

UNITED STATES BANKRUPTCY COURT FOR THE
MIDDLE DISTRICT OF ALABAMA

IN RE:

ALLEGRO LAW, LLC,

Debtor.

CASE NO. 10-30631-WRS
Chapter 7

**TRUSTEE'S BRIEF IN OPPOSITION
TO MOTION FOR EMERGENCY RELIEF**

Trustee Daniel Hamm files his opposition to receiver Louis Colley's Motion for Emergency Relief in the Form of Being Excused from the Automatic Stay and/or Other Alternative Relief as follows:

A. STATE COURT RECEIVER IS NOT AN ASSIGNEE FOR THE BENEFIT OF CREDITS

Bankruptcy courts have held that a state court receiver is **not** an assignee for the benefit of creditors. *In re Northgate Terrace Apartments, Ltd.*, 117 B.R. 328, 331-32 (Bankr. S.D. Ohio 1990) ("Case law indicates, however, that a state court receiver generally is not 'an assignee for the benefit of the debtor's creditors.' Rather, an assignee for the benefit of creditors is one to whom a debtor voluntarily assigns its property to be administered for the benefit of its creditors."); *In re Sundance Corporation*, 83 B.R. 746, 747-49 (Bankr. D. Montana 1988) ("A plain reading of § 101(10) with § 543(d)(2) convinces this Court that such subsection is not applicable to the facts here, where a state court receiver is placed in possession of the Debtor's property through judicial process, rather than where the debtor creates a consensual possession of the property for the benefit of its creditors, and

thereby voluntarily assigns the property to the assignee for administration or liquidation.”)

Highlighted copies of these 2 cases are attached hereto as Exhibits 1 and 2.

B. UNDER 542(d)(1), THE BANKRUPTCY COURT MUST CONSIDER THE INTERESTS OF ALL THE DEBTOR’S CREDITORS

Under 541(d)(1), the bankruptcy court must consider the interests of **all** the debtor’s creditors. *In re Metropolitan Adjustment Bureau*, 22 B.R. 67, 70 (9th Cir. 1982) (“Under state law, conservator’s concern is not for the creditors of the debtors as a whole, but rather, for the customers of the collection agencies The trustee’s responsibilities are to the creditors as a whole.”); *In re Constable Plaza Associates, L.P.*, 125 B.R. 98, 103 (S.D. New York 1991) (“Under this exception, as expressed in 11 U.S.C. § 541(d)(1), the court must consider the interests of all the debtor’s creditors.”) *In re Northgate Terrace Apartments, Ltd.*, 117 B.R. at 333 (Movant must show “that the interests of **all** creditors are better served” by the receiver) (emphasis added). Highlighted copies of the first 2 cases are attached hereto as Exhibits 3 and 4.

C. THE PROPERTY IN THE CUSTODY OF THE RECEIVER CLEARLY IS PROPERTY OF THE BANKRUPTCY ESTATE

The appointment of a state court receiver “does **not** deprive the debtor of its ownership of the property over which the receiver is given authority and the receiver does not generally take title to that property.” *In re Rimsat, Ltd.*, 193 B.R. 499, 501 (Bankr. N.D. Indiana 1996); *In re Willows of Coventry, Ltd. Partnership*, 154 B.R. 959 (N.D. Indiana 1993) (“ . . . the appointment of a receiver does not effect title to the property over which the receiver is given authority the appointment

of a receiver over the apartment complex did not terminate debtor's ownership of the property or the rents it generated.") Highlighted copies of these 2 cases are attached hereto as Exhibits 5 and 6.

CONCLUSION

For the reasons stated by the Trustee at the hearing on March 19 and for the reasons set forth above, the receiver's Motion for Emergency Relief is due to be denied.

Respectfully submitted this 22nd day of March, 2010.



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251-471-6191
251-479-1031 (fax)
Attorneys for Trustee

CERTIFICATE OF SERVICE

I hereby certify that on this the 22nd day of March, 2010, electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to all counsel of record.



STEVE OLEN

Westlaw

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117 B.R. 328, 20 Bankr.Ct.Dec. 1276
(Cite as: 117 B.R. 328)

H

United States Bankruptcy Court, S.D. Ohio, Eastern
Division.

In re NORTHGATE TERRACE APARTMENTS,
LTD., Debtor.

Bankruptcy Nos. 2-90-00217, 59-2373860.

June 4, 1990.

Motion was filed to excuse state court-appointed receiver from complying with turnover provisions, in Chapter 11 case. The Bankruptcy Court, Barbara J. Sellers, J., held that: (1) retention of the receiver was not mandatory, and (2) retention of the receiver was not appropriate under the Bankruptcy Court's discretionary powers.

Motion denied.

West Headnotes

[1] Bankruptcy 51 ↪3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of
Assets

51k3063 Collection and Recovery for Es-
tate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Generally, commencement of Chapter 11 case requires any custodian appointed by state court to manage debtor's property, upon receipt of knowledge of the commencement of the case, to cease disbursement of funds derived from that property except for expenditures necessary to preserve the property; property must be delivered to the representative of the bankruptcy estate along with an accounting. Bankr.Code, 11 U.S.C.A. § 543; Bankruptcy Rule 6002, 11 U.S.C.A.

[2] Bankruptcy 51 ↪2361

51 Bankruptcy

51IV Effect of Bankruptcy Relief; Injunction
and Stay

51IV(A) In General

51k2361 k. In General. Most Cited Cases

Bankruptcy 51 ↪3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of
Assets

51k3063 Collection and Recovery for Es-
tate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Generally, state court receivership is terminated upon bankruptcy filing by owner of the property. Bankr.Code, 11 U.S.C.A. § 543(a, b, d); Bankruptcy Rule 6002, 11 U.S.C.A.

[3] Bankruptcy 51 ↪3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of
Assets

51k3063 Collection and Recovery for Es-
tate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Debtor and Creditor 117T ↪4

117T Debtor and Creditor

117Tk1 Assignments for Benefit of Creditors

117Tk4 k. Appointment, Qualification, and
Tenure of Assignee or Trustee. Most Cited Cases

Retention of state court-appointed receiver was not mandatory in Chapter 11 case; receiver was not appointed at debtor's request or with its specific consent, and, thus, receiver was not "assignee for the benefit of creditors" under either applicable Florida law or the Bankruptcy Code. Bankr.Code, 11 U.S.C.A. §§ 543(d)(2), 1101 et seq.

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Exhibit 1

117 B.R. 328, 20 Bankr.Ct.Dec. 1276
(Cite as: 117 B.R. 328)

[4] Bankruptcy 51 ↪3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

State court receiver generally is not "assignee for the benefit of creditors," within meaning of Bankruptcy Code turnover provision governing retention of custodian appointed by state court; rather, assignee for the benefit of creditor is one to whom debtor voluntarily assigns its property to be administered for the benefit of its creditors. Bankr.Code, 11 U.S.C.A. § 543(d)(2).

[5] Bankruptcy 51 ↪3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Creditor, which filed motion to excuse state court-appointed receiver from complying with turnover provisions, had burden of all issues relating to that affirmative relief; Bankruptcy Code contemplates turnover. Bankr.Code, 11 U.S.C.A. § 543.

[6] Bankruptcy 51 ↪3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

In analyzing creditors' interest, for purposes of de-

termining whether interest of creditors would be better served if state court-appointed receiver is retained, court will examine likelihood of reorganization, probability that funds required for reorganization will be available, whether there are instances of mismanagement by debtor, and whether turnover would be injurious to creditors. Bankr.Code, 11 U.S.C.A. §§ 543(d)(1), 1101 et seq.

[7] Bankruptcy 51 ↪3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Existence of prepetition defaults in payment to lender which occurred prior to any action by lender to secure possession of future rents pursuant to rent assignment is not sufficient to entitle receiver to refuse to turn over debtor's property. Bankr.Code, 11 U.S.C.A. § 543(a).

[8] Bankruptcy 51 ↪3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Retention of state court appointed receiver was not appropriate under bankruptcy court's discretionary powers in Chapter 11 case; there was no showing that interests of all creditors would be better served if receiver were retained. Bankr.Code, 11 U.S.C.A. §§ 543(d)(1), 1101 et seq.

*329 Drew T. Parobek, Vorys, Sater, Seymour & Pease, Columbus, Ohio, for Goldome.

Thomas I. Blackburn, Denmead, Blackburn & Wil-

117 B.R. 328, 20 Bankr.Ct.Dec. 1276
(Cite as: 117 B.R. 328)

lard, Columbus, Ohio, for debtor.

Jay Alix, Southfield, Mich., Chapter 11 Trustee.

Michael L. Cook, Sally M. Henry, Skadden, Arps, Slate, Meagher & Flom, New York City, Gen. Counsel, Marilyn Shea-Stonum, Jones, Day, Reavis & Pogue, Columbus, Ohio, Sp. Counsel, to trustee.

*330 Charles M. Caldwell, Asst. U.S. Trustee, Columbus, Ohio, Columbus Office of the U.S. Trustee, for Region IX.

Lori Lapin Jones, Dewey, Ballantine, Bushby, Palmer & Wood, New York City, and Leon Friedberg, Benesch, Friedlander, Coplan & Aronoff, Columbus, Ohio, for Official Committee of Unsecured Creditors of Cardinal Industries, Inc.

P. Steven Kratsch, Kilpatrick & Cody, Atlanta, Ga., for Official Committee of Unsecured Creditors of Cardinal Industries of Florida, Inc.

Harvey S. Minton, Minton & Leslie, Columbus, Ohio, Counsel for Cardinal Industries of Georgia, Inc.

James H. Bownas, Columbus, Ohio, for Cardinal Industries Services Corp. and Cardinal Industries Mortg. Co.

Thomas R. Noland, Altick & Corwin, Dayton, Ohio, for Cardinal Partnership Corp. and Cardinal Partner Corp.

OPINION AND ORDER ON MOTION TO EXCUSE COMPLIANCE WITH 11 U.S.C. § 543

BARBARA J. SELLERS, Bankruptcy Judge.

This matter is before the Court on a motion to excuse a state court appointed receiver from complying with the turnover provisions of § 543 of the Bankruptcy Code. The motion was filed on behalf of Goldome Realty Credit Corp. ("Goldome"). The Chapter 11 debtor, Northgate Terrace Apartments,

Ltd. ("Northgate"), opposed the relief sought by Goldome and the matter was heard by the Court.

The Court has jurisdiction in this matter under 28 U.S.C. § 1334(b) and the General Order of Reference previously entered in this district. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (E) and (O) which this Court may hear and determine.

FINDINGS OF FACT

1. On or about November 22, 1983, Northgate executed and delivered to Goldome a promissory note in the original principal amount of \$1,296,000. Repayment of that note was secured by a mortgage against the apartment complex in Bay County, Florida (the "Property") owned and operated by Northgate.

2. In 1989 Northgate defaulted in payments of interest required under the terms and conditions of the promissory note.

3. After Northgate's default, Goldome commenced a state foreclosure action and requested the appointment of a receiver for the Property. On or about August 4, 1989, John Davidson Realty, Inc., was appointed as receiver (the "Receiver") by the state court in Bay County, Florida.

4. On or about November 16, 1989, the Florida court entered a Final Default Judgment of Foreclosure and scheduled a foreclosure sale of the Property for January 12, 1990.

5. On January 11, 1990 Northgate filed its voluntary petition for relief with this Court under Chapter 11 of the Bankruptcy Code.

6. Prior to the appointment of the Receiver by the Florida court the Property was managed by Cardinal Apartment Management Group, Inc. ("CAMG"), a wholly owned subsidiary of the general partner, Cardinal Industries, Inc.

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(Cite as: 117 B.R. 328)

7. CAMG failed to pay the real property taxes for 1988 for the Property. This failure caused the state of Florida to sell a tax certificate in respect of the Property. Goldome caused those taxes to be paid by the Receiver to maintain the priority of its mortgage lien.

8. The Receiver has retained CAMG as the on site manager of the Property.

9. The current occupancy rate of the Property of 94% is expected to rise during the summer months.

10. During the time period beginning with the appointment of the Receiver on or about August 4, 1989 and ending with the date of the hearing on this matter on March 26, 1990, the Receiver accumulated cash in excess of funds needed to operate the business. That cash surplus totals between \$39,000 and \$41,000.

*331 11. In February, 1990, the Receiver made a payment to Goldome in the amount of \$20,000. Authorization for that payment was not sought from this Court.

ISSUES

Two issues are before the Court for decision in this matter. First, whether the Court, under the mandatory language of 11 U.S.C. § 543(d)(2), must excuse the Receiver from complying with the turnover provisions of 11 U.S.C. § 543(b). Second, whether this Court in the exercise of its discretion under 11 U.S.C. § 543(d)(1) should excuse the Receiver from turning over the Property to Northgate as required by § 543(b).

DISCUSSION

A. Mandatory Excuse Under 11 U.S.C. § 543(d)(2).

[1][2] The commencement of a case under Chapter 11 of the Bankruptcy Code requires any custodian appointed by a state court to manage a debtor's

property, upon receipt of knowledge of the commencement of a bankruptcy case by the debtor, to cease disbursement of funds derived from that property except for expenditures necessary to preserve the property. The property must be delivered to the representative of the bankruptcy estate along with an accounting. 11 U.S.C. § 543(a), (b); Bankruptcy Rule 6002. Generally, a state court receivership is terminated upon a bankruptcy filing by the owner of the property. There are, however, two exceptions to that general rule. One of those exceptions provides:

(d) After notice and hearing, the bankruptcy court-

(2) shall excuse compliance with subsections (a) and (b)(1) of this section if the custodian is an assignee for the benefit of the debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, unless compliance with such subsections is necessary to prevent fraud or injustice.

11 U.S.C. § 543(d)(2).

[3] At the hearing of this matter Goldome asserted for the first time that this Court is required to retain the Receiver. Implicit within that argument under § 543(d)(2) is the assumption that a state court appointed receiver, who is a custodian pursuant to 11 U.S.C. § 101(10), is also an assignee for the benefit of the debtor's creditors. If the Receiver is such an assignee, the Receiver must be kept in possession of the property because the appointment occurred more than 120 days prior to the filing of Northgate's Chapter 11 petition.

[4] Case law indicates, however, that a state court receiver generally is not an "assignee for the benefit of the debtor's creditors." Rather, an assignee for the benefit of creditors is one to whom a debtor voluntarily assigns its property to be administered for the benefit of its creditors. *In re Sundance Corp.*,

117 B.R. 328, 20 Bankr.Ct.Dec. 1276
(Cite as: 117 B.R. 328)

83 B.R. 746, 748 (Bankr.D.Mont.1988).

Florida statutory and case law is in accord with this general rule. The Second District Court of Appeals of Florida, in construing credit transactions in light of Chapter 727 of the Florida Statutes stated that “[a]n assignment for the benefit of creditors made under Chapter 727 ... is purely a *voluntary* action of the debtor...” *Kitchens v. Kitchens*, 142 So.2d 343, 345 (1962) (emphasis added). *See also Dorr v. Schmidt & Ziegler*, 38 Fla. 354, 21 So. 279 (1896).

