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OCT 21 2004

UNITED STATES
BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

1 UNITED STATES BANKRUPTCY COURT
2 IN AND FOR THE DISTRICT OF ARIZONA

3
4 **In re**)
5 **INTERNATIONAL SURFACING,**)
6 **INC.,**)
7 **Debtor.**)

Case No. 96-05142 PHX-CGC
Chapter 11

**UNDER ADVISEMENT DECISION
RE: MOTION TO APPROVE
SETTLEMENT AGREEMENT**

8 **I. Introduction**

9 Before the Court for approval is the proposed settlement agreement among the bankruptcy
10 estates of International Surfacing, Inc. ("ISI") and JWJ Contracting Company, Inc. ("JWJ") and
11 the secured creditor of ISI, Finova Capital Corporation ("Finova") (hereinafter also referred to
12 collectively as "movants"). Objecting to the settlement agreement, as it affects the ownership of
13 a piece of real estate referred to as the 8.5 Acre Parcel, is the Carl C. Jacobson, Sr. Irrevocable
14 Life Insurance Trust ("Trust"). To understand the conflict, and more particularly the Trust's
15 interest in the settlement, a brief history is required.

16 **II. Background**

17 Prior to any of these bankruptcies being filed, but apparently within the preference period
18 of the JWJ bankruptcy, JWJ transferred the subject 8.5 Acre Parcel to a related entity, which then
19 transferred the property to the Trust in May, 1994. Carl Jacobson was the Trust's sole Trustee.
20 On July 1, 1994, JWJ filed bankruptcy and, approximately two years later, the Chapter 7 Trustee,
21 Joseph J. Janas ("Janas"), commenced an adversary proceeding in the JWJ bankruptcy against the
22 Trust and various others seeking to avoid, *inter alia*, the transfer of the 8.5 Acre Parcel to the
23 Trust (hereinafter referred to as the "JWJ/Trust Adversary").

24 By the time the JWJ/Trust Adversary was filed, title to the 8.5 Acre Parcel had been
25 transferred again as a result of an amendment to the 1993 Loan Agreement between Finova and
26 ISI ("Finova/ISI Loan" and/or "Loan Agreement").¹ Under the Loan Agreement, Finova was
27 secured by essentially all of ISI's property, and Carl and Marilyn Jacobson ("the Jacobsons")
28

¹Finova was not a creditor of JWJ at any time.

1 personally guaranteed the debt. As a condition of the second amendment to the Loan Agreement,
2 however, Finova required the Jacobsons to pledge additional collateral to secure the Finova/ISI
3 Loan. As such, Carl Jacobson, as sole trustee of the Trust, transferred the 8.5 Acre Parcel of
4 land out of the Trust and to himself and his wife by warranty deed, apparently under the express
5 condition that the property revert back to the Trust when Finova's underlying lien was released.²
6 The Jacobsons then executed a deed of trust in favor of Finova, pledging the 8.5 Acre Parcel as
7 additional collateral to Finova.

8 ISI itself filed for bankruptcy in 1996. The 8.5 Acre Parcel was not part of the ISI
9 bankruptcy estate, as it was not part of any collateral pledged by ISI but subject only to the
10 personal guaranty of the Jacobsons. Subsequently, ISI filed a motion before this Court to sell
11 certain assets free and clear of liens in order to pay its debt to Finova. On February 19, 1997, the
12 Court granted the motion, and the stay relief order provided for an immediate release of Finova's
13 liens against the property of ISI and all other property provided to Finova as additional security:

14 Effective immediately upon (1) the transfer of the Sale Proceeds to Finova pursuant
15 to the terms of this Order in the amount of Finova's claim and (b) this Order
16 becoming final and non-appealable, but not before, Finova's security interest in the
17 remaining Collateral . . . shall be extinguished. Thereafter, Finova shall execute
18 and deliver to Debtor any and all documents submitted to it for execution which
19 are reasonably necessary so as to effectuate the release of its security interest in the
20 Collateral (*and in certain real property not owned by Debtor which was provided
21 to Finova as additional security under the Loan Agreement*).

