

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK**

In Re:

**GEORGE K. & MARGARET MAIER,
Debtors.**

**CASE NO. 93-21670
DECISION & ORDER**

BACKGROUND

On July 21, 1993 George K. Maier and Margaret Maier (the "Debtors") filed a petition initiating a Chapter 13 case. The only property listed by the Debtors on their schedules were a house, lot and 97-acre farm (the "Farm") in Fairport, New York valued at \$750,000.00; miscellaneous personal property and clothing valued at \$2,100.00; rent, taxes and personal property due from Gary Craft ("Craft") valued at \$153,900.00; and two motor vehicles valued at \$2,000.00 each. The only creditors listed by the Debtors on their schedules were: (1) two secured creditors with total secured claims of \$103,000.00; (2) real estate taxes due to the Monroe County Treasurer in the amount of \$15,000.00; and (3) unsecured claims due to nine creditors with aggregate claims of \$103,451.64, including one dollar alleged to be due to Craft and \$58,000.00 due to the Debtor's attorney for legal services. In Schedule G, the Debtors listed Craft as being a purchaser of the Farm under a lease with an option to purchase (the "Craft Purchase Contract")¹. The statements filed by the Debtors indicated that they had filed a prior Chapter 13 case (#91-20391) on February 14, 1991. A July 15, 1993 sale plan filed by the Debtors with their petition (the "Plan") proposed to sell the Debtors' Farm to developers within two years and from the proceeds to pay secured creditors and real estate taxes in full and then dividends to unsecured creditors, without a stated amount to be paid to unsecured creditors. The Plan also proposed to reject the Craft Purchase Contract.

On September 16, 1993, Craft filed a proof of claim (the "Craft Proof of Claim"). Attached

¹ The purchase price in the Craft Purchase Contract is \$400,000.00.

as exhibits to the Craft Proof of Claim were copies of an April 14, 1993 Decision and a May 11, 1993 Judgment by New York Supreme Court Justice Raymond E. Cornelius. In the decision of Justice Cornelius, he found Craft's exercise of his option to purchase the Debtors' Farm on February 16, 1990 to be validly exercised during the term of the underlying lease, as provided for in the agreements among the parties, and directed that the Debtors specifically perform the terms of the agreement relating to the sale of the property. The Judgment, based on the Decision, (the "Specific Performance Judgment") ordered that the Debtors specifically perform the terms of the agreement between them and Craft, dated February 17, 1984, relating to the sale of their property situated at 1591 Webster-Fairport Road, Penfield, New York and granted costs and disbursements as taxed by the Clerk against the Debtors.

An initial Section 341 meeting of creditors was held on September 20, 1993 and adjourned to October 18, 1993. An attorney for Craft appeared at the initial Section 341 hearing, and on September 24, 1993, the attorney filed written objections on behalf of Craft to the Plan (the "Craft Objections"). The Objections indicated that in the Debtors' prior 1991 Chapter 13 case, now retired Bankruptcy Judge Edward D. Hayes had ordered that if the state court determined that Craft had properly exercised his option to purchase prior to the filing of the Debtors' petition that even if the Craft Purchase Contract was rejected, Craft, pursuant to Section 365(i), could choose to remain in possession and pay the purchase price and the Trustee would be obligated to deliver title to the property. The Objections also alleged that this ruling was appealed to the District Court and to the United States Court of Appeals for the Second Circuit, but that the appeal in the Second Circuit was dismissed for failure to prosecute.² The Objections further alleged that an Order of Specific

² The opinion of the District Court specifically dealt only with the Bankruptcy Court's granting of the motion by Craft, joined by the Chapter 13 Trustee, to have the stay lifted to allow the state court to determine if Craft had properly exercised his option to purchase. The opinion did not discuss the proposed rejection of the Craft Purchase Contract and the Bankruptcy Court's Section

Performance had been entered in New York State Supreme Court in favor of Craft after the dismissal of the Debtors' 1991 case and before the filing of the current Chapter 13 case, and that the only purpose for the filing of the current Chapter 13 case by the Debtors was to avoid obeying the prior Order of the Bankruptcy Court and the existing Specific Performance Judgment of the New York State Supreme Court.

