United States Bankruptcy Court Western District of Wisconsin

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In re Plover Motel, Inc., Debtor
Bankruptcy Case No. 94-50567-7

United States Bankruptcy Court
W.D. Wisconsin, Eau Claire Division

March 26, 1996

Randi L. Osberg, the Chapter 7 Trustee.
Paul J. Hinkfuss, for Intra Finanical Corporation.

Thomas S. Utschig, United States Bankruptcy Judge.

MEMORANDUM OPINION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

Presently before the Court is the final chapter of a sorry tale which lacks a happy ending or a pleasant epilogue. At the conclusion of the hearing held on September 27, 1995, the Court resolved virtually all of the contested issues and converted the debtor's chapter 11 proceeding to one under chapter 7. The lingering matter left unresolved is whether Intra Financial Corporation ("I.F.C.") must "disgorge" and pay the estate certain funds it received in an allegedly inequitable manner. The debtor had raised this issue prior to conversion, and Randi L. Osberg, the chapter 7 trustee, has adopted the debtor's position. Both Mr. Osberg and Paul J. Hinkfuss, the attorney for I.F.C., have submitted briefs on the issue and the matter is ready to be resolved.

A brief synopsis of this case's torturous history is necessary for an understanding of its ultimate resolution. When the debtor filed bankruptcy in 1994, it was the owner of a partially completed motel project in Plover, Wisconsin. The debtor's president, Patricia Mrozek, had obtained an AmericInn franchise for the location and as part of the franchise agreement engaged I.F.C. as the project's general contractor. Utilizing her position as a financial advisor in the area around Plover and Stevens Point, Wisconsin, Ms. Mrozek solicited investments totalling more than $500,000.00 from a number of senior citizens. Many of the investors gave Ms. Mrozek all of their savings on the promise that their investment would be repaid within a year at 10% interest. Unfortunately, these investments fell far short of the $2.8 million required for construction of the motel, and well short of the $1.4 million Ms. Mrozek needed to meet the requirements of a local bank's financing commitment to loan her company the remaining construction costs.

Despite this lack of funding, Ms. Mrozek broke ground on the motel in the fall of 1992. In truth, the project appears to have been launched in haste and without due consideration of the possibility that the necessary funds might never materialize. After the initial $500,000.00 in invested funds dwindled to nothing, the relationship between the debtor and I.F.C. deteriorated. I.F.C. filed construction liens against the property and initiated a state court lawsuit to collect its unpaid bills and foreclose its liens. The debtor filed bankruptcy to retain ownership of the property. In the course of a hotly contested hearing held in July of 1994, the parties hammered out a stipulation which all hoped would salvage the motel. The parties contemplated that I.F.C. would complete the motel and be paid upon completion and sale of the property.

The stipulation contains several provisions relating to the sale of the property which are the basis of the present dispute over disgorgement. Paragraph 4 of the stipulation provides that "[a]s soon as is reasonably possible, a reputable commercial real estate broker ("Broker") shall be retained by the Debtor for the purpose of marketing the Motel Project." All of the parties agreed to cooperate with this broker in marketing and selling the project. The agreement contemplated that the broker's listing contract would expire 52 days after a "certificate of occupancy"(1) was issued for the motel. All offers received by the broker were to be on "cash terms"(2) and were to be submitted to the Court for approval prior to the expiration of the listing contract. If such a cash offer were received, submitted, and approved within the appropriate time limits, paragraph 5 of the stipulation provided the procedure for distribution of the sale proceeds. In pertinent part, I.F.C. would receive "the first $1,884,185.00," closing costs would be paid, and any excess would be paid into the estate.

More relevant to the present inquiry is paragraph 6 of the stipulation, which granted the "mortgage holders" (the senior citizens solicited by Ms. Mrozek) an option to purchase the project upon its completion at the discounted price of $1,740,000.00. Upon issuance of the certificate of occupancy, the mortgage holders had seven days to notify I.F.C. of their intention to exercise the option and pay a $15,000.00 option fee. Thereafter, they had 45 days to close the sale. If the sale did not take place within the 45-day period, title to the motel would immediately be transferred to I.F.C. free and clear of all obligations as provided in paragraph 7 of the stipulation.

