

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

Presentment Date: 5/8/08 at 10:00 a.m.
Objection Date: 5/5/08 at 5:00 p.m.

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In re

Chapter 11

KOLLEL MATEH EFRAIM, LLC, a/k/a
MATEH EPHRAIM LLC, a/k/a
KOLEL MATEH EFRAIM

Case No. 04-16410 (SMB)

Debtor.

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ROBERT GELTZER, as Chapter 7 Trustee of
the Estate of the Debtor KOLLEL MATEH
EFRAIM, LLC, a/k/a MATEH EPHRAIM
LLC, a/k/a MATEH EPHRAIM LLC, a/k.a
KOLEL MATEH EFRAIM

Plaintiff,

Adv. Pro. No. 04-04545 (SMB)

- against-

HELEN-MAY HOLDINGS, LLC, and
IRENE GRIFFIN

Defendants

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**OBJECTION BY BACKENROTH FRANKEL & KRINSKY, LLP TO THE TRUSTEE'S
MOTION TO APPROVE ITS SETTLEMENT WITH HELEN-MAY HOLDINGS, LLC**

Backenroth Frankel & Krinsky, LLP ("BFK"), an administrative creditor, objects to the Trustee's motion to approve its settlement with Helen-May Holdings, LLC ("HMH")(AdvDoc. No. 59). The motion and/or settlement, should be denied since, among other things:

(A) The Court never ruled that HMH is entitled to either an administrative claim or \$1,500.00 a day under the Occupancy Agreement, and denied summary judgment on a similar HMH counterclaim;

(B) HMH's claim based on the Occupancy Agreement's \$1,500.00 day penalty provision, should be limited to a pre-petition general unsecured claim and not an administrative claim;

(C) HMH is precluded under the election of remedies doctrine from seeking damages based on the continuance of the Occupancy Agreement, i.e., the \$1,500.00 a day penalty provision from September 2004 through October 2007, and should be limited to the \$245,799.00 Use & Occupancy Judgment;

(D) The Trustee's motion also fails to contain an adequate record necessary to support

the settlement, including the basis for relinquishing either the debtor's substantial Collateral Claims seeking \$1,200,000.00 or claims for either Pre-Petition Improvements or Post-Petition Improvements; and

(E) HMH is not entitled to a super priority lien claim for its \$245,799 Use & Occupancy Judgment, since its operative Order to Show Cause neither sought a lien against the debtor's property under 11 U.S.C. § 364(c)(2); nor any priority against the debtor's other administrative creditors under § 364(c)(1).

BACKGROUND

The Contract

1. On April 29, 2004, HMH executed a contract of sale (the "Contract") with Aron Fixler to sell the property at 1141 County Road #114, Cohecton, New York (the "Property") for \$1,400,000, with an initial deposit of \$99,100 (the "Deposit") and the balance due at closing ("Closing"). Mr. Fixler assigned the Contract to the debtor.

2. The Contract further provided that if the purchaser defaulted, HMH's sole remedy would be limited to the Deposit as liquidated damages (Ex. A., Contract § 13.04). The Rider to the Contract reaffirmed that HMH's sole remedy, upon the purchaser's default, would be restricted to the Deposit as liquidated damages (Ex. A, Contract § 37).

The Occupancy Agreement

3. On June 3, 2004, HMH and the debtor entered into a use and occupancy agreement (the "Occupancy Agreement")(Ex. B) for the debtor's exclusive right to occupy the Property through Closing, which was extended to September 27, 2004.

4. The Occupancy Agreement further stated that the Deposit would be increased from \$100,000 to \$140,000, which would represent the new liquidated damage sum or HMH's sole remedy if the purchaser defaulted or if it was terminated (Ex. B, p. 3). The Occupancy

Agreement also contained a penalty provision for \$1,500.00 a day, if it was continued and/or not terminated and the debtor failed to close (Id.).

