

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA
Alexandria Division

In re:)	
)	
THE BENTLEY FUNDING GROUP, LLC.)	Case No. 00-13386-SSM
)	Chapter 11
Debtor)	

MEMORANDUM OPINION AND ORDER

The question before the court is whether an order to show cause should be issued against Edgar A. Reilly, Jr., Fredric L. Spain, James A. Jeffery, and Thomas J. Stanton, Esquire (collectively, “the respondents”), for violation of the discharge injunction by filing a chancery suit in state court to dissolve the reorganized debtor and by filing a memorandum of lis pendens against the reorganized debtor’s real estate. Messrs. Reilly, Spain, and Jeffery together hold a 21% minority membership interest in the reorganized debtor. Mr. Stanton is the attorney who filed the state court suit, and who represented Messrs. Spain and Jeffrey in an unsuccessful objection to confirmation of the debtor’s chapter 11 plan. Because it was not clear that the actions taken by the respondents would constitute violations of the confirmation order, the court held an expedited hearing on June 18, 2001, to consider whether the alleged facts, if proven, would constitute contempt. The reorganized debtor was present by counsel. Messrs. Reilly, Spain, and Stanton were present in person. Mr. Jeffrey was not present, it being represented that he was out of the country and had not received actual notice of the expedited hearing. For the reasons stated, the court declines to issue an order to show cause.

Background

Bentley Funding Group, LLC, (“Bentley” or “the debtor”) is a Virginia limited liability company that was formed in 1998 to develop approximately 173 acres of land in a mixed-use development known as “River Oaks” located in the Woodbridge area of Prince William County, Virginia. An unusual feature of Bentley is its tripartite membership and management structure, which has been aptly described as a “troika.” There are three classes of members, and each class elects its own manager. Class A consists of Peter Denger and Peter Horvat, each of whom owns a 33.5% membership interest. Class B consists of Fernando Gomez, James A. Jeffery, Edgar Reilly and Fredric L. Spain, each of whom own a 7.0% membership interest. Finally, Class C consists of Kenneth Young, who owns a 5.0% membership interest. Only the Class A members were required to invest money in the proposed development. The Class B members had identified the project and had brought it to the table, but neither they nor the Class C member were required to invest any of their own money. Under the company’s operating agreement, most business decision required the concurrence of at least two classes. The decision to file bankruptcy, however, required unanimous consent of the members.

The purchase of the River Oaks property had been financed by a note secured by a first-lien deed of trust. When the note went into default, it was purchased by SK&R Group, L.L.C. (“SK&R”), which then scheduled a foreclosure sale. Bentley had other serious financial problems as well: it had fallen far behind in payments to S. W. Rodgers Company, its general contractor, and its failure to complete the required public improvements had caused Prince William County to declare a default with respect to the subdivision performance bonds issued on the debtor’s behalf by AXA Global Risks U.S. Insurance Company (“AXA”). When the possibility of a voluntary chapter 11 filing to stop the

foreclosure was raised by the other members, Messrs. Reilly, Spain, and Jeffery refused to consent. Messrs. Denger, Horvat, and Gomez, together with two corporations they controlled, then filed an involuntary chapter 11 petition against the debtor on August 11, 2000, thereby invoking the automatic stay and preventing the foreclosure from going forward. On August 28, 2000, Mr. Reilly, as Class B manager, filed an answer *opposing* the involuntary petition. On September 5, 2000, however, he filed an answer on behalf of the debtor *consenting* to chapter 11 relief, and an order granting such relief was entered on September 6, 2000.

No trustee was appointed, and Bentley remained a debtor in possession throughout the chapter 11 case.¹ Approximately four months into the case, Bentley filed a motion to approve a sale of all but 22 acres of the River Oaks property to SK&R in full satisfaction of the sums due under the deed of trust. As part of the purchase, SK&R also paid \$300,000 to the debtor and agreed to pay the claims of S. W. Rodgers, AXA, another contractor which had filed a mechanic's lien, and Prince William County. That sale was approved by this court on January 30, 2001.