Under 11 U.S.C. § 543(d)(2), Congress also did not determine that a receiver was the same as an assignee for the benefit of creditors. Rather, the definition of a custodian explicitly includes both a receiver and an assignee for the benefit of creditors. *See* 11 U.S.C. § 101(10); *Sundance*, 83 B.R. at 749.

The Receiver appointed by the Florida court to manage Northgate's property was not appointed at Northgate's request or with its specific consent. Accordingly, the Receiver is not an assignee for the benefit *332 of creditors under either Florida law or the Bankruptcy Code. Further, Northgate's failure to actively oppose Goldome's motion seeking the receiver's appointment does not indicate consent in the circumstances of this case. Therefore, retention of the Receiver pursuant to § 543(d)(2) is not mandatory and Goldome's argument in that regard is without merit.

B. Discretionary Excuse Under 11 U.S.C. § 543(d)(1).

Even if retention of the Receiver is not mandated by § 543(d)(2), the Court may excuse the Receiver from complying with the turnover provisions of § 543. The statutory test pursuant to which the Court may exercise its discretion to excuse compliance is set forth in § 543(d)(1). That section states:

- (d) After notice and hearing, the bankruptcy court-
- (1) may excuse compliance with subsection (a),

(b) or (c) of this section, if the interest of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property, ...

11 U.S.C. § 543(d)(1).

[5] The evidence in this matter indicates that Northgate is insolvent. Therefore, under § 543(d)(1), the Court's inquiry is limited to the interest of creditors. Because the Bankruptcy Code contemplates turnover, Goldome, as the party seeking relief, has the burden of all issues relating to that affirmative relief.

[6] In analyzing creditors' interests, the Court will examine the likelihood of a reorganization, the probability that funds required for reorganization will be available, whether there are instances of mismanagement by the debtor, and whether turnover would be injurious to creditors. *In re Poplar Springs Apts. of Atlanta, Ltd.*, 103 B.R. 146, 150 (Bankr.S.D.Ohio 1989), *citing*, *First Nat'l Bank v. Powers Aero Marine Service (In re Powers Aero Marine Service)*, 42 B.R. 540 (Bankr.S.D.Tex.1989).

The likelihood of reorganization and the existence of income sufficient to make a reorganization possible cannot be determined in this case where the Receiver's presence has essentially deprived Northgate of access to some of the information required to make such a showing. Preliminary data, however, indicate that reorganization may not occur without the infusion of new capital. However, post-petition daily operation on site continues to be performed by the entity previously selected by Northgate and no instances of its mismanagement appear in the record.

It is undisputed that the Receiver has made at least one payment to Goldome during the pendency of this bankruptcy case. That payment was not authorized under 11 U.S.C. § 543(c) or under any order of this Court. Therefore, the interest of all prepetition

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(Cite as: 117 B.R. 328)

creditors, rather than the narrower interest of Goldome, might be better served by removing the Receiver and permitting the case to go forward as contemplated by Chapter 11 of the Bankruptcy Code. Because the financial data in this case makes the possibility of reorganization somewhat problematic, however, the length of time this case should be permitted to pend before other action may be warranted will be somewhat abbreviated.

[7][8] The existence of prepetition defaults in payment to a lender which occurred prior to any action by the lender to secure possession of future rents pursuant to a rent assignment is not sufficient to entitle a receiver to ignore the mandate of § 543(a) of the Bankruptcy Code and refuse to turn over a debtor's property. Further, the evidence indicates that separate segregated accounts have been established by Northgate for the receipt of rental income, Northgate intends to comply with all reporting requirements imposed by the United States Trustee, and CAMG, the management company previously selected by Northgate to manage its Property, continues to manage the day-to-day operations of the Property in a manner which is acceptable to all parties.

The turnover provisions of 11 U.S.C. § 543 are part of the statutory expression *333 of the Congressional preference that a Chapter 11 debtor be permitted to operate and control its business during the reorganization process. Moreover, that operation is for the benefit of all constituencies and is not solely for the benefit of the lender holding the primary mortgage against the debtor's property. "[G]enerally the basic equities would favor a debtor or debtor in possession. If nothing more, a substantial weight is added to the debtor's burden of attempting to reorganize and promulgate an acceptable plan of reorganization if the debtor cannot have access to all of its assets during its initial breathing spell." *In re KCC-FUND V, LTD.*, 96 B.R. 237, 239-240 (Bankr.W.D.Mo.1989).

The statute contemplates that property being managed by a receiver will be returned to the represent-

ative of the estate upon the commencement of a bankruptcy case by the owner. Excuse from this statutory mandate requires Goldome to show that the interests of all creditors are better served if the Receiver is kept in place. Absent a bad faith filing lacking any possibility of reorganization, the presence of grossly inept management of the Property, or fraudulent behavior, that burden will be hard to sustain. Under the facts of this case, that burden was not met. On balance the Court believes that removal of the Receiver may aid the reorganization effort and should not harm creditors.

CONCLUSION

Based upon the foregoing, the Court finds that Goldome's motion seeking to have the Court excuse the Receiver from complying with the turnover provisions of 11 U.S.C. § 543 shall be, and the same hereby is, denied.

IT IS SO ORDERED.

Bkrtcy.S.D.Ohio,1990.
In re Northgate Terrace Apartments, Ltd.
117 B.R. 328, 20 Bankr.Ct.Dec. 1276

END OF DOCUMENT

Westlaw

Page 1

83 B.R. 746, 18 Collier Bankr.Cas.2d 900
(Cite as: 83 B.R. 746)

H

United States Bankruptcy Court,
D. Montana.

In re SUNDANCE CORPORATION, Debtor.
Bankruptcy No. 88-40137.

March 11, 1988.

Chapter 11 debtor, as owner of apple orchard, sought termination of state court receivership. The Bankruptcy Court, John L. Peterson, J., held that continuation of receivership was in best interest of creditors.

Turnover excused.

West Headnotes

[1] Bankruptcy 51 ↻3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of
Assets

51k3063 Collection and Recovery for Es-
tate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

State court receiver placed in possession of debtor's property through judicial process is not equivalent of assignee for benefit of debtor's creditors, within meaning of Bankruptcy Code provision allowing such assignee to remain in possession after debtor petitions for bankruptcy; assignee for benefit of creditors stands in voluntary trust relationship with debtors while receiver does not. Bankr.Code, 11 U.S.C.A. § 523(d)(2).

[2] Bankruptcy 51 ↻3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of

Assets

51k3063 Collection and Recovery for Es-
tate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

State court receivership would not be terminated upon commencement of Chapter 11 case by owner of apple orchard absent showing that debtor would be able to fund orchard operations; continuation of receivership was in best interest of creditors. Bankr.Code, 11 U.S.C.A. § 523(d)(1).

*746 Jerome Shulkin, Seattle, Wash., Pierre L. Bacheller, Billings, Mont., for debtor.

John P. Paul, Great Falls, Mont., Douglas M. Ragen, Miller, Nash, Wiener Hager & Carlson, Portland, Or., for Community 1st Fed. Sav. & Loan.

Michael A. Arch, Wenatchee, Wash., for Scott Property Management.

ORDER

JOHN L. PETERSON, Bankruptcy Judge.

In this Chapter 11 case, Community First Federal Savings and Loan Association (Community) has filed a Motion to Excuse Compliance of a State Court Receiver (Scott Property Management, Inc. by its President Scott McDougall) with Section 543 of the Bankruptcy Code. An expedited hearing on the motion was held on March 10, 1988, with the Debtor appearing through its counsel in resistance to the motion. Evidence was taken by the Court and the matter is now ready for decision.

Sundance is fee title owner to over 2,500 acres of an apple orchard located in the State of Washington, which is the only asset of the debtor corporation. Community sought to foreclose its second mortgage lien against the property through a state court action in the Superior Court of the State of Washington, County of Grant, and ancillary to such

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Exhibit 2

83 B.R. 746, 18 Collier Bankr.Cas.2d 900
(Cite as: 83 B.R. 746)

such argument. Custodian is defined in subsection 101(10) of the Code as:

“(10) ‘custodian’ means-

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;

(B) assignee under a general assignment for the benefit of the debtor's creditors; or

*748 (C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors;”

The Matter of Cash Currency Exchange, Inc., 762 F.2d 542 (7th Cir.1985), held after setting forth the definition under § 101(10):

“The legislative history of section 101(10) indicates that Congress intended the term ‘custodian’ to encompass a variety of prepetition agents who had taken charge of the debtor's assets. For example, the Senate Report provides:

There is no similar definition in current law. It is defined to facilitate drafting, and means a prepetition liquidator of the debtor's property, such as an assignee for the benefit of creditors, a receiver of the debtor's property, or administrator of the debtor's property. The definition of custodian to include a receiver or trustee is descriptive, and not meant to be limited to court officers with those titles. The definition is intended to include other officers of the court if their functions are substantially similar to those of a receiver or trustee.

S.Rep. No. 989, 95th Cong., 2nd Sess. 23 (1978), U.S.Code Cong. & Admin.News, pp. 5787, 5809.

As the legislative history illustrates, the categor-

ies of custodians are descriptive rather than exhaustive. Congress defined the term broadly to include third parties who have taken charge of the debtor's assets for the general benefit of creditors. See, e.g., *In re Pride Foods, Inc.*, 22 B.R. 356 (Bankr.D.Neb.1982); *In re Lewis*, 12 B.R. 106 (Bankr.D.Ga.1981).” *Id.* at 553.

Section 101(10) is not without limitation, however. See e.g., *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983) (IRS is not a custodian by virtue of a tax lien which grants it a possessory interest pre-petition). A plain reading of § 101(10) with § 543(d)(2) convinces this Court that such subsection is not applicable to the facts here, where a state court receiver is placed in possession of the Debtor's property through judicial process, rather than where the debtor creates a consensual possession of the property for the benefit of its creditors, and thereby voluntarily assigns the property to the assignee for administration or liquidation. An assignee for the benefit of creditors is one to whom, under an insolvent or bankrupt law, the whole estate of a debtor is voluntarily transferred to be administered for the benefit of creditors.

“A general assignment for the benefit of creditors is ordinarily a conveyance by a debtor without consideration from the grantee of substantially all his property to a party in trust to collect the amount owing to him to sell and convey the property, to distribute the proceeds of all the property among his creditors, and to return the surplus, if any, to the debtor.” *Missouri-American Electric Co. v. Hamilton-Brown [Shoe] Co.*, 165 F. 283 (CCA 8).

Unlike the appointment of a receiver, the element of voluntary trust is present in every assignment, where permitted by state law. See, e.g., *Stanton Bank v. Northern Mont. Assn. of Credit Men*, 77 Mont. 153, 250 Pac. 596, 597 (1926):

“Under the rules applicable to commonlaw assignments for the benefit of creditors, counsel's second contention is correct. Such an assignment

83 B.R. 746, 18 Collier Bankr.Cas.2d 900
(Cite as: 83 B.R. 746)

created a trust, the power to compel the due observance and execution of which was peculiarly and exclusively of equitable cognizance, and this jurisdiction is not disturbed by statutory provisions which merely create and prescribe a new procedure for the administration and settlement of insolvent estate.”

By way of further example, Montana statutory law provides an insolvent debtor may, in good faith, execute an assignment of property to one or more assignees in trust for the satisfaction of his creditors. Mont.Code Ann., Sections 31-2-201, et. seq. By *749 contrast of such extra-judicial assignment, as Community points out in its brief,

“A receiver is an indifferent person between the parties to a cause, appointed by the court to receive and preserve the property or fund in litigation *pendente lite*, when it does not seem reasonable to the court that either party should hold it. He is not the agent or representative of either party to the action, but is uniformly regarded as an officer of the court, exercising his functions in the interest of neither plaintiff nor defendant but for the common benefit of all parties in interest. Being an officer of the court, the fund or property intrusted to his care is regarded as being *in custodia legis* for the benefit of whoever may finally establish title thereto, the court itself having the care of the property by its receiver, who is merely its creature or officer, having no powers other than those conferred upon him by the order of his appointment, or such as are derived from the established practice of the courts of equity-.” *Gloyd v. Rutherford*, 62 Wn.2d 59, 60-61, 380 P.2d 867 (1963).

Under § 543(d)(2) Congress specifically elected to place an assignee for the benefit of creditors in a different position than a state court receiver, obviously recognizing that the trust relationship reposed in the assignee warranted continual possession of the Debtor's property in that person, if the assignment was made for 120 days before the Order of Relief. The Washington state court receiver simply

does not fit into that definition as an assignee for the benefit of creditors, as subsection 101(10) makes clear by definition, and thus I conclude Community's reliance on 543(d)(2) is without merit.

[2] The crux of the controversy must be decided under Section 523(d)(1), and to that end, the best interest of creditors must be examined. As noted above, the property has been managed by McDougall since 1985, under an arrangement where the state court provided that Community fund the operation and maintenance of the property. I find McDougall has ably performed his duties as receiver. The Debtor, at this time, seeks recovery of possession of the orchard to reduce the costs of receivership (\$8,100.00 per month), and to that end has made arrangement with an able consultant and a foreman presently on the property to manage the property. Since the foreman has been performing the same task for the receiver, it is apparent the Debtor's selection of competent management is also in the best interest of creditors. However, the matter of Debtor funding the operation has been brought into serious dispute. The Debtor's evidence shows that it had made arrangements with the first mortgage holder (MONY) to fund the balance of the 1988 operation on a basis where MONY would receive a super priority position for the advancement of the operating funds. To that end, the Debtor had made arrangements for suitable operating personnel to maintain and care for the orchard. Those plans have now been upset by Community. On the day of the hearing, Community made an offer to MONY to buy-out its first mortgage position in 30 days, upon condition the orchard operation be preserved during that period of time. MONY through its counsel, seems receptive to the offer. If such buyout occurs, MONY will be taken out of the picture, and as a result, the Debtor's present plans for funding the daily operation will have aborted. The Debtor, to date, has not shown to the Court any other alternative of funding the operation, and Debtor's bankruptcy schedules clearly show it has no cash available to keep the orchard in operation. The matter is

83 B.R. 746, 18 Collier Bankr.Cas.2d 900
(Cite as: 83 B.R. 746)

further complicated by the present legal status of the receiver. As noted above, Community's complaint to foreclose its mortgage was dismissed. Yet, the very origin of the receiver's appointment *in custodia legis* derives from the filing of that dismissed complaint. The original order of appointment of February 11, 1985, as amended November 15, 1985, states "Scott Property Management, Inc., a Washington corporation, shall serve as the Receiver in this case for the period of time from February 11, 1985, through January 31, 1986 * * *." While the receiver was obviously continued in office post-1986, the judgment dismissing the complaint is silent as to the continuation of the receiver in office. By *750 letter of January 21, 1988, the State Superior Court Judge, indicated, without entry of a formal order, that Community was granted an equitable lien against the premises, the amount of which "will need to be adjusted for advances made during 1988 prior to the sale" and "that lien follows not only from equity but from the terms of the Order for Appointment of Receiver and Authorization to Disburse Funds entered herein on February 11, 1985, and the Order Amending Receivership Order entered November 15, 1985". Moreover, state court proceedings to clarify such letter were interrupted by the filing of the Chapter 11 case. The matter as to legal status of the receiver, as well as the finality of Community's offer to MONY, are thus left unresolved, in a situation where the orchard, by all parties' agreement, needs immediate and daily care.

