UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
HY-GAIN ELECTRONICS CORPORATION,	)	CASE NO. BK78-0-26
HY-GAIN DE PUERTO RICO, INC.,	)	CASE NO. BK78-0-25
HY-GAIN ELECTRONICS SYSTEMS CORP.,	)	CASE NO. BK78-0-81
	)	
BANKRUPTS	)	

MEMORANDUM OPINION

The matter now before the Court is the "Motion to Set Aside and Vacate Order Authorizing, Approving and Confirming Compromise of Controversy with Secured Banks Dated March 10, 1978," filed in each of the above-captioned cases by the trustee in bankruptcy. An understanding of certain factual background information is necessary to an understanding of the present controversy.

Each of the above-captioned bankrupts filed petitions under Chapter XI of the Bankruptcy Act on January 5, 1978, and on that date became debtors-in-possession. On January 14, 1978, the debtors filed their Application To Use Soft Collateral And Funds which sought authority to use the inventory and accounts receivable which were claimed as security for loans by Citibank, N.A., Citibank International Los Angeles, Security Pacific National Bank, and Columbia Union Bank and Trust Company, referred to herein as "Secured Banks". After a lengthy trial on the merits between the Secured Banks and the debtors, this Court denied permission for the debtors to use the inventory and the accounts receivable in the operation of its business. That decision occurred February 6, 1978. On February 17, 1978, Secured Banks filed an application to reclaim the inventory and receivables and, on March 1, 1978, Secured Banks filed a complaint seeking partial relief from the stay in an effort to recover the accounts receivable claimed as collateral. The partial reclamation filed March 1, 1978, was set for trial on March 10, 1978.

Before the trial of the complaint seeking to reclaim the accounts receivable, the debtors and the Secured Banks agreed to a compromise agreement whereby the debtors were given until March 30, 1978, to pay off Secured Banks' entire debts for an option price of $10,842,000.00 plus interest and attorneys' fees. The option price was approximately 50% of the total indebtedness due the Secured Banks. The compromise agreement provided that if the debtors failed to meet that deadline, the Secured Banks were authorized to take immediate possession of the collateral claimed by them which amounted to substantially all of the assets of the debtors. A condition required in the compromise agreement by the Secured Banks was that the debtors on behalf of themselves and any successors including a trustee in bankruptcy were to give up the right to attempt to invalidate or void the security interest claimed by the banks. It is this provision which has sparked the

present controversy. The Secured Banks and the debtors jointly applied to this Court for authority to execute the compromise agreement. That hearing came on upon notice to the Creditors' Committee and, after hearing, the compromise agreement was approved by this Court on March 10, 1978.

The debtors were unable to obtain the money necessary to meet the option price and the Secured Banks took possession of the collateral claimed by them and have proceeded to liquidate that collateral. The debtors were adjudged bankrupts on April 4 1978, at which time the trustee in bankruptcy was appointed.

The present motion by the trustee seeks to set aside the order dated March 10, 1978, which approved the compromise agreem between the debtors and the Secured Banks. In substance, the reason for the present motion is that the trustee has discovered information that certain security interests were perfected withi four months preceding the filing of the Chapter XI petitions or improperly perfected with regard to collateral located in Puertc Rico. The trustee's theory is that the perfection which occurre within four months of the filing of the Chapter XI petitions might make certain secured transactions voidable preferences within the meaning of Section 60 of the Bankruptcy Act. The trustee is prohibited from bringing any cause of action because of the compromise agreement.

One allegation by the trustee is that there was improper nc of the hearing held on March 10, 1978, which approved the comprc agreement. However, notice was given to the Creditors' Committe of the hearing and, by virtue of Rule 11-24(d) that is all that is required. In addition, at the hearing, the Court inquired of the attorney for the Creditors' Committee as to whether there was any objection to the notice that was given. The attorney for the Creditors' Committee indicated "No objection to the notice as such, Judge." (Transcript p. 2, Line 32; p. 3, Line 1

The main argument by the trustee is that the Secured Banks and their attorney failed to disclose to the debtor and the Creditors' Committee the fact that some security interests in Puerto Rico were perfected within the four months preceding the Chapter XI petitions. However, at the hearing held March 10, 1978, the attorney for the Creditors' Committee asked for a representation from the Secured Banks regarding certain matters. The attorney for the Secured Banks responded as follows:

> "Based upon the testimony of Mr. Windhorst, the chief financial officer of the debtor, who testified in an adversary proceeding in this court with respect to use of soft collateral, that in September and October the debtor had a net worth. It was not insolvent on its balance sheet. And based upon the August 31st, 1977 balance sheet represented to the banks prepared by the company's outside accountants, who I believe are not certified, is it correct, Mr. Windhorst? Which showed a net worth in excess of twelve million dollars. The security interests of the banks are not voidable under the voidable preference provisions of section 60 of the Bankruptcy Act. And that is the representation which I advised Mr. Frederick.
>
> BY THE COURT: Does that satisfy the provisions of the creditors' committee?
>
> MR. FREDERICK: Yes, Your Honor."

The trustee argues that the representation is misleading because it fails to advise the Creditors' Committee of the possible perfection within four months of the filing of the Chapter XI. However, the representation is only consistent with the possibility that perfection occurred within the four-month period. If the perfection had occurred prior to the four-month period, there would be no necessity for the representation that the debtors were solvent during the crucial period of time. In other words, if the filing had occurred prior to the four-month period, there was no possibility of attacking the perfection as a voidable preference. The Court's conclusion is that there is nothing misleading in the representation made.

The compromise agreement effectively precludes the trustee from bringing lawsuits based on a theory on voidable preference. However, it goes further and precludes the trustee from attempting to void or invalidate the security interest claimed by the banks under any theory. The reasons for this are detailed in the compromise agreement. At the time the compromise agreement was approved, the debtors were not operating their businesses because of the lack of money. The compromise agreement contemplated that the debtors might find new financing or a merger partner which would produce sufficient money to meet the option price and provide some type of plan of arrangement. The compromise agreement specifically states that litigation might take any number of years to conclude and that it was more advantageous for the debtors, the Secured Banks, and the other secured creditors to give the debtors this "breathing spell" in order to find some solution to the financial difficulties. The price for this potential benefit to the unsecured creditors was the waiver of the right to attempt to invalidate the Secured Banks' security interest in the future. I have some confidence that all parties understood the terms of the compromise agreement. Needless to say, there were other theories of possible avoidance other than that of a voidable preference. One possibility was that the taking of the security agreement outside the four-month period but within one year of bankruptcy might be a fraudulent conveyance under a theory similar to that adopted in Burroughs v. Fields, 546 F.2d 215 (7th Cir. 1976). However, the specific language of the compromise agreement makes it clear that all of these potential theories of the trustee were given up because it seemed to be in the best interests of all parties to do so.

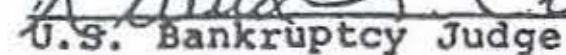
Clearly, this Court when it approved the compromise agreement realized that all attempts in the future to attack the validity of the Secured Banks' security interest was prohibited. I should add that nothing which was represented by the banks in open court misled this Court into approving the compromise agreement.

All in all, the unsecured creditors had the potential by virtue of the compromise agreement of receiving an acceptable plan of arrangement. Unfortunately, that opportunity did not materialize and bankruptcy followed. Nevertheless, having received the benefit of the compromise agreement, the unsecured creditors through their representative, the trustee, may not relieve themselves of its burden.

A separate order is entered in accordance with the foregoing.

DATED: June 22, 1979.

BY THE COURT:



U.S. Bankruptcy Judge

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