

Dated: February 04, 2013
The following is SO ORDERED:




David S. Kennedy
UNITED STATES CHIEF BANKRUPTCY JUDGE

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION**

In re

**Calvin Allen and
Latarsha Allen,**

Case No. 12-25604

Debtors.

Chapter 7

**SSN: xxx – xx – 4390 (H)
SSN: xxx – xx – 3773 (W)**

Bettye S. Bedwell, Chapter 7 Trustee,

Plaintiff,

v.

Adv. Proc. No. 12-00641

First Investors Financial Services,

Defendant.

**MEMORANDUM AND ORDER RE THE “MOTION FOR COMPROMISE AND
SETTLEMENT” AND RESPONSES THERETO COMBINED WITH NOTICE OF THE ENTRY
THEREOF**

This core proceeding under 28 U.S.C. § 157(b)(2)(A) and (O) arises out of a “Motion for Compromise and Settlement,” pursuant to FED. R. BANKR. P. 9019(a), filed by the chapter 7 trustee, Ms. Bettye Sue Bedwell, two responses filed by the creditor First Investors Financial Services, Inc. (“First Investors”), and two additional responses filed by the chapter 7 trustee. The parties’ motion for compromise and settlement seeks to resolve a pending adversary proceeding¹, where the chapter 7 trustee sought to avoid First Investors’ lien under 11 U.S.C. § 547(b). After agreeing to settle the dispute giving rise to the adversary proceeding but before court approval, First Investors now seeks to have the court rescind that agreement and not approve the instant Rule 9019(a) motion; whereas, the chapter 7 trustee asks the court to bind the parties, enforce the agreement, and approve it in accordance with the Rule 9019(a) motion. The threshold issue before the court is whether a consensual settlement not yet approved by the bankruptcy court pursuant to FED. R. BANKR. P. 9019 (“Rule 9019”) is a binding, valid contract under applicable Tennessee law that should be enforced and thereafter approved by the bankruptcy court pursuant Rule 9019(a).

Based on consideration of the entire case record as a whole, the following shall constitute the court’s findings of fact and conclusions of law in accordance with FED. R. BANKR. P. 7052. The undisputed and relevant background facts and judicial history are briefly summarized as follows.

Latarsha Allen (“Ms. Allen”) and her husband, Calvin Allen (“Mr. Allen”), the above-named joint debtors (collectively “Debtors”), filed a § 302 joint chapter 7 bankruptcy petition on May 30, 2012. First Investors is scheduled in the Debtors’ Schedule D as a secured creditor with a claim of \$22,120.00 collateralized by a 2011 Kia Sedona (the “Vehicle”) valued at \$23,000.00 and listed in Schedule B as property of Ms. Allen. In the Debtors’ Statement of Intention, they indicated their intent to retain the Vehicle and reaffirm the debt to First Investors. Following through with this intention, Ms. Allen and First Investors entered into a reaffirmation agreement on June 28, 2012, that was filed with the court on

¹ Adversary Proceeding No. 12-00641 between plaintiff Bettye S. Bedwell, chapter 7 trustee, and the defendant First Investors Financial Services, Inc.

the same date. In accordance with the reaffirmation agreement, Ms. Allen promised to pay to First Investors the sum of \$22,079.13 in monthly installments of \$537.57 over a 71.2 months period. The reaffirmation agreement states that the “reaffirmed debt is secured by a security interest or lien, which has not been waived or determined to be void . . .” and lists the 2011 Kia Sedona as the property securing the debt.

On October 18, 2012, the chapter 7 trustee filed the above-referenced adversary proceeding seeking to avoid First Investors’ security interest in the Vehicle as a preferential transfer under 11 U.S.C. § 547(b). The chapter 7 trustee alleged the Vehicle was purchased on March 6, 2012, for \$22,020.99 and financed the purchase through First Investors. First Investors was granted a lien and applied on April 12, 2012, for the lien to be notated on the vehicle’s certificate of title, which is the method of perfecting the lien under Tennessee law. The alleged timing of this perfection occurred 30 days after the Debtor received the Vehicle and within the 90 days before the filing of the chapter 7 petition; therefore, the chapter 7 trustee seeks to avoid the lien as a preferential transfer under § 547(b). First Investors filed a timely answer on November 13, 2012, denying the accuracy of the chapter 7 trustee’s timeline and seeking to dismiss the complaint with prejudice.

