UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO
Honorable Howard R. Tallman

In re:	)	
	)	
RAOUF BUGAIGHIS,	)	**Case No. 03-12112 HRT**
a/k/a Tony Bugaighis, individually and	)	
doing business as Famous Pizza and	)	**Chapter 7**
Famous Pizza, LLC,	)	
	)	
Debtor.	)	
	)	

ORDER APPROVING PROPOSED SETTLEMENT AND COMPROMISE

THIS MATTER comes before the Court on the Chapter 7 Trustee's Motion for Order Approving Settlement and Compromise of Adversary Proceeding (No. 03-2046 HRT), dated July 27, 2004, and the Debtor's Objection, dated August 20, 2004. Following a continuance of the originally scheduled hearing, the Court conducted a hearing to consider the proposed settlement on October 20, 2004. After considering the parties' pleadings, evidence, exhibits and arguments, the Court is prepared to rule.

FINDINGS OF FACT

1. The Debtor is the 100% owner of Famous Pizza, LLC, which ceased doing business on December 31, 2002, when it was seized and shut down by the Colorado Department of Revenue for unpaid state taxes, in the approximate amount of $13,355.

2. In early January 2003, the Debtor and Abdelhamid Horany engaged in business activities and transactions which culminated in the sale of Famous Pizza's assets to Horany and his company, Euphrates Pizza, LLC. Those events include:

a. On or about January 9, 2003, Horany obtained a cashier's check, which was used by Bugaighis and Horany to pay the outstanding state taxes and obtain the keys to the business premises from the Colorado Department of Revenue so the business could be re-opened. Immediately thereafter, the two men took steps to register a new business and went to the Colorado Secretary of State's office to complete the necessary forms. Horany also filed with that office an Assignment of Trademark transferring the trademark "Famous Pizza" from Famous Pizza, LLC, to Horany.

b. On January 14, 2003, Famous Pizza, LLC, as Seller, and Euphrates Pizza, LLC, as the Purchaser, and Horany and Bugaighis, each individually, entered into an Asset Purchase Agreement (the "Purchase Agreement") setting forth the terms of the already-in-progress sale and purchase transaction. That Agreement set a purchase price of $13,900

payable to the Seller for its business assets. And, by a Membership Interest Option Agreement attached as Addendum C (the "Option Agreement"), Bugaighis was granted an option to purchase a forty-nine percent (49%) membership interest in Euphrates Pizza, LLC, until January 31, 2004, for an option price of $13,355 payable in cash, failing which the option would terminate. The Purchase Agreement also contained the Seller's representation and warranty that it was not a party to, and was not aware of any pending or threatened action or assessment against it for the collection of taxes and that Seller had timely filed all tax returns and had paid in full all taxes owing to all taxing authorities.

c. In late January, 2003, the City and County of Denver advised Horany of its intent to seize and shut down his business for unpaid local taxes owed by Famous Pizza, LLC, and/or Bugaighis. To prevent a closure, Horany was able to negotiate a reduction of the penalties and interest owing, but was required to pay approximately $5,000 in tax. On February 1, 2003, Euphrates Pizza, LLC, and Bugaighis executed an Option Termination Agreement, attached to the Purchase Agreement as Addendum D, which cancelled Bugaighis' option to purchase any membership interest in Euphrates Pizza.

3. The Debtor filed this voluntary Chapter 7 case on February 10, 2003. Dennis King was appointed to serve as Trustee.

4. The Debtor voluntarily converted his case to one under Chapter 13 and the conversion Order entered on September 10, 2003.

5. On or about November 6, 2003, the Debtor sued Horany and Euphrates Pizza, LLC, (collectively, the "Defendants") in Adversary Proceeding No. 03-2046 HRT (the "Adversary Proceeding") for Contract Rescission, for Declaratory Judgment, for an Accounting with Appointment of a Receiver, for Turnover of Property of the Estate, to Set Aside Fraudulent Conveyance and for Other Damages and Remedies (the "Complaint"). Famous Pizza, LLC, was named as both a Plaintiff and a Defendant.

6. The Debtor had not listed this litigation claim on his Chapter 7 schedules and statements. Once in Chapter 13, the Debtor amended his schedules to reflect the claims underlying the Adversary Proceeding.

7. On or about December 17, 2003, the Defendants answered the Complaint and asserted defenses, affirmative defenses, counterclaims and cross-claims, including allegations that the Debtor had breached the Seller's representations and warranties as to outstanding taxes.

