

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Augusta Division

IN RE:)	
)	
Matthews, Wilson & Matthews,)	Chapter 7 Case
Inc.)	Number <u>03-13298</u>
)	
Debtor.)	
_____)	
)	
Matthews, Wilson & Matthews,)	
Inc.)	
)	
Movant)	
)	
v.)	
)	
People's Community Bank)	
of South Carolina)	
)	
Respondent)	
_____)	

MEMORANDUM AND ORDER ON
OBJECTION TO CLAIM

Matthews, Wilson & Matthews, Inc. ("Debtor"), objects to the claim of People's Community Bank of South Carolina ("PCB"), a purported creditor in this Chapter 7 case. A hearing was held. The Court has jurisdiction to hear this matter under 28 U.S.C. §157(b)(2)(B). Based on the parties written submission, the record of the hearing and relevant legal authorities, I make the following

findings sustaining in part the Debtor's objection to PCB's claim.

FINDINGS OF FACT

The facts are undisputed. On or about June 23, 1999 Doge, Inc. ("Doge") purchased three (3) tracts of land ("Doge Property") from Larry Prather ("Prather"). For part of the purchase price, Doge executed and gave a note and security deed to Prather for \$285,000.00, which security deed was recorded on Reel 650, page 1029, et. seq., Clerk's office, Richmond County, Georgia ("Prather Loan"). The security deed in the Prather Loan contained an "open-end" or dragnet clause providing that the security deed would also secure any additional loans made by Prather to Doge.¹ Subsequent to the Prather Loan, Doge obtained a loan for \$200,000.00 from, and granted a security deed, second in priority, to PCB secured by the same property as the Prather Loan recorded on Book 694, Page 1216, Clerk's office Richmond County, Georgia. This loan also had a

¹Security Deed recorded at Reel 650, page 1030, Clerk's office, Richmond County, Georgia states in relevant part:

". . . together with interest thereon from maturity as prescribed in said promissory note, and also for the purpose of securing such other and further indebtedness as may now be, or from time to time hereafter shall become owing to the party of the second part [PCB] by the party of the first part [Doge], or any one or more of them, which indebtedness shall include attorney's fees as provided for in said promissory note" (emphasis added)

dragnet clause included in the text of the security deed.²

Prather later assigned his first in priority security interest to PCB on or about January 10, 2001. Also on January 10, PCB entered into a modification of the Prather Loan with Doge ("Modification"). The Modification stated that the original security deed, with the new modifications, remained in full force and effect in accordance with the terms of the original Prather loan. Doge and PCB also ratified and confirmed the terms of the original note in the Modification. As additional security in connection with the Modification, but not directly mentioned therein, the Debtor gave PCB a guaranty for all the debts owed by Doge secured by the Doge Property. To secure this guaranty the Debtor executed a security deed on its property of record in Book

²Security Deed at Book 694, Page 1217, Clerk's office, Richmond County, Georgia states in relevant part:

This instrument shall secure the indebtedness herein described, any extensions or renewals thereof in whole or in part, whether evidenced by new notes, extension agreements or otherwise, the obligation to pay attorneys fees as provided in any such note or agreement and also *any other advances which may be made by Grantee to or on behalf of Grantor and any indebtedness or liability of Grantor to Grantee of whatever kind and however the same may be created, specifically including, but not being limited to, any liability as endorser, surety, grantor, or indemnitor.* (emphasis added)

1962, page 1, Clerk's office, Rockdale County, Georgia ("Rockdale Property").

As of November 5, 2002, the date of foreclosure of the Doge Property, PCB had a first and second priority security interest in the Doge Property and a fourth priority security interest on the Rockdale Property. The modified Prather Loan represented the first priority security interest in the Doge Property. PCB foreclosed on the modified Prather Loan and purchased the property for the amount owed in connection with that loan. PCB did not confirm the sale under Official Code of Georgia Annotated (O.C.G.A.) §44-14-161 after foreclosing on the Doge Property. PCB filed a secured proof of claim against the Debtor for \$130,720.55 and the Debtor objects to the claim.

The Debtor prays that I determine PCB's claim to be a deficiency claim which required confirmation before the Superior Court after the foreclosure sale in accordance with O.C.G.A. §44-14-161. In the absence of such confirmation, Debtor prays that I sustain the objection and strike the claim.

Conclusions of Law

A proof of claim is prima facie evidence of a valid debt for purposes of distribution from estate assets. Whitney v. Dresser, 200 U.S. 532 (1906); 11 U.S.C. §502(a); Bankruptcy Rule 3001(f). To

overcome the claim's presumptive validity, the objecting party bears the initial burden of introducing evidence sufficient to defeat the allegations contained therein. 3Collier on Bankruptcy ¶502.02, pp. 502-18-19 (15th ed. 1993). The objecting party satisfies its burden by offering evidence equal to the probative value of the proof of claim itself. Id.