Under these circumstances, the Court is left with no alternative than to keep the present custodian Scott Property Management, and its President Scott McDougall, in control of the Debtor's property, funded by Community, pending a re-hearing or resolution of the issues described above. Such will maintain the status quo. I find and conclude such interim arrangement must continue for the best interests of creditors. By this conclusion, I do not foreclose the Debtor from seeking turn over of property upon its future acquisition of suitable financing.

IT IS ORDERED the motion of Community First

Federal Savings and Loan Association to excuse the custodian Scott Property Management, Inc. from the provisions of 11 U.S.C. § 543(a), (b) and (c) is granted with leave of the Debtor, or any party in interest, to reconsider this Order upon proper application at any time.

Bkrcty.D.Mont.,1988.
In re Sundance Corp.
83 B.R. 746, 18 Collier Bankr.Cas.2d 900

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22 B.R. 67, 6 Collier Bankr.Cas.2d 1402, 9 Bankr.Ct.Dec. 445, Bankr. L. Rep. P 68,893
(Cite as: 22 B.R. 67)

C

United States Bankruptcy Appellate Panel of the
Ninth Circuit.

In re METROPOLITAN ADJUSTMENT BUREAU, a corporation, Metropolitan Adjustment Bureau, S. J., Inc., dba Metropolitan Adjustment Bureau, Debtors.

L. Scott McCLANAHAN, Appellant,

v.

METROPOLITAN ADJUSTMENT BUREAU, a corporation, Metropolitan Adjustment Bureau, S. J., Inc. dba Metropolitan Adjustment Bureau, Appellees.

BAP No. NC 81-1196 EKV.

Bankruptcy Nos. 481-02506W, 481-02507W.

Argued Feb. 19, 1982.

Decided July 14, 1982.

Appeal was taken from order of the United States Bankruptcy Court for the Northern District of California, Cameron W. Wolfe, J., requiring state-appointed conservator of debtors and their collection agency businesses to turnover all of debtors' property to trustee. The Bankruptcy Appellate Panels, Elliott, J., held that: (1) administration of debtors' assets by trustee rather than state-appointed conservator did not interfere with state's police or regulatory powers, therefore, statute which excludes from removability claims involving governmental exercise of police or regulatory powers was inapplicable; (2) turnover order was proper; and (3) trial court did not abuse its discretion in refusing to permit conservator to stay in possession of business.

Affirmed.

West Headnotes

[1] Bankruptcy 51 ↪2088

51 Bankruptcy
51I In General

51I(D) Venue; Personal Jurisdiction
51k2086 Transfer or Removal of Proceedings

51k2088 k. Removal from State Courts. Most Cited Cases

(Formerly 51k19)

Administration of debtors' assets by trustee under Bankruptcy Code rather than state-appointed conservator did not interfere with state's police or regulatory powers, in that state was free to proceed against debtors' licenses, therefore, statute which provides for removal of claim to bankruptcy court and excludes from removability claims involving governmental exercise of police or regulatory powers was inapplicable where state-appointed custodian was required under turnover provisions of Bankruptcy Code to deliver all of debtors property to trustee. Bankr.Code, 11 U.S.C.A. §§ 543(b)(1), 1101 et seq.; 28 U.S.C.A. § 1478(a).

[2] Bankruptcy 51 ↪3770

51 Bankruptcy

51XIX Review

51XIX(B) Review of Bankruptcy Court

51k3770 k. Presentation of Grounds for Review. Most Cited Cases

(Formerly 51k442)

Where debtors' conservator argued at trial court level that he was "custodian" within meaning of Bankruptcy Code, and conservator status as "custodian" was one of considerations noted by trial court in its turnover order, conservator could not argue on appeal that he was not "custodian." Bankr.Code, 11 U.S.C.A. §§ 101(10), 541(d), 543.

[3] Bankruptcy 51 ↪3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

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Exhibit 3

22 B.R. 67, 6 Collier Bankr.Cas.2d 1402, 9 Bankr.Ct.Dec. 445, Bankr. L. Rep. P 68,893
(Cite as: 22 B.R. 67)

51k3064 k. Turnover by Custodians.

Most Cited Cases

(Formerly 51k250(1))

Even if some property in question was subject to trust valid in bankruptcy, where debtors had legal title to some and legitimate possession of all property at commencement of conservatorship, and conservator was "custodian" within meaning of Bankruptcy Code, turnover order was proper. Bankr.Code, 11 U.S.C.A. §§ 101(10), 541(d), 543.

[4] Bankruptcy 51 3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

(Formerly 51k250(1))

Where, under state law, conservator's concern was not for creditors of debtors as whole, but rather, for customers of debtor's collection agencies, and bankruptcy court-ordered turnover not to debtors but to trustee, who was independent party appointed by bankruptcy court acting under its supervision and subject to fiduciary obligations, bankruptcy court did not abuse its discretion in refusing to permit state-appointed conservator to stay in possession of debtors' businesses. Bankr.Code, 11 U.S.C.A. § 543(d).

*68 Roy S. Liebman, Deputy Atty. Gen., Dept. of Justice, Sacramento, Cal., for appellant.

Edward D. Jellen, Jellen & Holman, San Francisco, Cal., for appellees.

Before ELLIOTT, VOLINN and KATZ, Bankruptcy Judges:

OPINION

ELLIOTT, Bankruptcy Judge:

The appellant, L. Scott McClanahan, was appointed by the Director of the Department of Consumer Affairs, State of California, as conservator of the above-named debtors and their collection agency businesses. The collection agencies then filed Chapter 11 petitions. McClanahan, represented by the Attorney General of the State of California, appeals from an order requiring McClanahan, as a custodian, to deliver all of the debtors' property to the trustee under 11 U.S.C. s 543(b)(1). We affirm.

ISSUES ON APPEAL

1. Did the turnover order unlawfully interfere with the state's police and regulatory power in violation of 28 U.S.C. s 1478?
2. Was the turnover order improper because under state law the funds held in trust for the debtors' clients were not property of the estate or the debtors?
3. Did the trial court abuse its discretion in failing to permit the conservator to retain the funds per s 543(d)?

I. INTERFERENCE WITH POLICE POWER

[1] Prior to the filing of these Chapter 11 cases, the State of California filed a disciplinary action seeking to revoke the license of the debtors. In a separate proceeding, McClanahan was administratively appointed as conservator of the debtors under s 6904 of the California Business and Professions Code (B & P) upon the basis *69 that debtors had failed to pay sums owed to customers, misappropriated trust funds and were insolvent. That statute also provides that the conservator may continue the business of the collection agency including collection and liquidation of accounts.

The conservator's reliance on 28 U.S.C. s 1478(a) which provides for removal of claims to bankruptcy courts and excludes from removability claims in-

22 B.R. 67, 6 Collier Bankr.Cas.2d 1402, 9 Bankr.Ct.Dec. 445, Bankr. L. Rep. P 68,893
(Cite as: 22 B.R. 67)

volving governmental exercise of police or regulatory power is misplaced.

The administration of the debtors' assets by a trustee under the Bankruptcy Code rather than a state appointed conservator does not interfere with the state's police or regulatory powers. In *re Thomassen*, 15 B.R. 907 (Bkrty.App. 9th Cir. 1981) does not control since the State of California is free to proceed against the debtors' licenses. In any event, no claim or cause of action has been removed to the bankruptcy court.

II. TURNOVER OF TRUST PROPERTY

McClanahan's principal argument is that the turnover order improperly forces him to give up property held in trust in which the debtors' estates have no interest. Under s 6904 of the B & P Code, prior to the filing of the Chapter 11 petitions McClanahan took possession of all the debtors' assets and took steps to receive the debtors' future revenues and mail.

Title 16 Cal. Administrative Code s 629, set forth in the margin, requires collection agencies to deposit proceeds of claims assigned by customers for collection into a trust account and permits disposition of those funds only with respect to certain categories of claims including, among others, amounts owed to customers. Section 629(b) requires that there be sufficient funds in the trust account at all times "to pay all moneys owing to all customers." McClanahan argues that all the funds received by him, including those received after the date of the Chapter 11 petition, are subject to the trust created by that provision of California law.

It is clear from McClanahan's arguments that he intends to apply all funds held by him including those diverted to him as conservator after the filing of the Chapter 11 petitions to make-up the alleged "shortfall" in the trust accounts. McClanahan argued before the bankruptcy court that s 629, "not only establishes the requirement that a licensee es-

tablish a trust account, but provides a detailed prioritization of how disbursements from said trust accounts shall be made." Appellant's Excerpts of Record at 10. In other words, McClanahan's argument is that s 629 creates a trust whose beneficiaries include not only the licensee's customers but those noncustomers who hold claims of the type s 629(b) permits to be paid from the trust account. More importantly, McClanahan clearly intends to treat the categories of permissible payees as priorities in the event of "shortage" in the account. Thus, McClanahan argues:

(T)he only interest in the trust moneys that Section s 629 provides the collection agency is that which may accrue to it after all previous priorities on the money are satisfied. Therefore, it axiomatically follows that if the trust account has been depleted to the point where the superior priorities cannot be satisfied, the collection agency has no interest in the money in the trust account unless and until the deficit in the trust account is eliminated.

Appellant's Excerpts of Record at 13.

Thus, it is because the licensee's right to receive payment from the account is listed last that McClanahan argues the debtors, and hence the estates, have no interest in the trust account.

The trustee argues that such a procedure recognizes either an invalid system of "disguised" state priorities or a set of statutory liens voidable under s 545(1)(C) or (E). Although *Elliott v. Bumb*, 356 F.2d 749 (9th Cir. 1966), and *In re Leslie*, 520 F.2d 761 (9th Cir. 1975) are particularly instructive in this regard, the correctness of McClanahan's interpretation of s 629(b), and the validity, nature and extent of the trust relationship created by the collection agency licensing scheme where bankruptcy intervenes, is not before us. We emphasize *70 that the extent to which the bankruptcy court may authorize the use of the trust funds in the operation of the business is also not before us. The only issue before us is the propriety of the turnover order. The

22 B.R. 67, 6 Collier Bankr.Cas.2d 1402, 9 Bankr.Ct.Dec. 445, Bankr. L. Rep. P 68,893
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conservator's arguments must be viewed in light of that fact.

[2] McClanahan argues that the debtors had neither "legal" or "equitable" title to the trust accounts. He also argues that at the date of the petition, debtors had no possessory right in the funds. At the time of the hearing before the trial court, McClanahan did not dispute that he was a "custodian" within the meaning of s 101(10). McClanahan's status as a "custodian" for the purposes of s 101(10) and s 543 was one of the considerations noted by the trial court in its turnover order. He now argues before this panel that he is not a "custodian." The argument raised at this stage will not be considered. Matter of Albin, 591 F.2d 94, 97-98 (9th Cir. 1979) .

[3] Given that McClanahan is a custodian within the meaning of s 101(10), it follows that the turnover order was proper. Even if some of the property is subject to a trust valid in bankruptcy, the debtors had legal title to some and legitimate possession of all the property at the commencement of the conservatorship. Because a s 101(10) type "custodian" normally controls all assets of the debtor, property of the debtor subject to turnover under s 543 must be read to reach all interests of the debtor superseded by the custodian at the commencement of his custodianship else s 543 would seldom, if ever, reach any property at all. This clearly includes the debtors' possessory and legal interest in property even where the debtor does not have an equitable interest. See s 541(d).

In re Teltronics, 649 F.2d 1236 (7th Cir. 1981), decided under the prior Bankruptcy Act and cited by McClanahan, is not on point even if its principles are valid under the Bankruptcy Code. In Teltronics, the court concluded that the debtor had no legitimate interest in the property in question because the property had been obtained by fraud. In the court's view, the existence of the fraud had been judicially established and thus the fact that the property did not belong to the debtor was established by collateral estoppel. Here the debtors held legal title and

their possession interest was legitimate. There has been no finding of fraud.

III. DISCRETION

[4] There is no evidence that the trial court abused its discretion in refusing to permit the conservator to stay in possession of the business. Under state law, the conservator's concern is not for the creditors of the debtors as a whole, but rather, for the customers of the collection agencies. The alleged misdeeds of the debtors recited by McClanahan are not relevant to the turnover issue. Here the bankruptcy court ordered turnover to the trustee in these cases not to the debtors. The trustee is an independent party appointed by the bankruptcy court acting under its supervision and subject to fiduciary obligations.

The trustee's responsibilities are to the creditors as a whole. The custodian's portrayal of the problem as one pitting the public interest against the debtors' misdeeds masks the conflict between the customer creditors and the non-customer creditors. The existence of the dispute regarding McClanahan's manifested interpretation of s 629(b) as a priority system attaching to both pre and post-petition receipts, the fact that the conservator refuses to act to protect all of the creditors of the debtors, and the fact that there is no evidence that as a practical matter, continuation of the custodianship will be in the best interests of the creditors as a whole, all provide a basis for the trial court having properly exercised its discretion under s 543(d).

FRIVOLOUS APPEAL

We do not view all of McClanahan's arguments as frivolous and accordingly decline to impose sanctions.

AFFIRMED.

9th Cir.BAP (Cal.), 1982.
In re Metropolitan Adjustment Bureau

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United States Bankruptcy Court,
S.D. New York.

In re CONSTABLE PLAZA ASSOCIATES, L.P.,
Debtor.
Bankruptcy No. 91 B 20249.

March 14, 1991.

