UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

IN THE MATTER OF	)	
	)	
DENNIS BAMBER, INC., d/b/a	)	CASE NO. 06-31800 HCD
THE WOODWIND & THE BRASSWIND,	)	CHAPTER 7
	)	
DEBTOR.	)	

Appearances:

Howard Adelman, Esq., attorney for debtor, Adelman, Gettleman, Ltd., 53 West Jackson Boulevard, Suite 1050, Chicago, Illinois 60604;

James M. Carr, Esq., attorney for Official Committee of Unsecured Creditors, Baker & Daniels LLP, 300 North Meridian Street, Suite 2700, Indianapolis, Indiana 46204;

Carl A. Greci, Esq., attorney for Official Committee of Unsecured Creditors, Baker & Daniels LLP, 205 West Jefferson Boulevard, Suite 250, South Bend, Indiana 46601;

Evan D. Smiley, Esq., attorney for Yamaha Corporation of America, Weiland, Golden, LLP, 650 Town Center Drive, Suite 950, Costa Mesa, California 92626;

James H. Milstone, Esq., attorney for Yamaha Corporation of America, Kopka, Pinkus, Dolin & Eads, P.C., Park Place at Edison Lakes, 3510 Park Place West, Mishawaka, Indiana 46545;

Michael A. Trippel, Esq., attorney for Dennis Bamber, Thorne Grodnik, LLP, 420 Lincolnway West, P.O. Box 1210, Mishawaka, Indiana 46545-5689;

Gary Boyn, Esq., attorney for American Way Marketing, LLC, Warrick & Boyn, LLP, 121 West Franklin Street, Suite 400, Elkhart, Indiana 46516;

J. A. Whitmer, Esq., attorney for US Band & Orchestra Supplies, Inc., 219 South Fourth Street, Elkhart, Indiana 46516;

R. William Jonas, Jr., Esq., attorney for LaSalle National Bank, Hammerschmidt, Amaral & Jonas, 137 North Michigan Street, South Bend, Indiana 46601; and

David J. Jurkiewicz, Esq., attorney for Conn-Selmer, Inc., Bose McKinney & Evans LLP, 135 North Pennsylvania Street, Suite 2700, Indianapolis, Indiana 46204.

MEMORANDUM OF DECISION

At South Bend, Indiana, on August 23, 2007.

Before the court is the "Motion of Yamaha Corporation of America for Order Compelling Debtor to Release Proceeds from Sale of Yamaha Corporation of America's Collateral to Satisfy Yamaha's Secured Claim" ("Motion of Yamaha") (R. 284), filed on February 26, 2007, by secured creditor Yamaha Corporation of America ("Yamaha") against the debtor Dennis Bamber, Inc. ("debtor" or "DBI"). Timely objections to the Motion of Yamaha were filed by the Official Committee of Unsecured Creditors ("the Committee") (R. 318) and Gibson Guitar Corporation ("Gibson") (R. 330); a belated objection was filed by Conn-Selmer, Inc. (R. 391). Yamaha replied to the Committee's Objection. (R. 328). Prior to the hearing, Yamaha and the Committee filed briefs. (R. 387, 388). The court held an evidentiary hearing on the matter on April 30, 2007.[1] At the conclusion of the hearing, the court took the Motion of Yamaha under advisement.[2] For the reasons that follow, the court now denies the Motion of Yamaha.

Jurisdiction

Pursuant to 28 U.S.C. § 157(a) and Northern District of Indiana Local Rule 200.1, the United States District Court for the Northern District of Indiana has referred this case to this court for hearing and determination. After reviewing the record, the court determines that the matter before it is a core proceeding within the meaning of § 157(b)(2)(K) over which the court has jurisdiction pursuant to 28 U.S.C. §§ 157(b)(1) and 1334. This entry shall serve as findings of fact and conclusions of law as required by Federal Rule of Civil

[1] Five motions were scheduled for the hearing. The "Debtor's Motion to Extend Exclusive Right to file a Plan of Reorganization and Disclosure Statement and to Solicit Acceptances Relating Thereto" was withdrawn by the debtor. Three Motions for Allowance and Payment of Administrative Expense Claim, filed individually by the creditors Fender Musical Instruments Corporation, US Band & Orchestra Supplies, Inc., and American Way Marketing, LLC, were resolved by agreement of the parties, debtor's counsel informed the court. The court granted the parties 15 days to submit agreed orders. Only the Motion of Yamaha remained to be heard.

