

Subordination Agreement
Payment under Plan on subordinated claim

Endeavor Structured Equity and Mezzanine Fund I, LP and THL Credit, Inc. v. Engel, et al.,
Adversary No. 14-6119-fra
C & K Market, Inc., Case No. 13-64561-fra11

4/16/2015

FRA

Unpublished (2015 WL 1777689)

Debtor C & K Market purchased the businesses of the three Defendants remaining in this adversary proceeding after the others defaulted. Debtor made a down payment and executed promissory notes for the remainder of the purchase price. Two of the three Defendants signed subordination agreements with Debtor's first lender by which any payments made on the Defendants' claims after specified events, including the filing of bankruptcy by the borrower (i.e. the Debtor), would instead be directed to the senior lender's claim, until such lender's claim was paid in full.

The Debtor thereafter obtained a loan from Plaintiffs to pay off the prior loan and obtained subordination agreements from the two Defendants who had earlier executed similar agreements with the prior lender. Shortly thereafter, Debtor purchased the business of the third Defendant, who took a promissory note for the balance of the purchase price. One of the documents signed by the third Defendant as part of the sale was a subordination agreement in favor of Plaintiff.

Debtor filed a chapter 11 bankruptcy and a plan was confirmed in which unsecured creditors, including Plaintiffs and the Defendants, received stock in the Reorganized Debtor in lieu of cash. Plaintiffs filed this adversary proceeding seeking a declaratory judgment that under the subordination agreements, Plaintiffs are entitled to hold the stock issued to the Defendants until such time as their pre-petition claims are paid in full in cash, as specified by the subordination agreements. Plaintiff filed a motion for summary judgment and Defendants filed a cross-motion for partial summary judgment.

Defendants cross-motion sought the court's ruling on three of its defenses that the subordination agreements are not enforceable: 1) there was no consideration given for the execution of the subordination agreements, 2) the subordination agreements were terminated by payment of the underlying debts, and 3) the subordination agreements were terminated pursuant to the terms of the confirmed chapter 11 plan.

The court ruled in favor of the Plaintiffs on the Defendants' second and third defenses. As for the argument that the subordination agreements were unenforceable due to lack of consideration, the court held that there are genuine issues of material fact outstanding requiring that the matter be determined at trial.

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

IN RE)
C & K MARKET, INC.,)
Debtor.)
-----)
ENDEAVOUR STRUCTURED EQUITY AND)
MEZZANINE FUND I, L.P. and)
THL CREDIT, INC.,)
Plaintiffs,)
vs.)
DALE ENGEL, MELVA J. ENGLE, MARCUS R.)
GOULD, CHARLOTTE J. GOULD, ROBERT)
KOMLOFSKE, KOMLOFSKI CORPORATION,)
KENNETH MARTIN, LYNDA MARTIN, S & J)
REED, INC., TARKS, INC., YANTIS)
ENTERPRISES, INC.,)
Defendants.)

Bankruptcy Case
No. 13-64561-fra11

Adversary Proceeding
No. 14-06119-fra

MEMORANDUM OPINION

FACTS

Prior to its petition for relief, the Debtor owned and operated approximately sixty grocery stores and pharmacies in Southern Oregon and Northern California. In 2004, the Debtor¹ purchased the business of

¹ Purchases of pharmacies and stores was actually made by C & K Express, Inc., a wholly-owned affiliate of C & K Market. Prior to bankruptcy, C & K Express was merged into the Debtor C & K Market, (continued...)

1 S & J Reed, Inc. (Reed) and in 2006 the business of Kenneth and Lynda Martin (Martin). Martin received a
2 cash down payment as part of the purchase price and a 10-year promissory note for the remaining balance
3 due. The Martins also signed a subordination agreement with C & K Market and the then senior lender for
4 C & K Market, General Electric Capital Corp. (GE), by which the amounts due under the promissory note
5 would be subordinated to C & K Market's obligation to GE in the event of an "Insolvency Event," and upon
6 the occurrence of such event no payments would be made on the Martin note until the obligation to GE was
7 paid in full. A similar sale was made in the case of Reed and, according to documents presented to the Court
8 by Plaintiff, a subordination agreement was also signed by Reed.

