UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

L.J. Hutchins Automotive Supply Co., Inc. Case No.03-17306 K

Debtor

DANIEL E. BRICK, Chapter 7 Trustee of
L.J. Hutchins Automotive Supply Co., Inc.

Plaintiff

-vs- AP No. 04-1302 K

JOHN L. HUTCHINS, both individually and
as an officer, debtor and/pr shareholder of
L.J. Hutchins, Inc., Hutch Enterprises, Inc.
and Hutchins CAW;
HUTCH ENTERPRISES, INC.;
GENERAL PARTS, INC.,
MICHAEL DOWD, ESQ.; and
ARGILUS LLC.

Defendants

OPINION AND ORDER ON MOTION FOR SUMMARY JUDGMENT

Prior to the filing of the Petition in this case, Defendant, General Parts, Inc. ("GPI") purchased substantially all of the assets of the Debtor in an arms length transaction totaling in excess of $7 million. The Debtor corporation was controlled by a single individual, John Hutchins, who also controlled a different, non-Debtor entity that was the Debtor's landlord at a number of store locations.

After the business terms were agreed upon, but before the Asset Purchase Agreement ("APA") was implemented, Hutchins demanded a renegotiation of those terms. Although GPI was tempted to walk away from the transaction, it agreed to listen to the demands. It turned out that the total consideration to be paid by GPI was not significantly different under the newly-demanded terms, but that some of the terms were to be re-characterized, and re-valued, based on Hutchins' new thinking about how he wished to allocate the proceeds of sale. The changed terms would benefit his other company and himself, and reduce the proceeds for the Debtor.

GPI agreed to the changed terms, and executed and consummated an APA based thereupon. The Debtor was left insolvent.

This Chapter 7 filing followed a short time after. (The Court was informed on the record in open court on the first day any matters in this case were heard, that although this was a voluntary Chapter 7 filing, it resulted from substantial threats of an involuntary filing by trade creditors of the Debtor.)

Two of the changed terms are alleged by the Trustee to have diverted several hundreds of thousands of dollars of assets of the Debtor corporation to Hutchins or his non-debtor entity. GPI is the Defendant in this Adversary Proceeding because the Trustee alleges that GPI acted in bad faith in agreeing to that alleged diversion, and that GPI was, consequently, the initial transferee of assets of the Debtor, for which assets GPI, in bad faith, paid non-debtor persons or entities, rather than the Debtor.

This is GPI's Summary Judgment Motion seeking to dismiss the Trustee's Complaint with regard to those two re-allocations. The sole question presented is whether the Trustee, simply by demonstrating the series of events above, may get to trial on the question of GPI's good faith or whether, on the other hand, GPI's mere acquiescence in the renegotiated terms cannot, as a matter of law, suffice as an allegation of some form of complicity in a scheme in fraud of the Debtor's creditors.

Recently, this Court held that mere knowledge of a transferor's financial difficulties does not cause a purchaser to lose its claim to "good faith" so long as the consideration paid is, in fact, fair and reasonable, and so long as there is no indication that the transferee was aware of any fraudulent scheme on the part of the transferor. See *Arnold v. Barberi In re William K. Walsh*, 05-26595 K (Bankr. W.D.N.Y. August 10, 2007). The present case picks up where the *Barberi* case left off. Did the fact that Hutchins demanded to renegotiate the business terms in such a way as to diminish the amounts to be paid to the corporation that shortly thereafter filed Chapter 7, coupled with the transferee's knowledge that the Debtor was in financial difficulty, give rise to a triable issue as to whether GPI received a fraudulent transfer, despite the fact that it seems agreed that it paid fair consideration, over all, for everything that it got?

Rather the plain language of the pertinent statutes applies.

Because of some "shifting of terrain" from the time of the initial pleadings, through stages of briefing and argument, right up to the time of submission, it is not entirely clear to the Court what theories of recovery remain asserted by Trustee.

The Court deems those theories to be these:

State Law Theory #1. Although GPI was a *bona fide* purchaser for value, and paid "fair consideration" for the total acquisition, the value paid for the assets <u>of the Debtor</u> was not "fair" because GPI knew that it was not paying fair value <u>to the Debtor</u> for certain assets that it was acquiring.

Section 548 Theory #1. Same as above, and Debtor was left insolvent by the transfer.

State Law Theory #2. The renegotiated terms demanded by the Principal placed GPI into complicity with the Principal in an actual fraud upon the Debtor's creditors, to the extent that value was re-allocated away from the Debtor.

Section 548 Theory #2. Same as # 2.

Once New York repealed Article 6 of the Uniform Commercial Code (in the year 2001) bulk sales became a question of "dog law" unless the bulk sale occurs in a Bankruptcy Court. This is to say that during the time that bulk transfer law still existed, the potential for frauds in such sales would be raised before the sale as a consequence of the notice required to be sent to creditors of the transferor, prior to the transaction, pursuant to Article 6 of the Uniform Commercial Code. And because this sale did <u>not</u> occur <u>after</u> the bankruptcy filing, it is only in litigation such as that before the Court, that the asset purchaser will learn, after-the-fact, whether what it did was wrong.

When several closely-held, affiliate companies own different parts of a single enterprise that a buyer wishes to buy at full fair value, what is the duty, if any, of the buyer to make sure that each particular transferor company will enjoy full fair value for <u>its</u> particular piece of the enterprise? Is the acquisition from each company a separate purchase that a buyer must analyze in isolation if it is to protect itself from later accusations of fraudulent transfer, or is it a single purchase, upon which the purchaser may rest comfortably so long as the total consideration for the acquisition is fair and reasonable? If the owner of the companies insists on dictating the allocation of proceeds, must the buyer walk away, at risk that continuation of the transaction would place the buyer at peril of becoming, in essence, an insurer of a "proper" allocation among the transferor companies?