8. On March 11, 2004, the Chapter 13 Trustee, Sally J. Zeman (the "Chapter 13 Trustee"), filed her Motion to Reconvert Chapter 13 Case to Case Under Chapter 7 of the Bankruptcy Code.

9. On or about March 26, 2004, the Debtor filed a Confession of Chapter 13 Trustee's Motion to Reconvert Case to Chapter 7. This Court subsequently granted an Order reconverting Debtor's case from Chapter 13 to one under Chapter 7 on March 31, 2004. Dennis King was re-appointed as the Chapter 7 Trustee, whereupon he investigated the facts and circumstances surrounding the Adversary Proceeding.

10. After negotiations, the Trustee, on behalf of the Debtor's estate and its sole ownership interest of Famous Pizza, LLC, and the Defendants have arrived at a full and final settlement of all controversies between and among them. The settlement and compromise, if approved, requires the Defendants (acting collectively) to make a one-time, aggregate cash payment to the Debtor's estate in the amount of $6,500, subject to court approval. The parties have executed a written settlement agreement which memorializes the terms and conditions of their settlement and compromise (the "Settlement Agreement"). Among other things, the Settlement Agreement contains mutual release language which would fully and forever release the parties from liability from one another for any matters and circumstances of any nature whatsoever occurring prior to the effective date of the Settlement Agreement, and, requires the estate to reaffirm and ratify the Purchase Agreement and its various attachments.

DISCUSSION

Standing

The Court has doubts that the Debtor has standing to object to the Settlement Agreement. It is important to note that a bankruptcy trustee can settle claims without the Debtor's approval. *In re New Concept Housing, Inc.*, 751 F2d 932, 938 (8th Cir. 1991). The Bankruptcy Rules provide that a debtor is entitled to notice of the hearing or the approval of a settlement, but that does not automatically give a debtor standing to challenge the settlement or a bankruptcy court's order entered over such objection. *In re Rangle*, 288 B.R. 213, 216 (B.A.P. 8th Cir. 2003).

A debtor, particularly a Chapter 7 debtor, rarely has a pecuniary interest in a settlement because how an estate's assets are disbursed by the trustee has no pecuniary effect on the debtor. However, if the debtor can show a reasonable possibility of a surplus after satisfying all debts, then the debtor has shown a pecuniary interest and has standing to object. Id. The 10th Circuit has expressed a similar standard:

> [A] debtor is not a person aggrieved by a bankruptcy court order affecting the administration of the estate "[u]nless the estate is solvent and excess will eventually go to the debtor or unless the matter involves rights unique to the debtor." *Monus v. Lambros*, 286 B.R. 629, 634 (N.D. Ohio 2002) (quoting *Weston v. Mann (In re Weston)*, 18 F.3d 860, 863-64 (10th Cir. 1994)).

Under this criterion, it is doubtful Debtor Bugaighis has any right to object to the Settlement Agreement or the Court's approval of it.

Among other things, the Debtor argues that the Trustee has not evaluated or appraised the pizza business or solicited any offers to sell that business, which the Debtor seeks to recover by rescinding the Purchase Agreement in the Adversary Proceeding. The Trustee's response correctly acknowledges that he does not own the business, since the Debtor sold it to the Defendant in January, 2003. Instead, the Trustee has control over the litigation claims of the estate raised by the Adversary Proceeding, which are subject to numerous defenses and counterclaims.

The Trustee testified that for purposes of the settlement, he valued the Debtor's Famous Pizza business as of January, 2003, at best, $26,000. This amount is based on the initial cash payment of $13,900 paid by Horany to the Debtor, which was then turned over to the Colorado Department of Revenue to satisfy the unpaid state taxes. The balance of the Trustee's valuation is based on the Debtor's potential interest as reflected in the Option Agreement, Addendum C, and the one-year option granted the Debtor to purchase a 49% interest in Euphrates Pizza, LLC, for a cash payment of $13,355. This option was never exercised and was later terminated by the parties. The Trustee believes that the $6,500 settlement amount represents a fifty percent (50%) recovery on the Debtor's interest without the need or attendant risks of litigation.

