NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. CC 04-1519-TKMa
AMERICAN COMPUTER & DIGITAL COMPONENTS, INC.,	Bk. No. LA 04-19259-TD
Debtor.	
ALAN SHEEN and JAMES SHEEN,	
Appellants,	
v.	**MEMORANDUM**[1]
RICHARD DIAMOND, CHAPTER 7 TRUSTEE; HARRIS TRUST AND SAVINGS BANK; UNITED STATES TRUSTEE; AMERICAN COMPUTER & DIGITAL COMPONENTS, INC.,	
Appellees.	

Argued and Submitted on May 12, 2005
at Pasadena, California

Filed - July 14, 2005

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable Thomas B. Donovan, Bankruptcy Judge, Presiding

Before: TCHAIKOVSKY,[2] KLEIN, and MARLAR, Bankruptcy Judges

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[1]This disposition is not appropriate for publication and may not be cited except when pertinent under the doctrine of law of the case or the rules of issue and claim preclusion. See 9th Cir. BAP Rule 8013-1.

[2]Hon. Leslie J. Tchaikovsky, United States Bankruptcy Judge for the Northern District of California, sitting by designation.

Appellants, the shareholders of the debtor American Computer & Digital Components, challenge the bankruptcy court's order overruling their objection to the release provision in a post-petition credit agreement entered into by Richard Diamond, the chapter 7 trustee, and the debtor's principal secured creditor, Harris Trust and Savings Bank. We hold that the bankruptcy court did not err or abuse its discretion by overruling the appellants' objection to the release provision and therefore AFFIRM.

FACTS

Prior to the commencement of this bankruptcy case, the debtor entered into a loan and security agreement with the bank. The agreement gave the bank a security interest in substantially all of the debtor's assets. The appellants guaranteed the loan obligation. In 2004, the debtor defaulted on the loan. When the bank attempted to take possession of its collateral, the debtor filed a chapter 11 petition. Shortly thereafter, the debtor stipulated to the appointment of a chapter 11 trustee, and Diamond was appointed as a chapter 11 trustee.

After his appointment, Diamond moved to convert the case to chapter 7. At the same time, he entered into an agreement with the bank for a post-petition loan of $500,000, to be secured by the estate's post-petition assets, including the proceeds of any avoiding power actions. The agreement provided that all the collections from the liquidation of the debtor's assets would be paid to the bank except that the bank agreed to subordinate its claim to pay administrative expenses of up to $50,000. Diamond agreed to waive

his right to surcharge the bank's collateral under 11 U.S.C. § 506(c) and released the debtor's claims against the bank in connection with the pre-petition loans. The agreement gave the trustee 15 days from the date of its execution to challenge the bank's pre-petition claim or security interest; other parties in interest were given 60 days from the date of entry of the order approving the agreement.[3]

The bankruptcy court approved the trustee's agreement with the bank on an interim basis at a preliminary hearing and granted the trustee's motion to convert the case to chapter 7. Prior to the final hearing, the appellants filed an objection. The objection was directed solely to the propriety of the release provision. The appellants contended that the bank had acted tortiously pre-petition and had caused the debtor significant harm. They noted that the bank had initiated litigation against the debtor pre-petition. They stated that they wanted to assert counterclaims against the bank on behalf of the debtor. The appellants asked the court to preserve their right to do so provided their claims were filed within 60 days after entry of the final order.

At the final hearing, the trustee and the bank urged the court to approve the agreement, including the release provision. They pointed out that the appellants would have 60 days to challenge the bank's claim or security interest. The appellants asked for clarification that they would also have an additional 60 days to assert the debtor's claims against the bank.

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[3]The agreement removed any financial incentive for asserting an avoiding power action against the bank since the bank's post-petition lien encumbered any recovery.

The court's response to this request was ambiguous. Although the court stated that it was approving the agreement in its entirety, it also assured the appellants that they had an additional 60 days to challenge "the deal." An order was entered reflecting the court's order approving the agreement. The order was also ambiguous. Paragraph 3 of the order provided that the agreement was approved in its entirety. However, paragraph 15 stated that the release provision was approved "subject to paragraph 11." Paragraph 11 gave parties in interest an additional 60 days to challenge the bank's claim and security interest.

