

**COURT OF APPEALS
DECISION
DATED AND RELEASED**

February 20, 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

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No. 95-0011

STATE OF WISCONSIN

**IN COURT OF APPEALS
DISTRICT I**

PREDCO, INCORPORATED,

Plaintiff-Appellant,

v.

FIRST BANK SOUTHEAST, N.A.,

Defendant-Respondent.

PREDCO, INCORPORATED,

Plaintiff-Appellant,

v.

**FIRST BANK SOUTHEAST, N.A.,
and DEAN BECK,**

Defendants-Respondents.

APPEAL from an order of the circuit court for Milwaukee County: MICHAEL D. GUOLEE, Judge. *Affirmed in part; reversed in part and cause remanded.*

Before Wedemeyer, P.J., Fine and Schudson, JJ.

PER CURIAM. This appeal results from two intransigent litigants making their respective bad business decisions worse. Predco, Incorporated was called upon to comply with an unconditional guaranty for a business it had divested itself of without obtaining a release of the guaranty. First Bank Southeast, N.A., formerly Kenosha National Bank, agreed to serve as trustee of an industrial bond issue that went sour. Predco relies upon aggressive litigation to pursue its ends. First Bank has exercised self-help attachment of money under its control.

In this particular appeal, Predco appeals from an order granting summary judgment to First Bank and Dean Beck. The order dismissed Predco's claims for return of any surplus funds Predco paid First Bank to satisfy an earlier judgment and for funds recovered by First Bank as expenses in a bankruptcy proceeding. In addition, the order Predco appeals from declared that First Bank had a first lien against funds the bank received on behalf of bondholders from the bankruptcy. The lien is for past and future attorney fees and litigation expenses flowing from the bankrupt's default on the repayment of the bonds. The trial court did not review any of the amounts claimed by First Bank or determine the amount of First Bank's lien.

On appeal, Predco contends that claim preclusion bars First Bank from recovering additional monies from Predco; that the doctrine of subrogation allows Predco to recover a portion of the funds it previously paid First Bank to satisfy a judgment the bank had against Predco; that the doctrines of claim preclusion and subrogation entitle Predco to the funds First Bank received from the bankruptcy; and that the trial court erred when it dismissed Predco's claims against Beck.

We reject Predco's claim that it is entitled to recover either any surplus funds paid on the earlier judgment or the funds First Bank received

from the LTV bankruptcy for its own expenses. While we agree that First Bank has a first lien on the funds received on behalf of bondholders, we conclude that the lien is not as extensive as First Bank argues. Further, the trial court must determine the actual amount of the lien. Therefore, we affirm the order in part and reverse in part, and we remand the case to the trial court for further proceedings.

FACTS

As all the filings in this case recite, this dispute has a lengthy history. In 1978, Wilton, Iowa, issued industrial revenue bonds to finance the construction of a production facility for Precision Steel Company - Iowa, a subsidiary of Predco. First Bank¹ agreed to serve as trustee. Precision Steel was to pay the bonds, and Predco guaranteed Precision Steel's obligations. The respective rights and obligations of the parties were detailed in a loan agreement between Wilton and Precision Steel, an indenture of trust between Wilton and First Bank, and a guaranty agreement between Predco and First Bank.

In 1981, Predco sold Precision Steel to Jones & Laughlin Steel, Inc., a subsidiary of LTV Corporation. In July 1986, LTV and its affiliated companies, including the successor to Precision Steel, filed a Chapter 11 bankruptcy petition. First Bank filed two claims in the LTV bankruptcy, one on behalf of the bondholders and one for its own expenses arising from the default on the bond obligation.

