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3
4 UNITED STATES BANKRUPTCY COURT
5 EASTERN DISTRICT OF CALIFORNIA

6 In re
7 CHERYL ANN MORRIS

8 Debtor.

Case No. 02-61835-A-7
DC Nos. TGM-9 and TGM-10

9 FINDINGS OF FACT AND
10 CONCLUSIONS OF LAW RE
11 TRUSTEE'S MOTION FOR
12 TURNOVER OF PROPERTY AND
13 TRUSTEE'S MOTION FOR
14 APPROVAL OF SALE OF
15 PERSONAL PROPERTY

16
17 On May 16, 2006, an evidentiary hearing was held on the
18 Trustee's motion for turnover of property of the bankruptcy
19 estate (TGM-9) and the Trustee's motion to approve a sale of
20 personal property of the bankruptcy estate (TGM-10). At the
21 hearing, the court heard testimony from Gaylene Moore, James
22 Salven (the chapter 7 trustee), Edith Mills, Robert Mills, and
23 Diana Butler. The parties stipulated to certain facts.
24 Following the hearing, the parties filed closing briefs, and the
25 matter was submitted as of June 6, 2006. This memorandum
26 contains findings of fact and conclusions of law required by
27 Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of
28 Civil Procedure 52. This is a core proceeding as defined in 28
U.S.C. §157(b)(2)(E) and (N).

Background Facts.

Stipulated Facts.

The parties have stipulated to the following facts:

1 1. Debtor Cheryl Ann Morris filed for relief under Chapter
2 7 of the Bankruptcy Code on December 27, 2002.

3 2. James E. Salven is the duly appointed, qualified and
4 acting Trustee of the above referenced bankruptcy estate.

5 3. At the time the Debtor filed her Chapter 7 petition,
6 the Debtor was operating two disabled adult care business located
7 at 4023 Damsen Avenue, Visalia, California, 93291, and 2211
8 Elowin, Visalia, California, both properties which are currently
9 owned by the Debtor's mother Edith Wilson Mills and her husband
10 Robert Mills.

11 4. The admission agreements of the patients were not
12 scheduled on the Debtor's Schedule G.

13 5. The Debtor also failed to list her business income on
14 her Schedule I.

15 6. The Debtor failed to disclose on her bankruptcy
16 schedules approximately \$50,000 business income she received post
17 bankruptcy filing, which were payments received from the Regional
18 Center for patient care provided by the Debtor prepetition.

19 7. The Debtor failed to disclose her interest in real
20 property located at 2500 Charter Oak Court, Visalia, California,
21 on her bankruptcy schedules.

22 8. On April 4, 2003, the Debtor filed an amendment to
23 schedules C, G, I and J, and served the amendment on the Trustee
24 on or about April 4, 2003.

25 9. Amended Schedule G listed the patient admission
26 agreements.

27 10. Amended Schedule I listed income from the disabled
28 adult care businesses.

1 11. The Debtor and Trustee stipulated to extend time to
2 object to the Debtor's discharge to June 30, 2004.

3 12. On or about July, 2003, the Debtor sold the two
4 disabled adult care businesses to Gaylene Moore for \$100,000.00
5 each.

6 13. The terms of the sale of the businesses are that
7 Gaylene Moore would pay the Debtor either \$3,000.00 per month for
8 ten years or \$6,000.00 per month for five years commencing July,
9 2003.

10 14. Commencing with July 2003, through February, 2006,
11 Gaylene Moore paid \$6,000.00 per month pursuant to the contract.

12 Additional Facts.

13 On about February 21, 2006, Trudi Manfredo, the Trustee's
14 attorney, received a telephone call from Gaylene Moore. Ms.
15 Moore told Ms. Manfredo that she had purchased the Debtor's adult
16 residential care business in July 2003 for \$200,000, with monthly
17 payments to be either \$6,000 per month for five years or \$3,000
18 per month for ten years. According to Ms. Moore, she had been
19 making the monthly payments of \$6,000 since July 2003. Ms. Moore
20 further informed Ms. Manfredo that the real properties where the
21 residential care business was operated were both owned by the
22 debtor's mother, Edith Wilson, and that she was leasing those
23 properties from Edith Wilson for \$3,300 per month.

24 After conducting initial discovery, the Trustee filed a
25 motion for turnover of property of the estate, requesting that
26 the Debtor be ordered to turn over \$186,000, representing the sum
27 of money allegedly received from Ms. Moore, to the Trustee. The
28 Trustee further filed a motion to approve a sale of personal

1 property. In this motion, the Trustee asks the court to approve
2 the sale of the residential care businesses to Ms. Moore. In
3 that motion, the Trustee stated:

4 "There are \$81,756.59 filed general unsecured claims in this
5 case; however, when the duplicate claims are eliminated, the
6 claims total \$66,062. The estate is presently holding
approximately \$64,000."

7 Therefore, taken together, the two motions ask the court to
8 order the Debtor to turn over the funds previously received from
9 Ms. Moore for sale of the business and to approve the sale so
10 that any additional sale proceeds will go from Ms. Moore to the
11 bankruptcy estate rather than to the Debtor. Pending the court's
12 decision on these motions, the parties have agreed that all
13 ongoing payments by Ms. Moore will be made to the Trustee, who
14 will hold the proceeds in a blocked account.

