IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

IN RE	)	
	)	
WBW, LLC, a Limited Liability Company,	)	**Case No. 03-02387-TLM**
	)	
	)	
Debtor.	)	**MEMORANDUM OF DECISION**
	)	
	)	

INTRODUCTION AND BACKGROUND

WBW, LLC ("Debtor"), a Washington limited liability company, filed a voluntary chapter 11 petition for relief on June 27, 2003. *See* Doc. No. 1. Debtor identified itself as a "real estate trading, holding, operating company." *Id.* at Ex. A. It alleged that it held $2,200,000 in assets and had $937,000 in liabilities. *Id.*

The petition listed Debtor's address in Bellvue, Washington, but Debtor filed its case in the District of Idaho apparently because its primary assets were located in Idaho. *See* 28 USC § 1408 (venue options include the district in which the principal assets of the debtor are located).[1]

[1] The petition's face page indicates the physical assets are located in Power and Bingham counties. Doc. No. 1. The case should therefore have been assigned to the eastern division of this Court. However, the case was designated as a southern Idaho division filing and assigned to the undersigned judge. Though incorrect, it will remain so.

This limited liability company was formed in 1997. Its sole and managing member is Melvin G. Heide. *See* Doc. No. 1 at Ex. A and at statement of financial affairs ("SOFA"), response to question 21; *see also* Doc. No. 118 at 2.

The record, including pleadings and financial reports, reflects that there has been minimal business activity in the chapter 11 since its inception.[2] Debtor has instead been involved in complex adversary proceeding litigation with the Internal Revenue Service ("IRS"). That litigation has not yet been concluded.

On April 28, 2005, Debtor filed a disclosure statement and proposed chapter 11 plan of reorganization. *See* Doc. Nos. 118, 119. In the disclosure statement, Debtor stated:

> Recently, Virgil Jahnke, acting ostensibly for WBW, entered into a transaction in Gallatin County, Montana, whereby an option was exercised that WBW had on a parcel of realty near Bozeman. That option was then sold to Sunrise Development (who has no affiliation with Jahnke, WBW or Heide) for $10,000. Mr. Heide had authorized Mr. Jahnke to see if the option could be sold, but did not authorize the sale of the property and did not authorize the transfer to Sunrise. The power of attorney used by Virgil Jahnke to consummate the transaction was apparently signed in 1996, prior to the formation of WBW, and the validity of the signature is in question. It has been also learned that the optionor on that property had agreed to pay $50,000 to WBW to <u>not</u> exercise the option, about which Mr. Heide also knew nothing. Since

[2] Financial activity reports include Doc. Nos. 17, 30, 32-35, 49-50, 59-65, 80-81, 87-88, 95-96, 105, 109-111, 114-17, 130, 146-47. The reports are on a form for "non-operating corporation or partnership." No employees are shown, no wages were paid, and no payroll account exists. Some income was received by Debtor from a farm lease on certain of its real property assets, and some mortgage payments to secured creditors are shown. As a whole, the reports show passive business activity and an overall net loss. Debtor asserts, for example, that post-petition property tax obligations cannot be serviced due to lack of cash flow.

> that time, Sunrise has agreed to match that proposal, and pay $50,000 to WBW upon approval of the Court.

Doc. No. 118 at 5.[3]

Also on April 28, 2005, Debtor filed a motion to approve a compromise of a controversy. *See* Doc. No. 120. It requested that the Court sanction a settlement under which Sunrise would pay $50,000.00 to the estate and, in return, Debtor would "execute a valid deed" to the Gallatin County property. *Id.* at 2-3.

Objections to that motion were filed by the United States Trustee ("UST") and by the IRS. *See* Doc. Nos. 124, 125. An objection was also filed jointly by Ken LeClair ("LeClair") and Delaney & Company, Inc. ("Delaney"). *See* Doc. No. 127.

A May 23, 2005, a hearing on the motion and the objections was continued. Before the second hearing commenced, Debtor and Sunrise Development, LLC ("Sunrise") filed a "Joint Amended Motion for Approval of Compromise" superseding Debtor's prior motion. *See* Doc. No. 135 (the "Joint Motion").

The Joint Motion and the original objections came on for evidentiary hearing on July 6 and 7, 2005. They were taken under advisement at the close of hearing. This Decision constitutes the Court's findings and conclusions pursuant

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[3] This disclosure statement characterizes Jahnke as Heide's friend who managed certain of Debtor's properties, Doc. No. 118 at 3, and the disclosure statement contends that the bankruptcy filing was caused by the IRS' assertion of a lien against Debtor's real property for Jahnke's tax liability under a "nominee or alter ego" theory. *Id.* at 4.

to applicable rule. *See* Fed. R. Bankr. P. 7052, 9014. The Court determines that the objections shall be sustained, and the Joint Motion will be denied.

