

**UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT**

BAP NO. MB 98-070

**IN RE: STEPHEN CARP & JOAN E. CARP,
Debtors.**

**RICHARD W. GANNETT,
Appellant,**

v.

**JOHN O. DESMOND, TRUSTEE,
Appellee.**

**On appeal from the United States Bankruptcy Court
for the District of Massachusetts
(Hon. Joan N. Feeney, Bankruptcy Judge)**

Before

LAMOUTTE, VAUGHN & CARLO, Bankruptcy Judges

Richard W. Gannett, for the appellant.

David I. Shorr and John O. Desmond, for the appellee.

September 22, 1999

LAMOUTTE, Bankruptcy Judge.

The issue on appeal is whether the bankruptcy court erred in granting the trustee's motion to compromise the claim of appellant Richard W. Gannett.

Jurisdiction and Standard of Review

The bankruptcy court's findings of fact are reviewed under a clearly erroneous standard, while its legal conclusions are reviewed *de novo*. Edmonston v. Murphy (In re Edmonston), 107 F.3d 74 (1st Cir. 1997); Jeffrey v. Desmond, 70 F.3d 183 (1st Cir. 1995); In re SPM Mfg. Corp., 984 F.2d 1305 (1st Cir. 1993). A bankruptcy court's approval of the compromise of a claim will be reviewed for abuse of discretion. In re Anolik, 107 B.R. 426 (Bankr. D. Mass. 1989).

Background

In 1991 the debtors, Stephen and Joan Carp, lived in a property they owned at 54 Lovett Road in Newton, Massachusetts. In March of 1991, the mortgagee foreclosed on the property and the Carps were subsequently evicted. During 1991 the Carps located a property for sale at 824 Dedham Street, Newton, Massachusetts, and attempted to purchase the same. However, they were unable to obtain financing, so they enlisted the assistance of Mordechai Pupkin to make the purchase. Pupkin bought the property in his own name but has never occupied it. Carp remodeled the property, during which time he began making payments to Pupkin in an amount

equal to the monthly mortgage payment, and thereafter he began living in the property.

The Carps filed their voluntary petition under chapter 7 of the United States Bankruptcy Code on February 7, 1995, case No. 95-10811-JNF. They did not list the Dedham Street property, nor any interest in it, in their schedules. John O. Desmond was appointed trustee of the estate.

On June 30, 1995, appellant Richard Gannett filed a complaint objecting to discharge under 11 U.S.C. § 727, thereby commencing adversary proceeding No. 95-1406. Gannett alleges that debtors failed to schedule their interest in the real estate located at 824 Dedham Street, Newton, Massachusetts (hereinafter "the property"). On December 17, 1996, the trustee filed a complaint against Pupkin, commencing adversary proceeding No. 96-1690. Counts I and II of the complaint allege a cause of action for fraudulent conveyance under state law, and Count III of the complaint seeks turnover of the debtors' interest in the property under 11 U.S.C. § 542.

In December of 1996, the United States Attorney for the District of Massachusetts charged co-debtor Stephen Carp with violations of 18 U.S.C. § 152 for concealing his interest in the property from his bankruptcy estate. On January 8, 1997, Carp pled guilty, and on May 2, 1997, he was sentenced to five months in prison and ordered to pay \$30,000.00 in restitution. Subsequently, the bankruptcy court granted Gannett's motion for summary judgment

against Stephen Carp on October 28, 1997, based upon his guilty plea in the criminal proceeding. Gannet's § 727 action is still pending against co-debtor Joan Carp. The bankruptcy court granted the trustee's motion to consolidate adversary proceeding Nos. 95-1406 and 96-1690 on November 18, 1997, based upon the factual similarities of the case.