5. HMH and its agents made numerous misrepresentations, both orally and in writing, directly to the debtor that the Property contained 77 acres when it contained only 60 acres. For example, HMH executed a Real Property Transfer Form RP-5217, and distributed an Environmental Report and marketing materials all stating that the Property contained 77 acres; and The Town Tax Bills and Tax Map also confirmed that the Property contained 77 acres (AdvDoc. No.'s 24 & 37, LefAffs.). Based on HMH's direct misrepresentations, the debtor invested an additional \$1.2 million to purchase two (2) adjacent properties and to develop, improve and renovate the Property (the "Collateral Claims"), including new kitchen and communication equipment and heating, ventilation and air conditioning units for each room. The debtor also made numerous and substantial improvements and renovations to the Property subsequent to the Bankruptcy filing, including but not limited to new roofs, updating the septic system and updating the pool (the "Post-Petition Improvements").

6. On September 22, 2004, the debtor and HMH entered into an extension agreement ("Extension Agreement") extending the Closing to November 29, 2004.

7. Mr. Jack Lefkowitz, the debtor's principal, observed a survey of the Property in Irene Griffin's possession and requested a copy (LefAffs). Ms. Griffin refused and instructed Mr. Lefkowitz to acquire his own survey which he received on or about September 27, 2004 and which revealed that the Property consisted of only 60 acres (Id.). Upon discovering the decrease

in the Property's quantity of acreage, the debtor requested an appropriate reduction in the purchase price which HMH refused, precipitating the Bankruptcy (Id.).

The Bankruptcy

8. On October 4, 2004, the debtor filed its Chapter 11 Bankruptcy.

9. On November 8, 2004, the Court issued an Order authorizing BFK's retention as debtor's counsel (BCDoc. No. 9).

10. On November 7, 2004, HMH moved for various relief, including to compel the debtor to pay post-petition expenses under the Occupancy Agreement from October 4, 2004 through approximately November 15, 2004, in the aggregate amount of \$183,778.33 (BCDoc. No. 8, paras 39 & 40). The Court, as conceded by HMH, issued an oral Order directing the debtor to pay only \$5,000 a month as adequate protection which was far less than \$183,778.33.

11. On November 15, 2004, the debtor filed a Complaint against HMH for various claims for relief, including the Collateral Claims and for pre-petition improvements to the Property (the "Pre-Petition Improvements")(AdvDoc. No. 1).

12. On December 9, 2004, HMH filed an Answer to the Complaint, asserting, among other things, that the debtor's rights under the Contract terminated pre-petition (AdvDoc. No. 2, para 32); and/or that the Occupancy Agreement modified the Contract and that the debtor owes substantial sums thereunder (Id., paras 42 & 44).

13. On June 12, 2005, HMH moved to, among other things, increase plaintiff's monthly use and occupancy payments from \$5,000 to \$12,000 per month (BCDoc. No. 25, Aff. paras 6-9). HMH's counsel filed a supporting affidavit admitting, under oath, that pursuant to the Occupancy and Extension Agreements, the debtor's right to occupy the Property terminated as of

November 29, 2004. (BCDoc. No. 25)(Aff. paras 6 & 6[a]). Moreover, HMH's motion recognized that the debtor was only required to pay the Property's fair market value use and occupancy, and not the sums due under the Occupancy Agreement (Id., Aff. paras 6-9).

14. On June 27, 2005, HMH filed reply papers in further support of its motion, asserting, among other things, that the debtor should pay \$12,000 per month as the reasonable value for the Property's use and occupancy (BCDoc. No. 33, Point III).

15. On July 20, 2005, the Court held a Trial and HMH presented a witness that testified that the Property's fair rental value on an annual basis would be \$140,000 (BCDoc. No. 54, 7/20/05 Tr. pp. 9[17]-10[7]). The Court ruled, based on HMH's witness, that the Property's reasonable monthly value was \$140,000 divided by 12, plus taxes (Id., pp. 12[22]-13[9]).

16. On April 25, 2007, the Court issued an Order (the "April 25, 2007 Order"), based on its July 20, 2005 ruling, setting monthly use and occupancy payments in the amount of \$13,553.00 and retroactive payments in the net amount of \$210,120.00 (BCDoc. No. 119). The Court's April 25, 2007 Order did not provide for entry of a judgment or lien if the debtor was unable to make any payments thereunder (Id.).

17. On May 14, 2007, HMH moved by Order to Show Cause (BCDoc. No. 125) seeking various relief based on the debtor's inability to pay under the April 25, 2007 Order. On May 15, 2007, the Court signed HMH's Order to Show Cause (BCDoc. No. 126).

18. HMH's Order to Show Cause neither sought a lien against the debtor's property under 11 U.S.C. § 364(c)(2); nor any priority against the debtor's other administrative creditors under § 364(c)(1) (BCDoc. No.'s 125-126).

19. On May 22, 2007, the Court held a Hearing on HMH's Order to Show Cause, and

indicated for the first time that it would award HMH a judgment on the unpaid amounts under the April 25, 2007 Order (BCDoc. No. 144).

20. On June 5, 2007, the Court issued an Order (BCDoc. No. 137) with respect to the Order to Show Cause which did not provide for entry of a judgment or lien.

21. Sometime on or about June 19, 2007, HMH sent the debtor a Ten Day Notice to Quit and Vacate, dated June 15, 2007, indicating that HMH has terminated the Contract, Occupancy and Extension Agreements.

22. On July 9, 2007, MEW Equity, LLC (“MEW”), the Property’s mortgagee, asserted that as of November 2005, the Property’s unpaid principal mortgage debt (exclusive of interest) was \$1,350,000 which came due November 2006 (BCDoc. No. 161, paras 12, 13, 16 & 17).

23. On August 3, 2007, HMH moved for summary judgment seeking, among other things, (a) dismissal of the Complaint; (b) a determination that the Contract terminated pre-petition; and (c) a determination on its first counterclaim that it was entitled to, among other things, \$1,500.00 a day in damages for every day the debtor stayed in possession of the Property beyond November 29, 2004 (the “First Counterclaim”)(AdvDoc. No. 27, HMHMem para 60). HMH asserted that the debtor’s failure to close by September 27, 2004 “terminated” its rights under both the Contract and Occupancy Agreement, including forfeiture of the Deposit and any improvements to the Property (Id., paras 21, 22, 54, 83, 86 & 89). On October 8, 2007, HMH filed its Reply, asserting that the agreements merged and that it was entitled to the \$1,500.00 a day payment thereunder (AdvDoc. No. 40, para 15).

24. On August 10, 2007, HMH obtained a judgment (the “Use & Occupancy Judgment”) (BCDoc. No. 186) against the debtor in the amount of \$245,779.00 for the payments

under the April 25, 2007 Order.

25. On October 11, 2007 the Court held a Hearing on HMH's motion for summary judgment. HMH argued among, other things, that Contract and Occupancy Agreement terminated pre-petition (BCDoc. No. 236, pp. 11-12). The Court denied HMH summary judgment for, among other things, (a) dismissal of the Collateral Claims and Pre-Petition Improvement claims; and (b) recovery on its Counterclaim for, among other things, \$1,500.00 per day (Id., at pp. 32, 39-41). The Court further indicated that there may be "mitigation issues" concerning HMH's right to damages under the Occupancy Agreement (Id., at p. 24[11-12]).

26. On October 29, 2007, the Court issued an Order converting the Case to Chapter 7.

27. On November 9, 2007, the debtor filed a Schedule of unpaid Chapter 11 post-petition debt, which included debts owed to (a) BFK for \$427,668.16; and (b) Maskil El-Dal Incorporated ("Maskil") for \$205,406.01 (BCDoc. No. 22). To date, there has been no objections to the administrative claims of either BFK or Maskil, which aggregate \$633,974.17.

28. On December 26, 2007, HMH objected to the Trustee's motion to extend its time to assume or reject the Contract, asserting that the Contract terminated pre-petition (BCDoc. No. 240, para 1). HMH also argued that the Contract was modified by the Occupancy Agreement, and that the Contract's cure amounts would include, among other things, \$1,500.00 per day from September 27, 2004 (Id., para 2).

29. On March 20, 2008, HMH objected to the Trustee's motion to approve bidding procedures and sale, asserting that the Contract terminated pre-petition (BCDoc. No. 251, para 3). Moreover, HMH argued that "the Occupancy Agreement is a modification of the Contract", and that the Contract's cure amounts would include, among other things, \$1,500.00 per day from

September 27, 2004 (Id., paras 4, & 18-20).

30. On April 3, 2008, the Court held a Hearing pursuant to HMM's request to renew the portion of its summary judgment motion on the issue of whether the Contract terminated pre-petition (BCDoc. No. p. 2[6-9]). During the Hearing, HMM argued that the Contract and Occupancy Agreement "are inseparable" (Id., p. 53[10-11]), and that the Occupancy Agreement modified the Contract (Id., p. 3[1-2]). HMM further asserted that its intent was to terminate both the Contract and Occupancy Agreement (Id., pp. 11[23]-12[2]).

31. On April 11, 2008, Maskil filed a proof of claim for pre-petition loans advanced to the debtor in the amount of \$1,296,620.24.

32. On April 14, 2008, the Court issued an Order denying HMM's renewed motion for summary judgment on the issue of whether the Contract terminated pre-petition, and set the issue down for a Trial on April 15, 2008 (BCDoc. No. 54).

33. On April 14, 2008, HMM submitted a Pre-Trial Brief, alleging that the Contract and Occupancy Agreement terminated pre-petition (AdvDoc. No. 56, para 1). HMM further asserted that the Property's mortgage debt was limited to only \$400,000 upon the Contract's signing in April 2004 (Id., paras 18 & 28). HMM's assertion, coupled with MEW's assertion, means that HMM increased the Property's principal mortgage debt from \$400,000 to \$1,350,000 during 2004 through 2005 and pulled out \$950,000 in mortgage proceeds. The Trustee also filed a Pre-Trial Brief alleging that HMM pocketed \$140,000 in liquidated damages pursuant to both the Contract and Occupancy Agreement (AdvDoc. No. 55, pp. 5-6).

34. On April 15, 2008, HMM proceeded to Trial on its claim that the Contract terminated pre-petition, and made evidentiary submissions in support of its claim.

35. On April 17, 2008, the Trustee and HMH reached a settlement whereby

(a) HMH obtains an allowed Chapter 11 administrative claim in the amount of \$1,737,000, based on the Occupancy Agreement's \$1,500.00 penalty provision from September 27, 2004 through October 29, 2007 (AdvDoc. 59, para 16[b]);

(b) HMH's Judgment obtains priority ahead of all other claims except for allowed Chapter 7 administrative claims, meaning the Trustee and his professionals (Id., 16[c]); and

(c) the Trustee rejects the Contract (Id., para 16[c]).

36. On April 28, 2008, the Trustee moved to approve the settlement (AdvDoc. No. 59). The motion confirms that HMH's allowed Chapter 11 administrative claim in the amount of \$1,737,000 is based on the Occupancy Agreement's \$1,500.00 penalty provision from September 27, 2004 through October 29, 2007 (Id., para 16[b]). The Trustee further confirms that it did not seek to assume the Occupancy Agreement (Id., para 10).

THE MOTION AND SETTLEMENT SHOULD BE DENIED

37. The Settlement provides HMH with an allowed administrative claim for \$1,737,3000 based on the Occupancy Agreement's \$1,500.00 day penalty from September 27, 2004 through October 29, 2007. However, the Court never ruled that HMH is entitled to either an administrative claim or \$1,500.00 a day under the Occupancy Agreement. Rather, the Court denied HMH summary judgment on its First Counterclaim, which was based on the same \$1,500.00 per day penalty provision (BCDoc. No. 236, pp. 32, 39-41) .¹

38. Moreover, the Trustee concedes that it did not seek to assume the Occupancy

¹ The Court merely indicated, at best, that such amounts were "necessary to cure" if the debtor was going to "assume this contract", meaning the Contract, subject to any prior rulings by Judge Blackshear (BCDoc. No. 54, 7/20/05 Tr. pp. 37[15]-38[22]).

Agreement (AdvDoc. No. para 10). The Trustee also asserts that it will reject the Contract (Id., para 16[c]).

39. It is well-settled that “rejection of an unassumed executory contract generally gives rise to a prepetition general unsecured claim for damages rather than an administrative expense priority.” In re Child World, Inc., 147 B.R. 847, 850 (Bankr. S.D.N.Y. 1992); accord, The Penn Traffic Company v. The Penn Traffic Company, 2008 WL 1885328 * 3 (2d Cir. 2008)(“In the event of rejection, the non-debtor party is generally relegated to pursuing an unsecured prepetition claim against the estate”).