Obviously, the overall price that the purchaser is willing to pay for the combined enterprise, depends on the answers to these questions.

In this particular case, one of the two re-allocations raised by the Trustee hinges on the value to be placed on "good will"/ "reputation value"/ "personal involvement" of John Hutchins, making the analysis even more subjective and difficult.[1] It seems that $250,000 was paid directly to John Hutchins, rather than the Debtor in this regard.

There obviously was no value in the Debtor's trade name here, because the acquirer immediately planned to, and did, change the name to its own nationally-recognized name.

Store location clearly had value, but title to those locations was held by Hutchins' other company, not the Debtor. The Debtor had only leasehold interests. Those leasehold interests were transferred to the buyer with the consent of Hutchins' other company and the Debtor (by John Hutchin's signature on behalf of the Debtor). And those leases were then recast in new leases executed between the purchaser and Hutchins' other company.

---

[1]For purposes of this decision, the terms quoted above are not used as the terms of art that Generally Accepted Accounting Principles might use. Though GAAP might suggest that "asset sales" belie the existence of any value for good will, the Court recognizes a more generic meaning to the term, and equates it to "reputation value." The term means (to this Court) that customers place a value on the name, the locations and the historic reliability, even though the new owners of the assets might end up disappointing customers in all regards. The "personal involvement of the former owner" is more complicated. It is obviously entwined with the other two terms, but even if the new owners disappoint customers immediately, the involvement of the former owner may offset the possible loss of business, may generate new business for the new owner, and may provide valuable advice to the new owner. Non-competition too, is an obvious issue.

The Debtor's workforce in place are knowledgeable people. They know the business well and are well acquainted with the regular customers. So part of the value that the previous owner demanded for himself was not only in the form of a non-competition agreement, but also for consulting services in assisting to maintain the existing work force. What the Trustee is upset about is that to have recognized that there is "value" in assisting in <u>maintaining</u> the Debtor's work force, is to recognize "value" in that work force; consequently, dollars should not have been reallocated from what the Debtor was to have received, to what the principal of the Debtor was to receive.

The other cause of action brought by the Trustee pertains to an entirely different matter. Under the terms of some of the leases by which the Debtor rented the retail premises from the insider landlord, leasehold improvements would not become the property of the landlord until the termination of the lease. The Trustee argues that those leases were not "terminated" by the asset purchase, and consequently the value ($375,000) of leasehold improvements in those store locations should have been recognized in the amounts to be paid to the Debtor. The purchaser responds that in its view, it is a matter of black letter law that the leases were in fact terminated within the asset purchase when, of necessity, both the Debtor/tenant and the insider/landlord agreed to new leases directly between the buyer and the landlord. Again, the total price paid by the buyer for all of the assets it acquired was over $7 million and the amounts in controversy here total less than $700,000.

The fact that less than 10% of what was paid to the Debtor at issue, probably would bring this case within the purview of *Arnold v. Barberi*, were it not for the fact that GPI knew more than the simple fact that the Debtor was in financial difficulty.

Pursuant to the APA, GPI possessed all of the books and records of the Debtor, even though it was not acquiring the Debtor itself - - just its assets. There is no evidence submitted thus far that those books and records demonstrated solvency. And further, GPI knew that the re-allocations diverted proceeds from the Debtor to John Hutchins and his other company.

These factors, in combination, entitle the Trustee to reach trial on the question of whether GPI knew that it was assisting in a fraudulent scheme.

This fact is clear as to the consulting agreement because no proposition of law is offered to the effect that the Debtor did not really "own" its workforce.

It is less clear as to the "leasehold improvements" issue, because it is offered by GPI that black letter law stripped the Debtor of ownership of leasehold improvements that contractually passed to the landlord upon consummation of the APA - - the leases, it is argued, were "terminated" by operation of law, so that the improvements vested in the landlord.

The cases cited by GPI are offered in support of the following assertion, as set forth in GPI's "Reply . . . to Trustee's Opposition to Summary Judgment Motion . . . ," at page 10:

"Hutch Enterprises having entered into new leases inconsistent with whatever rights the Debtor previously had . . . , under New York law, operated as a termination of those prior rights, which termination was implicitly consented to by the Debtor."

Reduced, then, to its simplest terms, the argument is that "there can't be a fraudulent transfer if the debtor has consented to giving up its property rights for no consideration."

Obviously that is not the law. <u>All</u> fraudulent transfers are consented-to by the debtor. In some cases, it is that very consent that makes a transfer "fraudulent."

A fair inference from the facts in evidence is that GPI had a side-deal - - a deal outside the APA - - with Hutchins' real estate company. GPI surely was not going to buy a "pig in a poke" regarding the terms of lease extensions, etc. with Hutchins. Yet that is all they would get under the APA - - assignments of the leases. And if all GPI got were assignments, those leases would not have been "terminated," and the improvements would belong to GPI (and, previously, the Debtor) until lease termination.

Drawing all fair inferences, from the undisputed facts in evidence, in favor of the Trustee, as the Court must do under Rule 56, a triable issue of material fact is presented as to whether such a side deal "finessed" a loss of value for the Debtor, in order for GPI to obtain a favorable treatment from Hutchins as landlord.

GPI's Motion is denied. This Adversary Proceeding is restored to the calendar for **November 21, 2007 at 11:30 a.m.**, for further scheduling.

Dated: Buffalo, New York
November 7, 2007

s/Michael J. Kaplan

U.S.B.J.