

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH

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In re)
)
UNITED ROBERTS CORPORATION, a)
Utah corporation; PANELERA)
CORPORATION, a Delaware)
corporation; PANELERA OF UTAH,)
INC., a Utah corporation; and)
PANELERA MANUFACTURING)
CORPORATION, a Texas)
corporation,)
)
Debtors.)

Bankruptcy Case No. 82C-02444
Chapter 11
Bankruptcy Case Nos. 82C-02456,
82C-02457 and 82C-02458
Chapter 7

Unpublished

In re)
)
W. CALVIN ROBERTS,)
)
Debtor.)

Bankruptcy Case No. 82A-03098
Chapter 11

In re)
)
RICHARD A. ROBERTS,)
)
Debtor.)

Bankruptcy Case No. 82A-03099
Chapter 11

In re)
)
FRANK W. ROBERTS,)
)
Debtor.)

Bankruptcy Case No. 82A-03100
Chapter 11

COPPER STATE THRIFT & LOAN,)
a Utah corporation, and)
COPPER STATE LEASING,)
)
Plaintiffs.)

Civil Proceeding No. 83PC-0837

-vs-

UNITED ROBERTS CORPORATION;)
PANELERA OF UTAH, INC.;)
PANELERA CORPORATION;)
DUANE H. GILLMAN, Trustee in)

MEMORANDUM OPINION

Bankruptcy; W. CALVIN)
ROBERTS; RICHARD A. ROBERTS;)
FRANK W. ROBERTS; and ROBERTS)
INVESTMENT COMPANY,)
)
)
Defendants.)

CASE SUMMARY

The question the court is called upon to decide is whether Copper State Thrift and Loan ("Copper State") is a secured or unsecured creditor of the debtors. The resolution of this issue depends on whether a leaseback contract constituted a novation that extinguished Copper State's security interest in certain parcels of real property or whether the leaseback constituted an extension of existing obligations, without affecting Copper State's status as a secured creditor.

FACTS

Involved here are seven separate bankruptcy cases: (1) In re United Roberts Corporation, (2) In re Panelera Corporation, (3) In re Panelera of Utah, (4) In re Panelera Manufacturing Corporation, (collectively referred to as "Panelera"); (5) In re W. Calvin Roberts, (6) In re Richard A. Roberts, and (7) In re

Frank W. Roberts, (collectively referred to as the "individual Roberts").

The four entities referred to here as Panelera filed voluntary petitions under Chapter 11 of the Bankruptcy Code on September 28, 1982. Thereafter, under an order for joint administration, Duane H. Gillman was appointed trustee of all four of these estates. Later three of the Panelera cases were converted to cases under Chapter 7.

The individual Roberts, who are owners and principals of the corporate entities, each filed voluntary petitions under Chapter 11 on November 30, 1982. No trustee has been appointed for these estates.

Approximately a year prior to these filings, on August 5, 1981, certain of the debtors obtained a loan from Copper State in the total amount of \$155,000.00. The loan to two of the corporate entities was made in two separate transactions.

The first transaction consisted of two loans made by Copper State and dated August 5, 1981. The first loan of \$77,760.00 was made to the United Roberts Corporation, and is evidenced by a promissory note executed by United Roberts Corporation and Frank Roberts, individually. The second loan was made to the Panelera Corporation in the amount of \$77,250.00, and was evidenced by a promissory note executed by Panelera Corporation. The individual Roberts guaranteed both notes. In addition, two trust deeds, one

securing each note, were executed naming Copper State as beneficiary and the United Roberts Corporation and Roberts Investment, the owners of the real property which is the subject of this action, as trustors. The two notes were due on February 5, 1982. The debtors, however, failed to pay the notes when they matured.

On February 25, 1982, the parties entered into the second transaction involving a sale-leaseback arrangement. As part of this transaction, Panelera Corporation executed a new promissory note in favor of Copper State in the amount of \$33,542.00, which represented accrued interest on the prior two notes. Then the parties entered into the sale-leaseback whereby one of the corporate debtors "sold" certain equipment to Copper State who then leased the equipment back to Panelera of Utah. There was no money paid by Copper State for the purchase of this equipment. The "lease" payments by the corporate debtor were, in effect, payments on the obligations evidenced by the original promissory notes for \$77,760.00 and \$77,250.00

The purpose of this arrangement, as explained by Copper State's witness, was that the debtors desired a long-term extension in which to repay the original promissory notes. This debtors were unable to do because of Copper State's internal policy which required the notes to be paid back within one year. But the policy would allow an obligation under a lease to be repaid within five years.

After the leaseback transactions of February 25, 1982, Copper State no longer carried these obligations on its books as promissory notes, but as a lease. However, the promissory notes were never marked paid nor returned to the debtors; moreover, the trust deeds of August 5, 1981 were never reconveyed.