The trustee filed a motion to compromise the claim against Pupkin for \$90,000.00 on June 22, 1998. Gannett objected, alleging (1) the trustee failed to file a summary judgment motion in the adversary proceeding; (2) Pupkin's attorney did not sign the motion; (3) Pupkin and Carp invoked the Fifth Amendment to avoid answering deposition questions; (4) the trustee did not take the deposition of Dora Carp; (5) the trustee did not state the percentage dividend resulting from the settlement; (6) the cost of a trial would not prejudice the estate because the trustee and his attorney had a contingency agreement; and (7) uncertainty as to the value of the property. The trustee responded to Gannett's objection. The bankruptcy court held a hearing on July 30, 1998, and, finding that the trustee's motion satisfied the factors set forth in Anolik, entered an order on August 17, 1998, allowing the motion to compromise the claim. Gannett appeals the court's decision.

Gannett alleges that the bankruptcy court failed to adequately analyze each of the four factors set forth in Anolik. First, he

argues that the bankruptcy court failed to consider the impact of In re Popa, 218 B.R. 420 (Bankr. N.D. Ill. 1998), *aff'd*, 1999 WL 414257 (D. Ill. May 27, 1999). According to Gannett, Popa provides that there would be no obligation to pay capital gains taxes, which affects the trustee's calculation of the amount of the compromise. Second, he argues that the trustee failed to capitalize upon Carp and Pupkin's refusal to testify regarding their transaction, which would have allowed the bankruptcy judge to draw negative inferences therefrom. Third, Gannett argues that the trustee failed to make any argument regarding the below-market rent which the Carps paid to Pupkin on the property. According to him, a higher compromise was warranted because of this "sweetheart" rent; this rent could have been used as evidence on summary judgment; and a claim should have been made for the difference between the rent actually paid and the market rate. Fourth, Gannett argues that the property should have been appraised as a rental property, and the failure to do so was to the detriment of the creditors. Fifth, Gannett argues that Pupkin refinanced the property without the approval or permission of the Bankruptcy Court; he implies that Pupkin used the proceeds of the refinancing to fund the settlement reached with the trustee.

The trustee alleges that the bankruptcy court did not err in allowing his motion to compromise Pupkin's claim because it was within the bankruptcy judge's discretion to do so, and there is no

indication that she abused that discretion. The trustee argues that although Gannett questions the appraisal of the property, he has not presented his own appraisal, and thus has failed to rebut the trustee's evidence as to the value of the property. Further, the trustee argues that although Gannett alleges that negative inferences from Carp and Pupkins' invocation of the Fifth Amendment lead to the conclusion that Carp may be entitled to more than fifty percent of the property, Gannett has not explained nor supported these allegations.

The trustee also alleges that Gannett's objection did not rebut any of the factors to be considered in approving a settlement. Although Gannett argues that the trustee should have filed a summary judgment motion, the trustee contends that to do so would have been futile due to the number of facts in dispute. The trustee disputes Gannett's contention that the capital gains tax issue was not considered, pointing out that the Popa case was discussed in his motion to compromise and the issue presented to the bankruptcy court.

Discussion

A bankruptcy judge may approve the compromise of a claim pursuant to Federal Rule of Bankruptcy Procedure 9019(a), which provides:

On motion by the trustee and after a hearing on notice to creditors, the debtor and indenture trustees as provided in Rule 2002(a) and to such other entities as the court may

designate, the court may approve a compromise or settlement.

The approval of a compromise is within the sound discretion of the bankruptcy judge, and the reviewing court will not overturn a decision to approve a compromise absent a showing that the bankruptcy judge abused her discretion. In re Anolik, 107 B.R. 426, 429 (D. Mass. 1989) (citations omitted).

In considering whether to approve a compromise, the bankruptcy court should:

[A]pprise [itself] of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely direction of such litigation, the possible difficulties in collecting on any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise.