[2] On May 10, 2007, the debtor's case was converted from a chapter 11 to a chapter 7 case. Joseph D. Bradley was appointed to be the chapter 7 Trustee. *See* R. 407.

Procedure 52, made applicable in this proceeding by Federal Rule of Bankruptcy Procedure 7052. Any conclusion of law more properly classified as a factual finding shall be deemed a fact, and any finding of fact more properly classified as a legal conclusion shall be deemed a conclusion of law.

Background

Prior to the April 30, 2007 hearing on the Motion of Yamaha, the Committee and Yamaha filed a Stipulation setting forth uncontroverted facts. *See* R. 389. Relying on that Stipulation and on the exhibits proffered without objection at the evidentiary hearing, the court presents the background information that led to the filing of the Motion before it.

On November 21, 2006, DBI filed its chapter 11 petition. *See id.* at 1, ¶ 1. On that date, the debtor owed LaSalle National Bank ("LaSalle" or "Bank") approximately $24.7 million plus accruing interest, costs and expenses. The parties refer to that debt as the "LaSalle Secured Prepetition Senior Indebtedness." LaSalle was secured by a senior security interest, designated the "LaSalle Prepetition Senior Liens," on essentially all of DBI's prepetition assets, including DBI's accounts receivable, inventory, and tangible personal property, referred to as the "LaSalle Prepetition Collateral."

Before the debtor filed bankruptcy, Yamaha entered into two agreements relevant to the debtor and its bankruptcy estate. The earlier instrument, the Intercreditor Agreement, executed on May 30, 2006, defines the relationship between LaSalle and Yamaha.[3] *See* Ex. 14. The stated purpose of the Intercreditor Agreement was "to determine [the parties'] relative priorities in the Collateral," which is comprised of all the debtor's assets, including Yamaha's inventory and cash proceeds. *See id.* at 1, ¶ C. Yamaha agreed that all of its rights with respect to the debtor's assets, including its own collateral held by the debtor, "shall be in all respects subject and subordinate to the rights of the Bank." *Id.* at 2, § 1. If the debtor defaulted, the Agreement provided that "the Bank may exercise all of its rights" concerning the debtor's assets and that Yamaha "agrees to forebear from

[3] The debtor also signed the Agreement, thereby consenting to it.

enforcing its rights and remedies" against the debtor or its assets "until such time as the Debtor has fully paid its Obligations to the Bank." *Id.*, § 4. If the debtor became insolvent, the Agreement continued in full force and effect. *Id.*, § 5. As the parties stipulated, under the Agreement "Yamaha subordinated the priority of the Yamaha Prepetition Security Interest to the priority of the LaSalle Prepetition Senior Liens." R. 389 at 2, ¶ 3.

Yamaha also entered into an inventory re-balancing agreement with DBI in October 2006. It agreed to take back from DBI the inventory that was damaged, obsolete, or overstocked, and it issued credits for its assessed value, approximately $288,000. *See id.* at 2, ¶ 2.

On the petition date, the debtor owed Yamaha a total of $2,814,659.93 plus accruing interest, costs, service fees and attorney fees. *See id.* at 2, ¶ 3. Yamaha held a valid security interest in Yamaha inventory that was sold prepetition to DBI on credit terms, and in Yamaha receivables that constituted identifiable proceeds (such as accounts receivable and cash from the disposition of Yamaha inventory). The Yamaha inventory had a cost basis of $2,109,335.00. The Yamaha receivables, which were collectible, were valued at $707,911.92. *See id.* at 2, ¶¶ 3-5.

Shortly after the debtor filed its petition, it filed a motion to obtain interim financing. Yamaha opposed the debtor's motion on the ground that LaSalle and DBI "were required to marshal the assets of the Debtor to protect Yamaha's collateral." *Id.* at 3, ¶ 6. In Yamaha's view, LaSalle's claim was required to "be satisfied first from assets or proceeds where Yamaha did not hold a junior security interest." *Id.* After a hearing, on December 22, 2006 the court entered a "Final Order (1) Authorizing Debtor to Incur Post-Petition Secured Indebtedness and Use Cash Collateral, (2) Granting Security Interests and Priority Claims, (3) Granting Adequate Protection, and (4) Modifying Automatic Stay" ("Final Order"). *See* Ex. 15. That Final Order did not include a mandate that the debtor marshal assets. Yamaha did not appeal the Final Order.