15 The Debtor opposed both motions. According to the Debtor,
16 the only property of the estate that was sold was tangible
17 personal property that had a value not in excess of \$5,000. The
18 rest of the value, according to the Debtor, paid by Ms. Moore was
19 for patient care contracts. While the Debtor acknowledges that
20 the patient care contracts were not transferrable, she also
21 argues that:

22 "Nevertheless, the Debtor had the ability to and did move
23 aside and enable the buyer to step into her shoes vis a vis
24 the contracts. Had the Debtor, with help from her family,
25 exercised her power to continue to perform the contracts
26 instead of facilitating the buyer's ultimate acquisition of
contracts to care for the Debtor's patient clients, neither
the buyer nor anyone else would have paid a penny for the
so-called good will of her businesses. . . . Clearly the
patient care contracts were of paramount importance to the
buyer."¹

28 ¹Debtor's "Hearing Brief" filed May 12, 2006, at ¶ 2.

1 The Debtor's argument is that the patient care contracts
2 which were not property of the bankruptcy estate at the time of
3 the sale and had been deemed rejected, were transferred to the
4 buyer. The Trustee never moved to assume the patient care
5 contracts. Therefore, according to the Debtor, they are not
6 property of the bankruptcy estate.

7 Gaylene Moore's Testimony.

8 Gaylene Moore has operated adult residential care homes
9 since 1995, and she is knowledgeable about licensing procedure
10 and requirements. She has known both Cheryl Morris and Diana
11 Butler for about ten years. In July 2003, Cheryl Morris
12 approached Gaylene Moore about purchasing her business. On July
13 7, 2003, Cheryl Morris, Edith Mills (Cheryl's mother), and
14 Gaylene Moore met. They agreed on the basics of the transfer of
15 the two homes operated by Cheryl Morris to Gaylene Moore. They
16 agreed that they would describe the purchase in more detail after
17 obtaining approval from the Central Valley Regional Center.
18 Cheryl Morris was present when the agreement was made and seemed
19 to understand the agreement. Edith Mills agreed to lease the two
20 buildings to Gaylene Moore.

21 Later, they met at the Regional Center. The Regional Center
22 representatives were concerned about continuity of care. On July
23 18, 2003, they met at Cheryl Morris's house to draw up the
24 agreement. Exhibit "2" is the handwritten agreement negotiated
25 that day.

26 Because Cheryl Morris was already being paid by the state,
27 they agreed that until the transfer of the license, Cheryl Morris
28 would receive payments from the state; take out the amount

1 Gaylene Moore owed for that month; and then transmit the balance
2 to Gaylene Moore. After Gaylene Moore was licensed, Gaylene
3 Moore would get the check from the state and pay Cheryl Morris
4 the amount for the purchase and Edith Mills the amount for the
5 lease. Until April 2005, all payments that Gaylene Moore made on
6 account of Cheryl Morris went to Edith Mills.²

7 The agreement provides that if the Regional Center fails to
8 approve the sale or clients are removed from the home, there will
9 be no sale.

10 Gaylene Moore believes the business had the value for which
11 she paid. There were beds filled, there were employees, and
12 there were furnishings. The location was convenient.

13 She did not purchase the patient contracts. Gaylene Moore
14 has paid for the purchase of the two businesses \$30,000 in 2003;
15 \$72,000 in 2004; \$72,000 in 2005; and, in 2006, \$6,000 per month.

16 In November 2005, Cheryl Morris asked that payment go to her
17 son Scott instead of to her mother Edith. She told Gaylene Moore
18 that her mom was taking her money and by putting it in her son's
19 name, it would not affect her bankruptcy or her disability
20 payments. At this point, Gaylene Moore decided to consult her
21 attorney, which led to her contacting the trustee.

22 Gaylene Moore never believed she was purchasing the client
23 contracts because they are not transferrable. She signed new
24 patient care agreements when she took over the business. She
25 knows that patients can terminate contracts at any time.

26
27 ²In approximately 2001, Cheryl Morris had surgery that
28 resulted in severe problems causing her disability. Diana
Butler, her sister, is her conservator.

1 Gaylene Moore did acknowledge that if the business had been
2 closed for seven months while new contracts were being signed, it
3 would have affected her purchase decision. One reason she was
4 willing to pay what she did, and on the terms to which she
5 agreed, for the businesses was that there were patients there.
6 The homes were established. They were all set up and in
7 compliance with state regulations and requirements. They had a
8 good reputation, and they had patients. She believed that the
9 patients would most likely stay in the homes based on Cheryl's
10 recommendation and on her own reputation. On reflection, she
11 said that she would have agreed to the deal without any patients.
12 Her good reputation with the Regional Center is important to
13 Gaylene Moore. The Regional Center will send her more clients
14 because she has a good reputation. By the end of July 2004, all
15 the patient care contracts were in Gaylene's name.

