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UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re:]	Case No. 92-57143-ASW
]	
Los Gatos Lodge, Inc.]	Chapter 7
]	
Debtor]	
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In re:]	Case No. 92-57303-ASW
]	
Norman and Jean McFate,]	Chapter 7
]	
Debtors]	
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MEMORANDUM DECISION
PERMITTING RECOVERY UNDER §506(c) IN PART
AND DENYING RECOVERY UNDER §506(c) IN PART

Before the Court is a motion in each of the above-numbered Chapter 7 cases, filed by Mohammed Poonja ("Poonja"), trustee in the case of Los Gatos Lodge, Inc. ("Corporation"). By such motions, Poonja seeks to surcharge collateral of Sacramento Savings Bank ("Bank"), predecessor of Alleghany Properties, Inc. ("Alleghany"), pursuant to 11 U.S.C.¹ §506(c).

¹ These cases were filed prior to October 22, 1994, the effective date of the amendments to Title 11, United States Code ("Bankruptcy Code") that were enacted in 1994; unless otherwise

1 Poonja is represented by Seymour J. Abrahams, Esq. and
2 Alleghany is represented by Jeffrey B. Gardner, Esq. of Saxon,
3 Barry, Gardner & Kincannon. The matter has been briefed and
4 argued, and this Memorandum Decision constitutes the Court's
5 findings of fact and conclusions of law pursuant to Rule 7052 of
6 the Federal Rules of Bankruptcy Procedure ("FRBP").

7
8 I.

9 FACTS

10 The facts of this matter are largely undisputed.

11 Corporation is the Debtor in Chapter 7 Case No. 92-57143,
12 and Norman and Jean McFate ("McFates") are the Debtors in Chapter
13 7 Case No. 92-57303. McFates (or their family trust) owned the
14 shares of Corporation; McFates (or their family trust) also owned
15 the real property upon which Corporation's business was located,
16 and leased the real property to Corporation. Corporation owned a
17 building on the real property, where Corporation operated a
18 business consisting of a motel, a restaurant, and a cocktail
19 lounge.

20 Corporation filed a Chapter 11 petition on October 13, 1992
21 and McFates filed one on October 20, 1992. Each bankruptcy
22 debtor operated as a debtor-in-possession until June 9, 1993,
23 when a Chapter 11 trustee was appointed in each case: Poonja was
24 appointed in Corporation's case and John Richardson
25 ("Richardson") was appointed in McFates' case. Corporation's

26
27
28 noted, all statutory references are to Title 11 as it provided
prior to such amendments.

1 case was converted to Chapter 7 on November 26, 1993 and Poonja
2 was appointed Chapter 7 trustee; McFates' case was converted to
3 Chapter 7 on December 17, 1993 and Richardson was appointed
4 Chapter 7 trustee.

5 Bank was owed over \$6.5 million by McFates, which debt was
6 secured by a first deed of trust on the real property that was
7 owned by McFates (or their family trust) and leased to
8 Corporation. Bank claimed that such debt of McFates was also
9 secured by a security interest in personal property of the motel
10 business that Corporation operated upon the real property, and in
11 the rents generated by the motel; the rents were subject to a
12 senior security interest held by Comerica Bank and the Court
13 ruled during the Chapter 11 phase of the cases that Bank held no
14 security interest in rents.

15 While the cases were in Chapter 11, Bank sought stay relief
16 to foreclose and such relief was granted in June 1993 with a stay
17 until September 2, 1993. Bank foreclosed on the real property
18 October 7, 1993 and bid \$6,570,903.47, which was \$200,000 less
19 than Bank was owed. Bank then foreclosed under its claimed
20 personal property security interest and bid \$200,000 for that
21 property.

22 At the request of another creditor, Poonja was appointed
23 Chapter 11 trustee in Corporation's case at approximately the
24 same time that stay relief was granted to Bank. At the hearing
25 on appointment of a trustee, Bank asked that a single trustee be
26 appointed to handle both Corporation's estate and McFates'
27 estate, but the office of the United States Trustee appointed
28 separate trustees. As trustee, Poonja operated Corporation's

1 business for approximately four months, until the foreclosures
2 and (by agreement with Bank) for six days after the foreclosure,
3 until Bank took possession. Bank never expressly consented to
4 Poonja surcharging Bank's collateral under §506(c), nor did Bank
5 tell Poonja during his operation of the business that Bank would
6 oppose such a surcharge.