Chapter 11 petition was filed by limited partnership which continued in possession and management of its property. Secured creditor moved for order directing debtor to turn over all rents from debtor's office building received after appointment of state court receiver or to continue receiver in possession as custodian of rents. Debtor moved for order authorizing its use of rents as cash collateral solely for maintenance of building. The Bankruptcy Court, Howard Schwartzberg, J., held that: (1) under New York law, assignment of rents clause in mortgage was merely pledge and was not absolute assignment prior to appointment of receiver to collect rents; (2) assignment of rents clause and prepetition appointment of state court receiver did not cut off all debtor's property interests in future rents with respect to its office building, and debtor continued to possess residual interest in rents which resulted in such rents being property of bankruptcy estate; and (3) debtor could use rents derived from its office building solely for purpose of maintaining and operating building, and monthly rents in excess of such expenses were required to be remitted to creditor on monthly basis.

Debtor's motion granted.

West Headnotes

[1] Mortgages 266 ↪199(2)

266 Mortgages
266IV Rights and Liabilities of Parties
266k199 Rents and Profits

266k199(2) k. Provisions of Mortgage or Special Agreement. Most Cited Cases
Under New York law, assignment of rents clause in mortgage was merely pledge and was not absolute assignment until receiver was appointed to collect rents, and thus, mortgagee was not entitled to collect rents pursuant to assignment of rents clause merely upon occurrence of default, but was required to first obtain appointment of receiver.

[2] Bankruptcy 51 ↪2576

51 Bankruptcy
51V The Estate
51V(D) Liens and Transfers; Avoidability
51k2576 k. Perfection or Recordation Under State Law, in General. Most Cited Cases

Secured Transactions 349A ↪184

349A Secured Transactions
349AV Assignments of Security Interests and Assignments Creating Security Interests
349Ak184 k. Rights and Liabilities of Parties. Most Cited Cases
Under New York law, assignee of future rents who has done nothing to perfect its rights will not prevail over execution creditor or trustee in bankruptcy.

[3] Bankruptcy 51 ↪2558

51 Bankruptcy
51V The Estate
51V(C) Property of Estate in General
51V(C)2 Particular Items and Interests
51k2558 k. After-Acquired Property; Proceeds; Wages and Earnings. Most Cited Cases
Assignment of rents clause in mortgage as additional security and prepetition appointment of state court receiver to collect rents did not cut off all of debtor's property interest in future rents with respect to its office building, and debtor continued to possess residual interest in rents which resulted in such rents being property of bankruptcy estate with-

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Exhibit 4

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in meaning of Bankruptcy Code. Bankr.Code, 11 U.S.C.A. § 541.

[4] Bankruptcy 51 ☞3064

51 Bankruptcy
51IX Administration
51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Secured creditor was not entitled to exception to general rule mandating turnover of rents collected by receiver appointed pursuant to debtor's default in mortgage, where it was too early to determine likelihood of debtor's successful reorganization, under either debtor's or creditor's approach, rents would be applied towards same purpose, i.e., maintenance and expenses in operation of debtor's office building, there was no issue raised as to any mismanagement by debtor, and state court foreclosure action pursuant to which state court receiver was appointed had been halted by automatic stay imposed under Bankruptcy Code. Bankr.Code, 11 U.S.C.A. §§ 362, 363(c)(2), 541(d)(1), 543(b)(1), (d)(1).

[5] Bankruptcy 51 ☞3064

51 Bankruptcy
51IX Administration
51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Custodian with knowledge of bankruptcy case has absolute duty under Bankruptcy Code to refrain from any further action in administration of property of debtor's estate and must deliver to debtor in possession any property of estate held by custodian at time knowledge of bankruptcy case was acquired. Bankr.Code, 11 U.S.C.A. § 543.

[6] Bankruptcy 51 ☞3064

51 Bankruptcy
51IX Administration
51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Exception to general rule in Bankruptcy Code mandating turnover of property of estate by custodian is, in essence, modified abstention provision; under exception, court must consider interests of all debtor's creditors. Bankr.Code, 11 U.S.C.A. §§ 541(d)(1), 543(b)(1), (d)(1).

[7] Bankruptcy 51 ☞3064

51 Bankruptcy
51IX Administration
51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

Factors which court should consider with respect to discretionary exemption from general rule mandating turnover of property of estate by custodian are: whether there will be sufficient income to fund successful reorganization, whether debtor will use turnover property for benefit of creditors, and whether there has been mismanagement by debtor. Bankr.Code, 11 U.S.C.A. § 543(d)(1).

[8] Bankruptcy 51 ☞3064

51 Bankruptcy
51IX Administration
51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

125 B.R. 98
(Cite as: 125 B.R. 98)

In deciding whether to allow receiver to continue to collect and hold property of estate, bankruptcy court should also consider whether there are avoidance issues raised with respect to property retained by receiver, because receiver does not possess avoiding powers for benefit of estate. Bankr.Code, 11 U.S.C.A. § 543(d)(1).

[9] Bankruptcy 51 ↪3082.1

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3082 Cash Collateral, Use of

51k3082.1 k. In General. Most Cited

Cases

(Formerly 51k3082)

Chapter 11 debtor could use rents derived from its office building, which were subject to assignment of rents clause in mortgage covering building, as cash collateral solely for purpose of maintaining and operating building, and monthly rents in excess of such expenses were required to be remitted to secured creditor mortgagee on monthly basis. Bankr.Code, 11 U.S.C.A. § 363(c)(2)(B), (e).

[10] Bankruptcy 51 ↪3084

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3082 Cash Collateral, Use of

51k3084 k. Proceedings. Most Cited

Cases

Debtor had burden of demonstrating that creditor would be adequately protected if debtor was authorized to use cash collateral, or rents, which had been assigned to creditor as additional security for debtor's obligation under mortgage and note with respect to debtor's office building. Bankr.Code, 11 U.S.C.A. § 363(e).

*100 Angel & Frankel, P.C., New York City, for debtor; John H. Drucker, of counsel.

McNamee, Lochner, Titus & Williams, P.C., Albany, N.Y., for Connecticut Mut. Life Ins. Co.; Peter A. Pastore, of counsel.

Ralph Nobile, Receiver, Bronxville, N.Y.

Wilkie Farr & Gallagher, Blueberry Harbor Corp., New York City, Donna H. Lieberman, of counsel.

DECISION ON MOTION FOR AN ORDER AUTHORIZING DEBTOR'S USE OF ASSETS IN WHICH CONNECTICUT MUTUAL LIFE INSURANCE COMPANY MAY ASSERT AN INTEREST

HOWARD SCHWARTZBERG, Bankruptcy Judge.

Connecticut Mutual Life Insurance Company ("Mutual") has moved for an order directing the Chapter 11 debtor, Constable Plaza Associates, L.P., to turnover all rents from the debtor's office building in New Rochelle, New York received after the appointment of a state court receiver. Alternatively, Mutual seeks to continue the receiver in possession as custodian of the rents pursuant to 11 U.S.C. § 543(d)(1). The debtor, in turn, has moved for an order under 11 U.S.C. § 363(c)(2)(B), authorizing its use of the rents as cash collateral solely for the maintenance, management, repairs and charges incurred with respect to the office building which generates the rents in question. The hearing was held on March 12, 1991.

BACKGROUND FACTS

On February 20, 1991, the debtor filed with this court its voluntary petition for reorganizational relief under Chapter 11 of the Bankruptcy Code and continued in possession and management of its property as a debtor in possession in accordance with 11 U.S.C. §§ 1107 and 1108.

The debtor is a limited partnership formed for the purpose of purchasing and operating an office building in New Rochelle, New York and a parcel

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of undeveloped land across the street from the office building. The debtor purchased its interest in the real property in question in December of 1988 from Blueberry Harbor Corporation ("Blueberry"), subject to a preexisting mortgage held by Mutual in the face amount of \$3,500,000.00. Additionally, a purchase money mortgage in the face amount of \$700,000.00 was given by the debtor to Blueberry. The debtor also gave Blueberry a \$100,000.00 mortgage on the vacant parcel of real estate across the street from the office building against which Mutual holds a first mortgage.

The Mutual first mortgage provides for a balloon payment of \$3,500,000.00 principal on December 22, 1991. Interest is to be paid in monthly installments at the rate of 10 percent, amounting to approximately \$29,166.00 per month. The first mortgage also contains a provision in Section 13.07 that in the event of a mortgage default, the mortgagor assigns to the mortgagee "as additional security for the indebtedness ... the rents, issues and profits, and any and all deposits held as security under said leases."

The debtor defaulted under the mortgage note and mortgage. On January 7, 1991, Mutual commenced a mortgage foreclosure action against the debtor in the New York Supreme Court, Westchester County. By order dated January 25, 1991, the state court judge appointed a receiver in the mortgage foreclosure action. Thereafter, the tenants at the office building were notified to pay rent to the receiver.

*101 On February 25, 1991, the parties appeared in this court in connection with the debtor's motion for contempt against Mutual for wilfully violating the automatic stay by urging the state court receiver to collect rents from the office building tenants. The debtor also sought a preliminary injunction. The motions were resolved by the parties whereby the debtor would collect rents and place them in a segregated account pending a determination of the motions made by the debtor and Mutual which were returnable thereafter and which are now the subject of the instant proceeding.

DISCUSSION

[1] Mutual argues that by obtaining the appointment of a receiver of rents and profits prior to the filing of the Chapter 11 petition, it perfected a valid recorded security interest entitling it to possession of the rents. Mutual reasons that the debtor's interest in the rents was cut off before the debtor filed its Chapter 11 petition with the result that as to the rents, the debtor has absolutely no interest in the rents which could be regarded as property of the estate within the context of 11 U.S.C. § 541.

[2] There is no question that Mutual's right to the rents under the prepetition assignment of rents clause in the mortgage and the subsequent appointment of a state court receiver must be determined under New York law. *See Butner v. United States*, 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979) (the determination of property rights in the assets of a debtor's estate is made according to state law). It is settled law in New York that an assignee of future rents who has done nothing to perfect its rights will not prevail over an execution creditor or a trustee in bankruptcy. *Sullivan v. Rosson*, 223 N.Y. 217, 119 N.E. 405 (1918). The Second Circuit in *In re Brose*, 254 Fed. 664 (2d Cir.1918) early held that as a result of the *Sullivan* case an assignment of rents clause in a mortgage operates merely as a pledge of the rents, to which the pledgee does not become entitled until it asserts its rights. The court also quoted, with approval, the following language of the United States Supreme Court:

The general rule is that the mortgagee is not entitled to the rents and profits of the mortgaged premises until he takes actual possession, or *until possession is taken, in his behalf, by a receiver....* (Emphasis added)

Freedman's Savings Co. v. Shepherd, 127 U.S. 494, 502, 8 S.Ct. 1250, 1254, 32 L.Ed. 163 (1888).

In the instant case, a receiver was appointed on Mutual's behalf in the state court foreclosure action before the debtor filed its Chapter 11 petition. Ac-

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cordingly, Mutual has a *prima facie* basis for asserting that the state court's prepetition appointment of a receiver pursuant to the assignment of rents clause in the mortgage transferred all title and interest in the rents prior to the commencement of the debtor's Chapter 11 case. However, the assignment of rents clause in the mortgage specifically states that such assignment was "as additional security for the indebtedness."

In accordance with *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983), the concept of property of the estate is to be given a broad application. Manifestly, Mutual did not cut off all of the debtor's property rights with respect to the rents; Mutual received an assignment of the rents as security for the mortgage debt, so that when the mortgage debt was satisfied, the debtor's right to receive the rents resumed. Obviously, Mutual does not claim an absolute right to collect rents indefinitely, even after such time as the debtor might have satisfied the mortgage debt.

The issue as to whether or not an assignment of rents clause in a mortgage creates an absolute assignment of the rents upon a mortgage default, or merely an assignment for security purposes, is important in determining if the mortgagee has perfected its interest. Thus, the issue is not whether or not the mortgagee has an absolute right forever to collect rents regardless of a possible future satisfaction of the mortgage, but instead, whether the mortgagor's default,*102 without more, gives rise to the mortgagee's right to collect the rents during the mortgage default phase. Hence, the distinction is significant in resolving the issue of perfection for the purpose of determining the mortgagee's right to collect the rents, and is not dispositive of the question as to whether the mortgagee has an absolute right to collect rents indefinitely, regardless of a satisfaction of the mortgage by the mortgagor.

As the Ninth Circuit Court of Appeals observed in *Equitable Mortgage Co. v. Fishman (In re Charles D. Stapp of Nevada, Inc.)*:

Under California law, if an assignment is absolute, the beneficiary of the deed of trust is entitled without further action to all rents accruing from the date of notice of the default. If the assignment-of-rents provision is construed as a pledge of the rents as additional security, the rents inure to the bankruptcy trustee until the trust deed beneficiary perfects his claim to them.

Equitable Mortgage Co. v. Fishman (In re Charles D. Stapp of Nevada, Inc.), 641 F.2d 737 (1981), *Great West Life Assurance Co. v. Rothman (In re Ventura-Louise Properties)*, 490 F.2d 1141, 1143-44 (9th Cir.1974). In the *Stapp* case, the court referred to the deed of trust, which is equivalent to a mortgage in New York, and concluded that the phrase "as additional security" did not appear in the assignment language. Therefore, the court concluded that the assignment was absolute. The term "absolute" did not mean that the mortgagee was forever entitled to the rents regardless of a possible satisfaction of the mortgage or deed of trust. Instead, the court said:

The assignment is "absolute" in the sense that it was effective upon default without further action by the creditor.

* * * * *

"Absolute" does not mean, however, that the assignee is relieved of all obligation to account or that the right to the rents is independent of the underlying debt. Upon foreclosure, the creditor of course, must account for any excess derived from the sale and rents collected between the date of the default and the date of foreclosure sale over and above the amount of the obligation owed. (Emphasis added)

Id. at 740.

In the instant case, Mutual was required to obtain the appointment of a receiver, which it did, in order to establish its right to collect the rents under the assignment of rents clause in the mortgage. See *Casbeer v. State Federal Savings & Loan Assoc. (In*

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re Casbeer), 793 F.2d 1436, 1442 (5th Cir.1986). Mutual was not entitled, without further action, such as the appointment of a receiver, to collect the rents accruing from the date of the notice of default. Therefore, under New York law, the appointment of a receiver triggered Mutual's right to collect the rents, because the assignment of rents clause was merely a pledge and was not an absolute assignment until the receiver was appointed. *See Sullivan v. Rosson*, 223 N.Y. 217, 119 N.E. 405 (1918); *In re Brose*, 254 Fed. 664 (2d Cir.1918). Indeed, the appearance in the assignment of rents clause of the phrase "as additional security" lends further support to the conclusion that the parties contemplated that no absolute assignment of the rents was to take effect upon the occurrence of a default and that further action was required by the mortgagee, such as the appointment of a receiver, before Mutual was entitled to collect the rents.

