

**IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION**

In Re:

In Proceedings Under Chapter 7

**J & M SALUPO DEVELOPMENT
CO., INC.,**

Case No.: 06-11373

Adv. Pro No. 06-01555

Debtor.

CHIEF JUDGE RANDOLPH BAXTER

**PAUL T. AND NANCY HAMERLY
Plaintiff,**

v.

**FIFTH THIRD MORTGAGE COMPANY,
et al.,**

Defendants.

MEMORANDUM AND ORDER

The matter before the Court is a motion for judgment on the pleadings (the "Motion") filed by co-Defendant Fifth Third Mortgage Company ("Fifth Third") in the above-styled adversary proceeding. Paul and Nancy Hamerly (the "Hamerlys" or "Plaintiffs") object to such relief. The Court acquires core matter jurisdiction over the instant matter pursuant to 28 U.S.C. §§ 157(a) and (b)(2)(K), 28 U.S.C. § 1334 and General Order No. 84 of this district. Upon examination of the pleadings, and after conducting a hearing on the matter, the following findings of fact and conclusions of law are hereby rendered:

*

On April 19, 2006 (the "Petition Date"), J & M Salupo Development Co., Inc. (hereinafter, the "Debtor") filed a voluntary petition for relief under Chapter 7 of Title 11

of the United States Code (the "Bankruptcy Code"). A Chapter 7 Trustee (the "Trustee") was appointed in the Debtor's bankruptcy case. The Trustee filed a no-asset report on July 17, 2006.

The above-captioned adversary proceeding arises from the Debtor's execution of a new construction purchase agreement (the "Purchase Agreement") for the sale of real property located at 6582 Summerwind Drive in Brecksville, Ohio (the "Property") to the Hamerlys on or about January 10, 2002. The Hamerlys filed the above-styled adversary proceeding against Fifth Third, the Debtor and others seeking a determination of their rights in the Property pursuant to § 365(i) of the Bankruptcy Code, a subordination, in whole or in part, of the claim of Fifth Third, and a determination of the validity, priority and extent of liens and other interest in the Property (the "Complaint").

The dispositive facts are generally undisputed. On or about June 28, 2000, the Debtor acquired title to the Property. Subsequently, the Debtor obtained a \$703,700.00 construction loan from Fifth Third and granted Fifth Third a mortgage to secure the loan on the Property (the "Mortgage"). See Open-End Mortgage attached to Fifth Third's Answer, Counterclaim and Cross-Claim to the Plaintiff's Complaint. The mortgage was duly recorded with the Cuyahoga County Recorder's Office on September 27, 2001 at Instrument No. 200109272458. Id. The Mortgage grants Fifth Third a lien on the Property. Id. The Debtor also executed an adjustable rate note in favor of Fifth Third (the "Note"). See Adjustable Rate Mortgage attached to Fifth Third's Answer, Counterclaim and Cross-Claim to the Plaintiff's Complaint.

Subsequent to the execution of the Mortgage and Note, the Debtor executed the Purchase Agreement with the Hamerlys for the construction of a new home on the subject

property for the purchase price of \$575,000.00, payable in installments at various stages in the construction of the residence. See New Construction Purchase Agreement attached to the Complaint. Pre-petition, and pursuant to the Purchase Agreement, the Hamerlys made installment payments to the Debtor totaling \$140,000.00¹. See Check Nos. 1134 and 1137 attached to the Complaint. In June of 2003, the Hamerlys and the Debtor adjusted the purchase price to \$570,565.98. See Addendum to Original Contract, dated June 13, 2003, attached to the Complaint. The closing of the Purchase Agreement was scheduled for June 13 or June 15, 2003. See Additional Agreement, dated June 12, 2003, attached to the Complaint. Pursuant to the agreement the Hamerlys took possession of the Property, pre-closing, on June 13, 2003 and continue to occupy the Property without the sale having closed between them and the Debtor. Id. Urefutedly, title to the Property remains in the Debtor's name. It is undisputed by the parties that although the Hamerlys occupy the Property they have no contractual relationship with Fifth Third.