ADDITIONAL FACTS

The evidence presented to the Court establishes the following facts in addition to those above.[4] Though the facts are complicated, an understanding of what occurred is necessary before addressing the merits of the Joint Motion.

As part of a May 2003 acquisition of real property in Gallatin County, Montana from Debtor, LeClair and Delaney granted back to Debtor an "Exclusive Option to Purchase" (the "Option"). *See* Ex. 1. Under the Option, Debtor had the right to purchase the Montana property for $435,000.00 plus certain additional expenses and interest. The Option ran through December 31, 2004. Debtor could exercise the Option by (a) providing written notice to LeClair and Delaney at least thirty days prior to December 31, 2004, that the Option would be exercised, and (b) closing the purchase of the property on or before December 31, 2004. The Option stated: "In the event Grantee [Debtor] fails to exercise this option, the Exclusive Option to Purchase shall expire at 5:00 P.M. on December 31, 2004 and

[4] The Court's findings are based primarily upon the testimony presented during the July hearing. The Court's consideration of credibility of witnesses and the weight to be accorded their testimony are incorporated in its findings. Additionally, several of the parties submitted affidavits in anticipation of the hearing. The Court cautioned counsel that such affidavits could be considered in the context of a contested matter only if they asserted facts to which no dispute was raised. *Cf* Fed. R. Bankr. P. 9014(d) (requiring disputed factual issues to be established through presentation of evidence as in adversary proceedings). The Court has therefore considered the affidavits only to the extent they provide background and are not otherwise subject to factual dispute.

shall be of no further force nor effect." *Id.* The Option was exclusive to Debtor and could not be assigned without the written consent of LeClair and Delaney. *Id.*

When Debtor filed its chapter 11 petition on June 27, 2003, it did not disclose any real property interest in the Gallatin County, Montana property. *See* Doc. No. 1 at schedule A.[5] Debtor also failed to disclose its contractual interest under the Option in its personal property schedules. *Id.* at schedule B, schedule G.

In response to a question on Debtor's statement of affairs requiring disclosure of "property, other than property transferred in the ordinary course of business or financial affairs of the debtor" within one year preceding the commencement of the case, Debtor stated as follows:

NAME AND ADDRESS OF TRANSFEREE, RELATIONSHIP TO DEBTOR	DATE	DESCRIBE PROPERTY TRANSFERRED AND VALUE RECEIVED
Friend of former partner in property none	May 2003	Tract A of COS at 1872 Bozeman, MT 59718. Valued at $435,000. Received $58,000 plus River property for exchange.

Id. at SOFA, response to question 10; *see also* Ex. 14. The information provided is obviously not fully responsive to the question (*e.g.*, the "name and address" of the transferee is required, as well as the transferee's relationship). The evidence indicates it is further inadequate because it failed to disclose that Debtor also

[5] The schedules and statements filed by Debtor under penalty of perjury in this bankruptcy case are considered by the Court pursuant to Fed. R. Evid. 801(d).

received the Option in the transaction, something Heide admitted occurred.[6]

As noted, Debtor is a limited liability company, and its sole and managing member is Heide. Debtor has no disclosed employees or contractors. Its financial reports indicate no employees, contractors or agents, and no business activities other than the receipt of farm tenant income and payment of some secured debt and administrative expense.

Heide is 76 years old. He testified that only 40% of his hearing remains and that he has difficulty understanding things due to this hearing impairment and also because of what he described as dyslexia. His testimony reflected a lack of awareness of many of the details of the business and Debtor's bankruptcy case activities.

Heide had and has a personal friendship and business relationship with Jahnke. Jahnke has in some fashion worked with or for Debtor and/or Heide over an extended period.[7] Heide resides near Seattle, Washington. Heide testified that Jahnke "works for" Debtor and "takes care of matters" for Debtor outside the State

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[6] Testimony at hearing indicated the description of the terms of the transaction is incomplete in other ways as well. This is not the only answer to a question on the statement that can be criticized as nonresponsive or inadequate. *See, e.g.*, Doc. No. 1 at SOFA, responses to questions 1, 18, 23. It is, however, the more important one for purposes of the present dispute.

