UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF MISSISSIPPI

IN RE:	)	
	)	
THE CONSOLIDATED FGH LIQUIDATING TRUST	)	**CASE NO. 01-52173**
	)	
	)	
f/k/a	)	
	)	
FRIEDE GOLDMAN HALTER, INC. et al., Jointly Administered.	)	

OPINION

The matter before the court is the objection to proofs of claim of Richard L. Marler and Hand Arendall, L.L.C., filed by Oakridge Consulting, Inc. and Ocean Ridge Capital Advisors, L.L.C., as Liquidating Trustee for The Consolidated FGH Liquidating Trust. Having considered the pleadings and memoranda submitted on behalf of the parties, the court concludes that the Liquidating Trustee's objection to claim number 148 of Richard L. Marler and Hand Arendall, L.L.C. should be overruled.

I. FACTUAL BACKGROUND

The Liquidating Trustee has objected to claims number 148, number 1409 and number 1806 filed on behalf of Richard L. Marler ("Marler") and Hand Arendall, L.L.C. ("Hand Arendall") in the amount of $740,963.77 including prepetition interest pursuant to a promissory note. The note was executed in connection with settlement of a lawsuit by Marler against Friede Goldman International, Inc., wherein Marler sought damages because he was not allowed to purchase stock by exercising a stock option related to his employment agreement with Friede Goldman International, Inc. In the lawsuit, Marler was the plaintiff in the action and Hand

Arendall was the law firm representing Marler in the suit. It was agreed that Marler would be paid $1,020,000.00 in three installments. The first installment of $340,000.00 pursuant to the settlement was paid. A promissory note was executed for the remaining $680,000.00 to be paid in two equal installments of $340,000.00, payable to Marler and Hand Arendall. The second and third installments remain unpaid and are the basis for the proofs of claim filed in this proceeding.

The Liquidating Trustee objected to the claims and asserted the following:

> (a) to the extent that the claim represents damages from wrongful termination, the claim is subject to limitation of Section 502(b)(7)(A); (b) to the extent that the claim represents damages arising from a security transaction, the claim is subject to Section 510(b) subordination; and (c) that all duplicate filings should be expunged as the proceedings are substantively consolidated.

Brief in Support of Objection to Proofs of Claim of Richard L. Marler and Hand Arendall, L.L.C. at 6.

II. CONCLUSIONS OF LAW

The matter before the court is a core proceeding pursuant to 28 U.S.C. § 157. The court has jurisdiction over the subject matter and the parties to this proceeding pursuant to 28 U.S.C. § 157 and § 1334.

The Liquidating Trustee argues that to the extent the claim has some basis relating to Marler's termination, the claim is capped by § 502. The claimants indicate there was no claim for wrongful termination or other employment termination in the lawsuit that was settled and that resulted in the promissory note. Therefore, the arguments relating to § 502(b)(7) which relate to damages resulting from termination of an employment contract, are not relevant for the court's consideration here.

Further, the Liquidating Trustee asserts that claims 1409 and 1806 should be disallowed

and expunged as duplicate filings. Marler and Hand Arendall have agreed that to the extent claims 1409 and 1806 duplicate claim number 148 they should be disallowed and expunged, and an agreed order was previously entered disallowing claims number 1409 and number 1806 as duplicate claims. This issue is no longer before the court.

On the remaining issue, the Liquidating Trustee asserts that the claim of Marler and Hand Arendall should be classified as a Class 9 equity interest claim, and that the claim should be subordinated under 11 U.S.C. § 510(b) because it arises from damages incurred in relation to a security transaction when the debtor failed to allow Marler to exercise his stock options.[1] *See Carrieri v. Jobs.com, Inc,* 393 F. 3d 508 (5th Cir. 2004); *Weissman v. Pre-Press Graphics. Company, Inc. (In re Pre-Press Graphics Company, Inc..),* 307 B.R. 65 (N.D.Ill. 2004); *In re Permian Producers Drilling, Inc.,* 263 B.R. 510 (W.D. Tex. 2000).

The Liquidating Trustee requests subordination pursuant to §510(b) of the Bankruptcy Code. That section provides that:

> (b) For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

11 U.S.C. § 510(b).

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[1] An adversary proceeding pursuant to Federal Rule of Bankruptcy Procedure 7001 is normally the procedure by which subordination is requested. Pursuant to Bankruptcy Rule 3007, if an objection to a claim is joined with a demand for relief of the kind specified in Rule 7001, it becomes an adversary proceeding. *See, In re Simmons* 765 F.2d 547, (5th Cir. 1985); *In re Danbury Square Associates, Ltd. Partnership* 153 B.R. 657 (Bankr. S.D.N.Y.1993*)*

Marler and Hand Arendall assert, however, that § 510(b) does not apply to a claim based on a debt instrument because the claim seeks only the recovery on the debtor's debt obligations. *See, In re Wyeth Co.,* 134 B.R. 920 (Bankr. W.D.Mo. 1991); *Official Committee of Unsecured Creditors v. American Capital Financial Services, Inc. (In re Mobile Tool International, Inc.),* 306 B.R. 778 (Bankr. D. Del. 2004)(claims based on promissory notes for debtor's repurchase of shareholder's stock were not subject to subordination); *Montgomery Ward Holding Corp. v. Schoeberl (In re Montgomery Ward Holding, Corp.),* 272 B.R. 836 (Bankr. D. Del. 2001)(a claim based on a promissory note related to stock redemption was not subject to subordination under 510(b)); *Burtch v. Gannon (In re Cybersight, LLC),* 2004 WL 2713098 (D.Del. 2004*)(*equity position was converted to judgment and became a fixed debt obligation entitled to general unsecured claimant status). The claimants argue that upon the tender of the promissory note to Marler and Hand Arendall, the obligation became fixed and that any variable nature was extinguished and they became general unsecured creditors for purposes of § 510(b), and are, therefore, not subject to subordination. They argue that Marler's claim in the bankruptcy is for non-payment of a debt which arose when he had no equity interest in FGI:

> When Marler compromised his lawsuit claims against FGI his stock rights were extinguished, his rights and potential rights as an equity holder were terminated, he lost the opportunity of equity appreciation and likewise eliminated the risk of equity decline. As such, his claim is not the type which section 510(b) mandates be subordinated. Of course, Hand Arendall, L.L.C. is also a payee on the note, thus making Hand Arendall a general unsecured creditor in this case. Hand Arendall, L.L.C. has never been a shareholder of FGI nor does it hold or has it ever held any equity security interest in FGI.
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> Therefore, there is no justification for subordination of this Claim per § 510(b).

Creditors Richard L. Marler and Hand Arendall, L.L.C.'s Brief in Response to Liquidating Trustee's Brief in Support of Objection to Proofs of Claim at 10.

In the case of *Official Committee of Unsecured Creditors v. American Capital Financial Services, Inc. (In re Mobile Tool International, Inc.),* 306 B.R. 778 (Bankr. D. Del. 2004), the court held the following:

> Here, the Defendants divested themselves of all forms of ownership when they sold the securities back to the Debtors and accepted notes in exchange. As such, they no longer enjoyed the primary benefit of ownership: the potential for unlimited profits. The Debtors' liability to the Defendants became fixed when the Debtors issued promissory notes. When the Defendants received the promissory notes, they removed the variable nature of their investment and placed themselves in the position of general creditors. Their claims are not the type which section 510(b) mandates be subordinated.

Id. at 782. A similar result was reached in *Burtch v. Gannon (In re Cybersight, LLC),* 2004 WL 2713098 (D.Del. 2004), where the court indicated that, "Mr. Gannon's equity stake in Cybersight extinguished pre-petition and with it Mr. Gannon's ability to participate in any of Cybersight's profits or losses. Once the state court entered Mr. Gannon's judgment, the judgment became a fixed debt obligation of Cybersight and Mr. Gannon was entitled to general unsecured claimant status." *Id.* at 3. Further, in the case of *Racusin v. American Wagering Inc. (In re American Wagering Inc.),* 465 F. 3d 1048 (9th Cir. 2006) the Circuit Court there stated the following:

> Racusin received a money judgment for services rendered nine years before the bankruptcy; he did not seek to enforce an award of an equity interest in debtors' companies. Racusin therefore contends that because the claim is based on a pre-petition money judgment it simply is not subject to subordination under section 510(b). In *In re Montgomery Ward Holding Corp.,* 272 B.R. 836, 842 (Bankr. D. Del. 2001), the court held that a claim based on a promissory note is not subject to subordination under section 510(b) because such claims are only for the recovery of an unpaid debt. *Id.* at 842-43; *accord In re Mobile Tool Int'l, Inc.,* 206 B.R. 778 (Bankr.D.Del. 2004). Although Racusin did not exchange his stock for a debt instrument, like the notes in *Montgomery Ward,* he sought to receive money damages for failure to deliver the stock well in advance of the debtors' filing for bankruptcy. . .
>
> The money judgment awarded at the direction of our Court in its earlier opinion

> established a fixed, pre-petition debt due and owing Racusin as a creditor, not the risk/return position of an equity investor in the now-bankrupt corporation.

Id. at 1053. *See also,* Frost, *Subordination of Securities Claims in Bankruptcy: What is the Scope of Section 510(b)?,* 27 No. 2 Bankruptcy Law Letter 1 (February 2007).[2]

Having considered the issue, the court agrees with arguments and authorities cited by the claimants and concludes that the claim based upon the promissory note is not the type upon which § 510(b) mandates subordination. The court further agrees with the arguments of the claimants that the cases upon which the Liquidating Trustee relies may be factually distinguished. Therefore, under the limited context of facts presented here, the claims of Marler and Hand Arendall are not subject to subordination under § 510(b) and the Liquidating Trustee's objection to claim number 148 of Marler and Hand Arendall should be overruled.

An order will be entered consistent with these findings and conclusions pursuant to Federal Rule of Bankruptcy Procedure 9021 and Federal Rule of Civil Procedure 58. This

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[2] In a discussion on recent decisions under § 510(b) and an analysis of legislative history, this article contained the following comments:

> Where the claimant seeks to enforce a claim as a creditor, courts hold that section 510(b) does not subordinate the claim as long as the conversion of the claim from equity to debt is complete. Thus where the claimant has delivered its stock in exchange for a promissory note . . . courts will enforce the claim as a credit claim. Similarly, where the claimant has sought and received a money judgment, extinguishing the claimant's interest in future profits, courts will refuse to subordinate the claim.

Id. at 8.

opinion shall constitute findings and conclusions pursuant to Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52.

DATED this the 12th day of March, 2007.

/s/ Edward R. Gaines
EDWARD R. GAINES
UNITED STATES BANKRUPTCY JUDGE

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