Pre-petition, the Debtor failed to make payments to Fifth Third in accordance with the Mortgage and the Note. Therefore, Fifth Third commenced a foreclosure action in the Cuyahoga County Court of Common Pleas. The action was stayed due to the Debtor's pending Chapter 7 case.

¹ The Hamerlys assert that they have paid \$240,000.00 in installment payments towards the Purchase Agreement, which includes a \$58,000 payment to contractors. See Response of Paul and Nancy Hamerly to Motion of Fifth Third for Judgment on the Pleadings. However, the Hamerlys have only provided this court with copies of checks from an account bearing their name with pay to order to the Debtor that together equal \$140,000. See Check Nos. 1134 and 1137 attached to the Complaint. The amount that the Hamerlys may or may not have paid pursuant to the Purchase Agreement is not an issue currently before the Court.

**

Fifth Third asserts that it has a valid Mortgage which was duly perfected through its recordation with the Cuyahoga County Treasurer's Office. It contends that its Mortgage is the first and best lien against the Property subject only to the lien of the Cuyahoga County Treasurer. Fifth Third avers that, as a matter of law, the Chapter 7 Trustee cannot transfer title to the Property to the Hamerlys free and clear of all liens, claims and encumbrances. Also, it asserts that its claim cannot be subordinated to any claim which the Hamerlys assert they have against the Property. Fifth Third contends that it is entitled to foreclose its interest in the Property. It also argues that there is no law to support the Hamerlys claims, and therefore judgment should be rendered in its favor. It also argues that it has no obligation whatsoever to the Hamerlys as there is no contractual relationship between them on any transaction.

The Hamerlys request that the Motion be denied. They contend that they are entitled to an order directing the Chapter 7 Trustee to convey to them title to the Property free and clear of all liens, claims and encumbrances in accordance with the terms of the Purchase Agreement. They also assert that the lien interest held by Fifth Third should be equitably subordinated to any interest they may have in the Property. The Hamerlys contend that they made payments to the Debtor in the aggregate amount of \$180,000.00. They also contend that they paid an additional \$58,992.00 directly to subcontractors at the direction of the Debtor, for credit against the purchase price pursuant to the Purchase Agreement. The Hamerlys contend that there are numerous and material factual issues that have to be resolved, which renders a judgment on the pleadings inappropriate at this time. They also contend that the following factual issues are in dispute: (a) the parties'

intention as to the nature of the title to the Property to be transferred pursuant to the Purchase Agreement and (b) Fifth Third's knowledge, duty and procedures as it related to the administration of its loan to the Debtor.

The dispositive issue is whether, under Federal Rule of Civil Procedure 12(c), there exists a material issue of fact.

Federal Rule of Civil Procedure 12(c) provides that “[a]fter the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings.” FED. R. CIV. P. 12(c) (incorporated by FED. R. BANKR. P. 7012(b)). When deciding a motion for judgment on the pleadings a court “must construe the complaint in the light most favorable to the plaintiff, accept all of the complaint's factual allegations as true, and determine whether the plaintiff undoubtedly can prove no set of facts in support of his claim that would entitle him to relief.” Kottmyer v. Maas, 436 F.3d 684, 689 (6th Cir.2006)(citation omitted). The legal standard employed to determine a motion for judgment on the pleadings “is identical to that employed under a Rule 12(b)(6) motion to dismiss.” Id. (quoting EEOC v. J.H. Routh Packing Co., 246 F.3d 850, 851 (6th Cir.2001); Grindstaff v. Green, 133 F.3d 416, 421 (6th Cir.1998)). “The motion is granted when no material issue of fact exists and the party making the motion is entitled to judgment as a matter of law.” Paskvan v. City of Cleveland Civil Serv. Comm’n, 946 F.2d 1233, 1235 (6th Cir.1991).

Section 365 of the Bankruptcy Code, in relevant part, provides:

(d)(1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory or unexpired lease of residential real property or of personal

property of the debtor within 60 days after the order of relief, or within such additional time as the court, for cause, within such 60-day period, fixes then such contract or lease is deemed rejected.

