In the United States Bankruptcy Court

for the Northern District of Iowa

JAMES H. DOLEZAL, CAROL A. DOLEZAL Debtors.	Bankruptcy No. 96-11466-C Chapter 7
JAMES H. DOLEZAL, CAROL A. DOLEZAL Plaintiffs vs. UNITED STATES OF AMERICA Defendant.	Adversary No. 96-6211-W

RULING

On March 27, 1997, the above-captioned matter came on for hearing pursuant to assignment. Plaintiffs/Debtors James and Carol Dolezal were represented by Greg Epping. Defendant United States of America on behalf of Farm Service Agency (FSA) was represented by Martin McLaughlin. The parties stipulate that this matter does not require an evidentiary record. They agree to resolution by the Court based on briefs and oral arguments. After oral arguments, the parties moved that the Court withhold its ruling while they attempted to reach settlement. As no settlement has been reached, the Court placed this matter under advisement on May 23, 1997. This matter is now ready for resolution. This is a core proceeding pursuant to 28 U.S.C. 157(b)(2)(K, N).

STATEMENT OF THE CASE

Debtors wish to sell $10,000 of farm equipment free and clear of FSA's senior lien and pay the proceeds to Arbie Mineral Feed Co., Inc. which has a second lien on the equipment. FSA answers that it does not consent to the sale of its security so long as the proceeds are paid to creditors whose interests are junior to FSA's interests.

FINDINGS OF FACT

Debtors owe FSA a total of $98,027.93, less the amount of any intervening Chapter 13 payments. This debt is secured by a mortgage lien on 156 acres of farmland which consists of two parcels and includes Debtors' homestead. One of the parcels is subject to a first mortgage lien in favor of the State Bank of Toledo in the approximate amount of $36,500. FSA has a first lien on the second parcel. The value of the farm (including both parcels) as determined by an independent appraiser is $235,000.

FSA's claim is also secured by a blanket security interest in livestock, crops, equipment, etc. Debtor's farm machinery and equipment is valued at over $39,000 on their Schedules and livestock is valued at $10,800. FSA's total claim of $98,000 is obviously fully secured by the real estate worth $235,000,

subject to State Bank's $36,500 lien, equipment worth approximately $39,000, and livestock worth $10,800.

Arbie Mineral Feed Company, Inc. asserts a total claim in the amount of $21,224. It is undisputed that Arbie's claim is secured by a second lien on Debtors' farm machinery and equipment. Debtors propose to sell $10,000 of their farm equipment and turn the proceeds over to Arbie to reduce its claim. The parties do not dispute that FSA has a senior security interest in this equipment. After the sale of the equipment, FSA would remain fully secured by the real estate, other farm equipment and the livestock. FSA objects to the sale of its collateral farm equipment to pay a junior lienholder.

CONCLUSIONS OF LAW

Debtors as debtors-in-possession in Chapter 13 have standing to invoke the doctrine of marshaling. Debtors typically have no standing to request an order to marshal assets in disregard of their express contractual provision upon "which the creditor is entitled to rely." 53 Am. Jur. 2d Marshaling Assets 19 (1996) (citing Sowell v. Federal Reserve Bank, 45 S. Ct. 528 (1925). However, the Bankruptcy Code gives a Chapter 13 debtor-in-possession the rights and powers of a trustee, 11 U.S.C. 1303, and a trustee has all the powers available to a judicial lien creditor under state law. 11 U.S.C. 544; In re West Coast Optical Instruments, Inc., 177 B.R. 720, 722 (M.D. Fla. 1992). Therefore, Debtors have standing to raise the doctrine of marshaling.

MARSHALING OF ASSETS

The Eighth Circuit recently considered the applicability of the equitable doctrine of marshaling of assets in bankruptcy in In re Oxford Dev., Ltd., 67 F.3d 683, 686 (8th Cir. 1995). It stated that two separate doctrines of marshaling are potentially applicable -- the state law doctrine and the doctrine of marshaling under federal bankruptcy law. Id. Under federal law, the marshaling doctrine is as follows:

> If a senior lienor has a lien that extends to and covers two funds or potential funds, and if a junior lienor has recourse to only one of those funds to satisfy the debt due to him, the senior lienor may be required to exhaust the fund available to him exclusively before proceeding against the fund that is also available to the junior lienor.

