

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

In re:

JESSANGEO, LLC,

Debtor.

Case No. DG 06-00863
Hon. Scott W. Dales
Chapter 7

JEFF A. MOYER, Chapter 7 Trustee,

Plaintiff,

Adversary Proceeding
No. 07-80526

v.

LAWRENCE L. BARAGAR, individually
and as successor in interest to LLB,
Inc., a dissolved Michigan corporation,

Defendant.

**FINDINGS OF FACT AND CONCLUSIONS OF LAW
AFTER TRIAL**

Chapter 7 Trustee Jeff A. Moyer (“Plaintiff” or “Trustee”) filed a Complaint in this adversary proceeding against Lawrence L. Baragar (“Mr. Baragar” or “Defendant”), seeking to avoid the Defendant’s lien and recover \$39,390.26 in proceeds from personal property formerly held by Jessangeo, LLC (the “Debtor”). I held a trial on August 5, 2008, in Grand Rapids, Michigan, at which time the parties generally stipulated to the relevant facts. Additionally, I heard Mr. Baragar’s testimony, and I regard it as credible and reliable. Drawing mainly

from the stipulations, the exhibits admitted into evidence without objection, and the Defendant's testimony, I have prepared the following findings of fact and conclusions of law pursuant to Fed. R. Civ. P. 52, made applicable to this proceeding by Fed. R. Bankr. P. 7052. In view of these findings, I will enter judgment for the Defendant, and dismiss the Complaint.

JURISDICTION

The court has jurisdiction pursuant to 28 U.S.C. § 1334. This matter is a core proceeding under 28 U.S.C. § 157(b)(2)(E) and (K) because it involves the Trustee's endeavor to avoid Defendant's lien and recover property that the Trustee claims as part of the bankruptcy estate.

Even in the absence of objection, I have a duty to determine the court's jurisdiction, a duty that touches on standing. I find the Trustee has standing to pursue recovery in this action for two reasons. First, in general a trustee has statutory standing to avoid unperfected security interests in property of the bankruptcy estate pursuant to 11 U.S.C. § 544. Second, and more specifically, this Trustee also has standing because he relies on the rights of various prepetition lien-holders, pursuant to a court-approved assignment memorialized in an order entered by my predecessor, Judge Stevenson. It states in relevant part:

All right, title and interest to any claims or causes of action existing in favor of RRG&G, the State and the IRS or any of them against Lawrence Baragar, Lois Baragar and/or LLB, Inc. (collectively, the "Baragars") with respect to amounts distributed to any of the Baragars at or about the sale closing on account of

any of the personal property sold pursuant to the Sale Order (the "Assigned Claims") are hereby assigned to Trustee.

See Plaintiff's Exhibit 8.

FACTS

The Defendant owned a restaurant, known as Giuseppe's (the "Restaurant"). In 1996, the Defendant sold the Restaurant to George Clark, Sr.

The Restaurant was located at 19 West Main Street in Fremont, Michigan (the "Real Estate"), and was subject to a land contract dated August 29, 1996 (the "Land Contract") between Mr. Baragar, as vendor, and George Clark, Sr., as purchaser. See Plaintiff's Exhibit 1. Mr. Baragar also claimed an Article 9 security interest in the Restaurant's personal property and liquor license to secure Mr. Clark's obligation under a Promissory Note for the balance of the purchase price. See Plaintiff's Exhibit 3. This security agreement was also dated August 29, 1996 (the "Security Agreement"). See Plaintiff's Exhibit 2.

After Mr. Clark's death, and a series of assignments not relevant to these proceedings, the Restaurant's assets were divided as follows: the Debtor held the tangible personal property used in the Restaurant's operation ("Personal Property"); non-Debtor JAGG, Inc. ("JAGG") held the Restaurant's liquor license; and non-Debtor Jessangeo Land, LLC ("LAND") held the vendee's rights under the Land Contract (collectively, the "Assets").

On March 3, 2006 (the "Petition Date"), the Debtor filed a voluntary petition for relief under Chapter 7 of the United States Bankruptcy Code. The

Plaintiff was appointed as Chapter 7 Trustee. The parties agree that Mr. Baragar's security interest in the Personal Property was unperfected as of the Petition Date.

With the permission of JAGG and LAND, and pursuant to 11 U.S.C. § 363(b) and (f), the Trustee sought approval for the sale of the Assets (the "Sale"). At that time, the Trustee believed all parties agreed to the Sale, mainly because selling the Assets as a package would maximize their value and benefit all stakeholders. Judge Stevenson granted the Trustee's motion to sell the Assets in an order dated April 18, 2006 (the "Sale Order"). See Plaintiff's Exhibit 9.

The Sale closing did not go so smoothly. Although the details remain sketchy, the parties agree that the Defendant refused to deliver a warranty deed for the Real Estate or otherwise release his land contract vendor's interest, unless he also received full payment of the debt evidenced by the Promissory Note, for all the Assets, not just the installments due under the Land Contract.

Evidently, the parties acceded to Mr. Baragar's demands, paying him in full at the closing. In an order dated June 8, 2007 (the "Proceeds Order") the court authorized the distribution of the remaining proceeds to various other entities, such as the brokers, taxing authorities, and the Debtor's former accountant. It also assigned to the Trustee the rights of the various lien-holders.

I find Mr. Baragar received \$98,470.74 at the closing, which included \$59,080.48 in installments due on the Land Contract and \$39,390.26 representing the balance due on the Promissory Note.

ANALYSIS

The Trustee contends that Mr. Baragar's refusal to release his interest in the Assets absent payment of the additional \$39,390.26 due under the Promissory Note was tantamount to "holding a gun" to the Trustee's head and taking control of the proceeds of the Personal Property to satisfy an unperfected security interest.

Mr. Baragar contends that he was simply asserting his rights under the Land Contract – an agreement that included "cross default" provisions making a default under the Promissory Note a default under the Land Contract. As such, he was not contractually obligated to release his vendor's interest in the Real Estate unless the Land Contract vendee, non-debtor LAND, cured the default under the Land Contract, including the cross-default under the Promissory Note.

This clash between the Trustee's reliance on Article 9 (principally as assignee) and Mr. Baragar's reliance on the cross-default provision of the Land Contract (as vendor) is at the heart of this dispute. I reject the Trustee's argument for several reasons.

First, my review of the Land Contract confirms that a default under the Promissory Note constituted a default under the Land Contract. See Land Contract at ¶ 6 ("the default of Promisor JAGG, INC. in the terms and conditions of said promissory note and/or security agreement shall constitute a default in the terms of this land contract."). Mr. Baragar credibly testified that, at the time of the closing, JAGG was in default under the Promissory Note and LAND was in

default under the Land Contract. Consequently, Mr. Baragar was not obligated to release his vendor's interest until the defaults were cured. See 77 Am.Jur. 2d. Vendor and Purchaser § 468; 25 Causes of Action 731 (2007)(a vendor ordinarily may refuse to close a transaction when the buyer has defaulted at the time of closing). Under Michigan Law, although LAND held equitable title to the Real Estate under the Land Contract, Mr. Baragar, as the land contract vendor, "retain[ed] legal title until the contractual obligations ha[d] been fulfilled . . ." Graves v. American Acceptance Mortgage Co., 469 Mich. 608, 614, 677 N.W.2d 829, 833 (2004) (citing Bowen v. Lansing, 129 Mich. 117, 119-21, 88 N.W. 384, 385 (1901)). Because "legal title remains in the vendor until full performance of all contractual obligations," and because payment of the Promissory Note was one those contractual obligations, Mr. Baragar was within his rights to retain legal title until all contractual obligations, including those reflected in the cross-default provision, were satisfied. Id. at 614. In short, because LAND's equitable interest in the Real Estate secured JAGG's performance under the Promissory Note, Mr. Baragar acted within his rights by refusing tender absent payment on account of both the Land Contract and Promissory Note.

The fact that Mr. Baragar's demand prompted the Trustee and the lien-holders to pay him \$39,390.26 from the proceeds of the sale at the closing does not mean he usurped the rights of a lien-holder with a higher priority. Rather, it means the holder of the higher priority lien, and other persons in control of the proceeds, agreed to buy Mr. Baragar's cooperation with \$39,390.26 that happened to come from the Sale proceeds. I have no doubt that Mr. Baragar

would have accepted \$39,390.26 in funds from the members or shareholders of LAND and JAGG, and did not insist on being paid from the proceeds of the Assets. Perhaps if the lien-holders had had more leverage at the closing, the payment might have come from these other parties, rather than from the proceeds. The point is this: economic leverage drove the closing, rather than the Defendant's assertion of an unperfected security interest.

To the extent the Trustee is requesting rescission of part of the payment made to Mr. Baragar, because the sale cannot be undone, the Trustee is incapable of restoring the *status quo ante*. Although Mr. Baragar probably could return the payment in question, the Trustee cannot return title to the Real Estate to Mr. Baragar. The inability of the party seeking rescission to restore the *status quo ante* is grounds to deny rescission. McMullen v. Joldersma, 174 Mich. App. 207, 218-19, 435 N.W. 2d 428, 432 (1988).

In addition, there is no evidence in the record that, at closing, the Trustee bargained to reserve his rights against Mr. Baragar prior to making the \$39,390.26 payment and Mr. Baragar's releasing his interest in the Real Estate. Indeed, as of the closing date, the Trustee did not have any such rights because his assignment from the lien-holders postdated the closing by nearly fourteen months when Judge Stevenson entered the Proceeds Order on June 8, 2007. Nor is there any evidence in the record that the lien-holders preserved their rights against Mr. Baragar at the closing.

It is certainly more plausible to infer that the lien-holders begrudgingly consented to pay Mr. Baragar in full at the closing, essentially as a carve-out, to

preserve the added value of selling the Assets together, rather than piecemeal. If the lien-holders, through whom the Trustee claims standing, consented to the transfer of these additional proceeds, the Trustee could not have received any rights to them by way of assignment.

Moreover, Judge Stevenson's Sale Order specifically authorized the Trustee to "pay [at closing] any lienholders or owners of the Assets as the Trustee determines, in the exercise of his discretion, as is needed to effect the sale of the Assets." Given Mr. Baragar's demands at closing, I find the Trustee, in his discretion, reasonably determined that paying Mr. Baragar the additional \$39,390.26 he demanded was "needed to effect the sale of the Assets." The payment to Mr. Baragar was therefore expressly authorized by the Sale Order.

I also find from the evidence in the record that the lien-holders and the Trustee consented to Mr. Baragar's receipt of \$98,470.74 for the Assets at closing. Without their consent, the closing would not have taken place.

The liens which the Trustee now asserts in this action by way of assignment did not attach to all the sale proceeds under the Sale Order, but only to the net sale proceeds. I construe the lien preservation language of the Sale Order to apply only to those proceeds that the Trustee held after paying customary closing costs, and making payments to lien-holders and owners "as the Trustee determine[d], in the exercise of his discretion, [was] needed to effect the sale of the Assets." To construe the Sale Order otherwise would mean the entities that received sale proceeds at closing, such as the real estate broker, title company, register of deeds, and real property tax creditors, would have

taken their court-approved payments subject to pre-existing liens. This result would be contrary to the Sale Order itself, as well as general bankruptcy sale practice.

Therefore, I prefer to construe the Sale Order's lien preservation language as pertaining to the net sale proceeds. Because the Trustee is unable to seek recovery of payments made to any of the above referenced entities by invoking the lien preservation provisions of the Sale Order, he cannot now single out Mr. Baragar for recovery of payment under the same provision simply because Mr. Baragar insisted upon payment in full before he delivered the deed to the Real Estate.

CONCLUSION

The Real Estate was not the property of the bankruptcy estate, so the Trustee's authority over Mr. Baragar and the Real Estate was limited by state law principles. The Trustee offered no authority under Michigan law that LAND, JAGG or the Debtor could have compelled Mr. Baragar to waive the undisputed default under the Land Contract and deliver a deed to the Real Estate. As such, I find that Mr. Baragar was not obligated to deliver a deed, unless and until JAGG cured the default under the Promissory Note. Mr. Baragar's demand for full payment was an exercise of his economic leverage, not a frustration of the priority scheme under Article 9.

Under the circumstances, after drawing reasonable inferences from the fact that the closing took place, and from the absence of any evidence that the Trustee or lien-holders bargained for any reservation of any rights against Mr.

Baragar *at the closing*, I find that Mr. Baragar acted within his rights under the Land Contract in demanding full payment of the Promissory Note, and that the Trustee acted reasonably and within his rights under the Sale Order in acceding to the demand. The lien-holders, too, acted reasonably in using a portion of their proceeds to pay Mr. Baragar so that the sale of the Restaurant as an integrated business could close.

The court will enter separate judgment for the reasons set forth in this Memorandum, dismissing the Complaint with prejudice.

Dated: August 14, 2008
Grand Rapids, Michigan

Scott W. Dales
United States Bankruptcy Judge