The appellants filed a subsequent objection to the release provision within 60 days of the entry of the order approving the agreement and a declaration in support of the objection. In the objection, the appellants claimed that the bank had destroyed the debtor's business by telling the debtor's employees and customers that the appellants were crooks and that the debtor was going out of business. They also contended that the bank's conduct was not commercially reasonable and rendered it liable under Cal. Comm. Code § 9625. Third, they argued that the agreement constituted a compromise of controversy and that the bankruptcy court had not addressed the factors required for approval of a compromise. See In re A & C Properties, Inc., 784 F.2d 1377, 1381 (9th Cir.), cert. denied 479 U.S. 854 (1986).

In its response to the appellants' objection, the bank contended that the objection was barred by the doctrine of claim and/or issue preclusion. It asserted that the order approving the agreement only

gave the appellants additional time to object to its pre-petition claim and security agreement, not to assert claims against the bank. In addition, the bank contended that the claims were without merit. In support of this contention, the bank asked the court to take judicial notice of a series of declarations filed in support of the trustee's motion to convert the case to chapter 7. The declarations described a variety of fraudulent transactions engaged in by the debtor prior to the commencement of the case, including the creation of fraudulent accounts receivable and check kiting. The bank also moved to strike the appellants' declaration.

In their reply, the appellants did not challenge evidence of wrongdoing submitted by the appellees nor did they oppose the motion to strike their declaration. Instead, they asserted two new legal arguments. First, they contended that the release provision was unreasonable because it did not waive the protection of Cal. Civ. Code § 1542 (general release of claims does not extend to unknown claims). Second, they argued that a release of the estate's claims was required to be submitted to competitive bidding. In support of the latter point, the appellants cited In re Mickey Thompson Entertainment Group, Inc., 292 B.R. 415 (9th Cir. BAP 2003). The appellants stated that they would be prepared to bid on the debtor's claims against the bank once bidding terms were set.

Prior to the scheduled hearing on the appellants' objection, the bankruptcy court issued a tentative ruling. The tentative ruling indicated that the bank's motion to strike the appellants' declaration would be granted. It stated that the appellants'

objection to the release provision would be overruled as not supported by sufficient evidence or cause and on the ground that Mickey Thompson did not apply. The appellants did not request a hearing, and an order was entered in accordance with the tentative ruling. The appellants filed a timely notice of appeal from this order.

JURISDICTION

The bankruptcy court had jurisdiction to enter the order overruling the objection to the release provision pursuant to 28 U.S.C. §§ 1334(b)(1) and 157(b)(2). We have jurisdiction over this appeal under 28 U.S.C. § 158.

ISSUES

1. Do the appellants have standing to appeal?

2. Did the order approving the agreement bar the appellants' subsequent objection to the release provision?

3. If not, did the bankruptcy court err or abuse its discretion by overruling the objection?[4]

STANDARD OF REVIEW

The preclusive effect of a bankruptcy court order raises mixed questions of fact and law in which legal issues predominate. See In re Associated Vintage Group, Inc., 283 B.R. 549, 554 (9th Cir. BAP 2002). Findings of fact are reviewed for clear error. In re Fowler, 394 F.3d 1208, 1212 (9th Cir. 2005). Conclusions of law are reviewed de novo. Associated Vintage, 283 B.R. at 554. Approval of a

[4]The appellants did not appeal the bankruptcy court's order granting the appellees' motion to strike the appellants' declaration.

compromise of controversy is reviewed for abuse of discretion. In re A & C Properties, Inc., 784 F.2d at 1380.

DISCUSSION

A. STANDING

The appellees did not challenge the appellants' standing to object to the release provision nor to file a notice of appeal from the order overruling the objection. However, we have an independent duty to consider this jurisdictional issue. In re Aheong, 276 B.R. 233, 238 (9th Cir. BAP. 2001). A party's standing in a bankruptcy case is governed by the "person aggrieved" standard. A "person aggrieved" is one whose pecuniary interests are directly and adversely affected. Id.; In re Fondiller, 707 F.2d 441, 442-43 (9th Cir. 1983). We conclude that the appellants qualify as "persons aggrieved."

At the hearing on the appeal, the appellants conceded that they had not filed proofs of claim and that it was unlikely that there would be any dividend to shareholders. However, the appellants urged that, because the trustee considered the estate's claims against the bank to have no value, he should abandon them to the debtor. See 11 U.S.C. § 554 (property of the estate may be abandoned if burdensome or of inconsequential value). If the claims were abandoned to the debtor, as the shareholders of the debtor, the appellants could assert them against the bank so as to diminish the bank's pre-petition claim against the debtor. To the extent this claim were diminished, the appellants' guaranty liability to the bank would also

be diminished. Thus, the appellants have a direct pecuniary interest in the outcome of this appeal.