22 (Emphasis added). Finova was then paid the full amount of its agreed upon claim of
23 \$2,314,746.60 upon the sale of the property, but it never released its lien on the 8.5 Acre Parcel.
24 To this there is no dispute, and Finova has no explanation for why it never released the lien.

25 Switching back to the JWJ bankruptcy, after Finova was paid in full under the settlement
26 agreement in the ISI bankruptcy, Trustee Janas instituted another adversary in the JWJ bankruptcy
27 -- this time against Finova to recover the above transfers from Finova pursuant to 11 U.S.C.
28 section 550. This in turn led to Finova filing in the ISI bankruptcy case a motion to confirm its
secured status, arguing that because of the claims against it by Trustee Janas in the JWJ

²The beneficiaries under the Trust are apparently Carl and Marilyn Jacobson's grandchildren. Despite the promise to return the property to the Trust, that has yet to happen.

1 bankruptcy, and notwithstanding the language of the stay relief order, it remained “secured by
2 Debtor’s assets pursuant to the terms of a pre-petition Loan and Security Agreement between
3 FINOVA and Debtor” – referred to by the parties as the clawback provision:

4 To the extent the Borrower makes a payment or Lender receives any payment or
5 proceeds of the Collateral for Borrower’s benefit which is subsequently
6 invalidated, declared to be fraudulent or preferential, set aside or required to be
7 repaid to a trustee, debtor in possession, receiver or any other party under any
8 bankruptcy law, common law, or equitable cause, then, to such extent, the
9 obligations or part thereof intended to be satisfied shall be revived and continue as
10 if such payment or proceeds had not been received by Lender.

11 Significantly, this provision is contained only in the loan agreement and not in the deed of trust.
12 Nevertheless, Finova sought by this motion to revive not only JWJ’s personal liability but also
13 its lien in certain assets that were and should have been released under the earlier stay relief order.
14 A review of Finova’s motion, however, confirms that no mention was made as to whether Finova
15 should or did retain its lien in the 8.5 Acre Parcel: The motion discussed only whether Finova
16 should or did retain its lien against “assets of the ISI estate.”³

17 Ultimately, Finova, ISI and Continental Insurance Company⁴ reached a settlement
18 agreement with respect to the motion to confirm secured status (hereinafter referred to as the
19 “Finova/ISI Settlement Agreement”). Under the Finova/ISI Settlement Agreement, Finova would
20 have a contingent claim against the ISI estate for any monies paid by it to the JWJ Trustee with
21 respect to the section 550 action, secured by a security interest in the \$120,000 of the remaining
22 sales proceeds subject to various conditions set forth in the settlement, including the condition that
23 Finova “take all reasonably necessary action to pursue all reasonably available guarantees and
24 collateral.”

25 ³Similarly, no mention was made of the “clawback” provision in the Continuing Guaranty
26 between Finova and the Jacobsons, upon which movants rely here to justify continuing Finova’s
27 secured status against the Jacobsons and the proceeds from the sale of the 8.5 Acre Parcel. There
28 is no clawback in the deed of trust encumbering the 8.5 Acre Parcel.

⁴Pursuant to an earlier settlement agreement and Bankruptcy Court Order, Continental was found
to have a secured interest in the \$120,000 of Undisbursed Sale Proceeds and thirty-five percent of
any monies received by the ISI estate in relation to ISI’s accounts receivable and/or contract rights.

1 There was no mention anywhere in the Finova/ISI Settlement Agreement of any security
2 interest in the 8.5 Acre Parcel. In fact, the settlement agreement expressly stated that “[n]othing
3 in this Agreement shall in any manner alter, amend, modify or otherwise affect Finova’s claims
4 and rights against any guarantor. . . . [and] [e]xcept as modified by this Agreement, all other
5 terms and conditions of the Disbursement Order and the Continental Settlement Agreement shall
6 remain in full force and effect,” essentially leaving intact the stay relief order’s mandate that
7 Finova release its lien in the 8.5 Acre Parcel. The Order itself further reiterated that the
8 Finova/ISI Settlement in no way impaired the JWJ Trustee’s section 550 argument that Finova
9 previously accepted full payment of its claim and liens under a prior settlement with the ISI
10 Trustee, stating