[3] The issue as to Mutual's right to collect the rents is not disputed. However, what is in question is the nature of the interest that Mutual acquired. Even if Mutual had an absolute assignment, rather than a pledge which required further action, it would not follow that the debtor's interest in the rent was totally cut off. *Equitable Mortgage Co. v. Fishman (In re Charles D. Stapp of Nevada, Inc.)*, 641 F.2d at 740. In a recent case in this district, District Judge Robert J. Ward, concluded that notwithstanding an absolute assignment under Georgia law regarding a building located in Georgia, the debtor, nonetheless, retained a residual interest in the rents which were assigned and was *103 entitled to an accounting for any rents beyond the amount of the mortgage debt. *Travelers Indemnity Co. v. Grant Associates (In re Grant Associates)*, 1991 WL 21228, 1991 U.S. Dist. Lexis 1245 (S.D.N.Y. Feb. 5, 1991). (The absolute assignment simply meant that the creditor had a perfected security interest in the rents as of the default, without further action being required).

In view of the fact that the debtor retains a residual interest in the rents assigned to Mutual "as addi-

tional security", it follows that such interest in the rents constitutes property of the estate within the meaning of 11 U.S.C. § 541. Therefore, it must next be determined if such cash collateral is available for use by the debtor pursuant to 11 U.S.C. § 363(c)(2)(B).

Continued Receiver's or Debtor's Use of Cash Collateral

[4][5] A custodian with knowledge of a bankruptcy case, such as the receiver in this case, has an absolute duty under 11 U.S.C. § 543 to refrain from any further action in the administration of property of the debtor's estate and must deliver to the debtor in possession any property of the estate held by the custodian at the time knowledge of the bankruptcy case was acquired. Although the receiver in this case has not yet collected any rents which might be subject to turnover, Mutual seeks to have the receiver continue in place and collect all future rents from the debtor's office building and apply such rents towards the maintenance, taxes, and expenses of operating the office building. On the other hand, the debtor seeks to use the rents as cash collateral for the same purpose, namely, for the exclusive costs of operating the office building.

In order to sustain its position, Mutual relies on 11 U.S.C. § 543(d)(1). This provision is an exception to the turnover requirement imposed by 11 U.S.C. § 543(b)(1) and excuses turnover "if the interests of creditors ... would be better served by permitting a custodian to continue in possession, custody or control of such property ...". The debtor also relies upon an exception with respect to cash collateral, because 11 U.S.C. § 363(c)(2) forbids a debtor to use, sell, or lease cash collateral. However, 11 U.S.C. § 363(c)(2)(B) provides an exception to this general rule and authorizes the debtor's use of cash collateral on condition that "the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section."

[6][7][8] The exception to the general rule in 11

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U.S.C. § 543(b)(1) mandating a turnover of property of the estate by a custodian, is in essence a modified abstention provision. See *In re Pine Lake Village, Apartment Co.*, 17 B.R. 829, 833 (Bankr.S.D.N.Y.1982). Under this exception, as expressed in 11 U.S.C. § 541(d)(1), the court must consider the interests of all the debtor's creditors. One of the factors that the court should consider with respect to this discretionary exemption is whether there will be sufficient income to fund a successful reorganization. *In re Powers Aero Marine Services, Inc.*, 42 B.R. 540 (Bankr.S.D.Tex.1984). Another factor for consideration is whether the debtor will use the turned over property for the benefit of the creditors. *In re CCN Realty Corp.*, 19 B.R. 526, 529 (Bankr.S.D.N.Y.1982). A third factor for consideration is whether there has been mismanagement by the debtor. *In re WPAS, Inc.*, 6 B.R. 40 (Bankr.M.D.Fla.1980). In deciding whether to allow a receiver to continue to collect and hold property of the estate, a bankruptcy court should also consider whether or not there are avoidance issues raised with respect to the property retained by the receiver, because a receiver does not possess avoiding powers for the benefit of the estate. *In re Property Management Investment, Inc.*, 19 B.R. 202, 206 (Bankr.M.D.Fla.1982).

In the instant case, the debtor has only recently filed its Chapter 11 petition and it is too early to determine the likelihood of a successful reorganization, other than to note that under either the debtor's or Mutual's approach, the rents will be applied towards the same purpose; the maintenance and expenses in the operation of the *104 debtor's office building. Moreover, under either approach, the rents will be used for the benefit of creditors because it is in their interests to preserve the operation of the office building.

A recent bankruptcy decision *In re Rancourt*, 123 B.R. 143, 21 B.C.D. 494 (Bankr.D.N.H.1991), reflects the fact that the court was mindful of the point that a debtor was entitled to use rents as cash

collateral in the early stage of a case, rather than turn over the rents to a mortgagee with an assignment of rents clause in its mortgage because the mortgagee was adequately protected.

In the present case, on its particular facts, the issue before the Court really comes down to the question as to whether the movants are entitled *at this early stage* of the case to prohibitions or conditions upon the use of rents "as is necessary" to provide them adequate protection pursuant to § 363(c) of the Bankruptcy Code. It is obvious that the movants are in no real danger at this state of not being covered in full with regard to their secured debt. This is true because rentals, uniquely among cash collateral categories, have the additional dimension of the real property mortgage reaching an equity cushion in the underlying real property to safeguard the secured debt. In my view the language "as is necessary" in § 363(c) can appropriately be construed to take into account the unique situation of rents-as distinguished from the other types for cash collateral which have no such underlying protection.

In re Rancourt, 123 B.R. 143, 152, 21 B.C.D. 494, 499 (Bankr.D.N.H.1991).

At least for the purposes of the motions before the court no issues have been raised as to any mismanagement by the debtor other than a default in the payment of monthly mortgage interest installments. As to issues implicating avoiding powers, the debtor has raised a question as to whether Mutual's perfection of its assignment of rents by the appointment of a receiver within ninety days from the Chapter 11 filing constitutes a voidable preferential transfer proscribed under 11 U.S.C. § 547(b). This issue is yet to be heard by the court. Even if the receiver is permitted to collect future rents the debtor will still be in a position to raise this issue. However, if the debtor is correct as to this point, the receiver's standing will be eliminated. Until this issue is resolved, the receiver's right to collect rents and hold property of the estate will continue under a cloud. This disputed issue undermines the

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strength of Mutual's request for an exception to the turnover requirement imposed under 11 U.S.C. § 543(b)(1).

A more significant factor to be considered is that the state court foreclosure action has been halted by the automatic stay imposed under 11 U.S.C. § 362. Therefore, if the basic action in which the state court receiver was appointed is no longer active, there is no reason to excuse the receiver's compliance with 11 U.S.C. § 543(b)(1) in order to activate a state court receiver whose appointment was ancillary to the enjoined foreclosure action. Unless and until the automatic stay is modified or terminated, the administration of the debtor's case and the disposition of property of the estate should continue under the aegis of this court and in accordance with the general provisions of the Bankruptcy Code and Rules. In light of all the circumstances in this case, there does not appear to exist any cogent reason why the court should exercise its discretion and enter an order excepting Mutual and the state court receiver from complying with the requirements of 11 U.S.C. § 543(b)(1).

Cash Collateral

[9][10] The debtor has the burden of demonstrating that the creditor will be adequately protected if it is authorized to use the cash collateral, or rents, which have been assigned to Mutual "as additional security" for the debtor's obligation under the mortgage and note with respect to the debtor's office building. See 11 U.S.C. § 363(e). See also *In re Markim, Inc.*, 15 B.R. 56 (Bankr.E.D.Pa.1981). Mutual concedes that it is presently over-secured and there exists an equity cushion between the amount of its claim and the value of the secured property. However, Mutual argues*105 that this cushion will decline because it is losing the value of the interest it would earn if it could collect and deposit the rents in its own bank account. The concept of lost opportunity has been rejected with respect to an undersecured creditor. See *United Savings Assoc. of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 108 S.Ct.

626, 98 L.Ed.2d 740 (1988). In the case of an over-secured creditor, the right to interest will continue to accrue in accordance with 11 U.S.C. § 506(b). See *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989). Hence, to the extent that the debtor is unable to bank the assigned rents it will be deprived of the interest to which it would otherwise be entitled. However, this argument loses significance in the light of Mutual's objective for claiming the assigned rents. Mutual seeks to apply the rents, or cash collateral, for the purpose of maintaining and operating the debtor's office building. Hence, to the extent the rents are plowed back into the office building there will be that many fewer funds in its bank account accruing interest. The issue of lost interest will have significance only with respect to those funds not needed to operate the office building.

The debtor does not now seek unfettered use of the rents, or cash collateral. The debtor would like to collect the rents in order to pay the expenses relating to the operation of its office building. Therefore, any expenses in excess of this proposed use should be turned over to Mutual pursuant to its right to receive or collect the assigned rents. The debtor may use the rents only for the purpose of operating the office building. To this extent, Mutual is adequately protected by the admitted equity cushion between the value of the building and the debtor's obligation to Mutual. See *In re Triplett*, 87 B.R. 25, 26 (Bankr.W.D.Tex.1988); *In re Oak Glen R-Vee*, 8 B.R. 213, 217 (Bankr.C.D.Cal.1981). Furthermore, the debtor's plowing back rents solely for the purpose of maintaining and operating its office building will serve to preserve or enhance the value of the building which, in turn, will protect the collateral covered by Mutual's mortgage.

Manifestly, the application of the rent income solely to maintain and repair the property so as to prevent further deterioration will enhance the value of the property which serves as the collateral for the plaintiff-mortgagee's claim. The protec-

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tion and maintenance of the plaintiff-mortgagee's collateral, without any diversion of funds to the debtor, clearly ensures that the plaintiff-mortgagee's investment is adequately protected.

In re Pine Lake Village Apartment Co., 16 B.R. 750, 756 (Bankr.S.D.N.Y.1982).

Additionally, Mutual did not contend that the debtor's operation of the office building would impair its secured interest in the collateral. It has been held that a creditor did not bargain for the income stream when the creditor bargained for collateral in excess of the debt. See *In re Triplett*, 87 B.R. 25, 27 (Bankr.W.D.Tex.1988). ("Furthermore, the income stream is almost never 'bargained for'; use of rent assignment clauses and other devices are merely collateralization techniques."). Therefore, the debtor will be allowed to use the rents generated by its office building, but only for maintenance, repairs, taxes, insurance and operating expenses with respect to the building. All the expenditures shall be specifically accounted for in detailed monthly reports which the debtor shall file with the court, the U.S. Trustee's office and with Mutual. Any rents in excess of the amounts plowed back into the office building shall be turned over to Mutual each month, unless the debtor obtains Mutual's consent that the excess monthly rents will be required to satisfy specifically designated future expenses pertaining to the building. In the event that the parties cannot agree as to a specific disputed future expense item, or any other proposed use to which the rents are to be applied, they may submit the issue to this court for prompt determination.

CONCLUSIONS OF LAW

1. This court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. § 1334 and 28 U.S. § 157(a). This is a core proceeding in accordance with 28 U.S.C. § 157(b)(2)(E) and (M).

*106 2. Mutual's motion for an order pursuant to 11 U.S.C. § 543(d)(2) excusing the state court receiver

from complying with 11 U.S.C. § 543(b)(1) is denied.

3. The assignment of rents clause in the mortgage "as additional security" and the prepetition appointment of a state court receiver did not cut off all of the debtor's property interests in the future rents with respect to its office building; the debtor continues to possess a residual interest in the rents which results in characterizing such rents as property of the estate within the meaning of 11 U.S.C. § 541.

4. Based on the undisputed facts in this case the debtor may use the rents derived from its office building, which are subject to Mutual's assignment of rents clause in its mortgage covering such building, solely for the purpose of maintaining and operating the building in accordance with the procedure expressed in the foregoing decision and in accordance with 11 U.S.C. § 363(c)(2)(B). The monthly rents in excess of such expenses shall be remitted to Mutual on a monthly basis.

SETTLE ORDER in accordance with the foregoing decision.

Bkrcty.S.D.N.Y.,1991.
In re Constable Plaza Associates, L.P.
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END OF DOCUMENT

Westlaw

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H

United States Bankruptcy Court,
N.D. Indiana,
Fort Wayne Division.

In the Matter of RIMSAT, LTD., Debtor.
Bankruptcy No. 95-10120.

Jan. 24, 1996.

Prepetition receiver sought dismissal of bankruptcy case of Chapter 11 debtor as party in interest. The Bankruptcy Court, Robert E. Grant, J., held that: (1) receiver was not party in interest, and (2) even if party in interest, receiver lacked standing to seek dismissal.

Motion to dismiss case denied.

West Headnotes

[1] Federal Civil Procedure 170A ↪103.2

170A Federal Civil Procedure
170AII Parties
170AII(A) In General
170Ak103.1 Standing
170Ak103.2 k. In General; Injury or Interest. Most Cited Cases
Federal courts must satisfy themselves as to party's standing, whether or not such issue has been raised by any of the litigants.

[2] Federal Civil Procedure 170A ↪103.2

170A Federal Civil Procedure
170AII Parties
170AII(A) In General
170Ak103.1 Standing
170Ak103.2 k. In General; Injury or Interest. Most Cited Cases
In considering question of standing, focus is on party, not claim itself; requirement of standing focuses on party seeking to get his complaint before

federal court and not on issues he wishes to have adjudicated.

[3] Bankruptcy 51 ↪2205

51 Bankruptcy
51III The Case
51III(A) In General
51k2204 Parties
51k2205 k. Reorganization Cases; Right to Be Heard. Most Cited Cases
Prepetition receiver of Chapter 11 debtor was not "party in interest" for purposes of case; receiver was omitted from statute's list of those who qualify as party in interest, and, unlike others listed, receiver did not have ownership interest in or claim upon debtor's assets or duty under Bankruptcy Code, and did not have direct legal interest in case, but was entity that was supposed to have ceased to function as result of case. Bankr.Code, 11 U.S.C.A. §§ 543, 1109(b).

[4] Bankruptcy 51 ↪2205

51 Bankruptcy
51III The Case
51III(A) In General
51k2204 Parties
51k2205 k. Reorganization Cases; Right to Be Heard. Most Cited Cases
Exclusion of receiver from statute's list of those considered to be party in interest in Chapter 11 proceedings was not necessarily determinative of issue of whether prepetition receiver was party in interest, given illustrative nature of list. Bankr.Code, 11 U.S.C.A. § 1109(b).

[5] Receivers 323 ↪69

323 Receivers
323III Title to and Possession of Property
323k69 k. Title or Right Acquired by Receiver in General. Most Cited Cases
Appointment of receiver does not deprive debtor of ownership of property over which receiver is given

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Exhibit 5

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authority and receiver does not generally take title to that property; instead, it is receiver's duty to preserve property for benefit of those ultimately determined to be entitled to it.