ARGUMENTS

This matter came before the court for hearing on Copper State's July 28, 1983 complaint for relief from the § 362 automatic stay, against defendants and debtors Panelera and Duane H. Gillman, Trustee ("Trustee"). The hearing was held on August 31, 1983.¹

Plaintiff Copper State asserts an interest in four parcels of property located in Salt Lake County, Utah, as security for a debt in the amount of \$289,495.23, as of August 31, 1983. The parties have stipulated that the current fair market value of this property is \$800,000.00 and that prior liens on the property total approximately \$620,173.00.

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Appearing were Anna W. Drake and Jeffrey M. Jones of Nielsen and Senior, attorneys for Copper State; Steven H. Gunn of Ray, Quinney & Nebeker, attorneys for the individual Roberts; Craig B. Terry, of Parsons, Behle & Latimer, attorneys for Tracy Mortgage Co.; Milton V. Backman of Backman, Clark & Marsh, attorneys for G.T. Lisonbee; and Duane H. Gillman, of Boulden & Gillman, Trustee.

The debtors do not dispute the amount of the debt, but assert that Copper State is an unsecured creditor without standing to seek modification of the automatic stay. The debtors argue that the sale-leaseback agreement affected a novation of the original contracts between the parties, and that this novation extinguished the debt evidenced by the promissory notes and trust deeds. Because the lease document, by its terms, does not provide for any security other than the equipment itself, the debtors assert that Copper State is unsecured as to the real property.

Copper State argues that the sale-leaseback agreement was either a modification or renewal (or both) of the original contracts between the parties and that the trust deeds, by their terms, provide that any extension or modification of the original obligations will be secured by the subject real property. Accordingly, Copper State claims that it continues to be secured and is entitled to relief from the automatic stay in order to foreclose its interest in the subject property.

ISSUE

The central question presented in this case is whether the leaseback arrangement of February 25, 1982 constitutes a novation of the original contracts thereby extinguishing Copper State's security interest in the collateral, or whether the leaseback was

merely a modification or extension of the existing obligations.

DISCUSSION

A novation is a substitution of a new contract or obligation for an old one which is thereby extinguished. There are four requisites for a novation: (1) an existing valid obligation, (2) an agreement of the parties to a new contract, (3) a valid new contract, and (4) the extinguishment of the old obligation.

The parties agree that, with regard to the leaseback arrangement, the first three requisites have been met in this case. The dispute centers upon whether the old obligation of August 5, 1981 was extinguished by the new leaseback agreement of February 25, 1982.

In In re Marking Systems, Inc. v. Interwest Film Corp., 567 P. 2d 176, 178 (1977), the Utah Supreme Court sets forth the standard for determining whether an old obligation is extinguished.

To constitute a novation, there must be among other elements, a mutual agreement between the creditor and his debtor which is intended to extinguish the old obligation by substituting a new one therefor. For the giving of a new note for an obligation under a prior note to have the effect of discharging liability on the prior note, the new note must be given with that understanding on the part of both the maker of the new note and the holder of the prior note.

Id. at 178, citing 11 Am. Jur. 2d, Bills and Notes § 914.

In In re First Security Bank of Utah v. Proudfit Sporting Goods Co., 552 P. 2d 123, 124 (Utah 1976), the court again stated that the intent of the parties is controlling:

Nor does the giving of a new note in renewal of another note extinguish the debt for which the original note was given unless it clearly appears that it was the intention of the parties that the execution of the new note and the cancellation of the old note should extinguish the debt represented by the old note.

Citing In re Interstate Trust v. Headlund, 171 P. 515 (Utah 1918).

The testimony of Copper State's witnesses shows that it was clearly not the intent of Copper State to release the debtors from the original obligation, nor was it Copper State's intent to extinguish the original notes. Further, the August 5, 1981 notes were never marked "paid", and the trust deeds securing the notes were never reconveyed.

There is absolutely no evidence concerning the intent of the debtors. The party asserting novation as a defense bears the burden of establishing that a novation in fact occurred. In re Jones, 12 B.R. 199 (Bk. D. S.C. 1981). The debtors failed to meet this burden at the hearing, and the court finds that no novation occurred.

The original obligations owed to Copper State were secured by trust deeds on the four parcels of property. These trust deeds secure the debts, not merely the evidence of the debts. As

long as the debts continue, the trust deeds are effective, even though the notes secured by the trust deeds are renewed, modified, or otherwise changed in form. In re Lambert Enterprises, Inc., 21 B.R. 529 (Bk. W.D. Va. 1982), citing In re Jones v. Guaranty and Indemnity Company, 101 U.S. 622 (1879).

CONCLUSION

The court finds that Copper State has an allowed secured claim to the extent the value in the property exceeds the \$620,000.00 in prior liens. Based upon the stipulated value of the property of \$800,000.00, there is no equity in the property available to the debtors. There is no evidence that the property is necessary for effective reorganization. Accordingly, an order shall enter lifting the stay to allow Copper State to foreclose, pursuant to the trust deeds, its security interest in the property in question.

DATED this 11 day of April, 1984.

BY THE COURT:



GLEN E. CLARK
UNITED STATES BANKRUPTCY JUDGE