At a pretrial conference on December 11, 2012, and aware of factual and legal disputes, the parties reached a compromise and settlement, subject to court approval after notice to all creditors and a hearing. This settlement was announced in open court by the attorneys for both parties, and the chapter 7 trustee that same day filed a motion seeking court approval of this agreement pursuant to Rule 9019(a). This agreement called for First Investors to pay \$11,000.00 to the chapter 7 trustee on behalf of the chapter 7 § 541 estate and for First Investors to be allowed an unsecured claim for distribution purposes of \$11,000.00. Neither party disputes that such a compromise and settlement was reached.

Subsequent to this agreement and the filing of the Rule 9019(a) motion seeking court approval but prior to the court hearing on the Rule 9019(a) motion, First Investors became aware of an asserted temporary lien allegedly acknowledged by the State of Tennessee. A letter from the Tennessee Secretary of State dated March 26, 2012, was provided to First Investors via Gossett Motor Cars, who is not a party

these proceedings but who originally sold the Vehicle to Ms. Allen. First Investors asserts that this temporary lien is newly discovered evidence that significantly affects the validity of its secured status of its claim against Ms. Allen because it indicates that the lien was duly perfected within the 30 day period allowed under § 547(e)(2)(A) of the Bankruptcy Code.

Beginning on January 6, 2013, and continuing to January 25, 2013, First Investors and the chapter 7 trustee filed a series of four responses that arose out of the Rule 9019(a) motion for compromise and settlement. Collectively summarizing these responses, First Investors seeks to have the compromise and settlement agreement rescinded because it was entered into by mutual mistake of the parties as to secured status of First Investors' claim while the chapter 7 trustee seeks to have the compromise enforced and approved by the court because the mistake was unilateral and does not affect the ultimate disposition of the matter. First Investors weighing the now known fact believes in good faith that it is secured by this asserted temporary lien that has been properly perfected and, had it known about this lien when the compromise and settlement was negotiated, it would not have entered into such an agreement. The chapter 7 trustee admits it did not know about this asserted temporary lien. First Investors, thus, seeks to rescind the compromise and settlement under the doctrine of mutual mistake applied under traditional Tennessee contract law. The chapter 7 trustee contrarily argues that the mistake was unilateral and that First Investors should be held to its bargain. Furthermore, the chapter 7 trustee challenges the validity and enforceability of the temporary lien, believing that the asserted temporary lien has no impact on the secured status of First Investors' claim and that the chapter 7 trustee would prevail on its § 547(b) avoidance complaint.

After becoming aware of the Chapter 7 trustee's complaint, Ms. Allen filed on November 14, 2012, a motion seeking to ultimately rescind her previously filed reaffirmation agreement with First Investors also on the basis of mutual mistake. As noted, First Investors filed a timely objection thereto on December 3, 2012. The resolution of the reaffirmation agreement is pending until a final determination on the chapter 7 trustee's complaint is reached.

As noted earlier, the threshold issue now before the court is whether the compromise and settlement between the chapter 7 trustee and First Investors should be enforced and approved by the court pursuant to Bankruptcy Rule 9019(a) or rescinded based on asserted mutual mistake. The court is NOT at this time making a determination regarding the validity and the nature of the asserted temporary lien under Tennessee law nor is the court determining how the instant issue impacts Ms. Allen and First Investors' pending motion regarding the reaffirmation agreement. These latter two issues will be determined at a later date, as necessary.

Under applicable Tennessee law, "a settlement agreement is merely a contract between the parties to the litigation" and enforceability of this contract is governed by local contract law. *Sweeten v. Trade Envelopes, Inc.*, 938 S.W. 2d 383, 385 (Tenn. 1996). Specifically, when the terms of a settlement agreement are announced or stipulated in an open court or memorialized in a signed document, the terms of the settlement are an enforceable contract, even if one party later repudiates. *In re Estate of Creswell*, 238 S.W. 3d 263, 268 (Tenn. Ct. App. 2007); *see also Grigsby v. Harris*, 2012 WL 6449782 (Tenn. Ct. App. 2012); *Environmental Abatement, Inc. v. Astrum R. E. Corp.*, 27 S.W. 3d 530 (Tenn. Ct. App. 2000). Although an exception to this rule applies when a settlement agreement is reached but not announced in open court or memorialized in a signed document and the state court must later approve the settlement, a later repudiation for whatever reason has been allowed. *Harbour v. Brown for Ulrich*, 732 S.W. 2d 598 (Tenn. 1987). This court finds that the exception introduced in *Harbour* applies only to Tennessee procedure applicable in appropriate Tennessee courts and is not binding on a Federal bankruptcy court. This court will rely on *In re Estate of Creswell* as the applicable contract law governing the formation of a Tennessee settlement contract.

