UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION

In Re:	)	Case No. 95-30996
	)	Chapter 11
HOLT CARPETS, INC. f/k/a	)	
WUNDA WEVE CARPETS, INC.,	)	
	)	
Debtor.	)	
	)	

ORDER RECONSIDERING PRIOR ORDERS DATED JULY 26, 1995, AUGUST 10, 1995, AND AUGUST 11, 1995, IN PART

THIS MATTER came before the Court for hearing on August 31, 1995, upon Motion filed by Mont Cooper, William Howard, Joe Howard, Jodie White, and Julie Williams (the "Employees"), for New Trial or Amendment of Judgment pursuant to Bankruptcy Rule 9023 and for Relief from Judgment or Order Pursuant to Bankruptcy Rule 9024 and 11 U.S.C. 105 and Request for Expedited Hearing filed August 21, 1995, together with the Debtor's Objection thereto filed August 31, 1995. Holt Carpets, Inc. f/k/a Wunda Weve Carpets, Inc. ("Debtor"), the Employees, and World Carpet, Inc. ("World") appeared at hearing through counsel. Although this matter affects them as well, Marglen Industries, Inc. ("Marglen") and T. Walter Brashier ("Brashier") were not present at this hearing. The record is not clear whether these parties were given notice of this hearing, which like previous related hearings held in this case, was conducted on shortened notice.

In short, the Employees' Motion seeks relief from injunctions entered by this Court in three Orders dated July 26, 1995, August 10, 1995, and August 11, 1995, approving sales of the Debtor's

assets under 11 U.S.C. 363(f), free and clear of liens. The Debtor and World oppose this relief.

FINDINGS OF FACT

The Debtor, prior to bankruptcy, was engaged in the manufacturing and selling of carpet. Its main manufacturing facility is located in Greer, S.C. The Debtor also owned plants in Greenville, S.C. and White, Georgia. The Debtor has long been in the carpet business, having been formed just after the end of World War II. In 1965, the company was acquired by Dan River, Inc., combined with another yarn plant, and became the Floor Coverings Division of that company.

The Debtor was purchased by members of management in 1990 through a leveraged buy-out ("LBO"), wherein the Debtor borrowed some $25,500,000 from Sanwa Business Credit Corp. ("SBCC"). Most, if not all, of the Debtor's assets were pledged to secure this debt and that of Transamerica Business Credit Corp. ("Transamerica").

Unfortunately, the increased profitability anticipated by management did not materialize. The Debtor's pre-LBO sales had peaked in 1986 at $76,500,000. One year after the LBO, sales were only $51,600,000, and in fiscal year 1991, the Debtor sustained a net loss of $8,900,000. Although it experienced somewhat better results thereafter, the company has never rebounded from these losses, nor has it been able to consistently make debt service payments to SBCC. By the date of bankruptcy, the Debtor had

inventory of only $9,109,332 (book value) and sales for the nine months ended June 3, 1995, had dropped to $33,124,000.

By mid-1994, the Debtor's Board had reached the conclusion that the company's long-term viability was in doubt and began to seek a sale of the business. A comprehensive marketing effort was undertaken in the Spring of 1995, and bids to acquire the company were sought from eleven potential purchasers. Ultimately, five bids were submitted. After reviewing these offers, the World bid was selected by the Debtor's Board, although it like the others contemplated an asset purchase, not a purchase of the Debtor's entire business.

In the meantime, the carpet industry was consolidating, and many of the smaller members of the industry were being squeezed out. Thus, when the Debtor and World came to terms, it was necessary to seek a quick closing, before market conditions and the debtor's unprofitable operating condition further reduced the value of the Debtor's business.

Seeking an expeditious way to complete this sale, the Debtor filed a Chapter 11 bankruptcy case with this Court on July 12, 1995. At the same time it filed its bankruptcy petition, the Debtor also filed a motion seeking approval of the sale to World of a substantial part of its assets, free and clear of liens, and as provided for under Code Section 363(f). The proposed purchase price was slightly more than $10,000,000.

The World sale proposal, and the Marglen and Brashier sales which would follow, were no more than attempts to liquidate SBCC

and Transamerica's collateral for going concern values. It was readily apparent that the debtor's assets were worth much less than the secured claims of SBCC and Transamerica, under any valuation. The Debtor owed SBCC on the filing date approximately $27,000,000; Transamerica was owed between $6,500,000-7,000,000. Since neither secured creditor would be able to recover their full secured debts under any sale alternative, unsecured creditors stood to receive nothing at all.

