

Not Reported in B.R.

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(Bankr.E.D.Cal.)

In re Ralph W. CROSBY and Beverly F. Crosby, Debtors.

Bankruptcy No. 91-21031-B-07.

Motion No. FHS-2.

United States Bankruptcy Court, E.D. California, Sacramento
Division.

April 20, 1994.

Barbara L. Roberts, Schill & Roberts, Paradise, CA, for
debtors.

Byron Lee Lynch, Redding, CA, for trustee William L. Conway.

Dennis K. Cowan, Redding, CA, for claimants Douglas and Gayle
Reed.

AMENDED FINDINGS OF FACT AND CONCLUSIONS OF LAW RE: OBJECTION
TO CLAIM

DAVID E. RUSSELL, Chief Judge.

*1 Douglas Reed and Gayle Reed ("Reeds") timely filed their claim in this bankruptcy proceeding. Debtors Ralph W. Crosby and Beverly F. Crosby filed an objection to the claim, in which trustee William L. Conway joined. The matter came on regularly for a continued hearing on November 29, 1993.

After consideration of the declarations of the parties and witnesses, the pleadings, memorandums, briefs, and arguments of counsel, the Court made and filed its findings of fact and conclusions of law on February 28, 1994 and gave the parties an opportunity to request a further hearing to adduce additional testimony and settle the findings. Upon a request, a further hearing was held on April 20, 1994 at 10:00 a.m. After consideration of the cross-examination of witnesses and further argument of counsel the Court hereby amends its Findings of Fact and Conclusions of Law to read as follows:

FINDINGS OF FACT

1. On or about May 1989 the Reeds sold that certain bar/restaurant business in Red Bluff, California known as the "Palomino Room" to debtor Ralph W. Crosby ("Crosby") and Joseph D. Eitzen ("Eitzen") for \$335,000 plus the value of the inventory. The parties assigned the following values to the assets:

Asset Value

Fixtures and Equipment \$ 50,000

Goodwill 5,000

Covenant Not to Compete 205,000

Leasehold Interest 50,000

Liquor License 25,000

Total Assigned Values \$ 335,000

2. Crosby and Eitzen paid \$100,000 plus the inventory value into escrow and signed two promissory notes dated May 24, 1989 payable to the Reeds, one for \$50,000 due on September 5, 1989, and the other for \$185,000 with principal payable \$100,000 on January 2, 1990 and the balance on July 1, 1990. A security agreement of the same date was executed by the parties, securing both notes with collateral consisting of "(a)ll stock in trade and good will (sic) of ... the Palomino Room ... and the ... fixtures and equipment" listed on a seven page exhibit. The covenant not to compete was not taken as security. The security agreement was duly perfected by the filing of an UCC-1 with the California Secretary of State. Subsequent to the sale Crosby and Eitzen apparently transferred the business and assets to the Crosby/Eitzen partnership.

3. Other provisions in the security agreement included, *inter alia*, that

All rights, powers and remedies of Secured Party hereunder shall be cumulative and not alternative. No delay on the part of Secured Party in the exercise of any right or remedy shall constitute a waiver thereof, and no exercise by Secured Party of any right or remedy shall preclude the exercise of any other right or remedy or further exercise of the same remedy. It is further agreed, subject to applicable law, that upon any sale of the Security according to law, or under the power herein given, that Secured Party may bid at said sale, or purchase the Security, or any part thereof at said sale.

4. Crosby and Eitzen defaulted on the notes and the Reeds filed an action in the Tehama County Superior Court against the debtors, Eitzen and Eitzen's wife, Brenda Eitzen (jointly, "the Eitzens") to foreclose the security interest, to enforce

the promissory notes and for damages. The debtors and the Eitzens filed a cross-complaint for fraud. After a jury trial, a Judgment on Verdicts was filed on May 22, 1990 finding for the Reeds against the debtors and Eitzens and awarding damages of \$235,000 and interest, attorneys' fees and costs of \$29,359.75. Judge Murray signed and filed a Proposed Tentative Decision on June 22, 1990 denying rescission to the debtors and the Eitzens and holding that the Reeds were entitled to foreclose on the equipment and sell it at public or private auction, and to bid in at such auction as provided for in the security agreement. Finally, a Judgment After Trial by Court was filed on July 13, 1990 in favor of the Reeds and against the debtors, the Eitzens, and "the Palomino Room Partnership." The judgment impliedly incorporated Judge Murray's tentative decision and the jury verdict.

***2** 5. A Chapter 11 bankruptcy petition for Crosby/Eitzen, a California partnership, dba Palomino Room, was filed on June 6, 1990 as Case No. 290- 03718-B-11. The Eitzens filed their Chapter 7 petition on August 7, 1990 as Case No. 290-05122-B-7. The debtors filed the instant case on February 12, 1991 under Chapter 11. It was subsequently converted to a Chapter 7 case.

