

UNITED STATES BANKRUPTCY COURT  
MIDDLE DISTRICT OF GEORGIA  
MACON DIVISION

In the Matter of:	:	Chapter 11
	:	
WESTEK GEORGIA, LLC,	:	
	:	
Debtor	:	Case No. 03-55298 RFH
	:	
WESTEK GEORGIA, LLC,	:	
	:	
Plaintiff	:	
	:	
vs.	:	
	:	
ALAN R. OGLESBEE,	:	
ROBERT E. JOHNSON, and	:	
GREGORY W. PHILLIPS,	:	
	:	
Defendants	:	Adversary Proceeding No. 04-5058

BEFORE

ROBERT F. HERSHNER, JR.  
CHIEF UNITED STATES BANKRUPTCY JUDGE

COUNSEL:

For Westek Georgia, LLC:	Ms. Karen Fagin White Mr. Bruce Z. Walker Ms. Kelly S. Scarbrough 3350 Riverwood Parkway, Suite 1600 Atlanta, Georgia 30339
For Alan R. Oglesbee, Robert E. Johnson, and Gregory W. Phillips:	Mr. Hubert C. Lovein, Jr. Ms. Cater C. Thompson Post Office Box 6437 Macon, Georgia 31208-6437

## MEMORANDUM OPINION

Alan R. Oglesbee, Robert E. Johnson, and Gregory W. Phillips, Defendants, filed on May 19, 2004, a Motion to Dismiss Plaintiff's Complaint to Subordinate All Claims. Westek Georgia, LLC, Plaintiff, filed a response on June 25, 2004. Defendants' motion came on for hearing on September 7, 2004. The Court, having considered the record and the arguments of counsel, now publishes this memorandum opinion.

The Court, in considering the motion to dismiss, will accept as true the well plead facts in Plaintiff's complaint. Defendants bear a "very high burden" of showing that Plaintiff cannot conceivably prove any set of facts that would entitle it to relief. Dudley v. Citicorp Mortgage, Inc., (In re Dudley), Ch. 7 Case No. 02-51225 RFH, Adv. No. 02-5087 (Bankr. M.D. Ga., Jan. 10, 2003).

Defendants were officers, directors, shareholders, and employees of a tire cordage business known as Westek, Inc. Plaintiff agreed to purchase substantially all of the assets of Westek, Inc. The assets included real property, machinery, and equipment. Plaintiff and Westek, Inc. entered into an Asset Purchase Agreement dated October 30, 2002. Defendants negotiated the sale on behalf of Westek, Inc.

As an essential part of the sale, Plaintiff and Defendants executed a

Noncompetition Agreement dated November 11, 2002. The Noncompetition Agreement provides, in part, that Defendants would not disclose certain confidential information or work in a competitive business for a period of five years. The Noncompetition Agreement was the primary vehicle for payment of cash to Defendants as consideration for the sale. Plaintiff was to make quarterly payments to Defendants through October 10, 2008. The payments would total \$1,080,000. As security for the obligation, Plaintiff executed a deed to secure debt on the real property in favor of Defendants. Plaintiff also executed a security agreement on the machinery and equipment in favor of Defendants.

Plaintiff's business was not successful. Plaintiff contends that Defendants fraudulently misrepresented the financial obligations of Westek, Inc.

Plaintiff filed on October 24, 2003, a complaint against Defendants and Westek, Inc. in the Superior Court of Upson County, Georgia. Plaintiff asserts claims for fraud, breach of contract, and indemnification. Defendants filed a response, a counterclaim, and a third party complaint. The state court action will determine the mutual claims and obligations between Plaintiff and Defendants. The state court action is currently pending.

Defendants and other creditors filed on November 12, 2003, an involuntary petition under Chapter 7 of the Bankruptcy Code against Plaintiff. Plaintiff, on January 14, 2004, exercised its right to convert the Chapter 7 case to a Chapter 11 case. Plaintiff is the debtor-in-possession in the Chapter 11 case. Defendants filed

proofs of claim asserting secured claims that total almost \$1.13 million.

Plaintiff filed this adversary proceeding on April 15, 2004. Plaintiff contends that Defendants' claims should be subordinated to all unsecured claims for purposes of distribution. Plaintiff also contends that Defendants' deed to secure debt and security agreement should "in effect be voided."

Section 510(c) of the Bankruptcy Code provides:

**§ 510. Subordination**

...

- (c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may—
  - (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or
  - (2) order that any lien securing such a subordinated claim be transferred to the estate.

11 U.S.C.A. § 510(c) (West 2004).

In Allied Eastern States Maintenance Corp. v. Miller, (In re Lemco Gypsum, Inc.),<sup>1</sup> the Eleventh Circuit Court of Appeals stated, in part:

Title 11 U.S.C.A. § 510(c) adopts the long-standing judicially developed doctrine of equitable subordination under which a bankruptcy court has power to subordinate claims against the debtor's estate to claims it finds ethically superior

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<sup>1</sup> 911 F.2d 1553 (11th Cir. 1990).

under the circumstances. Proper exercise of the equitable subordination power can take place only where three elements are established:

- (1) The claimant must have engaged in some type of inequitable conduct,
- (2) The misconduct must have resulted in injury to the creditors or conferred an unfair advantage on the claimant,
- (3) Subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Act.

The inequitable conduct need not be related to the acquisition or assertion of the claim. The claim can be subordinated only to the extent necessary to offset the harm suffered by the bankrupt and its creditors on account of that conduct.

911 F.2d at 1556.

Collier on Bankruptcy states, in part:

Secured as well as unsecured claims may be subordinated. All or part of a claim may be subordinated. A claim may be subordinated to all or part of another allowed claim. Thus, depending on the circumstances, a subordinated claim may be regulated to the bottom rung of claims or may be simply allowed after rather than ahead of the claim of a party who has in some way been injured by the conduct of the holder of the subordinated claim.

4 Collier on Bankruptcy, ¶ 510.05, p. 510-16, -17 (15th ed. rev. 2004).

Equitable subordination is not concerned with whether Defendants have a valid counterclaim or right of set off. 1 Ginsberg & Martin on Bankruptcy, § 10.11[A][3] (2003 Supp.)

“Subordination and disallowance [of a claim] are two distinct theories within the bankruptcy process because the former addresses the question of priority and

participation, while the latter results in the complete exclusion from participation. Subordination is an appropriate remedy for the Court in the exercise of its equitable powers, but disallowance is not.” In re Huckabee Auto Co., 33 B.R. 132, 139-40 (Bankr. M.D. Ga. 1981).

In their motion to dismiss,<sup>2</sup> Defendants contend, in part:

12.

[Defendants] move to dismiss Plaintiff’s Complaint to subordinate their claim on the grounds that the Superior Court Action is a prior pending Action involving the same claims as the instant preceding. The Superior Court Action will determine the mutual claims and amounts owing as between the [Plaintiff] and [Defendants]. The Superior Court will determine whether [Defendants have] breached [their] contracts with [Plaintiff] and whether [Defendants have] fraudulently concealed and misrepresented the liabilities of Westek, Inc. The same acts of inequitable conduct that allegedly give rise to Plaintiff’s claim for equitable subordination are the basis for Plaintiff’s Superior Court Action. The evidence necessary to sustain the complaint for equitable subordination is exactly the same evidence necessary to sustain the Superior Court Action.

13.

[Plaintiff] is attempting to prosecute the same cause of Action in two different courts. In the Superior Court Action, [Plaintiff] is attempting to defeat its liability to [Defendants] by alleging fraud and inequitable conduct. However, if it loses the Superior Court Action, it hopes to achieve the same result by alleging the exact same fraud and inequitable conduct as grounds for subordinating [Defendants] claims. Although [Plaintiff] alleges different legal theories, the underlying facts are the same.

Defendants rely upon the “prior pending action doctrine.” Under that doctrine

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<sup>2</sup> Motion to Dismiss Plaintiff’s Complaint to subordinate All Claims, p. 3 - 4 (filed May 19, 2004).

a subsequent action can be dismissed provided that: (1) an identity of issues exists with the prior pending action, and (2) the controlling issues in the subsequent action will be determined in the prior pending action. 5C Charles A. Wright & Arthur R. Miller, Federal Practice and Procedure, §1360, p. 89 (3rd ed. 2004). See also Community Savings Bank v. Canter, (In re Canter), 1 B.R. 172, 175 (Bankr. D. Mass. 1979).

Dismissal should not be granted if the controversy in the subsequent action could not or will not necessarily be determined in the prior action. See Federal Practice and Procedure, § 1360 at n. 36.

Turning to the case at bar, Plaintiff has not filed an objection to Defendants' proofs of claim. Defendants' claims are deemed allowed in the amount of almost \$1.13 million.<sup>3</sup> In this adversary proceeding, the Court is not asked to disallow Defendants' claims or to determine whether Defendants have a valid counterclaim against Plaintiff. The only issue before the Court is whether Defendants' allowed claims should be subordinated. See In re Huckabee Auto Co., 33 B.R. at 140.

The state court has no jurisdiction to subordinate Defendants' allowed claims under section 510(c) of the Bankruptcy Code. This Court has sole jurisdiction to determine how much, if any, of Defendants' claims should be subordinated. This Court may also determine that Defendants' claims should be subordinated to some

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<sup>3</sup> 11 U.S.C.A. § 502(a) (West 2004).

but not all unsecured claims.

The issue of subordination will not be decided in the state court action. The Court is persuaded that Defendants' motion to dismiss must be denied.

An order in accordance with this memorandum opinion will be entered this date.

DATED this 1st day of December, 2004.

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ROBERT F. HERSHNER, JR.  
Chief Judge  
United States Bankruptcy Court