THIS OPINION IS NOT INTENDED FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	CASE NO. 98-50531
LUCERNE PRODUCTS, INC.	)	
Debtor-in-Possession	)	CHAPTER 11
	)	
LUCERNE PRODUCTS, INC.	)	ADV. NO. 98-5125
Plaintiff	)	
	)	JUDGE MARILYN SHEA-STONUM
v.	)	
	)	
DOUGLAS D. MATHEWS, et al.	)	**ORDER REQUIRING**
Defendant	)	**TURNOVER OF PROPERTY**

This matter came before the Court on the debtor's "Motion for Contempt, Motion to Turn Over Property and Request for Emergency Hearing and Temporary Restraining Order" filed on November 30, 1998 (the "Motion") against defendant, Douglas Matthews ("Matthews"). A hearing on the plaintiff-debtor's request for an emergency hearing was held on December 1, 1998. At the conclusion of the December 1st hearing, the Court entered a temporary restraining order against Matthews and set a final hearing on the Motion for December 8, 1998. At the December 8th hearing, counsel represented that they were attempting to settle the matter and requested that the final hearing on the Motion be adjourned. The final hearing was then adjourned to December 17, 1998. On December 16, 1998, Matthews filed a response to the Motion.

The final hearing on the Motion was held on December 17, 1998. During the hearing, the Court received evidence in the form of exhibits and in the form of testimony from the following: (i) Matthews, (ii) John Anderson, a prototype engineer with W.B. Design Group, (iii) Myers Hand, a principal of Lucerne Technologies, LLC, purchaser of substantially all of plaintiff-debtor's assets ("Lucerne Technologies"), (iv) Jan Michaud, a former design engineer with plaintiff-debtor, (v) Tim Bryant, former materials manager at plaintiff-debtor's Bolivar, Tennessee plant , (vi) Randy Collins, former supervisor of plaintiff-debtor's Bolivar-Tennessee plant, and (vii) Mark Manuel, an electro-mechanical design engineer and employee of Lucerne Technologies. The deposition testimony of

John McHugh, representative of Nartron Corporation, a one time potential purchaser of plaintiff-debtor's assets, was also admitted into evidence. At the conclusion of the hearing, the parties were given additional time to file proposed findings of fact and conclusions of law. Those pleadings were timely filed, and the matter was then taken under advisement.

This proceeding arises in a case referred to this Court by the Standing Order of Reference entered in this District on July 16, 1984. This matter is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(E) over which this Court has jurisdiction pursuant to 28 U.S.C. §1334(b). Based upon testimony and evidence presented at the December 17, 1998 hearing, the arguments of counsel and the documents of record in this adversary proceeding and the main chapter 11 case, the Court makes the following findings of fact and conclusions of law.

I. FACTS

On February 24, 1998, an involuntary chapter 7 bankruptcy petition was filed against plaintiff-debtor. On March 16, 1998, plaintiff-debtor voluntarily converted the proceeding to a chapter 11 case. On November 23, 1998, an order in the main chapter 11 case was entered approving the sale of substantially all of plaintiff-debtor's assets to Lucerne Technologies (the "Lucerne Assets"). Pursuant to that order of sale, and pursuant to another order entered in the main chapter 11 case on September 11, 1998, Matthews, a former employee and officer of plaintiff-debtor, was ordered to turn over to either plaintiff-debtor or Lucerne Technologies all Lucerne Assets in his possession or control. Also pursuant to the November 23, 1998 order of sale, plaintiff-debtor was required to assist Lucerne Technologies in obtaining the return of any Lucerne Assets not located in plaintiff-debtor's Bolivar, Tennessee plant.

In the Motion, plaintiff-debtor alleges that despite this Court's prior orders, Matthews still has possession of or control over some Lucerne Assets. Plaintiff-debtor seeks a Court order requiring that the following Lucerne Assets be turned over by

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[1] The term "DC Switch" has been previously defined by the parties in other orders entered in this case. *See, e.g.*, order entered on September 11, 1998 as docket number 153 in the main case.

Matthews: (i) all "DC Switch"[1] working and non-working prototypes and related parts and (ii) a list of the names of owners of each injection mold formerly used by plaintiff-debtor [(i) and (ii) shall hereinafter be referred to collectively as the "Disputed Assets"].[2]

A. The DC Switch Working and Non-Working Prototypes

It is undisputed that plaintiff-debtor produced one working DC Switch prototype. It is also undisputed that sometime between June and August, 1997, a working prototype was installed into a DeWalt drill in preparation for Matthews' attendance at a Chicago trade show. During that same period of time, the drill was fitted with a small plastic window through which potential customers could view the working DC Switch prototype. The working DC Switch prototype could be easily removed from the DeWalt drill.

Matthews, who had some direct involvement with the development of the DC Switch, contends that when the working prototype was installed in the DeWalt drill, the speed control was malfunctioning. Matthews also contends that sometime in August, 1997, he ordered certain plaintiff-debtor employees to remove the malfunctioning prototype from the DeWalt drill to correct the speed control problem before his attendance at the Chicago trade show. Matthews further contends that after the working prototype was removed from the DeWalt switch, he replaced it with a competitor's switch but still continued to represent it as a working DC Switch to potential customers at the Chicago trade show and thereafter. Matthews claims that after he asked that the working prototype be removed from the drill, he never saw that working prototype again.

During his testimony, Matthews identified a group of five employees to whom he made the request that the working prototype be removed from the drill due to the speed control problem. With the exception of Jan Michaud, none of the other identified employees were called as witnesses at the December 17th hearing.

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[1] The term "DC Switch" has been previously defined by the parties in other orders entered in this case. *See, e.g.*, order entered on September 11, 1998 as docket number 153 in the main case.

[2] During the December 17, 1998 hearing on the Motion, plaintiff-debtor did not seek an order for either contempt or sanctions against Matthews but reserved the right to seek such relief against Matthews at a later date if the Court ordered turn over of the Disputed Assets and if Matthews failed to abide by such turnover order.

Jan Michaud was the design engineer in charge of the development of the working prototype for the DC Switch. Mr. Michaud testified that sometime during June or July, 1997, he installed the working DC Switch prototype into the DeWalt drill and performed basic functionality tests on the installed prototype. Mr. Michaud further testified that he never noticed any speed control problems with the working prototype and that he never received notice from Matthews that the working prototype did not function properly. Mr. Michaud also testified that he was never asked to remove the working prototype from the DeWalt drill and indicated that anyone familiar with switch technology would notice if the DC Switch working prototype was replaced with a competitor's switch.

Pursuant to the deposition testimony of John McHugh, Matthews had both the working and non-working DC Switch prototypes in his possession during an October 23, 1998 meeting at plaintiff-debtor's Bolivar, Tennessee plant. Mr. McHugh's deposition testimony sets forth that although he saw the working prototype installed in the DeWalt drill during the October, 1998 meeting with Matthews, he did not see the DeWalt drill function. Tim Bryant, who was also in attendance at the October 23rd meeting, testified that during that meeting Matthews represented to all present that the DeWalt drill contained the DC Switch working prototype and not a competitor's switch. Mr. Bryant further testified that at the conclusion of the October 23rd meeting, Matthews placed the working and non-working DC Switch prototypes into his briefcase and left the Bolivar, Tennessee plant.

During the December 17th hearing, Mr. Bryant testified that without possession of the working prototype, Lucerne Technologies' production of the DC Switch will be delayed by at least three to four months. Mr. Bryant also testified that Lucerne Technologies' production cost for creating a new working prototype will total between $50,000 and $60,000.

It is undisputed that some DC Switch non-working prototypes were produced for plaintiff-debtor. Pursuant to conflicting testimony, it appears that between three and five of these non-working prototypes were made. Matthews claims that sometime in August, 1998, he turned over the non-working prototypes to plaintiff-debtor at its Bolivar, Tennessee plant. Despite Matthews' contention, both Mr. Bryant and Mr. McHugh testified that Matthews had several non-working prototypes in his possession during the October 23, 1998 meeting at plaintiff-debtor's Bolivar, Tennessee plant. Additionally, Mr.

Bryant testified that at the conclusion of the October 23rd meeting, Matthews put the non-working prototypes into his briefcase and left the Bolivar, Tennessee plant.