Id. at 687 (citations omitted).

> [The doctrine's] purpose is to prevent the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security. It deals with the rights of all who have an interest in the property involved and is applied only when it can be equitably fashioned as to all of the parties.

Oxford, 67 F.3d at 686-87 (citing Meyer v. United States, 375 U.S. 233, 237, 84 S. Ct. 318, 321).

The doctrine of marshaling has long been recognized in Iowa. Gaumer v. Hartford-Carlisle Sav. Bank, 451 N.W.2d 497, 501 n.1 (Iowa 1990).

> [It] is an equitable doctrine which may apply when two creditors seek satisfaction out of the assets of their joint debtor, and one of the creditors can resort to two funds but the other has recourse to only one of the funds. Under the doctrine, the former creditor may

> be required to first seek satisfaction from the fund to which the latter creditor has no claim.

Id. The doctrine is only applied if it can be done without injustice. Id. It is not intended to deprive any secured creditor of the benefit of its security so far as it is necessary for the creditor's protection. Mead v. City Nat'l Bank, 8 N.W.2d 417, 420 (Iowa 1943).

In Iowa, a homestead liable for contractual debt may be sold only "after exhausting all other property pledged by the same contract for the payment of the debt." Iowa Code 561.21(2). The doctrine of marshaling assets cannot be used to force a senior claimant to satisfy indebtedness from a mortgaged homestead without first exhausting all other property securing such indebtedness. Gaumer, 451 N.W.2d at 501. In Bankers' Life Ass'n v. Engelson, 126 N.W. 951 (Iowa 1910), and In re Butterfield's Estate, 195 N.W. 188 (Iowa 1923), the Iowa Supreme Court refused to assert the doctrine of marshaling to benefit a junior lienholder when the senior lienholder would have been compelled to seek satisfaction of indebtedness first against a mortgaged homestead.

Marshaling cannot impair a superior or equal security interest of another.

> If the first mortgage could have been satisfied by drawing on the debtor's property in such a manner as to assure payment of both mortgages, to the burden of the debtor, equity would have required that it be done; but if the burden is to fall on another creditor, by dissipating his security, the same equitable considerations are not present and the rule does not apply.

In re Borges, 184 B.R. 874, 880 (Bankr. D. Conn. 1995). Marshaling of assets has been disallowed where a trustee admitted that the order would reduce the security collateral and prejudice a senior claimant's ability to recover its claim in full. In re Dig It, Inc., 129 B.R. 65, 67 (Bankr. D.S.C. 1991).

The court in In re Century Brass Prods., Inc., 95 B.R. 277, 279 (D. Conn. 1989), stated that, at the very least, the doctrine of marshaling requires that the senior creditor not receive less if there is marshaling than if there is not. In that Chapter 11 case, a junior lienholder requested that it receive proceeds from the sale of certain idle machinery, which was also subject to a senior creditor's blanket lien. Id. at 278. The court refused to allow marshaling because it was uncertain whether the senior would recover the entire amount of its debt and there were no other plans to sell the debtor's other assets. Id. at 279.

At this point, it appears that FSA's claim is oversecured. Debtors' Chapter 13 plan provides for payment of that claim over time. In the event of a default, however, FSA would need to resort to its security, which will be diminished if Debtors are allowed to liquidate $10,000 of machinery and equipment now, paying the proceeds to Arbie. Part of FSA's security consists of Debtors' homestead. It is difficult to predict whether FSA would eventually reach the homestead to satisfy its claim, which would be contrary to Iowa law on marshaling.

The Iowa and federal doctrines of marshaling of assets compel the conclusion that Debtors' request to pay proceeds of the sale of equipment to Arbie is inappropriate. FSA has a senior security interest in

these proceeds. It would be prejudiced by losing a portion of its collateral. The Court, in its equitable discretion, concludes that Debtor may not invoke the doctrine of marshaling because it deprives FSA of the full benefit of its security interest.

WHEREFORE, Debtors' Complaint is DENIED.

FURTHER, Debtors may not sell machinery and equipment free and clear of FSA's lien, paying the proceeds to Arbie.

SO ORDERED this 16th day of June, 1997.

Paul J. Kilburg
U.S. Bankruptcy Judge