

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

In re:)	Chapter 11
)	
AUTOMOTIVE PROFESSIONALS, INC.,)	Case No. 07-6720
)	
Debtor.)	Honorable Carol A. Doyle
)	

**TRUSTEE’S SECOND MOTION TO APPROVE
SETTLEMENT AGREEMENTS WITH CERTAIN DEALERS**

Frances Gecker (the “Trustee”), not individually, but as the Chapter 11 trustee for Automotive Professionals, Inc. (“API,” or the “Debtor”) respectfully requests the entry of an order, pursuant to 11 U.S.C. § 363(b) and Fed. R. Bankr. P. 9019, authorizing the Trustee to enter into settlements with the dealerships identified on Exhibit A attached hereto (the “Dealers”), as described herein and more particularly set forth in the forms of Settlement Agreement and Release (the “Settlement Agreement”), copies of which are attached hereto as Exhibit B and Exhibit C. In support of her motion (the “Motion”), the Trustee respectfully states as follows:

JURISDICTION

1. This Court has jurisdiction over the Motion pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409.
2. Consideration of the Motion is a core proceeding pursuant to 28 U.S.C. § 157(b).
3. The relief sought is appropriate and proper pursuant to 11 U.S.C. § 363(b) and Rule 9019 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”).

BACKGROUND

4. On April 13, 2007 (the “Petition Date”), the Debtor filed a voluntary petition for

relief under chapter 11 of the United States Bankruptcy Code, 11 U.S.C. § 101, *et seq.* (the “Bankruptcy Code”).

5. On June 6, 2007, the Court ordered the appointment of a Chapter 11 trustee.

6. Upon the recommendation of the U.S. Trustee, on June 12, 2007, the Court approved the appointment of Frances Gecker as Chapter 11 Trustee.

7. Prior to the Petition Date, API entered into an agreement with each of the Dealers (the “API/Dealer Agreement”) pursuant to which, among other things, API agreed to serve as claims administrator under vehicle service contracts (the “VSCs”) that the Dealers sold to their customers through one of API’s incentive programs known as the Rapid Profit Program (“RPP Program”) and the Maximum Protection Plan (“MPP Program,” and together with the RPP Program, the “API Program”). A copy of the form used for the API/Dealer Agreement is attached hereto as Exhibit D. A copy of the form used for the MPP Addendum is attached hereto as Exhibit E. A copy of the form used for the RPP Addendum is attached hereto as Exhibit F.

8. As of July 31, 2007, there were 21,607 unexpired VSCs sold by the Dealers and administered by API. A copy of the relevant form of VSCs issued by API, comprised of the Application and Terms and Conditions is attached hereto as Exhibit G. This is the same VSC held by each of the consumers implicated in the settlement proposed herein.

9. Under the API Program, when a Dealer met certain criteria, API was required to establish an account into which a portion of that Dealer’s VSC sale proceeds were deposited (with reference to a given Dealer, the “Reserve Account”). MPP Addendum at ¶ 2; RPP Addendum at ¶ 2. API paid the cost of repairs from the Reserve Account associated with each Dealer.

10. Both the MPP Addendum and the RPP Addendum further provide that the Dealer shall have no beneficial or other property interest in the funds in the Reserve Accounts. MPP Addendum at ¶ 2; RPP Addendum at ¶ 5. In addition, the MPP Addendum provides that when “all Contracts issued by Dealer have expired by their terms and all obligations thereunder have been fully satisfied, the remaining balance in the Reserve Escrow Accounts, if any, shall be paid to Dealer. If the Dealer is no longer in business, has no heirs, successors or assigns or has relinquished its right to Additional Commissions, as provided in this Addendum, the remaining balance in the Reserve Escrow Accounts, if any, shall be retained by the Administrator.” MPP Addendum at ¶ 4(B).

11. The Trustee and the Dealers understand that any claim reserve accounts that existed in connection with GPRs sold to the Dealers’ customers under the Marathon Program have been depleted in their entirety.

12. Prior to the Petition Date, on February 15, 2007 (the “Assignment Date”), API executed an assignment for the benefit of creditors, and transferred its assets, including the Reserve Accounts, to the API Creditors’ Trust, administered by Michael Kayman as Assignee (the “Assignee”). Subsequently, API ceased processing claims in connection with the VSCs.

13. After the Assignment Date, the Assignee transferred the funds in the Reserve Accounts to an account (the “LaSalle Account”) at LaSalle Bank National Association (“LaSalle”). After the appointment of the Trustee, the Trustee and LaSalle entered into a settlement agreement in connection with their respective claims and defenses against each other, including their respective claims and defenses relating to the funds in the LaSalle Account (the “LaSalle Agreement”). Pursuant to the LaSalle Agreement, among other things, LaSalle transferred and assigned whatever rights, claims and interest it held the funds that were in the

LaSalle Account to the Trustee. The Bankruptcy Court approved the LaSalle Agreement on July 25, 2007 [Docket No. 298].

14. Based on the Debtor's records, the Trustee has been able to allocate the funds in the LaSalle Account to the separate reserve accounts which API had maintained in connection with the individual dealers. The reserve allocation for the Dealers' Reserve Accounts as of July 31, 2007 is \$7,519,912.16.

15. Since the Assignment Date, the Dealers have not had access to the funds in the Reserve Accounts, which under the API/Dealer Agreement, were to be used to pay repair, replacement and cancellation costs associated with claims made by consumers participating in the API Program. Instead, the Dealers have been forced to expend their own funds in connection with the payment and processing of claims tendered by participants in the API Program, and will pay additional sums in order to procure an appropriate reinsurance coverage package for the outstanding VSCs.

