**United States Bankruptcy Court**
**Western District of Wisconsin**

Cite as: [Unpublished]
[aff'd, Case No. 00-C-270-S (W.D. Wis. June 29, 2000)]

**Michael E. Kepler, Trustee, Plaintiff, v.**
**The Travelers Indemnity Co., Defendant**
(In re Anthony Grignano Co., Debtor)
Bankruptcy Case No. 98-35139-7, Adv. Case. No. 99-3144-7

United States Bankruptcy Court
W.D. Wisconsin

March 21, 2000

Timothy J. Peyton, Kepler & Peyton, Madison, WI, for plaintiff.
Patricia M. Gibeault, Axley Brynelson, Madison, WI, for defendant.

Robert D. Martin, United States Bankruptcy Judge.

## MEMORANDUM DECISION

The facts of this case are not in dispute. Prior to 1989, the Travelers Indemnity Co. ("Travelers") acted as surety for the debtor, Anthony Grignano Co. ("Grignano"), on several construction projects. Grignano defaulted and Travelers paid as surety. In 1989, Grignano, Travelers and M&I Bank entered into a workout agreement to allow for an orderly liquidation of the debtor's assets. Under that agreement, Grignano agreed to sell its real estate and pay the net proceeds to Travelers.

In 1995, Travelers commenced a state court action against Grignano, claiming that it was owed more than $360,000 under the terms of the surety agreement and the workout agreement. Grignano filed an answer and counterclaims, challenging Travelers' claim to a money judgment and to any equitable rights in the proceeds from the sale of the real estate. On June 19, 1995, in an injunction order, the state court allowed the sale of the last real estate asset owned by Grignano, but required that the net proceeds from the sale be held in two joint bank accounts, in the name of Travelers and Grignano ("the accounts"), until further order of the court. A trial was scheduled for November 4, 1998.

On October 14, 1998, John Kasimatis, a judgment creditor of Grignano, whose motion to intervene in the state court suit was denied, filed an involuntary bankruptcy petition against Grignano. Travelers obtained relief from the automatic stay to allow the state court trial to proceed and determine the amount owed by Grignano to Travelers. The state court entered a judgment that Grignano was indebted to Travelers in the amount of $388,818.34 plus interest in the amount of $45,903.72 and separately released the bond Travelers had posted to obtain the Injunction Order, but made no other ruling on the rights of the parties in the accounts.

The trustee, Michael E. Kepler ("the trustee") brought this adversary proceeding to compel turnover of the funds in the accounts. Travelers brought a motion for summary judgment on three grounds: (1) under the doctrine of *custodia legis*, the funds were held

in escrow for the benefit of Travelers, and are not available to other creditors until Travelers' claims have been satisfied; (2) Travelers holds an equitable or a judicial lien on the accounts, which cannot be defeated by the trustee in bankruptcy; and (3) Travelers has a security interest in the accounts under the U.C.C. The trustee filed a cross motion for summary judgment seeking a declaratory judgment that Travelers is an unsecured creditor on three grounds: (1) the doctrines of *custodia legis* and collateral estoppel are inapplicable in this case; (2) Travelers does not have an equitable lien on the accounts, and is therefore not a secured creditor; and (3) Travelers does not have a security interest under the U.C.C.

The standard for summary judgment in the Seventh Circuit was outlined by this court in In re Cole, 234 B.R. 417, 418 (Bankr. W.D. Wis. 1999):

The movant has the burden to demonstrate that there is no genuine issue of material fact in dispute. Celotex v. Catrett, 477 U.S. 317, 322, 106 S.Ct. 2548, 2552, 91 L.Ed. 2d 265 (1986). Furthermore, the evidence offered by the movant is viewed in a light most favorable to the non-moving party. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249, 106 S.Ct. 2505, 2510, 91 L.Ed. 2d 202 (1986). However, once the Motion for Summary Judgment has been made and properly supported, Celotex, 477 U.S. at 324, 106 S.Ct at 2553, the party opposing the motion may not rely on the mere allegations and denials contained in its pleadings, but must submit countervailing evidence to show that a genuine issue exists for trial. Fed. R. Civ. P. 56(e). No genuine issue for trial exists if the record, taken as a whole, does not allow a rational trier of fact to find for the nonmoving party. Matsushita Elec. Ind. Co. v. Zenith Radio Corp., 475 U.S. 574, 587, 106 S.Ct. 1348, 1356, 89 L.Ed. 538 (1986).