[7] Jahnke's involvement and relationship with Heide and Debtor form the basis of certain IRS contentions in the two pending adversary proceedings. However, the precise nature and history of that relationship is not critical to today's Decision; Jahnke's authority to act on behalf of Debtor post-petition in connection with the Option is important, and is addressed further below.

of Washington. None of Debtor's filings in this case reflect Jahnke is an employee or agent, or that Jahnke has any ownership or other interest in Debtor.[8] None of the monthly financial reports or other post-petition pleadings filed by Debtor in this chapter 11 proceeding disclose any such relationship or involvement by Jahnke.

Debtor's description of the transaction in Montana, as included in its April 28 disclosure statement, was set out earlier in this Decision. Heide's testimony at hearing elaborated.[9]

According to Heide, Jahnke called in November, 2004, and advised that he had, or could find, someone to pay at least $10,000.00 for the Option on the Montana property. Heide testified that in this conversation[10] he authorized Jahnke to pursue a sale of the Option if Jahnke could get at least $10,000.00 for Debtor.[11] He stated that he did not give Jahnke authority to actually sell or exercise the

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[8] Debtor's schedules do show Jahnke as a "co-debtor" on a claim asserted by the IRS. *See* Doc. No. 1 at schedule H. Debtor is here referring to the IRS secured lien claim against Debtor's real estate based on Jahnke's taxes. *Id.*; *see also supra* note 3.

[9] Jahnke did not testify.

[10] Heide could recall only this one phone conversation with Jahnke. He could not recall any details of further phone conversations with Jahnke, though he believed they occurred. Nor could he recall ever seeing the documents involved with the Option's exercise.

[11] While this was discussed in terms of Jahnke locating someone willing to pay $10,000.00 if Debtor would "sell" the Option, Heide was on notice that the Option could neither be sold nor assigned to a third party. Further, Heide exercised no independent judgment on whether the $10,000.00 was an appropriate return for the Option, and relied solely on Jahnke's input.

Option or close any transaction, and that Jahnke was at no time authorized to execute documents on behalf of Debtor.

After Heide's telephone conversation with Jahnke, Heide executed a "notice" to Delaney and LeClair advising them that Debtor intended to exercise the Option and repurchase the Montana property. *See* Ex. 2. Heide signed this notice as Debtor's manager on November 30, 2004. He sent it via fax from Seattle to Jahnke in Montana, who in turn delivered it to LeClair and Delaney. The fax machine used for receipt of the notice was that of Clair Daines. Daines is a principle of Sunrise, and is a real estate developer and a competitor of LeClair and Delaney.[12]

Daines knew Jahnke from prior dealings. According to Daines, Jahnke had approached him in September 2004 mentioning "his" option on the Montana property and proposing some sort of "joint venture" under which the Option could be exercised and the property acquired.

In late November 2004, Daines got a preliminary title report, verified the existence of the Option, and apparently learned that it was Debtor's Option, not Jahnke's. In reviewing a copy of the Option and seeing that a notice not later than thirty days prior to December 31 was specifically required, Daines advised Jahnke that Debtor had to quickly give notice to Delaney and LeClair. Daines suggested

[12] Sunrise was formed several years ago by the Daines family, and not solely for the purposes of the instant transaction or property.

that Jahnke use a Montana attorney, Larry Holle, to give that notice. According to Daines, Jahnke advised him that Debtor would authorize Holle to provide the notice on behalf of Debtor.

On December 1, 2004, Holle issued a letter to LeClair indicating that he had "been retained" by Debtor and "on [Debtor's] behalf" was authorized to exercise the Option. *See* Ex. A. Holle, however, never had any discussions with Heide or anyone else on behalf of Debtor related to his retention. He relied solely on Daines' statement that Debtor had given the authorization, which in reality was simply what Jahnke told Daines.[13]

According to Holle, his retention by and representation of Debtor was limited to his provision of the December 1, 2004 notice. There was no written agreement for Holle's representation of Debtor. There was never any request for Bankruptcy Court approval of Debtor's retention of Holle as a professional. Holle testified that he was unaware of Debtor's bankruptcy until February, 2005. Furthermore, Holle and his firm simultaneously represented Daines and Sunrise, parties with different roles in the anticipated transaction.[14]

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[13] Jahnke's ability to execute documents on behalf of Debtor becomes a significant issue in this transaction. Daines and Sunrise, and its attorneys, would appear to have been put on notice of some potential difficulty on this score since, if Jahnke had the ability to sign on behalf of Debtor and was present in Montana, there would have been no need for the Holle notice.