First Bank also demanded that Predco honor its guaranty obligations, which Predco refused to do. First Bank filed suit in federal court to enforce the guaranty in 1988, obtained a judgment in 1989 and a supplemental judgment in 1992 (collectively, "federal judgment"), and ultimately collected the judgments in 1992. The federal judgment was for principle and interest owed to bondholders, attorney fees and costs incurred in the litigation on the guaranty

¹ In order to simplify the recitation of facts, First Bank is identified as the trustee in this opinion although Kenosha National Bank was the bank that agreed to serve as trustee. First Bank is the corporate successor to Kenosha National Bank.

through 1992, and attorney fees and costs incurred in connection with the LTV bankruptcy through 1989. The federal judgment also earned post-judgment interest. In part because the interest rate on the federal judgment exceeded the interest rate on the bonds, First Bank received \$207,745.40 more than it paid to bondholders. The amount of \$55,805.58 was interest, and the remainder was reimbursement for attorney fees and expenses. In December 1992, Predco filed suit to recover this alleged "surplus judgment" of \$55,805.58.²

After paying the judgment against it, Predco filed a motion in the LTV bankruptcy for transfer of First Bank's claims to Predco. The bankruptcy court denied the request, not because it determined that Predco was not entitled to the claims, but because the dispute did not affect the bankruptcy proceeding itself. The bankruptcy judge held that the dispute would be better resolved in state court.

A plan of reorganization was finally approved in the LTV bankruptcy in 1993. On the claim submitted on behalf of the bondholders, First Bank received \$312,526.00 and two classes of securities. Conceding that Predco has an interest in this payment based upon subrogation, First Bank nonetheless claims a first lien against the cash received. The lien secures unreimbursed expenses First Bank has or will incur because of the default on the bonds. First Bank contends that the secured expenses include the litigation expenses incurred in the present case and any related future litigation Predco may file. Although First Bank transferred the securities to Predco, it has refused to transfer any of the cash payment without a full release of all liabilities from Predco.

On its claim for administrative expenses, First Bank submitted a claim of \$303,223.82 in the LTV bankruptcy. According to the summary judgment materials, this claim included all expenses actually incurred through April 15, 1993, and additional expenses estimated to June 30, 1993. LTV accepted First Bank's claim, but reduced it by the \$207,745.40 First Bank

² The complaint alleged that the amount of the "surplus judgment" was \$72,281.15. In the trial court brief on the summary judgment motions, Predco addressed only the \$55,805.58 that First Bank admitted receiving as interest on the federal judgment. Additionally, in the brief on appeal, Predco refers to the "surplus judgment" as \$55,805.58. Therefore, we use the same number.

received under the federal judgment that was not paid to bondholders. First Bank received the difference, \$95,478.42, in cash.

In August 1993, Predco filed suit to recover the proceeds of the bankruptcy claims from First Bank. In addition, Predco named Dean Beck, a trust officer with First Bank, as a defendant. The suit was consolidated with the litigation for the "surplus judgment," and Predco filed an amended complaint claiming subrogation, breach of contract, conversion, unjust enrichment/constructive trust, and negligence. In its answer, First Bank filed a counterclaim seeking a judgment declaring that it had a continuing first lien on the proceeds from the LTV bankruptcy for fees and expenses it incurred as trustee as a result of the default on the bonds.

The parties filed cross-motions for summary judgment, and the trial court granted the motions of First Bank and Beck. Although First Bank repeatedly described Predco's claims as frivolous, both in briefs filed with the trial court and on appeal, First Bank did not seek a finding that the claims or appeal were frivolous.

LEGAL PRINCIPLES GOVERNING CLAIMS AGAINST FIRST BANK

Before addressing the specific claims made by Predco, it is necessary to set forth the legal principles that govern the issues raised by Predco's claims against First Bank. Essentially, Predco contends that by subrogation it is entitled to an alleged "surplus judgment." Predco also contends that the principles of merger and claim preclusion, or *res judicata*, bar First Bank from recovering additional money from Predco. Conversely, First Bank claims that the trust indenture gave it an open-ended right to recover all expenses of collection caused by the default on the bonds, including the expenses of defending against Predco's claims. Therefore, this appeal involves the doctrines of subrogation, merger, and claim preclusion, as well as our standards of review for contract interpretation and summary judgment.

Subrogation is an equitable action that may be applied when a party who is secondarily liable satisfies the debt or obligation of one who bears the primary legal responsibility for the debt or obligation. *Cunningham v.*

Metropolitan Life Ins. Co., 121 Wis.2d 437, 443-44, 360 N.W.2d 33, 36 (1985). When the party with secondary liability pays the obligation, he or she succeeds to the rights, or "steps into the shoes," of the party who was paid. *Id.* at 444, 360 N.W.2d at 36. The purpose of subrogation is to place the ultimate loss on the party primarily responsible and to avoid unjust enrichment to that party. *Id.* Subrogation arises by operation of law ("equitable subrogation") or by contract ("conventional subrogation"). *Id.* at 445, 360 N.W.2d at 37.