Id. *citing* In re Balay, 113 B.R. 429, 434 (Bankr. N.D. Ill. 1990). I find that there are no issues of material fact, and that summary judgment is appropriate to resolve this case. However, I find none of the grounds for summary judgment argued by the parties completely dispositive of the issues. I will not address those arguments specifically, except to say that the requirements of a perfected security interest under Wisconsin's version of the Uniform Commercial Code have not been met by Travelers. In considering the other attributes of their competing interests, there is a clearer and preferable basis for analysis to that offered by the parties.

Although the state court did not describe its injunction as an attachment of the sale proceeds, the injunction order, which required that the proceeds from the sale of real estate by the debtor be placed in the accounts, had the qualities and the effect of an attachment under Wisconsin law. Wisconsin law provides for attachment on a contract or judgment on the following terms:

Before any writ of attachment shall be executed the plaintiff or someone in the plaintiff's behalf shall make and annex thereto an affidavit setting forth specific factual allegations to show that the defendant is indebted, or that property of the defendant is available to the plaintiff in a sum exceeding $50 specifying the amount above all setoffs, and that the same is due upon contract or upon a judgment and that the affiant knows or has good reason to believe...[t]hat the defendant has disposed of or concealed or is about to dispose of or conceal the defendant's property or some part thereof with intent to defraud the defendant's creditors....

Wis. Stat. §811.03(b).[(1)]

It is clear that Judge Aulik, after reviewing one or more affidavits submitted by Travelers, considered the same factors in granting the injunction order that a court would consider in granting a pre-judgment attachment. First, the debt owing to Travelers arose by contract through the surety agreement and the workout agreement.

Second, the workout agreement provided that Grignano would sell its real estate and pay the proceeds to Travelers. The transcript of the injunction hearing reveals that the real estate at issue was agreed to be the last asset of real estate owned by Grignano and was Travelers' last reliable source of payment. The transcript also makes clear that Judge Aulik believed Travelers had reason to fear that Grignano would conceal or dispose of the proceeds with the intent to defraud its creditors. Grignano had not notified Travelers of the sale of the real estate; Travelers found out about it from the newspaper. Moreover, it appeared that money from the sale of other Grignano real estate had been used to pay the claims of insiders or was unaccounted for. The transcript of the hearing shows that Judge Aulik used an attachment analysis in granting the injunction.

Under the injunction order, in June of 1995, Travelers was placed in the position of a pre-judgment attachment creditor who had levied on and "caught" the proceeds from the sale of Grignano's last real estate asset. Under Wisconsin law, an attaching creditor is treated as having a lien in the property when the creditor levies upon the attachment. *See* Robertson v. Kinkhead, 26 Wis. 560 (Wis. 1870) (holding that "attachment becomes a lien...from the time when it is attached"); Nassauer v. Kahn, 65 Wis. 388, 27 N.W. 80 (Wis. 1886); Barth v. Graf, 101 Wis. 27, 76 N.W. 1100 (Wis. 1898); French Lumbering Co. v. Theriault, 107 Wis. 627, 83 N.W. 927 (Wis. 1900); Gallun v. Weil, 116 Wis. 236, 92 N.W. 1091 (Wis. 1903); Spellbrink v. Bramberg, 245 Wis. 322, 14 N.W.2d 38 (Wis. 1944). Therefore under Wisconsin law, Travelers had a lien which was the perfect analog to an attachment lien in the proceeds of the real estate when the proceeds were deposited in the accounts.

This analysis is bolstered by Judge Aulik's use of the word "lien" in his ruling in the injunction proceeding. Judge Aulik stated:

The bottom line is that I'm going to conclude that the -- I'm going to grant a temporary injunction in favor of the plaintiff creating a lien against the proceedings [sic] of the sale of the real estate, and nothing should take place by plaintiff to in any way encumber or impede that sale, and that upon that taking place that the -- you shall furnish a bond, sufficient surety, to cover the amount of that claim -- double the amount of that claim, the amount of the net proceeds.

Transcript of Proceedings, p. 51. Other courts have also found a temporary injunction to be akin to a pre-judgment attachment. In Wind Power Systems, Inc. v. Cannon Financial Group, Inc., 841 F.2d 288, 291 (9th Cir. 1988), the Ninth Circuit discussed the effect of a temporary protective order on the debtor's property:

California law allows a creditor to obtain a TPO against a debtor's property after it has shown in an ex-parte proceeding the probable validity of its claim and the probability of great harm if relief is not granted. The TPO creates a lien on all of the debtor's named property which survives most transfers.... The creditor can then obtain an order to attach and a writ of attachment after notice and a full hearing. At the hearing, the creditor must show that, on the facts presented, it would be entitled to a judgment on the claim on which the attachment is based.... When the creditor levies upon the writ, an attachment lien is created in its favor.... If the property thereby attached was also subject to a TPO at the time of levy, "the priority of the attachment lien relates back to the date the earlier lien was created."

Id. The TPO in Wind Power seems very similar to the injunction order in this case. As in Wind Power, Judge Aulik's injunction order created a lien in favor of Travelers in the proceeds. Placing the funds in the accounts and requiring the signatures of both Grignano and Travelers gave notice to the world that Travelers had an interest in the funds, at least until the state court, by order, ruled to the contrary. No more was

necessary for Travelers to perfect its interest.

The remaining issues that I must determine are whether the accounts ever became property of the estate and whether Travelers' lien may be avoided by the trustee. Only the "strong arm" powers given the trustee under §544(a) have been claimed to benefit the trustee.

Under the Bankruptcy Code, property of the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. §541(a)(1). However, 11 U.S.C. §541(d) provides:

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

Id. To prevail, the trustee must demonstrate that at the time of Grignano's bankruptcy, Grignano held something more than bare legal title in the amount of the accounts necessary to satisfy the claim of Travelers.

There is little Wisconsin case law on pre-judgment attachment, and it is very old. Robinson Bros. Shoe Co. v. Knapp, 82 Wis. 343, 52 N.W. 431 (Wis. 1892), a case with facts similar to the case at hand, discusses a creditor's interest in property of the debtor that has been attached. In Robinson, a creditor commenced attachment proceedings against the debtor. Id. The property was levied, sold, and the proceeds were held in the custody of the court pending final judgment on the attachment. Id. The debtor then commenced insolvency proceedings. Id. The court held that "the attaching creditor has a prior right over insolvency proceedings to the debtor's property....." Any assignment to another creditor in the insolvency proceedings vests with the assignee only the interest that the debtor had in the property at the time of the insolvency proceedings. Id. *See also* Mowry v. White, 1867 WL 1707 (Wis. 1867). Applying Robinson to this case, Travelers has a right to the funds in the accounts which is prior to any right of the trustee.

Other jurisdictions and more recent cases have also determined that property subject to a lien is not property of the estate under 11 U.S.C. §541(a), (d). In In re Carousel Int'l Corp., 89 F.3d 359, 362 (7th Cir. 1996), the Seventh Circuit discussed what constitutes property of the estate under §541(a):

[T]he scope of "property" under §541 is necessarily limited to the property owned by the debtor at the commencement of the bankruptcy.... A debtor's interest in a portion of the property does not subject the entire property to §541. Nor does a debtor's claim to property mean that the entire property is part of the bankruptcy estate. Put simply, the bankruptcy estate does not own property solely because the estate has a claim of ownership.

Id. In In re Roggenbuck, 51 B.R. 913, 917 (Bankr. E.D. Mich. 1985, J. Spector), the bankruptcy court stated that "[t]he trustee's powers in §544(a) must be read in conjunction with 11 U.S.C. §541(d).... The effect of this provision is that the interest in property to which the trustee succeeds can be no greater than that which the debtor itself had.... Thus, if a creditor holds an equitable interest in property, the trustee may not avoid that interest by resorting to §544(a)." Upon application of the analogy to an attachment, the trustee must be seen to have an interest in the subject proceeds that is

junior to that of Travelers.

Travelers' lien in the proceeds may not be avoided by the trustee using his avoiding powers under §544(a). Section 544(a) provides:

The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by-

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists;

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such purchaser exists.

11 U.S.C. §544(a). Travelers obtained its attachment-like lien in June of 1995. A state court did not enter judgment determining the amount that Travelers could recover until November of 1998, one month after Grignano's involuntary bankruptcy petition. For those forty odd months, the amount of Travelers' interest was undetermined, but its priority was not. A subsequent creditor could only reach the portion of the accounts which were ultimately determined to be unnecessary to satisfy Travelers.

In In re Southern California Plastics, 165 F.3d 1243, 1246 (9th Cir. 1999), the Ninth Circuit discussed the priority of an attachment lien under California law:

An attachment lien is created when the creditor files a notice of attachment or otherwise levies on the property.... This lien has priority over subsequent liens.... Unlike the holder of a security interest, however, the attachment creditor has no right to proceed against the property until after the creditor obtains a judgment.... "The attaching creditor obtains only a potential right or a contingent lien..." which is perfected or converted to a judgment lien upon judgment for the creditor.... The priority of the judgment lien relates back to the date of the attachment lien. Thus, an attachment lien acts as a placemaker, ensuring the creditor's spot in the priority line until the creditor can obtain judgment. The inchoate nature of an attachment lien, however, does not make it vulnerable to a trustee's strong arm powers.... [A] trustee could not avoid an attachment lien though it was not perfected by judgment. Typically, a trustee, acting as a hypothetical lien creditor pursuant to 11 U.S.C. §544, may avoid an unperfected security interest.... An attachment lien, however, differs from an unperfected interest; assuming that the attachment creditor reduces its claim to judgment, the lien cannot be defeated by a judicial creditor whose lien arose after the attachment.

Id. Applying this analysis to the case at hand, Travelers had a contingent lien under the 1995 injunction order. However, once Travelers obtained relief from stay and a judgment in state court in November of 1998, Travelers' lien was converted into a judgment lien that related back to June 1995.[(2)] The trustee has not identified any lien creditor prior to Travelers through which he claims under 11 U.S.C. §544(b). Under 11 U.S.C. §544(a), the trustee cannot avoid Travelers' interest in the proceeds anymore

than a subsequent judgment creditor could prime it.

In In re Giordano, 169 B.R. 12, 13 (Bankr. D.R.I. 1994, J. Votolato), the bankruptcy court held that a "prejudgment attachment constitutes a valid and perfected lien which is superior to the rights of the Trustee, notwithstanding that judgment has not been entered." In In the Matter of DeLancey, 94 B.R. 311, 314 (Bankr. S.D.N.Y. 1988, J. Schwartzberg), the bankruptcy court held that an unperfected prejudgment attachment lien could be pursued after bankruptcy. Upon judgment, the prejudgment attachment lien would ripen into a vested lien, relating back to the date of attachment. Id. As discussed above, under Wisconsin law, an attachment becomes a lien upon the property on the date of levy. The sale proceeds were levied upon when, by order of the state court, Grignano was required to deposit the proceeds into the accounts.

I conclude that Travelers had an interest in the proceeds held in the accounts as of the date of the injunction order. Travelers' interest became fully vested when the state court entered a judgment in its favor in November of 1998. Travelers' interest held its place in line (its priority) as to the accounts until its interest vested, and related back to June of 1995, the date of the injunction order. Therefore, Travelers' interest is paramount to and may not be avoided by the trustee in bankruptcy.

**END NOTES:**

1. The writ of attachment finds it origin in history, and traces of the attachment remedy have been found even in Roman law. It was a recognized remedy in the early practices and customs of London merchants. The common law of attachment has been codified by state statutes which must be consulted to determine the extent and scope of attachment in its modern applications. *See* 6 Am. Jur. 2d *Attachment and Garnishment* §15 (1999).

2. The state court may have tacitly recognized the priority of Travelers' lien when it denied Kasimatis' (whose claim to the proceeds was based upon a subsequent judgment lien) motion to intervene in the state court case, although the denial may have been for purely procedural reasons.