7 Poonja took the position that Bank's personal property
8 security interest did not extend to property owned by Corporation
9 and applied only to property owned by McFates, who were Bank's
10 debtors and who had granted the security interest. That
11 controversy was compromised in May 1994 by a Court-approved
12 settlement ("Settlement"), under which: 1) Bank paid Poonja
13 \$138,054.39 (allocated by Allegheny as: \$3,100 for a van; \$9,000
14 for the business' liquor license; \$17,454.39 for inventory and
15 cash on hand; \$28,500 for the business' name and goodwill; and
16 \$80,000 for furnishings, fixtures, and equipment); 2) Poonja
17 agreed to assert no further interest in the subject personal
18 property; 3) the secured claim that Bank had filed in
19 Corporation's case was disallowed; and 4) Poonja turned over
20 \$21,000 of the amount paid by Bank to Comerica, which had
21 asserted a senior security interest in some of the same property
22 that Bank claimed as collateral. The Settlement expressly
23 provides that the parties' respective rights under §506(c) are
24 not affected by the Settlement and are reserved.

25 Poonja claims to have devoted \$80,861.37 worth of time and
26 money to operating Corporation's business, and has requested
27 allowance of a Chapter 11 administrative expense claim in
28 McFates' case for that amount. Poonja has received in response a

1 letter from counsel for Richardson, refusing to pay such claim
2 and saying that Poonja should pursue Bank under §506(c) because
3 it was Bank that benefitted from Poonja's efforts rather than
4 McFates' estate, and Richardson is not going to pursue Bank under
5 §506(c) on behalf of McFates' estate.

6
7 II.

8 LEGAL ISSUES

9 Poonja seeks to recover from Bank's successor Alleghany the
10 sum of \$80,861.37, alleged to be the value of Poonja's services
11 and expenditures devoted to preserve Bank's collateral, which
12 preservation is alleged to have benefitted Bank to an extent
13 exceeding such amount; he also seeks attorney's fees (in an
14 amount to be determined) incurred to pursue such recovery.
15 Poonja is proceeding under §506(c), which provides:

16 The trustee may recover from property
17 securing an allowed secured claim the
18 reasonable, necessary costs and expenses of
19 preserving, or disposing of, such property to
20 the extent of any benefit to the holder of
21 such claim.

22 Alleghany opposes, on the following bases:

23 A/ Relief under §506(c) must be sought by means of an
24 adversary proceeding.

25 B/ Poonja lacks standing as trustee of Corporation's
26 estate, since Bank is not a secured creditor of that estate and
27 §506(c) permits recovery only from "property securing an allowed
28 secured claim".

C/ Poonja lacks standing as an administrative
creditor of McFates' estate because he does not hold an allowed

1 administrative claim in that case.

2 D/ Poonja's services did not benefit Bank and §506(c)
3 permits recovery only "to the extent of any benefit to the holder
4 of" an allowed claim secured by the property sought to be
5 surcharged.

6 E/ Poonja's charges are not reasonable and/or
7 necessary.

8

9 A. Requirement of Adversary Proceeding

10 Alleghany correctly points out that FRBP 7001(1) requires an
11 adversary proceeding "to recover money or property", with certain
12 exceptions not relevant here.

13 Poonja argues that everything is before the Court now and no
14 purpose would be served by requiring him to commence an adversary
15 proceeding and file the same pleadings in that matter that have
16 already been filed in these two bankruptcy cases. Poonja notes
17 that In re Palomar Truck Corp., 951 F.2d 229 (9th Cir. 1991),
18 cert. denied sub nom General Electric Capital Corp. v. North
19 County Jeep & Renault, Inc., 506 U.S. 821, 113 S.Ct. 71 (1992)
20 ("Palomar") and "many" other cases concerning §506(c) have been
21 handled as contested matters rather than as adversary
22 proceedings. That is true (at least as to Palomar), but Palomar
23 is distinguishable, since there is no indication in that case of
24 any objection to the motion procedure, whereas Alleghany does
25 object here.

26 Poonja correctly points out that Alleghany has shown no
27 prejudice thus far from the use of motion procedure rather than
28 of an adversary proceeding, and cites In re Orfa, 170 B.R. 257

1 (E.D.Pa. 1994) ("Orfa") (a case also cited by Alleghany), in
2 which a district court declined to "elevate form over substance"
3 by requiring an adversary proceeding where no prejudice was shown
4 to have resulted from treating the dispute as a contested matter.
5 Orfa cites with approval In re Command Services Corp., 102 B.R.
6 905, 908-909 (Bkrtcy. N.D.N.Y. 1989), which in turn cites
7 extensive authority supporting Poonja's position:

8 ... courts have concluded that where the
9 rights of the affected parties have been
adequately presented so that no prejudice has
10 arisen, form will not be elevated over
substance and the matter will be allowed to
11 proceed on the merits as originally filed.
See, e.g., In re Szostek, 93 B.R. 399, 403 n.
12 6 (Bankr.E.D.Pa.1988) (Bankr.R. 7001(5):
revocation of confirmation order); In re
13 Morysville Body Works, Inc., 89 B.R. 440,
441-442 (Bankr.E.D.
14 Pa.1988) (Bankr.R. 7001(7): debtor's
petition to stay IRS in collecting
15 responsible penalty tax from its principal);
In re Roberts Hardware, Co., No. 87-01800,
16 slip op. at 4 n. 3, --- B.R. ----, ----, n. 3
(Bankr.N.D.N.Y. Apr. 11, 1988) (Bankr.
17 R. 7001(1): action to recover property); In
re Data Entry Serv. Corp., 81 B.R. 467, 468
18 n. 1 (Bankr.N.D.Ill.1988) (Bankr.R. 7001(2):
lien determination and distribution order);
In re McClain Airlines, Inc., 80 B.R. 175
19 (Bankr.D.
Ariz.1987) (defense under Code § 541 to
20 debtor's motion to assume lease does not
require opponent to file adversary
21 complaint); In re Stern, 70 B.R. 472, 473 n.
1 (Bankr.E.D.Pa.1987) (Bankr.R. 7001(4):
22 revocation of discharge); In re Wallman, 71
B.R. 125, 126 n. 1 (Bankr.D.S.D. 1987)
23 (Bankr.R. 7001(2): debtor's motion for
contempt and sanctions due to nonexistence of
24 lien); Doran v. Treiling (In re Treiling), 21
B.R. 940, 941 n. 1 (Bankr.E.D.N.Y.1982)
25 (Bankr.R. 7001(1): proceeding to recover
money); cf. Smith v. New York State Higher
26 Education Serv. Corp. (In re Smith), No.
83-01317, slip op. at 8-9, 11, --- B.R. ----,
27 ---- - ----, ---- (Bankr.N.D.N.Y. Mar. 21,
1988) (noting operative verb in Bankr.R. 7001
28 is "may", in contrast to "shall" in Bankr.R.

1 9014). Accord In re Banks, 94 B.R. 772
2 (Bankr. M.D.Fla.1989) (motion of Chapter 11
3 debtor's counsel for recog- nition and
4 approval of charging lien). ... Indeed, the
5 notice pleading of the Federal Rules and the
6 mandate of Rule 8(f) of the Federal Rules of
7 Civil Procedure ("Fed.R.Civ.P."),
8 incorporated by Bank. R. 7008(a), that "[a]ll
9 pleadings shall be so construed as to do
10 substantial justice" support this liberal
11 interpretation by a court of equity. ...
12 Bankr.R. 9005 is also germane, applying as it
13 does Fed.R.Civ.P. 61 which provides, in part,
14 that "[t]he court at every stage of the
15 proceeding must disregard any error or defect
16 in the proceeding which does not affect the
17 substantial rights of the parties." See In
18 re Ross & Hurney Paving, Inc., supra, 51 B.R.
19 at 375.

20 Alleghany has not cited, nor has this Court located, any
21 binding precedent that prohibits use of motion procedure for
22 claims under §506(c). FRBP 9014 provides that the Court "may at
23 any stage in a particular matter" direct that any of the rules
24 governing adversary proceedings are to apply to contested matters
25 such as motions. Under the circumstances of this case,
26 Alleghany's rights will be fully protected if Part VII of the
27 FRBP governing adversary proceedings is applied to these motions
28 with respect to any future proceedings.

Poonja may proceed under §506(c) by means of motion, with
the rules governing adversary proceedings made applicable
prospectively.

B. Poonja's Standing in Corporation's Case

Alleghany argues that Poonja lacks standing to assert
§506(c) against Alleghany in Corporation's case because
Alleghany's predecessor Bank did not hold an allowed secured
claim in Corporation's case and §506(c) only applies to recovery

1 from "property securing an allowed secured claim". Alleghany
2 notes that Poonja objected to the secured claim filed by Bank in
3 Corporation's case, which secured claim was disallowed pursuant
4 to the Settlement.

5 Poonja points out that Rule 408 of the Federal Rules of
6 Evidence ("FRE") prohibits evidence of a settlement to prove the
7 validity or amount of a claim so, to any extent that the
8 Settlement may have determined whether Bank was a secured
9 creditor in Corporation's case, the Settlement should not be
10 admitted as evidence to establish that fact now. Poonja is
11 correct since, unlike a judicial decision, a settlement does not
12 determine the truth of any disputed fact, it merely acts
13 prospectively to give effect to a bargain; these parties'
14 agreement to treat each other in certain ways does not mean that
15 Bank's claim was not (or was) actually secured. Poonja also
16 notes that the Settlement expressly reserves issues concerning
17 the parties' respective rights under §506(c), so that such rights
18 cannot now be affected by the fact that the Settlement exists,
19 nor by the provisions or operation of the Settlement. The Court
20 agrees with Poonja's position on that point since, to do
21 otherwise would be contrary to the parties' agreement that their
22 §506(c) rights would remain intact despite the Settlement.