The party seeking to prove subrogation has the burden of introducing evidence to establish his or her claim. *Id.* at 445-46, 360 N.W.2d at 37. As a general rule, payment by a guarantor subrogates the guarantor to the rights of the creditor to whom the guarantor has made payment. *Winter v. Trepte*, 234 Wis. 193, 198, 290 N.W. 599, 602 (1940). The subrogation right does not enlarge or diminish the creditor's rights, however. *Employer's Ins. v. Sheedy*, 42 Wis.2d 161, 164-65, 166 N.W.2d 220, 222 (1969) (subrogee subject to any defense primary obligor has against original obligee). Additionally, because of its equitable nature, subrogation is not automatically allowed whenever a possible claim for subrogation exists. *First National Bank v. Hansen*, 84 Wis.2d 422, 429, 267 N.W.2d 367, 370 (1978). Recovery is permitted if the equities favoring the party seeking subrogation are greater than those of the party seeking to deny it. *Id.*

Under the doctrine of merger, a valid, final judgment entered on a contract claim merges the contract claim into the judgment. *Production Credit Ass'n v. Laufenberg*, 143 Wis.2d 200, 205, 420 N.W.2d 778, 779 (Ct. App. 1988). The contract loses vitality and ceases to bind the parties. *Id.* Thereafter, the party recovering the judgment may only maintain an action on the judgment. *Id.*

The doctrine of merger is not without limitation, however. Rights and advantages given to the judgment creditor in the original claim may still be preserved, for example, liens imposed on specific properties or statutory priority rights. RESTATEMENT (SECOND) OF JUDGMENTS § 18 cmt. g (1982); 50 C.J.S. *Judgments* § 599 at 22-23 (1947). Thus, non-monetary contract rights in favor of the plaintiff are not destroyed when the plaintiff reduces the obligation created by the contract to judgment. *Aiken v. Bank of Georgia*, 113 S.E.2d 405, 407 (Ga. Ct. App. 1960) (bank's right to set-off granted in notes survived judgment to collect on notes).

Claim preclusion, or *res judicata*, makes a final adjudication on the merits in a prior action a bar to subsequent actions between the same parties as to all matters that were or could have been litigated in the earlier action. *Northern States Power Co. v. Bugher*, 189 Wis.2d 541, 550, 525 N.W.2d 723, 727 (1995). For earlier proceedings to bar the present suit under claim preclusion, three factors must be present. *Id.* at 551, 525 N.W.2d at 728. First, there must be identity between the parties or their privies in both proceedings; second, there must be identity between the claims in the two proceedings; and third, there must be a final judgment on the merits in the earlier proceeding. *Id.* Identity of claims exists if the claims arose from the same transaction, incident, or factual situation. *Id.* at 554, 525 Wis.2d at 729. Therefore, the emphasis is on the underlying facts and not the number of legal theories that can be developed from the facts. *Id.*

Construction of a contract presents a question of law, and appellate courts need not defer to the trial court's interpretation. *Waukesha Concrete Prod. Co. v. Capitol Indem. Corp.*, 127 Wis.2d 332, 339, 379 N.W.2d 333, 336 (Ct. App. 1985). The court's objective when construing a contract is to ascertain the intent of the parties from the contract language. *Id.* A basic tenet of contract construction is that the court should select a construction that gives effect to each word or provision of the contract. *Jones v. Jenkins*, 88 Wis.2d 712, 722, 277 N.W.2d 815, 819 (1979). Similarly, the meaning of a particular contract provision is ascertained by reference to the contract as a whole. *Crown Life Ins. Co. v. LaBonte*, 111 Wis.2d 26, 36, 330 N.W.2d 201, 206 (1983).