The Final Order authorized the debtor to enter into financial arrangements with LaSalle Bank. It stated that the debtor had been unable to obtain alternative sources of cash or credit and that, without the court's approval of this financing with the Bank, "its operations would be severely disrupted, it would be unable to pay operating expenses, . . . and unable to operate its businesses in an orderly manner . . . ." Ex. 15 at 8, ¶ I. It therefore authorized the debtor to incur post-petition secured indebtedness from LaSalle and to use cash collateral. It also granted security interests, priority claims, and adequate protection, and it modified the automatic stay. It established that proceeds from the sale of all collateral were to be applied first to the Bank's indebtedness "until paid in full," and second to the debtor-in-possession indebtedness "in such order as determined by the Lender in its sole discretion." *Id.* at 19, ¶ 6(b).

Of importance in this matter are the provisions of the Final Order that concern Yamaha. In the Order, Yamaha was listed as one of five "Subordinated Secured Creditors" who are parties to intercreditor agreements and/or subordination agreements. It stated that those agreements "provide that any and all liens and security interests held by such Subordinated Secured Creditors against the DIP [debtor-in-possession] Collateral[4], including, without limitation, purchase money security interests, are junior and subordinate to the Prepetition Senior Liens." *Id.* at 10, ¶ M. The Order granted replacement liens on the DIP collateral as adequate protection for the Subordinated Secured Creditors. *Id.* at 24, ¶ 9(c). However, those replacement liens were "in all respects subject and subordinate to the Carve-Out, DIP liens, Prepetition Senior Liens and Adequate Protection Senior Liens."[5] *Id.* In paragraph 17, the Order acknowledged that Yamaha had reserved its right to demand that LaSalle marshal the proceeds from the sale of Yamaha inventory and that LaSalle had reserved its objections and defenses to marshaling. *See id.* at 31, ¶ 17(a); *see also* R. 389 at 3, ¶ 7. Finally, in paragraph 27 of the Final Order, the court reiterated that all subordination agreements are enforceable pursuant to 11 U.S.C. § 510:

> [I]ntercreditor agreements between and/or among the Lender, Debtor and any non-Debtor party thereto, . . . remain in full force and effect and are not amended or modified by the terms of this Order. Nothing herein shall affect or alter the continuing validity, enforceability or effectiveness of such Subordination Reaffirmation, intercreditor agreements and subordination provisions or

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[4] The Final Order defines "DIP Collateral" as "all currently owned or hereafter acquired property and assets of the Debtor of any kind or nature whatsoever." Ex. 15 at 19, ¶ 7. The paragraph lists types of property that would be included in that category. *See id.* at 19-20.

[5] The Final Order defines "Carve-Out" in ¶ 11 (pp. 25-26); "DIP liens" in ¶ 7 (p. 19); "Prepetition Senior Liens" in ¶ E(2) (p. 5); and "Adequate Protection Senior Liens" in ¶ 8(a) (p. 20). *See* Ex. 15, Final Order.

> constitute a waiver or release by any party of any rights, remedies, benefits and/or privileges arising thereunder or in connection therewith.

Id. at 41, ¶ 27.

After the financing arrangements were in place pursuant to the Final Order, DBI continued its retail operations until February 9, 2007 ("the Retail Period"). *See* R. 389 at 3, ¶ 9. It sold at retail its inventory of musical instruments, including the Yamaha inventory.

On February 9, 2007, DBI closed a sale of substantially all its assets, on a "going concern" basis, to Musician's Friend, Inc. ("MFI") for approximately $26 million. Once the LaSalle indebtedness was deducted from the proceeds, the net proceeds amounted to approximately $5 million.[6] *See id.* at 3-4, ¶ 9. During the Retail Period, the debtor received total gross proceeds from the sale of Yamaha inventory in the amount of $1,465,607.[7] As required by the Final Order of December 22, 2006, all the proceeds received by DBI from the retail sale of the Yamaha inventory, as well as the proceeds received by DBI from the Yamaha receivables, in the amount of $577,837, were paid to LaSalle. *See id.* at 4, ¶¶ 10-11.

As part of the sale to MFI, DBI sold Yamaha inventory to MFI at cost in the amount of $919,262.00. MFI also acquired $104,938.41 of Yamaha receivables, which the parties agree are fully collectible. DBI retained the government-related receivables, totaling $25,136.39. *See id.* at 4-5, ¶¶ 12, 14.