11 Neither this order nor the settlement agreement attached to this Motion (the
12 “Settlement Agreement”) shall be construed to limit, prejudice, or impair the JWJ
13 Trustee’s argument, if any, that pursuant to the Stipulated Order described in
14 paragraph E of the [Finova] Settlement Agreement, Finova accepted a sum certain
15 in full satisfaction of (a) claims against its borrower and guarantors, and (b) liens
16 granted by its borrower, guarantors or their affiliated entities. Such liens may
17 include but are not necessarily limited to a lien against a parcel of approximately
18 8.5 acres in which the JWJ Trustee claims an interest.

19 By 1999 in the JWJ/Trust Adversary, the Trust and Trustee Janas had reached a settlement
20 in the JWJ/Trust Adversary pursuant to which the Trust paid Janas \$375,000 to settle the claims
21 against it. In return, Janas agreed that he and the JWJ estate would discharge and release the
22 Trust from any and all claims, known or unknown, regarding the various transfers. Janas further
23 agreed not to pursue any further money or property, including the 8.5 Acre Parcel from the Trust.
24 This settlement was approved by the Court on July 21, 1999.

25 The true impact of these various settlements and orders did not come to a head until
26 judgment was rendered in favor of the JWJ Trustee in the section 550 action against Finova for
27 over \$1 million. This then led Finova to claim that the non-debtor guarantors, the Jacobsons,
28 remained obligated under the clawback provision in the guarantee to repay Finova in light of the
judgment in the section 550 adversary and that such obligation remained secured by the lien on
the proceeds from the sale of the 8.5 Acre Parcel. This claim is made despite the requirement of
the stay order that the lien be released and the lack of a clawback provision in the 8.5 Acre parcel

1 deed of trust.⁵ Disputes also exist between Finova and the JWJ and ISI bankruptcy estates
2 regarding whether Finova is secured against the ISI bankruptcy estate following the Stay Relief
3 Order, whether Finova has any right to receive payment from the ISI bankruptcy estate pursuant
4 to the Finova Settlement, whether the JWJ Trustee has any further obligation to remit payments
5 to the ISI estate or Finova under the ISI/JWJ Settlement. The settlement proposal at issue here
6 allegedly resolves these various disputes, including an express amendment or clarification of this
7 Court's earlier Stay Relief Order to include the following language:

8 However, this Order shall not be construed to require Finova's release of its lien
9 against real property not owned by the Debtor or the ISI Bankruptcy Estate if (a)
10 any payments received by Finova on account of ISI's indebtedness are avoided
11 pursuant to 11 U.S.C. §§ 547 - 550, and (b) Finova repays the avoided payments
12 to any other party pursuant to applicable bankruptcy law.

13 The Trust, who is not a party to this settlement, objects to the amendment on the ground
14 that it improperly attempts to resurrect Finova's lien in the 8.5 Acre Parcel, which should have
15 been released under the terms of the Stay Relief Order.

16 **III. Analysis**

17 **A. Standing**

18 The Trust is not a party to the proposed settlement and movants summarily argue that it
19 therefore lacks standing to challenge the settlement agreement and its amendment to the earlier
20 stipulated Stay Relief Order. The Court agrees. The parties to the proposed settlement agreement
21 are the JWJ Chapter 7 Trustee Joseph Janas, the ISI Chapter 7 Trustee Alan Meda and Finova.
22 The Trust is not a party to the proposed agreement and, more importantly was not a party to the
23 prior stipulated Stay Relief Order that the parties seek to clarify or modify. While perhaps the
24 Trust could have been or should have been a party to the 1997 stipulated Stay Relief Order (since
25 the Order involved property to which it claimed ownership), the Trust has not raised that
26 argument here – nor did it object to the stipulated Stay Relief Order back in 1997 or seek to join

27 ⁵On or about September 1, 2000, with the consent of the Trust and Finova, the 8.5 Acre Parcel
28 was sold to a third party who is not a party to the case. The proceeds from the sale are being held
in a segregated escrow account by First American Title Company pending resolution of these various
issues.

1 in those proceedings.

2 Further, while the Court acknowledges that this proposed settlement may have an indirect
3 impact on the Trust (by not finding the lien released by Finova and then arguably transferred back
4 to the Trust by virtue of Jacobson's apparent promise to do so), it really is in fact one step
5 removed from the issues presented here. It is important to look at the true source of the Trust's
6 injury. What really hurt the Trust was the initial transfer of the property by Jacobson to himself
7 and the subsequent lien granted on the property to Finova. Thus, the Trust's real complaint lies
8 against Carl Jacobson as Trustee of the Trust and perhaps Finova as a result of the original
9 transfer by Carl Jacobson to himself and the resulting lien in favor of Finova. The Trust may
10 have a claim against Jacobson for breach of fiduciary duty and Finova for aiding and abetting the
11 breach or, perhaps, a fraudulent transfer claim against the pair, but the Court does not see how
12 the proposed settlement impairs those claims. They still exist and, indeed, a suit on those theories
13 is pending.

14 B. Settlement Agreement

15 Regardless of the Trust's standing, however, this Court has an obligation to review the
16 terms of the proposed settlement itself to determine the reasonableness of the settlement
17 agreement's terms and, perhaps more importantly, determine whether the terms are in fact
18 consistent with this Court's earlier Stay Relief Order as argued by the parties or whether the terms
19 of the prior Stay Relief Order should be modified.

20 Movants ISI, JWJ, and Finova make several arguments to justify this proposed settlement,
21 none of which this Court finds persuasive. First they argue that Finova was never paid in full so
22 that it did not have to release its lien. This argument is simply wrong. Finova was paid in full.
23 The Stay Relief Order provided that Finova would be considered paid in full once it received
24 payment from ISI of \$2,341,710.94. Finova admits receiving this payment. Simply because it
25 was required two years later to disgorge over a million dollars of these funds, does not mean
26 Finova was not paid in full at the time ISI made the payment or that the payment was in effect
27 never made. Clearly it was made and Finova had those funds for its own use during those years.

28 Second, movants argue that regardless of whether Finova was paid in full, the fact remains

1 that Finova never released its lien on the 8.5 Acre Parcel. Therefore, they argue, the lien still
2 exists and is now enforceable as a result of the judgment against Finova. This argument ignores
3 the fact that this Court's Stay Relief Order required Finova to release the lien on the 8.5 Acre
4 Parcel. Finova is in direct violation of a Court Order and offers absolutely no explanation for
5 why it did not do what is was required. All counsel for Finova could offer at the hearing was that
6 the matter basically fell through the cracks. Finova should not get the benefit of its wrongdoing.

7 In addition to the language of the Stay Relief Order, Finova's failure to release the lien
8 also violated Arizona Revised Statute section 33-707, which requires the release of a lien upon
9 full payment of the underlying obligation, and the language in the Deed of Trust securing the
10 Jacobsons' guaranty, which provided that the upon payment in full, the Deed of Trust would be
11 terminated and reconveyed and released "in the manner provided by law."

12 The Court also rejects the parties' argument that the earlier Stay Relief Order did not in
13 fact release Finova's claims against the non-debtor Guarantors. The language of the Order is quite
14 clear:

15 Effective immediately upon the transfer of the Sales Proceeds to Finova . . . ,
16 *Finova's security interests in the remaining Collateral . . . shall be extinguished.*
17 Thereafter, Finova shall execute and deliver to Debtor any and all documents
18 submitted to it for execution which are reasonably necessary so as to effectuate the
19 release of its security interest in the Collateral (*and in certain real property not*
20 *owned by Debtor which was provided to Finova as additional security under the*
21 *Loan Agreement).*

19 (Emphasis added). That "certain real property not owned by Debtor which was provided to
20 Finova as additional security under the loan agreement" included the 8.5 Acre Parcel. There is
21 no dispute about his. Nothing in the Stay Relief Order excluded the property and nothing in the
22 Order discussed any clawback provision that would reinstate the lien in the property

23 The Court also dismisses Trustee Janas's argument that this Court lacked authority to
24 discharge a non-debtor guarantors liability to Finova. Unlike the cases cited to support the
25 argument,⁶ this was a stipulation presented by Finova and the ISI Trustee whereby Finova on its
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27 ⁶See, i.e., *Underhill v. Royal*, 769 F.2d 1426 (9th Cir. 1985); *In re American Hardwoods, Inc.*, 885
28 F.2d 621 (9th Cir. 1989).

1 own accord agreed to release its lien on the 8.5 Acre Parcel. This Court did not force Finova to
2 release the lien against the non-debtor guarantors. Finova offered to do so. The Court simply
3 approved Finova's request. Frankly, the Court is surprised by Mr. Janas's argument on this
4 point.

5 The Court also rejects movants' argument that the parties to the stipulated Stay Relief
6 Order intended at the time to allow reinstatement of the lien on the 8.5 Acre Parcel if it were ever
7 undone at a later time. The Court finds no support of this in the record. The fact is no one
8 contemplated this scenario at the time of the stipulated Stay Relief Order, as admitted at the
9 hearing, but that alone is insufficient for this Court to conclude that the parties to the stipulated
10 Stay Relief Order made a mistake that should be remedied now with such drastic re-write of the
11 Order. To modify its earlier Order to such an extent will materially affect the rights of others and
12 the Court is unwilling to do so.

13 In the alternative, movants argue that Finova's payment of the JWJ judgment triggered not
14 only its renewed lender's claim against the ISI estate, but also the "clawback" provision of the
15 Jacobson guaranty and, as such, its right to resort to the security provided to secure the Jacobson's
16 guaranty – the proceeds from the sale of the 8.5 Acre Parcel.⁷ This Court disagrees. First, the
17 clawback provision says nothing about Finova's *lien interest* springing back once released. The
18 focus of the clawback language in the guaranty is simply to say that if the Jacobsons are released
19 from any liability under the guaranty, the liability may spring back if the repayment to Finova of
20 its loan is subsequently undone. Nothing says that the Jacobsons' guaranty will also then be
21 secured again by the 8.5 Acre Parcel once released.

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⁷For clarification, the clawback provision of the Continuing Guaranty between Finova and the
24 Jacobsons is not the same as the clawback provision in the underlying security agreement between
25 Finova and ISI as quoted on page 3, *supra*, of this decision. The clawback in the Continuing
26 Guaranty provides that "the undersigned's liability hereunder shall automatically be revived,
27 reinstated and restored and shall exist as though such voidable transfer had never been made to
28 Lender. In the event Lender shall have returned this Continuing Guaranty to the undersigned and
subsequently be required or advised by counsel to restore or repay any such voidable transfer, the
amount thereof, or any portion thereof, the undersigned shall remain liable as provided herein to the
same extent as if this Continuing Guaranty had not been returned to the undersigned."

1 Deed of Trust would spring back into effect upon exercising the clawback provision of the
2 guaranty. In fact, the Deed of Trust clearly provides that "upon Performance of all of the
3 Obligations, this Deed of Trust shall be subject to termination and reconveyance and shall be
4 released in the manner provided by law." Paragraph 5.14, entitled Reconveyance by Trustee, in
5 turn also says nothing about any clawback provision upon release of the Deed of Trust. The
6 Court's conclusion, based on these facts, is that while the Jacobsons' guaranty springs back into
7 effect, the Deed of Trust securing the guaranty does not. Finova may seek recovery from the
8 Jacobsons pursuant to the guaranty, but it is not secured by the 8.5 Acre Parcel or its proceeds.

9 **IV. Conclusion**

10 For the foregoing reasons, the Court denies the motion to approve the proposed settlement
11 agreement as drafted, without prejudice to the parties presenting a modified agreement consistent
12 with this decision.

13 So ordered.

14 DATED: Oct. 21, 2004

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16 

17 Charles G. Case II
18 UNITED STATES BANKRUPTCY JUDGE

19 ~~Copy of the~~ foregoing hand-delivered and/or mailed
20 this 21st day of October, 2004, to:

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