B. DID THE ORDER APPROVING THE AGREEMENT BAR APPELLANTS' SUBSEQUENT OBJECTION TO THE RELEASE PROVISION AS MATTER OF CLAIM PRECLUSION?

The appellees contend that the order approving the agreement was a final order. They argue that, because the appellants did not file a timely notice of appeal from that order, they were not entitled to file their subsequent objection to the release provision. They assert that the appellants' subsequent objection was barred by the doctrine of issue and/or claim preclusion and that their appeal is untimely. We disagree.

The law is clear that a final order has a preclusive effect, barring both the reassertion of claims actually litigated--i.e., issue preclusion--and claims that could have been litigated as part of the controversy affected by the order--i.e., claim preclusion. See Associated Vintage, 283 B.R. at 555. We agree with the appellees that the order approving the agreement was a final order. Two factors support this conclusion. First, the order was denominated a final order. Second, the bank relied on the finality of the order by advancing substantial sums to the bankruptcy estate. However, concluding that the order was final does not end our inquiry. The essential question is not whether the order was final but whether the order should be construed as giving the appellants an additional 60 days to object to the release provision.[5]

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[5]The order clearly left some things to be determined later: i.e., any challenge to the bank's pre-petition claim or security (continued...)

Several factors support the conclusion that it did not. As discussed above, the agreement did not give the appellants an additional 60 days to challenge the release provision. Section 4.6 of the agreement gave them 60 days only to assert an objection to "the validity, enforceability or perfection of the Bank's Pre-petition Loan and its interests in the Property of the Debtor's estate." The release provision was set forth in a different section: i.e., section 9.14. This section did not give the appellants any additional time to challenge its provisions. To the contrary, section 9.14 reads as a *fait accompli*: i.e., in that section, the trustee, "fully, unconditionally, and irrevocably" releases the bank from any and all claims. Finally, the appellees' motion asked the court to approve the agreement, and the order approving the agreement stated that the agreement was approved in its entirety.

However, several more compelling factors override these considerations. First, at the final hearing, in response to the appellants' request that the court preserve its right to assert claims against the bank, at least for 60 days, the bankruptcy judge assured the appellants that they would have an additional 60 days to challenge "the deal."[6] Second, paragraph 15 of the final order, which deals with the release provision, stated that the provision was

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[5](...continued)
interest. The appellees did not contend that this provision prevented the order from becoming final.

[6]See Associated Vintage, 283 B.R. at 549, n6 (quoting from the Restatement (Second) of Judgments § 26, which identifies as an exception to claim preclusion when the "court in the first action has expressly reserved the plaintiff's right to maintain the second action").

approved subject to paragraph 11. Paragraph 11 was the paragraph that gave the parties an additional 60 days to assert claims against the bank's pre-petition loan and security agreement. Finally, and most important, the bankruptcy court construed its own order as permitting the subsequent objection. The court's tentative ruling addressed the merits of the objection; it was not based on the grounds of issue or claim preclusion. For all of these reasons, we conclude that the order approving the agreement, although final, did not bar the appellants' subsequent challenge to the release provision.

C. DID BANKRUPTCY COURT ERR OR ABUSE ITS DISCRETION BY OVERRULING OBJECTION TO RELEASE PROVISION?

The appellants contend that the bankruptcy court erred or abused its discretion by overruling their objection to the release provisions for several reasons. First, they argue that the release constituted the sale of an estate asset and that the court erred by not submitting it to competitive bidding. Second, they contend that the release constituted a compromise of controversy and that the bankruptcy court erred by not considering the factors set forth in A & C Properties. Third, they assert that, for various other reasons, the release provision was not in the best interests of the estate and that the bankruptcy court abused its discretion by approving it. None of these arguments has any merit.

1. Release Provision as Sale of Estate Asset

If a chapter 7 debtor has a claim against a third party when the bankruptcy petition is filed, that claim becomes property of the

estate. See 11 U.S.C. § 541(a)(1). If the trustee transfers the claim to another for consideration, the transaction is fairly characterized as a sale. A release of a claim by the estate against a third party is equivalent to the sale of the claim to the third party. Thus, the standards applicable to approval of a release are the same as those applicable to a sale of other estate property.

