional issues raised by Connecticut v. Doehr, combined with the due process allegations of Sovran, cause this Court concern about the sufficiency of notice to Sovran by the Trustee's lis pendens.

It is implicit in the Tennessee statute that a basis for the asserted lien right exists. In re Airport-81 Nursing Care, Inc., 32 B.R. 960, 964 (Bankr. E.D. Tenn. 1983). In that case, Judge Clive W. Bare stated that the Tennessee statute alone "does not create a lien lis pendens. There must be some other authority, equitable or otherwise, providing the basis for a lien right." Id. In other words, the underlying cause of action here must provide a basis for the lien. At the time of recording the lis pendens, the underlying complaint alleged only fraudulent conveyance. The Trustee's only support is found in a broad interpretation of rather vague statutory language. The Trustee attempts to tie the statute's "brief statement of the nature" of the lien to liberal notice pleading rules. But different interests are addressed by those two theories. A lis pendens should put the world on notice of a pending suit and the nature of the lien sought to be fixed. Pleadings are intended to put the

parties to the pleadings on notice of the causes of action alleged against them. Sovran had no notice of the Trustee's self-interested transaction cause of action until it received the Trustee's amended complaint, which of course was filed after Sovran had recorded its deed of trust. The lis pendens notice was specific in its reference to only fraudulent conveyance causes of action.

It certainly may be argued whether it was prudent for Sovran to rely upon a deed of trust recorded after the Trustee's lis pendens notice. However, Sovran was entitled to rely upon the lis pendens being restricted to the scope defined by that notice. Had the Trustee prevailed on a fraudulent conveyance theory the Trustee's ultimate judgment lien would take priority over Sovran's lien, assuming the constitutionality of Tennessee's lis pendens statute. However, based upon the Trustee's recorded notice, the lis pendens is limited to the "nature . . . of the lien sought to be fixed." Tenn. Code Ann. §20-3-101(a). The Trustee's notice described the asserted lien as one arising from a fraudulent conveyance. Recovery of a lien under any other theory would not place Sovran on notice of the possibility of such a lien.

CONCLUSION

The Court concludes that the recorded notice of lis pendens failed to provide sufficient notice to Sovran of the Trustee's self-interested transaction cause of action and that the Trustee's amended complaint does not cure that insufficiency. As a result, the Trustee's equitable lien is subordinate to Sovran's recorded mortgage lien. See Tenn. Code Ann. §20-3-101.

A judgment will be entered by the Clerk in favor of the Trustee and against Hambleton Hill Industries, Inc. and E & W Building Venture for $799,726.04 plus prejudgment interest from October 16, 1987, at the Tennessee maximum statutory rate of ten percent (10%).

The Trustee is granted an equitable lien against the William R. Moore Building; however, that lien is subordinate only to the recorded mortgage held by Sovran Bank/Memphis.

A separate order and judgment will be entered.

_____

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE
SITTING BY DESIGNATION

ch 22, 1993

cc:

Mr. D. Alexander Fardon
Attorney for the Trustee
Harwell, Martin & Stegall
1800 First American Center
Nashville, Tennessee 37238

Mr. Randall Mashburn
Ms. Tracey Coleman
Attorney for Trustees for
Sovran Bank/Memphis
Heiskell, Donelson, Bearman,
Adams, Williams & Kirsch
511 Union Street, Suite 600
Nashville, Tennessee 37219

Mr. William T. Ramsey
Attorney for Hambleton Hills
Industries, William R. Moore
Development, Inc. and E & W
Building Venture
2000 Dominion Tower
150 Fourth Avenue, North
Nashville, Tennessee 37219

(Published)