[6] Bankruptcy 51 ↪3501

51 Bankruptcy
51XIV Reorganization
51XIV(A) In General
51k3501 k. In General; Nature and Purpose. Most Cited Cases
Reorganization of corporation in bankruptcy is matter between corporation and its stockholders on one hand and its creditors on other.

[7] Bankruptcy 51 ↪2205

51 Bankruptcy
51III The Case
51III(A) In General
51k2204 Parties
51k2205 k. Reorganization Cases; Right to Be Heard. Most Cited Cases
To qualify as party in interest in Chapter 11 case requires more than merely being interested in outcome of bankruptcy proceeding; it requires direct legal interest in case. Bankr.Code, 11 U.S.C.A. § 1109(b).

[8] Bankruptcy 51 ↪3064

51 Bankruptcy
51IX Administration
51IX(B) Possession, Use, Sale, or Lease of Assets
51k3063 Collection and Recovery for Estate; Turnover
51k3064 k. Turnover by Custodians. Most Cited Cases
Pursuant to Bankruptcy Code provisions requiring custodian to cease administration, deliver property to trustee, and account for all property, upon initiation of bankruptcy proceeding receivership is effectively over and done with, and control over and decisions concerning receivership's assets become

domain of bankruptcy court, and its authority is paramount and exclusive. Bankr.Code, 11 U.S.C.A. § 543(a), (b)(1, 2).

[9] Bankruptcy 51 ↪2205

51 Bankruptcy
51III The Case
51III(A) In General
51k2204 Parties
51k2205 k. Reorganization Cases; Right to Be Heard. Most Cited Cases
Prepetition receiver who has not been relieved of obligation to comply with statute requiring receiver to cease administration, deliver property to trustee, and account for all property is not party in interest for purposes of Chapter 11 case. Bankr.Code, 11 U.S.C.A. §§ 543, 1109(b).

[10] Bankruptcy 51 ↪3064

51 Bankruptcy
51IX Administration
51IX(B) Possession, Use, Sale, or Lease of Assets
51k3063 Collection and Recovery for Estate; Turnover
51k3064 k. Turnover by Custodians. Most Cited Cases
Custodian who has been excused from compliance with Bankruptcy Code provisions requiring custodian to cease administration, deliver property to trustee, and account for all property and has been allowed to remain in possession in same fiduciary capacity as trustee or debtor-in-possession and subject to control and supervision of bankruptcy court. Bankr.Code, 11 U.S.C.A. § 543(a), (b)(1, 2).

[11] Bankruptcy 51 ↪2205

51 Bankruptcy
51III The Case
51III(A) In General
51k2204 Parties
51k2205 k. Reorganization Cases; Right to Be Heard. Most Cited Cases

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Custodian excused from compliance with Bankruptcy Code provisions requiring custodian to cease administration, deliver property to trustee, and account for all property, and allowed to remain in possession, would be party in interest for purposes of Chapter 11 case. Bankr.Code, 11 U.S.C.A. §§ 543, 1109(b).

[12] Bankruptcy 51 ↪3593

51 Bankruptcy

51XIV Reorganization

51XIV(C) Conversion or Dismissal

51k3593 k. Proceedings. Most Cited Cases

Prepetition receiver of Chapter 11 debtor lacked standing to seek conversion or dismissal of bankruptcy case, even if considered to be party in interest, given failure to bring himself within scope of interests protected by statute permitting party in interest to request conversion or dismissal of case; receiver had no right to receive and manage debtor's assets, his desire to protect rights of others was insufficient to create standing, and receiver identified no legally protectable interest of his own. Bankr.Code, 11 U.S.C.A. §§ 543, 1109(b), 1112(b).

[13] Federal Civil Procedure 170A ↪103.2

170A Federal Civil Procedure

170AII Parties

170AII(A) In General

170Ak103.1 Standing

170Ak103.2 k. In General; Injury or

Interest. Most Cited Cases

To have standing to invoke statute, party must be one of the persons whom statute is intended to protect.

[14] Bankruptcy 51 ↪2205

51 Bankruptcy

51III The Case

51III(A) In General

51k2204 Parties

51k2205 k. Reorganization Cases;

Right to Be Heard. Most Cited Cases

Right to appear and be heard, conferred on party in interest in Chapter 11 proceedings, is not same as standing. Bankr.Code, 11 U.S.C.A. § 1109(b).

[15] Bankruptcy 51 ↪2205

51 Bankruptcy

51III The Case

51III(A) In General

51k2204 Parties

51k2205 k. Reorganization Cases;

Right to Be Heard. Most Cited Cases

Provision conferring right to appear and be heard upon party in interest in Chapter 11 proceeding does not necessarily mean that every party in interest can seek relief on every issue. Bankr.Code, 11 U.S.C.A. § 1109(b).

[16] Federal Civil Procedure 170A ↪103.2

170A Federal Civil Procedure

170AII Parties

170AII(A) In General

170Ak103.1 Standing

170Ak103.2 k. In General; Injury or

Interest. Most Cited Cases

Party's desire to protect rights of others does not permit court to adjudicate claim.

*500 Jack Roebel, Fort Wayne, IN, Robert Beckman, Washington, DC, for Hilliard.

Grant Shipley, Fort Wayne, IN, for Kauthar Sdn. Dht.

Mark A. Warsco, Fort Wayne, IN, for trustee.

DECISION

ROBERT E. GRANT, Bankruptcy Judge.

This case began with an involuntary petition for relief under Chapter 11 of the United States Bankruptcy Code, filed soon after Carl B. Hilliard, Jr. was appointed receiver for the debtor by the High Court of Justice for the Federation of St. Christoph-

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er and Nevis. On February 3, 1995, the court denied the receiver's motion, filed pursuant to § 305, to dismiss the case or abstain from it. The involuntary petition was subsequently granted, relief ordered under Chapter 11, and Mr. Paul Underwood is currently serving as the Chapter 11 Trustee.

*501 The matter is before the court with regard to the receiver's motion to dismiss, which has been filed pursuant to § 1112(b) of the United States Bankruptcy Code.^{FN1} The merits of the motion are not before the court. Instead, the issue presently before it concerns whether or not a pre-petition receiver has standing to seek conversion or dismissal under § 1112(b). This question has been submitted to the court for a decision following a hearing and the submission of briefs from counsel.

FN1. To the extent the present motion is also premised upon § 305 of the Bankruptcy Code, it was denied by the court's order of October 6, 1995, based upon the proposition that it was barred by the doctrines of res judicata and/or collateral estoppel. This decision was recently affirmed by the District Court. See *Hilliard v. Underwood*, (N.D.Ind. Case No. 1:95cv371, Jan. 12, 1996).

[1][2] “[F]ederal courts must satisfy themselves as to a party's standing whether or not such an issue has been raised by any of the litigants.” *In re Dien Host, Inc.*, 835 F.2d 402, 404 (1st Cir.1987). In considering the question of standing, “[t]he focus is on the party, not the claim itself. The requirement of standing focuses on the party seeking to get his complaint before a federal court and not on the issues he wishes to have adjudicated.” *In re Dykes*, 10 F.3d 184, 188 (3rd Cir.1993) (quoting *Flast v. Cohen*, 392 U.S. 83, 99, 88 S.Ct. 1942, 1952, 20 L.Ed.2d 947 (1968)) (internal quotations and citations omitted). Such an inquiry is particularly appropriate in bankruptcy proceedings. As the Seventh Circuit has observed, “limits on standing are vital in bankruptcy, where clouds of persons indirectly affected by the acts and entitlements of others

may buzz about, delaying final resolution of cases.” *Matter of Deist Forest Products, Inc.*, 850 F.2d 340, 341 (7th Cir.1988). See also *Matter of DuPage Boiler Works, Inc.*, 965 F.2d 296, 297 (7th Cir.1992), cert. denied, *Scherl v. Fisher*, 506 U.S. 954, 113 S.Ct. 409, 121 L.Ed.2d 334 (1992).

[3] In support of the argument that a pre-petition receiver has standing to seek conversion or dismissal under § 1112(b), Mr. Hilliard contends that the receiver is a party in interest. See 11 U.S.C. § 1109(b). Thus, he argues the receiver “may raise and may appear and be heard on any issues in a case under [Chapter 11].” 11 U.S.C. § 1109(b).

[4] Section 1109(b) does not specifically define who it is that may be a party in interest with regard to Chapter 11 cases. It does, however, give illustrative examples which include the debtor, the bankruptcy trustee, committees, creditors, and equity security holders of the debtor. A pre-petition receiver or custodian, see 11 U.S.C. § 101(11), is not included. Given the illustrative nature of the list contained in § 1109(b), a receiver's exclusion from it is not necessarily determinative of the issue. *In re Ionosphere Clubs, Inc.*, 101 B.R. 844, 849 (Bankr.S.D.N.Y.1989). Nonetheless, since Congress was well-aware that bankruptcy proceedings could be initiated following the appointment of a custodian, see 11 U.S.C. § 303(h)(2), and specifically identified the rights and obligations of such an entity, see 11 U.S.C. § 543, the omission seems significant.

[5] This significance is enhanced when one compares the rights or interests of the entities identified in § 1109(b) with the rights of a pre-petition receiver. Such an appointment does not deprive the debtor of its ownership of the property over which the receiver is given authority and the receiver does not generally take title to that property. Instead, it is the receiver's duty to preserve the property for the benefit of those ultimately determined to be entitled to it. See *Matter of Willows of Coventry, Ltd. Partnership*, 154 B.R. 959, 962 (Bankr.N.D.Ind.1993). The entities listed in § 1109(b) have very different in-

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terests in the bankruptcy proceeding and the assets subject to it. The interest of the debtor is obvious. It is the entity subject to the proceeding and the owner of the assets. In one fashion or another, creditors and equity security holders have a claim upon these assets, whether on account of a pre-petition debt or some type of ownership interest, which may be altered or restructured in the reorganization process. The committees are those organized under the auspices of the Bankruptcy Code to speak for their creditor or equity security holder constituents and the trustee is the one *502 charged with the administration of case and the bankruptcy estate.

[6][7] “The reorganization of a corporation in bankruptcy is a matter between the corporation and its stockholders on the one hand, and its creditors on the other.” *In re South State Street Bldg. Corp.*, 140 F.2d 363, 366 (7th Cir.1943), cert. denied, *Hofheimer v. Gold*, 322 U.S. 761, 64 S.Ct. 1279, 88 L.Ed. 1588 (1944). The term “party in interest” should be interpreted against this background. See *Ionosphere Clubs*, 101 B.R. at 849; *In re Addison Community Hospital Authority*, 175 B.R. 646, 650 (Bankr.E.D.Mich.1994). Consequently, to qualify as a party in interest requires more than merely being interested in the outcome of the bankruptcy. It requires a direct legal interest in the case. *Addison Community Hosp.*, 175 B.R. at 650; *In re International Oriental Rug Center, Inc.*, 165 B.R. 436, 440 (Bankr.N.D.Ill.1994). Given this prerequisite, it is doubtful that a pre-petition receiver qualifies as a party in interest. The receiver has no rights in or claim to the debtor's assets to be adjusted or restructured by the proceeding.

[8][9][10][11] This court's suspicion that a pre-petition receiver is not a party in interest is reinforced when one considers the impact of a bankruptcy proceeding on a pre-petition receivership and the receiver/custodian's resulting obligations. The statutory directive is to cease administration, 11 U.S.C. § 543(a), deliver property to the trustee, 11 U.S.C. § 543(b)(1), and account for all property, 11 U.S.C. § 543(b)(2). The import of § 543 is clear.

Whether characterized as having been superseded, *In re 245 Associates, LLC*, 188 B.R. 743, 748 (Bankr.S.D.N.Y.1995); *In re Dressler Producing Corp.*, 262 F. 257, 260 (2d Cir.1919), terminated, *In re Northgate Terrace Apartments, Ltd.*, 117 B.R. 328, 331 (Bankr.S.D. Ohio 1990), deactivated, *In re Dill*, 163 B.R. 221, 225 (E.D.N.Y.1994), or devoid of power, *In re Broadmoor Enterprises Corp.*, 84 Misc.2d 120, 374 N.Y.S.2d 1013, 1016 (N.Y.Sup.1975), the conclusion is the same. The receivership is effectively over and done with; it has come to an end. Control over and decisions concerning the receivership's assets “become the domain of the bankruptcy court”, *In re Sundance Corp., Inc.*, 149 B.R. 641 (Bankr.E.D.Wash.1993), and its authority is “paramount and exclusive.” *Taylor v. Sternberg*, 293 U.S. 470, 472, 55 S.Ct. 260, 261, 79 L.Ed. 599 (1935); *In re Cook*, 101 F.2d 394, 398 (7th Cir.1938), cert. denied, *Fahey v. Cook*, 306 U.S. 642, 59 S.Ct. 583, 83 L.Ed. 1042 (1939). Nothing remains for the pre-petition receiver to do except to comply with § 543. While it may have the opportunity to seek to be relieved of those obligations either directly, through § 543(d), or indirectly, through § 305, if those efforts are not successful, the custodian's only remaining option is compliance. To allow anything more, under the rubric of a party in interest, would be to continue to recognize an entity which effectively should no longer exist and which is supposed to have ceased to function. In light of the foregoing, this court concludes that a pre-petition receiver, who has not been relieved of the obligation to comply with § 543, is not a party in interest. ^{FN2} *Matter of Property Management & Investments, Inc.*, 17 B.R. 728, 730 (Bankr.M.D.Fla.1982); but see *Matter of Ofly Corp.*, 44 B.R. 479, 482 (Bankr.D.Del.1984).

FN2. “Once excused from compliance and allowed to remain in possession, a custodian is in the same fiduciary capacity as a trustee or a debtor-in-possession”, *In re Posadas Associates*, 127 B.R. 278, 281 (Bankr.D.N.M.1991), and subject to the control and supervision of the bankruptcy

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court. *Id.*; *In re Uno Broadcasting Corp.*, 167 B.R. 189, 201 (Bankr.D.Ariz.1994); *245 Associates*, 188 B.R. at 748. As such, the excused custodian would be a party in interest.

[12][13][14][15] Even if a pre-petition receiver would be a party in interest within the scope of § 1109(b), this is not enough to give him standing, under § 1112(b), to seek conversion or dismissal of this case. “To have standing to invoke a statute, you must be one of the persons whom the statute is intended to protect.” *Matter of James Wilson Associates*, 965 F.2d 160, 168 (7th Cir.1992). As noted by the Seventh Circuit:

[W]e do not think that [§ 1109(b)] was intended to waive other limitations on standing, such as that the claimant be within the class of intended beneficiaries of the statute that he is relying on for his *503 claim, although a literal reading of section 1109(b) would support such an interpretation. We think all the section means is that anyone who has a legally protected interest that could be affected by a bankruptcy proceeding is entitled to assert that interest with respect to any issue to which it pertains.... *James Wilson Associates*, 965 F.2d at 169.