Finally, summary judgment is used to determine whether there are disputed issues for trial. *U.S. Oil Co. v. Midwest Auto Care Servs., Inc.*, 150 Wis.2d 80, 86, 440 N.W.2d 825, 827 (Ct. App. 1989). When reviewing a grant of summary judgment, we apply the same methodology as the trial court. *Id.* Summary judgment is appropriate when material facts are not disputed and the moving party is entitled to judgment as a matter of law. Section 802.08(2), STATS. All doubts on factual matters are resolved against the party moving for summary judgment. *Grams v. Boss*, 97 Wis.2d 332, 338-39, 294 N.W.2d 473, 477 (1980). We will reverse a trial court's decision granting summary judgment if the trial court incorrectly decided a legal issue or if material facts are in dispute. *Hammer v. Hammer*, 142 Wis.2d 257, 263, 418 N.W.2d 23, 25 (Ct. App. 1987). The practical effect of reciprocal summary judgment motions is a stipulation to the facts, and an agreement that the issues presented can be decided as a matter

of law. *Silverton Enter., Inc. v. General Casualty Co.*, 143 Wis.2d 661, 669, 422 N.W.2d 154, 157 (Ct. App. 1988).

"SURPLUS JUDGMENT"

Predco contends that because First Bank obtained the federal judgment against it in a representative capacity, i.e., as trustee for the bondholders, First Bank may not retain the \$55,805.58 "surplus judgment." Predco relies upon a clause in the indenture of trust to argue that this "surplus judgment" is owed to Precision Steel's successor. Predco then argues that it is subrogated to the rights of Precision Steel's successor.

Predco is not subrogated to any claim that Precision Steel's successor may have. Under the principles of subrogation, Predco became subrogated to the rights of First Bank when it paid the judgment to First Bank. See *Cunningham*, 121 Wis.2d at 443-44, 360 N.W.2d at 36. Predco stepped into the shoes of First Bank, not Precision Steel's successor. Predco provides no legal authority to support its argument that it is subrogated to the rights of Precision Steel's successor. Additionally, if a "surplus judgment" existed, the right of Precision Steel's successor to the surplus was determined in the LTV bankruptcy. First Bank's bankruptcy claim for administrative expenses was reduced by all sums the bank received from Predco but did not pay to bondholders. Therefore, any "surplus judgment" has been accounted for and has not been retained by First Bank.

PAYMENTS FROM LTV BANKRUPTCY

Predco contends that the denial of its claims to recover the payments First Bank received from the LTV bankruptcy ignores the principles of merger and claim preclusion. Predco correctly argues that the guaranty agreement merged into the judgment in the federal court proceeding. Further, claim preclusion bars First Bank from pursuing further litigation to enforce the guaranty. See *Laufenberg*, 143 Wis.2d at 205, 420 N.W.2d at 779.

Predco's argument, however, ignores First Bank's position in the present case. First Bank does not rely on the guaranty. First Bank relies on the indenture of trust between itself and Wilton, Iowa, to support its efforts to retain part or all of the funds recovered from the LTV bankruptcy.

Section 10.2 of the indenture of trust provided that First Bank was entitled to payment and reimbursement for reasonable fees for its services and all advances, counsel fees and other expenses reasonably and necessarily made or incurred by First Bank or its agents in connection with its services as trustee. The section also provided that in the event of default, First Bank had a "first lien with right of payment prior to payment on account of principal of, premium, if any, and interest on [b]onds" for fees, charges, and expenses incurred by First Bank. Section 9.7 of the trust indenture, governing the application of moneys in the event of default, also provided that bondholders would be paid after the payment of the expenses and costs of any proceeding to collect the moneys and of the expenses, liabilities and advances incurred by First Bank. The second granting clause of the indenture contains a provision that the trust terminated upon full compliance with the obligations of the indenture, including all payments due to First Bank, otherwise the indenture continued in full force and effect.

First Bank bases its right to retain part of the LTV bankruptcy payments on the indenture of trust, the document upon which the bankruptcy claims were based. Neither merger of the guaranty into the judgment nor claim preclusion from the guaranty litigation against Predco affect the payments First Bank received from the LTV bankruptcy. To determine Predco's right to recover part or all of the payments First Bank received from the LTV bankruptcy, we must examine each claim separately.