16 James Salven's Testimony.

17 The Trustee testified that he conducted a 341 meeting with
18 Cheryl Morris in January 2003. She appeared to understand his
19 questions and had no speech anomalies. She failed to disclose
20 \$50,000 more or less in post-petition payments she received from
21 the Regional Center for pre-petition services. The Trustee was
22 able to figure this out from looking at the bank statements she
23 provided. Although she seemed competent to testify, she did tell
24 the Trustee that she had been in an abusive relationship and
25 suffered from post-traumatic stress.

26 The Trustee was told about the adult care business by the
27 debtor's parents. At some point, he began to feel that perhaps
28 Ms. Morris did not understand what was going on.

1 Diana Butler's Testimony.

2 Diana Butler is Cheryl Morris's sister and is her
3 conservator. She has twenty years experience in the adult care
4 industry.

5 Gaylene Moore and Cheryl Morris entered into an agreement
6 for purchase by Gaylene Moore of Cheryl Morris's adult care home
7 business at two locations. Edith Mills was willing to lease the
8 two houses to Gaylene Moore and entered into a lease agreements
9 to do that.

10 The parties agreed that until Gaylene Moore had received
11 licensing and "vendorization" for the two homes, the payments
12 would be deducted from the checks from the State of California to
13 Cheryl Morris. The parties further agreed that Gaylene would
14 make checks payable to Edith Wilson Mills for both the lease of
15 the homes and the purchase of the home care business "because
16 Edith will be managing Cheryl's payments while she is sick."

17 They further agreed that if the Regional Center failed to
18 approve Gaylene Moore or the clients were removed from the home,
19 Gaylene would be released from the purchase agreement and the
20 lease.

21 The Legal Issues.

22 What did Gaylene Moore purchase? Did she purchase a
23 business that was property of the estate, or did she purchase
24 executory contracts that the Trustee had failed to assume and, in
25 fact, which he could not assume?

26 The Trustee could not assume the patient care contracts.
27 Bankruptcy Code § 365(c)(1)(A) provides that a trustee may not
28 assume or assign an executory contract of the debtor if

1 applicable law excuses a party other than the debtor from
2 accepting performance from an entity other than the debtor.

3 There is language in the patient care contracts that
4 prohibits assignment. California Code of Regulations Title 17,
5 § 50606(g) prohibits assignment. Further, the Lanterman
6 Developmental Disabilities Services Act contains many provisions
7 reflecting the intent of the legislature to give the
8 developmentally disabled individual control over the provider of
9 services. See California Welfare and Institutions Code § §
10 4648(a)(1), (3), (6)(E), (7).

11 Gaylene Moore had to enter into new patient care agreements
12 with each patient after she purchased the business.

13 The evidence and the law lead the court inescapably to the
14 conclusion that Gaylene Moore did not purchase the patient care
15 agreements. Further, the Trustee could not have assumed the
16 patient care agreements and then assigned them to Gaylene Moore.
17 Gaylene Moore purchased all the other bundle of rights that were
18 contained in the business, which was property of the estate under
19 Bankruptcy Code § 541. She purchased the ability to enter into a
20 lease; the furnishings; the employees; the reputation; the
21 location; and everything else that made up the business. It was
22 important to her that patients were there because that made it
23 more likely, especially with her good reputation, that the
24 existing patients would sign new patient care agreements with
25 her. Everything that Gaylene Moore purchased in a sale arranged
26 by Cheryl Morris after she filed her bankruptcy case, was
27 property of the bankruptcy estate.

28 Therefore, Cheryl Morris is obligated to turn over to the

1 Trustee all of the funds she received from Gaylene Moore.
2 Gaylene Moore paid the \$6,000 per month pursuant to the contract
3 through February 2006. The total payments made were \$186,000.
4 From May 12, 2004 through March 2, 2005, the \$6,000 per month
5 payments were made to Edith Wilson on Cheryl Morris's behalf.
6 Thus, \$66,000 was paid to Edith Wilson on Cheryl Morris's behalf.
7 The Debtor maintained control over the funds paid to Edith
8 Wilson. It was at the Debtor's request that the funds be paid to
9 Edith Wilson. The Debtor then contacted Gaylene Moore asking
10 that the funds be redirected to her. The Debtor and her sister,
11 Diana Butler, then requested that Gaylene Moore direct the funds
12 to be turned over to the debtor's son, Scott Morris. There is no
13 dispute about the amount of the payments. The only issue is
14 whether the payments were for property of the estate. Therefore,
15 a motion for turnover under section 542 is appropriate. See, In
16 re Nat'l Audit Defense Network, 332 B.R. 896, 911 (Bankr. D. Nev.
17 2005).

18 Further, as the assets in question were property of the
19 bankruptcy estate, the Trustee can enter into an agreement to
20 sell those assets in his sound business judgment. He has done
21 so.

22 For the above reasons, the motion for turnover will be
23 granted and the motion for sale approved. Counsel for the
24 Trustee shall submit appropriate forms of orders.

25 DATED: July 24, 2006

26
27 _____
28 WHITNEY RIMEL, Judge
United States Bankruptcy Court