10 Lawrence P. King, et al., Collier on Bankruptcy ¶ 9019.02 (15th ed. rev. 1999), citing Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968). In deciding whether or not to approve a compromise proposed by the trustee, the bankruptcy court must do more than give mere boilerplate approval to the compromise; rather, it "must assess and balance the value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal." Anolik, 107 B.R. at 429 (citations omitted). Expressing the standard set forth by the Supreme Court in TMT

Trailer Ferry, the court in Anolik delineated the following factors for the bankruptcy judge to consider:

(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; and

(d) the paramount interest of the creditors and a proper deference to their reasonable views in the premise.

Id. The failure of the bankruptcy judge to consider these or similar factors would be grounds for finding abuse of discretion.

Id. Most circuit courts which have considered the issue have adopted a uniform standard such as that set forth in Anolik. Collier, ¶ 9019.02 at 9019-3. The First Circuit has stated that in evaluating a compromise, the bankruptcy court:

may consider, among other factors: (1) the probability of success were the claim to be litigated-given the legal and evidentiary obstacles and the expense, inconvenience and delay entailed in its litigation-measured against the more definitive, concrete and immediate benefits attending the proposed settlement...; (2) a reasonable accommodation of the creditors' views regarding the proposed settlement; and (3) the experience and competence of the fiduciary proposing settlement.

Hicks, Muse & Co. v. Brandt (In re Healthco International, Inc.), 136 F.3d 45, 50 (1st Cir. 1998) . Thus, a compromise should be approved if it is "fair and equitable" and in the best interest of

the estate. Collier , ¶ 9019.02 at 9019-4.

Compromise and settlement are favored in bankruptcy. In re C.P. del Caribe, Inc., 140 B.R. 320 (Bankr. D.P.R. 1992). However, the First Circuit has noted that “[a] court approving a compromise in reorganization proceedings does not play the same role as a court approving a compromise between individual litigants. ... Therefore, ... the supervising court must play a quasi-inquisitorial role, ensuring that all aspects of the reorganization are ‘fair and equitable.’” Id. at 325, citing In re Boston & Providence Railroad Corporation, 673 F.2d 11, 12 (1st Cir. 1982). In considering a compromise, the bankruptcy court is expected to “‘assess[] and balance the value of the claim[s]...being compromised against the value ... of the compromise proposal.’” Healthco, 136 F.3d at 50, citing Jeffrey v. Desmond, 70 F.3d at 185 (citations omitted).

Specifically, the court found that the trustee’s probability of success in the litigation “weighs strongly in favor of approval of the compromise” because Counts I and II of the complaint are based upon the assertion that Carp fraudulently transferred the property to Pupkin, but there is no evidence that Carp had an interest in the property which he could convey. See generally Order of August 17, 1998, Appellant’s Appendix at A-207. Moreover, the court found that Count III is also problematic because it merely refers to § 363, leading to the assumption that the trustee

seeks turnover of whatever interest debtor may have in the property under § 542. Thus, the court found that the trustee's motion to compromise satisfies the first factor set forth in Anolik; that is, the low probability of success in the litigation favors approval of the compromise.

The bankruptcy court further found that the refusal of Carp and Pupkin to testify on Fifth Amendment grounds means it is unlikely the trustee can obtain evidence as to the specific terms of their agreement and would result in considerable delay and expense. Moreover, without evidence as to their agreement, the bankruptcy court found it was reasonable for the trustee to propose a compromise which would equally divide the proceeds from the sale of the property between the estate and Pupkin. Thus, the court, in effect, found that the trustee's motion to compromise satisfies the second and third factors set forth in Anolik; that is, the difficulties which may be encountered in collection as well as the complexity of the litigation and the expense, inconvenience and delay which go along with it.