23 Poonja argues that Bank was a secured creditor of
24 Corporation's estate at the time Poonja performed the subject
25 services (June through October 1993) and lost that status only by
26 virtue of the Settlement (May 1994), which occurred after Poonja
27 had provided Bank with the benefit of his work in operating the
28 business until Bank foreclosed and took possession. Under the

1 Settlement, Bank acquired from Corporation's estate title to
2 personal property that Bank had not attempted to foreclose upon
3 (items such as the van and the liquor license, which were
4 indisputably not encompassed within Bank's security interest),
5 and also was relieved of a cloud on title to such personal
6 property as Bank had purported to foreclose upon under a security
7 interest that Poonja claimed was defective. Once the Settlement
8 was completed, Bank ceased to be a secured creditor of
9 Corporation's estate but, prior to that time, Bank was a secured
10 creditor of Corporation's estate because there had been no
11 judicial determination that the security interest asserted by
12 Bank was not valid. Further (although Poonja does not make this
13 point), §502 provides that a claim is deemed allowed until
14 objected to and the secured claim filed by Bank was only
15 disallowed as part of the Settlement, after Poonja's services had
16 been provided. Alleghany cites no facts or law under which
17 Bank's loss of secured status at the time of the Settlement in
18 May 1994 should be given retroactive effect,² such that Bank
19 should be considered to have been an unsecured creditor at the
20 time Poonja was rendering services during the latter half of
21 1993. Poonja is correct that Bank was the holder of an allowed
22 secured claim in Corporation's case at the time Poonja rendered
23 the services for which he now seeks to charge Alleghany.

24 Poonja argues that the requirement of secured creditor
25

26 ² This is not a situation where a court found in a
27 contested proceeding that no security interest ever existed, and
28 this Court does not reach the issue of what the result would be
under such facts.

1 status contained in §506(c) should apply to the creditor's status
2 at the time the creditor's collateral is benefitted, not to the
3 creditor's status at some later time after the benefit has
4 already been conferred -- Alleghany appears to argue the opposite
5 position, although that is not entirely clear. Poonja cites no
6 authority for his proposition, nor has this Court located
7 anything on point, but the opposite approach would render the
8 statute useless in many (perhaps most) situations. Adopting a
9 position contrary to that taken by Poonja would mean that §506(c)
10 could never be used after a secured creditor forecloses because a
11 secured creditor that has foreclosed upon its collateral is
12 necessarily left with only an unsecured deficiency claim against
13 the estate; it would be nonsensical to say that one who preserves
14 collateral pre-foreclosure cannot use §506(c) post-foreclosure,
15 merely because the creditor who was secured by the collateral
16 pre-foreclosure (during the period of preservation) is no longer
17 secured post-foreclosure. Similarly, whenever a trustee or
18 debtor-in-possession sells a secured creditor's collateral and
19 pays the creditor in full from proceeds, the creditor thereupon
20 ceases to be a creditor of the estate; if the relevant time for
21 secured status was something other than the time at which the
22 collateral was benefitted, the seller could not, post-payoff,
23 look to the former creditor to recover expenses of sale and/or of
24 preserving the collateral pending sale because the former
25 creditor would then no longer be a secured creditor, having been
26 paid in full.

27 Alleghany also argues that Bank was unsecured because Bank's
28 claimed collateral was subject to a senior lien held by Comerica

1 for \$553,000, which was far more than the value of Bank's claimed
2 collateral, so that Bank was undersecured to the point of being
3 completely unsecured. Poonja responds that this is not a case
4 with a "massive" senior lien that absorbs all value and leaves a
5 junior lienholder such as Bank effectively unsecured, because
6 only part of Bank's claimed collateral was subject to a senior
7 lien; Poonja correctly points out that Comerica's documents show
8 its security interest to be limited to pre-petition accounts
9 receivable and some inventory (such as food and beverage
10 supplies, linens, and janitorial supplies), the value of which
11 Poonja contends was not great and was consistent with the \$21,000
12 that Comerica accepted under the Settlement. Alleghany does not
13 argue that Comerica's security interest served to encumber all of
14 the collateral claimed by Bank and the amount of the debt claimed
15 by Comerica is irrelevant with respect to the extent of
16 Comerica's security interest.

17 Poonja has standing to proceed under §506(c) in
18 Corporation's case.

19

20 C. Standing in McFates' Case

21 Poonja contends that, if he were found to lack standing to
22 assert §506(c) in Corporation's case, he would nevertheless have
23 such standing in McFates' case. Alleghany argues that Poonja
24 lacks standing to assert §506(c) in McFates' case because §506(c)
25 is only available to the trustee of that estate or, perhaps, to
26 the holders of allowed administrative claims against that estate,
27 and Poonja is neither.

28 Poonja relies upon Palomar, a case that Alleghany contends

1 takes an unduly "expansive" view of §506(c) and was wrongly
2 decided. In Palomar, the holder of an allowed administrative
3 claim proceeded under §506(c) when the Chapter 11 trustee did not
4 make use of the statute himself and did not object to the
5 creditor making use of it. The Ninth Circuit noted a three-way
6 split in authority as to whether §506(c) was available for use by
7 anyone other than a trustee or Chapter 11 debtor-in-possession,
8 and found (at 232) that "no compelling policies are served by a
9 restrictive reading of §506(c) in the circumstances of this
10 case"; the Court also noted (*id.*) that, if somebody did not make
11 use of §506(c), the result would be a "windfall" to the secured
12 creditor whose collateral was enhanced by the administrative
13 creditor. Alleghany argues that United States v. Ron Pair
14 Enterprises, 489 U.S. 235, 109 S.Ct. 1026 (1989) ("Ron Pair")
15 calls for statutory interpretation based on "plain meaning" and
16 §506(c) expressly provides for recovery by a "trustee", so the
17 Ninth Circuit should not have permitted anyone other than a
18 trustee to use it. Poonja points out that Palomar was decided in
19 1991, two years after Ron Pair, so the Ninth Circuit must have
20 been aware of Ron Pair in making the decision that it did. In
21 any event, however much Alleghany may disagree with Palomar, the
22 fact remains (as Poonja notes) that the case has not been
23 overturned and remains binding upon this Court.

24 Alleghany argues that, even if Palomar is applied here, it
25 does not assist Poonja, since the non-trustee party permitted to
26 make use of §506(c) in that case was an administrative creditor
27 and Poonja does not hold an allowed administrative claim in
28 McFates' case. Poonja points out that Alleghany cites no

1 authority for the proposition that a non-trustee using §506(c)
2 must be an administrative creditor, simply because that is what
3 the non-trustee party in Palomar happened to be; Poonja argues
4 that the rationale of Palomar was to avoid a "windfall" to a
5 secured creditor who benefitted from a non-trustee's efforts, and
6 such rationale would be defeated by denying relief to Poonja
7 solely because he may not hold an allowed administrative claim
8 against McFates' estate. This Court agrees with Poonja that the
9 rationale of Palomar does not depend upon whether the non-trustee
10 party seeking to use §506(c) holds an allowed administrative
11 claim -- the stated goal of Palomar was to avoid windfalls to
12 secured creditors who are benefitted by the services of others
13 (whether those others be trustees, administrative creditors, or
14 some different type of party in interest) and there is no
15 apparent reason for limiting the holding of that case to
16 administrative creditors as opposed to some other kind of non-
17 trustee party. One of the three schools of thought discussed by
18 Palomar holds that a non-trustee party can make use of §506(c)
19 only when the trustee has refused to do so, and that is the case
20 here, where counsel for McFates' trustee Richardson has stated
21 that Richardson will not make use of §506(c).

22 Pursuant to Palomar, Poonja has standing to proceed under
23 §506(c) in McFates' case.

24

25 D. Benefit

26 The Ninth Circuit has held that

27 [T]o satisfy the benefit test of section
28 506(c), [the movant] must establish in
quantifiable terms that it expended funds

1 directly to protect and preserve the
2 collateral. [Citations omitted]. [The
3 movant's] recovery, however, is limited to
4 the extent that the secured creditor
5 benefited from the services. [Citation
6 omitted].

7 In re Cascade Hydraulics and Utility Service, Inc., 815 F.2d 546,
8 548 (9th Cir. 1987).

9 Alleghany argues that Poonja's services in operating
10 Corporation's business did not benefit Bank, or at least not to
11 the extent of more than the \$138,054.39 that Bank paid Poonja
12 under the Settlement, and that Poonja's operation of the business
13 was for the purpose of benefitting Corporation's estate and did
14 benefit that estate.

15 Poonja contends that, when he was appointed Chapter 11
16 trustee, Corporation had no prospect of reorganization, because:
17 Bank had received relief to foreclose in three months; the lease
18 to the real property upon which Corporation's business was
19 located had been deemed rejected when not assumed within sixty
20 days post-petition as required by §365, and Corporation owed
21 "many months" of unpaid rent; tangible assets were of "limited
22 value"; gross revenues for that year were \$2,340,000 with
23 anticipated net earnings of \$112,313, without accounting for
24 monthly rent of \$72,000 (\$864,000 per year); Corporation had
25 "serious" problems with its management company and faced charges
26 of unfair labor practices and illegal activity in the lounge;
27 "very substantial" deferred maintenance required attention
28 (including termite fumigation) and one wing of the motel could
not be rented due to its poor condition. Poonja claims that the
only reason he undertook operation of the business was to

1 preserve its going-concern value pending Bank's upcoming
2 foreclosure, in case the trustee in McFates' case were able to
3 prevent foreclosure by sale or refinance. However, foreclosure
4 did occur and Bank bid \$200,000 for the personal property of
5 Corporation in which Bank asserted a security interest. Poonja
6 points out that, had he not kept the business operating until
7 Bank foreclosed, Bank would have taken over only a vacant
8 building furnished and equipped as a motel/restaurant/lounge that
9 had been closed for four months, which interruption would have
10 created such problems as: a need to hire and train new
11 employees; a loss of advance reservations; a "very substantial"
12 loss of business from travel agents and corporate travel
13 managers, whose patronage would be transferred elsewhere after
14 the closing and would have to be solicited again, if it could be
15 recaptured at all; a loss of established customers for the
16 restaurant and lounge, who would find other facilities during the
17 hiatus and might not return; risks of theft and vandalism, and
18 the expense of preventive attempts such as fencing and security
19 services; the possible necessity of conforming to local building
20 codes as a prerequisite of reopening; and a "great reduction" in
21 resale value compared to the value of a functioning business
22 operation. Alleghany notes that Poonja's point about the
23 possibility of Bank having to comply with current building codes
24 is "speculative", but does not seriously contradict the rest of
25 Poonja's allegations. Poonja has been on this Court's panel of
26 Chapter 7 trustees for many years, is an experienced Chapter 11
27 trustee and examiner, and has served as a receiver in State Court
28 matters; he is well qualified to state reliable opinions as to

1 the difference between taking over a business such as that here
2 in the form of a going concern, and taking over such a business
3 after it has been closed for four months. Poonja has demon-
4 strated that the value of Bank's collateral was preserved by his
5 operation of the business pending foreclosure.

6 Poonja does not attempt to compare in dollar amounts the
7 value that Bank's collateral would have had if the business had
8 not been operated with the value that Bank's collateral did
9 ultimately have, other than to contend that the collateral's
10 value would have been depressed had the business closed, and that
11 Bank bid \$200,000 at foreclosure for the personal property in
12 which Bank asserted a security interest. Alleghany does not
13 attempt to show that the value of its collateral declined during
14 Poonja's operation. Poonja has established that Bank's
15 collateral was worth at least the amount that Bank bid for it at
16 foreclosure (i.e., \$200,000).

17 Alleghany argues that Bank paid \$138,054.39 under the
18 Settlement to buy the subject personal property from
19 Corporation's estate, and that the price set by the Settlement
20 should be considered to represent any value attributable to
21 Poonja's services (which amount has already been paid in full).
22 Poonja argues that evidence of the Settlement cannot be used to
23 show the value of the personal property because FRE 408 forbids
24 use of settlements to prove the amount of a claim, and also
25 points out that the Settlement expressly provides for §506(c)
26 rights to be unaffected by the Settlement. As discussed below,
27 the price paid by Bank under the Settlement appears to have been
28 based on many factors other than the value of the personal

1 property but, whatever that price may have represented, the plain
2 language of the Settlement makes clear that the price was not
3 compensation as con- templated by §506(c). The Settlement's
4 provision that the parties' rights under §506(c) are to remain
5 unaffected is completely in- consistent with Alleghany's position
6 that the amount called for by the Settlement should determine an
7 issue raised by §506(c), i.e., the value of Bank's collateral.

8 Poonja contends that, if the price in the Settlement is to
9 be considered, the "controlling factors" in arriving at that
10 price must also be taken into account, and are as follows: that
11 Bank had "a very strong claim" that Bank already owned most of
12 the personal property by virtue of having bid \$200,000 for it in
13 foreclosure, whereas Poonja had a "technical" argument against
14 the validity of Bank's security interest; that it would be
15 expensive for Poonja to remove from the premises such things as
16 air conditioners, stoves, beds, dressers, etc. and their market
17 value once removed would be "negligible", whereas it would be
18 expensive for Bank to install replacement items for whatever
19 Poonja removed; and that Bank wanted to avoid delay in using the
20 business' liquor license. Poonja points out that Bank was the
21 party allocating the amount paid under the Settlement, and Poonja
22 considers the allocations to be "low" under normal circumstances
23 (e.g., \$30,000 for good will and signs of a
24 motel/restaurant/lounge is low, even for a business being sold in
25 bankruptcy). This Court concludes that the facts surrounding
26 creation of the Settlement show that it was intended by the
27 parties to be just that, a settlement, designed to compromise a
28 controversy as to whether Bank held a valid security interest in

1 personal property that Bank wished to own. Bank had just bid
2 \$200,000 to acquire the property by foreclosure, only to face
3 Poonja's "technical" challenge that Bank had no security interest
4 to foreclose; even though it might not be cost effective for
5 Poonja to remove the property from the building, it would be
6 time-consuming and costly for Bank to replace the property if
7 Poonja did remove it -- further, Corporation's estate held title
8 to a van and a liquor license that Bank wanted soon and those
9 were indisputably not subject to Bank's claimed security
10 interest, so Poonja's control of those items gave him some
11 leverage with respect to the other items. The position of each
12 party had strong points and weak points, and litigation would
13 have entailed risk, delay, and expense for both -- those are
14 factors typically found in compromises, and compromise is what
15 occurred in this case. Bank agreed to pay \$1,300 to buy the van
16 and \$9,000 to buy the liquor license, plus \$125,954.39 to settle
17 the dispute over the validity of the security interest that Bank
18 claimed in the other items. The gravamen of the Settlement is
19 not a purchase of Bank's claimed collateral, it is a compromise
20 that can be presumed to have taken into account not only the
21 subject property's value to each party, but also such factors as
22 litigation costs avoided, expenses associated with delay, and the
23 degree of risk posed by litigation. To any extent that the
24 Settlement may be indicative of the collateral's value, it is
25 certainly not dispositive of that issue and Alleghany has not
26 established that Bank's payment of the amount called for by the
27 Settlement constituted payment for the full value of the
28 collateral, as opposed to payment in order to effect compromise

1 of a controversy. As for whether Corporation's estate
2 benefitted from Poonja's operation of the business, Alleghany
3 argues that the business was operating at a monthly net loss of
4 \$29,000 when Poonja took over but was operating at a monthly net
5 gain of \$1,000 when Bank foreclosed, so the estate benefitted
6 from Poonja's efforts to the extent of at least \$90,000, which
7 enabled Poonja to sell estate assets such as inventory and
8 goodwill to Bank. Poonja replies that Alleghany's figures are
9 drawn from the monthly operating reports filed by Corporation's
10 estate and those were prepared on a "modified accrual" basis so
11 as to be consistent with the method used by Corporation prior to
12 Poonja's appointment as trustee; such basis did not account for
13 monthly rent of \$72,000 that was being accrued but not paid, and
14 rent payments of even \$6,000 per month would have absorbed any
15 apparent profit. Poonja also points out that his operation of
16 the business could not have assisted the estate because there was
17 no hope of reorganization, for the reasons set forth above.
18 Poonja's operation of the business has not been shown to have
19 been for the benefit of the estate, nor to have actually
20 benefitted the estate rather than having benefitted Bank.

21
22 E. Reasonable and Necessary Charges

23 Expenses recoverable under §506(c) are limited to "the
24 reasonable, necessary costs and expenses of preserving, or
25 disposing of" the collateral sought to be surcharged. Alleghany
26 argues that Poonja claims amounts that were not reasonable and
27 necessary, for various reasons discussed below.

28 Poonja likens the services provided by him to those of

1 receivers in State Court matters. Poonja contends that, if a
2 Chapter 11 trustee had not been appointed, Bank's remedy would
3 have been to seek appointment of a receiver in the State Court to
4 run the business pending foreclosure, in order to preserve the
5 going-concern value of the collateral -- however, Bank's receiver
6 could not have taken charge of assets that were not Bank's
7 collateral, such as receipts of the restaurant and lounge, or the
8 liquor license needed to operate the lounge, or the accounts
9 receivable and rents that were subject to the security interest
10 of Comerica -- thanks to the appointment of a Chapter 11 trustee,
11 Bank was not limited to the imperfect remedy of receivership and
12 was instead able to avail itself of Poonja's services in
13 operating the entire three-part business with the liquor license
14 intact. Poonja provides a declaration by Randy Sugarman and one
15 by Jerome Robertson, both of whom state that they are experienced
16 receivers in State Court matters: the Sugarman declaration
17 states that he charges \$300 per hour for his services, \$220 to
18 \$250 per hour for the services of partners and principals in his
19 firm, \$100 per hour for the services of financial analysts, and
20 \$40 per hour for clerical services; the Robertson declaration
21 states that he charges \$200 per hour for his services, \$125 per
22 hour for the services of his associates, and \$85 per hour for
23 clerical and accounting services; each declarant opines that a
24 receivership of the type described by Poonja would be time-
25 consuming and expensive, though neither has reviewed Poonja's
26 itemized charges. Poonja also provides a declaration of himself,
27 in which he states that he has served as a receiver in State
28 Court matters and it is his opinion that operation of Corp-