[14] Whether Daines and Sunrise provided appropriate informed consent to the dual representation is not material. That Debtor was also informed and consented is unproven, and would not overcome § 327 restrictions in any event.

With the notice given, attention turned to the process of completing the exercise of the Option before the December 31, 2004 deadline. Debtor lacked the financial ability to close the transaction, and Sunrise was aware of that fact. Sunrise, however, was interested in obtaining and developing the property, and wanted to use Debtor's Option to facilitate that goal.

Aware that the Option could neither be assigned nor sold to Sunrise, and aware that Debtor could not independently exercise the Option, Sunrise contemplated a transaction where it would loan the funds necessary for Debtor to exercise the Option and acquire the property from LeClair and Delaney. As soon as Debtor closed that transaction and acquired the property, Sunrise and Debtor would then immediately close a second, related transaction in which Debtor would sell and convey the property to Sunrise. The consideration for this sale would be satisfaction of Debtor's debt to Sunrise for the financing advanced plus $10,000.00. Daines and Sunrise's lawyers characterized this as a "simultaneous closing" or a "flip transaction."

There was no written agreement between Sunrise as lender and Debtor as borrower for the loan necessary for Debtor to exercise the Option with LeClair and Delaney. Sunrise and its counsel characterized the loan as being on an "open account" unsecured basis. There was also no written agreement regarding Debtor's obligation to sell the property, once acquired, to Sunrise or establishing

the terms of that transaction. In the absence of such documents signed by both Debtor and Sunrise, Sunrise relies on the testimony of Daines and its lawyers to establish the terms of both agreements. Additionally, they point to a letter of December 29, 2004 from Sunrise's counsel to the title company describing the simultaneous closing transaction. *See* Ex. 4. This document is signed only by counsel for Sunrise; it is not signed by Debtor.

Several days prior to that letter, Sunrise's counsel sent a December 22 letter to Jahnke in relation to the transaction. A warranty deed was enclosed for use in the conveyance of the property from Debtor to Sunrise. *See* Ex. 3. In addition to the deed, an "Option Agreement" was enclosed. It recited that Debtor held an option for the Montana real estate and was willing to convey its interest in such real estate to Sunrise in exchange for (a) $10,000.00 *and* (b) the granting of an option agreement to Jahnke. It also stated that Jahnke had an ownership interest in Debtor. Under the "mutual premises and covenants" as stated in this document, Sunrise would agree to grant Jahnke an option to repurchase one half of the subject property for a period of two years.

Jahnke edited this draft Option Agreement, striking the assertion that he had an ownership in Debtor and amending the statement regarding the consideration.[15]

[15] The effect of this second amendment was to make the agreement indicate that Debtor would be conveying its interest in the real estate in exchange solely for the sum of $10,000.00 and not also for the grant of the option to Jahnke.

Jahnke signed the edited Option Agreement in his individual capacity, and Daines signed it as manager of Sunrise. *See* Ex. 12. This agreement was never executed by Debtor.

LeClair and Delaney learned that Debtor's acquisition of the property was being financed by a third party. They also were aware that, as a general proposition, once the real property was acquired by Debtor it could thereafter be sold by Debtor to any other party. However, they were not aware that both events would occur at the same time or of the simultaneous closings or "flip transaction."

The closing of the first aspect of the transaction – the exercise of the Option by Debtor and its acquisition of the property – required only Debtor's payment of the required Option amount to LeClair and Delaney, and the delivery of a deed by LeClair and Delaney to Debtor. LeClair and Delaney, and their lawyers, were ready to close. However, they prepared a hand written letter addressed to Jahnke and Heide indicating that, in the event Debtor would walk away and not close the purchase, they would offer it the sum of $50,000.00. *See* Ex. 8. This letter was provided to the title company with instructions for its delivery to Debtor at closing.

The closing of the second aspect of the transaction – Debtor's sale of the property to Sunrise for $10,000.00 and satisfaction of the financing – required Debtor's execution of appropriate documentation. Sunrise contemplated that its acquisition would be insurable. *See, e.g.*, Ex. 4 (Sunrise letter to title company of

December 29, 2004, indicating "authorizing resolutions" from Debtor were to be provided along with an appropriately executed warranty deed from Debtor to Sunrise).[16]

LeClair and Delaney executed a warranty deed on December 30, 2004 conveying the property to Debtor as grantee. *See* Ex. 9. Delaney and Susan Swimley, one of Delaney and LeClair's attorneys, went to the title company for closing that same day.[17]

At roughly the same time, Sunrise's attorneys, Holle and his associate, Gina Sherman, ran into difficulties with the title company concerning the second stage of the transaction because Jahnke could not produce proof of his ability to sign on behalf of Debtor. In addition to this problem, the title company raised some other issues, including the lack of an appropriate corporate resolution by Debtor and the need for a copy of its operating agreement. These issues jeopardized the ability to close the sale of the property from Debtor to Sunrise.