As to the fourth Anolik factor - the interest of the creditors and deference to their views - the bankruptcy court found that although Gannett raised some legitimate points, he "ultimately failed to rebut the Trustee's evidence as to the value of the Property and failed to articulate how negative inference from the invocation of the Fifth Amendment lead to the conclusion that Carp

is entitled to more than 50% of the proceeds from the sale of the Property.” Appellant’s Appendix at A-208. Therefore, the bankruptcy court found that it was reasonable for the trustee to accept a settlement based on an equal division of the proceeds and the turnover of \$90,000.00 to the estate. Appellant assigns various errors to the bankruptcy judge’s findings. However, none of his allegations explain how the bankruptcy judge erred in considering the matter raised or how they would have shifted the balance of the Anolik factors against approval of the compromise. Appellant argues that the bankruptcy judge failed to consider the Popa decision; however, as the trustee points out, the issue was before the bankruptcy court. In fact, although not mentioning the case by name, the bankruptcy judge noted in her opinion that “the Trustee admitted that there was serious doubt as to both the liability for and the amount of any capital gains tax” Appellant’s Appendix at A-206. Thus, she clearly considered the issue in weighing the Anolik factors. Furthermore, any doubts regarding the payment of capital gains taxes is not related to the applicability of the Popa decision;¹ rather, it is related to questions regarding the ownership of the property.

Further, appellant argues that the trustee should have taken

¹ It should be noted that the Popa rationale has not been agreed with by every court which has considered the issue. See, e.g., In re Winch, 236 B.R. 591 (Bankr. S.D. Ohio 1998); In re Barden, 205 B.R. 451 (E.D.N.Y. 1996), aff’d 105 F.3d 821 (2nd Cir. 1997); In re Mehr, 153 B.R. 430 (Bankr. D.N.J. 1993).

advantage of Carp and Pupkin's refusal to testify, which would have allowed the bankruptcy judge to draw negative inferences. The appellant also argues that the trustee should have made an issue of the "sweetheart rent" - that it could have been evidence of summary judgment, that the trustee should have claimed the difference between it and the market rate, and that it warranted a higher compromise. However, although appellant argues that the trustee should have raised these issues in a summary judgment motion in the action against Pupkin instead of compromising the claim, he does not elaborate how this constitutes error on appeal.

Further, the record shows that the bankruptcy judge did consider both the refusal of Carp and Pupkin to testify, as well as the rent issue. First of all, it was the refusal of Carp and Pupkin to testify which weighed in the Anolik factors in favor of compromise, because she found it exacerbated the complexity, expense, inconvenience and delay in the litigation. Second, she specifically noted that appellant "failed to articulate how negative influences from the invocation of the Fifth Amendment lead to the conclusion that Carp is entitled to more than 50% of the proceeds from a sale of the Property." Appellant's Appendix at A-208. Finally, the judge noted that appellant "ultimately failed to rebut the Trustee's evidence as to the value of the Property" Id.

Gannett also argued that the property should have been

appraised as a rental property. However, the court found that the trustee presented an updated appraisal in support of his motion for compromise, and no contradictory appraisal was presented by Gannett in support of his allegations. The judge noted "in support of his Motion and his position that the Property has a value of \$355,000, the Trustee obtained an updated appraisal of the Property, dated June of 1998, which appraisal was prepared by a certified appraiser ...". Appellant's Appendix at A-206.

Finally, appellant argues that Pupkin's refinancing of the property without court approval is suspect, implying that the trustee did not object to it (at least not until after it was effected) because they had an understanding that the proceeds of the refinancing would be used to fund the settlement compromise. This issue was not raised before the bankruptcy court. It is not a basis for finding reversible error, and may not be raised for the first time on appeal. Upon appeal the reviewing court is limited to the record which was before the bankruptcy court. In re: Colonial Mortgage Bankers Corporation, 1999 WL 552607 (1st Cir. August 2, 1999).

Conclusion

A review of the bankruptcy court's findings in its order approving the compromise of Pupkin's claim shows that the bankruptcy judge considered and properly weighed the factors set forth in Anolik. There has been no showing that the bankruptcy

judge abused her discretion; accordingly, the order of the bankruptcy court granting trustee's motion to compromise the claim of Pupkin is affirmed.

SO ORDERED.