9 On October 28, 2010, a promissory note (the C & K Note) was executed between Endeavor
10 Structured Equity and Mezzanine Fund I, L.P., THL Credit, Inc. (collectively the Senior Lenders) and C & K
11 Market², by which C & K Market borrowed unsecured funds which were used to refinance the claims held
12 by GE and another lender. Senior Lenders and U.S. Bank replaced GE and the former lender, whose debts
13 were paid in full. Payment in full of GE's and the second lender's loan terminated the subordination
14 agreements entered into by Martin and Reed, according to the terms of those agreements.

15 Sometime after the C & K Note was entered into, a representative of C & K Market sent a letter to
16 both Martin and Reed, requesting that they sign new Subordination Agreements, which they did. As with the
17 earlier subordination agreement, Martin and Reed subordinated their right to payment from C & K Market to
18 C & K Market's obligation to its Senior Lenders and U.S. Bank.

19 In January 2011, Chetco, a predecessor of Defendant Yantis Enterprises, Inc. (Yantis), sold a
20 pharmacy to C & K Market. Timothy Yantis, as representative of Chetco, was presented with and signed a
21 Subordination Agreement identical to the ones received by Martin and Reed, along with other documents of
22 the sale, including a promissory note in the amount of \$1.5 million.

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24 ¹(...continued)
25 and ceased to exist. Any actions taken by C & K Express will be referred herein as being taken by the
26 Debtor, C & K Market.

² The Note and Warrant Purchase Agreement dated October 28, 2010.

1 On November 19, 2013, C & K Market filed for bankruptcy under chapter 11. A Plan was thereafter
2 confirmed which provided stock in the Reorganized Debtor to unsecured creditors in lieu of cash. The
3 secured claim of U.S. Bank was paid in full on the effective date of the Plan. As the holders of the majority
4 by dollar amount of unsecured claims against the Debtor, the Senior Lenders became the controlling
5 shareholders of the Reorganized Debtor. The Senior Lenders filed this adversary proceeding against Martin,
6 Reed, and Yantis (collectively, the Subordinated Creditors), and other defendants who had signed
7 Subordination Agreements with the Senior Lenders. The defendants other than Martin, Reed, and Yantis
8 chose not to contest the matter and have been defaulted.

9 The adversary proceeding seeks a declaratory judgment that under the Subordination Agreements,
10 Senior Lenders are entitled to hold the stock issued to the Subordinated Creditors, as collateral, until such
11 time as the pre-petition obligation under the C & K Note is paid in full in cash. The Subordinated Creditors
12 filed a joint answer with affirmative defenses and a counterclaim.

13 Plaintiffs filed a motion for summary judgment, seeking judgment that (a) declares that the applicable
14 Subordination Agreements as between the Plaintiffs and the Defendants are enforceable according to their terms;
15 and (b) directs C & K Markets, Inc. (the "Debtor") to deliver the reorganization securities to which the Junior
16 Creditors would otherwise be entitled under the Debtor's confirmed *Second Amended Chapter 11 Plan of*
17 *Reorganization* to the Senior Lender Representative (as that term is defined in the Subordination Agreements) to
18 hold as collateral until the Senior Lenders' claims are paid in full and in cash as calculated under the operative
19 loan and intercreditor agreements.

20 Defendants filed a cross-motion for partial summary judgment on two of their affirmative defenses
21 and on their counterclaim: 1) absence of consideration, 2) termination of the Subordination Agreements
22 through payment by Debtor of the underlying debts, and 3) termination of the Subordination Agreements by
23 termination of the underlying debt instruments under the Plan of Reorganization. A hearing was held for
24 oral argument and the matter was taken under advisement.

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1 cancelled, there no longer exists a debt to which the Defendants' debts are subordinated. The Subordination
2 Agreements are therefore terminated and the Court should so find.

3 The Subordination Agreements signed by the Defendants specify in ¶ 1 the duration of the
4 Agreement:

5 Until Senior Indebtedness shall have been paid in full in cash and all commitments by Senior
6 Lenders to make advances or any extensions of credit to Borrowers shall have expired or have
7 been terminated, Creditor agrees that its rights to receive payments in respect of the Junior
Indebtedness shall be fully subordinated to the rights of the Senior Lenders to receive
payments

8 Paragraph 3 of the Subordination Agreement provides the effect of a bankruptcy filing by C & K
9 Market:

10 Upon any distribution of all or any of the assets of Market to creditors of Market or upon the
11 dissolution, winding up, liquidation, arrangement, reorganization, adjustment, protection,
relief or composition of Market or its debts . . . any payment or distribution of any kind
12 (whether in cash, property or securities) which otherwise would be payable or deliverable
upon or with respect to the Junior Indebtedness will be paid or delivered directly to the Senior
13 Lender Representative for application (in the case of cash) to, or as collateral (in the case of
non-cash property or securities) for, the prepayment or payment of the Senior Indebtedness
14 until the Senior Indebtedness shall have been paid in cash in full. . . .