After conditional approval to operate the motel was received in December of 1994, I.F.C. notified the mortgage holders that the seven-day option period was running. Although they contended that the period had not yet begun,(3) the mortgage holders nonetheless paid the $15,000.00 fee. They then had 45 days in which to close. Unfortunately, the mortgage holders were unable to obtain financing, and the closing deadline expired on February 9, 1995.(4) Pursuant to paragraphs 6 and 7 of the stipulation, title to the motel automatically transferred to I.F.C. on that date. On February 23, 1995, I.F.C. sold the motel to Water Tower Enterprises, Inc. ("Water Tower"), for a total purchase price of $2,050,000.00.(5)

It is uncontested that I.F.C. was aware of Water Tower's interest in the motel before the mortgage holders' option rights expired but took no steps to inform them of this interest. At the September 27, 1995, hearing the mortgage holders and the debtor contended that this non-disclosure required some penalty; the trustee has spent considerable effort carrying the argument forward. The trustee argues that I.F.C. was unjustly enriched because of its failure to comply with the requirement of "good faith" embodied in the stipulation and should not be allowed to retain the profits it received as a result of its conduct. The trustee's argument can be summed up by this excerpt from his brief:

> Because of the non-disclosure or the failure to fulfill that promise [to cooperate and assist in the marketing and sale of the motel], [the debtor] could not take action to attempt to negotiate a sale to these undisclosed parties [Water

Tower] and therefore injustice can only be avoided by enforcing this promise.

Trustee's Brief at p.6.

The trustee would have the Court order that I.F.C. disgorge $296,283.14 in excess "profits" and pay those funds to the estate. The trustee calculates that this is the amount the mortgage holders would have received *if* they had purchased the motel pursuant to paragraph 6 of the stipulation and then sold the property to Water Tower themselves. The trustee argues that the Court may require this disgorgement under the terms of the contract, under the implied covenant of good faith, or under a "reformed contract" based upon the purported intentions of the parties. As statutory authority for his position, the trustee offers as alternatives 11 U.S.C. §§ 105, 542, and 549.

In response, I.F.C. contends that it in fact complied with both of its contractual obligations and any duty of good faith implicit in the stipulation. I.F.C. points out that the obligation to assist in the marketing and sale is contained in paragraph 4 of the stipulation, which deals exclusively with the retention of a broker. The debtor never retained a broker to whom I.F.C. could provide any assistance. Furthermore, I.F.C. contends that the sale to Water Tower was not a "cash offer" within the meaning of the stipulation because of the presence of the $300,000.00 promissory note. I.F.C. also argues that the sales agreement with Water Tower would have required the mortgage holders to hold title to the motel, even though they never had the ability to actually purchase the property as contemplated by the stipulation. Finally, I.F.C. contends that it did nothing inequitable, and that 11 U.S.C. §§ 542 and 549 are inapplicable to this case.

It must be remembered at the outset that the Court has previously held that I.F.C. did nothing to interfere with the mortgage holders' attempts to purchase the property. The testimony reflected a simple inability to obtain the requisite funding. Further, the testimony indicated that the mortgage holders apparently wished to purchase the motel and had little, if any, interest in offers to sell the property to a third party. During the period of time that they were represented by counsel,[(6)] the mortgage holders were apparently approached by an investor who offered to buy the motel through them and return the principal amount of their investments, without interest, over the next eight years. They rejected this offer and terminated their attorney's services, contending that by endorsing this proposal he was acting against their interests.

As the trustee indicates in his brief, the stipulation is to be interpreted as a contract. Richards v. Richards, 58 Wis. 2d 290, 295, 206 N.W.2d 134, 136 (1973). However, the Court cannot construe the stipulated terms as he requests, nor reform the stipulation to reflect what the debtor and the mortgage holders now contend were the intentions of the parties. The stipulation was heavily negotiated and carefully drafted. Indeed, there were several different drafts before the document reached its final form. Generally speaking, the best indicator of the parties' intent is the language of the contract itself. In re Zersen, 189 B.R. 732, 743 (Bankr. W.D. Wis. 1995); Matter of Alexander's Estate, 75 Wis. 2d 168, 248 N.W.2d 475 (1977). The Court's obligation is to consider the instrument as a whole in order to give each of its provisions the meaning intended by the parties. Zersen, 189 B.R. at 744; Ketay v. Gorenstein, 261 Wis. 332, 53 N.W.2d 6 (1952).