* * *

(i)(1) If the trustee rejects an executory contract of the debtor for the sale of real property or for the sale of a timeshare interest under a timeshare plan, under which the purchaser is in possession, such purchaser may treat such contract as terminated, or, in the alternative, may remain in possession of such real property or timeshare interest.

(2) If such purchaser remains in possession—

(A) such purchaser shall continue to make all payments due under such contract, but may, offset against such payments any damages occurring after the date of the rejection of such contract caused by the nonperformance of any obligation of the debtor after such date, but such purchaser does not have any rights against the estate on account of any damages arising after such date from such rejection, other than such offset; and

(B) the trustee shall deliver title to such purchaser in accordance with the provisions of such contract, but is relieved of all other obligations to perform under such contract.

(j) A purchaser that treats an executory contract as terminated under subsection (i) of this section, or a party whose executory contract to purchase real property from the debtor is rejected and under which such party is not in possession, has a lien on the interest of the debtor in such property for the recovery of any portion of the purchase price that purchaser or party has paid.

11 U.S.C. § 365.

Section 365(d)(1) provides the trustee with 60 days after the order of relief, to assume or reject most executory contracts and unexpired leases in Chapter 7 cases. 11 U.S.C. § 365(d)(1). If the Chapter 7 trustee fails to take any action within the prescribed time period, § 365(d)(1) provides that the agreement is deemed rejected. Id; See e.g. Miller v. Chateau Communities, Inc. (In re Miller), 282 F.3d 874, 877 (6th Cir.2002); United States v. Dewey Freight Systems, Inc., 31 F.3d 620, 623 (8th Cir.1994). The Trustee did not move to assume or reject the Purchase Agreement between the Debtor

and the Hamerlys. Therefore, the Purchase Agreement was deemed rejected by operation of law on June 18, 2006, sixty-days after the Debtor's petition was filed.

Notwithstanding, § 365(i) creates an exception to the treatment accorded rejected executory contracts and expired leases. 11 U.S.C. § 365(i). Section 365(i) of the Bankruptcy Code provides a purchaser to an executory contract for the sale of real property, with alternative remedies if the purchaser is in possession of the subject real property and the debtor is the seller. See 11 U.S.C. § 365(i); In re Maier, 127 B.R. 325, 327 (Bankr. W.D. N.Y. 1991).

The starting point in determining a resolution to this dispute is the statutory language. United States v. Ron Pair Enters., 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) "The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of the drafters'." Id.; See also First Union Mortgage Corp. v. Eubanks (In re Eubanks), 219 B.R. 468, 471 (6th Cir. BAP 1998). Even if the statutory language of § 365(i) were ambiguous and it were appropriate to resort to the legislative history, it provides no further explanation of the statutory provision.²

² The Legislative History and Comments related to § 365(i) provide:

Subsection (i) gives a purchaser of real property under a land installment sales contract similar protection [as § 365(h) provides to lessees]. The purchaser, if the contract is rejected, may remain in possession or may treat the contract as terminated. If the purchaser remains in possession, he is required to continue to make the payments due, but may offset damages that occur after rejection. The trustee is required to deliver title, but is relieved of all other obligations to perform.

A purchaser that treats the contract as terminated is granted a lien on the property to the extent of the purchase price paid. A party with a contract to purchase land from the debtor has a lien on the property to secure the price already paid, if the contract is rejected and the purchaser is not yet in possession.

H.R.Rep. No. 595, 95th Cong., 1st Sess. 349 (1977); S.Rep. No. 989, 95th Cong., 2d Sess. 60 (1978), reprinted in 1978 U.S.C.C.A.N. pp. 5787, 5963.