First Bank's summary judgment materials represented that the smaller payment, \$95,478.42, was for administrative expenses allowable under 11 U.S.C.S. § 503(b), and that its total claim was reduced by the expenses and interest it recovered from Predco. The record does not include a copy of the order approving the claim or a confirmation of the final plan of reorganization. We note, however, that under the bankruptcy code an indenture trustee may be entitled to an allowance for administrative expenses and reasonable compensation for making a substantial contribution in a case filed under

chapter 9 of the bankruptcy code. 11 U.S.C.S. § 503(b)(3)(D) & (5) (Law. Co-op. 1995).

We conclude that Predco is not entitled to recover any part of this payment. According to the summary judgment materials, this payment to First Bank was from an \$8,000,000 fund set up solely to pay the fees and expenses of the "steel indenture trustees." Therefore, the payment is for First Bank's own expenses approved by LTV and the bankruptcy court. Further, because First Bank's claim was reduced by part of the federal judgment the bankruptcy claim for trustee expenses is not duplicative of any amounts previously paid by Predco.³

The amount First Bank recovered on the bondholder's claim, \$312,526 and securities, is subject to Predco's right of subrogation. First Bank acknowledges this right and has transferred the securities to Predco. First Bank refuses to release any part of the cash payment, however, because it claims that the indenture of trust grants it a continuing first lien for all expenses. The trial court held that a first lien exists, but it left unanswered the extent of the lien. First Bank contends that the indenture of trust entitles it to be made whole, i.e., to recover all of its litigation expenses until litigation ceases or the fund is exhausted.

First Bank's argument goes too far. The bondholders have been paid. First Bank has recovered the expenses it incurred collecting under the

³ We recognize that the indenture of trust limits First Bank's right to reimbursement to **reasonable** costs and expenses. From the materials submitted on summary judgment, it appears that First Bank recovered from the LTV bankruptcy expenses that the federal court had specifically held in the action on the guaranty to be unreasonable or excessive. Under the doctrine of issue preclusion, or collateral estoppel, LTV could have used this determination against First Bank to challenge the amount First Bank claimed. See *Lindas v. Cady*, 183 Wis.2d 547, 558-59, 515 N.W.2d 458, 463 (1994) (issue preclusion or collateral estoppel may limit relitigation of an issue actually litigated in a prior case even when there is not a strict identity of the parties). Had LTV rejected any amount of claimed expenses as unreasonable, the benefit would have gone to other "steel indenture trustees," not to the bondholders. Predco has not provided any authority that under these facts it is entitled to challenge the bankruptcy court's determination of First Bank's expenses. We express no opinion, however, on whether Predco may, on remand, rely on the federal court's determination to seek an adjustment of the amount of First Bank's lien claim.

guaranty and pursuing the bondholder's claim in the LTV bankruptcy. This is what First Bank is entitled to under the indenture of trust. First Bank is not entitled to recover its expenditure for attorney fees to defend against Predco's legitimate attempts to recover on Predco's subrogation rights. Unless otherwise authorized by statute or contract, parties to litigation in this state are responsible for their own attorney fees. *Hunzinger Constr. Co. v. Granite Resources Corp.*, 196 Wis.2d 327, 338, 538 N.W.2d 804, 809 (Ct. App. 1995). First Bank's contractual right to recover attorney fees and expenses for efforts on behalf of the bondholders provided by the indenture of trust does not extend to defending against the subrogation claim.

The summary judgment materials do not address the nature of the expenditures for which First Bank claimed a lien against the bondholders' fund. Therefore, the trial court's order declaring that First Bank has a continuing first lien on the bondholder's fund is reversed. The cause is remanded for a determination of the amount, if any, of First Bank's lien against the fund.

PREDCO'S CLAIM AGAINST BECK

Predco's final argument challenges the trial court's dismissal of its negligence claim against Dean Beck, the First Bank trust officer who became responsible for the Precision Steel bonds while the guaranty litigation and LTV bankruptcy were pending. The amended complaint alleged that Beck breached a duty of good faith and a duty to exercise ordinary care towards Predco. Specifically, the amended complaint identified the failure to (1) promptly transfer to Predco all funds and property received from the LTV bankruptcy, (2) properly and adequately assert and prosecute claims in the LTV bankruptcy, (3) assign the LTV bankruptcy claims to Predco after Predco paid the judgment against it, and (4) pay the "surplus judgment" to Predco. Predco's brief asserts that the tort liability was primarily based on the handling of the LTV bankruptcy claims and their proceeds after the guaranty litigation ended. Predco asserts that Beck has individual liability based upon his personal involvement and participation in the allegedly tortious conduct. See *Oxman's Erwin Meat Co. v. Blacketer*, 86 Wis.2d 683, 692, 273 N.W.2d 285, 289 (1979).

