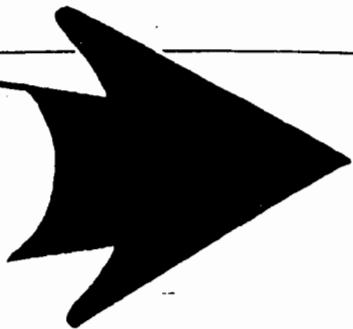


THE ARROW



A Publication of:
GREENE & COOPER, ATTORNEYS

THE CASE OF HONEST JOHN'S USED CARS:

One Involuntary Petition That Worked!

Editor's Note: This article represents the first in a proposed series of articles based upon actual cases from the files of the attorneys at Greene & Cooper. The names of the parties have been changed, but the facts have not been altered.

Honest John's used cars had been in business in a small town in western Kentucky for some years. Keeping sufficient inventory on hand had always been a problem for this used car dealer, and a local savings and loan association, which we will call Easy Going S&L, wanted to help Honest John out. Unfortunately, Easy Going S&L had little knowledge of, or experience with, floor-planning dealer inventory.

In a typical floor plan situation, the inventory financer files a blanket lien against all inventory of the car dealer. The inventory financer then receives a payment equal to the wholesale price of each vehicle when it is sold off the car lot. The inventory financer also receives a monthly payment representing interest on the total wholesale purchase price of the inventory on the floor at any given time.

Easy Going S&L set up its own unique system, however, whereby it wrote up each purchase of a car by Honest John for his inventory as a separate loan to Honest John. Easy

Going S&L retained the original of the title papers until such time as Honest John informed Easy Going S&L's loan officer that he had a buyer for a particular automobile. Easy Going S&L would then surrender the original certificate of title to Honest John so that he could close the deal, trusting Honest John to remit the principal and interest due when he was paid.

As time went on, Honest John found himself in a bad cash crunch and determined that his best hope for relief was a Chapter 7 bankruptcy petition. When Easy Going S&L learned of the impending bankruptcy, and in fact, while the petition was in the mail to the courthouse, Easy Going S&L swooped down and repossessed Honest John's entire inventory of used cars, and removed them to its own parking lot. Faced with a potential loss in the bankruptcy, Easy Going S&L then consulted counsel and learned that its security agreements on the various automobiles had not been properly perfected under the Uniform Commercial Code (UCC).

Unfortunately for Easy Going S&L, some general, unsecured creditors took the trouble to learn of Easy Going S&L's failure to properly perfect. That is, they checked the UCC records in the County Clerk's

office. When the Chapter 7 trustee was appointed, these creditors informed him that there was a significant asset in the estate—Honest John's entire inventory of used cars. Although Easy Going S&L had perfected its security interest by seizing possession of the vehicles prior to the petition date, the seizure was within 90 days of the bankruptcy, and was thus a preference, an avoidable transfer which could be set aside by the Chapter 7 trustee.

Fearful of the trustee's avoidance power, Easy Going S&L then proposed a new deal to Honest John—if he would dismiss his bankruptcy petition, Easy Going S&L would forgive any deficiency claim. Easy Going S&L and its lawyer reasoned that since there were no competing liens on the inventory, but only the claims of unsecured creditors and the trustee in bankruptcy, the preference claim would go away if the Chapter 7 was dismissed, and Easy Going S&L would be free to apply the proceeds from the used car inventory to Honest John's loans from Easy Going S&L. Honest John and his bankruptcy counsel accepted the offer of a deficiency waiver and agreed to dismiss his Chapter 7.

Although the unsecured creditors and the Chapter 7 trustee objected to Honest John's motion to dismiss his bankruptcy petition, the court granted the requested dismissal. Five days later counsel for three of

the unsecured creditors filed an involuntary Chapter 7 petition against Honest John. The filing of the involuntary petition locked Easy Going S&L back into its position as the holder of an avoidable preference because the involuntary petition was well within 90 days of the repossession.

The trustee in the new Chapter 7 involuntary proceeding then hired the counsel for the original petitioning creditors as counsel for the trustee to file an adversary proceeding against Easy Going S&L. The result was the recovery of over \$130,000 for the general, unsecured creditors of Honest John. The bankruptcy court granted summary judgment against Easy Going S&L without the necessity of a trial.

The three petitioning creditors were awarded their attorney fees and court costs for filing the involuntary petition as an administrative priority expense of the bankruptcy, since their action clearly benefited all of the general, unsecured creditors. Easy Going S&L was of course relegated to the position of a general, unsecured creditor and had to share *pro rata* with other creditors the very funds which it was forced to pay back into the estate. It would be hard to find a better example of how an involuntary bankruptcy should work or a better set of facts for filing one.

This publication is not a legal opinion of Greene & Cooper nor any partner thereof. You should consult with legal counsel prior to relying on any information contained herein.