With these principles in mind, a close examination of the stipulation reveals the conceptual error embodied in the trustee's argument. The trustee wishes to combine paragraphs 4, 5, and 6 of the stipulation, reading into these provisions an ongoing obligation which required I.F.C. to inform the mortgage holders of a potential buyer.

However, these paragraphs outline two separate and distinct procedures for the disposition of the motel. In the first of these, the parties agreed to market and sell the property as outlined in paragraphs 4 and 5 of the stipulation. It was *the debtor's obligation* to retain the broker described in these paragraphs. No broker was ever retained, and in fact the mortgage holders rejected a proposal which contemplated that they would sell the motel. The overwhelming evidence demonstrates that they chose to pursue only one course of action and abandoned the procedure outlined in paragraphs 4 and 5 of the stipulation.

Paragraph 6 contains the second, independent procedure for disposition of the motel. Under this paragraph, the mortgage holders were given an option to purchase the property, and had a total of 52 days after the issuance of a certificate of occupancy in which to close their purchase.[(7)] While it would have been possible for the parties to pursue both procedures simultaneously (i.e., retain a broker at the same time that the mortgage holders pursued financing to fund their acquisition of the property), they did not do so. Now the trustee wishes to combine the two procedures and suggests that I.F.C. violated the spirit of the agreement by not revealing that it had located an alternative buyer. Had the debtor performed its obligation to retain a broker with whom I.F.C. was required to cooperate, such an argument might have merit. However, the retention of the broker was the necessary predicate for operation of the remaining terms in paragraphs 4 and 5 of the stipulation (including the obligation to cooperate in the marketing and sale of the motel), and in the absence of such a broker the other provisions are simply inapplicable.

In truth, paragraph 4 does not place *any* affirmative obligation upon I.F.C. to direct inquires to the debtor or otherwise reveal that it had a buyer waiting in the wings. I.F.C.'s obligations were limited to providing information to buyers obtained by the broker. Since the debtor chose to direct all of its energy toward enabling the mortgage holders to acquire the property, and the mortgage holders themselves chose to ignore the alternative sales procedures, it is a little late for them to complain that I.F.C. did not comply with paragraph 4. The failure to comply with the stipulated terms began with the debtor and the mortgage holders when they failed to secure a broker. Given that failure, I.F.C. cannot be required to comply with the remaining provisions of paragraphs 4 and 5, both of which expressly contemplate and necessitate the presence of an independent broker.

Even though the provisions of paragraphs 4 and 5 are inapplicable due to the lack of a broker, it is also doubtful that the agreement with Water Tower could be considered a "cash offer" within the meaning of those paragraphs of the stipulation. The sale necessitated $300,000.00 in seller financing. "Cash" is usually defined as:

> "[m]oney or the equivalent; usually ready money. Currency and coins, negotiable checks, and balances in bank accounts. That which circulates as money.

Black's Law Dictionary, 5th ed. (1979). Similarly, the term "cash sale" is defined as "a sale for money in hand." Id. The stipulation clearly contemplated that if the property were to be sold to a third party under the auspices of the bankruptcy court, the buyer would need to deliver 100% of the purchase price in cash upon closing. As the $300,000.00 promissory note does not fall within the traditional conception of "cash," this is not a cash offer as contemplated by the stipulation. Since this offer does not meet the fundamental requirement of the stipulation that it be a cash offer, it is not subject to the terms of paragraphs 4 and 5.

Finally, the trustee's argument that 11 U.S.C. §§ 542 or 549 can be utilized to justify the requested relief ignores the fact that these sections both involve reclaiming "property of the estate" which had been inappropriately transferred to another party. 11 U.S.C. § 542 relates to turnover of "property of the estate" held by someone other than the debtor prior to the bankruptcy petition. 11 U.S.C. § 549 deals with the avoidance of postpetition transfers of estate property. At the time I.F.C. sold the property, the motel was no longer property of the debtor's estate. It had been transferred to I.F.C. pursuant to the stipulation, and there is nothing in the record which renders that transfer invalid. Accordingly, these sections are inapplicable. The trustee also argues that the Court could fashion relief under the broad equitable powers available in 11 U.S.C. § 105. However, resort to § 105 is warranted only in rare circumstances, and is inappropriate given the lack of any inequitable conduct by I.F.C.

The foregoing discussion simply demonstrates the unfortunate posture of this case. The mortgage holders are clearly innocent parties, injured by the haste with which the debtor moved to develop this motel. Many of them have lost the savings of a lifetime. Yet at the same time, I.F.C. is not to blame for their woes. I.F.C. agreed to build the motel and deserved to get paid for its labor. The mortgage holders placed their money at risk when they put it in the hands of Ms. Mrozek, and one of the risks they assumed was that the project might fail. Fail it did, and while the agreement fashioned in this Court granted them the opportunity to salvage their shattered expectations, it still recognized that I.F.C. would get paid for building the motel.

Notwithstanding the trustee's arguments to the contrary, none of I.F.C.'s actions justify disgorgement of the funds it received. Had the debtor and the mortgage holders performed the fundamental requirement to retain a broker to market and sell the motel, I.F.C. might be taken to task for failing to disclose a potential buyer. Since they chose instead to pin all their hopes on Ms. Mrozek's promises that she could get them financing, the provisions relating to a broker's sale of the property are simply inapplicable. In the absence of a broker, I.F.C. reasonably expected that the mortgage holders had no intention of selling the motel and were instead pursuing their option rights. When they failed to close by February 9, 1995, title to the motel property transferred automatically to I.F.C on that date. The terms of the sale to Water Tower are not subject to review by this Court, and neither the debtor's estate nor the mortgage holders are entitled to any portion of the proceeds of that sale.

Accordingly, the trustee's request for an order requiring I.F.C. to disgorge $296,283.14 in alleged sales proceeds is denied.

This decision shall constitute findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052 and Rule 52 of the Federal Rules of Civil Procedure.

END NOTES:

1. This case is an excellent example of the difficulty experienced in determining the actual meaning of a contract term. As extended testimony at the various hearings in this matter demonstrated, the Village of Plover does not issue a single document titled "Certificate of Occupancy." Nonetheless, the various Village inspectors approved the project in December of 1994. The Court previously found that this conditional approval (final approval was received a month later, in January of 1995) constituted what the stipulation contemplated by its reference to a certificate of occupancy -- namely, the right to operate the motel.

2. Another undefined term, the meaning of which plays into the outcome of this

dispute.

3. By prior order, the Court determined that the period did in fact begin in December of 1994, when conditional approval for operation of the motel by the Village inspectors was granted, and not January of 1995, when final approval was issued. The Court will not revisit the issues involved in this determination.

4. At the September 27, 1995, hearing the Court rejected claims made by the debtor and the mortgage holders that I.F.C. somehow "interfered" with their ability to obtain the financing necessary for their purchase of the motel. The testimony indicated that the mortgage holders were simply unable to obtain financing, and I.F.C. did nothing which tangibly or materially interfered with their efforts.

5. The exact details of this rather intricate sales transaction need not be described for purposes of this decision. Suffice it to say that part of the purchase price is represented by a nonrecourse $300,000.00 promissory note from Water Tower to I.F.C. with repayment provisions which contemplate payment only if the motel makes a sufficient profit to do so.

6. The Court on numerous occasions encouraged, suggested, and even told the mortgage holders to obtain separate legal counsel. Although they were briefly represented by an attorney, they terminated his services and thereafter tied their fortunes to Ms. Mrozek for a second and equally ill-fated time.

7. The stipulation gave the mortgage holders seven days from the issuance of the certificate to pay their option fee, then an additional 45 days in which to actually close, for a total of 52 days. Similarly, the broker's listing agreement contemplated by paragraph 4 also expired 52 days after the issuance of the certificate of occupancy. In other words, 52 days after the motel was operational either the broker was to have received a "cash offer" and submitted it to the Court for approval, or the mortgage holders were to have closed their purchase of the property. In the absence of either occurrence, title to the motel transferred automatically to I.F.C. under paragraphs 6 and 7 of the stipulation.