In the Motion of Yamaha now before the court, Yamaha asserted that it was an oversecured creditor holding a secured claim of $2,814,659.93, a claim that would increase by about $48,570.00 each month. *See* R. 284 at 1-2; Ex. 19 (Proof of Claim #144). The court notes that this Motion was filed two months before the Stipulation. At that time, Yamaha had been informed and believed that the debtor held net proceeds of $7-9

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6 The parties agreed in the Stipulation that the debtor sold the DBI assets to MFI for about $26 million, paid LaSalle about $21 million, and ended with net proceeds of about $5 million. *See* R. 389 at 3, ¶ 9. These agreed amounts are significantly lower than the ones Yamaha relied upon in its Motion of Yamaha, filed two months before the Stipulation. The parties and the court now acknowledge that the net proceeds total about $5 million.

7 The parties stipulated that the cost of the Yamaha inventory had been $1,190,073; the debtor therefore made a gross profit of 18.8% on that inventory. *See* R. 389 at 4, ¶ 10.

million, after the sale of its assets to MFI for approximately $29.9 million and after payment of LaSalle's first priority claim, rather than the $5 million in proceeds subsequently acknowledged by the parties in the Stipulation. Yamaha had concluded that those proceeds were "far in excess of all potential secured claims." *Id.* at 4. Asserting its status as an oversecured creditor whose claim was increasing each day that it remained unpaid, Yamaha asked the court to direct the debtor to pay its secured claim in full. *See id.* at 5.

Gibson Guitar filed a limited objection to the Motion of Yamaha. It claimed to be in a substantially better collateral position than Yamaha and insisted that it be paid in full before Yamaha is paid. *See* R. 330.

The Committee also filed an objection. *See* R. 318. It argued that, under the Intercreditor Agreement, Yamaha subordinated its security interest in its collateral to LaSalle's senior security interest in all of the debtor's inventory and proceeds. As a result, it claimed, the amount of Yamaha's secured claim was much smaller than the amount Yamaha had asserted. According to the Committee, the purchase price for the debtor's assets must be categorized properly to determine what portion "should be allocated as the price that MFI paid for the Remaining Yamaha Inventory." *Id.* at 2. In its view, the valuation of Yamaha's remaining inventory determines the amount of Yamaha's secured claim under § 506. However, the debtor's assets first must be divided among accounts receivable; inventory; furniture, fixtures and equipment; and the debtor's good will. Then the purchase price paid by MFI for those assets must be allocated to each category. The Committee argued that the Motion of Yamaha should be denied and that the determination of the amount of Yamaha's claim be determined after MFI's purchase price has been allocated. *See id.* at 5-6.

Yamaha filed a Reply to the Committee's objection. *See* R. 328. It pointed out that Yamaha had received a replacement lien against all the debtor's assets to secure any diminution in the value of its collateral as of the petition date. *See id.* at 2. It also argued that the Intercreditor Agreement subordinated Yamaha's security interest only to that of the Bank's security interest, but not to the claims of administrative creditors, priority creditors, and general unsecured creditors. It claimed that "LaSalle has been paid in full, and the Debtor is holding more than sufficient net proceeds to pay the secured claims that were properly perfected in full, including Yamaha." *Id.* Yamaha alleged that the Committee was attempting "to 'reverse marshal' the Debtor's assets to the detriment of the junior lienholders and the benefit of unsecured creditors," *id.*, and suggested that the better course was to allocate the cash received from the sale of the debtor's assets "in a manner so that LaSalle's lien is first satisfied from the funds on which no other creditors have liens." *Id.* In a footnote, Yamaha explained that its suggestion was consistent with the equitable doctrine of marshaling. It insisted that the debtor had received the retail value of the Yamaha inventory and concluded that "[a]llocation of the purchase price paid by Musician's Friend to the various assets is therefore not relevant and the money to which Yamaha is legally entitled should not be held hostage while the Committee makes what are tantamount to ransom demands." *Id.* at 3.

At the hearing on April 30, 2007 [8], Yamaha asserted that it had a validly perfected security interest and that the value of its secured claim, which would be established by Yamaha's expert witness Joseph D. Vecchiolla, should be allowed in full. It also insisted that Yamaha had a right to marshal the debtor's assets. The Creditors' Committee distinguished between the value of Yamaha's lien and the value of its collateral and urged the court to recognize that its lien was now at issue. It pointed out that, under the Intercreditor Agreement, Yamaha's lien was subordinate to the Bank's: Yamaha had agreed that it would not enforce its rights until LaSalle was paid in full. The Committee also stated that the debtor did not hold sufficient proceeds to pay all secured claims in full. Finally, the Committee argued that it was not seeking reverse marshaling, as Yamaha alleged, and that Yamaha had waived its right to seek marshaling of the debtor's assets when it entered into the Intercreditor Agreement.