15 Defendants argue that the exception provided in Plan § 12.2 does not apply to them because they are
16 not guarantors of or otherwise liable for the C & K Note. However, that provision is broadly written and
17 does not specify that it is limited to "guarantors" of the loan. It states that "nothing shall affect the liability
18 of any entity other than the Debtor . . . for . . . such claim." That provision, being broadly written, must be
19 interpreted to encompass the Defendants' duties to Plaintiffs respecting payment of the C & K Note in the
20 event of a "Subordination Event," such as the filing of bankruptcy by C & K Market. Granted, the
21 Defendants' obligation to Plaintiffs for payment of the C & K Note is limited to the distributions received by
22 them under the Plan of Reorganization.

23 Rather than evidencing a claim, the Subordination Agreements are an agreement between claimants
24 establishing their relative priority of payment and Plaintiffs' right to be paid first in the event of a defined
25 event. That right was not terminated by the Plan of Reorganization.

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1 Finding that the Defendants' duties under the Subordination Agreements were not cancelled at
2 confirmation, the Court must determine whether the obligation was extinguished by payment of the
3 bankruptcy distribution to the Plaintiffs. Again, the debt was extinguished as to C & K Market, which has
4 fulfilled its financial duty to Plaintiffs under the Plan, but the Defendants' obligation was not terminated.
5 Under the Subordination Agreements, the stock received by the Defendants under the Plan of Reorganization
6 is subject to payment of the C & K Note until such time as the debt to Plaintiffs is "paid in full in cash." It
7 can be argued that there are certain "cash equivalents" which should qualify as cash in a transaction.
8 However, stock in a closely held corporation with no active market in its securities cannot be deemed a "cash
9 equivalent." Summary judgment must therefore be denied with respect to Defendants' affirmative defense of
10 Payment and Count 1 of its Counterclaim of Discharge of the Subordination Agreement.³

11 *Lack of Consideration in Contractual Formation*

12 Defendants argue that the Subordination Agreements are unenforceable because there was no
13 separate consideration given for the Defendants' execution of the Agreements. Consideration is an element
14 required under Oregon law to the successful formation of a contract.

15 A. Consideration Under Oregon Law

16 "[C]onsideration consists of the accrual to one party of some right, interest, profit or benefit or some
17 forbearance, detriment, loss or responsibility given, suffered or undertaken by the other." *Shelley v. Portland*
18 *Tug & Barge Co.*, 158 Or. 377, 387, 76 P.2d 477 (1938). *Emmert v. No Problem Harry, Inc.*, 222 Or.App.
19 151, 155, 192 P.3d 844 (2008). "'Benefit' as used in this rule, means that the promisor has, in return for his
20 promise, acquired some legal right to which he would not otherwise have been entitled. 'Detriment' means

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23 ³ Defendants' motion for partial summary judgment also includes Counts 2 and 3 of their
24 Counterclaim, which are alternatives to Count 1. They seek orders by the Court, should the Court determine
25 that the Subordination Agreements are enforceable, fixing the value of the Plaintiffs' distribution under the
26 Plan of Reorganization and establishing a deadline and procedures for transferring shares to the Plaintiffs.
The Court finds that the remedies sought by Defendants in Counts 2 and 3 are not amenable to determination
as part of this summary judgment and declines to address them herein, not least because it has no basis at this
point for making such determinations.

1 that the promisee has, in return for the promise, forborn some legal right which he would otherwise have
2 been entitled to exercise.” *Shelley* at 388. Moreover, “[t]he promise and the consideration must purport to
3 be the motive each for the other, in whole or at least in part. It is not enough that the promise induces the
4 detriment or that the detriment induces the promise, if the other half is wanting.” *Schafer v. Fraser*, 206 Or.
5 446, 467 290 P.2d 190 (1955)(citing *Wisconsin & Michigan R. v. Powers*, 191 U.S. 379 (1903)).

6 Once a contract has been made, any promise thereafter made between the parties is unenforceable
7 unless it is supported by some new consideration. *McGrath v. Electrical Const. Co.*, 230 Or. 295, 305-06,
8 364 P.2d 604 (1961). Modification of a contract requires new consideration. *Mitchell v. Pacific First Bank*,
9 130 Or.App. 65, 74, 880 P.2d 490 (1994).