The principal issue regarding the sale of estate property is whether the sale represents the optimal return to the estate under the circumstances. The court defers to the trustee's business judgment as to the best way to achieve this return. However, there are clearly limits to this deference. When a party in interest files an objection to the sale, the ultimate responsibility for the decision rests with the court. In re Lahijani, 325 B.R. 282 (9th Cir. BAP 2005).

Frequently, the maximum value of estate property will be realized by competitive bidding. However, this is not always true. In Mickey Thompson, upon which the appellants rely, we reversed the bankruptcy court's approval of a chapter 7 trustee's unexplained sale of claims to a third party for a lower price after establishing an overbidding procedure and receiving a higher bid. Under these circumstances, we held that the trustee breached his fiduciary duty to maximize the return to the estate. However, we noted that not every compromise must be submitted to overbidding. We stated that: "[w]hether to impose formal sale procedures" and to establish "a competitive process" with respect to the proposed disposition of claims by the estate against a third party was "ultimately a matter

of discretion" dependent "upon the dynamics of the particular situation." Mickey Thompson, 292 B.R. at 422.

In its tentative ruling, the bankruptcy judge stated that Mickey Thompson was inapplicable. Because the appellants did not request a hearing, we have only the bankruptcy judge's conclusion, not his rationale for this decision. However, his conclusion is clearly supported by the record.[7] The bank was not offering a set price for purchase of the claims. The release was part and parcel of a multi-term agreement. It would not have been feasible to call for overbids.

Moreover, approval of the agreement was time sensitive. The estate had no cash. The appellants expressed their interest in purchasing the estate's claims against the bank for the first time in their reply to the bank's response to their subsequent objection. The court could have reasonably concluded that, under these circumstances, the delay occasioned by requiring an overbidding procedure to be established would not have been in the best interests of the estate. Consequently, the bankruptcy judge did not err in finding Mickey Thompson inapplicable.

2. Release Provision as Compromise of Controversy

The appellants also contend that the release provision represented a compromise of controversy and that, before approving the compromise, the bankruptcy judge was required to consider the

[7]By not requesting a hearing and by submitting to the tentative ruling, the appellants bear the responsibility for the limited state of the record. We may affirm the bankruptcy court's conclusion as long as the record supports it. In re Crystal Properties, Ltd., L.P., 268 F.3d 743, 755 (9th Cir. 2001).

factors set forth in A & C Properties. We agree with this contention. See In re Lahijani, 325 B.R. at 290 (sale of claims to defendant must be analyzed as a compromise).

In A & C Properties, the Ninth Circuit held that, in approving a compromise, in addition to finding that the settlement negotiations had been conducted in good faith, the bankruptcy court was required to consider:

> (a) The probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.

A & C Properties, 784 F.2d at 1381. The appellants contend that the bankruptcy court did not consider any of these factors. They contend that, for various reasons, approval of the compromise was not in the best interests of the estate.

Again, because the appellants did not request a hearing on their subsequent objection, thereby submitting to the tentative ruling, we are unable to determine whether or not the court considered these factors in concluding that the objection was unsupported by sufficient cause. As noted above, the appellants bear the responsibility for the limited state of the record, and we may affirm as long as the record supports the bankruptcy court's decision to approve the release provision under the standards set forth above. In re Crystal Properties, Ltd., L.P., 268 F.3d 743, 755 (9th Cir. 2001). We conclude that it does.

The evidence submitted by the appellees, which was uncontradicted by any competent evidence presented by the appellants, indicated that the debtor's purported claims against the bank lacked any merit. While presumably the estate would have had no difficulty collecting any judgment against the bank, any litigation would have been complex and would have resulted in an undesirable delay in administering the estate. The only parties challenging the compromise were the appellants. The bankruptcy court could have reasonably concluded that, under these circumstances, approving the compromise was in the best interests of the estate. Thus, the bankruptcy court did not abuse its discretion in overruling the appellants' objection to the release provision.

3. Appellants' Other Arguments

The other legal arguments asserted by the appellants are not persuasive. First, the appellants contended that the bank was liable to the debtor because it acted in a commercially unreasonable manner by refusing to restructure the pre-petition loan in return for additional collateral. They asserted that the bank had an obligation to establish that it acted reasonably. In support of this contention, they cited Cal. Comm. Code §§ 9607, 9625, and 9626.[8]

The appellants contended that § 9607 requires a secured creditor

[8]Section 9607 requires a secured creditor to proceed in a commercially reasonable manner in enforcing its rights against its collateral in the event of a default. Section 9625 makes a secured creditor liable for any damages caused as result of the creditor's failure to proceed in a commercially reasonable manner. Section 9626 places the burden on the secured creditor, under certain circumstances, to establish that it has proceeded in a commercially reasonable manner.

to settle and compromise claims with a debtor. They argued that the bank was required to agree to restructure their pre-petition loan in return for their offer of additional collateral. The language of § 9607 does not support this contention, and the appellants have cited no case authority to support it either. Moreover, the evidence of the debtor's fraudulent conduct pre-petition supports the view that the bank acted in commercially reasonable manner by refusing to continue to deal with the debtor under any terms.

The appellants' second argument has even less substance. They contended that the bankruptcy court erred by approving the release provision because the trustee did not waive the protection of Cal. Civ. Code § 1542. Section 1542 provides that a general release does not extend to unknown claims. This protection can be waived, and in fact the trustee did waive it. Section 9.14 expressly waives all claims, known and unknown related to the bank's loan relationship with the debtor.

Moreover, the appellants' concern with the trustee's purported failure to waive unknown claims makes no sense. The appellants expressed the desire to assert claims against the bank in future litigation on behalf of the debtor.[9] However, those claims are not "unknown claims." In addition, if they were unknown claims, it would have been to the appellants' advantage if the trustee had not waived the protection of § 1542. If the protection had not been waived,

[9]The appellants also expressed the desire to assert their own claims against the bank. However, the release provision approved by the bankruptcy judge did not purport to release the appellants' claims against the bank.

unknown claims would not have been included in the release and would have been abandoned to the debtor when the estate was closed. See 11 U.S.C. § 554.

CONCLUSION

The appeal was not untimely nor was it barred by issue or claim preclusion. The order approving the agreement was clearly a final order. However, given the court's statements at the hearing and the form of the order, the order must be construed as giving the appellants an additional 60 days to challenge the release provision. The bankruptcy court construed its own order in this fashion by addressing the merits of the objection, rather than ruling on the ground that the objection was barred by the preclusive effect of the order.

The bankruptcy court did not err nor did it abuse its discretion by overruling the appellants' objection. First, it did not abuse its discretion by concluding that competitive bidding for the release provision was not required under these circumstances. Second, although approval of a release should be viewed as a compromise and the factors applicable to a compromise considered, the record supports the bankruptcy court's conclusion that approval of the release provision was in the best interests of the estate. We conclude that it does and therefore AFFIRM.

MARLAR, Bankruptcy Judge, concurring:

I agree with the result, but disagree with my colleagues as to a portion of the analysis.

Appellants lack standing to challenge the court's order. See Fondiller v. Robertson (In re Fondiller), 707 F.2d 441, 442 (9th Cir. 1983) (only persons who are "directly and adversely affected pecuniarily" by an order of the bankruptcy court have standing to appeal); Duckor Spradling & Metzger (In re P.R.T.C., Inc.), 177 F.3d 774, 777 (9th Cir. 1999) (same). Appellants are not creditors, did not file claims, and acknowledged at oral argument that the estate would not be in a position to pay creditors one hundred percent, plus interest. Thus, because the estate is insolvent, shareholders are deprived of appellate standing. See id. at 778 & n.2 (ordinarily only a solvent debtor can challenge a bankruptcy court's order affecting the size of the estate). They simply cannot interfere with the administration of the estate by the creditor's representative, the trustee. See Stoll v. Quintanar (In re Stoll), 252 B.R. 492, 495 (9th Cir. BAP 2000). Cf. Matter of Schultz Mfg. Fabricating Co., 956 F.2d 686, 690 (7th Cir. 1992) (only chapter 7 trustee had standing to appeal settlement on behalf of debtor and unsecured creditor shareholders).

Simply because they may have executed personal guarantees does not confer standing in the debtor's case. To the extent that they have defenses against the Bank, they are not precluded from asserting them.

I also believe that the order was final, and any appeal therefrom was untimely. The order allowed parties in interest to challenge only the Bank's security interest. It did not open the Bank up to all of appellees' potpourri of claims. Moreover, the judge's statements, however "ambiguous," were overridden by the terms of the actual signed order. That order is not ambiguous.