Two witnesses testified at the hearing. The testimony of David Yoder, Chief Financial Officer and Vice President of DBI, gave a historical perspective concerning the debtor's business. He described the $9 million judgment against the business, DBI's eventual filing of a chapter 11 case in bankruptcy, and its more

[8] Attorneys for Dennis Bamber (individually), American Way Marketing, LLC, US Band & Orchestra Supplies, Inc., LaSalle National Bank, and Conn-Selmer, Inc., appeared at the hearing and spoke on behalf of their clients.

diminished value after Steinway Musical Instruments, Inc. (the company that had presented the highest bid to purchase the debtor) rescinded the offer to buy DBI. He told the court of the subsequent purchase by MFI, and opined that the price would have been $7 million higher if DBI had been able to close on the original offer. According to Yoder, MFI bought most of DBI's assets, including Yamaha's inventory that remained after Yamaha's stock rebalancing in the fall and after the sale of its products during the Retail Period. On cross-examination, the witness stated that the revolving loan to LaSalle Bank was reduced from about $22 million to about $17 million through the sale of inventory from Yamaha and other vendors. He also testified that, if the debtor had been closed and liquidated immediately upon sale, without allowing the debtor a Retail Period, the debtor's value would have been much lower.

Yamaha's expert witness, Joseph D. Vecchiolla, was presented as an expert highly experienced in distressed musical instrument retailer sales. He offered his expert opinion concerning the value of Yamaha's secured claim on the petition date. Testifying before the court and summarizing his evidence with a power point presentation, he valued the inventory thus: The debtor received $1,465,607 when it sold Yamaha's inventory during the Retail Period. The expert reduced that amount by 4.5%, in consideration of the costs of the sale, for a value of $1,395,991. The expert then assigned a 100% value to the Yamaha inventory sold to MFI for $919,262, because that was the value of the inventory on the petition date. In his opinion, the total inventory value on the petition date thus was $2,315,253. The expert added the accounts receivable amount, $707,912, and came to a total value of Yamaha's collateral, as of the date of the petition, of $3,023,165. On cross-examination, Vecchiolla stated that he determined the value of Yamaha's collateral, not its lien. He did not look at the Intercreditor Agreement, the debtor-in-possession monthly financial reports, the court's Final Order, or other documents, and did not deduct the rent, employees' salaries, or other costs that caused the debtor to lose money during that period.

After closing arguments, the court took the Motion of Yamaha under advisement.

Discussion

In its Motion, Yamaha asks this court to compel the debtor DBI to release the proceeds from the sale of Yamaha's collateral in order to satisfy Yamaha's secured claim. It argues that the court authorized the debtor to sell its assets free and clear of liens pursuant to 11 U.S.C. § 363(f), but required immediate distribution of those sale proceeds only to reduce the secured indebtedness of LaSalle Bank. Yamaha asserts that it is an oversecured creditor owed a debt of $2,814,659.93 – or even more, $3,023,165.00, if the court accepts the opinion of Yamaha's expert witness. According to Yamaha, because it received a replacement lien against all the debtor's assets to secure any diminution in value of its collateral, it remains fully secured. It admits that, under the Intercreditor Agreement, it subordinated its security interest in the Yamaha collateral to LaSalle's security interest in the debtor's assets. Nevertheless, Yamaha insists that it did not agree to release its lien. It believes that LaSalle, the senior secured creditor, has been paid in full and that the debtor holds more than sufficient net proceeds to pay the properly perfected secured claims. Yamaha thus demands that its secured claim be paid in full, as well.

The court begins with Yamaha's acknowledgment that it agreed to subordinate its security interest to the Bank's security interest. In the court's view, this voluntary agreement into which Yamaha and the Bank entered, months before DBI filed bankruptcy, defines their relationship as mutual claimants of the debtor's assets. The Intercreditor Agreement, which establishes Yamaha's consent to be subordinated to the Bank, thus is central to the court's analysis of Yamaha's demand for payment of its secured claim.