40. Thus, HMH’s purported claim arising out of the Occupancy Agreement’s \$1,500.00 day penalty provision, should be limited to, at best, a pre-petition general unsecured claim and not an administrative claim.

41. In any event, under the election of remedies doctrine “the non-breaching party must choose between two remedies-[it] can elect to terminate the contract and recover liquidated damages or [it] can continue the contract and recover damages solely for the breach”. ESPN, Inc., v. Office of the Commissioner of Baseball, 76 F.Supp.2d 383, 387 (S.D.N.Y. 1999).

42. Here, HMH has repeatedly argued that the Occupancy Agreement modified the Contract and that they are “inseparable”. Moreover, both the Contract and Occupancy Agreement limit HMH’s sole remedy upon purchaser default to the Deposit as liquidated damages (Ex. A, § 13.04 & Rider, § 37; Ex. B, p. 3). HMH has also repeatedly asserted that both the Contract and Occupancy Agreement terminated pre-petition, and even retained the Deposit as liquidated damages thereunder. Furthermore, HMH made two (2) separate summary judgment motions asserting that the Contract and Occupancy Agreement terminated pre-petition and even

proceeded to Trial on that issue. HMH also elected to proceed to Trial seeking use and occupancy payments based solely on the Property's fair market value and further submitted and obtained the Use & Occupancy Judgment for those amounts. Thus, HMH is precluded under the election of remedies doctrine from seeking damages based on the continuance of the Occupancy Agreement, i.e., the \$1,500.00 a day penalty provision from September 2004 through October 2007. Instead, HMH's damages should be limited to the \$245,799.00 Use & Occupancy Judgment.

43. The Trustee's motion also fails to contain an adequate record necessary to support the settlement. For example, the Trustee fails to even discuss, much less assert the basis for relinquishing, either the debtor's substantial Collateral Claims seeking \$1,200,000.00 or claims for either Pre-Petition Improvements or Post-Petition Improvements.

44. Rather, the Trustee asserts that "it appears questionable that (HMH) would have the financial wherewithal to satisfy any judgment that the Trustee might obtain against (HMH)". (AdvDoc. No. 59, para 29). However, the Collateral Claims and Pre- and Post-Petition Improvement claims are, at the very least, potential offsets, since the Court has indicated that there may be "mitigation issues" concerning HMH's right to damages under the Occupancy Agreement (BCDoc. No. 236, at p. 24[11-12]). Moreover, the Trustee's assertion as to HMH's alleged lack of finances is unsupported by the record, since HMH pocketed, at least, \$950,000 in mortgage proceeds and \$140,000 in liquidated damages, for the aggregate amount of \$1,090,000.

45. Furthermore, BFK (an administrative creditor for \$427,668.16) has conferred with the Trustee for Maskil (an administrative creditor for \$205,406.01 and pre-petition creditor for \$1,296,620.04) and it likewise opposes both the motion and settlement.

46. The settlement should also be denied, since it omits any payment of capital gains

taxes. Since HMH asserts that the mortgage encumbering the Property was only \$400,000.00 upon the Contract's signing, the sale of the Property will likely trigger substantial capital gains taxes (AdvDoc. No. 56, paras 18 & 28). Thus, to prevent a fraud on the Court, the settlement should contain some provision ensuring the payment of capital gains taxes after the liens.

47. The settlement also provides HMH with a super priority lien claim for the \$245,799 Use & Occupancy Judgment. However, HMH's operative Order to Show Cause neither sought a lien against the debtor's property under 11 U.S.C. § 364(c)(2); nor any priority against the debtor's other administrative creditors under § 364(c)(1)(BCDoc. No.'s. 125-126). Thus, HMH's \$245,799 Use & Occupancy Judgment should be limited to only an administrative claim and not a lien.

CONCLUSION

For all the foregoing reasons set forth herein, the Court should deny the Trustee's motion for approval of its settlement with HMH (AdvDoc No. 59); and for such other and further relief as it deems just and proper. At the very least, BFK's Objection requires the Court to schedule a Hearing on the motion, as conceded by the Trustee's Notice of Presentment.

Dated: New York, New York
May 5, 2008

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