A hearing was then held on approval of an amended plan of reorganization that had been filed by the debtor on March 6, 2001. Since all of the secured claims had been paid or otherwise provided for by the sale to SK&R, the only claims and interests, other than administrative claims, dealt with by the plan were general unsecured claims (Class 4), "insider" unsecured claims (Class 5) and equity interests (Class 6). Class 4 claims were to be paid in full at confirmation. The Class 5 claims were to

¹ Initially, Mr. Reilly was named as the debtor's designated representative under Fed.R.Bankr.P. 9001(5) (allowing court to designate a person to perform the duties of a debtor when the debtor is not a natural person). On motion of the Class A members, however, the court amended the order of designation to designate Mr. Gomez as the debtor's representative.

be recharacterized as equity contributions. The Class 6 equity interests would simply retain their existing rights. No changes were proposed to the management of the debtor. The remaining 22 acres of land, which were now unencumbered, would be developed or sold by the reorganized debtor, with any distributions to the members being governed by the operating agreement.

Classes 4 and 5 voted to accept the plan. Ballots were not solicited from the equity holders since they were unimpaired by the plan. Messrs. Spain and Jeffrey, who were represented by Thomas J. Stanton, Esquire, nevertheless filed an objection to confirmation. The primary focus of their objection was that the plan, by failing to remove Messrs. Denger, Horvat, Young, and Reilly from management control, failed to satisfy 11 U.S.C. § 1129(a)(5), which requires, as a condition of confirmation, that the appointment to, or continuance in, office of any individual proposed to serve, after confirmation of the plan, as “a director, officer, or voting trustee” of the debtor be “consistent with the interests of creditors and equity security holders and with public policy.” In particular, Messrs. Spain and Jeffrey contended that Messrs. Denger and Horvat, abetted by Mr. Reilly, wholly mismanaged the project, failed to invest the capital they were required to invest by the operating agreement, and improperly orchestrated the involuntary chapter 11 filing to avoid the unanimous-consent requirement of the operating agreement. The fear expressed by Messrs. Spain and Jeffrey at the confirmation hearing was that if the existing management structure were left unchanged, Messrs. Denger and Horvat would somehow contrive to siphon off the value of the remaining 22 acres.

After considering the evidence and arguments, the court overruled the objections to confirmation and entered an order on May 31, 2001, confirming the plan of reorganization. No appeal was taken from the confirmation order. However, on June 1, 2001 – the day following entry of the

confirmation order – Messrs. Spain and Jeffrey, now joined by Mr. Reilly, and represented by Mr. Stanton, filed a bill of complaint in the Circuit Court of Prince William County against Bentley and against Messrs. Denger, Horvat, Gomez, and Young for dissolution of Bentley under Va. Code § 13.1-1047. As additional relief, the plaintiffs requested that the remaining 22 acres owned by Bentley be sold by the court and that any distributions due to the defendants be “subordinated” to their own claims. Contemporaneously with the filing of the chancery suit, they filed a memorandum of lis pendens in the land records of Prince William County referencing the chancery suit. The memorandum stated that “the general object [of the suit] is the judicial dissolution of Bentley Funding Group, L.L.C., the sale of the real property described below, and a determination and adjustment on sale of the property of the damages caused the Plaintiffs by the Defendants, and the subordination of any claims of the defendants to those of the plaintiffs, upon final liquidation of the subject land.” The memorandum then described the land and stated that “the owner of the . . . property whose estate is intended to be affected is BENTLEY FUNDING GROUP, L.L.C.”

The reorganized debtor responded on June 5, 2001, by filing the motion that is presently before the court for an order requiring Messrs. Spain, Jeffrey, Reilly, and Stanton to show cause why they should not be held in contempt for violation of the confirmation order and discharge injunction.

Discussion

A.

In a chapter 11 case, the provisions of a confirmed plan

bind the debtor . . . and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the

plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

11 U.S.C. § 1141(a). Additionally, except to the extent otherwise provided in the plan, confirmation

(A) discharges the debtor from any debt that arose before the date of such confirmation ...; and

(B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

11 U.S.C. § 1141(d). Finally, a discharge

operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived[.]

11 U.S.C. § 524(a)(2). The respondents do not dispute these general principles but argue that they are inapplicable, since the chancery suit, although naming the debtor as party defendant, does not in literal terms attempt to enforce a claim against the debtor. They further argue that nothing in the plan modifies the rights of equity security holders or insulates the reorganized debtor from state court dissolution proceedings.

B.