Section 510(a) of the Bankruptcy Code states that a "subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law." 11 U.S.C. § 510(a). The Intercreditor Agreement provides that it is governed by Illinois law, and subordination agreements have been found to be enforceable under Illinois law. *See Bank of America v. North LaSalle St. Ltd. P'ship (In re 203 North LaSalle St. P'ship)*, 246 B.R. 325, 329 (Bankr. N.D. Ill. 2000); *Marriott Family Restaurants v. Lunan Family Restaurants (In re Lunan Family Restaurants)*, 194 B.R. 429, 447 (Bankr. N.D. Ill.

1996); *In re Chicago, South Shore and South Bend R.R.*, 146 B.R. 421, 425 (Bankr. N.D. Ill. 1992). "The intent of § 510(a) (subordination) is to allow the consensual and contractual priority of payment to be maintained between creditors among themselves in a bankruptcy proceeding[]." *Beatrice Foods Co. v. Hart Ski Mfg. Co., Inc. (In re Hart Ski Mfg. Co., Inc.)*, 5 B.R. 734, 736 (Bankr. D. Minn. 1980).

Subordination and intercreditor agreements are simply contracts, and they are governed by the state laws of contract – in this case, Illinois law. They often are created when a single debtor or borrower, like DBI, has entered into commercial dealings with two or more creditors, such as the Bank and Yamaha, and the parties attempt to resolve foreseeable conflicts contractually, through an intercreditor agreement which establishes the relative rights and obligations of the parties. One type of intercreditor agreement is a subordination agreement. *See Krafsur v. Scurlock Permian Corp. (In re El Paso Refinery, LP)*, 171 F.3d 249, 256-57 (5th Cir. 1999) (finding that the intercredit agreement before it was a subordination agreement); *see also* Schnebel, Debra J., "Intercreditor and Subordination Agreements – A Practical Guide," 118 Banking L.J. 48, 48-49 (Jan. 2001).

> A subordination agreement is ". . . nothing more than a contractual modification of lien priorities and must be construed according to the expressed intention of the parties and its terms." The parties to a subordination agreement normally consist of a "common debtor" who owes a debt to two creditors or two groups of creditors, a creditor known as the "junior creditor" that agrees to subordinate its debt to the debt of another creditor, and a "senior creditor" that benefits from the subordination agreement and acquires priority over the junior creditor. Such agreements are routinely entered into by one creditor to induce another to extend additional credit to the debtor or ensure that its loans are used as working capital by the debtor and not just to repay insider debts.

In re Chicago, South Shore and South Bend R.R., 146 B.R. at 426 (citations omitted). In this case, both the Bank and Yamaha hold liens on the same collateral, namely Yamaha's inventory, proceeds, and receivables, to secure their respective obligations. By agreeing to subordinate its rights, Yamaha modified a right that belonged to it prior to the subordination agreement.

"As with other contracts, Illinois law provides that, in the absence of ambiguity, the terms of subordination agreements are to be construed according to their plain language." *In re 203 North LaSalle St. P'ship*, 246 B.R. at 329. The court finds that the language of this Intercreditor Agreement is not ambiguous. The

Agreement expressly states that its purpose is to set forth the parties' relative priorities in the debtor's assets. *See id.*, p.1, ¶ C. Yamaha, the junior creditor, agrees to subordinate all of its rights with respect to the debtor's assets to the rights of the Bank, the senior creditor. *See id.*, p.2, § 1. The expansiveness and clarity of that language – subordination of all of its rights – leave no doubt of Yamaha's consent to the total payment of the Bank's indebtedness prior to any payment of Yamaha's debt. The Agreement also establishes that the senior creditor has exclusive rights of enforcement and that the junior creditor will forego its right to enforce payment of its debt if the debtor defaults. *See id.*, § 4; *see also* Schnebel, 118 Banking L.J. at 61. In addition, even if the debtor files bankruptcy, the Agreement continues in full force and effect. *See id.*, § 5. The Agreement clearly declares that Yamaha intended and agreed to subordinate all of its rights in the debtor's collateral to the senior rights of the Bank. Yamaha offers no evidence to contradict the unambiguous terms of the Agreement. *See Sunset Hollow Properties, LLC, v. Bank of Western Massachusetts (In re Sunset Hollow Properties, LLC)*, 359 B.R. 366, 376-77 (Bankr. D. Mass. 2007).