1 oration's business by a receiver would have cost at least as much
2 as Poonja now seeks; he also points out that, in order to have a
3 receiver appointed, Bank would have had to pay: 1) an attorney
4 to file a complaint and move for appointment; 2) the cost of
5 posting a receivership bond; 3) an attorney to represent the
6 receiver; and 4) the receiver's fees and expenses. Poonja's
7 itemized charges include \$250 per hour for his services and \$80
8 per hour for the services of an associate; they also include
9 \$14,000 in rent payments attributable to the period during which
10 Poonja operated the business prior to Bank's foreclosure, based
11 on a Court-approved compromise with trustee Richardson for rent
12 owed by Corporation's estate to McFates' estate.

13 Alleghany complains that Poonja charges for overhead,
14 including preparation of reports filed with the Court. Poonja
15 points out that receivers in State Court matters charge, and are
16 paid, for all services in connection with the receivership,
17 including preparation of reports required by the State Court.
18 Poonja's charges do not include specific items of overhead, such
19 as his office rent or the like.

20 Alleghany notes that the recovery sought by Poonja exceeds
21 that permitted by §326 governing compensation of bankruptcy
22 trustees. Poonja correctly points out that §326 limits what
23 bankruptcy trustees are permitted to charge estates, not what
24 they are permitted to recover from others for estates, and it is
25 the latter that Poonja seeks to do here. Poonja confirms that
26 the recovery sought by these motions is for the benefit of
27 Corporation's estate and not for Poonja's own personal benefit,
28 noting that his trustee commission based on such recovery will be

1 only the 3% rate provided by §326.

2 Alleghany takes issue with Poonja's charges of \$80 per hour
3 for services provided by an associate, without explaining why
4 such amount is too much. Poonja responds by stating the
5 associate's qualifications and duties (most of which appear to
6 have been clerical), and also points out that the Robertson
7 declaration states an hourly rate of \$85 for "clerical" staff of
8 a receiver.

9 This Court agrees with Poonja's analogy of his role in
10 operating this business to that occupied by a State Court
11 receiver, since it does appear that receivership would have been
12 Bank's remedy in the absence of a trustee; Alleghany does not
13 contend otherwise, or show that the analogy is inapposite. The
14 declarations of Sugarman, Robertson, and Poonja are useful in
15 determining the type and amount of reasonable and necessary
16 charges incurred by receivers; Alleghany provides no evidence to
17 the contrary. This Court has reviewed Poonja's charges and finds
18 them both reasonable and necessary within the meaning of §506(c)
19 under the facts of these cases.

20 Poonja also seeks to recover his attorney's fees and costs
21 incurred to prosecute these motions (in an amount to be
22 determined), citing In re Soucek, 50 B.R. 753 (N.D.Ill. 1985).
23 That case does not address the issue, nor does this Court find
24 any authority on point. Since §506(c) permits recovery only of
25 expenses incurred to preserve or dispose of collateral, and only
26 to the extent that such preservation or disposition benefits the
27 holder of a lien upon such collateral, it is not readily apparent
28 how the expense of seeking relief under §506(c) could be

1 recoverable under that statute. Poonja has not demonstrated that
2 he is entitled by §506(c) to recover from Alleghany his
3 attorney's fees incurred to prosecute these motions.

4

5

6

III.

7

CONCLUSION

8

For the reasons hereinabove set forth:

9

Poonja's motions are granted in part and he is entitled
10 to recover from Alleghany the sum of \$80,861.37 (\$65,520.80 for
11 services plus \$15,340.57 for costs) pursuant to §506(c), as
12 reasonable and necessary expenses incurred to preserve the
13 collateral of Alleghany's predecessor; and

14

Poonja's motions are denied in part and he is not
15 entitled to recover from Alleghany his attorney's fees and costs
16 incurred to prosecute such motions; such denial is without
17 prejudice to Poonja demonstrating entitlement to such recovery
18 under §506(c).

19

Counsel for Poonja shall submit an order consistent with
20 this Memorandum Decision, after review as to form by counsel for
21 Alleghany.

22

Dated:

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ARTHUR S. WEISSBRODT
United States Bankruptcy Judge

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