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Sale free and clear of liens  
Assumption and assignment of contracts

In re Agripac, Inc. 699-60001-fr11

4/2/99 FRA Unpublished

The DIP sought leave to sell its canned goods division pursuant to Code § 363 and to assume and assign to the purchaser certain contracts under Code § 365. A number of objections to both the sale and the assumption and assignment of contracts were made by interested parties. The court concluded that the sale and the assumption and assignment could proceed under certain circumstances.

The proposed sale did not comply with terms of the Debtor's collective bargaining agreement with its employees nor had the DIP complied with Bankruptcy Code § 1113 requiring good-faith bargaining prior to rejection of a collective bargaining agreement. Consequently, the sale could not go forward without compliance with the collective bargaining agreement, until Code § 1113 is complied with, or an agreement between the buyer and the union renders compliance moot.

A creditor objected to that part of the proposed sale which effectively provided for direct payment of the sale proceeds to CoBank, a secured creditor. The court required as a condition of the sale that all funds be deposited into a separate account so that distribution may be made pursuant to a confirmed plan of reorganization.

The final condition of the sale is a limit of \$60,000 cost to the estate for the assumption of contracts. Any amount above that figure must be either waived or borne by the purchaser.

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UNITED STATES BANKRUPTCY COURT

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FOR THE DISTRICT OF OREGON

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In Re:

) Bankruptcy Case No.

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AGRIPAC, INC.,

) 699-60001-fra11

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12

Debtor.)

) MEMORANDUM OPINION

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The Debtor-in-Possession seeks leave to sell its Canned Foods Division, pursuant to Bankruptcy Code § 363. In connection with the sale it seeks leave to assume certain executory contracts, and assign them to the purchaser, pursuant to Code § 365.

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The matter came on for hearing on March 31 and April 1, 1999.

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Having considered the evidence, testimony and argument of the

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parties, the Court concludes that the sale and assignment of

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contracts may proceed, but only on certain conditions discussed in

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this opinion. Moreover, the Court finds that the proceeds of the

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sale must be held by the Debtor-in-Possession pending further

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proceedings in this Chapter 11 case.

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I. FACTS

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The Debtor-in-Possession has reached an agreement with NorPac

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Foods, Inc., for the sale by the Debtor-in-Possession and purchase

1 by NorPac of the DIP's Canned Foods Division. A complete copy of  
2 the written agreement was placed into evidence as Exhibit Z. The  
3 purchase price, set out at Paragraph 2.4 of the Agreement, is \$10  
4 Million, plus 80% of the value of the bulk of the Debtor's  
5 inventory, 50% of the remaining inventory, and 95% of the book value  
6 of the Debtor-in-Possession's receivables. The value of the  
7 inventory is to be determined in accordance with generally accepted  
8 accounting principles, and the contract provides, at Paragraph 2.5,  
9 for post-closing adjustments which take into account, among other  
10 things, variations in the available inventory. A provision is also  
11 made for arbitration in the event of any dispute regarding the  
12 amount or value of the inventory.

13         At Paragraph 2.6 the Agreement contemplates that it will be  
14 closed in escrow, with CoBank, ACB, acting as escrow agent. CoBank  
15 is a secured creditor of the Debtor-in-Possession, and has a  
16 standing banking relationship with NorPac. The Agreement  
17 contemplates that CoBank will finance the sale for NorPac. The  
18 security interest securing the Debtor-in-Possession's obligation to  
19 the Banks attaches to the proceeds of this sale. The Agreement  
20 provides for payment to the Bank by allowing the Bank simply to  
21 issue a new note to NorPac, acquire a new security agreement, and  
22 make appropriate entries crediting the sale price against the amount  
23 owed to the Bank by AgriPac. In furtherance of a prior agreement  
24 between the Bank, AgriPac, and the Unsecured Creditors' Committee,  
25 the Bank would cause \$3 Million in cash to be paid to the Debtor-in-  
26 Possession, free and clear of any security interest.

1           While the terms are not spelled out in Exhibit Z, implicit in  
2 the understanding between AgriPac and NorPac is NorPac's announced  
3 intention to pay \$2 Million in "sign-up bonuses" to growers who,  
4 once the sale closes, contract with NorPac to provide crops for  
5 processing. The parties assume that a significant number of the  
6 farmers availing themselves of this arrangement will be growers  
7 previously associated with AgriPac.

8           Three interested parties have raised objections to the sale.  
9 The Unsecured Creditors' Committee, and Crown Cork and Seal ("CCS"),  
10 an unsecured creditor, each claim that the sale price is inadequate,  
11 and that the Debtor-in-Possession has failed to articulate a sound  
12 business reason for the sale in the absence of a confirmed plan of  
13 reorganization. Counsel for the Committee advised at the hearing  
14 that the Committee did "not Necessarily oppose" the sale, but was  
15 concerned that the Debtor-in-Possession had not provide sufficient,  
16 and timely, information from which the Committee could ascertain  
17 whether the sale was appropriate. In addition, Crown Cork and  
18 Seal objects to the handling of the sale proceeds, in light of  
19 claims it is asserting against the Bank. Finally, Teamster Local  
20 670 has objected for the reason that the sale, as constituted,  
21 violates provisions of the Union's collective bargaining agreement  
22 with the Debtor-in-Possession, and because the Debtor-in-Possession  
23 has failed to comply with Code § 1113 regarding the rejection of  
24 Collective Bargaining Agreements.

1 II. DISCUSSION

2 Ordinarily, estate property in a Chapter 11 case is disposed  
3 of, and the proceeds distributed, pursuant to a plan of  
4 reorganization. Proceeding in this manner provides significant  
5 protections to the interests of creditors, who are entitled to full  
6 disclosure of the provisions of the plan, and an opportunity to  
7 vote. This general rule notwithstanding, the courts in many cases  
8 have recognized that, under certain circumstances, partial or even  
9 total liquidation of the assets of a debtor-in-possession under Code  
10 § 363, in the absence of a plan of reorganization, may be  
11 appropriate. See, e.g., In re Lionel Corp., 722 F.2d 1063(2d  
12 Cir.1983),In re Chateagay Corp., 973 F.2d 141 (2d Cir, 1992). A  
13 review of the applicable case law yields the following distillation  
14 of the factors a court should consider in reviewing an application  
15 for a sale, prior to or in lieu of confirmation of a plan, of a  
16 substantial portion of the Debtor's assets:

17 1. Whether there is an articulated business justification  
18 for the sale. This requires consideration of (a) the proportion of  
19 the assets to be sold to the whole of the estate; (b) the time which  
20 has elapsed since commencement of the case; (c) the likelihood of  
21 any reorganization, or, conversely, whether a liquidation is being  
22 proposed; (d) whether the assets to be sold are gaining or losing  
23 value, or whether an immediate sale as a going concern is likely to  
24 yield materially more than an orderly liquidation over time.

25 2. Whether there has been fair, adequate and accurate notice  
26 to interested parties of the transaction and its terms. "Fairness"

1 in this context includes time to make reasonable inquiry into the  
2 value of the assets and the terms of the transaction. Whether the  
3 time allowed is reasonable will depend on the particular situation,  
4 and exigent circumstances may justify an otherwise unreasonably  
5 short time for review and decision. However, less weight should be  
6 given to such circumstances if the exigency is attributable to the  
7 debtor's unjustified delay in seeking relief.

8 The Court must also consider whether there has been adequate  
9 information given to interested parties, either through discovery or  
10 the original notice. In particular, the Court must look at whether  
11 any material terms remain to be negotiated, and whether doubts about  
12 such terms render notice ineffective.

13 3. Whether the price is adequate and fair under the  
14 circumstances. This does not mean simply the highest bid, or proof  
15 that a quick sale may yield something more than an ordered  
16 liquidation. Where the face value of a quick sale is only  
17 marginally higher than an ordered liquidation, the Court must weigh  
18 the marginal benefit against the loss of vital creditor protections  
19 under Chapter 11, including the right to vote on a plan after full  
20 disclosure.

21 4. Whether the terms of the proposed transaction are  
22 severable, allowing the Court to defer or deny approval of  
23 particular aspects of the agreement which may be inappropriate under  
24 the circumstances.

1           5. Whether the transaction requires approval of assumption  
2 and assignment of executory contracts, and whether in fact such  
3 contracts may be assigned.

4           6. Whether the transaction is proposed in good faith. This  
5 includes the requirement that the proposed transaction not unfairly  
6 discriminate against any creditor or class of creditors or  
7 claimants, and that it not give undue advantage to the purchaser, or  
8 to equity holders, or any class of creditors or claimants.

9           7. Whether the proposed transaction, and he any resulting  
10 distribution, is consistent with the provisions of the Bankruptcy  
11 Code. The sale should not contemplate a transfer of assets in  
12 derogation of the absolute priority rule either by direct payment to  
13 interest holders or agreed payments to holders (as such) by the  
14 purchaser.

15           8. Whether the transaction subjects the estate to  
16 unjustified administrative expenses or claims.

17           These principles lead to the following conclusions regarding  
18 the issues in dispute:

19           A. Justification of Sale

20           The agreement to sell to NorPac was reached after lengthy  
21 negotiations between the Debtor-in-Possession and NorPac, and  
22 Chiquita Brands, a competing suitor. These discussions culminated  
23 in an auction spread over two to three days immediately prior to the  
24 hearing on this matter. I am persuaded that the auction yielded the  
25 best available price, particularly in light of time constraints  
26

1 which required a virtually immediate sale of the assets prior to the  
2 commencement of this year's growing season.

3         The objecting parties' expert testified to certain aspects of  
4 the Debtor's records which suggest that further investigation might  
5 yield evidence tending to prove that a liquidation over time, as  
6 opposed to a sale as a going concern, might have yielded a better  
7 result. However, there is no firm evidence to that effect. The  
8 Debtor-in-Possession has, at the very least, made out a *prima facie*  
9 case that the consideration for the sale is adequate, and that a  
10 valid business purpose exists for allowing the sale at this time.  
11 Evidence that the Debtor-in-Possession might have tried harder is  
12 not, by itself, sufficient to overcome this *prima facie*  
13 demonstration. I find that there is an articulated business reason  
14 for the sale.

15         The Unsecured Creditors' Committee argues that the sale price  
16 is indefinite, since the contract is based on the value of the  
17 Debtor-in-Possession's inventory, and the contract is not clear in  
18 defining how that value is to be arrived at. However, it appears  
19 that the contract calls for application of generally accepted  
20 accounting principles, and arbitration by an accountant in the event  
21 of a dispute. These provisions provide adequate protection of the  
22 Debtor-in-Possession's and the estate's interests, under the  
23 contract.

24         The issue of adequacy of notice is more difficult. Opposing  
25 counsel have pointed out frequently, and not unreasonably, that  
26 important information has been delivered to them at the last minute.



1 There is no denying that this case has proceeded at a breathtaking  
2 pace. The Debtor-in-Possession justifies its insistence on  
3 accelerated action by pointing out that the sale (and the sale of  
4 the frozen food division that proceeded it) can only succeed if  
5 accomplished in time for the growing season. It is true that nature  
6 will not slow down in order to accommodate lawyers and judges. In  
7 this case the crops necessary to support the canned foods operation  
8 have to be planted by early April. On top of that, the auction  
9 process that finally yielded the enhanced sale price makes it  
10 impossible to obtain complete information days in advance, much less  
11 provide the information to others.

12 On the other hand, the deadlines imposed by nature have been  
13 known to the parties all along. The Debtor-in-Possession also knew,  
14 as early as August 1998, that it was in severe financial trouble.<sup>1</sup>  
15 This case was commenced on January 4, 1999. Given the delay in  
16 starting the bankruptcy process, the DIP's argument that the high  
17 speed treatment of the case is appropriate is not entirely  
18 satisfactory.

19 This is not to suggest that opposing creditors have been kept  
20 completely in the dark, at least judging by the record before the  
21 Court. The court finds that, on balance, the inadequacy of notice  
22 is not by itself sufficient to deny approval of the sale.

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26 <sup>1</sup>This is based on testimony by the Debtor-in-Possession's CEO  
on previous occasions.

1 B. Payments to Growers

2 The Unsecured Creditors object to the Agreement to the extent  
3 it provides for payment by the purchaser to AgriPac member/growers.  
4 It is argued that such payments violate the absolute priority rule,  
5 11 U.S.C. § 1129(b) (2) (B) (ii).

6 The absolute priority rule, is not violated by the proposed  
7 payments to growers, if the funds are not payable from the estate,  
8 or paid strictly on account of the recipient's prior relationship  
9 with AgriPac. It is necessary for any entity purchasing the Debtor-  
10 in-Possession's assets to induce growers to contract to provide  
11 agricultural products to be processed. Payment of sign-up bonuses  
12 is a standard practice. It follows that these payments are an  
13 ordinary cost to the purchaser in a transaction such as the one  
14 under review here. This is not the equivalent to receipt by the  
15 growers of property of the estate, or payments on account of their  
16 interest in AgriPac.

17 The Court was assured at the hearing that there would be no  
18 discrimination in the payment of bonuses in favor of, or for that  
19 matter, against, any former member/grower of AgriPac. The order  
20 approving the sale should so direct, in order to remove any doubt on  
21 this point.

22 C. Collective Bargaining Agreement

23 The Sale Agreement contains the following provisions of  
24 concern to Teamster Local 670:

25 **3.19. Labor Matters.** Seller has not engaged in any  
26 unfair labor practice with respect to its present or  
former personnel which could reasonably be expected to

1 have a material adverse effect on the results of  
2 operations or financial condition of the Canned Food  
3 Business, nor is there any unfair labor practice  
4 complaint pending against Seller with respect to any  
5 of its present or former personnel. There is no labor  
6 strike, dispute, slowdown or stoppage pending, or, to  
7 the knowledge of Seller, threatened against or  
8 affecting Seller and Seller has not experienced any  
9 primary work stoppage or other labor dispute involving  
10 their employees during the last five years. There are  
11 no pending or, to Seller's knowledge, threatened,  
12 state or federal administrative claims, grievances,  
13 arbitrations, litigation or consent decrees against  
14 Seller.

15 **3.22. Employee Relations.** Buyer shall have no  
16 obligation to hire any specific number of Seller's  
17 former employees or to assume Seller's collective  
18 bargaining agreements with respect to the Canned Food  
19 Business. Section 3.22 of the Disclosure Memorandum  
20 contains a list of each salaried and hourly employee  
21 of the Seller and such employee's years of service,  
22 salary and grade. Seller believes that its relations  
23 with its employees are satisfactory. Except as set  
24 forth in Section 3.22 of the Disclosure Memorandum, no  
25 claim has been asserted or, to the knowledge of  
26 Seller, threatened by an employee on account of any  
alleged violation by Seller of any law relating to  
employment discrimination or employment practices or  
any other law governing the employment relationship  
within the last three (3) years.

**5.1. Employees.** Buyer will offer employment to some  
of the Seller's administrative personnel and some of  
the production workers involved in the Canned Food  
Business, in its sole discretion according to its  
business needs and plans.

**8.3. Labor Agreement.** [As a condition of closing]  
Buyer must have reached a full agreement with  
Teamsters Local 670 resolving all issues and questions  
with respect to: all seniority, hiring and benefit  
rights and obligations of Buyer with respect to former  
employees of Seller that Buyer may hire; the  
integration of the pre-existing supervisory and union  
workforces of Buyer into the Canned Food Business, and  
vice versa; and a complete labor agreement and/or  
agreement resolving all grievances and unfair labor  
practice or other employment related claims,  
satisfactory to Buyer in its sole discretion,  
applicable to the operations of the Assets.

1           The Collective Bargaining Agreement ("CBA") between Teamsters  
2 Local 670 and the Debtor-in-Possession provides that:

3           This Agreement shall be binding upon the parties and  
4 their successors. In the event that the Company's  
5 business is sold, transferred or merged, such business  
6 shall continue to be subject to the terms and  
7 conditions of this Agreement. The Company shall give  
8 notice of the existence of this Agreement to any  
9 purchaser, assignee, etc., of the business. Such  
10 notice shall be in writing with a copy to the Union  
11 and shall be given at the time of such sale or  
12 transfer of the business. In the event that the  
13 Company fails to require the purchaser or transferee  
14 to assume the obligations of this contract, the  
15 Company shall be liable to the Union and to the  
16 employees for all damages sustained as a result of  
17 such failure to require the assumption of the terms of  
18 this Agreement, but shall not be liable if the  
19 purchaser or transferee has agreed to assume the  
20 obligation of this Agreement.

21           The proposed sale agreement does not comply with the terms of  
22 the Collective Bargaining Agreement. Moreover, it is obvious from  
23 the Union's protests that provisions in the Purchase Agreement  
24 concerning labor relations have not been complied with.

25           The proposed sale is a sale of the Debtor-in-Possession's  
26 business as that term is employed in Article XII of the Collective  
Bargaining Agreement. Failure to include in the Sale Agreement a  
successor clause as required by the CBA is a breach of the  
Collective Bargaining Agreement which may result in a substantial  
claim against the estate. Moreover, the claim may be subject to  
priority treatment as an administrative expense, having occurred  
post-petition. It follows that any order permitting the sale to go  
forward must be conditioned on compliance with the CBA, or a waiver

1 of strict compliance by the Union. Otherwise the economic benefit  
2 of the sale to the estate will be substantially eroded by the  
3 Union's claims under the CBA.

4 In addition, Bankruptcy Code § 1113 requires that the Debtor-  
5 in-Possession bargain in good faith with the Union prior to  
6 rejecting the Collective Bargaining Agreement. The sale of the  
7 Canned Foods Business without compliance with the Collective  
8 Bargaining Agreement, amounts to a rejection of the contract for  
9 purposes of §1113. It follows that the sale cannot go forward until  
10 §1113 is complied with, or an agreement between the Union and the  
11 new buyer renders compliance moot.

12 D. Sequestration of Funds

13 Crown Cork and Seal objects to that part of the Agreement  
14 which effectively provides for direct payment of the sale proceeds  
15 to CoBank, the secured creditor. CCS has commenced an adversary  
16 proceeding seeking equitable subordination of CoBank's secured  
17 claim, pursuant to Code § 510. They now argue that the escrow  
18 arrangement contemplated by the sale deprives them of their remedy  
19 under § 510.

20 In response, the Bank refers to a settlement agreement  
21 entered into between the Debtor-in-Possession, Unsecured Creditors'  
22 Committee, and the Banks, in connection with the prior sale of the  
23 Debtor-in-Possession's Frozen Food Division. The agreement was  
24 approved by the Court and incorporated into its order of February  
25 18, 1999, approving that sale.

26 The provisions relied on by the Bank read as follows:

1 2.d. Any unsold collateral that has not been  
2 transferred to the Buyer of either the Frozen or  
3 Canned Divisions will be transferred or surrendered to  
the Banks in partial satisfaction of debt or sold  
pursuant to a sale under § 363.

4 The Bank further argues that the settlement agreement  
5 constituted a release of claims such as the one now asserted by  
6 Crown Cork and Seal in its action under Code § 510.

7 It does not appear that the equitable subordination claim was  
8 subject to the February 18 agreement. Paragraph 4 of the agreement  
9 provides, in part, that "[T]his release does not extend to any claim  
10 or cause of action of a creditor which is not derivative of a claim  
11 or cause of action of the bankruptcy estate." The complaint in the  
12 adversary proceeding alleges a claim on behalf of Crown Cork and  
13 Seal, and not a derivative claim on behalf of the estate.

14 The sale of estate property and distribution of the proceeds  
15 of the sale are distinct matters. The general rule is that  
16 distribution on pre-petition debt in a Chapter 11 case should not  
17 take place except pursuant to a confirmed plan of reorganization,  
18 absent extraordinary circumstances. In re Air Beds, Inc., 92 B.R.  
19 419 (9<sup>th</sup> Cir. BAP 1988), In re Conroe Forge & Manufacturing Corp., 82  
20 B.R. 781 (Bankr. W.D. Penn. 1988).

21 I find no compelling circumstance which justifies  
22 distribution of the proceeds of the sale in the absence of a plan of  
23

1 reorganization, and in light of a colorable claim asserted for  
2 equitable subordination of the Bank's interest.<sup>2</sup>

3 A provision in the settlement agreement relied on by the Bank  
4 provides that "unsold collateral" will be surrendered to the Bank or  
5 sold pursuant to Code § 363. This language does not appear to  
6 include cash collateral. To the extent that it does, the provision  
7 is inconsistent with the rule laid down in Air Beds and Conroe. The  
8 agreement and the order approving it should be construed in a manner  
9 consistent with applicable legal principles and, accordingly, I find  
10 that the provision does not apply to the proceeds of the sale.

11 Pending further proceedings, the sale proceeds must be  
12 retained by the Debtor-in-Possession in an appropriate interest  
13 bearing account.

14 F. Assumption of Contracts

15 The Unsecured Creditors' Committee argues, not unreasonably,  
16 that the Court should not allow the Debtor-in-Possession's motions  
17 seeking leave to assume certain contracts for the purpose of  
18 assigning them to the purchaser. On the other hand, in a sale of  
19 this complexity, where the identity of the buyer could not be  
20 determined until the end of an auction, it is difficult to fashion a  
21 method consistent both with the review requirements of the Code and  
22 the need for the parties to move quickly to close the sale. The  
23 principal concern of the Unsecured Creditors is the cost to the  
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25 <sup>2</sup>Nothing in this opinion should be construed as reflecting any  
26 judgement by the Court as to the merits of CCS's claim, or the  
Bank's response.

1 estate of assuming the contracts (which is a condition of  
2 assignment, see Code § 363) may have been severely underestimated.  
3 Protection of the estate and vindication of Code requirements of  
4 Court approval (which implies that the Court and all parties be duly  
5 advised) require some conditions on approval. That the assumption  
6 and assignment should be approved goes without saying, since the  
7 assignment of the contracts is an integral part of the purchase  
8 transaction.

9 The Court will approve the proposed assumption and  
10 assignment, on the condition that the total cost to the estate of  
11 assuming the subject contracts not exceed \$60,000. Any costs above  
12 that amount must be waived by the third party or paid by the  
13 purchaser. In addition, the buyer must identify the contracts to be  
14 assumed prior to closing, and notify interested parties.

15 III. SUMMARY

16 1. The sale of the Canned Food Division is approved, subject  
17 to the following conditions:

18 a. The Purchase Agreement must be modified to comply with  
19 the requirements of the Collective Bargaining Agreement, or an  
20 agreement reached between the Union and the Purchaser wherein the  
21 Union waives the requirement;

22 b. Code § 1113 must be complied with before the sale is  
23 closed, unless compliance is rendered moot by an agreement between  
24 the buyer and the Union;

25 c. The proceeds of the sale, net of costs attributable to  
26 the closing, must be retained by the Debtor-in-Possession in an



1 appropriate interest-bearing account pending further proceedings in  
2 this Court;

3 e. The order approving the sale shall specify that any asset  
4 not explicitly described in the Sale Agreement is retained by the  
5 estate;

6 f. Sign-up bonuses or similar consideration paid to growers  
7 contracting with the Buyer shall not discriminate in favor of or  
8 against any person or entity on account of its prior association  
9 with AgriPac.

10 2. The assumption by the Debtor-in-Possession of contracts  
11 necessary to be assumed and assigned to the Buyer is approved, on  
12 the following conditions:

13 a. Total costs of assumption to the estate shall not exceed  
14 \$60,000; and

15 b. The Buyer shall, at least seven days prior to the  
16 closing, identify the contracts to be acquired by it, and give  
17 notice of those contracts to the Debtor, Creditors' Committee, Crown  
18 Cork and Seal, and U.S. Trustee.

19 The foregoing constitutes the Court's findings of fact and  
20 conclusions of law, which will not be separately stated. Counsel  
21 for the Debtor-in-Possession shall prepare a form of order  
22 consistent with this memorandum.

23  
24 FRANK R. ALLEY, III  
25 Bankruptcy Judge  
26