The Hamerlys argue that the Trustee is obliged by statute to convey title to the Property to them free and clear of liens. They rely upon § 365(i)(2) for the relief. Such reliance is misplaced. The statutory language of § 365(i) precludes the debtor from avoiding its contractual obligations to deliver title under the purchase agreement, unless the purchaser elects to have the contract terminated. 11 U.S.C. § 365(i); see also McCannon v. Marston, 679 F.2d 13, 18 (3rd Cir.1982) (concluding that § 365(i) specifically concerns the case in which a trustee rejects an executory contract of the debtor for the sale of real property under which the purchaser is in possession, and is not limited in application to land installment contracts); Maier, 127 B.R. at 327(Bankr. W.D. N.Y. 1991). Section 365(i)(2)(B) requires the trustee to deliver title in accordance with the contract, but relieves him of all other obligations to perform under the contract. See 11 U.S.C. § 365(i)(2)(B). The authority granted to the trustee to deliver title to a purchaser in possession “merely specifies how a limited power is to be used; it does not give the trustee authority to override or convey interests in property of entities other than the estate.” In re Delaney, 2003 WL 23096937, *5 (Bankr. D. Mass. 2003).

As noted above, §365(i)(2)(B) requires a trustee to deliver title to an affected purchaser in accordance with the provisions of the relevant purchase contract. That requirement is, however, tempered to the extent that the same provision relieves the trustee “of all other obligations to perform under such contract.” 11 U.S.C. § 365(i)(2). As reviewed nothing in the Purchase Agreement, a two-page document, executed between the Debtor and the Hamerlys requires the trustee to deliver any property title to the Hamerlys free and clear of liens. The Purchase Agreement in paragraph three provides:

3) TITLE TRANSFER

(A) purchaser shall obtain possession of the subject premises on or before TITLE TRANSFER subject to the performance by Purchaser of its obligation under the Purchase Agreement. TITLE transfer shall be on or before _____*. (The closing date). All closing fees and instructions listed in Conditions Agreement attached.

See New Construction Purchase Agreement, attached to the Complaint.³ The title transfer provision, described above, required the Debtor to transfer title on the closing date, which was never consummated on the purchase transaction. It is undisputed that the Purchase Agreement was rejected by operation of law pursuant to § 365(d)(1). It is also undisputed that the Hamerlys are purchasers in possession of the subject property, as the term is utilized in § 365(i). The parties did not dispute that the Hamerlys may opt, pursuant to § 365(i), to have the trustee deliver title of the Property to them in accordance with the provisions of the subject agreement; unless they elect to terminate the subject agreement. However, the parties do dispute whether the trustee is authorized to deliver title to the property free and clear of liens. Although the § 365(i) issue reached the court in In re Delaney differently (the mortgagee requested relief from the automatic stay), the case is otherwise analogous to the case before this Court. See 2003 WL 23096937. The Delaney court held that the trustee could not convey “better” title to the property than the debtor had. Id. The Delaney court also held that there was no legal basis to grant the relief sought by the purchasers in that case, specifically a conveyance of title free and clear of liens. Id.

The statutory language of § 365(i) is unambiguous. The Trustee is not required or authorized upon the purchaser’s option to deliver title to the subject property free and

³ The “Title Transfer” provision briefly mentions “all closing fees and instructions listing in Conditions Agreement attached.” There was no Conditions Agreement attached to the Purchase Agreement provided to the Court.

clear of all liens, claims and encumbrances. Section 365(i) requires a transfer of title pursuant to the Purchase Agreement upon the Hamerlys election. The Hamerlys may elect to close on the subject Property, if so the Trustee must convey title pursuant to the Pursuant Agreement. However, the Hamerlys acceptance of title to the Property comes with the acceptance of all liens, claims and encumbrances associated with said title. Therefore, there is no material issue of fact as it relates to the Hamerlys rights pursuant to § 365(i). The Trustee does not have the authority to convey title to the Property to the Hamerlys free and clear of liens.

Fifth Third also requests a determination that its claim cannot be subordinated to any claim which the Plaintiff's may have against the Property. The Hamerlys assert that Fifth Third failed to properly monitor the Debtor and administer the loan it provided to the Debtor.

