28 U.S.C. § 157(b)(1)
28 U.S.C. § 1334
negligent misrepresentation
fraud
ORICO
summary judgment
conversion

Maitland v. Mitchell, Civ. No. 92-1350-JO (D. Or. Mar. 12, 1993)
Judge Jones (affirming Judge Glover)

The plaintiffs sued the bankruptcy trustee and others alleging fraud, negligent misrepresentation and ORICO violations arising out of the purchase of estate assets. The defendants brought counterclaims alleging breach of contract, conversion and seeking equitable relief. The district court found that the action was a core proceeding and affirmed an order granting summary judgment finding that no party was entitled to any relief. The record was insufficient to raise an inference of fraud in connection with the sale. As to the negligent misrepresentation claim, the district court found no duty to the plaintiffs. The bankruptcy judge did not err in *sua sponte* dismissing the ORICO claims. While a court must generally give a party ten days notice and a chance to present new evidence before granting summary judgment *sua sponte*, an exception exists where the losing party otherwise had a full and fair opportunity to "ventilate the issues involved in the motion."

The bankruptcy court correctly dismissed the breach of contract counterclaims. Dismissal of the counterclaim alleging conversion of collateral was also correct because the secured party had not declared a default. The bankruptcy judge did not abuse his discretion in refusing to award costs to either party.

P93-4(24)

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

GEORGE MAITLAND, et al., Appellants, v. JOHN MITCHELL, et al., Appellees.	Civil No. 92-1350-JO Bkcy No. 386-36604-P11 Adv. No. 90-3536 OPINION AND ORDER

JONES, Judge:

This case, which involves a bankruptcy trustee's sale of a furniture manufacturing operation, is on appeal from a ruling by the bankruptcy court granting summary judgment for defendants on plaintiffs' claims and for plaintiffs on defendants' counterclaims.

This case is awash in red ink with plaintiffs hoping this litigation will stanch its flow. However, I agree with Bankruptcy Judge Glover that the plaintiffs fail to make out a case of common law fraud. The bottom line is that purchaser plaintiffs, two CPAs and a lawyer, were well aware they were dealing with a financially troubled company; they gambled and lost. The defendants' claims are equally infructuous. I affirm

151

146

the ruling of the bankruptcy court for the reasons put forth below.

BACKGROUND AND FACTS

Harris Pine Mills ("Harris Pine") is an Oregon corporation comprised of four operations: (1) a furniture division; (2) a redwood division, which manufactured patio furniture; (3) Harris Building Supply, a hardware store located in Pendleton; and (4) logging.

When Harris Pine filed a Chapter 7 petition for bankruptcy, John Mitchell, Inc. ("JMI") was appointed trustee. The trustee, in turn, successfully petitioned the court to convert the case to a Chapter 11 reorganization.[1]

As part of the reorganization, JMI operated the furniture division, with John Mitchell and Rodgers Higgins assigned to manage the manufacturing operation.

The trustee tried to sell the furniture division in 1988, at one point negotiating with a company called Lignatech. George Maitland, a CPA, was involved in investigating the purchase on behalf of Lignatech, which was unsuccessful in buying the business. In September of 1988, the trustee gave notice of intent to sell the furniture division to Kroehler Cabinet Company. Maitland, who by then had ended his relationship with Lignatech, and lawyer Neil Robblee submitted an "upset bid." The

[1]Defendants describe the chronology differently; they say Mitchell was appointed Chapter 7 trustee and moved to convert the case to Chapter 11, at which time JMI was appointed Chapter 11 trustee. The difference does not affect this decision.

trustee held an auction and Maitland and Robblee were the highest bidders. Cary Garman, a business broker who is also a CPA, assisted the parties during the sale negotiations. The parties eventually agreed that Garman, through a stock purchase, would become one of the owners of Harris of Pendleton, Inc. ("HOPI"), the corporation formed to purchase the assets of the furniture division.

During the sale negotiations, defendants supplied plaintiffs with financial statements for Harris Pine for periods before and after the bankruptcy filing, as well as with the monthly reports required by Bankruptcy Rule 2015. Plaintiffs allege that defendants made misrepresentations during this negotiations period and that those misrepresentations form the basis of plaintiffs' claims.

