

Covenant not to execute  
Objection to Claim after distribution

Helmut and Helga Schwartz, Case No. 697-64654-fra7

07/16/03 FRA

Unpub

Creditor Schwartzenberg Associates ("SA") filed a proof of claim in the bankruptcy estate in 1998 and an amended claim in the amount of \$335,487 in 2003 after an objection made by the Trustee.

In a related adversary proceeding against the Debtors, SA obtained a default judgment in the amount of \$215,931 in bankruptcy court against Debtors and a declaration that its debt is nondischargeable. Debtors subsequently moved to vacate the judgment and the parties negotiated a settlement whereby they stipulated to entry of an amended judgment in the amount of \$50,000 which is also nondischargeable. It was further agreed that the Debtors would pay to SA the sum of \$6,000 at \$100/month and creditor would not enter the amended judgment in any state court or execute on it as long as the Debtors made all payments toward the \$6,000 when due. The agreement was set out in a written "Covenant Not to Execute."

The Trustee filed his final report and distributed to creditors \$19,934 (SA received \$18,371). The Debtors thereafter objected to the creditor's claim on the grounds that the claim was satisfied by the settlement in the adversary proceeding and payment of the \$6,000 by the Debtors.

The court rejected SA's argument that the objection was filed too late, finding that the Rules anticipated objections to claim after a distribution of assets by the estate. However, the court held that the Covenant Not to Execute was not a release and that it did not prevent SA from collecting on its judgment from sources other than the Debtors. As the Estate is a separate entity from the Debtors, SA was free to submit a claim with and receive distribution from the Estate.

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UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

In Re: ) Bankruptcy Case No.  
          ) 697-64654-fra7  
HELMUT L. SCHWARZ and )  
HELGA J. SCHWARZ, )  
                                  ) MEMORANDUM OPINION  
                                  ) Debtors. )

Debtors object to the claims of Schwarzenberg Associates.  
The objection should be overruled. My reasons for so holding are as follows:

FACTS

This case was commenced under Chapter 11 of the Code on August 14, 1997, and converted to Chapter 7 on October 24, 1997. Schwarzenberg Associates filed its proof of claim number 7 on March 19, 1998. An amended claim was filed on March 14, 2003, for the sum of \$335,487.12. (The objection is addressed to claim number 7. Since claim number 12 is clearly an amendment to number 7, the objection applies to it as well.)

1           In a related adversary proceeding, a default judgment in  
2 favor of Schwarzenberg Associates and against Debtors was entered on  
3 November 20, 1998. The judgment awarded the sum of \$215,931.33, and  
4 declared that debt to be excepted from discharge. Subsequently,  
5 Debtors moved to vacate the judgment. The parties negotiated a  
6 settlement whereby the parties stipulated to entry of an amended  
7 judgment, also nondischargeable, in the sum of \$50,000. It was  
8 further agreed that the Defendants would pay to Schwarzenberg  
9 Associates the sum of \$6,000, and that Schwarzenberg Associates  
10 "agrees not to enter the amended judgment with any state court or  
11 execute on it so long as defendants pay to plaintiff all payments  
12 set forth in paragraph 2 when due." The agreement was set out in a  
13 written "covenant not to execute," a copy of which was submitted to  
14 this Court as Exhibit 1.

15           The Trustee filed his final report and notice thereon on  
16 March 31, 2003 (Document No. 67), and a copy was served on Debtors  
17 and their attorney. The report included a notice that "a final  
18 distribution order resolving all applications for compensation,  
19 requests for administrative expenses, and distribution of assets  
20 pursuant to 11 U.S.C. § 726 will be issued. . .without a hearing  
21 unless within 31 days of the date in the "clerk" stamp above an  
22 interested party" objects to the report. No such objection was  
23 filed, and the Court entered an order directing the Trustee to pay  
24 claims allowed against the estate on May 9, 2003. Pursuant to that  
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1 order, on May 11, the Trustee distributed to the creditors the sum  
2 of \$19,934.33.

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6 The Debtors' objection to the claim was filed on May 12,  
7 2003.

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#### ISSUES

9 1. Was the objection to the Schwarzenberg Associates' claim  
10 untimely, and for that reason subject to disallowance?

11 2. Is the objection subject to stricter scrutiny having been  
12 made after distribution had commenced?

13 3. On the merits, did the covenant not to execute operate to  
14 deny the creditors the right to receive a distribution from the  
15 estate?

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#### DISCUSSION

17 1. Timeliness

18 Objections to claims are governed by Fed.R.Bankr.P. 3007.  
19 The only restriction on time is that the objection be delivered to  
20 the claimant, debtor and trustee "at least 30 days prior to the  
21 hearing." As a practical matter this means only that any hearing  
22 must be scheduled not less than 30 days from the date the objection  
23 is delivered.

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1           Apart from that, the rules impose no restrictions. The  
2 Advisory Committee's notes, in fact, appear to contemplate the  
3 possibility of an objection even after distribution is made:

4           By virtue of the automatic allowance of a claim not  
5 objected to, a dividend may be paid on a claim which  
6 may thereafter be disallowed on objection made  
7 pursuant to this rule. The amount of the dividend  
8 paid before the disallowance in such event would be  
9 recoverable by the trustee in an adversary proceeding.

10           The creditors, without elaboration or evidence, assert that  
11 the objection should be overruled on the grounds of laches. While  
12 laches cannot be ruled out as grounds for overruling an objection in  
13 any case, there is no basis for applying the doctrine here. The  
14 parties cannot be said to be prejudiced as a matter of law if  
15 subjected to a process, such as disallowance of the claim and a  
16 forced return of distributed funds, where the rules contemplate  
17 exactly that result.

## 18 2. Effect of Order of Distribution

19           As noted, the Court entered an order directing the Trustee to  
20 pay allowed claims, after at least 30 days notice to interested  
21 parties. The objection to the claim after entry of the order is, in  
22 effect, a motion for relief from the effect of the order, and should  
23 be allowed only if the criteria provided for such relief in  
24 Fed.R.Bankr.P. 9024, and Fed.R.Civ.P. 60 are met. The rule provides  
25 for relief from the effect of an order upon a showing that the order  
26 was entered because of the mistake, inadvertence or excusable  
neglect of the adversely affected party. No such showing is made in

1 this case, and, for that reason, the objection may be overruled on  
2 procedural grounds alone.

3 3. Effect of Covenant not to Execute

4         Setting aside the procedural arguments, the objection also  
5 fails on the merits.

6         The covenant not to execute in this case places no  
7 restriction on the right of the creditor to recover from sources  
8 other than the Debtors themselves. This means they had every right  
9 to submit a claim and receive distribution from the estate, which,  
10 as is well know, is an entity separate from the Debtors themselves.

11         The Court will not, as the Debtors effectively urge, construe  
12 the covenant to be a release. If the Court can reasonably interpret  
13 a document as a covenant not to execute rather than a release, it  
14 should do so. See Dale Hilton, Inc. v. Triangle Publications, Inc.,  
15 198 F.Supp. 638 (S.D. N.Y. 1961). When the document speaks in terms  
16 of covenanting not to sue or execute, rather than releasing, and  
17 when the covenant is given in consideration of an amount that is  
18 clearly not in full satisfaction of the plaintiff's claims, the  
19 document should be construed as a covenant and not a release. Id.

20         For the foregoing reasons, the objection to the claim of  
21 Schwarzenberg Associates is overruled. An order to that effect has  
22 been entered contemporaneously herewith.

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25                                 FRANK R. ALLEY, III  
26                                 Bankruptcy Judge