10 An exception to the requirement that consideration be present is the doctrine of promissory estoppel.
11 This provides that despite the lack of consideration, a promise may be binding on the promisor when a
12 “promise which the promisor should reasonably expect to induce action or forbearance of a definite and
13 substantial character on the part of the promisee . . . does induce such action or forbearance . . . if injustice
14 can be avoided only by enforcement of the promise.” *Schafer v. Fraser*, 206 Or. at 468.

15 Plaintiffs cite to two additional cases which they offer for the proposition that consideration may be
16 given to a third party. In *Cummings v. Central Oregon Bank et al.*, 110 Or. 101, 223 P. 236 (1924), the
17 defendant hired plaintiff to care for cattle upon which the defendant held a “mortgage.” Plaintiff performed
18 the work, but defendant refused to pay. The court awarded plaintiff a judgment for the value of his services
19 and defendant appealed, arguing that there was no consideration for the contract of employment with
20 plaintiff. The Oregon Supreme Court held that there had been consideration: the benefit to defendant was
21 the labor in caring for the cattle upon which the defendant held a mortgage, the detriment to the plaintiff to
22 whom the promise was made was the loss of his time and labor in caring for the cattle. Having found that
23 consideration did exist between the promisor and the promisee, the court went on to state, citing *Williston on*
24 *Contracts*, “It would be a detriment to the promisee, in a legal sense, if he, at the request of the promisor and
25 upon the strength of that promise, had performed any act which occasioned him the slightest trouble or
26 inconvenience and which he was not obliged to perform. . . .” This is essentially a restatement of the

1 doctrine of promissory estoppel. A benefit does not have to run to the promisor if, at the request of the
2 promisor and upon the strength of that promise, the promisee performs some action or forbearance.

3 The second case cited by Plaintiffs is a bankruptcy case from Hawaii: *Chang et al. v. Crouch et al.*
4 (*In re Hokulani Square, Inc.*), 413 B.R. 706 (Bankr. D. Hawaii 2009). The plaintiffs argued that even if they
5 had signed the two subordination agreements at issue in that case, they received no consideration for doing
6 so and that both agreements were therefore invalid. The court defined “consideration” under Hawaii law “
7 ‘as a bargained for exchange whereby the promisor receives some benefit or the promisee suffers a
8 detriment.’ . . . If the promisee incurs a detriment, it does not matter that the promisor receives no benefit . . .
9 . Similarly, consideration is sufficient even if it flows to a third party. The court does not need to consider
10 what induced the promisor to make the promise for the third party.” *Id.* at 713 (internal citations omitted).
11 Aside from the fact that this opinion is interpreting the Hawaii law of contracts, it appears that the key, once
12 again, is that even if the benefit of a bargained for exchange between the promisor and promisee runs to a
13 third-party, the promise made must reasonably induce in the promisee an action or forbearance. To the
14 extent the holding is otherwise, it is inconsistent with Oregon law.

15 B. Consideration in the Execution of the Subordination Agreements

16 1. Reed and Martin Subordination Agreements

17 Paragraph 6.3 of the C & K Note deals with Junior Subordinated Debt. The first half of the
18 paragraph deals with subordination of the “Nidiffer Note,” a debt owing to the former principals of C & K
19 Market, Inc. Execution of a Junior Subordination Agreement for the Nidiffer Note was made a condition of
20 the loan agreement. The second half of the paragraph reads as follows:

21 Following the Closing Date, and no later than December 31, 2010, Borrowers⁴ will use
22 commercially reasonable efforts to obtain the consent of the parties to the subordination
23 agreements delineated in Schedule 6.3 to the assignment of such agreements to Agent in form
and substance reasonably satisfactory to Required Lenders.