6. On December 11, 1990 this Court filed its order in the Crosby/Eitzen bankruptcy granting the Reeds relief from stay to foreclose on the restaurant collateral securing their judgment, deeming the sublease for the premises rejected, and requiring the collateral and premises to be surrendered to the Reeds. Pursuant to that order, the Reeds took possession of the premises, fixtures, equipment and inventory on December 12, 1990. Immediately before vacating the premises Crosby/Eitzen counted and valued the inventory at \$11,916.15, which the Court accepts as its value. Part of the inventory was perishable, and the rest was typical of the type of merchandise sold to restaurants and bars.

7. The debtors also turned over \$766.79 of pre-repossession proceeds to the Reeds.

8. Mr. Reed reopened the restaurant on or about December 14, 1990 for coffee and banquets and applied for a liquor license. He filed a Fictitious Business Statement on January 17, 1991 for the use of the name "Palomino Room" and was operating the restaurant on a full time basis by the end of January. He had the fixtures and equipment appraised. The appraised value was \$40,290.55. He repainted the leasehold premises and installed new carpet and made other improvements and repairs.

9. On August 7, 1991 the Reeds, through their attorney, mailed notice of the public auction sale of the stock in trade and goodwill of the Palomino Room as well as the fixtures and equipment listed in the notice to the debtors, the Eitzens, the Crosby/Eitzen partnership and the Chapter 7 trustee. The notice was published once on August 10, 1991 in the Red Bluff Daily News. The sale was properly conducted by a licensed auctioneer, Jack Epperson. Mr. Reed was the only bidder at the sale on August 17, 1991. He purchased everything with a credit bid of \$40,000.

10. The reasonable costs, including the auctioneer's fee of \$300 for retaking, holding, preparing for sale and selling the collateral was \$1,000.

11. The Reeds never intended to accept the collateral as full satisfaction of the Tehama County Judgment.

CONCLUSIONS OF LAW

1. The Tehama County Superior Court Judgment On Verdicts established the joint and several obligation of the Eitzens and the debtors to the Reeds in the amount of \$264,359.75.

2. The Reeds had the right, as stated in Judge Murray's Proposed Tentative Decision, to "sell, or cause to be sold the secured equipment at public or private auction with plaintiff

being permitted, pursuant to the security agreement, to bid in at such auction."

3. The operation of the restaurant business by the Reeds and the use of the goodwill, equipment and fixtures from December of 1990 until August of 1991 was reasonable and for the purpose of preserving the value of the collateral. California Commercial Code ("UCC") § 9207(4).

***3** 4. The use of the inventory was equivalent to the purchase by the Reeds of goods customarily sold in the recognized restaurant/bar market, and as such, was a partial disposition of the collateral which did not require notice to the debtors. UCC § 9504(3). The debtors are entitled to a credit of \$11,916.15 for that inventory.

5. Notice of the public auction sale was in compliance with the security agreement and the requirements UCC § 9504(3). The Reeds acted in good faith and the auction sale was commercially reasonable as required by UCC § 9504(3).

6. Interest on the judgment of May 22, 1990 to the date the Reeds repossessed the collateral on December 12, 1990 was \$14,775.17 ($\$26,435.975 / 365 \times 204$ days), at 10% per annum. California Code of Civil Procedure (CCP) § 685.010. The credits due the debtors for the pre-repossession proceeds (which were presumably received about that time), inventory, and the auction sale bid should be applied on December 12, 1990, because the inventory was more than likely consumed shortly after the change in possession, and the sale bid because the delay in the sale was caused by the Reeds. Thus, the balance of the judgment on that date after application of the three credits was \$227,451.98 ($\$264,395.75 + \$14,775.17$, less $\$11,916.15 + \$766.79 + \$39,000$ (see paragraph 7, below)).

7. Upon entry of the state court judgment, the provisions of the security agreement and promissory note were merged in the

judgment. Attorney's fees and nonlegal costs for enforcement of a judgment are therefore not collectible. Nevertheless, pursuant to UCC § 9504(1)(a) the proceeds of disposition are first applied to the reasonable expenses of retaking the collateral, holding it, preparing it for sale, and selling it, and the like, so those costs of \$1,000 should be deducted from the sales price and related back to December 12, 1990.

8. Interest on the judgment until February 12, 1991 was \$3,863.55 ($\$22,745.198 / 365 \times 62$ days), making the total claim on that date \$231,315.53.

9. Except as the claim is modified by these Findings and Conclusions, the claim objection to the claim is OVERRULED and it shall be allowed in the amount of \$231,315.53. If there are sufficient assets to pay all claims in the estate, interest is payable on the principal sum of \$227,451.98 from February 13, 1991.