The Debtor's valuation of the business, based on his testimony, is confusing, inconsistent and not corroborated by any supporting documentation. He testified the business would be worth $450,000 today, based on his view of what should be the average monthly sales for a business of that type. The Debtor also indicated that over the years he has turned down purchase offers in the $150,000 to $250,000 range. When the Debtor eventually disclosed his claims regarding the business following the conversion of this case to Chapter 13, his answer to Question 4 of the Statement of Financial Affairs, listed a value of $275,000.[1] In the Complaint commencing the Adversary Proceeding, the Debtor alleged the business was apparently worth $200,000. In his objection to the Settlement Agreement, the Debtor states he believes the value of the business

[1] Curiously, the Debtor's Chapter 13 Plan did not provide that any of this value would be available to pay his creditors. Even if successful in the Adversary Proceeding, the Debtor's Plan offered to pay unsecured creditors a total of $9,490.91 at $290 per month for 36 months.

"exceeds $50,000." Finally, in questioning by the Trustee concerning the Debtor's tax returns for the years 2000 and 2001, the Debtor indicated that, in 2000, gross income for the business was $300,720, resulting in a net income of $2,306; and, in 2001 the gross was $270,000, with a net loss of ($70,799). In the Court's view, such numbers do not justify the high values asserted by the Debtor. Given the $400,000 difference in the Debtor's range of values, the Court finds the Debtor's attempts at valuing the business unpersuasive and not deserving of any weight.

The Debtor's values are for the business and do not take into account the Defendants' claims and counterclaims and the anticipated expenses of litigation. As to the litigation itself, the Debtor has only indicated that he has previously rejected offers from the Defendants in the range of $20,000 to $30,000.

The Court finds that the Trustee's assessment of the value of the litigation to the estate is more credible than that of the Debtor. Part of the value of the litigation relates to the value of the underlying business interest that formerly belonged to the Debtor. A variety of factors must be considered in valuing an interest in a small business. *See, generally, Estate of Godley v. Commissioner of Internal Revenue*, 286 F.3d 210, 214 (4th Cir. 2002) (discussion of closely held business valuation factors). Part of the Debtor's testimony focused on the value of the business based on his opinion of business performance after it was no longer under his management. He also referenced purchase offers that he purportedly turned down before the business was seized by the Department of Revenue for non-payment of taxes. But that testimony misses the point. The Trustee must look to the value of the business in light of circumstances that existed at the time of the transaction giving rise to the dispute. At that point in time, the business was closed by the Department of Revenue and the Debtor lacked to resources to pay the back taxes in order to reopen the business. The Option Agreement provides significant guidance as to the value of the business at that point in time. It indicates that this Mr. Bugaighis himself was willing to pay $13,555 for a 49% share of the business at the precise time in question. The Court can find no fault with the Trustee's use of that figure as a starting place for his estimate of the value the business as it relates to the value of the litigation to the estate.

As to the Debtor's liabilities, the Court notes that in his original schedules, the Debtor listed the IRS as a priority claim of $71,000 and all unsecured debt as $188,000 for total liabilities of $259,000. The Debtor later filed an Amended Schedule F to add $14,575 to his unsecured debts. He did not revise those amounts when he amended his schedules and statements after he converted to Chapter 13. Since the filing of this case, creditors have filed Proofs of Claims totaling approximately $267,200. The IRS claim which was admitted at hearing as Exhibit 2, asserts a priority claim of $127,000 (including a $45,000 estimated liability due to the Debtor's failure to file returns for the periods in question), and an unsecured claim of

$33,000 for a total of $160,000. To date, no claim objections have been filed. The testimony also showed that the Debtor did not disclose any amount owing to the IRS at the time of the Purchase Agreement.

Using the Trustee's valuation of the business in agreeing to settle the Adversary Proceeding, there is no surplus available to the Debtor. When the Court considers the Debtor's wide-ranging, but totally uncorroborated, possible asset values in relation to the Debtor's liabilities, plus the expenses to be incurred if this hotly-contested Adversary Proceeding were litigated, the Court also believes that it is quite unlikely that any surplus would be available to pay the Debtor after satisfaction of all prior claims.

Even without a potential for a surplus to be paid to the Debtor, he might have standing to object to the Settlement Agreement if the litigation involves rights that are unique to the Debtor. But, that is not the case. A review of the Complaint reveals that this is a contract dispute involving rescission of a contract and money damages. All of the rights in the litigation passed to the bankruptcy estate upon Mr. Bugaighis' filing of his bankruptcy petition. If the Trustee were to pursue this litigation to trial and successfully rescind the Purchase Agreement, it would then own a pizza business that it would sell for the benefit of the estate. This is a dispute about money and a successful conclusion to the litigation would cause no unique rights to flow back to the Debtor. The Debtor's only interest is in receiving a surplus of estate funds after payment of all claims. But no reality-based analysis of the value of this litigation to the bankruptcy estate demonstrates even a remote possibility of a surplus being generated that would confer standing on this Debtor to object to the Trustee's Settlement Agreement.