The court finds that the Intercreditor Agreement is enforceable under Illinois law and under § 510 of the Bankruptcy Code. It further determines that the Agreement is clear on its face and thus that the court must effectuate its terms and the parties' intentions. *See In re Hinderliter Indus., Inc.*, 228 B.R. 848, 852 (Bankr. E.D. Tex. 1999) (finding that drafters of subordination clause intended to protect senior debt holders; enforcing its terms); *In re Chicago, South Shore & South Bend R.R.*, 146 B.R. at 428 (enforcing subordination agreement under Illinois law). The parties agreed that Yamaha's interest in the debtor's collateral and proceeds therefrom was fully subordinated to that of the Bank. Under the terms of the Agreement, unless and until the Bank's fully secured claim is paid in full, Yamaha has no interest in proceeds from sale of the debtor's collateral. *See In re Lunan Family Restaurants*, 194 B.R. at 447; *In re Chicago, South Shore & South Bend R.R.*, 146 B.R. at 429.

Yahama asserts, however, that its replacement lien secures any diminution in the value of its collateral and leaves it fully secured. The grant of replacement liens on all the debtor's assets was provided in the court's Final Order of December 22, 2006. The Order stated that DBI and the other Subordinated Secured Creditors received "replacement liens on the DIP collateral as adequate protection to the extent of any diminution in value of such holder's interest in its prepetition collateral." *Id.* at 24, ¶ 9(c). However, paragraph 9(c) also provided that those replacement liens were "in all respects subject and subordinate to the Carve-Out, DIP liens, Prepetition Senior Liens and Adequate Protection Senior Liens."[9] *Id.* Yamaha's replacement lien thus is junior and subordinate to the Bank's senior lien, the carve-out, and other liens. Moreover, the paragraph continues, if the replacement liens do not provide adequate protection, the replacement lienholder is entitled to "to the full benefits and protections of a claim arising under section 507(b) of the Bankruptcy Code, which claim shall be in all respects subject and subordinate to the Super-Priority Claims and Adequate Protection Senior Claims." *Id.* The court's Final Order clearly provides, therefore, that Yamaha's adequate protection replacement lien is junior to the Bank's and other liens, and that its recourse is to assert a priority claim under § 507(b), even though it will be subordinate to super-priority and other senior claims.

After reviewing in detail the record in this case, the documentary evidence, testimony, and arguments of counsel at trial and in briefs, the court determines that the Bank and Yamaha each held security interests in the same collateral and that the proceeds from the sale of that collateral were paid over to the Bank, not to Yamaha, as the parties had agreed in the Intercreditor Agreement. It finds that it was the clear intent of the parties to that Agreement to protect and benefit the senior creditor, the Bank. *See, e.g., Goldberg Co., Inc. v. County Green Ltd. P'ship (In re County Green Ltd. P'ship)*, 438 F. Supp. 693, 699 (W.D. Va. 1977); *In re Hinderliter Indus., Inc.*, 228 B.R. at 852. "The very purpose of subordination clauses is to allow holders of senior indebtedness to recover if the debtor cannot meet its obligations." *In re Envirodyne Indus., Inc.*, 161 B.R. 440, 448 (Bankr. N.D. Ill. 1993). The language of the Intercreditor Agreement is unambiguous and unequivocal:

> [Yamaha] does hereby agree that *all of its rights* with respect to the Collateral, including, without limitation, the Creditor Collateral, *shall be in all respects subject and subordinate* to the rights of the Bank with respect to such Collateral in connection with and on account of all obligations and liabilities owed to the Bank by Debtor.

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[9] *See* fn. 5, *supra*, for the Final Order's definition of those terms.

Ex. 15, § 1 (emphasis added). In addition, the Final Order undeniably continued that protection of the Bank as senior lien holder. The Order provided that the Intercreditor Agreement remained in full force during the debtor's bankruptcy. *See* Ex. 15 at 41, ¶ 27. It also ordered that all the liens and security interests held by Yamaha and the other "Subordinated Secured Creditors" who were parties to intercreditor agreements and/or subordination agreements were "junior and subordinate to the Prepetition Senior Liens." *See id.* at 10, ¶ M. It subordinated the replacement liens, as well. *See id.* at 24, ¶ 9(c). The parties' intention to benefit the Bank, holder of the prepetition senior liens, is manifest.

Therefore, when the debtor received proceeds from the sale of Yamaha's inventory during the Retail Period, the proceeds were paid to LaSalle, not to Yamaha, to reduce the debt DBI owed to LaSalle. Furthermore, even though Yamaha's replacement lien attached to the proceeds from the sale of Yamaha collateral, it remained subordinate to the Bank's and other liens. *See* Schnebel, 118 Banking L.J. at 62 ("Lien subordination provides the senior creditor with priority to the extent of the collateral."). The court determines that, pursuant to the Intercreditor Agreement and the Final Order, Yamaha's right to the Yamaha collateral, through its perfected security interest and replacement lien, is in all ways subordinated to the Bank's rights and to those liens listed in the Final Order.