Very limited testimony was presented on the monetary and/or replacement value of the non-working prototypes. According to Mr. Michaud, who was unfamiliar with the cost of traditional prototyping, a non-working prototype could be rapidly produced within one to two days and the cost for such rapid production would be between $300.00 to $1,000.00.

B. The List of Names of Owners of Injection Molds

During the December 17th hearing, Matthews testified that he does not have and during the pendency of the chapter 11 case did not have in his possession or control a list of owners of the injection molds formerly used in plaintiff-debtor's business and subsequently sold to Lucerne Technologies. That testimony was directly contradicted by Randy Collins who indicated that sometime during July, 1998, while temporarily residing in Matthews' home, he saw a box of 3 x 5 index cards in a cupboard behind a wetbar in Matthew's family room. Mr. Collins recognized the box as one usually kept by Bill Baldwin in his office at plaintiff-debtor's Bolivar, Tennessee plant and containing the name of each owner of an injection mold, the date that mold was manufactured and the number of cavities contained on each mold. Mr. Baldwin was not called as a witness during the December 17th hearing.

Very limited testimony was presented on the monetary and/or replacement value of the list of owners of injection molds. Pursuant to Matthews' testimony, the information being sought could be reproduced by other records kept by plaintiff-debtor. Pursuant to Myers Hand's testimony, it is ethically important for company's in plaintiff-debtor's line of work to have a list of owners of injection molds to ensure that a mold that is already owned by one customer is not used to benefit a competing customer.

II. DISCUSSION

The burden of proof in a turnover action rests on the party seeking the turn over of property. The applicable standard of proof to be applied in this matter is disputed by the parties. Plaintiff-debtor argues that a preponderance of evidence standard should be applied and Defendant argues that a clear and convincing standard should be applied. Pursuant to the 1994 amendments to the Bankruptcy Code and the absence of any recent controlling authority on the matter, this Court adopts the reasoning set forth *Alofs*

Manufacturing Co. v. Toyota Manufacturing, Kentucky, Inc. (In re Alofs Manufacturing Company), 209 B.R. 83 (Bankr. W.D. Mich. 1997) and holds that plaintiff-debtor must prove each of the elements of its turnover action by a preponderance of the evidence.

In order to prevail in its turnover action, plaintiff-debtor must prove the following elements: (i) that the plaintiff-debtor has a legal interest in the Disputed Assets, (ii) that Matthews has possession of or control over the Disputed Assets and (iii) that the Disputed Assets have more than inconsequential value or benefit to the estate. 11 U.S.C. §542(a). *See also In re Matheny,* 138 B.R. 541, 548 (Bankr. S.D. Ohio 1992); *In re Redman Oil Co., Inc.* 95 B.R. 516, 521 (Bankr. S.D. Ohio 1988). In determining whether these elements are met, the bankruptcy court, as trier of fact, must weigh conflicting facts, determine the credibility of witnesses and draw inferences from the evidence presented. *Investors Credit Corp. v. Batie (In re Batie),* 995 F.2d 85, 88 (6th Cir. 1993); Fed. R. Bankr. P. 8013.

A. Legal Interest in the Disputed Assets

The initial element that plaintiff-debtor must prove is that it has a legal interest in the Disputed Assets. It is undisputed that prior to its sale of assets to Lucerne Technologies debtor had a legal interest in the Disputed Assets. It is also undisputed that pursuant to the November 23, 1998 order approving the sale of substantially all of plaintiff-debtor's assets, ownership of the Disputed Assets was transferred to Lucerne Technologies and plaintiff-debtor accepted a continuing contractual obligation to cause delivery of those Disputed Assets. Therefore, proof of the first element of the turnover action has been met.

B. Matthews' Possession of or Control Over the Disputed Assets

***The DC Switch Working and Non-Working Prototypes*:** Pursuant to the collective testimony of Jan Michaud, John McHugh and Tim Bryant as to the working prototype, and pursuant to Matthews' inability to convincingly contradict that collective testimony, the Court finds that Matthews had the DC Switch working prototype in his possession at least as of October 23, 1998. Because no credible evidence was presented to explain the whereabouts of the working prototype since October 23, 1998, it is more probable than not that Matthews still either has the working prototype in his possession or knows of its whereabouts.

Pursuant to the collective testimony of Tim Bryant and John McHugh as to the

non-working prototypes, and pursuant to Matthew's inability to convincingly contradict that collective testimony, the Court finds that Matthews had the DC Switch non-working prototypes in his possession from at least as of October 23, 1998. Because no credible evidence was presented to explain the whereabouts of the non-working prototypes since October 23, 1998, it is more probable than not that Matthews still either has the non-working prototypes in his possession or knows of their whereabouts.

The List of Names of Owners of Injection Molds: Pursuant to the rather detailed and seemingly unbiased testimony of Randy Collins regarding the metal box containing 3 x 5 cards listing the owners of the injection molds formerly used in plaintiff-debtor's business and subsequently sold to Lucerne Technologies, and pursuant to Matthew's inability to convincingly contradict Mr. Collins' testimony, the Court finds that Matthews had that box from at least July, 1998. Because no credible evidence was presented to explain the whereabouts of that box since July, 1998, it is more probable than not that Matthews still either has the box in his possession or knows of its whereabouts.

C. The Value of the Disputed Assets

The DC Switch Working and Non-Working Prototypes: Pursuant to Mr. Bryant's testimony, if Lucerne Technologies were delivered possession of the working prototype, it could save between $50,000 and $60,000 in production costs and speed up its production of the DC Switch by up to three to four months. Clearly then, the working prototype is not of inconsequential value to plaintiff-debtor's estate. The evidence presented as to the value of the non-working prototypes was not as clear. However, because these items were included in the list of assets to be purchased by Lucerne Technologies, they clearly had value to Lucerne Technologies, which is entitled to its bargained for rights pursuant to the November 23, 1998 sale order. Therefore, plaintiff-debtor has sustained its burden in proving that the working and non-working DC Switch prototypes were not of inconsequential value to plaintiff-debtor's estate.

The List of Names of Owners of Injection Molds: The evidence presented as to the value of the list of owners of the injection molds formerly used in plaintiff-debtor's business and subsequently sold to Lucerne Technologies was also not clear. However, because such information enables a company to avoid ethical dilemmas by ensuring that a mold already owned by one customer is not used for a competing customer, it has intrinsic value. Matthews' testimony that this information could be reproduced by information

already in Lucerne Technologies' possession is of no consequence as Lucerne Technologies should not be forced to incur additional expense to produce information which Lucerne Technologies is clearly entitled pursuant to the November 23, 1998 sale order. Therefore, plaintiff-debtor has sustained its burden in proving that the list of owners of the injection molds formerly used in plaintiff-debtor's business and subsequently sold to Lucerne Technologies is not of inconsequential value to plaintiff-debtor's estate.

III. CONCLUSION

Based upon the foregoing, the Court finds that plaintiff-debtor has met its burden in proving all the necessary elements of its turnover action as to the Disputed Assets. **THEREFORE, IT IS HEREBY ORDERED:**

1. That Matthews is in contempt of this Court's prior orders to turn over the Disputed Assets.
2. That in order to purge himself of such contempt, Matthews shall turn over the Disputed Assets to his attorney, Leland Cole, on or before **February 16, 1999**, and that upon receipt of the Disputed Assets, Mr. Cole shall contact plaintiff-debtor's attorney to determine how the Disputed Assets will be delivered to Lucerne Technologies.
3. That if Matthews fails to turn over the Disputed Assets by February 16, 1999, counsel for plaintiff-debtor or Lucerne Technologies shall appear at a hearing to be held on **February 18, 1999**, at **1:30 p.m.**, in Room 250, U.S. Courthouse and Federal Building, 2 South Main Street, Akron, Ohio, and state for the record Matthew's failure to comply with this Order. At such hearing, and without further notice to Matthews or his counsel, the Court will consider and decide upon damages and/or other appropriate relief to be granted for Matthew's continuing contempt. Additionally at the February 18th hearing, the Court, without further notice to Matthews or his counsel, may also consider a criminal referral of Matthew's violations of the orders of this Court and other applicable bankruptcy law to the United States attorney pursuant to 18 U.S.C. §3057.

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MARILYN SHEA-STONUM

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Bankruptcy Judge

DATED: 2/8/99