Merits

Even if the Debtor had standing to object, the Court would nevertheless approve the Settlement Agreement.

Bankruptcy Rule 9019 governs a bankruptcy court's approval of settlements and compromises. It provides only that, after a hearing on notice to creditors, the Court may approve a compromise or settlement. The standards by which to evaluate a settlement proposal have been defined by case law. In general, the Court must determine whether the settlement is fair and equitable and in the best interests of the estate. To make this determination, the Court should consider 1) the probable success of the litigation on the merits; 2) any potential difficulty in collection of a judgment; 3) the complexity and expense of the litigation; and 4) the interests of creditors in deference to their reasonable views. *Kaiser Steel Corp. v. Frates (In re Kaiser Steel Corp.)*, 105 B.R. 971, 976-77 (D. Colo. 1989) (citations omitted). In addition, the Court should consider "the extent to which the settlement is truly the product of arms-length bargaining, and not of fraud or collusion." *Conn. Gen. Life Ins. Co. v. United Companies Fin. Corp. (In re Foster Mortgage Corp.)* 68 F.3d 914, 918 (5th Cir. 1995).

"With respect to the first factor, it is unnecessary to conduct a mini-trial to determine the probable outcome of any claims waived in the settlement. 'The judge need only apprise himself of the relevant facts and law so that he can make an informed and intelligent decision . . ..'" *Official Comm. of Unsecured Creditors v. Cajun Elec. Power Coop., Inc. (In re Cajun Elec. Power Coop., Inc.)*, 119 F.3d 349, 356 (5th Cir. 1997) (quoting *La Salle Nat'l Bank v. Holland (In re American Reserve Corp.)*, 841 F.2d 159, 163 (7th Cir.1987)).

Probability of Success in the Litigation

The Court does not find that the Debtor's chances for success in the litigation to be that promising. The Debtor would be attempting to rescind the contract and to get his business back after Horany has been operating as Euphrates Pizza for almost two years. The Court has reviewed the Purchase Agreement and finds it clearly provides for the sale of the Debtor's pizza business assets.

The Debtor testified that he did not have separate counsel and did not understand the true nature of the Purchase Agreement, asserting he understood it to make he and Horany business partners. He also testified that he did not even read the Purchase Agreement before signing it, that he trusted Horany's counsel to look out for him. The Debtor would now have this Court undo his mistakes as part of his fresh start.

The Bankruptcy Code provides a means for the Debtor to obtain a fresh start going forward; it does not necessarily provide the Debtor with a vehicle for going back and undoing his pre-petition mistakes as part of that fresh start. The Debtor acknowledged that he failed to read the Purchase Agreement. The fact that the Debtor didn't know what was in the contract because he failed to read it provides no grounds for relief from that mistake. *See, e.g., Rasmussen v. Freehling*, 412 P.2d 217, 219 (Colo. 1966).

The Court also believes that the Defendants raise significant defenses and counterclaims in response to the Debtor's attempt to rescind the sale. The Defendants' Answer lists fifteen (15) separate Defenses and Affirmative Defenses to the allegations in Debtor's Complaint, including estoppel, laches, waiver, unclean hands, accord and satisfaction, lack of justifiable reliance and more. The Defendants have also asserted Counterclaims against the Debtor and Cross-Claims against Famous Pizza, LLC, alleging breach of contract, promissory estoppel, breach of covenant of good faith and fair dealing, and unjust enrichment. The Trustee and Horany testified to tax liabilities that were undisclosed when the sale occurred, in violation of paragraph 6.1.7 of the Purchase Agreement, which may expose the bankruptcy estate to contractual damages should it pursue the litigation and lose.

Potential Difficulty in Collection of Any Judgment

The Trustee testified that he could probably collect on a judgment, if successful in the Adversary Proceeding. However, anticipating the expense and time likely needed to get to that point, if ever, after trial and expected appeals, the Trustee does not believe that pursuing such path is justified. After considering testimony and the defenses and counterclaims raised, the Court has serious doubt the estate would obtain a judgment.

Complexity, Duration, Expense and Delay of Litigation

The Adversary Proceeding involves a number of state law claims that one would expect to be generally associated with an attempt to rescind the sale of a business. Although the statutory and equitable underpinnings of these causes of action may not be extraordinarily complex or unusual for a Bankruptcy Court to handle, the Court believes that the discovery and pre-trial process, given the Court's current calendar, may take a minimum of nine (9) to twelve (12) months to get to trial. The Defendants have made it clear that they will vigorously defend against the Trustee's claims and prosecute their own claims with equal determination and vigor. If Defendants were to lose, they appear committed to pursue appeals. The Trustee estimated that litigation expenses would be $15,000-$20,000 minimum. Considering the Debtor's testimony at hearing, it is unlikely that the Trustee could rely solely on that basis to prove his case. The Court would anticipate the Trustee's need for expert witness testimony for any necessary valuation or damage calculation evidence. Such an expert or experts would cost money that the Trustee does not have.

The Trustee has no money to pursue the litigation, however, on the day of the hearing, the Debtor's counsel offered that the Debtor would litigate the Adversary Proceeding and would pay the estate thirty-three percent (33%) of any recovery. The Debtor's counsel would submit an application for Court approval so the estate could pay his fees and costs. Apparently, the Debtor would get 67% of any recovery with no cost. The Trustee declined and the Court finds that his reasons for doing so to be a reasonable exercise of his business judgment. The Trustee had previously invited the Debtor and his counsel to take on the litigation or propose their potential litigation options, without response, until the day of the hearing to consider the Settlement Agreement. The Trustee has examined the Debtor's assets, reviewed documents relevant to the Adversary Proceeding, and considered statements and information received from all parties. The Trustee stated that this investigation has led him to have concerns about the correctness and legal merit of the allegations and claims in the Debtor's Complaint. Especially, where success in the litigation would depend significantly on using the Debtor as his primary witness.

The Interest of Creditors

The Court notes that no creditor has objected to the proposed Settlement Agreement after notice and the opportunity to do so. The Trustee is bound by a fiduciary duty to maximize the return to the estate by controlling or collecting estate assets, reducing them to cash, and closing the estate as efficient and effectively as possible. The Court accepts the Trustee's analysis of the pros and cons of pursuing the Adversary Proceeding and concludes that a weighing of the benefits and risks involved by both sides of the dispute has resulted in a reasonable, fair and adequate compromise.

Other Factors

The Court finds that the Debtor's remaining objections to the Settlement Agreement are without merit:

The Court believes that the Settlement Agreement is the result of an arms-length negotiation. The Debtor claims that the Defendants previously offered up to $30,000 to settle the litigation. That figure, apparently did not account for the additional fees and expenses incurred and more entrenched positions taken by the parties, following the Debtor's rejection of that offer. The Defendants initially offered the Trustee no monetary settlement at all, because of those added costs. The Court and the Trustee cannot now correct what may have been, in hindsight, a previous, improvident decision by the Debtor. The Trustee believes that the $6,500 settlement amount is a fair and adequate payment amount for the estate's interest in the litigation.

The Debtor argues that the Trustee was two weeks late in filing the Motion to Approve the Settlement. Based on the evidence at hearing, the Court appreciates that given the difficulties encountered by the Trustee in fully investigating the litigation claims, some delays might be expected. The Debtor was not prejudiced by the delay. In addition, the hearing on this motion was continued by agreement of the parties.

The Debtor states that he never received the $13,900 purchase price recited in the Purchase Agreement and that no closing ever occurred to effectuate the transaction. The Trustee and Horany respond that the money was paid, but it was immediately turned over to the Colorado Department of Revenue for the taxes, and such action constituted a closing of the parties' deal. The Court finds the Trustee's analysis a more realistic account of the events at that time.

The Debtor objects that it is fundamentally unfair for the Defendants to be able to buy their way out of litigation. In a sense, that is what happens every day in Bankruptcy Court when parties settle adversary proceedings. The Debtor complains that the Settlement Agreement does

not represent the actual value of the business, Famous Pizza. However, the Debtor does not take into account that the settlement concerns litigation and that his arguments do not consider the risks to recovery posed by the Defendants' defenses and counterclaims or the expense and delay of achieving success, if ever.

For the above reasons, the Court

ORDERS that the Debtor's Objections are DENIED, and

FURTHER ORDERS that the Trustee's Motion for Order Approving Settlement and Compromise of Adversary Proceeding (No. 03-2046 HRT) is GRANTED, and the Trustee is authorized to take all necessary action, including the submission of a form of Order, to effectuate consummation of the proposed Settlement Agreement.

Dated this 5th day of November, 2004.

BY THE COURT:

/s/ Howard Tallman
Howard R. Tallman, Judge
United States Bankruptcy Court