As a general proposition, the court agrees that a plan that does not modify the rights of equity security holders does not prevent the holders of such interests from proceeding after confirmation to enforce rights available to them under nonbankruptcy law, at least to the extent such enforcement is not inconsistent with the terms of the plan and does not interfere with the performance of the plan. The plan that was confirmed in this case contained no injunction against enforcement by the members of any state-law claims they might have against each other, nor did it expressly, or by necessary implication,

prohibit enforcement of any right the members might have under state law to dissolve the company.

This is not a case, it must be stressed, in which the ongoing operation of the debtor following confirmation is the means by which creditors are to be paid. Faced with those circumstances, the court would unquestionably have the power to prohibit post-discharge actions that would threaten such payment by interfering with the debtor's operations. Here, by contrast, all allowed non-insider claims were paid or otherwise satisfied at or before confirmation, and the debtor emerged from chapter 11 with no claims to be paid from future operations.

It is unquestionably true, as the debtor argues, that the *grounds* upon which the three minority members now seek dissolution of the company are essentially identical with those upon which they unsuccessfully urged the denial of confirmation. The fact that they are now seeking a second bite at the apple may well be grounds for the state court to deny relief based on the principles of res judicata or collateral estoppel. However, preclusion issues are ordinarily addressed to the court in which the new action is brought, not to the court which rendered the first judgment. It is further true that some of the activities which are set forth in the bill of complaint as grounds for dissolution of the company involves actions ratified by this court.² To the extent the minority members are impermissibly attempting a

² In particular, the bill of complaint alleges that the filing of the involuntary petition was fraudulent; that some of the filed insider claims are fraudulent; and that the 151 acres were improperly sold without the consent of the Class B members. As to the filing of the involuntary petition, the court notes that Mr. Reilly, having filed a *consent* to the order for chapter 11 relief, is surely estopped from now attacking the validity of the filing. Messrs. Spain and Jeffrey, while they did not expressly consent to the filing, apparently endorsed Mr. Reilly's action at the time. In any event, they had nine months while the case was pending to bring a motion to dismiss the case on the ground that it was not properly commenced, and they failed to do so. Entry of the confirmation order constitutes a final determination by this court that the case was properly filed, and, as noted, no appeal was taken from that order. With respect to

(continued...)

collateral attack on orders of this court, the impropriety of doing so – in the absence of any harm to the bankruptcy estate or to the payment of claims by the reorganized debtor – is more appropriately considered by the state court.³

ORDER

For the foregoing reasons, the court is unable to conclude that the filing of the bill of complaint and memorandum of lis pendens violated either the discharge injunction under 11 U.S.C. § 524(a)(2) or the order confirming the plan. Accordingly, it is

ORDERED:

1. The motion for an order to show cause is denied, without prejudice to the right of the reorganized debtor to assert any matters raised in such motion in defense of the state court litigation.

²(...continued)

the sale of the 151 acres, that action was expressly authorized by an order of this court and did not under bankruptcy law require the approval of the Class B members. With respect finally to the insider claims, Messrs. Spain and Jeffrey have already filed objections in this court to the allowance of those claims, and this court retains jurisdiction to determine the amount, if any, the insider creditors were owed.

³ Also properly addressed to the state court is the debtor's argument that the filing of a memorandum of lis pendens is not permissible under state law. *See* Va. Code § 8.01-268(B) ("No memorandum of lis pendens shall be filed unless the action on which the lis pendens is based seeks to establish an interest by the filing party in the real property referred to in the memorandum."). Whether or not permitted under state law, the mere filing of a lis pendens would not normally constitute a violation of the discharge injunction, since under Virginia law a memorandum of lis pendens does not create a lien against property but serves "merely as 'notice of the pendency of the suit to any one interested and a warning that he should examine the proceedings therein to ascertain whether the title to the property was affected or not by such proceedings.'" *Green Hill Corp. v. Kim*, 842 F.2d 742 (4th Cir. 1988). *See also In re Brewer*, 148 B.R. 346 (Bankr. M.D. Fla. 1992) (debtor's former wife did not violate discharge injunction by filing lis pendens in connection with partition suit); *Gilbert v. Ben Franklin Hotel Assocs.*, 1995 WL 598997 (E.D. Pa. 1995) (outlining factors to be considered by bankruptcy court in determining whether to abstain from hearing motion to dismiss post-discharge lis pendens).