However, Sunrise and its counsel were also aware that, unless the exercise of the Option was completed by Debtor before 5:00 p.m. on December 31, 2004, the Option would expire and there would be nothing for Debtor to convey to

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[16] This letter also indicated that the $10,000.00 payable to Debtor could be released after both the warranty deeds (from LeClair/Delaney to Debtor, and from Debtor to Sunrise) had been recorded and, further, that the second stage of the transaction was confidential and should not be disclosed to LeClair and Delaney.

[17] Swimley had a limited power of attorney from LeClair to execute necessary documents on his behalf, and signed the deed, Ex. 9, for him.

Sunrise. Swimley had made clear to the title company that, absent timely closing, Delaney and LeClair would not convey the property to Debtor. Thus, even with problems looming on the second stage of the flip transaction, Sunrise knew the first stage must be completed or the opportunity would be lost.

Sunrise was unwilling to forfeit that opportunity, and it elected to proceed with funding Debtor's acquisition of the property through exercise of the Option. Sunrise knew that it faced problems but anticipated that it would be able to obtain appropriate documentation to close the subsequent conveyance of the property from Debtor to Sunrise.

Despite earlier taking the position that the transaction needed to close by Friday, December 31, 2004, in order to meet the terms of the Option, Swimley learned that the Gallatin County offices would be closed on December 31. She came to the conclusion that this was not a legal holiday and, thus, not an appropriate closing of those offices, creating an issue as to whether LeClair and Delaney could declare the Option expired due to a failure to close by 5:00 p.m. on that date. LeClair and Delaney therefore agreed to and did close the transaction on Monday, January 3, 2005. LeClair and Delaney accepted payment[18] and the deed

[18] Sunrise had obtained two cashiers' checks, each in the amount of $261,579.32, one payable to Delaney and the other payable to LeClair. *See* Ex. 7. The face of the checks note that the remitter was "Sunrise Development." *Id.*

they earlier executed, Ex. 9, was recorded.[19]

Sunrise was still attempting to address the impediments to closing the second stage of the transaction. Jahnke tried to support his ability to execute documents on behalf of Debtor by providing Sunrise a power of attorney executed by Heide in 1996. *See* Ex. 5. This power of attorney is, on its face, personal to Heide, and it does not purport to grant authority to act on behalf of Debtor. Indeed, Debtor was not even formed as a limited liability company until the following year. Additionally, Jahnke could not establish the bona fides of this power of attorney. *See, e.g.*, Ex. 10 (a January 12, 2005 affidavit of Jahnke addressing the loss of the original acknowledgment page on the power of attorney). These several efforts were important because the warranty deed transferring the property from Debtor to Sunrise that the parties were using had been executed on December 29, 2004, by Jahnke as "attorney in fact" for Debtor's manager, Heide. *See* Ex. 11.

The signature/power of attorney issue, and the absence of a borrowing resolution and Debtor's operating agreement, prevented Sunrise from obtaining title insurance. Sunrise elected to close the second aspect of the transaction without the benefit of title insurance. The Jahnke-executed warranty deed from

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[19] Swimley and LeClair testified that the $50,000.00 alternative offer was conveyed to Debtor through Sherman and through the title company's fax to Heide, Jahnke and Holle. *See also* Ex. 15 at Ex. D. There are arguments as to whether it was timely made or received. In any event, it was not accepted.

Debtor to Sunrise, Ex. 11, was recorded on January 13, 2005. The $10,000.00, however, was not conveyed to Debtor.

The IRS became aware of the transaction and it's counsel communicated both by telephone and, subsequently, in writing with several of the parties in Montana. By mid-February 2005, all of the Montana participants were aware of Debtor's pending bankruptcy proceeding and of the related concerns over the propriety of the conduct and transactions by or purportedly on behalf of Debtor.

DISCUSSION AND DISPOSITION

In the Joint Motion for approval of compromise, Debtor and Sunrise ask the Court "to approve and confirm the sale and transfer of the option property in Montana to Sunrise" in exchange for a payment by Sunrise in the amount of $50,000.00. *See* Joint Motion at 2.

The problems with this request, and the Joint Motion in its entirety, are several.

First, there is the fact that Debtor failed to ever adequately disclose its interest in the Montana property or in the Option. There was nothing about this asset in schedule A or B filed with this Court. That the absence of disclosure in the schedules was merely an oversight or due to forgetfulness, as Heide testified, is belied by the fact that the transaction giving rise to the Option occurred on May 28, 2003, just one month prior to the June 27, 2003 filing of the petition for

relief.[20] Innocent oversight is also belied by the fact that a specific reference is made to the transaction that gave rise to the Option (though incompletely and inadequately) in Debtor's statement of financial affairs. *See* Doc. No. 1 at SOFA, response to question 10.[21]

Second, there was nothing for Debtor to sell or transfer to Sunrise until Debtor effected a timely exercise of the Option and acquired the property in the first place. Debtor concedes it lacked the financial resources to exercise the Option on its own. This concession is substantiated by the balance of the record, from the time of the petition's filing forward. Debtor never sought any Court-approved financing with which to engage in business. *See* § 364(b), (c). The Court finds and concludes that Debtor failed to comply with § 364 in obtaining unsecured credit from Sunrise, in the apparent amount of $523,158.64, which it needed to exercise the Option.

Third, even assuming Debtor could validate in a chapter 11 sense its obtaining the financing from Sunrise and its acquisition of the Montana property

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[20] And, to counter any attempt of Debtor to argue that the Option's lack of value explained the lack of disclosure on the schedules, the Court would note that all assets must be disclosed and listed on schedules, even those that a debtor feels may lack any realizable value. Moreover, the information received by Debtor from Jahnke in November, 2003 that a party might pay $10,000.00 for the Option required a prompt amendment of its schedules, whether the prior omission was based on oversight or a believed lack of value.

[21] There is another error involved here. Debtor never recorded a copy of its petition or a notice of bankruptcy in the Gallatin County real property records. *Cf.* § 549(c). Had it done so, it is doubtful that events would have unfolded the way they did.

through exercise of the Option, Debtor blatantly failed to comply with § 363 in its sale of that property to Sunrise. There was never any motion for approval of such a sale under § 363(b)(1) of the Code, and no compliance with any of the several applicable Rules and Local Rules.

In connection with both § 363 and § 364, Debtor and Sunrise argue that Debtor was in the real estate business and that the subject transactions were, or should be determined after the fact to have been, within the ordinary course of business for an entity such as Debtor. However, from and after the filing of the petition for relief in June, 2003, Debtor conducted no such business. Its filed financial reports, as untimely and terse as most of them are, confirm this lack of business activity. The only sale activity in the case was advanced by Debtor through a motion under § 363(b)(1). *See* Doc. No. 40. The entirety of the record in this case indicates that Debtor's business was effectively halted while the litigation with the IRS was pursued.

Debtor's manager, the individual responsible for Debtor's conduct in this case, is elderly and claims to be in poor health. From the testimony at hearing, the Court is forced to conclude that, whether due to these physical problems or for other reasons, Heide was only marginally aware of what Jahnke was doing. While Heide "authorized" Jahnke to see if someone could be found to pay $10,000.00 for a "sale" of the Option, he could recall no phone conversation with Jahnke other

than the initial one. Heide never followed up on what Jahnke was doing, never reviewed any documentation, and may not have advised Debtor's chapter 11 counsel of what was contemplated.[22]

The Court concludes that Debtor was essentially rudderless during this transaction. From the evidence at the compromise hearing, Debtor had no active and knowledgeable management. There was no supervision or control of Debtor's affairs. There is no accountability in this case.

Debtor's disclosure statement and its first compromise pleadings assert unequivocally that Heide did not authorize the sale of the Option or the transfer of the Montana property. *See* Doc. No. 118 at 5 (discussed *supra* pp. 2-3). Debtor's first compromise motion stated Heide "did not know about Mr. Jahnke's activities." *See* Doc. No. 120 at 2. These admissions, and the testimony, could not be clearer. Heide put events into motion and failed completely to follow up, supervise or control Jahnke. As a result, Jahnke was able to advance, all the way to an actual closing, a real estate transaction of a value in excess of $500,000.00 purportedly "on behalf of" Debtor. And during the process, Jahnke negotiated for himself a *personal* post-closing option.

In summary, the record, including Debtor's concessions in the pleadings and Heide's testimony, establishes a number of things. Among them are:

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[22] Heide testified that Debtor's counsel was advised "at some point" of the notice Heide signed to exercise the Option, Ex. 2.

– Debtor failed to properly list and disclose in its bankruptcy the Option and its interest in the Montana property.

– Debtor put in motion an attempted sale or other financial realization on an asset, and utterly failed to deal with any of the bankruptcy implications including disclosure and Court approval.

– Debtor, though allowing Jahnke to prospect for buyers on its behalf, never confirmed or even inquired about what Jahnke was doing and what was being proposed in connection with Debtor's now apparently valuable asset.

– Heide, acting for Debtor, limited Jahnke's authority but failed to convey those limitations to anyone.

– Heide and Debtor failed to supervise and control Jahnke.

– None of the specific transactions that occurred (the loan Debtor got from Sunrise, Debtor's exercise of the Option and purchase of the property, and the sale of the property by Debtor to Sunrise) were ever authorized by Debtor, much less accomplished in accord with Bankruptcy Code requirements, which would here include in each instance express Court approval following notice and hearing.

In the face of all this, Debtor and its co-proponent of the Joint Motion, Sunrise, not surprisingly focus on Sunrise's offer to pay $50,000.00 for an order of this Court and good insurable title. They view this amount as equal to what LeClair and Delaney had offered in December for Debtor *not* to exercise the

Option and, thus, an adequate return to the estate. They also emphasize that a settlement infuses the chapter 11 case with cash "necessary to pay approved and unpaid administrative expenses" and provide cash reserves it does not now have. *See* Doc. No. 135 at 10.[23]

Debtor also sees a benefit from the compromise because the desired judicial approval "would also allow [Debtor]. . . to execute another deed to Sunrise for the property" and give Sunrise "insurable title to the option property." *Id.* at 9. Debtor argues that, without such a deed, there will be an inevitable conflict and controversy between Debtor and Sunrise over Debtor's conduct. It is this "controversy" that Debtor seeks to compromise.

Perhaps the threatened litigation is inevitable. But that hardly provides compelling reason for the Court to sanction Debtor's blatant Code violations and dereliction of its fiduciary duties to creditors under Title 11.[24] The objectors correctly characterize the compromise as little more than an after the fact attempt to validate a totally improper and indefensible transaction.

The Court is fully aware of the legal standards governing approval of compromises. They have been articulated often and clearly enough in the reported appellate decisions as well as in its own cases.

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[23] As best the Court can determine, however, the only "approved" administrative expenses in the case are interim fees and costs under § 331 to Debtor's counsel.

[24] A debtor in possession stands in a fiduciary relationship to its creditors. *Woodson v. Fireman's Fund Ins. Co. (In re Woodson)*, 839 F.2d 610, 614 (9th Cir. 1988).

The Court may approve a compromise or settlement only if it is "fair and equitable." *Arden v. Motel Partners (In re Arden)*, 176 F.3d 1226, 1228 (9th Cir. 1999); *Martin v. Kane (In re A & C Props.)*, 784 F.2d 1377, 1381 (9th Cir. 1986); *Goodwin v. Mickey Thompson Entm't Group, Inc. (In re Mickey Thompson Entm't Group, Inc.)*, 292 B.R. 415, 420-22 (9th Cir. BAP 2003); *In re Marples*, 266 B.R. 202, 206-08 (Bankr. D. Idaho 2001). This requires a bankruptcy court to evaluate all relevant facts, and to consider certain factors described in those cases if applicable, in exercising its discretion to approve or disapprove the suggested settlement. The court has "great latitude" in authorizing a compromise. *Mickey Thompson*, 292 B.R. at 420 (quoting *Woodson*, 839 F.2d at 620). The party proposing the compromise has the burden of proving that it is fair and equitable and should be approved. *Id.* (citing *A & C Props.*, 784 F.2d at 1381).

As the objectors have all observed, in one fashion or another, there really is no existing, clearly limned controversy with Debtor to be settled. Litigation against Debtor has not yet commenced. LeClair and Delaney filed a lawsuit against Sunrise and Daines in Montana state court claiming fraud, constructive fraud, tortious interference with contract and other causes. *See* Ex. 15. But LeClair and Delaney did not sue Debtor in this action, given its chapter 11 status and the existence of § 362(a). Neither has Sunrise sued Debtor.

Debtor argues that its participation in the Montana litigation, or subsequent

litigation, is virtually certain.[25] However, Debtor finds itself forced to rely on the generic proposition that compromise would avoid presently unknown claims against the estate. This makes evaluation of the compromise under the traditionally articulated factors difficult.

What Debtor to a large degree is doing is seeking approval for realization of $50,000.00 from a sale of the optioned property as property of the estate. *See Mickey Thompson*, 292 B.R. at 421-22 (noting that a court is obligated to consider, as part of the "fair and equitable" analysis, whether estate property is being conveyed and whether higher value might be obtained through competitive processes and/or compliance with the Code's sale procedures).

The Court can easily concede that the $50,000.00 is (a) more than the $10,000.00 Jahnke was attempting to obtain for Debtor through a "sale" of the Option and (b) is equal to what LeClair and Delaney at one point offered for Debtor not to exercise the Option. What it cannot conclude on this record is that $50,000.00 is an appropriate value for conveyance of Debtor's interest in the

[25] The complaint, Ex. 15, asks the state court to "void" the transfer of the property from LeClair and Delaney to Debtor and to void any subsequent transfer by Debtor, even though Debtor is not named as a party. It also seeks damages and punitive damages against Sunrise and Daines. Debtor posits that, either in connection with this suit or upon an adverse judgment, Sunrise will assert a claim against Debtor. Without opining at this time as to whether such a claim could be brought in the state court action as opposed to assertion in the bankruptcy case, the Court does not quarrel with Debtor's prediction. Debtor's conduct certainly exposes it to the threat of litigation.

property.[26] Debtor's prior conduct, and now its use of the compromise approach, eliminates the protections inherent in bankruptcy sale procedures that assure notice, adequate information, and competitively established values.[27]

Debtor wanted to obtain value for the Option as an asset of the estate. Because the language of the Option effectively prohibited Debtor from selling or assigning it for value, Debtor had limited choices. It could have attempted to negotiate a payment from the optionor (LeClair and Delaney) in return for cancelling and releasing the right. Or it could have negotiated the financing necessary for it to exercise the Option and bring the real estate into the estate, trusting that an ultimate sale of the property would generate a return in excess of the cost of that financing. But either approach required compliance with procedural and substantive provisions of the Code. Debtor cannot and should not be easily excused or forgiven for ignoring the fact that it was in chapter 11.

The Court's role is to either approve or disapprove the suggested compromise. It need not conduct a mini-trial on the merits of any of the claims being asserted, or the claims that may be asserted in the future, that are to be

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[26] On January 3, 2004, the deed conveying the property to Debtor was recorded. Debtor's request that the Court "approve and confirm" the sale to Sunrise requires Debtor to prove that $50,000.00 plus satisfaction of the $523,000.00 debt is appropriate return to the estate for a subsequent conveyance of its interest in that property.

[27] There is no doubt that LeClair/Delaney and Daines/Sunrise are competitors, and that each group is interested in the subject property. However, Debtor's approach to the Option's exercise initially and now its suggested compromise places both groups into awkward positions and eliminates the sort of fair competition the Code and Rules contemplate in selling estate assets.

resolved through compromise. *See, e.g., Burton v. Ulrich (In re Schmitt)*, 215 B.R. 417, 423 (9th Cir. BAP 1997). "When assessing a compromise, courts need not rule upon disputed facts and questions of law, but rather only canvass the issues." *Id.* Thus, the Court here has reviewed all the issues and circumstances presented by the parties or evident from the record in determining whether the proponents have met their burden to show that the settlement is "fair and equitable." For the reasons indicated in this Decision, and after considering those factors set out in the case law to the extent they apply, the Court concludes that the proponents have not met that burden.

CONCLUSION

The objections to the Joint Motion will be sustained, and the Joint Motion will be denied. An order will be entered accordingly.

DATED: September 8, 2005

TERRY L. MYERS
CHIEF U. S. BANKRUPTCY JUDGE

CERTIFICATE RE: SERVICE

A "notice of entry" of this Decision, Order and/or Judgment has been served on Registered Participants as reflected by the Notice of Electronic Filing. A copy of the Decision, Order and/or Judgment has also been provided to non-registered participants by first class mail addressed to:

Lawrence K. Engel
P.O. Box 9598
Seattle, WA 98109

Doug James
27 North 27th Street
Suite 1900
Billings, MT 59101

Oregon State FSA Office
7620 SW Mohawk
Tualatin, OR 97062-8121

Case No. 03-02387-TLM (WBW LLC)

Dated: September 8, 2005

/s/Jo Ann B. Canderan
Judicial Assistant to Chief Judge Myers