

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF SOUTH CAROLINA

FILED
JUN-1 PM 4:47
SOUTH CAROLINA

IN RE:

Earl Smith Cooler, Sr. and Frances
Eugenia Cooler,

Debtors.

Note Buyers, Inc.,

Plaintiff,

v.

Frances E. Cooler and Earl S. Cooler, Sr.,

Defendants.

C/A No. 98-02856-W

Adv. Pro. No. 98-80162-W

JUDGMENT

Chapter 7

Based upon the Findings of Fact and Conclusions of Law as recited in the attached Order of the Court, the United States Trustee's objection to the dismissal and settlement of this adversary proceeding is overruled and the dismissal and settlement should be, and hereby is, approved.

Columbia, South Carolina,
June 1, 1999.


UNITED STATES BANKRUPTCY JUDGE

ENTERED

JUN 02 1999

J.G.S.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF SOUTH CAROLINA

FILED
JUN 01 PM 4:47
SOUTH CAROLINA

IN RE:

Earl Smith Cooler, Sr. and Frances
Eugenia Cooler,

Debtors.

Note Buyers, Inc.,

Plaintiff,

v.

Frances E. Cooler and Earl S. Cooler, Sr.,

Defendants.

C/A No. 98-02856-W

Adv. Pro. No. 98-80162-W

ORDER

Chapter 7

THIS MATTER comes before the Court on the objection of the United States Trustee to a proposed settlement and dismissal of this adversary proceeding to deny the Debtors' discharge pursuant to 11 U.S.C. § 727(a).¹ Based upon the arguments of counsel, a review of the file and a review of the proposed settlement, the Court makes the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

Earl Smith Cooler, Sr., and Frances Eugenia Cooler ("Debtors") filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code on April 2, 1998. A Chapter 7 Trustee ("Trustee") was appointed shortly thereafter and was advised by a creditor, Note Buyers, Inc. ("Note Buyers"), that it had filed an action to avoid fraudulent transfers by the Debtors in the Court of Common Pleas in Jasper County prior to the filing of the petition. The state court

¹ Further references to the Bankruptcy Code, 11 U.S.C. § 101 *et seq.*, shall be by section number only.

JW-1 of 10 -

ENTERED
JUN 02 1999

J.G.S.

25

action named as defendants the Debtors, their sons Earl S. Cooler, Jr. and Thomas Cooler, and Cooler, Inc. Note Buyers requested that the Trustee pursue the action or a similar action asserting the alleged transfer was an improper transfer of estate assets. The Trustee conducted an examination of the Debtors pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure on June 1, 1998 and the attorney for Note Buyers participated in that examination and made his state court file available to the Trustee. The Trustee also requested and the Debtors produced a substantial number of documents to the Trustee.

On July 14, 1998, the last day to timely object to the Debtors' discharge, Note Buyers filed the instant adversary proceeding to deny the Debtors' discharge pursuant to § 727(a)(2)(A), (a)(3), and (a)(4). No other creditor, the United States Trustee, nor the Trustee elected to object to the Debtors' discharge.

The record indicates that the Plaintiff, Note Buyers, filed a Proof of Claim on October 2, 1998, in the amount of \$186,888.40. The claim is evidenced by a confession of judgment that was filed with the Jasper County Clerk of Court on November 21, 1997. The claim is secured by collateral of an unknown value. During the course of this Chapter 7 case, the judgment lien was avoided to the extent it impaired the Debtors' exemption in their residence, but continues on certain non-exempt commercial real property that is property of the estate.

The Debtors are represented by counsel and filed a timely Answer in response to the Note Buyers' Complaint. After discovery and pretrial conferences, the matter was set for trial on January 20, 1999; however, on the morning of trial, the parties announced a settlement of the proceeding. On January 28, 1999, notice of the proposed settlement was given to all parties in interest.



The settlement provides that the Debtors, in exchange for the dismissal of the action and release of the judgment lien against them, would execute a non-dischargeable promissory note in the principal amount of \$30,000.00 to the Plaintiff, with interest at an annual rate of eight percent (8%). Payments on the note would be equal in amount beginning ninety (90) days from January 20, 1999. In addition to the Debtors, the Debtors' sons, Earl S. Cooler, Jr. and Thomas Michael Cooler, would execute the promissory note. The notice of settlement also provides for penalties in the event of default. The notice of settlement does not provide, but the parties have informed the Court, that the payments are to be made monthly over a five-year term. Upon payment of the note, the judgment lien would be released by Note Buyers. The notice of settlement specifically provides that the settlement does not affect the Chapter 7 estate.

The United States Trustee and one creditor objected to the settlement. The creditor's objection was not served on the parties and the creditor did not appear at the hearing. Consequently, the creditor's objection was not considered and was overruled. The United States Trustee objects to the settlement arguing that a § 727 action brought by a creditor should not be dismissed or settled unless the proceeds of the settlement are paid to the estate. The United States Trustee agrees that all other terms of the settlement are reasonable.

CONCLUSIONS OF LAW

Some courts have adopted a *per se* rule that actions under § 727(a) may not be settled. See *In re Smith*, 207 B.R. 177 (Bkrcty. N.D.Ind. 1997); *In re Vickers*, 176 B.R. 287 (Bkrcty. N.D.Ga. 1994); and *In re Moore*, 50 B.R. 661 (Bkrcty. E.D.Tenn. 1985).

Other courts that have addressed the issue have ruled that § 727 actions may be settled in exchange for monetary consideration. Creditors were authorized to settle in *In re Corban*, 71



B.R. 327 (Bkrcty. M.D.La. 1987); *In re Margulin*, 135 B.R. 671 (Bkrcty. D.Col. 1992); and *In re Mavrode*, 205 B.R. 716 (Bkrcty. D.N.J. 1997). Chapter 7 Trustees have also been allowed to settle § 727 actions for the payment of money. See *In re Bates*, 211 B.R. 338 (Bkrcty. D.Minn. 1997).

The United States Trustee objects to the dismissal and seeks a *per se* rule that a § 727 action brought by a creditor cannot be settled or dismissed unless the settlement proceeds are paid to the Chapter 7 Trustee for distribution to all creditors. In this proceeding, the United States Trustee has not requested to be substituted for the Plaintiff for purposes of a trial objecting to the discharge of the Debtors. Additionally, the United States Trustee has not shown that the settlement is unreasonable - either that the matter should go to trial and not be settled, or that in this settlement the creditor is taking unfair advantage of an honest debtor for a private benefit or that the Debtors are paying the settlement from hidden assets. The United States Trustee has not asked for more time to undertake a further investigation of those issues; instead, the United States Trustee wishes to step into the creditor's shoes solely for the purpose of receiving the settlement proceeds for the Chapter 7 Trustee. Both parties to this litigation, Note Buyers and the Debtors, object to such allowance. Neither the Chapter 7 Trustee nor any creditor appeared at the hearing to join in the United States Trustee's position in this matter. While the United States Trustee wishes to be the settling party, it is clear that it cannot perform an important condition of the settlement - specifically the release of the judgment lien held by Note Buyers on the commercial real estate. There is no evidence presently before the Court to indicate that the Debtors can reach an alternative settlement with the United States Trustee.

Therefore, the United States Trustee leaves this Court and the parties in a predicament. It

A handwritten signature in black ink, appearing to be "JW4", is located at the bottom center of the page.

does not want to prosecute the adversary, cannot settle on the terms agreed to by the parties to the litigation, and does not indicate any other means of settling the proceeding. The United States Trustee has suggested that absent a settlement in which the estate gets the proceeds, the creditor has only two alternatives; to either try the action to conclusion or dismiss it and allow the Debtors' discharge.

In taking this position, the United States Trustee relies upon the Advisory Committee's Notes to Bankruptcy Rule 7041 which seems to suggest that dismissal of a complaint objecting to a discharge should not be allowed if it is induced by an advantage given to the plaintiff.

However, Bankruptcy Rule 7041 provides as follows:

Rule 41 F.R. Civ.P. applies in adversary proceedings, except that a complaint objecting to the debtor's discharge shall not be dismissed at the plaintiff's instance without notice to the trustee, the United States Trustee, and such other persons as the court may direct, and only on order of the court containing terms and conditions which the court deems proper.

While this Court believes that Bankruptcy Rule 7041 requires that a dismissal of a complaint objecting to discharge as part of a settlement should receive close scrutiny by the Court and that notice of the terms of dismissal should be provided to the trustee, United States Trustee, and all creditors in order to allow them the opportunity for full inquiry, Bankruptcy Rule 7041 makes it clear that no *per se* rule is appropriate. Bankruptcy Rule 7041 expressly provides a court with discretion to approve settlements upon "terms and conditions which the court deems proper". In addition, there appears to be no other Statute or Rule which would prohibit dismissals such as that proposed by the litigants in this case.

It is well established that settlement should be encouraged. Rule 1001 of the Federal

Rules of Bankruptcy Procedure provides that the rules “shall be construed to secure the just, speedy and inexpensive determination of every case and proceeding”. If settlements are not allowed, the resolution of the cases and proceedings may be neither speedy nor inexpensive. The court in *In re Nicolosi*, 86 B.R. 882 (Bkrcty. W.D.I.a. 1988), which denied approval of the settlement of a discharge action because the discharge had previously been denied, offered the following statement regarding the importance of settlements.

With these safeguards available, I have extreme difficulties with the holdings in *Moore* and *Levy*, *supra*, that a section 727(a) objection to discharge cannot be compromised. The purposes of the justice system are the peaceful, just, speedy and inexpensive resolution of disputes. The law normally favors compromise to achieve these ends. If voluntary compromise can be effected, the justice reached by the parties themselves may be superior to that judicially imposed. Compromise also reduces burdens on the public treasury and lessens judicial backlog. Reduction in backlog allows cases to be brought to trial before the memories of witnesses dim and documents are lost, thus brightening the prospect that, in other cases awaiting trial, justice will truly be done. Compromise also reduces the costs and burdens that society imposes on “innocent bystanders”, non-litigants whose documents or testimony is subpoenaed.

In re Nicolosi, 86 B.R. at Fn. 4.

In the current case, there is no evidence that the settlement is not fair and equitable. The United States Trustee concedes that there are problems on both sides of the case and that the results are not certain. The United States Trustee agrees that the settlement amount is reasonable.

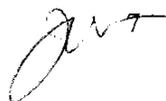
It is also important that the grounds upon which the Complaint objecting to discharge is based were reviewed in great detail with the Chapter 7 Trustee, who has the duty under § 704(6) to oppose the discharge of the Debtors if advisable, in advance of the Rule 4004 deadline but that

A handwritten signature in cursive script, appearing to be 'JW' with a small 'o' or flourish at the end.

the Chapter 7 Trustee declined to act on behalf of the estate. There is no dispute that the Chapter 7 Trustee declined to bring any complaint objecting to the Debtors' discharge based upon the allegation of improper transfer or concealment of these assets, presumably because he thought it had no merit or that the costs and expenses of such an action would outweigh the potential benefit to creditors.² Notably, the Chapter 7 Trustee did not object to the settlement before the Court nor ask to be substituted for purposes of a trial. If circumstances were different and the complaining creditor had special knowledge providing the basis for the denial of discharge which had not been shared with the Trustee or the other creditors, the Court might be less likely to approve the settlement. For example, in *In re Taylor, supra*, the proposed settlement was held in abeyance to allow the Chapter 7 Trustee to investigate the matter. Indeed, § 727(c)(2) specifically provides that "the court may order the Trustee to examine the acts and conduct of the debtor to determine whether a ground exists for denial of discharge". In the present case however, the evidence indicates that the Plaintiff and the Debtors reviewed the circumstances of the case with the Chapter 7 Trustee and he chose not to pursue it for the general benefit of the creditors of the estate.

The majority of bankruptcy courts facing similar situations have allowed the creditor or party who objects to such a dismissal and settlement of a discharge action to be substituted as the prosecuting plaintiff for purposes of proceeding to trial as the means of compliance with

² The Court notes that it is speculation that had the Chapter 7 Trustee brought the complaint that he would or could have received an offer of settlement similar to the one before the Court and even if he had, whether, after the costs of the action and other general Trustee commissions, fees and administrative expenses, there would have been any significant dividend to be paid to creditors.

A handwritten signature in black ink, appearing to be the initials 'JVT' written in a cursive, stylized font.

Bankruptcy Rule 7041. See *In re Joseph*, 121 B.R. 679 (Bkrcty. N.D.N.Y. 1990); *In re Lindsey*, 208 B.R. 169 (Bkrcty. E.D.Ark. 1997); *In re Margulin*, 135 B.R. 671 (Bkrcty. D.Col. 1992), *In re Nicolosi*, 86 B.R. 882 (Bkrcty. W.D.La. 1988) and *In re Short*, 60 B.R. 951 (Bkrcty. M.D.La. 1986).³ However, it is not necessary in the current case to determine whether the United States Trustee or the Chapter 7 Trustee could be substituted for the Plaintiff in order to pursue the matter to trial for neither have expressed any desire or intention to do so. The United States Trustee has requested substitution only insofar as necessary for the United States Trustee or the Trustee to consummate the settlement with the Debtors.

Finally, other policy considerations support the approach taken in this proceeding. If an honest creditor has grounds which justify a complaint objecting to discharge, it should be encouraged to proceed before the statutory deadline. Eliminating the option of dismissal with court approval by establishing a *per se* rule which provides that any benefit to be achieved by the litigation must be shared with, and significantly diluted by, all other claims and administrative expenses would discourage such action. It seems less likely that a creditor would readily agree to assume the risks and expenses of litigation with no way out but a final trial. Secondly, the prospects of settling such an action by a reasonable monetary settlement would certainly be reduced if the complaining creditor has to speculate on what portion of the proceeds it would receive after Trustee fees and expenses and other administrative expenses before it could agree to

³ The Second Circuit Court of Appeals has criticized the substitution of plaintiffs in § 727(a) actions. In *In re Chalasani*, 92 F.3d 1300 (2nd Cir. 1996), the Court of Appeals reversed the bankruptcy court's holding that the objecting creditor may be substituted for the plaintiff. The Court of Appeals held that the creditors request for substitution was time-barred by the requirement of Rule 4004 of the Federal Rules of Bankruptcy Procedure that any objection to discharge be brought within sixty (60) days of the meeting of creditors.

a settlement. Such a rule would be impracticable and would create a disincentive for such a creditor's action. Furthermore, to hold, as one court has, that the filing of such a complaint objecting to discharge by a creditor establishes a duty to all other creditors without any showing of reliance by those creditors opens a Pandora's Box. Could such a creditor face an action for breach of duty by other creditors if it did not prevail in the action to deny discharge or was otherwise "deficient" in prosecuting the action, either in discovery or at trial? If this Court creates such a duty, one which is not otherwise set forth in the Bankruptcy Code or Rules, would it not further discourage creditors from acting in good faith to object to the discharge of even dishonest debtors? Rather than imposing an impracticable duty on a single creditor, this Court relies upon the statutorily imposed duty of the Chapter 7 Trustee to act, if advisable, for the benefit of all creditors.

Finally, the Court gives some consideration in this proceeding to the fact that prior to this Order, there has been no clear policy or prior ruling in this District which restricts the settlement of such actions to the extent requested by the United States Trustee. In many ways it would be unfair to these specific litigants to put in place such a policy at the eleventh hour - at least under the circumstances of this case and when the settlement appears to the Court to be a fair and reasonable compromise.

For all of these reasons, it appears that the dismissal and settlement in this adversary proceeding should be approved. There is no dispute that the amount of the settlement is fair and reasonable. There is no evidence of creditor overreaching or of the Debtors buying a discharge from hidden assets. The Debtors appear to be paying the settlement proceeds from post-petition earnings that are not assets of the estate or from the Debtors children; consequently, there is no

A handwritten signature in black ink, appearing to be "J. W. [unclear]", located at the bottom center of the page.

harm to the estate. No creditor or other party in interest, including the United States Trustee, has requested that it be substituted for the purpose of pursuing the matter to trial. Finally, the facts and circumstances surrounding the objection to discharge were reviewed in detail with the Chapter 7 Trustee. In considering all the facts and circumstances of the case, it appears that the dismissal and settlement should be approved.

The Court believes it is best to consider such dismissals and settlements on a case by case basis, under the circumstances and conditions before the Court, and not establish a *per se* rule prohibiting dismissal unless the estate receives the proceeds. However, the Court herein does establish the rule that all dismissals and settlements of objections to discharge, including where a § 727 action accompanies an action seeking an exception to the dischargeability of a debt under § 523, should be noticed to the Chapter 7 Trustee, United States Trustee, and all creditors unless otherwise ordered in a particular case. Giving those parties a full and adequate opportunity to examine the dismissal and settlement assists the Court in giving such matters close scrutiny. It is therefore,

ORDERED, that the United States Trustee's objection to the dismissal and settlement of this adversary proceeding is overruled and the dismissal and settlement should be, and hereby is, approved.

AND IT IS SO ORDERED.

Columbia, South Carolina,

June 1, 1999.


UNITED STATES BANKRUPTCY JUDGE



CERTIFICATE OF MAILING
The undersigned deputy clerk of the United States
Bankruptcy Court for the District of South Carolina hereby certifies
that a copy of the document on which this stamp appears
was mailed on the date listed below:

JUN 2 1999

~~DEBTOR, DEBTOR'S ATTORNEY, TRUSTEE~~

JUDY G. SMITH

Deputy Clerk

w/ judgment

Stack

Dunton

Driffin

Nevens

Index

99-100