COURT OF APPEALS
DECISION
DATED AND RELEASED

October 31, 1996

A party may file with the Supreme Court a petition to review an adverse decision by the Court of Appeals. *See* § 808.10 and RULE 809.62, STATS.

NOTICE

This opinion is subject to further editing. If published, the official version will appear in the bound volume of the Official Reports.

No. 95-2104

STATE OF WISCONSIN **IN COURT OF APPEALS**
DISTRICT IV

BANK ONE WISCONSIN TRUST COMPANY, N.A.,

Plaintiff-Respondent,

v.

COTTON MILLS ASSOCIATES LIMITED PARTNERSHIP,

Defendant,

CITY OF JANESVILLE, AND THE COMMUNITY DEVELOPMENT AUTHORITY OF THE CITY OF JANESVILLE, WISCONSIN,

Defendants-Appellants,

CHARLES I. TRAINER, DANIEL J. MC CARTY, THOMAS G. BEACH d/b/a TMB DEVELOPMENT COMPANY, A WISCONSIN GENERAL PARTNERSHIP, CHARLES I. TRAINER, DANIEL J. MC CARTY AND THOMAS G. BEACH,

Defendant-Respondents.

APPEAL from a judgment of the circuit court for Rock County: PATRICK J. RUDE, Judge. *Dismissed*.

Before Eich, C.J., Dykman, P.J., and Vergeront, J.

VERGERONT, J. This appeal arises out of a foreclosure action by Bank One Trust Company involving certain property owned by Cotton Mills Associates Limited Partnership. The City of Janesville and The Community Development Authority of the City of Janesville (collectively the City) claim an interest in the property. The City appeals from a judgment dismissing its counterclaim against Bank One for marshaling of assets, that is, requiring the bank to pursue other assets before foreclosing on the property.

The trial court held that the City was not entitled to a marshaling of assets because there were not two funds belonging to the same debtor. We agree with the trial court. We concluded that because the guarantors of the indebtedness had not pledged specific property, there were not two funds belonging to the same debtor. Since the City is not entitled to a marshaling of assets, and since there is no other relief now available to the City, we dismiss the appeal as moot.

BACKGROUND

Cotton Mills developed and owned a multi-family housing project located in Janesville, Wisconsin (the property). As part of the City's rehabilitation efforts, the City issued Series A and B multi-family housing revenue bonds in the aggregate amount of $1,400,000. Bank One held the bonds as trustee. Bank One Janesville owned the Series A bonds and Robert W. Baird & Co., Inc. owned the Series B bonds. In connection with the bond issue, Cotton Mills issued a mortgage note in the principal amount of $1,400,000. The mortgage note was secured by a mortgage against the property and a limited guaranty agreement signed by Charles I. Trainer, Daniel J. McCarty and Thomas G. Beach, d/b/a TMB Development Company, and Charles I. Trainer, Daniel J. McCarty and Thomas G. Beach as individuals. Trainer, McCarty and Beach are general partners of Cotton Mills' general partner. The City also loaned Cotton Mills $300,000. This note was nonrecourse and secured only by a mortgage against the property.

Cotton Mills defaulted when it failed to make a principal payment on the bond note and failed to pay its 1993 real estate taxes. Bank One filed a foreclosure action against Cotton Mills, the guarantors and the City. Neither Cotton Mills nor the guarantors answered the complaint. The City answered the complaint, admitted the priority of the Bank One mortgage and Bank One's right to foreclose, but in its counterclaim sought application of the marshaling of assets doctrine. Bank One and the City entered into a stipulation providing for foreclosure judgment to be entered against Cotton Mills and the guarantors, as demanded by Bank One in its amended complaint, and judgment was entered.

Because no party filed an answer to the counterclaim, the City obtained a default judgment requiring Bank One to first enforce its claim against the guarantors before enforcing its claim against the property. After the entry of this judgment, the guarantors sought leave to intervene on the City's counterclaim. Bank One moved to vacate the default judgment and for leave to file a reply to the counterclaim denying that the City was entitled to application of the marshaling of assets doctrine. The trial court granted the motion to intervene, vacated the default judgment and dismissed the counterclaim, concluding that the marshalling of assets doctrine did not apply.

On appeal, the City challenges both the trial court's decision to grant relief from the default judgment and its decision to dismiss the counterclaim. Bank One responds that the City's appeal is moot because the bank has completed the foreclosure process, the property has been sold to an independent third party, and the indebtedness due Bank One has been satisfied. The City responds that the controversy is not moot because, since it was entitled to have the trustee first satisfy its indebtedness from sources other than foreclosure of the property, it is entitled to marshaling by way of subrogation or an award of damages.[1]

The City appears to concede that if it were not entitled to have other assets marshaled, the appeal would be moot. Because we conclude that the marshaling of assets doctrine does not apply, we dismiss the appeal as moot without reaching any other issue.

