UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

KAYAK MANUFACTURING CORP. Case: 90-12981 M

Debtor

MARK S. WALLACH, Trustee

Plaintiff

-vs- AP 92-1102 K

MAJESTIC POOLS & EQUIPMENT CO., INC.
BEAUTY POOLS, INC.
GERALD B. COHEN, Individually and
d/b/a PARAMOUNT ENTERPRISES,
CORTZ, INCORPORATED and
ROBERT DOUGLAS KROTZER, a/k/a
R. DOUGLAS KROTZER

Defendants

BEAUTY POOLS, INC. and
MAJESTIC POOLS & EQUIPMENT CO., INC.

Third-Party Plaintiffs

-vs-

AMERICAN TELEPHONE & TELEGRAPH,
RICHARD GERSPACH, d/b/a ISLAND POOLS,
MONTE QUICK, d/b/a KAYAK POOLS OF
INDIANA, JORNIC ENTERPRISES, INC.,
d/b/a JORY POOLS, and UNITED SERVICES
CORPORATION a/k/a JOHNNY'S POOLS &
SPAS,

Third-Party Defendants

DECISION AND ORDER

INTRODUCTION

If a Debtor-in-Possession is a retailer of goods and obtains an order permitting it to sell (at wholesale or in bulk)

goods it "no longer needs in the operation of its business," and if that Debtor-in-Possession offers at wholesale or in bulk some of the same type of goods it sells at retail, can the wholesale or bulk buyer who is aware of the order and its limitation ever be a "good faith" buyer? Stated another way, is the buyer ever entitled to rely on the representation of the Debtor-in-Possession that goods are "no longer needed," or is that buyer obliged to turn down the offer of sale until the Debtor obtains a further order from the Court?

When people buy things from someone they know to be acting as a fiduciary, the fiduciary might be engaged in impermissible self-dealing;[1] the fiduciary might be acting for the benefit of its trust, but using poor business judgment; the fiduciary might, as in the case at bar, be empowered to make only certain types of sales for the benefit of its trust. Other scenarios are possible. The question at bar is whether there was a burden upon the defendants in this Adversary Proceeding to require proof from the Debtor-in-Possession (a fiduciary) that it was not acting beyond its stated authority, either mistakenly or otherwise. Stated yet another way (and at an extreme), is there a duty upon the buyer to avoid taking advantage of (or assisting the fiduciary in abusing) a broadly-worded authorization issued to the fiduciary?

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[1] *In re Albion Disposal*, 152 B.R. 794 (Bankr. W.D.N.Y. 1992).

The Trustee in this Chapter 7 case commenced this Adversary Proceeding seeking to recover, under 11 U.S.C. § 549, post-petition transfers made by the Debtor-in-Possession and to recover damages for unauthorized use of the Debtor's property in violation of the automatic stay. (A Debtor-in-Possession acts as a Trustee for the benefit of its creditors.[2]) Defendants/ transferees Beauty Pools, Inc. and Majestic Pools and Equipment, Inc. ("Beauty" and "Majestic") have moved for an order granting partial summary judgment dismissing the First Cause of Action and part of the Fifth Cause of Action. R. Douglas Krotzer ("Krotzer"), defendant and former principal of the Debtor joins in the motion.

The defendants' motion is granted. The Order of the Court authorizing certain sales did not impose any further duty of inquiry upon Beauty and Majestic beyond that which they fulfilled.

FACTS

The Debtor was a nationally known maker, seller, and installer of swimming pools and related supplies and equipment for homes, sold directly to homeowners. It filed a Petition under Chapter 11 of the Bankruptcy Code on October 5, 1990. On December 10, 1990, the Debtor moved for an order permitting it to sell

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[2] *Id.*

equipment, inventory and furnishings "no longer needed" for the operation of the business. No one item valued at more than $5,000 was to be sold without the Court's further approval. In addition, no sales were to be made to insiders of the Debtor. All inventory appeared at the time to be overencumbered and lienors consented to the provisions of a negotiated order. On December 12, 1990, U.S. Bankruptcy Judge Beryl E. McGuire signed an Order as described later in this decision.

On March 22, 1991, Majestic purchased all of the "inground" inventory of the Debtor (pools that are set in, rather than on, the ground) for a total of $40,000. On April 1, 1991, Majestic and Beauty jointly acquired the "above-ground" inventory as well as office equipment and furnishings of the Debtor for $154,000. In neither sale was any individual item bought for more than $5,000, nor is it alleged that any single item had a value in excess of $5,000.

The case was converted to Chapter 7 on June 17, 1991, and Mark Wallach, Esq. was appointed Trustee. He filed this Complaint seeking (among other causes of action) to recover, as unauthorized post-petition transfers under 11 U.S.C. § 549, the goods sold by the Debtor to Majestic and Beauty (or the value thereof). Defendants Majestic, Beauty and Krotzer moved for partial summary judgment dismissing the First Cause of Action as well as that portion of the Fifth Cause of Action that seeks an accounting from

Majestic and Beauty for profits earned from those items acquired from the Debtor.