A confirmation hearing was held on September 20, 1993 at which time, in view of the Craft Objections, the Court adjourned the confirmation hearing to an evidentiary hearing calendar where a hearing was scheduled for November 4, 1993 to consider confirmation of the Debtors' Plan and whether the Debtors should be authorized to reject the Craft Purchase Contract. At the same time, at the request of the attorney for the Debtors, a pretrial was scheduled for November 3, 1993.³

On November 3, 1993, the Debtors filed a written application to reject the Craft Purchase Contract, which advised that the Debtors had appealed the Specific Performance Judgment to the Appellate Division of the State Supreme Court.

On the November 4, 1993 hearing date, after brief oral arguments, the Court reserved on the issues of the rejection of the Craft Purchase Contract, confirmation of the Plan and the oral request at the hearing by the attorney for Craft for sanctions against the Debtors. The Debtors were afforded twenty days to make any additional submissions; however, no additional submissions were made by or on behalf of the Debtors.

On November 8, 1993, the Chapter 13 Trustee (the "Trustee") filed a Motion to Convert the Debtors' case to a Chapter 7 case. The Motion was made returnable on December 13, 1993. In his

365(i) ruling.

³ The attorney for the Debtors indicated that one of the Debtors' principal concerns was the collection of the unpaid rent and taxes, which they claimed was due from Craft since his 1990 exercise of the option to purchase. The attorney indicated that the Debtors believed the amount due was in excess of \$150,000 and that if this claim could be resolved, the entire matter might settle.

Motion to Convert, the Trustee alleged that: (1) the Debtors do not have regular income sufficient to fund a plan; (2) the Debtor's plan is not feasible in its present form and there are insufficient assets to pay continuing accrued real estate taxes and other charges on the property pending completion of the proposed sale plan; (3) a mortgage on the property to be sold is all due and payable in December, 1993 and no provision has been made to extend or otherwise modify the terms of the mortgage to prevent postpetition foreclosure; (4) the property of the estate, which includes either an interest in real estate or an interest in a purchase contract, will be jeopardized by the continued delay in the confirmation of the Debtors' plan; (5) upon information and belief, there is sufficient equity in the assets of the estate to fully pay all of the unsecured creditors; (6) the Debtors filed a previous Chapter 13 sale plan and failed to make interim payments under said plan pending sale, resulting in that plan being dismissed for cause in 1992; and (7) it is unreasonable to expect payments to creditors to be delayed pending the completion of state court proceedings (an appeal of the Specific Performance Judgment) unless there is a strong likelihood of success in a short period of time in said proceeding. The Motion further alleged that because of the presence of substantial assets, the proceeding should be converted to one under Chapter 7 of the Bankruptcy Code.

On the December 13, 1993 return date of the Motion to Convert, the attorney for the Debtors appeared and requested that if the Court determined not to allow the rejection of the Craft Purchase Contract and confirm the Debtors' Plan, that the case be dismissed rather than converted. The Court reserved on the Trustee's Motion to Convert and indicated that it would decide the Motion in connection with the pending motion for the rejection of the Craft Purchase Contract, the request for confirmation of the Plan and the request by Craft for sanctions.

DISCUSSION

11 U.S.C. Section 1322(b)(7) allows the debtor's plan to provide for rejection of an executory contract. *In re Meehan*, 46 B.R. 96, 98 (Bankr. E.D.N.Y. 1985), *aff'd*, 59 B.R. 380 (E.D.N.Y. 1986).

The Court will confirm the debtor's plan if the plan "complies with the provisions of this chapter and with other applicable provisions of this title." 11 U.S.C. Section 1325(a)(1). Therefore, Section 365 of the Code sets the standards for and determines the legal consequences of the assumption and rejection of executory contracts under the terms of a Chapter 13 plan. *Id.*

Section 365(d)(2) provides that: "[i]n a case under Chapter 9, 11, 12 or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of residential real property or personal property of the debtor at any time before the confirmation of a plan ..." Section 365(a) provides that: "[e]xcept as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."

The standard adopted by the Second Circuit Court of Appeals to determine whether to allow the rejection of an executory contract is known as the "business judgment" test which focuses on whether the rejection would result in greater benefit for the debtor's creditors. *In re Minges*, 602 F.2d 38, 43 (2d Cir. 1979). In adopting the test, the Court reasoned that the Court had to exercise its discretion "fairly in the interest of all who have had the misfortune of dealing with the debtor," and a rigid test which would permit rejection only where an executory contract would cause a net loss to the estate if performed "might work a substantial injustice in cases where it can be shown that the non-debtor contracting party will reap substantial benefits under the contract while the debtor's creditors are forced to make substantial compromises of their claims." *Id.* "The primary issue when applying the 'business judgment test' is whether rejection would benefit the general unsecured creditors, with resolution of this issue possibly involving a balancing of interests." *Meehan*, 46 B.R. at 101. The Court may refuse to authorize rejection where rejection might damage the other party to the contract disproportionately to any benefit to be derived by the general creditors of the estate. *In re Sundial Asphalt Co., Inc.*, 147 B.R. 72, 82 (E.D.N.Y. 1992).

A fundamental issue is whether the Craft Purchase Contract is an executory contract within the meaning of Section 365. Many courts have held that a contract for the purchase and sale of land is no longer executory once a state court with proper jurisdiction has granted a final judgment of specific performance. *Sundial Asphalt Co.*, 147 B.R. at 80. In this case, the New York State Supreme Court has ordered specific performance; however, it appears that the case is on appeal to the Appellate Division, Fourth Department. The Court does not know whether a stay pending appeal has been granted. Therefore, for purposes of this Decision and Order, the Court will consider the Craft Purchase Contract to be an executory contract.

In this case, it is clear that rejection of the Craft Purchase Contract will not benefit the estate and the unsecured creditors so as to warrant the Court exercising its discretion and approving the requested rejection. An assumption and completion of the Contract will result in the immediate receipt of purchase proceeds for the Farm that will pay all of the secured, priority and unsecured creditors in full, together with interest, and leave the Debtors with a significant amount of money and the right to commence a separate action in state court against Craft on their claim for unpaid rent and taxes. An assumption and completion of the Contract will also allow Craft to have the benefit of his bargain which he negotiated with the Debtors in good faith and at arms length. On the other hand, a rejection of the Contract would only, at best, delay the purchase and sale of the Farm and the full payment with interest to the creditors which would be prejudicial to them. Furthermore, such a rejection would cause Craft to lose the benefit of his bargain with the Debtors. At worst, after a rejection of the Contract, the Farm might not be resold at some future time for enough to pay the creditors in full. An otherwise valid arms length purchase and sale contract for the principal asset of a non-business debtor, which if assumed will pay all of the creditors in full together with interest and result in significant proceeds for the Debtors, is not burdensome to the estate. Furthermore, the rejection of such a contract is not in the best interests of the estate and will damage the other party

to the contract more than it will benefit the estate.

Since the Court, in its discretion, has determined that it will not approve a rejection of the Craft Purchase Contract, it need not determine whether, as Judge Hayes did, Craft is a purchaser in possession for purposes of Section 365(i) or whether the decision of Judge Hayes on that issue is *res judicata*.

Since the Court has determined that it will not approve a rejection of the Craft Purchase Contract by motion or as requested by the Debtors in their Plan because: (1) the Contract is not burdensome to the estate; (2) a rejection of the Contract will not benefit the creditors more than an assumption and completion of the Contract, since a rejection of the Contract and confirmation of the Plan will delay full payment to the creditors; and (3) a rejection of the Contract will damage Craft disproportionately to any benefit to the creditors and the estate, the Court denies the confirmation of the Debtors' Plan as not being feasible or in the best interests of creditors.

On all of the facts and circumstances of this case and for cause under Section 1307(c), including unreasonable delay by the Debtors that is prejudicial to creditors, since by an assumption and completion of the Craft Purchase Contract creditors could be paid in full immediately, and because the Court believes that conversion of the case and the appointment of a trustee to administer the estate rather than a dismissal is in the best interests of creditors, the Debtors' case is converted to a case under Chapter 7.

The history of the relationship between the Debtors and Craft appears to be both long and difficult. A footnote to the April 14, 1993 Decision of Justice Cornelius indicates that in April, 1987 in connection with a trial regarding disputes over the Craft tenancy, the Court adjudicated Margaret Maier in contempt for failure to adhere an order of that Court. Imposing sanctions under Rule 9011 or Section 105 of the Bankruptcy Code is a matter left to the sound discretion of the Bankruptcy Court. Having observed the Maiers in the courtroom, their relationship with their attorney, who they