Although the burden shifts to the objecting party, the ultimate burden of proof always remains on the claimant. Id. Once the objector tenders evidence of equally probative value, the claimant must then demonstrate the validity of its claim by a preponderance of the evidence. Id. See also In re Williams, Chapter 13 Case No. 92-50546 at pp. 2-3 (Bankr. S.D. Ga. Savannah Division, March 30, 1994) (J. Walker).

Georgia law requires a creditor in a non-judicial foreclosure sale follow O.C.G.A. §44-14-161³, the Georgia confirmation statute,

³O.C.G.A. 10-41-161 states:

(a) When any real estate is sold on foreclosure, without legal process, and under powers contained in security deeds, mortgages, or other lien contracts and at the sale the real estate does not bring the amount of the debt secured by the deed, mortgage, or contract, no action may be taken to obtain a deficiency judgment unless the person instituting the foreclosure proceedings shall, within 30 days after the sale, report the sale to the judge of the superior court of the county in which the land is located for confirmation and approval and shall obtain an order of confirmation and approval thereon.

(b) The court shall require evidence to show the true market value of the property sold under the powers and shall not confirm the sale unless it is satisfied that the property so sold

before seeking a deficiency judgment. The purpose of the confirmation statute is to insure that property subject to a non-judicial foreclosure sale receives true market value, rather than a nominal purchase price. Redman Industries, Inc. v. Tower Properties, Inc., 517 F.Supp. 144, 149 (N.D. Ga. 1981); United States v. Golf Club Co., 435 F. 2d 9 (5th Cir. 1970). Historically, the confirmation statute was enacted during the Depression when many mortgagors were forced into bankruptcy by deficiency judgments sought and obtained against them after mortgagees had acquired their property at non-judicial foreclosure sales for nominal or depressed prices. Taylor v. Thompson, 282 S.E. 2d 157, 158 (Ga. App. 1981); Thompson v. Maslia, 195 S.E. 2d 238 (Ga. App. 1972). The protection of the statute applies equally to individual and corporate debtors. See Southeast Timberlands, Inc. et al. v. Haiseal Timber, Inc., 479 S.E. 2d 443 (Ga. App. 1996). Additionally, the statute is in derogation of common law and it has been, and must be, strictly construed. First Nat. Bank v. Kunes, 197 S.E. 2d 446 (Ga. App. 1973).

The ultimate issue before me is whether PCB was required to

brought its true market value on such foreclosure sale.

(c) The court shall direct that a notice of the hearing shall be given to the debtor at least five days prior thereto; and at the hearing the court shall also pass upon the legality of the notice, advertisement, and regularity of the sale. The court may order a resale of the property for good cause shown.

confirm the foreclosure sale of the Doge Property and if it was, the effect of such failure on its secured claim in this case. In reaching a decision, I must first determine if the dragnet clause in the Prather loan applied to PCB and Doge.

PCB asserted that the assignment of the Prather Loan left the dragnet clause unenforceable. Georgia law is clear. An assignment nullifies a dragnet clause. O.C.G.A. §44-14-1; See Citizens Fed. S. & L. Assn. v. Andrews, 150 S.E. 2d 301 (Ga. App. 1966). Here however, PCB is not simply an assignee. After the assignment, PCB entered into the Modification of the Prather Loan with Doge. PCB was no longer an assignee, rather under the Modification PCB became the original party lender to a loan agreement, note and security deed with Doge.

In the Modification the parties agreed that the terms of the Prather Loan would remain in full force and effect. There is no dispute that the Prather Loan contained a dragnet clause and there is nothing in the Modification that would contradict the terms of the Prather Loan documents. Paragraph 4 of the Modification expressly adopts all of the terms of the original Prather Loan documents. This includes the dragnet clause. The dragnet provision in the Prather Loan automatically applied to any then-existing indebtedness and all indebtedness incurred by Doge in the future owed to PCB.

With the dragnet clause enforceable in the Modification, PCB's failure to confirm its foreclosure sale precludes it from seeking a deficiency judgment against Doge. United States v. Yates, 774 F. Supp. 1368, 1374 (M.D. Ga. 1991) ("the [dragnet] provision . . . embraces both . . . [n]otes, and 'when the instrument sued upon is embraced by the previous foreclosure, it is a deficiency judgment' (citations omitted)"). In fact, under the dragnet clause the two debts effectively merged and became one debt for the purposes of foreclosure. See id. Confirmation of PCB's foreclosure on the modified Prather Loan was required as a result of the dragnet clause in the original Prather Loan security deed in order for PCB to seek a deficiency judgment.

The second in priority \$200,000 loan and the modified Prather Loan, held by the same creditor and owed by the same borrower, are inextricably intertwined. See C.K.C. v. Free, 395 S.E. 2d 666 (Ga. App. 1990). Debts that are "inextricably intertwined" are not independent of each other, and a foreclosure of one affects the other. Tufts v. Levin, 213 Ga. App. 35, 37 (Ga. App. 1994). If the whole of the property is exhausted in foreclosing the first security interest, there is still a debt for which PCB desires to collect. See id. Applying the confirmation requirement to separate loans that are inextricably intertwined prevents creditors from avoiding the very purpose of the confirmation statute: to protect debtors from deficiency judgments when their property is sold at a

foreclosure sale for less than market value. Oakvale Road Associates, Ltd. v. Mortgage Recovery Fund-Atlanta Pools, L.P., 499 S.E. 2d 404, 415-16 (Ga. App. 1998) (citations omitted).