A determination of Yamaha's lien status and of the valuation of the collateral upon which it holds a security interest is complicated by the fact that the DBI bankruptcy case was converted to a chapter 7 case. The court's records reflect that the debtor turned over to the chapter 7 Trustee funds in the total amount of $4,142,370.13. *See* R. 484, Amended Final Report and Account. It also filed a schedule of unpaid liabilities in the Chapter 11 case and unpaid administrative claims. *See* R. 486, Amended Schedule of Unpaid Liabilities. At this point, it is unclear which assets of the debtor are available for payment of secured claims against the debtor's estate.[10] *See In re 203 North LaSalle St. P'ship*, 246 B.R. at 332 ("If the assets in a given estate are sufficient,

[10] The Final Order states that it is "practically difficult and costly not only to trace and allocate the cash proceeds received by Debtor to particular items of DIP Collateral . . . but to determine the extent to which such proceeds (continued...)

a subordinated claim certainly has the potential for receiving a distribution."). What is clear, nevertheless, is that the Bank is the beneficiary of the Intercreditor Agreement and that the court's Final Order proclaims that Agreement "in full force and effect." As a result, the court must construe the Agreement to effectuate that protection. *See In re Sunset Hollow Properties, LLC*, 359 B.R. at 376 (stating its obligation to construe subordination agreement to afford substantial practical benefits to Bank, as beneficiary of agreement).

There are, of course, other secured claims against the debtor's estate. The court finds that there is clear evidence that the Bank is first in priority of payment from the debtor's assets, but no evidence upon which to base an order disbursing any amount or making any distribution of the property of this estate to Yamaha prior to other secured creditors. Nor has Yamaha cited to the court any statutes or case law to support its demand for immediate satisfaction of its claim. Now that this case has been converted to a chapter 7 asset case, the Trustee has the responsibility of prioritizing claims before disbursement.[11] *See In re Hinderliter Indus., Inc.*, 228 B.R. at 854 (finding that "premature disbursement could require eventual disgorgement, further litigation and could cause additional costs and expenses to accrue against the estate to the detriment of all creditors"). The court therefore denies the Motion of Yamaha asking the court to compel the debtor to release the proceeds from the sale of Yamaha's collateral to satisfy its secured claim.

One other matter must be considered. Yamaha suggested, in its Reply Brief and Trial Brief, that the Committee was seeking to "reverse marshal" the debtor's assets. *See* R. 328 at 2; R. 388 at 8-10. It discussed the equitable doctrine of marshaling in a footnote of the Reply Brief and asserted its right to marshal the debtor's assets in its Trial Brief and at the hearing. *See* R. 328 at 2, n.1; R. 388 at 11-12. Such informal references to marshaling and accusations of the Committee's "reverse marshaling" are not issues or allegations properly raised

[10](...continued)
are attributable to Prepetition Collateral as distinguished from DIP Collateral not constituting Prepetition Collateral." Ex. 15 at 12, ¶ P.

[11] Because the chapter 7 Trustee is aware of the prior agreements made between certain Subordinated Secured Creditors and the debtor, before it converted to chapter 7, in resolution of their claims, the court is confident of the fair treatment to be accorded to the remaining Subordinated Secured Creditors.

before the court. Yamaha never has sought marshaling through any formal filing. Because marshaling is a doctrine seeking equitable relief, it must be brought in an adversary proceeding. *See* Fed. R. Bankr. P. 7001(7); *In re Borges*, 184 B.R. 874, 882 (Bankr. D. Conn. 1995); *In re Mel-O-Gold, Inc.*, 88 B.R. 205, 207 (Bankr. S.D. Iowa 1988). Moreover, even if Yamaha's comments could be treated as legal arguments, such arguments raised for the first time in a reply brief are deemed waived. *See Black v. Educational Credit Mgmt. Corp.*, 459 F.3d 796, 803 (7th Cir. 2006).

Conclusion

For the reasons set forth in this Memorandum of Opinion, the court denies the Motion of Yamaha Corporation of America for Order Compelling Debtor to Release Proceeds from Sale of Yamaha Corporation of America's Collateral to Satisfy Yamaha's Secured Claim.

SO ORDERED.

/s/ Harry C. Dees, Jr.
HARRY C. DEES, JR., CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT