

AUG 08 1995

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

BY: BARON GROSHON
Deputy Clerk

In Re:)
)
RONNIE L. PENDLETON,)
)
Debtor.)
_____)

Case No. 90-31907
Chapter 13

ORDER

JUDGEMENT ENTERED ON AUG 08 1995

This matter came before the Court for hearing on May 19, 1995 upon the Debtor's Motion for Turnover of Funds to the estate from Mechanical Supply Company. After hearing the arguments of counsel and based upon evidence proffered by the parties' attorneys, the Court **Finds and Concludes** as follows:

1. This case was filed under Chapter 7 on December 10, 1990.
2. Prior to bankruptcy, the Debtor, a sole proprietorship acted as a plumbing contractor.
3. At the filing date, the Debtor was owed monies for plumbing services performed for Eastwood Construction Company ("Eastwood"). The Debtor procured the materials that he used on this job from Mechanical Supply Company ("Mechanical").
4. As of the date of bankruptcy, the Debtor had not been paid by Eastwood, nor had he paid Mechanical. The Debtor's bankruptcy petition scheduled an obligation owed to Mechanical in the amount of \$37,097.11. This was listed as an undisputed, general unsecured claim.
5. After bankruptcy, Mechanical brought suit in Mecklenburg County Superior Court to perfect and enforce its subcontractor's liens arising from this debt. The Debtor was named as a Defendant

in the action, but due to the automatic stay, Mechanical sought recovery only against Eastwood.

6. After a trial wherein the Debtor assisted Mechanical's recovery efforts by appearing as a witness, a jury found in favor of Mechanical and as against Eastwood. The jury verdict found that Eastwood owed Pendleton the principal sum of \$31,066.00, plus accrued interest, of \$11,704.97. The jury further determined Eastwood owed the Debtor \$42,770.97.

7. As the verdict amount exceeded the total amount sought by Mechanical in the action (\$34,707.71) under its liens, the Superior Court concluded "the amount due Pendleton from Eastwood is more than sufficient to satisfy Plaintiff's lien claims in full," and ordered Eastwood to pay the Plaintiff the full amount sought under its notices of claim of lien. No evidence has been presented at the current hearing that would indicate that Mechanical was seeking anything less than its full debt owed by Pendleton in that state court action.

8. After the verdict was entered, Mechanical and Eastwood settled the state court lawsuit, agreeing that Eastwood would pay Mechanical \$32,500.00 in full satisfaction of that action.

9. Consistent with this agreement, on February 28, 1995, Mechanical's attorney wrote the Debtor thanking him for his assistance, informing him that it had been settled and apologizing that as Mechanical was acting only for itself, that he would not be receiving any of the additional sums owed him by Eastwood under the settlement. That letter then states:

It is clear, however, that Mechanical has been paid in full for the amount you owed it according to your bankruptcy petition (although Mechanical did not, in fact, receive even close to all the interest due it at its invoice rate in the settlement with Eastwood. For this reason, I believe that it is appropriate that this debt be shown as satisfied in your bankruptcy proceeding."

10. While the state court action was proceeding, Mechanical had been receiving distributions from the Chapter 13 Trustee, based upon having an unsecured claim of \$37,097.11. As the Debtor's plan called for a 10% payout to unsecured creditors by the time that the State Court lawsuit concluded, the Trustee had paid Mechanical another \$2,596.00.

11. On April 12, 1995 the Debtor having received the letter from Mechanical's attorney, filed a Motion for Turnover by Mechanical of the \$2,596.00. Mechanical opposes that relief. Its principal arguments are set out in a letter from its counsel dated April 12, 1995 directed to the Debtor's attorney. Mechanical now contends that the statement in its attorney's letter of February 28 to the effect that it had been paid in full was erroneous, and self righteously declares that the Debtor's counsel should have been aware of this fact at the time. Mechanical contends that since it received \$32,500.00 from its settlement with Eastwood, it was anticipating that the remainder of its debt would be paid out of the bankruptcy case.

12. On the other hand, the Debtor contends that Mechanical having settled its claim in full with Eastwood, it should not be allowed to keep monies distributed from the Debtor's plan. Alternatively, the Debtor argues that the Plan distribution to

Mechanical (\$2,596.00) on what should at most be a deficiency claim of \$4,597.11 (\$37,097.11-\$32,500.00) paid under a 10% Plan has paid Mechanical \$2,136.89 more than it should have received.

CONCLUSIONS OF LAW

1. The parties have suggested no controlling law as to this dispute which arises in a most unusual posture. Mechanical was being treated in the bankruptcy Plan as an unsecured claim for its full debt while it was pursuing liquidation of its collateral--that is, the state court lien action. Usually, a creditor with a lien on a debtor's property is treated under the Plan, and its claim is classified as a secured claim to the extent of value. While under the Plan, the claim is amortized with interest. If the creditor is later granted relief from stay to liquidate its lien, the secured claim is removed from the Plan, and no distribution is made until a deficiency claim is filed. Any such deficiency is then included in the Plan and begins to receive distributions as an unsecured claim under the Plan. Had this been done, it would have resulted in a much lower payout to Mechanical at this point than the distribution that Mechanical has received.

2. In any event, despite Mechanical's assertions to the contrary, this record does not reflect that Mechanical was counting on the bankruptcy distribution in agreeing to its settlement with Eastwood. No mention of this reservation is made in Mechanical's attorney's February 28, 1995 letter to the Debtor. Instead, he advises in clear and forceful language that because of the settlement his client has no claim as against this bankruptcy estate. In

like measure, there is no clear indication in the state court record, or at least that portion thereof which was presented to this Court, that Mechanical was settling anything less than its full claim against this Debtor. No contemporaneous documentary evidence has been produced which would show that less than the full claim was being settled or any rights were being reserved against the Debtor.

2. If such a condition was to be imposed, it is reasonable to expect that this reservation would have been clearly reflected in the paperwork and discussed with the debtor. This is particularly true since the Debtor was actively assisting Mechanical in this action, and because the receivable being settled was the Debtor's property under 11 USC 541.

3. Viewing the facts that are presented, the Court believes it more likely that Mechanical settled the state court lawsuit for an amount that it viewed as sufficient to "come out" on the entire debt and without giving any thought to the bankruptcy distribution. The Eastwood settlement amount was for more than the principal debt owed by the Debtor to Mechanical. Mechanical's claim included some \$11,000 of default rate interest to the Debtor on the account, and it had room to negotiate the claim amount downward without doing injury to itself.

4. Even if this were not so, Mechanical should not be allowed to keep these monies. Mechanical made a business decision to settle the state court lawsuit, and chose to do so without involving the Debtor even though it was the Debtor's property that

was being compromised. Mechanical now contends that it could have settled the state court action for more had it known that it would have to refund the amounts paid it in the bankruptcy case. The documents and record do not support this; but if true, then Mechanical has only itself to blame that it did not resolve this issue before settling the action. Mechanical chose to settle with Eastwood for less than what was due. Absent, his consent, the Debtor should not have to finance the discount Eastwood negotiated with Mechanical out of his postpetition plan payments.

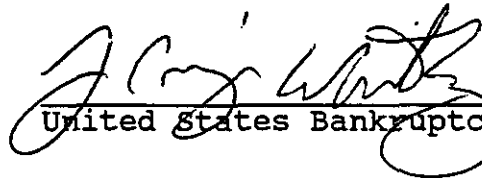
5. Finally, from the perspective of other creditors, Mechanical has been treated better than it was entitled to under the Bankruptcy Code. Although the Court believes that it is not entitled to keep any of the Plan distributions, at a minimum, it has been overpaid by \$2,136.89 on its "unsecured" claim, and received a higher percentage payout under the Plan than other unsecured claims. The Bankruptcy Code prohibits such a result. See, 11 USC 1322(b).

IT IS THEREFORE ORDERED:

1. The Debtor's motion for turnover of the sum of \$2,596.00 is ALLOWED. Interest will accrue on this amount at the legal rate, beginning ten (10) days from the entry date of this Order until paid in full.

2. Mechanical's unsecured claim shall be stricken from this plan.

This the 78th day of August, 1995.


United States Bankruptcy Judge