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26 ⁴ i.e. C & K Market, Inc. and C & K Express, LLC, a wholly owned affiliate of C & K Market, Inc]

1 Schedule 6.3 includes the names of nine creditors, other than the Nidiffer Family, LLC, including Martin and
2 Reed. A letter dated November 2, 2010 was sent to Martin stating that as C & K Market's new lender, U.S.
3 Bank required that a new subordination agreement⁵ be signed by all note holders. Reed stated in his
4 declaration that he remembered receiving such a letter as well. The subordination agreement signed by each
5 stated in its preface that "[i]t is a requirement of the Financing Agreement [with U.S. Bank] and the Note and
6 Warrant Purchase Agreement [with Plaintiffs] that" the note holder enter into a new subordination
7 agreement. Neither of the Defendants received any additional consideration for signing. Plaintiffs argue
8 that both Reed and Martin, by signing the Subordination Agreements, made a promise to subordinate the
9 payment of their notes to C & K Market's obligation to the Plaintiffs and U.S. Bank. The benefit of that
10 bargain went to C & K Market, which received the loans from U.S. Bank and Plaintiffs, while a detriment
11 was incurred by Plaintiffs and U.S. Bank, who parted with money via the loans to C & K Market. The
12 question as to enforceability of the bargain is this: were the promises by Martin and Reed to subordinate
13 payment of their notes and the detriment of making loans by Plaintiffs and U.S. Bank the motives for each
14 other? In other words, were the loans made by Plaintiffs and U.S. Bank predicated on subordination
15 agreements being executed by the junior note holders?

16 The only evidence the Court has is the terms of the C & K Note itself. As indicated above, ¶ 6.3 of
17 the Note requires that C & K Market "use commercially reasonable efforts to obtain the consents of the
18 parties to the subordination agreements." Unlike the subordination of the Nidiffer note, which was made a
19 precondition of the C & K Note, prior subordination of the other note holders was not necessary under the
20 terms of the Note. Similarly, a later termination or attempted revocation of the Nidiffer note is an event of
21 default at ¶ 11.1(i)(r) of the Note, but not with respect to other subordination agreements. Paragraph
22 11.1(i)(c) provides for an event of default where "any Borrower does not observe, perform, or comply with
23 any term or provision of this Agreement or of any of the other Purchase Documents to which it is a
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26 ⁵ Actually, Martin and Reed each signed two Subordination Agreements, as each received two promissory notes for the sale of their businesses.

1 party” Clearly, the borrower (C & K Market) was required under the terms of the C & K Note to “use
2 commercially reasonable efforts” to obtain the subordination agreements. Failure to use such (undefined)
3 efforts would presumably be an event of default. However, what would be the effect if a creditor, when
4 presented with the subordination agreement, refused to sign? Would anything short of success constitute an
5 “unreasonable” commercial effort? It would not seem likely, but because the Court must view this evidence
6 and draw all inferences in the light most favorable to Plaintiffs, it is sufficient to prevent a grant of summary
7 judgment. Moreover, the Defendants’ obligations were also subordinated to C & K Market’s obligation to
8 U.S. Bank. According to the Subordination Agreements, it was a “requirement” of U.S. Bank’s financing
9 agreement. The lack of this financing agreement in the record of this case, and information as to the effect of
10 a failure to obtain subordination agreements from the Defendants, is also sufficient to prevent summary
11 judgment.

12 2. Yantis Subordination Agreement

13 The situation in Yantis is different from that of the other two Defendants in that Mr. Yantis was
14 presented with a Subordination Agreement at the time that he sold his business to C & K Market in January
15 2011. He states in his declaration that he doesn’t specifically remember seeing or signing the document or
16 that there was any discussion regarding the document.

17 The C & K Note payable to the Plaintiffs does not appear to contain any requirements that the
18 obligation due on future sales to C & K Market be subordinated to the obligation to Plaintiffs. However, the
19 Subordination Agreement also states that U.S. Bank’s financing statement has such a requirement. If there
20 was such a requirement and the Yantis sale would not have occurred absent an executed Subordination
21 Agreement, then there would have been consideration for the execution of the Subordination Agreement: the
22 sale of the business. Yantis would have received a down payment and a promissory note for the balance,
23 partly in exchange for his execution of the Subordination Agreement.

24 The record does not contain a copy of U.S. Bank’s financing statement and/or testimonial evidence as
25 to the requirement that a Subordination Agreement be executed. Absent that material information, the Court

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1 cannot grant summary judgment on the defense of lack of consideration for the Yantis Subordination
2 Agreement.

3 CONCLUSION

4 Based on the foregoing, the Court will enter an order granting in part the Plaintiffs' motion for
5 summary judgment as to Defendants' affirmative defense of discharge through payment of the underlying
6 debt and on Count 1 of the Defendants' Counterclaim. Defendants' motion for partial summary judgment
7 will be denied. All issues not otherwise disposed of in this summary judgment proceeding will be left for
8 trial.

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11 FRANK R. ALLEY, III
12 Chief Bankruptcy Judge
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