Furthermore, under Tennessee law contracts executed under a mutual mistake of fact or law regarding a basic assumption underlying the contract can be reformed or rescinded. *Alexander v. Shapard*, 240 S.W. 287, 291-94 (1922). "If parties contract under a mutual mistake and misapprehension as to their relative and respective rights, the result is that the agreement is liable to be set aside as having proceeded upon a common mistake." *Id*; *see also, among others, Sikora v. Vanderploegg*, 212 S.W. 3d 277, 286

(Tenn. Ct. App. 2006); *Kozy v. Werle*, 902 S.W.2d 404 (Tenn. Ct. App. 1995); *Pierce v. Flynn*, 656 S.W.2d 42 (Tenn. App. 1983); *City of Memphis v. Moore*, 818 S.W.2d 13 (Tenn. Ct. App. 1991). A party seeking to reform or rescind such a contract must prove the mistake by clear and convincing evidence. *Chandler v. Charleston Volunteer Fire Dept.*, 2011 WL 4026844 (Tenn. Ct. App. 2011); *Hazlett v. Bryant*, 241 S.W.2d 121, 125–26 (Tenn. 1951). Other than a clear and convincing showing of mutual mistake, Tennessee courts have generally only allowed reformation and rescission upon a showing that the contract was induced by fraud, duress, or other contract remedies of which none are at issue in this instant case.

Though this court looks to Tennessee law to see if a settlement agreement (i.e., contract) was formed, settlement agreements reached on matters under the jurisdiction of the bankruptcy court must be approved pursuant to Bankruptcy Rule 9019(a). Thus, though a valid, enforceable contract under Tennessee law may exist, that contract is not necessarily enforceable under Federal bankruptcy law until final approval by the presiding bankruptcy judge applying traditional Rule 9019(a) factors for approving such settlements. A bankruptcy judge should assess, among other things, whether a settlement agreement is fair and equitable by applying the following factors: (a) the probability of success in the litigation; (b) the collectability; (c) the complexity, expense, inconvenience and delay necessarily attendant to litigation; and (d) the paramount interest of the creditors and a proper deference to their reasonable views. *Drexel v. Loomis*, 35 F.2d 800 (8th Cir. 1929); *see also In re Haven, Inc.* 2005 WL 927666 (6th Cir. B.A.P. 2005) (applying the *Drexel* test); *In re MQVP, Inc.* 477 Fed.Appx. 310 (6th Cir. 2012); *In re Speece*, 159 B.R. 314 (Bankr. E.D. Cal. 1993).

The purpose of this approval process is to protect the bankruptcy estate and its creditors that are not parties to the settlement from bad deals made between a single creditor and the trustee. *In re United Shipping Co.*, 1989 WL 12723 (Bankr. D. Minn. 1989). Parties to a valid settlement agreement under state law are bound to the contract unless and until the bankruptcy court rejects the settlement. *In re Seminole Walls & Ceilings Corp.*, 388 B. R. 386 (M.D. Fla. 2008); *see also In re Turner*, 274 B.R. 675 (Bankr. W. D. Pa. 2002); *In re Frye*, 216 B.R. 166 (Bankr. E. D. Va. 1997). This promotes certainty and

predictability between the parties and encourages parties to abide by the agreements they make. *Id.* A party should not be saved from a bad bargain simply because of Rule 9019's requirement for court approval, but rather a party should be saved only when its bad bargain taints the interests of other creditors and the bankruptcy estate in general.

Under the totality of the instant facts and circumstances, both parties admit a valid settlement agreement was reached and announced in open court; thus, an enforceable settlement contract under Tennessee law indeed was reached. However, the parties dispute whether the settlement contract should be rescinded due to mutual mistake regarding the lien perfection status of First Investors claim against the Vehicle. First Investors argues that both it and the chapter 7 trustee were mistaken as to the lien perfection status and that an agreement would not have been reached absent this mistake.