Section 510(c) of the Bankruptcy Code provides:

(c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may--

- (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or
- (2) order that any lien securing such a subordinated claim be transferred to the estate.

11 U.S.C. § 510(c). Section 510(c) authorizes the bankruptcy court to subordinate claims in favor of the claims of other creditors when, in circumstances of the case, such action would be equitable. See Id. A successful claim of equitable subordination requires the movant to demonstrate “(1) the claimant engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankruptcy or conferred an unfair advantage on the claimant; and (3) equitable subordination of the

claim must not be inconsistent with the provisions of the Bankruptcy [Code].” Bayer Corp. v. Macotech, Inc. (In re Autostyle Plastics, Inc., 269 F.3d 726, 744 (6th Cir.2001)(citation omitted). “Equitable subordination is an unusual remedy which should be applied in limited circumstances.” Id. at 744-45. Additionally, satisfaction of the equitable subordination test does not obligate a bankruptcy court to equitably subordinate a claim, but rather permits a court to take action. Id. Where the creditor whose claim is the subject of an equitable subordination claim is a non-insider, the degree of scrutiny its conduct will be subject to is lesser that if the claimant is an insider. See First National Bank of Barnesville v. Rafoth, 974 F.2d 712, 718 (6th Cir.1992); see also In re 80 Nassau Associates, 169 B.R. 832, 820 (Bankr. S.D. N.Y. 1994) (holding that claim of a noninsider fiduciary in a commercial case can only be subordinated based on inequitable conduct, if the claimant has substantially breached a duty arising under contract, tort, or other area of law); In re Aluminum Mills Corp., 132 B.R. 869 (Bankr. N.D. Ill. 1991) (“The quality of conduct considered to be 'inequitable' under § 510(c) depends on the nature of the legal relationship between the creditor and the debtor”). “Where the claimant is a non-insider, egregious conduct must be proven with particularity. It is insufficient for the objectant in such cases merely to establish sharp dealing; rather, he must prove that the claimant is guilty of gross misconduct tantamount to ‘fraud, overreaching or spoliation to the detriment of others.’” Id. (citing In re Teltronics Serv., Inc., 29 B.R. 139, 169 (Bankr. E.D.N.Y. 1983)).

It is uncontested that Fifth Third is a non-insider of the Debtor, therefore the alleged inequitable conduct pursuant to the equitable subordination test must reach a level of “gross misconduct tantamount to fraud, overreaching or spoliation to the detriment of

others.” First National Bank of Barnesville v. Rafoth, 974 F.2d at 718 (6th Cir.1992).

The Hamerlys contend that Fifth Third failed (a) to alter the terms of the Mortgage it had with the Debtor, during the course of the construction to account for the projected cost of the Purchase Agreement (\$575,000), which was much less than the loan amount; and (b) to credit the installment payments made by the Hamerlys to the Debtor pursuant to the Purchase Agreement because it failed to monitor the Debtor. Accepting all of the Complaint's factual allegations as true, the Hamerlys undoubtedly cannot prove facts in support of their claim that would entitle them to relief. Firstly, they are not in privity on any loan transaction with Fifth Third. The Hamerlys have not proven that Fifth Third's procedures or administration of the loan with the Debtor was inequitable or in contradiction of their relationship outlined pursuant to the Mortgage, Note and/or Ohio law. Further, the Hamerlys have not set forth the behavior or lack thereof, resulting in injury to the creditors or conferring an unfair advantage to Fifth Third. This is significant since Fifth Third duly recorded the Mortgage prior to the execution of the Purchase Agreement executed between the Debtor and the Hamerlys. Therefore, Fifth Third's claim shall not be subordinated to any claim of which the Hamerlys may have against the Property.

The Court further finds that the pleadings establish that Fifth Third is entitled to judgment as a matter of law.

CONCLUSION

Accordingly, Fifth Thirds' Motion is well premised and is hereby granted. The Hamerlys objection is overruled. Each party is to bear its respective costs.

IT IS SO ORDERED.

Dated, this 22^d day of
December, 2006



**RANDOLPH BAXTER
CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT**