

In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

CARGO, INC.
Debtor.

Bankruptcy No. X90-00200S
Chapter 7

RULING RE: TRUSTEE'S MOTION TO COMPROMISE ADVERSARY NO. X90-0098S

Trustee Wil Forker seeks approval of his compromise of adversary proceeding X90-0098S. Notice of the compromise was served on all creditors and parties-in-interest. The following entities have filed objections: the debtor, Frank DeJute, Tauro Brothers Trucking, Inc., and Kathryn Tauro. Hearing on the motion and objections was held December 3, 1990 in Sioux City, Iowa. This is a core proceeding under 28 U.S.C. 152(b)(2)(0).

I.

Cargo, Inc. (CARGO), a New Jersey corporation, was engaged in the business of truck transportation. It operated with authority from the Interstate Commerce Commission. Cargo is a wholly owned subsidiary of J. C. Holding Corp., an Iowa corporation. J. C. Holding Corp. is owned by Tauro Brothers Trucking, Inc. (TAURO BROTHERS), an Ohio corporation. Kathryn Tauro and Frank DeJute are officers and directors of Cargo and Tauro Brothers.

On June 26, 1987, Cargo entered into a "Commission Agent Agreement" with Don Main Enterprises, Inc. (MAIN). The agreement made it possible for Main to provide trucking services to the public for which Main lacked its own ICC authority and the necessary insurance coverage. Under the agreement, Main, as an independent contractor, would act as agent for Cargo in soliciting customers and in providing these customers with trucking services. Main would bill the customers for the services on cargo invoices. copies of the invoices were sent to Cargo. At the end of each week, based on the copies submitted by Main, Cargo would pay Main, as commission, 85% of the total billings for the week. This money would be paid prior to collection of the invoices by Cargo. The written contract did not provide who would bear the loss for unpaid customer invoices. Frank DeJute testified that Cargo and Main orally agreed that uncollected accounts would be deducted by Cargo from subsequent payments to Main. DeJute doubts that such deductions were ever made.

The written agreement provided that Main would be responsible for detainage charges which Cargo was unable to collect from the customers. Detainage charges were billed to Cargo by rail carriers whose equipment had been held beyond prescribed periods by Main and subcontractors who worked for Main. Cargo was responsible to the railroads for these charges. Cargo would re-bill the customers for these charges; it could also charge the detainage against the amounts it owed Main. If such charges

were deducted from Main's commission, Cargo was required by the agreement to pay Main any detainage charges it later collected from the customers.

Main was to provide its own employees, office facilities, phone lines, workmen's compensation insurance, and comprehensive liability insurance. Main was also responsible for the general cost of providing the trucking services, including storage, demurrage, trailer spotting and repositioning, and lift charges. Cargo was to provide insurance coverage (public liability, property damage and cargo) for Main's contractors and was to provide comprehensive and collision insurance on trailers utilized in Main's operation.

The relationship between Cargo and Main soured in the spring of 1989. In April, 1989, Cargo stopped payment on a \$25,727.24 commission check which had been issued to Main. Cargo also withheld payment of further commissions in the amount of \$23,157.74. It was not long before litigation ensued. Cargo struck first. It filed a petition against Main in Nebraska state court alleging breach of contract. Cargo sought to recover \$133,324.75 in detention charges billed to it by rail carriers. Cargo also sought general damages in the amount of \$500,000.00. The suit was dismissed by the state court on jurisdictional grounds.

In July, 1989, Main sued Cargo, J. C. Holding Corp., Tauro Brothers, Kathryn Tauro and Frank DeJute in the U. S. District Court for the Northern District of Ohio. Main's claims against Cargo included breach of contract, "tortious conversion", "anticipatory breach of contract", tortious interference with business relations, fraud, violation of antitrust laws, and federal and Ohio RICO violations. Some, but not all, counts sought duplicative damages. However, at their very minimum, the damage claims exceed \$60,000.00.

In Count VI, described as a claim for "anticipatory breach of contract", Main alleged that it was in possession of invoices totaling approximately \$60,008.00. If Main were to send the invoices, it would be entitled to \$51,125.30 in commissions. Main also claimed possession of unsent detention invoices totaling \$9,951.00. If the customers paid Cargo this amount, Main would allegedly be entitled to a like payment from Cargo. Main feared that if it billed the customers, it would not be paid its commission by Cargo.

On September 28, 1990, the Honorable Alvin I. Krenzler entered an order in the civil action which directed customers of Main and Cargo to pay unpaid invoices directly to the clerk of court. This order was submitted to the court by the parties. It stated:

This matter is before the Court on the Parties' Joint Motion for an order directing the customers of Don Main Enterprises, Inc., and Cargo, Inc., to pay directly into Court amounts which are due and owing pursuant to freight bills prepared by the parties. By agreement of the parties, and for good cause shown, IT IS HEREBY ORDERED that the attached order of the Court directing the customers of Don Main Enterprises, Inc. and Cargo, Inc., pay directly into this Court monies which are due and owing pursuant to freight bills which have been prepared and which will be sent to the respective customers. That Order shall be attached to the freight bills so as to be sent to the customers with the freight bills.

The order to be provided to the customers read as follows:

AS A RECEIVOR of services provided by Don Main Enterprises, Inc., and/or Cargo, Inc., and being identified in the attached freight bill, you are hereby ORDERED to make

payments directly to this Court of any and all outstanding amounts which may be due to Don Main Enterprises, Inc. and/or Cargo, Inc. These payments should be payable to:

CLERK
United States District Court
Northern District of Ohio
Eastern Division
United States Courthouse
201 Superior Avenue N.E.
Cleveland, Ohio 44115

Reference:
Don Main Enterprises, Inc. v. Cargo, Inc.
Case No. 4:89 CV 1310
Judge Alvin I. Krenzler

At the time of the hearing, approximately \$58,000.00 was being held by the district court clerk pursuant to the order. Cargo claims that at least \$15,000.00 of that money was paid to the clerk in error by customers which owed Cargo for services independent of the agreement with Main. Cargo alleges that the balance of the funds held by the court is its property, and that Main has already been paid in full on the invoices represented by the court-held payments. Main alleges that the money belongs to it.

During its business relationship with Cargo, Main provided approximately \$40,000.00 per week in covered trucking services. Generally, Cargo received payment from the Main-provided services about 60 to 100 days after billing.

Cargo filed its chapter 7 petition on February 6, 1990. Wil Forker was appointed trustee. On June 4, 1990, Forker filed a complaint against Main and James S. Gallas, clerk of the federal district court in Ohio. Forker seeks a turnover of the funds being held by the clerk. Gallas has not filed an answer or responsive motion. Main filed its answer asserting that it has complete legal and equitable title to the funds being held by the district court. Main also contends that the money is being held in constructive trust for the benefit of Main.

Trustee and Main have reached a settlement of the turnover dispute. Under the agreement, the trustee and Main would each receive one-half of the money being held by the district court clerk. Each would receive its one-half of the funds free of the lien or ownership claims of the other. The settlement would not dispose of Main's claims against the estate nor would it dispose of the estate's claims against Main. Main has filed a proof of claim in bankruptcy in the amount of \$2,162,181.50. The claim is presumably based on the same allegations as are found in the federal civil action.

The entities objecting to the settlement claim that the funds being held by the clerk belong to Cargo, and that payment of one-half of the funds to Main would result in preferential treatment to Main to the detriment of unsecured creditors of the estate.

II.

The court considers four factors in determining whether to approve a proposed settlement:

- a. The probability of success in the litigation;
- b. The difficulties, if any, to be encountered in the matter of collection;
- c. The complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it;
- d. The paramount interest of the creditors and a proper deference to the reasonable views in the premises.

Drexel v. Loomis, 35 F.2d 800, 806 (8th Cir. 1929).

Said another way, the court must determine "whether the settlement 'fall[s] below the lowest point in the range of reasonableness. Cosoff v. Rodman (In re W. T. Grant Co.), 699 F.2d 599, 608 (2nd Cir. 1983) citing Newman v. Stein, 464 F.2d 689, 693 (2nd Cir.), cert. denied sub nom. Benson v. Newman, 409 U.S. 1039 (1972).

III.

The trustee does not specify in his complaint whether he seeks turnover from the clerk of court pursuant to S 542 or 543 of the Bankruptcy Code. Under 542(a), the trustee can force an entity, other than a custodian, to turn over property which the trustee "may use, sell, or lease under 363 Generally, 363 authorizes a trustee to use, sell, or lease any property of the estate. 11 U.S.C. 363(b) (1). However, limitations are placed on the use of cash collateral. Cash collateral includes cash or cash equivalents in which the estate and an entity other than the estate have an interest. 11 U.S.C. 363 (a). Cash collateral may not be used unless the entity which has the interest consents or the court authorizes such use. 11 U.S.C. 363(c)(2). Court authorization is usually predicated on adequate protection of the affected entity's interest.

Turnover under S 543 is somewhat different. That section applies to custodians. A custodian with knowledge of commencement of a bankruptcy case may not make any disbursements from "property of the debtor" or "property of the estate." 11 U.S.C. 543(a). It is also the duty of the custodian to "deliver to the trustee any property of the debtor held by or transferred to such custodian. . . ." 11 U.S.C. 543(b). In another context, that of preferences, "property of the debtor" has been defined as "that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings." Begier v. IRS, 110 S.Ct. 2258, 2263 (1990).

A comparison of 543 and 542 indicates that a custodian's duty of turnover exists despite whether or not the trustee may use the property turned over under 363. The Code, defines "custodian" as

- A. receiver or trustee of any 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
- 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.

11 U.S.C. 101(10).

The Code's definition of "custodian" may be broad enough to include the district court clerk holding the funds pursuant to that court's order.

It is likely that if the turnover complaint were fully litigated, the trustee would be able to obtain turnover of the funds from the clerk under 543 or 542. However, the settlement resolves more than just the turnover of the funds. An important issue regarding these funds is whether their possession by the clerk creates a lien against the funds in favor of Main. If so, does the lien continue when the funds are surrendered to the trustee? If the funds were turned over to the trustee unfettered by any lien, then the resolution of the estate's and Main's conflicting claims would be irrelevant to the trustee's use of the money. If the money were turned over to the trustee by the clerk impressed by a lien in favor of Main, then use of the money must depend on the outcome of the litigation or an adequate protection pending the outcome of litigation. If the funds come to the trustee impressed by a lien, and if Main is successful in recovering from the estate, the turnover of funds would be of no benefit to the estate. If the trustee recovers against Main, then the funds would presumably be available to satisfy the trustee's recovery.

The language of the district court's order does not tell us whether the possession by the clerk creates a lien in favor of Main. Possession by a clerk arguably creates a "judicial lien" defined by the Bankruptcy Code as one "obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." 11 U.S.C. 101(32). Although entered by consent, the district court's authority for ordering the deposit of funds would be based on Fed.R.Civ.P. 64. This Rule requires the court to look at state law in determining the availability and application of remedies providing for the seizure of property. These remedies include attachment and sequestration.

If the effect of the district court's order was to attach the property to secure any judgment which Main might obtain, then under Iowa law, the attachment would create a lien. In the Matter of Yetter, 112 B.R. 301, 303 (Bankr. S.D. Iowa 1990).⁽¹⁾ Although the Bankruptcy Code definition of "judicial lien" includes a lien created by "sequestration", it is apparently not uniformly held that a lien is created by sequestration. 70 Am.Jur.2d, Sequestration 44. The latter text describes sequestration as an act which "operates to preserve property during the litigation so that it may be subjected to such orders or judgment as the court may make or render." Id.

If a lien on the funds is created by attachment or sequestration, is it dissolved when the custodian surrenders the funds to the trustee? If the lien is not dissolved, is the claimant entitled to adequate protection before the funds may be used? Answers to these questions are not certain. See Norton, Bankruptcy Law & Practice, 29A.18 (1990).

The trustee is concerned about the uncertainty. He prefers settlement which would provide him with 50 per cent of the funds on deposit free of any claim of Main. This money would be useable in the estate to pay administrative expenses which in this case will probably exceed the trustee's share of the settlement.

If Main obtains an affirmative recovery against the estate in any claims litigation, it would receive a pro rata distribution with other unsecured creditors, but would have no lien against the funds turned over by the clerk. However, in compromising, the trustee gives up access to approximately \$29,000.00 which would otherwise have contributed to the satisfaction of any affirmative recovery the estate might obtain against Main.

There are gaps in the presentation to the court. There is not sufficient information to gauge the likelihood that the trustee will be successful in recovering against Main. There is no evidence as to whether a recovery against Main would be collectible by the trustee in the absence of the funds on deposit. There was no evidence introduced at trial to indicate whether any of the transfers to the clerk of court are avoidable as preferences. However, none of these gaps are wide enough to prevent approval of the proposed settlement. The immediate concern of the trustee is that the money in possession of the clerk is affixed with a lien which secures a potential recovery by Main. His doubts over the outcome of trying that issue moves him to compromise. The settlement provides benefits to the

estate. it gives the trustee immediate access to the funds unencumbered by any claims of Main. Given the benefits and the uncertainty, the court finds that the settlement is reasonable and should be approved.

ORDER

IT IS ORDERED that the trustee's motion to compromise adversary X90-0098S is granted. Judgment shall enter accordingly.

SO ORDERED ON THIS 9th DAY OF JANUARY, 1991.

William L. Edmonds
Bankruptcy Judge

1. The parties have cited no authority which would indicate the impact of Ohio law in this case.