To give some meaning to this exercise, the Debtor had exacted a concession from its lenders that $600,000 could be withheld from the sales proceeds to be applied towards the Debtor's administrative expense, priority and unsecured claims. Due to these exigencies, the Court agreed to consider the World sale on shortened notice and set a hearing on that sale proposal for July 26, 1995, with the Debtor to serve notice of the motion and opportunity for hearing.

At the outset of the case, the Debtor had obtained entry of an Order limiting Notice of the World sale. Its motivation in limiting notice was cost. Given the large number of small unsecured creditors, the limited monies available, and the fact that the assets to be sold were fully encumbered, the Debtor wished to limit case notices to creditors with substantial claims and creditors specifically requesting notice.

The Court approved the Debtor's Notice and Scheduling Order dated July 11, 1995 which, subject to objections, would limit service of the World sale motion to the Debtor's twenty largest

unsecured creditors, secured creditors, and the Bankruptcy Administrator. The Notice and Scheduling Order further required the Debtor to serve a copy of the Notice and Scheduling Order on all creditors and parties in interest by no latter than July 12, 1995 and to publish notice of the proposed World sale in the Wall Street Journal.

In the Notice and Scheduling Order, creditors were advised that (1) the Debtor was seeking a sale of its assets to World; (2) a hearing would be held on July 26, 1995 with objections to that sale to be due by July 25, 1995; (3) upon closing of the sale the Debtor's operations would cease, and (4) further case notices would be limited to parties requesting notice.

The Debtor served the Notice and Scheduling Order by mail on all parties in interest on July 12, 1995. Due to some confusion in the Debtor's attorneys office, the published Notice of sale did not run in the "Wall Street Journal" until July 25, 1995, or one day prior to the sale hearing. However, on the strength of the case-wide notice of the Notice and Scheduling Order, and the need to go forward, the Court considered the Debtor's Motion to sell to World on July 26, 1995.

As of the hearing date, no objections or responses had been filed to the Debtor's proposal to sell to World. At hearing, no parties appeared in opposition to the sale. In addition to the Debtor and World, the Debtor's two secured creditors, SBCC and TransAmerica, both supported the sale. Additionally, counsel for the Bankruptcy Administrator reported that prior to this hearing

he had organized and conducted a meeting of the Unsecured Creditors' Committee (the "Committee"). The Bankruptcy Administrator reported that the Committee did not oppose the sale either. There being no objections, the Court approved the Debtor's asset sale to World and the underlying Asset Purchase Agreement.

The next day, July 27, 1995, the Debtor filed motions seeking to sell its remaining assets--the Greenville and White plants, under Section 363, free and clear and upon shortened notice. Those motions proposed that objections be filed no later than August 9, 1995 and that a hearing to be set on August 10. For the same reasons as in the World sale, the Court approved setting these matters on for hearing on August 10.

At the August 10 hearing, the Employees made their first appearance in this case and objected to the second group of sales. The Employees assert that they hold claims against the debtor under the Workers Adjustment and Retraining Notification Act ("WARN"), codified at 29 U.S.C. 2901, et seq.. In general, WARN requires that employers subject to the Act give sixty days prior notice to employees of an impending plant shutdown and specifies damages for an employer's failure to do so.

The Employees initially objected to the second group of sales arguing that insufficient information was available to determine whether the same should proceed. This objection was overruled. They then modified this position to request that from the sale proceeds, sufficient monies be escrowed to cover their claims. As

this would elevate their claims over other creditors, the Court denied this request as well and by Orders dated August 10 and August 11, 1995 authorized the second set of sales to Brashier and Marglen, respectively.

The present dispute arises from language contained in all three of the sale Orders which states that the purchaser-

> shall not acquire any of the debtor's liabilities except as expressly set forth in the contract, and any and all persons are enjoined in any way from pursuing (purchaser) or his assigns, by suit or otherwise, to recover on any claim which it had, has or may have against the debtor, unless such claim was assumed by (purchaser) in the contract. Order of July 26, 1995 (World Sale), p.16, par.16; Order of August 10, 1995 (Brashier Sale), p.10, par.12; Order of August 11, 1995 (Marglen Sale), p.11, par.12.

The current dispute arises because while the employees were given notice of the proposed sales, the Notice and Scheduling Order did not advise these parties that an injunction was being sought as against them and in favor of the prospective purchasers. The Employees learned of this injunction language in the Orders only when they received copies of the Marglen and Brashier sales Orders after the hearings on the second set of sales.

In the interim, the Employees had filed an action in U.S. District Court in Greenville, South Carolina, not against the Debtor, but as against World (Docket No. 6-95-2580-21). The Employees allege that under the WARN Act, World as successor in interest to the Debtor, was required to provide proper notice of the shutdowns to employees and has liability to them independent of the Debtor for its failure to do so.

The Employees then filed the present Motion seeking relief from these injunctions. The Employees argue that as no prior notice was given to them of the injunction requests, they have been denied procedural due process as guaranteed by the Fifth Amendment of the Constitution. They further argue that these injunctions, being violative of that provision, are legally void, citing In re Rideout, 86 B.R. 523 (Bankr. N.D. Ohio, 1988). Although Brashier and Marglen have not been sued to this point, the Employees also seek relief from the injunctions entered in conjunction with those sales as well that in the World order.

The Debtor makes four arguments against this Motion. First, it contends that the notice given to the Employees in the Notice and Scheduling Order was sufficient to put them on notice of the injunction. The Debtor argues that the employees had a duty upon receipt of the Notice to inquire further of the terms of that sale, and are now bound by its terms. Secondly, the Debtor contends that these employees may not have claims at all and no notice was required to them of the injunction. Third, the Debtor contends that the injunction is simply a complement to the Section 363(f) "free and clear" sale Orders and is necessary to implement these sales. Finally, the Debtor argues that any liability owed to the employees is a claim against it, and not against the purchasers. Should these parties be entitled to bring suits against the buyers, the Debtor's purchase contracts may require it to indemnify the buyer which will deplete the Debtor's estate.

CONCLUSIONS OF LAW

There is little question that this Court has jurisdiction to stay actions brought against the Debtor, if appropriate. Under the Bankruptcy Code, the Court has exclusive jurisdiction over the Debtor and its property. 28 U.S.C. 1334(e). To effectuate this provision, Section 362 of the Code enjoins actions against the Debtor or its property brought in other courts. The Bankruptcy Court also has nonexclusive jurisdiction over civil proceedings which are "related to" cases under Title 11. 28 U.S.C. 1334(b). This authority, when combined with Code Section 105, enables the Court, under certain limited circumstances to enjoin parties from proceeding in other courts against nondebtors as well. Celotex Corp. v. Edwards, __U.S.__, 115 S.Ct. 1493, 131 L.Ed. 2d 403 (1995); A.H. Robins Co., Inc. v. Piccinin, 788 F.2d 994 (4th Cir. 1986), cert. denied, 479 U.S. 876, 107 S.Ct. 251, 93 L.Ed. 2d 177 (1986).

Here, there appears to be a very real question whether the Employees' have independent causes of action against these buyers under the WARN Act, or are instead simply obligations of the Debtors which are being pursued against third parties. The record suggests that all of the plant notices and shutdowns predated the sales closing, which suggests that the Debtor only bears the liability. A brief review of that Act and its legislative history suggests that under such circumstances the liability may not in fact follow the buyer. ("[O]nly a plant closing or a mass layoff..., after the effective date of sale, would trigger the

notice requirements." Remarks of Sen. Hatch, 134 Cong. Rec. 16026, 16104-05 (1988)).

However, the Employees have filed suits for their WARN Act claims against the purchaser(s), not the Debtor. Procedurally, since it is not certain at this point that these are solely liabilities of the Debtor and not the purchasers, in order to enjoin these actions, one looks not to Section 362 of the Code, but to Section 105.

The distinction is important. The injunction in Section 362 arises upon the case filing, by operation of law. A Section 105 injunction however, is not self-executing and requires an order by the Court in accordance with F.R.B.P. 7065 and F.R.C.P. 65. For despite the broad language contained in Section 105(a), ("The Court may issue any order...that is necessary... to carry out the provisions of this title."), a Section 105 injunction is akin to making a preliminary injunction request, and as such, the proponent must meet the requirements of Rule 65 of the Federal Rules of Civil Procedure, as applied by Bankruptcy Rule 7065. Collier on Bankruptcy, 15th Ed., Section 105.02, 105-10.

Under the Federal Rules, injunctions may be granted only upon full notice to the party to be enjoined and after opportunity for hearing. F.R.C.P. 65. Injunctions are extraordinary relief and are not to be granted without a clear showing of entitlement. To obtain injunctive relief, the proponent must demonstrate: (1) a strong likelihood of prevailing on the merits, (2) imminent irreparable harm without such relief, (3) a balancing of the harm

between the parties, and (4) that relief is favored by public policy concerns. Blackwelder Furniture Co. v. Selig Mfg.Co., Inc., 550 F.2d 189, 193 (1977).

Finally, under Bankruptcy Rules 7001(7) and 7065, to obtain a Section 105 injunction outside of a Plan, one must first file an adversary proceeding.

An injunction may be obtained for the purpose of restraining proceedings against nondebtors only in "unusual circumstances." "Unusual circumstances" exist where there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor." Robins, 788 F.2d at 999.

Seen against this legal backdrop, the procedural deficiencies in the injunctions contained in these sales orders are obvious. In the first instance, these injunctions were imposed by motions to sell, not by adversary proceedings. Second, sufficient notice of the injunction was not given. The notice given the Employees advised only that the debtor was intent upon liquidating and proposed selling its assets to World. That notice did not advise that an injunction was being sought against them as well.

The Court rejects the suggestion that the Debtor's Notice and Scheduling Order put a burden of inquiry on the Employee, such that the sales orders now bind them. It is not reasonable to expect a creditor, even one knowledgeable of bankruptcy, who receives notice of a sale motion to obtain a copy of the motion and thereafter to

dissect the bowels of the pleadings to determine whether an injunction is being sought against it. Such a notion flies in the face of both Rule 65 and traditional American notions of procedural due process. See, In re Herd, 840 F.2d 757, 759-60 (10th Cir. 1988).

Nor is such an injunction simply an accessory order to a sale free and clear as the Debtor suggests. Sales free and clear are **in rem** actions, which serve to remove specific liens and interests from property. These motions are effective only if notice is given to the interestholder. In re Savage Industries, Inc., 43 F.3d 714, 721 (1st Cir. 1994).

The present injunctions, by contrast, restrain not only claims against the property but **in personam** actions against the buyer as well. The persons restrained are not simply identified lienholders, but the whole world. And rather than issuing after notice and hearing, these injunctions predate any effective notice or opportunity for hearing.

In point of fact, rarely are Section 363 sales orders accompanied by such injunction requests. The usual practice is to seek injunctive relief only after such sale, if and when a creditor ignores the free and clear order terms. Even then one seeks injunctive relief by filing an adversary proceeding against the specific party violating the sale order. See In re Savage Industries, Inc., 43 F.3d 714 (1st Cir. 1994).

Requesting such relief in the body of a sale motion which is itself not served on the party to be enjoined is entirely

insufficient. Based upon the circumstances presented, the Court does not believe that due process was afforded to the Employees by the notices previously given herein.

On the other hand, the Court is concerned that the Employees' claims may be only a liability of the Debtor, not the purchasers, and that precious resources of this estate may be depleted if the District Court litigation proceeds. This is particularly true inasmuch as the Debtor acknowledges liability for such claims, and depending on their priority, these WARN claims may be paid, at least in part, from this estate.

If instead that litigation proceeds, the buyers' expenses of defending this litigation may become administrative expenses of this Debtor's estate, whether or not the Employees' claims have merit. This would add claims to this estate and could also upset the bankruptcy priorities (if, for example, the Employee claims are unsecured claims, but by virtue of the contract indemnities are elevated to administrative expense status). Finally, if these claims are pursued in two forums they will be defended and adjudged twice, doubling the expense to these parties, and offering the prospect of conflicting verdicts from the tribunals. Thus, even though brought against third parties, this litigation is "related to" this estate, and if not stayed may have imminent irreparable effects.

While the current injunctions are procedurally defective, the procedural matter is one easily cured. The Debtor or one of the purchasers needs only to file an adversary proceeding against the

parties it wishes to enjoin in this Court and serve them with the Summons and Complaint. If the Debtor or the purchasers believe that the Employees' pending District Court litigation is based upon claims against or adverse to this estate, then they may consider removing the action to this Court as well and seeking to join it with any new adversary under 28 U.S.C. 1452. In this manner, these issues can be adjudged on the merits, and upon due process to all concerned.

Based upon the notice given in the current motion, the record before the Court at the August 31, 1995 hearing, the costs that this litigation might place upon this estate if the present injunctions are lifted and the possibility that the claims being raised in that litigation are in effect claims against the debtor, the Court will maintain the current injunctions in effect for ten days (10) from the date of this Order to permit the Debtor or purchasers to correct the procedural problems. Thereafter, unless a temporary restraining order or preliminary injunction has previously been obtained from this Court in accordance with the Rules of Procedure, the injunctions issued in these three Orders will be lifted. Except to this extent, the Court's earlier Orders dated July 26, 1995, August 10, 1995 and August 11, 1995 will remain in full force and effect.

IT IS SO ORDERED.

This the 12th day of Sept., 1995.

J. Craig Whitley
United States Bankruptcy Judge