The court is not convinced the facts at issue give rise to a finding of mutual mistake under applicable Tennessee law. "The question always is, [w]hat did the parties intend at the time they contracted [and] not what they would have done if they had been better informed." *Alexander v. Shapard*, 240 S.W. 287, 291 (1922). Ignorance of the law furnishes no ground for rescission. *Id.* Here, the relied upon documents associated with the lien, the perfections, and the debt are not alleged to be in error. Furthermore, the certificate of title, the notations to title, and the Tennessee Secretary of State's Motor Vehicle Temporary Lien Database² have not been alleged as deficient so to provide insufficient constructive notice under Tenn. Code. Ann. § 55-3-126 (b) and (f) and give rise to an excusable mutual mistake. The parties here did not enter into the settlement agreement under a mutual mistake of fact or law but rather both parties were uninformed that a temporary lien may have existed³. Mere ignorance must be distinguished from mistake. The court finds that a mutual mistake did not occur at the time the settlement agreement was entered by the parties. Consequently, there are no grounds under Tennessee law

² The State of Tennessee maintains a Motor Vehicle Temporary Lien Database under Tenn. Code. Ann. § 55-3-126(f) and it can be accessed at the Tennessee Secretary of State's website.

³ This court is not determining whether a temporary lien was properly perfected and enforceable under these circumstances. The existence and nature of a temporary lien is in substantial dispute by the parties.

or Federal bankruptcy law for this court to rescind this settlement agreement between the parties that has been found valid under Tennessee law.

Though the parties' settlement agreement cannot be rescinded, it, nonetheless, still must be approved under the sound discretion of the bankruptcy court pursuant to Rule 9019(a). *In re Albert-Harris, Inc.*, 313 F.2d 447, 449 (6th Cir. 1963). The court now applies the *Drexel* test. See *Drexel v. Loomis*, 35 F.2d 800 (8th Cir. 1929). The probability of success of the litigation is extraordinarily difficult to assess in this case. The complaint seeks to avoid under § 547(b) a lien of First Investors that was temporarily perfected under Tenn. Code Ann. § 55-3-126(f) and then later perfected under the ordinary perfection standards for a motor vehicle in Tennessee. This court is aware of the U.S. Supreme Court's opinion in *Fidelity Financial Services, Inc. v. Fink*⁴ and is also equally aware that 1998 Tenn. Laws Pub. Ch. 1016 (H.B. 2684), which is codified as Tenn. Code Ann. § 55-3-126(f), is a non-uniform perfection law specifically aimed to circumvent the U.S. Supreme Court's holding in *Fidelity*. Whether this Tennessee perfection law is valid or preempted by Federal bankruptcy law and *Fidelity* is far from a probable success for either party. Neither party can be assured they would have succeeded on the merits of this litigation, and a compromise avoids the delay and costs of lengthy, complex, and uncertain litigation. Resolving this dispute appears to be in the manifest best interests of the § 541(a) estate and the debtor's creditors because it brings funds into the estate to pay creditors of what previously was a "no asset case." Also, it appears to be fair and equitable to the parties and the estate because the debt to First Investors is \$22,079.13 and the payment under the settlement is \$11,000.00 or approximately half of the disputed secured claim, which in essence recognizes that that litigation was far from certain and more like a 50-50% bet.

Based on the complexity of the issue to be litigated, the expense and delay that would inevitably be incurred against by the estate with very few assets, and the relative uncertainty as to who would prevail, the court finds pursuant to Rule 9019(a) that the compromise and settlement before the court is in

⁴ *Fidelity Financial Services, Inc. v. Fink*, 522 U.S. 211 (1998)

the paramount best interests of the § 541 estate and the Debtors' other creditors and is both fair and equitable under a totality of the particular facts and circumstances.

Based on the foregoing and the entire case record as a whole, IT IS ORDERED AND NOTICE IS HEREBY GIVEN that:

- 1) the compromise and settlement at issue between the parties is a valid and binding contract that is enforceable under Tennessee law;
- 2) First Investor's request to rescind the compromise and settlement at issue due to an asserted mutual mistake under Tennessee law is denied; and
- 3) the compromise and settlement at issue is approved in accordance with Bankruptcy Rule 9019(a).

The Bankruptcy Court Clerk is directed to cause a copy of this Memorandum, Order, and Notice to be sent to the following entities:

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