While it is important to understand the nature of the confirmation statute in relation to PCB and Doge, I must now determine whether PCB can maintain its claim against the Debtor, as a guarantor of Doge, for the deficiency in spite of its failure to confirm the foreclosure sale. It can.

It is clear the confirmation process is required to obtain a deficiency judgment against the mortgagee, Doge. However, failure to confirm a foreclosure sale does not leave a creditor without remedy. The failure to obtain confirmation of a foreclosure sale does not operate to extinguish the remaining debt. Rather, it simply precludes the lender exercising the power of sale from instituting suit to obtain a deficiency judgment against the defaulting borrower. Turnip v. North American & C. Corp., 166 S.E. 2d 588 (Ga. App. 1969). Failure to confirm does not estop a creditor from pursuing other contractual security on the debt, and under the strict construction of the confirmation statute, PCB may extinguish the debt by other than deficiency judgment means. Salter v. Bank of Commerce, 189 Ga. 328 (1939); Taylor v. Thompson, 158 Ga. App. at 672.

The Debtor executed a guaranty of the Doge debt secured by a security deed. While it is clear that the Georgia confirmation

statute is strictly construed, the term "debtor" in the confirmation statute has been determined to include guarantors. The Georgia Supreme Court has held at least where notice of the confirmation hearing is at issue the term "debtor" in O.C.G.A. 44-14-161(c) (see footnote 3) includes the guarantor of a loan. See Ameribank, N.A. v. Quattlebaum, 269 Ga. 857 (Ga. 1998). In Quattlebaum, the Court found the notice to the guarantor of the loan at issue to be insufficient. Id. Georgia case law supports the principle that the guarantor should be given the opportunity to rebut the true market value evidence offered by the creditor in a confirmation hearing. Id.; First Nat. Bank, etc., Co. v. Kunes, 128 Ga. App. 565, aff'd 230 Ga. 888 (Ga. 1973).

Although guarantors are part of a confirmation process, a guarantor is only entitled to exercise the same rights as the borrower it has guaranteed. In re Bickerstaff, 73 B.R. 421 (Bankr. N.D. Ga. 1987). In Bickerstaff, a creditor filed a claim and a motion for relief from stay in the chapter 13 case. The creditor made a loan with a corporation and the corporation granted the creditor a security interest in certain real and personal property as collateral. Id. at 421. As additional collateral, the creditor secured personal guarantees from the now chapter 13 debtors and took a security interest in their primary residence. Id. at 421-22. The creditor conducted a foreclosure sale on the corporation's collateral. Id. at 422. Similar to this case, a portion of the debt remained

and creditor did not obtain judicial confirmation of its initial foreclosure sale. Id. After initial foreclosure sale, the creditor attempted to extinguish the remaining debt by foreclosing its interest in the debtors' residence. Id. The Court held that a guarantor is entitled to the same rights as the borrower had against a creditor. Since the corporate debtor in the loan transaction could not have insisted on confirmation of the sale before the creditor attempted to collect the deficiency by subsequent additional foreclosure, then the Chapter 13 debtors, as guarantors, were also not entitled to make such a demand. See id. The court, guided by Georgia case law, lifted the stay to the extent that the creditor's claim was not paid in full. Id.

The Bickerstaff court allowed the creditor to use other contractual remedies to collect the deficiency. See e.g. Worth v. First National Bank of Alma, 333 S.E. 2d 173 (Ga. App. 1985). The failure of the creditor to obtain confirmation of the sale did not operate to extinguish the remaining debt. Rather, it simply precluded the creditor from instituting suit to obtain a deficiency judgment against the debtor corporation or the guarantors. Powers v. Wren, 198 Ga. 316 (Ga. 1944).

PCB may not seek a deficiency judgment against either Doge or the Debtor. Pursuant to the dragnet clause PCB was required to confirm the foreclosure sale of the Doge Property in order to collect a deficiency judgment against either Doge or the Debtor, as

a guarantor. PCB may, however, exhaust any and all other contractual remedies available to extinguish the debt, including its interest in the Debtor's Rockdale Property. Here, the PCB claim is simply an in rem secured claim to the extent there is value in the collateral to satisfy the claim.

PCB has a fourth priority security interest in the Debtor's Rockdale Property. Satisfaction of PCB's proof of claim is limited to the proceeds of the sale of the Rockdale Property. To the extent there are sufficient proceeds from the sale of the Rockdale Property to satisfy the first three priority security interests, PCB may extinguish its debt by collecting against its fourth priority security interest in the proceeds of the sale.

Therefore, Debtor's objection to claim is ORDERED sustained in part allowing the claim of PCB as an in rem secured claim secured by the Rockdale property and its sale proceeds only.

JOHN S. DALIS
UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia

this 22nd Day of August, 2005.