Consequently, the right to appear and be heard is not the same as standing and § 1109(b) does not necessarily mean that every party in interest can seek relief on every issue. *In re Southwest Equipment Rental*, 152 B.R. 207, 209 (Bankr.E.D.Tenn.1992).

Before the court may properly entertain the receiver's motion, he must, in some way, bring himself within the scope of the interests protected by § 1112(b). In an effort to do so, the receiver advances two arguments. First, he relies upon his right or responsibility, as a pre-petition receiver, “to receive and manage” debtor's assets. *Transcript of hearing held on October 2, 1995*, p. 43, In. 23-25. In view of the clear commandments of § 543(a) & (b), the receiver has no such right. Furthermore, to the extent it may exist, that opportunity is recognized and

protected through § 543(d), by which the pre-petition custodian may seek to be excused from complying with the obligations § 543 otherwise imposes upon it.^{FN3}

FN3. Not only has Mr. Hilliard never sought to be excused from compliance with any portion of § 543, but the court also notes that, by a judgment entered on September 27, 1995, he was, in essence, ordered to fulfill the obligations imposed upon him by § 543(b). The decision doing so was recently affirmed by the District Court. *See Hilliard v. Underwood*, (N.D.Ind. 1:95cv367, January 12, 1996).

[16] The second argument the receiver advances in support of his standing to bring the present motion is also premised upon his obligations as a receiver. Mr. Hilliard argues that, as receiver, he has an obligation “to find a way to protect the interests of creditors.” *Transcript* p. 45, In. 10-12. In other words, Mr. Hilliard is not trying to protect any interest unique to the receiver but, rather, the derivative rights of the creditors of Rimsat, Ltd. *Transcript* p. 45, In. 18-22. This is not sufficient. A party's desire to protect the rights of others does not permit the court to adjudicate a claim. *Deist Forest Products*, 850 F.2d at 341. *See also Matter of Andreuccetti*, 975 F.2d 413, 420 (7th Cir.1992).

The only arguments advanced in support of the receiver's standing to seek conversion or dismissal of this case are rights which no longer exist or his desire to protect the interests of others. He has not identified any legally protectable interest of his own. Given this, even if a pre-petition custodian could be a party in interest within the scope of § 1109(b), movant has failed to demonstrate that he is one of the persons whom § 1112(b) was intended to protect. Thus, the receiver lacks standing to seek conversion or dismissal of the case.

The motion will be denied. An order doing so will be entered.

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▷

United States Bankruptcy Court,
N.D. Indiana,
Fort Wayne Division.

In the Matter of WILLOWS OF COVENTRY,
LTD. PARTNERSHIP, Debtor.
Bankruptcy No. 93-10516.

May 7, 1993.

Chapter 11 debtor-in-possession, owner of apartment complex, sought turnover of rents from receiver that mortgagee had appointed for the apartments. The Bankruptcy Court, Robert E. Grant, J., held that: (1) appointment of receiver did not change debtor's ownership interest in property or the income generated from the property; (2) because debtor assigned rents as a security device, the assignment was a mortgage under Indiana law; and (3) receiver as custodian of the rents which were property of the bankruptcy estate had to turn over the rents to the debtor in possession.

Motion granted.

West Headnotes

[1] Bankruptcy 51 ↪3066(6)

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3066 Proceedings

51k3066(6) k. Evidence and Fact Questions. Most Cited Cases

In turnover proceeding, moving party bears burden of proving that custodian has possession, custody or control of property and that such property is property of bankrupt debtor. Bankr.Code, 11 U.S.C.A. § 543.

[2] Receivers 323 ↪65

323 Receivers

323III Title to and Possession of Property

323k65 k. Effect of Appointment and Qualification of Receiver. Most Cited Cases

Under Indiana law, appointment of receiver does not affect title to property over which receiver is given authority.

[3] Receivers 323 ↪1

323 Receivers

323I Nature and Grounds of Receivership

323I(A) Nature and Subjects of Remedy

323k1 k. Nature and Purpose of Remedy.

Most Cited Cases

Under Indiana law, purpose of receiver is to preserve property pending its final disposition.

[4] Receivers 323 ↪71

323 Receivers

323III Title to and Possession of Property

323k71 k. Nature and Right of Possession of Receiver. Most Cited Cases

Under Indiana law, receiver only holds possession of property for benefit of party or parties ultimately determined to be entitled thereto.

[5] Receivers 323 ↪71

323 Receivers

323III Title to and Possession of Property

323k71 k. Nature and Right of Possession of Receiver. Most Cited Cases

Under Indiana law, appointment of receiver over Chapter 11 debtor's apartment complex did not terminate debtor's ownership of the property or the rents it generated; the appointment only deprived debtor of its statutory right to possession of the property. West's A.I.C. 32-8-11-1.

[6] Mortgages 266 ↪27

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Exhibit 6

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266 Mortgages

266I Requisites and Validity

266I(A) Nature and Essentials of Conveyances as Security

266k26 Equitable Mortgage

266k27 k. In General. Most Cited Cases Under Indiana law, in equity, if transaction resolves itself into a security, or an offer to pledge land as security for debt or liability, it is treated as mortgage without regard to the form it may assume.

[7] Mortgages 266 ¶32(2)

266 Mortgages

266I Requisites and Validity

266I(A) Nature and Essentials of Conveyances as Security

266k31 Absolute Deed as Mortgage

266k32 In General

266k32(2) k. Intention of Parties.

Most Cited Cases

Under Indiana law, whether an instrument constitutes mortgage or absolute conveyance depends upon intention of parties at time of its execution.

[8] Mortgages 266 ¶37(2)

266 Mortgages

266I Requisites and Validity

266I(A) Nature and Essentials of Conveyances as Security

266k35 Evidence as to Character of Transaction or Instrument

266k37 Admissibility

266k37(2) k. Parol Evidence. Most

Cited Cases

While parol or extrinsic evidence is admissible to prove that an apparently absolute conveyances is, in reality, a mortgage, if document memorializing the transaction reveal mortgage was intended, parol evidence should not be received to prove otherwise.

[9] Mortgages 266 ¶27

266 Mortgages

266I Requisites and Validity

266I(A) Nature and Essentials of Conveyances as Security

266k26 Equitable Mortgage

266k27 k. In General. Most Cited Cases Under Indiana law, assignment of rents generated by Chapter 11 debtor's apartment complex to secure contemporaneously executed note was a mortgage.

[10] Bankruptcy 51 ¶2535(1)

51 Bankruptcy

51V The Estate

51V(C) Property of Estate in General

51V(C)2 Particular Items and Interests

51k2535 In General

51k2535(1) k. In General. Most

Cited Cases

Rents generated by Chapter 11 debtor's apartment complex were property of the bankruptcy estate by virtue of debtor's continuing ownership interest in the rents after a receiver for the complex had been appointed, even though under Indiana law the receiver for the apartments had right to possession of both the rents and the underlying real estate. Bankr.Code, 11 U.S.C.A. § 541(a)(1).

[11] Bankruptcy 51 ¶3064

51 Bankruptcy

51IX Administration

51IX(B) Possession, Use, Sale, or Lease of Assets

51k3063 Collection and Recovery for Estate; Turnover

51k3064 k. Turnover by Custodians.

Most Cited Cases

State court receiver for Chapter 11 debtor's apartments had to turn over the rents generated from the apartments to the debtor-in-possession; the rents were property of the bankruptcy estate and, as such, were subject to turnover; debtor's ownership in the property and the income it generated was not terminated by the appointment of the receiver. Bankr.Code, 11 U.S.C.A. § 543.

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[12] Bankruptcy 51 ↪ 2252.1

51 Bankruptcy

51III The Case

51III(C) Voluntary Cases

51k2252 Good Faith; Motive

51k2252.1 k. In General. Most Cited

Cases

When determining whether bankruptcy case should be dismissed for bad-faith petition filing, factors commonly used to determine presence of bad faith are to be balanced in determining the presence or absence of debtor's good faith in seeking bankruptcy relief; they are not to be applied mechanically.

*960 Daniel J. Skekloff, Scot T. Skekloff, Fort Wayne, IN, for debtor.

Alen Loble, Dominic Polizzotto, Indianapolis, IN, for Travelers.

DECISION^{FN1}

FN1. This decision supplements the findings of fact and conclusions of law announced orally, following the conclusion of the trial of the issues raised by the matter before the court.

ROBERT E. GRANT, Bankruptcy Judge.

This matter is before the court following the trial of the issues raised by the debtor's motion, filed pursuant to 11 U.S.C. § 543, for turnover from a custodian and Travelers Insurance Company's objection thereto, as well as Travelers' motion to dismiss this case.

Debtor is the owner of an upscale apartment complex in Fort Wayne, Indiana. The property is encumbered by a mortgage in favor of Travelers which secures payment of a debt that, as of the date of the petition, was in excess of \$14,000,000.00. Travelers also holds an "assignment of leases and

collateral assignment of rents" with regard to this property. Prior to the date of the petition, Travelers declared debtor in default and initiated proceedings to foreclose its mortgage. In doing so, it also requested and received an order appointing a receiver to take possession of the property. On March 31, 1993, debtor filed a voluntary petition for relief under Chapter 11.

[1] Although both motions ultimately turn upon the same issue, the moving party in each bears the burden of proof. Travelers bears the burden of showing cause to dismiss this case under 11 U.S.C. § 1112(b). *In re Klein*, 100 B.R. 1004, 1008 (D.N.D.Ill.1989); *Matter of Berryhill*, 127 B.R. 427, 430 (Bankr.N.D.Ind.1991). In the turnover proceeding, on the other hand, the moving party bears the burden of proving:

(1) that a custodian has possession, custody or control of property; and

(2) that such property is property of the debtor. *In re Lee*, 126 B.R. 978, 982 (Bankr.S.D.Ohio 1991).

Therefore, the debtor bears the initial burden on these two points. *In re Redman Oil Co.*, 95 B.R. 516, 521 (Bankr.S.D.Ohio 1988), *aff'd on reh'g*, 100 B.R. 945 (Bankr.S.D.Ohio 1989). Once it has presented a *961 prima facie case, the burden then shifts to Travelers to prove that turnover should be excused under 11 U.S.C. § 543(d). *In re Northgate Terrace Apartments, Ltd.*, 117 B.R. 328, 332 (Bankr.S.D.Ohio 1990).

The parties agree that the resolution of the issues presented by debtor's motion for turnover and Travelers' motion to dismiss turns primarily upon the question of who is entitled to possession of the rents generated by the apartment complex. Travelers contends that those rents do not constitute property of the bankruptcy estate, while the debtor contends they do.^{FN2} Thus, the present matter requires the court to enter the debate, which it has heretofore happily avoided, concerning whether or not rents

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from leased property constitute property of the bankruptcy estate, where those rents are the subject of an assignment in favor of a lienholder who obtained the appointment of a receiver prior to the date of the petition.

FN2. Although debtor contends that the rents in question are property of the bankruptcy estate, it concedes, for the purposes of the present motions, that those rents constitute cash collateral, which it may not use without Travelers' consent or the court's authorization and which, pending disposition, must be segregated. See 11 U.S.C. § 363(c)(1), (c)(2), (c)(4).

Property of the bankruptcy estate is defined by § 541(a) of the United States Bankruptcy Code. The estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case" wherever located and by whomever held. 11 U.S.C. § 541(a)(1). A determination that the rents in question are not property of the estate requires the court to conclude that the debtor had no legal or equitable interest in those rents as of the date of the petition.

The starting point for any analysis of the competing rights of debtors and creditors is state law. Bankruptcy begins with these state law entitlements and then adjusts them in order to equitably distribute the assets of the estate and provide relief to the debtor.

Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.... The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests, including the interest of a mortgagee in rents earned by mortgaged property. *Butner v. United States*, 440 U.S. 48, 55, 99 S.Ct. 914, 918 [59 L.Ed.2d 136] (1979).

Consequently, this court must begin by analyzing the relative rights of the debtor and Travelers as they would otherwise exist under Indiana law and then determine whether federal law has altered those rights.

Travelers bases its argument that the rents are not property of the estate upon the rights it exercised under an "Assignment of Leases and Collateral Assignment of Rents" it received from the debtor on March 24, 1988 and which was recorded with the Allen County Recorder on the next day. Reduced to its essence, this rather lengthy document reads:

[T]he Assignor [Willows] ... hereby grants, transfers, assigns and sets over to the Assignee [Travelers] the Assignor's entire interest as lessor in and to any existing leases and to all other present and future leases and all other rents, issues, income, charges, awards, premiums, proceeds, profits and any other sums which may become payable to the Assignor as lessor of the real estate located in Allen County....

This Assignment is made for the purposes of securing:

A. The payment of the principle sum, interest and indebtedness evidenced by a certain First Mortgage Note and any amendments, extensions or renewals thereof, in the original principle sum of Fourteen Million Two Hundred Thousand Dollars (\$14,200,000.00), made by the Assignor to the Assignee of even date herewith....

B. Payment of all other sums, with interest thereon, becoming due and payable to the Assignee under the provisions *962 of this Assignment and of the Note and Mortgage.

* * * * *

This Assignment is made on the following terms, covenants, and conditions:

1. So long as there shall exist no default by the Assignor ... the Assignor shall have the right to

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collect ... all rents, income and profits arising from the Real Estate, and to retain, use and enjoy the same.

2. At any time permitted by law, and, in any event, upon or at any time after default ... the Assignee ... may, at its option, without notice ... enter upon and take possession of the Real Estate pursuant to the terms of the Mortgage and have, hold, manage, lease and operate the same on such terms and for such period of time as the Assignee may deem proper and, either with or without taking possession of the Real Estate in its own name, demand, sue for or otherwise collect and receive all rents, income and profits of the Real Estate ... and to apply such rents, income and profits to the payment of:

(a) all expenses of managing the Real Estate ... and

(b) the principle sum, interest and indebtedness secured hereby....

4. Upon payment in full of the principal sum, interest and indebtedness secured hereby, this Assignment shall become void.... (Travelers' Exhibit "2").

The debtor defaulted in the performance of its obligation to Travelers under the note and mortgage prior to March 29, 1993. On that date, Travelers initiated proceedings with the Allen Superior Court in order to foreclose its mortgage upon the apartment complex. In doing so, pursuant to the authority granted by the note and mortgage and in accordance with Indiana law, it requested and received, without notice, an order appointing Revel Companies, Inc. as a receiver in order to "take possession of [the apartment complex] manage same and collect the rents therefrom, all until further order of the court." (Travelers' Exhibit "3"). This order also directed the debtor to "surrender possession of and management of the property to the receiver...." *Id.*

The appointment became effective the next day, when Travelers posted the bond required by the state court. Debtor's petition for relief under Chapter 11 was filed on March 31, 1993, after the receiver went into possession of the property in question.

Given what transpired prior to the date of the petition, the court is required to determine whether the appointment of a receiver, debtor's default, the assignment of rents, and/or Travelers' exercise of its rights thereunder terminated debtor's interest in the rents and other income generated by the mortgaged property.

[2][3][4] As a matter of Indiana law, the appointment of a receiver does not effect title to the property over which the receiver is given authority.

The appointment of a receiver effects no change in the title to the property involved. He does not, as a general rule, take a legal title thereto. He is a mere custodian pending the litigation, and his possession [is] the possession of the court which appoints him. *Polk v. Johnson*, 76 N.E. 634, 635 (Ind.App.1906). See also *Durbin v. Northwestern Scraper Co.*, 36 Ind.App. 123, 73 N.E. 297, 301 (1905), *appeal dismissed*, 165 Ind. 237, 75 N.E. 1 (1905).

The purpose of a receiver is "to preserve the property pending its final disposition." *Johnson v. LaPorte Bank & Trust Co.*, 470 N.E.2d 350, 353 (Ind.App.1984). Thus, the receiver only "holds possession of the property for the benefit of the party or parties ultimately determined to be entitled thereto. His custody is considered to be the custody of the court." *Parfenoff v. Kozlowski*, 218 Ind. 154, 161, 31 N.E.2d 206, 208 (1941).

[5] As a result, Travelers' success in securing the appointment of a receiver over the apartment complex did not terminate debtor's ownership of the property or the rents it generated. That appointment did nothing more than deprive debtor of its statutory right to possession of the property, *963 see

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the other. A recognized method by which to determine *964 whether a deed, absolute on its face, may nevertheless operate as a mortgage, is to ascertain whether or not, at the time of its execution, there was a pre-existing or concurrently created debt, by way of loan, owing to the grantee, the subsequent payment of which, in pursuance of a contemporaneous agreement, entitled the grantor or debtor to a re-conveyance of the estate. An absolute conveyance, without any other consideration than that assumed, coupled with an agreement to reconvey, will be regarded as a mortgage.

Whatever form the transaction may have assumed, if the relation of debtor and creditor, with its reciprocal rights, continues between the contracting parties, or if such relation was there created, by a loan or advance, and if the agreement, whether in the deed or in a separate instrument concurrently executed, is such that the debtor, by merely paying his debts, becomes entitled to insist upon a re-conveyance, or otherwise defeat the estate conveyed, the conveyance will be regarded as a security for such continuing or newly created debt....

A deed, and an agreement in writing executed contemporaneously therewith, having the characteristics above stated, constitute a mortgage by construction of law. Parol evidence will not be received for the purpose of showing that the parties intended that a transaction evidenced by writings of that description should constitute a sale. *Voss*, 10 N.E. at 75-76 (citations omitted). See also, *Singer*, 140 Ind.App. at 383, 216 N.E.2d at 535-36.

There is absolutely no reason this court can identify which would indicate that the Indiana courts would not apply these same fundamental principles to an assignment of rents, in connection with determining whether such an agreement constitutes an absolute conveyance or a lien.

[9] When these principles are applied to the agree-

ment between Travelers and the debtor, it is clear, beyond any doubt or debate, that the assignment of rents was intended to be nothing more than a security device. By its very terms, that assignment states that it was made for the purpose of securing a contemporaneously executed note. Furthermore, upon full payment of the note, the conveyance would be defeated because the assignment provided that it was to become void. Under these circumstances, nothing more is required to prove that there was no absolute conveyance to Travelers.^{FN3} Indeed, the contractual provision voiding the assignment upon full payment of the debt due Travelers means that agreement constitutes nothing more than a mortgage as a matter of law. *Voss*, 10 N.E. at 76. See also *Beidleman v. Koch*, 42 Ind.App. 423, 85 N.E. 977, 978 (1908) (where the grantor agrees to reconvey upon payment of the debt "the transaction is conclusively presumed to be a mortgage.") Since the assignment of rents is nothing more than a security device, Travelers "takes merely as a mortgagee, and has no other right or remedy...." *Brown*, 58 N.E. at 199.

FN3. Other extraneous factors which indicate that this transaction was nothing more than a security device include Willow's indebtedness to Travelers and the payment of interest thereon, debtor's retention of possession and control of the property and Travelers' lack thereof. See *Moore v. Linville*, 170 Ind.App. 429, 434-35, 352 N.E.2d 846, 849-50 (1976).

The events that took place following the execution of the assignment of rents did not change its original character as a security device. Indiana follows the simple rule that "[o]nce a mortgage, always a mortgage...." *Doyle v. Ringo*, 180 Ind. 348, 102 N.E. 18, 20 (1913).

There is no principle in equity better settled than that every contract for the security of a debt, by the conveyance of real estate, is a mortgage, and all agreements of the parties tending to alter in any subsequent event the original nature of the

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mortgage, and prevent the equity of redemption is [sic] void. If the conveyance or assignment was a mortgage in the beginning, the right or [sic] redemption is an inseparable incident, and cannot be restrained or clogged by agreement. Though the conveyance be absolute in terms, yet, if the intention appears to make it a redeemable estate, *965 it will continue so until foreclosure....
Turpie, 15 N.E. at 841.

[10] As a matter of Indiana law, the assignment of rents given to Travelers constituted nothing more than a security device. Its original character was not changed by debtor's subsequent default or Travelers' exercise of its right to proceed against its security. Despite the exercise of those rights, debtor remained the owner of the rents. Even the appointment of the receiver by the state court did not terminate debtor's interest as owner. All that changed was the right to possession. Thus, as of the date of the petition, the rents generated by the apartment complex constituted property of the bankruptcy estate, despite the fact that, under state law, the receiver had the right to possession of both the rents and the underlying real estate.

[11] As of the date of the petition, the right to possess both the mortgaged property and the income it produced was in the state court receiver, not the debtor. This, however, is only the first part of the analysis required by *Butner*. The court must also determine whether federal law has altered those rights. Fortunately, determining whether 11 U.S.C. § 543 alters the rights of the parties as they would otherwise exist under state law is a question more easily answered than determining what those underlying rights might be. Both the Bankruptcy Code and the Supreme Court have explicitly addressed the issue.

A state court receiver constitutes a custodian. 11 U.S.C. § 101(11). Pursuant to § 543 of the Bankruptcy Code:

(b) A custodian shall-

(1) deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents, or profits of such property, that is in such custodian's possession, custody, or control on the date such custodian acquires knowledge of the commencement of the case [.] 11 U.S.C. § 543(b)(1).

The Supreme Court has specifically recognized that this portion of the Bankruptcy Code, in conjunction with § 541, "bring[s] into the estate property in which the debtor did not have a possessory interest at the time the bankruptcy proceedings commenced." *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 & n. 10, 103 S.Ct. 2309, 2313 & n. 10, 76 L.Ed.2d 515 (1983).

In *Whiting Pools* the Supreme Court was called upon to decide whether a Chapter 11 debtor could compel the turnover, pursuant to 11 U.S.C. § 542, of property that had been seized by a secured creditor prior to the petition. In answering the question, the Court readily determined that the property in question constituted property of the estate, notwithstanding the pre-petition seizure. *Whiting Pools*, 462 U.S. at 202-09, 103 S.Ct. at 2312-15. In concluding that the turnover order was properly granted the Court stated:

As does all bankruptcy law, § 542(a) modifies the procedural rights available to creditors to protect and satisfy their liens.... In effect, § 542(a) grants to the estate a possessory interest in certain property of the debtor that was not held by the debtor at the commencement of reorganization proceedings. The Bankruptcy Code provides secured creditors various rights, including the right to adequate protection, and these rights replace the protection afforded by possession. *Whiting Pools*, 462 U.S. at 207, 103 S.Ct. at 2314-15 (citations omitted).

The Court then concluded:

Section 542(a) simply requires the [creditor] to seek protection of its interest according to the

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congressionally established bankruptcy procedures, rather than by withholding the seized property from debtor's efforts to reorganize. *Whiting Pools*, 462 U.S. at 212, 103 S.Ct. at 2317.

The Court's comments and conclusions in *Whiting Pools* are equally applicable to the case at hand. Although this court is confronted with turnover from a custodian, pursuant to § 543, rather than § 542, the two cases are functionally identical. The only distinction is that rather than taking possession of the secured property directly, Travelers did so through a state court receiver.*966 Nonetheless, the rights it obtained are no different from the rights the secured creditor in *Whiting Pools* possessed as a result of its seizure of the property there in question. As a matter of Indiana law, the appointment of a receiver did not terminate the debtor's ownership of the apartment complex or the income it generated; the appointment was only a provisional remedy which brought the property into the custody of the state court pending its final disposition. See *Whiting Pools*, 462 U.S. at 210-11, 103 S.Ct. at 2316-17. Since that disposition had not taken place prior to the petition, the property in question is property of the bankruptcy estate and is subject to turnover, to the debtor-in-possession, pursuant to § 543.

Travelers contends that the Seventh Circuit's decision in *Matter of Century Investment Fund VIII, L.P.*, 937 F.2d 371 (7th Cir.1991) mandates a different result. The court disagrees. To the extent Travelers argues that the Seventh Circuit concluded that a creditor's pre-petition efforts to perfect a lien upon rents and to obtain the appointment of a receiver resulted in the property being excluded from the estate as a matter of federal bankruptcy law, that interpretation of the decision cannot withstand scrutiny. Such a construction would place the Seventh Circuit in conflict with the Supreme Court's decision in *Whiting Pools*, something this court doubts the Seventh Circuit intended. To the extent the Seventh Circuit may have held that the property in question was not property of the estate, it did so on the basis of Wisconsin law. If this was its con-

clusion, this court perceives Wisconsin law to be very different from the Indiana law which governs the matter now before us. More importantly, however, when the *Century Investment* decision is properly understood, in the context of the proceedings which took place before both the Bankruptcy Court and the District Court, this court's decision concerning turnover is entirely consistent with it.

In *Century Investment*, the Seventh Circuit reversed the District Court's decision and remanded the matter "with instructions to reinstate the [order of the Bankruptcy Court]." *Century Investment*, 937 F.2d at 380. The issue in dispute before the courts below was not whether rents from leased property were excluded from the bankruptcy estate but only whether or not those rents were cash collateral. See *In re Century Investment Fund VIII, L.P.*, 155 B.R. 1002, 1003 (Bankr.E.D.Wis.1989); *In re Century Investment Fund VIII, L.P.*, No. 89-C-380, 1990 U.S. Dist. Lexis 8128, at *5 (D.E.D.Wis. April 26, 1990). Cash collateral is, by definition, property of the estate. 11 U.S.C. § 363(a) (" 'cash collateral' means cash, ... or other cash equivalents ... in which the estate and an entity other than the estate have an interest..."). The Bankruptcy Court determined that the creditor held a perfected lien upon the rents in question. Despite this conclusion, however, it nonetheless allowed the debtor a limited right to use those rents in connection with its efforts at reorganization, subject to the obligation to adequately protect the lienholder. *In re Century Investment Fund, VIII, L.P.*, 155 B.R. at 1008 (Bankr.E.D.Wis.1989). The Bankruptcy Court did not conclude that the rents were excluded from the estate. On appeal, the District Court held that the creditor did not have a lien upon the rents.

First Bank's commencement of a foreclosure action and filing for the appointment of a receiver did not give rise to a perfected security interest in the rents.... Hence, the rents do not constitute cash collateral, and the bankruptcy trustee may determine the best application of the rental proceeds. *Century Investment*, 1990 U.S. Dist. Lexis

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8128, at *14.

By reversing the District Court and reinstating the Bankruptcy Court's order, the Seventh Circuit effectively concluded that the rents in question were property of the estate; albeit property encumbered by a lien in favor of the bank and, therefore, cash collateral. This conclusion is precisely the result this court has reached in its analysis of the competing rights of the debtor and Travelers to the rents in issue.

*967 The court's conclusion that the property in the possession of the state court receiver constitutes property of the estate which must, pursuant to § 543(b)(1), be turned over to the debtor-in-possession easily disposes of the remaining issues before the court. The debtor met its burden of proving that the property in question is property of the estate. It thus became Travelers' burden to show why turnover should be excused, pursuant to § 543(d). Other than the erroneous argument that the rents are not property of the bankruptcy estate, no argument has been advanced which would justify excusing the state court receiver from its clearly stated statutory obligation to deliver the property in its possession to the debtor-in-possession. Indeed, given the receiver's candid admission that, if turnover is excused, its loyalties and obligations will run to the state court which appointed it, rather than to this court, the need for turnover is critical. Travelers has failed to carry its burden under § 543(d) of proving that turnover should be excused.

[12] Travelers has also failed to carry its burden of proving that this case should be dismissed. In support of its motion, it argues that debtor's petition constitutes a bad faith filing, when measured by the standards articulated by the district court in *Matter of Grieshop*, 63 B.R. 657, 663 (D.N.D.Ind.1986). What Travelers fails to appreciate, however, is that those factors are to be balanced in determining the presence or absence of a debtor's good faith in seeking bankruptcy relief; they are not to be applied mechanically. See *Matter of Elmwood Development Co.*, 964 F.2d 508, 510 (5th Cir.1992); *In re Clause*

Enterprises of Ft. Myers, Ltd., 150 B.R. 476, 478-79 (Bankr.M.D.Fla.1993); *In re Don Sellers Village Lanes, Inc.*, 121 B.R. 649, 652 (Bankr.M.D.Fla.1990); *In re MGN Co., III*, 116 B.R. 654, 658 (Bankr.S.D.Ind.1989); *In re Marion Street Partnership*, 108 B.R. 218, 223 (Bankr.D.Minn.1989); *In re Clinton Centrifuge, Inc.*, 72 B.R. 900, 905 (Bankr.E.D.Pa.1987). Indeed, the mechanical approach which Travelers apparently urges us to follow would automatically doom almost every single asset case, ab initio.

When the *Grieshop* factors are properly applied and balanced, Travelers has failed to carry its burden of proving that this case has been filed in bad faith. Quite to the contrary, when the evidence presented is properly weighed and balanced, it is the court's conclusion that Willows' petition represents a good faith effort to attempt to reorganize its financial affairs, in accordance with the spirit and the purpose of the Bankruptcy Code.

Debtor's motion for turnover will be granted and Travelers' motion to dismiss will be denied. An appropriate order will be entered.

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