UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF MISSISSIPPI

IN RE:

REALTY MORTGAGE CORPORATION, **CASE NO. 09-00544-NPO**

DEBTOR. **CHAPTER 11**

MEMORANDUM OPINION AND ORDER DENYING AMENDED MOTION TO APPROVE COMPROMISE AND SETTLEMENT WITH COUNTRYWIDE BANK, FSB AND COUNTRYWIDE HOME LOANS, INC.

This matter came before the Court on the Amended Motion to Approve Compromise and Settlement with Countrywide Bank, FSB and Countrywide Home Loans (the "Motion") (Dkt. # 127) filed by Realty Mortgage Corporation (the "Debtor"). At the hearing on this matter (the "Hearing"), Craig M. Geno represented the Debtor, and Stephen W. Rosenblatt and David M. Unseth represented Countrywide Bank and Countrywide Home Loans ("Countrywide"). The Court, having heard and considered the Motion, testimony, evidence, and arguments of counsel, finds that the proposed settlement agreement ("Settlement Agreement") (Motion at Ex. A) is not "fair and equitable," nor is it "in the best interests of the estate." See Protective Comm. For Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968). As such, the Court finds that the Motion is not well-taken and should be denied. Specifically, the Court finds as follows:[1]

Jurisdiction

The Court has jurisdiction over the subject matter herein and the parties hereto pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding under 28 U.S.C. 157(b)(2)(A), (D), (K), and (O).

[1]The following constitutes the findings of fact and conclusions of law of the Court pursuant to Federal Rules of Bankruptcy Procedure 7052 and 9014.

Facts

The Debtor filed its voluntary petition for relief under chapter 11 of the Bankruptcy Code on February 18, 2009 (Dkt. #1). It filed an Emergency Motion to Use Cash Collateral and for Other Relief on February 26, 2009. (Dkt. # 24). The Court entered an Interim Order Authorizing Debtor to Obtain Post-Petition Secured Financing on February 27, 2009. (Dkt. # 27). On March 2, 2009, the Debtor filed its First Amended and Supplemental Emergency Motion for Authority to Use Cash Collateral and/or to Obtain Credit and Grant Security and for Other Relief. (Dkt. #31). Two days later, on March 4, 2009, the Debtor filed its Second Amended and Supplemental Emergency Motion for Authority to Use Cash Collateral, and/or to Obtain Credit and Grant Security Therefor and for Other Relief (Dkt. # 34). On April 1, 2009, the Court entered a Final Order Authorizing Debtor to Obtain Post-Petition Secured Financing. (Dkt. # 134).[2] The Debtor filed its Motion to Approve Compromise and Settlement with Countrywide Bank, FSB (Dkt. # 125) on March 30, 2009. Later that same day, the Debtor filed an Amended Motion to Approve Compromise and Settlement with Countrywide Bank, FSB and Countrywide Home Loans, Inc. (Dkt. # 127).

Discussion

1. The Standard Regarding Settlements.

Compromises are favored in bankruptcy. 10 COLLIER ON BANKRUPTCY, ¶ 9019.01 at p. 9019-2 (15th ed. Revised 2005). Courts have adopted the standards set forth in the TMT case. 390 U.S. at 424. In TMT, the U.S. Supreme Court held that a compromise would be approved by the bankruptcy court only after it

[2]The Debtor's motions regarding financing will be referred to as the "Financing Motions."

> apprise[s itself] of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties in collecting on any judgment which might be obtained and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise.

Id. at 424.

The Fifth Circuit stated its standard in Official Comm. of Unsecured Creditors v. Cajun Electric Power Coop., Inc., 119 F.3d 349 (5th Cir. 1997). In Cajun Electric, the Fifth Circuit directed bankruptcy judges to consider:

(1) [t]he probability of success in the litigation, with due consideration for the uncertainty in fact and law;
(2) [t]he complexity and likely duration of the litigation and any attendant expense, inconvenience and delay; and
(3) [a]ll other factors.

Id. at 356. These factors have been summarized as requiring the compromise to be "fair and equitable" and "in the best interests of the estate." TMT, 390 U.S. at 424; Cajun Electric, 119 F.3d at 355.

2. The Settlement Agreement before the Court.

No objections were filed to the Motion. Present at the Hearing, however, were numerous third parties - possibly commissioned real estate agents, real estate appraisers, and other individuals who reported credit scores and certified flood certificates ("Third Party Claimants") - who claim to be adversely affected by the Settlement Agreement. See Testimony of Ms. Wood at p. 5.

The Settlement Agreement proposed to settle disputes between Realty Mortgage and Countryside, including disputes regarding the Over/Under Account (the "Over/Under Account"). Countrywide asserted, and the Debtor did not dispute, that the Over/Under Account "is not an actual,

separate bank account in the Debtor's name that holds actual cash deposits of the Debtor, but rather an accounting mechanism utilized to assist Countrywide and the Debtor in settling transactions [between them]." (Motion at Ex. A).

The Debtor contends that, in the ordinary course of business, the Debtor and Countrywide established the Over/Under Account. In its Financing Motions, the Debtor explained its view of how that account worked. See e.g. Second Amended and Supplemental Emergency Motion for Authority to Use Cash Collateral, and/or to Obtain Credit and Grant Security Therefor and for Other Relief (Dkt. # 34). At the closing of a mortgage transaction, the Debtor causes the loan amount to be wired out of the warehouse line of credit. When a loan was actually funded from Countrywide, the amount of the secured claim is credited back to the warehouse line of credit, and the balance is wired into the Over/Under Account. The Over/Under Account, therefore, included funds for commissions for real estate agents, appraisal fees, credit reporting agency fees and flood certificate fees ("Third Party Claims").

At the time of the Hearing, the Debtor represented that the Over/Under Account included approximately $3.5 million. As part of the Settlement Agreement, the Debtor agreed to relinquish approximately $2.8 million to Countrywide in consideration for forgiveness of the DIP loans and $325,000 in cash. According to Countrywide's counsel, Countrywide agreed to "carve-out" or "hold back" $700,000 against which Third Party Claimants may attempt to recover. However, Countrywide's counsel asserted that Countrywide has a perfected security interest against the $700,000 "carve-out" which would take priority over any Third Party Claims and that it intended to litigate its right to retain the $700,000.[3]

[3]The Settlement Agreement did not provide for the creation of a settlement fund of $700,000. It merely created a ledger entry for that amount.

The Debtor's representative, Sally Wood ("Ms. Wood"), testified at the Hearing that certain mortgage loans closed, but that agent commissions, appraisal fees, credit reporting fees, and flood certificate fees were not paid. Ms. Wood stated that she thought the claims for those amounts would total approximately $660,000 to $675,000. When asked by counsel for the Debtor if she was satisfied that the mechanism established in the Settlement Agreement by which these third parties could make claims was fair, Ms. Wood testified that:

> I'm sorry. I am not. That's the reason we're all here today. The procedure is not defined as was intended when we had our settlement. Not to say that it would not be defined exactly as we intended and we certainly don't see any other option other than settling, but that's where the confusion has arisen. When the verbiage came out for the settlement, the definition did not appear to be there that reflected the intent which was to be able to have a claims process for those commissioned loan officers. Obviously, those commissioned loan officers are employees of Realty Mortgage. As such, they are a priority claim and if that procedure is not in place properly, they'll end up claiming back with the regular employees, and we would have settled without enough money to pay anybody.
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> . . . .
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> It is obviously in the best interest of all the parties to try to settle, but our intent was to try to protect the income obligations that we felt we had in the settlement. And I hope that was the intent, it just doesn't seem that the verbiage specifies it appropriately.

The testimony of Ms. Wood continued as follows:

Mr. Geno: Your Honor, I am confused. I have to admit I am completely confused by the witness's testimony. I don't understand if she is saying she wants to repudiate the settlement agreement or if it is not satisf. . ., I am confused.

Judge Olack: Well, I think I followed her. I think she says that the settlement agreement that you reached was fine, she just doesn't like the way it was documented because it does not reflect what she understood the agreement was.

Ms. Wood: That's exactly right.

Mr. Geno: Well, Your Honor, I guess we don't have a deal.

After a recess, Ms. Wood returned to the stand and recanted her previous testimony with a lack of conviction. Even while recanting, she noted the significant problem in the wording of the settlement which did not limit who may make a claim against the $700,000 "carve out." The $700,00 estimate, however, was based on a limited universe of potential claimants. Ultimately, the Court was not persuaded by Ms. Wood's changed testimony.

The Court finds that the Settlement Agreement treated the Third Party Claimants looking to the "carve out" in an unfair manner. In order to recover their monies from the Over/Under Account, these claimants, including individuals with small claims, would have to bear the risk that:

1. They would prevail on the claims procedure described in the Settlement Agreement;
2. They would succeed in challenging Countrywide's interest in the $700,000;
3. The $700,000 estimate was correct and sufficient to cover all the claims; and,
4. Any award granted by this Court would be collectible since the Settlement Agreement is not funded with real dollars but only by an "accounting mechanism." In order to recover money damages, the Third Party Claimants would then bear the burden of filing an action in another court to collect their damages if Countrywide did not pay them voluntarily.

The Settlement Agreement clearly did not settle all the litigation. It did, however, likely affect the rights of Third Party Claimants as to future litigation. We can expect that Countrywide would claim that this Settlement Agreement caps its liabilities as to these Third Party Claimants at $700,000. The Court is mindful of the concerns of other courts regarding the ability of bankruptcy courts to so affect these types of rights. The U.S. Supreme Court has agreed to hear two appeals from the Second Circuit Court of Appeals wherein that court reversed the bankruptcy court's

interpretation of certain broad third-party injunctions entered in In re Johns-Manville Corp., 517 F.3d 52 (2nd Cir. 2008).[4] While the issues in those appeals and this case are not identical, the jurisdictional issues are similar and problematic.

Conclusion

No doubt a settlement with Countrywide of some sort is in the best interest of the estate. This settlement, however, places an undue burden and far too much risk on one group of creditors. As such, it is not "fair and equitable." Moreover, the terms of the Settlement Agreement raised significant jurisdictional issues that are due to be resolved by the U.S. Supreme Court. Given these circumstances, the Motion should be denied.

A separate final judgment consistent with this Memorandum Opinion and Order will be entered by this Court in accordance with Federal Rule of Bankruptcy Procedure 9021.

IT IS, THEREFORE, ORDERED that the Motion is denied.

SO ORDERED.

Neil P. Olack
United States Bankruptcy Judge
Dated: May 1, 2009

[4]Travelers Indemnity Co. v. Bailey (U.S. Dkt. # 08-295) and Common Law Settlement Counsel v. Bailey, (U.S. Dkt. # 08-307).