The sale of the furniture division to HOPI was effective as of Dec. 31, 1988. The down payment was financed by Congress Financial Services ("Congress"), which also gave HOPI a line of credit. After a year in business, HOPI filed for bankruptcy.

This action originated in Multnomah County Circuit Court, where Maitland, Robblee and Garman sued JMI, Mitchell and Higgins for fraud and negligent misrepresentation in connection with the sale of the furniture division to HOPI. Defendants removed the case to this court and moved to refer it to the bankruptcy court. Plaintiffs moved to remand. In November, 1990, Judge Frye denied plaintiffs' motion to remand and granted defendants' motion to refer.

Defendants filed counterclaims, alleging that plaintiffs breached their promise to put money into HOPI and that plaintiffs converted HOPI funds for their own use. Plaintiffs amended their complaint twice, first adding Harris Pine[2] as a defendant and then adding a claim under ORICO.

Both plaintiffs and defendants filed summary judgment motions. Judge Thomas T. Glover, a visiting bankruptcy judge, granted summary judgment in favor of defendants on plaintiffs' claims and in favor of plaintiffs on defendants' counterclaims. Plaintiffs appeal to this court from that ruling, and defendants cross-appeal.

STANDARDS OF REVIEW

When hearing appeals of core matters from the bankruptcy court, this court applies the same standard of review the circuit courts of appeal use when reviewing district court civil decisions, pursuant to 28 U.S.C. § 158(c). In re Castlerock Properties, 781 F.2d 159, 161 (9th Cir. 1986). The Ninth Circuit Court of Appeals reviews a district court's grant of summary judgment de novo. T.W. Elec. Service, Inc. v. Pacific Elec. Contractors Ass'n, 809 F.2d 626, 629-30 (9th Cir. 1987). "Therefore, when reviewing a grant of summary judgment, this court sits in the same position as the district court and applies

[2]The proper party to join would be the estate of Harris Pine, because of the bankruptcy proceedings. The court reads the pleadings before it as joining the estate but for simplicity will refer to Harris Pine as the defendant.

the same summary judgment test that governs the district court's decision." Id.

If no factual issues exist for trial, then summary judgment is proper. The party opposing the motion must show that the fact in contention is material, that is, that it might affect the outcome of the suit under applicable law. Lindahl v. Air France, 930 F.2d 1434, 1436-37 (9th Cir. 1991).

The opposing party's evidence is to be believed, and all reasonable inferences that may be drawn from the facts in front of the court must be drawn in the light most favorable to the nonmoving party. Id. However, the nonmoving party "must do more than simply show that there is some metaphysical doubt as to the material facts." Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 106 S.Ct. 1348, 1356 (1986).

> [T]he nonmoving party may not merely state that it will discredit the moving party's evidence at trial and proceed in the hope that something can be developed at trial in the way of evidence to support its claim. . .Instead, it must produce at least some "significant probative evidence tending to support the complaint."

T.W. Elec., 809 F.2d at 630 (citations omitted).

DISCUSSION

1. Jurisdiction

District courts have original jurisdiction of all civil proceedings arising under title 11, the bankruptcy laws. 28 U.S.C. § 1334 (Supp. 1992). The district courts may provide that "any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11" shall be referred to the district's bankruptcy judges.

28 U.S.C. § 157(a) (Supp. 1991). A bankruptcy court may enter appropriate orders and judgments regarding core bankruptcy proceedings. 28 U.S.C. § 157 (b)(1). As to proceedings that are non-core but related to bankruptcy, the bankruptcy court submits proposed findings of fact and conclusions of law to the district court judge. 28 U.S.C. § 157(c)(1).

Plaintiffs allege that because their claims arise under state common law and not under bankruptcy law this court does not have jurisdiction. Alternatively, plaintiffs claim that "the most that can be said is that these claims are 'related to' cases under title 11 (the bankruptcy laws)." Because these were not core proceedings, plaintiffs argue, the bankruptcy judge had no authority to enter final judgment.

In granting defendants' motion to refer this action to the bankruptcy court, Judge Frye held that this action was a core proceeding. Such proceedings include, but are not limited to, matters concerning the administration of the bankrupt estate and other proceedings affecting the liquidation of the estate assets. 28 U.S.C. § 157(b)(2). In concluding that this action was a core proceeding, Judge Frye reasoned that although this is a tort action, it involves a sale made by John Mitchell, Inc., the bankruptcy trustee, as part of the administration of the bankruptcy estate, and resolution of the matter will directly affect the liquidation of the bankruptcy estate's assets.