Beck filed a motion for summary judgment. The trial court granted the motion, holding that because the guaranty did not require First Bank to file a claim in the bankruptcy, Beck was under no duty to undertake extraordinary measures in pursuing the bankruptcy claims.

We have previously concluded that there was no excess "surplus judgment" and that Predco is not entitled to any part of the claim for trustee's expenses. Neither Beck's failure to act or his negligent actions with respect to either item is actionable because there was no injury to Predco. See *Johnson v. Seipel*, 152 Wis.2d 636, 643, 449 N.W.2d 66, 68 (Ct. App. 1989) (cognizable negligence claim requires injury).

Further, Predco has no claim against Beck for actions he did or did not take in the LTV bankruptcy. Although the guaranty agreement merged into the federal judgment, First Bank's rights and protections survived. See RESTATEMENT (SECOND) OF JUDGMENTS § 18 cmt. g (1982); 50 C.J.S. *Judgments* § 599 at 22-23 (1947). Language in the guaranty agreement precludes Predco from raising any claim for impairment of collateral. Beck, as First Bank's agent, is entitled to the same protection.

The allegation that Beck breached a duty of good faith does not state a claim for negligence. Although a covenant of good faith is implied in every contract, *Chayka v. Santini*, 47 Wis.2d 102, 107 n.7, 176 N.W.2d 561, 564 n.7 (1970), breach of an implied covenant of a contract is a breach of the contract, not a tort, see *Hauer v. Union State Bank*, 192 Wis.2d 576, 595, 532 N.W.2d 456, 463 (Ct. App. 1995).

This leaves only the allegation that Beck was negligent with respect to the fund received for the bondholders' claim in the LTV bankruptcy. First Bank and Predco have competing claims to the fund. Although Predco's claim arises from equitable subrogation, the competing claims are resolved by the terms of the indenture of trust. Therefore, First Bank and Beck's duties to Predco rest on the contract.

Although the negligent performance or nonperformance of a contractual duty to use due care is actionable in tort, see *Colton v. Foulkes*, 259 Wis. 142, 146-47, 47 N.W.2d 901, 903-04 (1951), the contract may not be used to create the underlying duty of care necessary for a tort claim, *Landwehr v. Citizens Trust Co.*, 110 Wis.2d 716, 723, 329 N.W.2d 411, 414 (1983). A tort claim arises out of a breach of contract only if there exists an independent, common-law duty of care. *Id.* To determine if a duty of care exists, a court ignores the existence of the contract. *Dvorak v. Pluswood Wisconsin, Inc.*, 121 Wis.2d 218, 220, 358 N.W.2d 544, 545 (Ct. App. 1984).

Predco argues that Wisconsin has long recognized that a bond trustee owes certain extra-contractual duties to all parties in interest with regard to bond transactions. *Marshall & Ilsley Bank v. Guaranty Inv. Co.*, 213 Wis. 415, 422-24, 250 N.W. 862, 864-65 (1934); *Schroeder v. Arcade Real Estate Co.*, 175 Wis. 79, 106, 184 N.W. 542, 552 (1921). Those duties, however, are based on the trustee's fiduciary obligations and not on a duty of ordinary care. *McGeoch Bldg. Co. v. Dick & Reuteman Co.*, 253 Wis. 166, 173-75, 33 N.W.2d 252, 255-56 (1948). Predco, however, is alleging negligence, not a breach of a fiduciary obligation; therefore, the authority is inapposite. Predco failed to present authority that Beck owed it a duty of care independent of the indenture of trust. Therefore, the trial court properly granted Beck's motion for summary judgment.

By the Court.—Order affirmed in part; reversed in part and cause remanded.

This opinion will not be published. *See* RULE 809.23(1)(b)5, STATS.