ANALYSIS

The Defendants' Rule 56 motion is supported by affidavits or deposition testimony of officers, employees, or legal counsel of Majestic and Beauty attesting to their concern about the limits of the order, their consultation with Beauty's attorneys, the attorney's consultation with the attorney for the Debtor-in-Possession, and their vigorous assertion that they at all times acted in good faith reliance upon their understanding of the Order of the Court. The Trustee presents not a single fact in response. His First Cause of Action, thus, rises or falls solely on a glib retort contained in his responding papers - "if a company is in the business of selling and installing swimming pools and selling related pool accessories and supplies, it cannot sell off its inventory of these items and remain in business." The Trustee's argument thus seems to raise either an issue of the credibility of the Defendants' affiants, or to raise a novel issue of law. Arguably, it places the burden upon the Defendants to prove that their purchases fell within the terms of the order, rather than the Trustee undertaking the burden of proving that the Defendants fell outside the terms of the order. This shifting of burden of proof, however, is not inappropriate in light of the fact that this is an

action under 11 U.S.C. § 549, and Bankruptcy Rule 6001 clearly does accomplish that burden-shifting.

It is best, then, to first ask whether the Defendants' summary judgment motion sets out a prima facie case that they acquired the goods by means of a Court-approved post-petition transfer. The Court finds that they have set forth that prima facie case. They have established in the means prescribed by Rule 56(e) (by deposition testimony and by Affidavit) that they were aware that they were dealing with a Debtor-in-Possession, that they sought proof of authority for the Debtor-in-Possession to sell goods outside the ordinary course of business, that they examined the order, that they sought the advice of counsel regarding the order, that their counsel consulted with counsel for the Debtor-in-Possession who reassured them, and that throughout the transactions they sought to act in full accord with the Court's order.

Even with the burden of proof altered as required by Bankruptcy Rule 6001, the Trustee may not ignore the requirements of Rule 56(e) in responding to a summary judgment motion which makes such a prima facie showing.

He has not offered a single fact. One could readily imagine the Trustee's cross-examination of those persons who acted on behalf of Beauty and Majestic and who have attested that they acted in good faith upon the Court's order. The Trustee's "glib retort" is readily recognizable, thus, as a credibility argument. But although the Trustee has not complained of an inability to

depose those or other persons and to explore that argument, he has not offered any transcript of deposition testimony by which those affiants might have given inconsistent answers or evasive answers. He has presented no documents at all, let alone documents that might suggest that the Defendants' affiants and deponents had a hidden agenda or are not forthright or that other officers or agents of the Defendants had knowledge or intentions different from the affiants' and deponents'.

It may be that these Defendants took advantage of a vague authorization in order to make a "bargain basement" buy of the Debtor's assets at its Creditors' expense. It may be that a Plaintiff like the Chapter 7 Trustee at bar is under severe limitations in obtaining the facts necessary to launch a well-founded attack upon such persons.[3] But it is not sufficient, in response to this properly-supported summary judgment motion, to present no facts and to simply suggest that the Court should find the defense incredible.

This matter was well-addressed by Judge William W. Schwarzer in his definitive article on "Summary Judgment Under the Federal Rules: Defining Genuine Issues of Material Fact," at 99 F.R.D. 465, 485. There Judge Schwarzer focused on the fact that since amended in 1963, Rule 56(e) of the Federal Rules of Civil Procedure has required that a party responding to a summary

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[3]See *In re Tremont*, 143 B.R. 989 (Bankr. W.D.N.Y. 1992).

judgment motion present opposing evidence consisting of "specific facts" showing that there is a genuine issue for trial. Prior to 1963, he noted, "there was disagreement among courts whether an opposition raising merely a credibility issue was sufficient to preclude summary judgment. The present text of the rule, requiring the opponent to present specific facts [and even giving her the right to conduct discovery of experts] seems to settle that matter." *Id.*

Such result appears to be not only good law, but good bankruptcy policy as well. For if we consider the Trustee's argument to be one which raises an issue of law, rather than an issue of credibility, we reach the same result.

Under 11 U.S.C. § 363(a) a Debtor-in-Possession may conduct sales in the ordinary course of business without approval of the Court. Under Section 363(b), however, Court approval is required of transactions outside the ordinary course of business. The Debtor wished to sell goods outside the ordinary course of business, but it is clear from the application filed with the Court, and the order entered thereon, that the principal concern wasn't that of obtaining authority to sell goods outside the ordinary course of business, but with meeting the requirements of Section 363(f) by which encumbered goods may not be sold free and clear of liens except under certain circumstances. It is readily apparent that the Court thought that it was dealing with an order concerning the liquidation of overencumbered collateral. The order

read, in part,

> ... that the Debtor is authorized to sell items of tangible personal property consisting of its office equipment, machinery, furnishings (Equipment), inventory (except the goods sold to debtor by Alumax) and excess or scrap materials (Inventory) no longer needed in the operation of debtor's business, provided each item sold shall not exceed $5,000 in value and provided that no sale may be made directly or indirectly to debtor's insiders, affiliates, or sister companies ...[4]

The order contained numerous other provisions regarding the segregation of proceeds for the benefit of the various creditors holding liens upon the goods in question. There was clear emphasis upon Section 363(f) in the application and order, manifested in provisions of the order that gave secured creditors rights to monitor such sales and prevent sales that were not thought to be in the secured creditors' best interest.

The portion of the order at issue here contained two discrete elements, one of which was unequivocally within the knowledge of any prospective buyer and one of which was not necessarily within the prospective buyer's knowledge. The buyer would know whether any item of property was of a value greater than $5,000 (though the buyer would certainly tend to diminish its value so as to obtain a bargain). But the buyer would not necessarily know what property is or is not "no longer needed" in whatever the state of the operation of the Debtor's business is at any given

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[4]Order of Hon. Beryl E. McGuire, U.S.B.J., December 12, 1990.

moment in time. What was the buyer to do? Was it to require an affidavit, and if so, then whose affidavit? Was it to require a copy of a "business plan" demonstrating that such items were no longer necessary? Was it to require a Court-approved business plan?

The Debtor unequivocally sought to avoid having to seek Court approval of each and every outside-the-ordinary-course-of-business sale, and the Court unequivocally placed trust in the Debtor. Other elements of the present complaint address the question of whether that trust was well-placed.[5]

Focusing upon the principles that govern those who deal with a fiduciary, it is found that a purchaser from a Trustee (and Beauty and Majestic knew that the entity with which they were dealing was a fiduciary with Trustee's responsibilities) must investigate to see that all conditions precedent to the Trustee's power to sell are complied with: even if there is a breach of trust, a bona fide purchaser may nonetheless obtain good title so long as the purchase was for value in good faith without actual or implied knowledge of the breach. See generally 76 Am.Jur.2d Trusts, §§ 295, 311-314, 555 (1992). Here, the Debtor's authority was spelled out in an order which contained limitations, and the

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[5]This decision addresses the actions of Beauty and Majestic only. This Court today makes no findings as to any other defendant in this case. The Krotzer motion is denied to the extent that it seeks a determination in favor of Krotzer. Krotzer has thusfar made no prima facie showing under Bankruptcy Rule 6001.

fact that agents of Beauty and Majestic examined the order entitled Beauty and Majestic to rely on the limitations expressed in the order; they were under no duty to make further inquiry as to the scope of the Debtor's authority,[6] except possibly as to interpretation of the order. Thus we turn to its interpretation.

The Trustee asserts that the Debtor's sales were bulk sales and thus violated the "spirit" of the Court's order, since that authority was used to effect a "liquidation" rather than to continue business. The Trustee confuses the actions of the Debtor-in-Possession with the rights of bona fide purchasers. As indicated above, the question of whether the trust invested in the D-I-P was well-placed will be decided later. Other than by innuendo, the Trustee does not allege that Beauty or Majestic colluded with the D-I-P to defeat the Chapter 11 process or evade the terms of the Court's order. He fails to offer any factual support for any such notion. Consequently, the question of what the D-I-P caused, affected, accomplished, or intended is of no relevance to the present motion; what is of moment is what Beauty or Majestic knew or should have known.

It appears to be admitted that it was the Debtor's "remaining" inventory that was purchased. "Remaining" where? "Remaining" from what? In the absence of complicity or confederacy shall the Trustee be permitted to charge buyers with a duty to

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[6] 3 Am.Jur.2d Agency § 86.

translate the phrase "no longer needed in the operation of Debtor's business" as if it read "no longer needed to reorganize as a retailer of such goods"?

The question must be answered in the negative, despite the potential for mischief. The Chapter 11 process could not otherwise function. There are many reasons why certain items might "no longer [be] needed in the operation of Debtor's business." Discontinuation of product line; defective or inferior quality; surplus at a given location; seasonal clearance; or even, transition to an orderly liquidation.[7] If a buyer must read all § 363(b) orders restrictively, this Court will have little time for anything else but custom-drafting orders to provide comfort to each § 363(b) buyer.

Were fraud, collusion or other wrongdoing on the part of the buyers to be alleged, the result might be different, but here they were entitled to read the order expansively, rather than restrictively, and the burden was upon the creditors, the U.S. Trustee and the creditor's committee, if any, to oversee the Debtor's performance of its trust and to obtain a more restrictive Order, if required.

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[7]The Order in question was a multipage document that focused, as noted above, on the rights of encumbrancers. In such context a good-faith buyer could well have read the phrase as signifying the Court's understanding that the Debtor "no longer needed" the goods because it was "no longer" in operation.

The First Cause of Action is dismissed. The Fifth Cause of Action is dismissed to the extent that it seeks an accounting as to the items addressed in the First Cause of Action.

SO ORDERED.

Dated: Buffalo, New York
September 28, 1993

U.S.B.J.