Defendants argue that Judge Frye's decision to refer is binding as "law of the case." That doctrine, however, is not a limit on courts' power; rather, it only expresses the general practice of courts not to reopen what has already been decided. Christianson v. Colt Industries Operating Corp., 108 S.Ct. 2166, 2178 (1988).

Regardless of the nature of the previous decision to refer, I find it the correct decision. In general, claims against the debtor in possession (or the trustee, as in this case) arising from conduct connected with the estate after the bankruptcy petition is filed concern the administration of the estate and qualify as core matters. In re Cinematronics, Inc., 916 F.2d 1444, 1450 (9th Cir. 1990). This holds true even when the claims involved are based on state law if the action seeks to impose personal liability on a trustee. In re Jacksen, 105 Bankr. 542, 544 (Bankr. 9th Cir. 1989).

PLAINTIFFS' CLAIMS

2. The fraud claim.

Plaintiffs, the HOPI shareholders, say that they formed and funded HOPI for the sole purpose of buying the assets of Harris Pine's furniture division. Plaintiffs claim that the purchase was made in reliance upon representations made by defendants Mitchell and Higgins, agents of defendant JMI.

Plaintiffs assert that during purchase negotiations defendants made representations and presented information showing that HPM was "only" losing relatively small amounts of money. Plaintiffs say they purchased the business in reliance on these representations and on their ability to make the company profitable by changing its management. They further allege that defendants did not disclose "huge" operating losses that took place under defendants' management until after the sale closed, and that they never would have proceeded with the sale if they had known the true state of affairs. Finally, plaintiffs allege that there was substantial evidence from which a jury could find that defendants fraudulently concealed Harris Pine's unprofitability to dispose of HPM's assets.

Plaintiffs group defendants' allegedly fraudulent misrepresentations into four categories:

1. Defendants' accounting system. Plaintiffs say that defendants represented that the Harris Pine books were prepared on an accrual basis. They further state that under generally accepted accounting practices merchandise received but not paid for would be charged to accounts payable in an accrual basis system. Plaintiffs say that through discovery they have learned that payables were actually maintained on a cash basis. They allege that this practice enabled defendants to defer reporting steadily increasing amounts of payables, thereby substantially understating the unprofitability of Harris Pine prior to the sale.

2. The Rule 2015 reports. Plaintiffs allege that these reports, filed with the court and delivered to plaintiffs, consistently represented that accounts payable were current within 30 days; plus, defendants attached a schedule purportedly identifying the accounts payable due and owing on the date of the

report. Plaintiffs further allege that defendants claim that they represented statements of accounts owed on the date of preparation of the reports, rather than the closing date of the reports. Plaintiffs allege that regardless of the time periods actually covered by these reports, plaintiffs have shown that there were hundreds of thousands of dollars of payables which were not recorded on the books of Harris Pine and not reported to the court in the Rule 2015 reports.

3. The gross margin issue. Plaintiffs allege that defendants represented to plaintiffs that Harris Pine had a 20 percent gross margin (the ratio of gross profit to sales), meaning that financial statements prepared in months in which a physical inventory was taken reduced inventory at the rate of 80 percent of total sales in order to derive profit or loss. Plaintiffs further allege that defendants represented that this gross margin figure had been verified by physical inventories. Plaintiffs allege that the gross margin was actually about 5 percent.

4. The check-holding allegation. Plaintiffs allege that throughout the latter part of 1988 Mitchell and Higgins continued to represent that there were no material changes in the manner that HPM was doing business. Plaintiffs further allege that during this time the two defendants were failing to report increasingly large amounts of accounts payable and were holding increasingly large amounts of checks which had been written, but not released. Plaintiffs accuse defendants of holding $700,000

in checks and failing to report in excess of $400,000 of accounts payable by the end of 1988.

Plaintiffs say that they have demonstrated that defendants Mitchell and Higgins engaged in a pattern of misrepresentation to conceal the overwhelming unprofitability of Harris Pine. They allege that although Mitchell, as trustee, may have improved operations at the furniture operation he still lost millions and subsidized these losses by liquidating Harris Pine's timber holdings. Plaintiffs further allege that Mitchell wanted to sell the company to justify the "enormous" fee he charged,[3] and that no one shown the true state of the company would have bought it as a going concern.

I agree with Judge Perris that plaintiffs have standing to bring individual claims. I now turn to defendants' response to plaintiffs' allegations:[4]

<u>Defendants' accounting system and the Rule 2015 reports</u>. Plaintiffs allege that defendants' accounting system allowed them to defer steadily increasing amounts of payables, which resulted

---

[3]At oral arguments the parties appeared to agree that this fee was in the range of $1 million.

[4]This response is to what defendants call plaintiffs' "new theory." Defendants allege that plaintiffs realized the "inherent impossibility" of their "old theory" after receiving defendants' motion for summary judgment, and that they abandoned their original claim. Defendants argue that a party cannot create a genuine issue of material fact for purposes of opposing a summary judgment motion by contradicting its own sworn statements. For purposes of this hearing, however, I need not consider that argument, as I am charged with considering the amended complaint and motions before me on appeal.

in an understatement of Harris Pine's unprofitability. Defendants argue that plaintiffs have produced no evidence -- such as checks or invoices -- of unpaid accounts payable.

Defendants acknowledge that the 2015 reports did not include as expenses the amount of all payables existing at the end of the month. Instead, those amounts were included as expenses in the month in which they were paid, a practice Harris Pine followed both before and after bankruptcy.

Defendants say when the trustee took over operation of Harris Pine, he continued to use the company's existing accounting personnel and procedures and in fact got a court order to that effect. They further allege that the effect of Harris Pine's continued use of its system was at most that "unreported" expenses were recorded in the month after they were incurred, and that the amount of unreported payables did not increase.

Finally, defendants explain that the reason plaintiffs can produce no invoices which were not paid within 30 days is because Harris Pine paid vendors within that time period to take advantage of trade discounts.

<u>The check-holding allegations</u>. Defendants contend that lacking evidence that accounts payable were increasing, plaintiffs now infer that defendants "held" checks in order to conceal unpaid accounts.

Rochelle Griffin, who handled accounts payable at Harris Pine, said in her affidavit that because the company was in bankruptcy, some vendors required cash on delivery; thus, signed checks needed to be ready for those companies demanding COD. Higgins and Mitchell were the only people authorized to sign checks, and they were not in Pendleton every day. As a result, sometimes checks were prepared ahead and signed in anticipation of deliveries, and then held until the delivery was made.

Defendants say checks for non-COD items were also typically prepared ahead, as Higgins and Mitchell would sign a number of checks at one sitting a few times each month. Defendant refers to the Christmas bonus checks as one example. On about December 7, 1988, defendants signed approximately 600 bonus checks for Harris Pine employees. They were held until the last pay day before Christmas. Such activity does not rise to an intentional holding of checks to hide payables, defendants claim.

<u>The gross margin issue</u>. Defendants maintain that the only other evidence plaintiffs have to support their allegations that the furniture division had a 5 percent gross margin were schedules prepared by Maitland, which defendants claim are based on inaccurate figures and incorrect assumptions.

First of all, defendants assert that the trustee used a formula whereby the cost of goods sold each month for the furniture division equals 80 percent of furniture division sales. Because the inventory usage component of cost of goods sold is essentially a fill-in number based on the 80 percent assumption, defendants claim it is arithmetically impossible for the furniture division's gross margin to be anything other than 20 percent in a month when no physical inventory is taken. However, in Schedule 1 prepared by Maitland, the furniture division's gross margin in August, 1988 is 4.6 percent.

Secondly, defendants say, the schedules assume that the inventory pricing difference between the 80 percent cost of goods sold formula used by the trustee and the 75 percent figure used for pricing inventory in the sale to HOPI amounts to only $160,000, whereas the actual difference is about $300,000.

Finally, defendants claim, Maitland's schedules assume that operating results in December, 1988 should have yielded a representative gross margin even though manufacturing ceased for two weeks at the end of the month, down time related to the need to take physical inventory in connection with the sale to HOPI. Maitland's schedules fail to make any allowance for this down time, defendants say.

Judge Glover found the following regarding the above allegations:

> And even if they weren't keeping accrual records there is no evidence on this record that they [defendants] were accumulating receivables -- or payables. Where's the evidence. They slop over another month. They're taking trade discounts. Where's the evidence in this record that they're, over some period of time, accumulating accounts payable.

I agree with Judge Glover that the evidence does not raise a genuine issue of material fact as to the existence of the alleged fraud.

At oral arguments, plaintiffs emphasized a graph they had prepared showing disproportionately high losses and expenditures in December, 1988. In their brief they claim that the "huge" amount of purchases recorded in December, January, February, and March can be attributed either to the payment of unrecorded paybles incurred in the months before December or to the purchase of large quantities of inventory in December. "In either case it is evident plaintiffs were defrauded," they conclude.

As defendants point out, if defendants were accumulating hundreds of thousands of dollars in upaid accounts payable each month, plaintiffs should be able to produce invoices and checks for at least one or two of those unpaid accounts. Plaintiffs conceded at oral arguments that they have not come up with any such evidence.

As to the large inventory purchase, defendants explain that the 2015 report for December, 1988 was prepared on a different computer than previous reports and many line items were classified differently in the December 1988 report. When considered as a whole, defendants say, no discrepancy exists. For example, while the reclassification of expenses resulted in figures showing that the cost of lumber and materials was about $820,000 higher than the monthly average from June to November, 1988, it also caused other purchases to be $690,000 less than the monthly average.

Plaintiffs argue that these December figures -- extracted from the Maitland schedules -- are sufficient to merit submission of this case to a jury. I disagree. The party opposing a summary judgment motion must show that an inference from circumstantial evidence is reasonable in light of competing inferences. Matsushita Elect. Indus. Co. v. Zenith Radio, 475 U.S. 574, 588 (1986). In light of the lack of plaintiffs' evidence and the explanations offered by defendants in regard to their accounting records, no jury could find plaintiffs' inferences of fraud reasonable.

Defendants argue that they are also entitled to summary judgment because plaintiffs could not reasonably rely on any representations they made, based on the following:

--Because of a disclaimer in the purchase and sale agreement, plaintiffs could not justifiably rely on the defendants' representations as a matter of law.

--Plaintiffs were aware that the 20 percent figure used to prepare the 2015 reports was only an estimate.

--Defendants told plaintiffs about inadequacies in Harris Pine's accounting system, especially as it relates to inventory.

--Plaintiffs undertook their own investigation of the furniture division's assets and operations and had unimpeded access to Harris Pine's records and employees. I find this argument particularly persuasive as two of the plaintiffs are CPAs -- while a third is a lawyer -- and were at no disadvantage when conducting their own investigation.

--Plaintiffs understood that the reported results for the period from June 1987 to June 1988 did not contain meaningful information about the operation of the furniture division. Thus, they could not have reasonably relied on any alleged representations about the gross margin or operating results based on their understanding of the November 1987 or June 1988 physical inventories.

--Plaintiffs must have observed that certain expenses were not being reported on an accrual basis, because they reviewed all of Harris Pine's 2015 reports and allegedly incorporated them into HOPI's business plan.

Although in general the issue of justifiable reliance should be decided by the trier of fact, in some circumstances courts have determined that there is insufficient evidence to support a reasonable inference by the factfinder in favor of the plaintiff. Judge Glover came to that conclusion in this case, and I believe it was correct. He found:

> So we have a trustee in bankruptcy operating a business who finds another purchaser, and then the plaintiff comes in and says, "Hey, I'm interested," and then we have an auction. And the plaintiff buys the assets at auction.
>
> Well, we're not quite done with negotiations, and there have been review of financial documents before and presumably -- I don't presume -- they're actually after this date of the auction. But we come up with an agreement that says in it the trustee is not representing anything concerning this business. In fact, one of the plaintiffs doesn't like that very well. But that's what the deal was, and it's in great big print.
>
> Now, we've got to be careful in enforcing those kinds of clauses in the law because one can't for instance, exculpate oneself from fraud through putting those kinds of things in agreements. So we don't throw it out altogether, but it's a statement that the trustee is making to these sophisticated purchasers to accountants and a lawyer, and they've had experience in this business that says, "Hey, you need to take a look at this thing. It's been in bankruptcy. And I've [the trustee] been operating it, and I'm not standing behind any representations. You bought it at auction. So be careful. It's more than that."

> It's saying, "Look, if you want to buy this thing, you really need to make your own decisions on it." That's really what the trustee's saying."

I conclude that the evidence in this case does not raise a genuine issue of material fact as to whether or not (1) defendants' alleged misrepresentations were material and (2) plaintiffs reasonably relied on them; additionally, a reasonable jury would not make such an inference. Thus, I need not not reach the other elements of a fraud claim. Judge Glover's decision granting defendants' motion for summary judgment on the fraud claim is affirmed.

3. The negligent misrepresentation claim.

Plaintiffs argue that defendants owed them a duty of care because they prepared financial statements and supplied them to plaintiffs. Defendants argue that plaintiffs failed to establish such a duty because, among other reasons, the transaction involved was at arm's length.

Plaintiffs assign as error what they characterize as Judge Glover's ruling that plaintiffs cannot bring a claim for negligent misrepresentation because they had a duty to investigate aspects of defendants' accounting system. Plaintiffs say that defendants never specifically alleged contributory negligence as an affirmative defense, and as such Judge Glover's ruling was wrong.

I need not reach this argument because I find as a matter of law that plaintiffs cannot maintain their claim for negligent misrepresentation. In a long-awaited ruling handed down only a month ago, the Oregon Supreme Court recognized the tort of negligent misrepresentation. Onita Pacific Corp. v. Trustees of Bronson, 315 Or. 149 (1992) (Onita I). While the court declined to state a black-letter rule regarding the tort's scope of duty and recovery, Onita, 315 Or. at 159, it did make the following clarification: "In an arm's-length negotiation, a negligent misrepresentation is not actionable." Onita, 315 Or. at 165.

Regardless of the Onita opinion -- in the event that the retroactivity of this ruling becomes an issue -- I find that prior to its issuance, the law in Oregon was that in order to sustain a claim for negligent misrepresentation, the plaintiff must show "some relationship between the parties that gives rise to a duty other than that which exists simply by virtue of the foreseeability of harm." Onita Pacific Corp. v. Trustees of Bronson, 104 Or. App. 696, 708 (1990), rev'd, 315 Or. 149 (1992) (Onita II). Under both Onita I and Onita II, a negligent misrepresentation is not actionable if it occurred in an arm's-length transaction negotiated by adversarial parties.

The parties in this case were negotiating at arm's length. Judge Glover's decision granting summary judgment for defendants' on the negligent misrepresentation claim is affirmed.

The ORICO claim.

The Oregon Racketeer Influenced and Corrupt Organization ("ORICO") statute allows plaintiffs to establish an ORICO claim by demonstrating that they were injured by a pattern of "racketeering activity," which includes committing crimes such as falsifying business records, issuing a false financial statement, obtaining an execution of documents by deception, perjury and mail fraud.

As explained above, I conclude plaintiffs have not established a reasonable inference of fraud. It follows that plaintiffs have not made a sufficient showing that defendants' alleged conduct constituted crimes and as such the bankruptcy court was correct in dismissing plaintiffs' ORICO claim. Computer Concepts, Inc. v. Brandt, 310 Or. 706, 717 (1990).

Plaintiffs claim that Judge Glover's sua sponte dismissal of the ORICO claims is reversible error because they were not given adequate notice to demonstrate genuine issues of material fact and present materials pertinent to the claims under consideration. While it's true that as a general rule a district court must give a losing party 10 days notice and a chance to present new evidence before granting summary judgment sua sponte, there's an important exception: the court may grant summary judgment if the losing party has had a full and fair opportunity to ventilate the issues involved in the motion. United States v. Grayson, 879 F.2d 620, 625 (9th Cir. 1989).

In light of the extensive briefing and oral arguments in this case, I find plaintiffs have had a fair and complete opportunity to present the issues involved in this case. I suspect Judge Glover's comment that the ORICO charge filed by plaintiffs is "improvident at best" is not a statement of personal opinion but rather a shorthand way of coming to the conclusion described above; at any rate, in view of the undisputed facts I find summary judgment on plaintiffs' ORICO claims appropriate.

DEFENDANTS' COUNTERCLAIMS

5. Breach of contract (capitalization).

Defendants, in their first counterclaim, allege that plaintiffs Robblee and Maitland promised them that they would contribute $600,000 to the capitalization of HOPI in the form of $300,000 in cash and $300,000 in net worth of American Entertainment Centers, Inc. ("AEC"), the company Maitland owned.

Plaintiffs Robblee and Maitland counter that they had no enforceable contract with defendants; that capitalization of HOPI was a condition of financing of the transaction, not a contractual commitment; the condition was in fact met by shareholders; and defendant has not been damaged by any alleged breach of contract.

Judge Glover concluded, "When one looks at the purchase and sale agreement in this particular case, which is the contract, it does not say anything about the capitalization of the new venture." I come to the same conclusion: The agreement contained no agreement by the shareholders regarding capitalization. In the absence of a contract, there can be no breach. Judge Glover's decision granting plaintiffs' motion for summary judgment on the breach of contract counterclaim is affirmed.

6. Breach of contract (stock option).

In their fourth counterclaim, defendants allege that plaintiffs Robblee and Maitland entered into an agreement with HOPI to purchase stock of HOPI in exchange for $600,000 in cash and assets. Defendants allege that defendant JMI, as a creditor of HOPI, is entitled to enforce the rights of HOPI to the performance of agreements with HOPI to purchase stock.

Plaintiffs argue that any claim that plaintiffs breached their agreements to subscribe for shares belongs to HOPI's bankruptcy trustee, and that defendant JMI may not enforce this claim. Defendants argue that this claim is personal to the Harris Pine trustee as a creditor of HOPI and may be pursued by it notwithstanding HOPI's bankruptcy. Defendants further argue that this is actually a claim sounding in tort whereby a creditor of a corporation may recover from shareholders who have received bonus or watered stock, although the claim is designated here as a breach of contract claim.

I find Judge Glover was correct in ruling that defendants have failed to create a reasonable inference of wrongdoing on plaintiffs' part. "The directors have the ability to value these kinds of things in whatever way they want to, and it seems to me that that isn't a separate and distinct claim that's actionable, and that particular counterclaim is dismissed." The ruling of the bankruptcy judge is affirmed.

7. Conversion.

In their fifth counterclaim, defendants state that defendant JMI held a security interest in all of HOPI assets. They charge plaintiffs with improperly withdrawing HOPI assets and using them for plaintiffs' own benefits. They further allege that plaintiffs' actions deprived JMI of its right to possess the assets of HOPI and to have HOPI's obligations by JMI secured by those assets.

Defendants further claim that the withdrawal of the assets, in conjunction with Robblee's and Maitland's failure to contribute the promised capital, was a significant factor in HOPI's failure. Finally, defendants allege those actions were malicious and taken with wanton disregard of JMI and other HOPI creditors.

Plaintiffs argue that this counterclaim must fail because Congress, not JMI, is the real party in interest; plaintiffs are not liable for any alleged conversion; and the payments do not constitute a conversion.

Plaintiffs note that under the Uniform Commercial Code, a secured creditor with the right to possession of collateral after default may maintain an action for conversion against one who has exercised unauthorized acts of dominion over the property to the exclusion of the creditor's right. However, I find no evidence here that JMI declared HOPI to be in default, and the payment to AEC (one of the assets used for plaintiffs' own benefit) was made before the disputes between HOPI and JMI arose. Accordingly, I conclude defendants have not made out a case of conversion.

Judge Glover's decision granting plaintiffs' motion for summary judgment on defendants' conversion counterclaim is affirmed.

6. Other counterclaims.

Defendants also appeal Judge Glover's dismissal of defendants' second and third counterclaims for promissory estoppel and quantum meruit, respectively. These two counterclaims were not briefed by the parties on appeal; however, based on the extensive record, I affirm Judge Glover's dismissal of these two counterclaims.

AWARD OF COSTS

Plaintiffs allege that Judge Glover erred in awarding costs to defendants, arguing that they incurred costs in defending against the counterclaims. However, those counterclaims appear to be more in the nature of the old maxim, "the best defense is a strong offense." Plaintiffs initially filed this action and judgment on those initial claims was for defendants. I find no abuse of discretion in Judge Glover's award of costs to defendants.

CONCLUSION

The decision of the bankruptcy judge granting defendants' motions for summary judgment on plaintiffs' claims and plaintiffs' motions for summary judgment on defendants' counterclaims is AFFIRMED.

DATED this 12th day of March, 1993.

ROBERT E. JONES
United States District Judge