DISCUSSION

The City contends that the trial court should have required Bank One to first enforce the guaranty before looking to the property because the guarantors are not "mere sureties." According to the City, the principal debtor, Cotton Mills, and the guarantors are "so closely intertwined" that it makes no sense to say that there are not two funds belonging to the same debtor. The City argues that since Bank One can satisfy its claim against Cotton Mills out of the guaranty as well as out of foreclosure on the property, while the City can only resort to the property, equity should compel the trustee to enforce the guaranty. The City refers to the guaranty as a second fund available to Bank One but not to the City.

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[1] The trial court denied the City's motion for relief pending appeal on October 31, 1995, and afforded the City forty days from that date to seek relief pending appeal from this court. In its motion to this court for relief, the City sought an order that the trustee hold in trust the City's claimed share of proceeds from the foreclosure sale and that the judgment of foreclosure shall not be satisfied to the extent of the City's claim plus any deficiency. We denied the City's motion for relief pending appeal.

As a general rule, even though one creditor is secured by the debtor's surety while a second creditor is not, equity will not compel the secured creditor to exhaust his remedy against the surety before proceeding against the principal debtor. ***Moser Paper Co. v. North Shore Publishing Co.***, 83 Wis.2d 852, 862, 266 N.W.2d 411, 416 (1978). Where the surety has simply guaranteed the debtor's obligation, even though the surety is liable at law to pay the principal's debt, equity will not normally permit the surety's property to be made to satisfy the principal debt when the principal's property will suffice. ***Id.*** at 862, 266 N.W.2d at 417.

The doctrine of marshaling assets, when it applies, functions as an exception to that general rule. The doctrine provides an equitable remedy when a creditor has a lien on or interest in two funds or properties in the hands of the same debtor, and another creditor has a lien on only one of those funds or properties. In such a situation, equity, at the request of the latter creditor, will compel the creditor with two funds to satisfy his or her debt out of that fund to which the other creditor cannot resort. ***Id.*** at 860, 266 N.W.2d at 416.

Before a court of equity will marshal assets and securities between two creditors, it must appear that: (1) they are creditors of the same debtor, (2) that there are two funds belonging to that debtor, and (3) that one of them alone has the right to resort to both funds. ***Id.*** at 861-62, 266 N.W.2d at 416.

In ***Moser***, the court addressed the requirement that there be two funds belonging to the debtor. There the officers and principal shareholders of the company guaranteed the company's debts and granted mortgages on their residences in order to secure their own note and mortgages as sureties and also to secure the company's debt. ***Id.*** at 854-56, 266 N.W.2d at 413-14. The ***Moser*** court noted that the guarantors were not "mere sureties" but had pledged their residences to secure not only their note and their performance but also the debt of the original debtor. ***Id.*** at 862, 266 N.W.2d at 417. The court found that the residences of the guarantors were more than the property of a surety because they secured the aggregate obligation of the debtor and its officers directly. ***Id.*** The court concluded that under these circumstances the mortgages created a fund which equity will consider a fund of the company itself and the marshaling of assets doctrine was appropriate. ***Id.*** at 864, 266 N.W.2d at 418.

The trial court here dismissed the City's counterclaim because the requirements for the marshaling of assets doctrine were not met. Specifically, the court found that while Bank One and the City had a secured claim against the partnership's real estate, there was no other "fund" or asset of the partnership to which Bank One had a claim. The court determined that what the City called a "second fund"--the guarantees of the general partners as individuals--was not a fund owned by the partnership and therefore was not an asset that could be marshaled.

The City argues that since the guarantors and Cotton Mills are so closely intertwined, the trial court should have extended the exception in ***Moser*** even without a pledge of specific property on the part of the guarantors. We disagree. ***Moser*** is an exception to the general rule that the second fund must belong to the same debtor, which itself is an exception to the general rule that a surety's property is not available to satisfy the principal's debt when the principal's property will suffice. Unlike ***Moser***, the guarantors here did not pledge specific property. The assets sought to be marshaled in this case secure only the guaranty--they do not secure Cotton Mills' debt to the City. We are not convinced that equity requires an expansion of ***Moser*** to the facts of this case. As Bank One points out, the effect of the City's position would be to force senior secured parties holding guarantees to forgo attempting to collect against their primary real estate collateral in favor of pursuing guarantors with possibly uncertain collectability whenever it would benefit junior creditors who have not obtained guarantees. We conclude that the trial court correctly decided that the City was not entitled to judgment directing that the trustee look to the guarantors' assets before satisfying its indebtedness from the foreclosure of the real estate.

By the Court.—Appeal dismissed.

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