16. Prior to the Petition Date, on August 1, 2005, First Colonial Insurance Company ("FCIC") and API entered into an Administrative Agreement, pursuant to which API agreed to serve as administrator for FCIC of automobile vehicle service products. FCIC has established a servicing arrangement with CareGard Warranty Services, Inc. ("CareGard"), as an administrative agent, to process and pay claims in connection with the API Program.

17. In an effort to minimize any further disruptions and inconveniences to the Dealers' consumer customers holding VSCs issued by API, and to resolve any issues regarding the disposition of the Reserve Accounts, the Trustee, the Dealers, Caregard and FCIC have engaged in good faith, arm's-length discussions with respect to resolving all of the respective rights, obligations, claims and defenses of the Dealers, the Trustee, API and API's bankruptcy

estate in connection with the API/Dealer Agreements. In that regard, the Trustee has proposed that the Trustee and the Dealers enter into a settlement, the terms of which are incorporated into the Settlement Agreement.

18. Attached hereto as Exhibit B and Exhibit C are two forms of the Settlement Agreement and Release. Each of the Dealers may enter into one of the two forms of Settlement Agreement. The difference between the form Settlement Agreements is that Exhibit B resolves only valid VSCs sold by the Dealer, while Exhibit C resolves valid VSCs and GPRs sold by the Dealer. If the Dealer assumes responsibility for paying valid GPR claims, the Dealer will be entitled to assert a claim against the bankruptcy estate for the refunds paid by the Dealer for GPRs.

19. Pursuant to the terms of both forms of the Settlement Agreement, upon execution of the Settlement Agreement with the Dealer, and as consideration for FCIC providing a vehicle service contract reimbursement insurance policy naming the API bankruptcy estate as the named insured (the “FCIC Policy”), the Trustee will transfer to FCIC the sum of the Reserve Account Balance listed in Exhibit A for the Dealer (the “Reserve Account Transfer”), less a sum of either 8% or 10% of the Reserve Account balance, which will be held by the Trustee as an asset of API’s bankruptcy estate. A copy of the FCIC Policy is attached hereto as Exhibit H.

20. If the Dealer elects to contribute 10% of the Reserve Account balance to the estate, the Dealer shall retain a general claim in the amount of funds contributed to the estate. The Trustee will also retain the accrued interest earned on the Reserve Account Transfer as an asset of API’s bankruptcy estate.

21. The FCIC Policy will be issued upon execution of the Reserve Account Transfer, and will cover valid repair and cancellation claims. CareGard will administer the processing of the claims under the FCIC Policy.

22. Pursuant to the Settlement Agreement, FCIC has agreed to provide the Trustee with monthly reports detailing all payments and claims processed under the API Program.

RELIEF REQUESTED

23. The Trustee requests, pursuant to 11 U.S.C. § 363 and Bankruptcy Rule 9019, that this Court enter an order approving the terms of her proposed settlement agreement with the Dealers as described herein and set forth in the form Settlement Agreements attached hereto as Exhibit B and Exhibit C.

BASIS FOR RELIEF SOUGHT

24. The Settlement Agreement is fair and reasonable and in the best interests of the estate and its creditors, and should be approved by the Court. Pursuant to Bankruptcy Rule 9019(a), after notice and a hearing, the court may approve a settlement or compromise. Fed. R. Bankr. P. 9019. Compromises are tools for expediting the administration of the case and reducing administrative costs and are favored in bankruptcy. *See Fogel v. Zell*, 221 F.3d 955, 960 (7th Cir. 2000). In addition, to the extent that the Settlement Agreement implicates the use of property of the estate, such use is permitted under 11 U.S.C. § 363 because the Trustee has articulated sound business reasons. *See, e.g., In re Schipper*, 933 F.2d 513, 515 (7th Cir. 1991).

25. A bankruptcy judge has discretion whether to approve a settlement agreement. *In re American Reserve Corp.*, 841 F.2d 159, 162 (7th Cir. 1987). The Court's discretion hinges upon whether the settlement is fair and equitable and in the best interest of the estate. *Depoister v. Mary M. Holloway Foundation*, 36 F.3d 582, 586 (7th Cir. 1994) (citations omitted).

26. In making its determination, this Court must first compare the terms of the settlement with the probable costs and benefits of litigation. *Id.*, quoting *Protective Committee for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968) (the Court should try to apprise itself “of all facts necessary for an intelligent and objective opinion on the probabilities of ultimate success should the claim be litigated”).

27. The Court should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting on any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise. Basic to this process in every instance is the need to compare the terms of the compromise with the likely rewards of the litigation. *Id.* The Court should also consider the delay involved if the settlement is not approved, “including the possibility that disapproving the settlement will cause wasting of assets.” *Amer. Reserve Corp.*, 841 F.2d at 161.

28. Second, the Court should determine whether the settlement falls within the reasonable range of litigation possibilities. *In re Energy Coop.*, 886 F.2d 921, 929 (7th Cir. 1989). Such inquiry does not, however, require an evidentiary hearing. *Depoister*. Moreover, the latter determination is to be weighed in favor of settlement since a challenged settlement fails the test only if it falls below the lowest point in the range of reasonableness. *In re Telesphere Comm., Inc.*, 179 B.R. 544, 553 (Bankr. N.D. Ill. 1994) (internal citations omitted).

29. The Settlement Agreement is fair and equitable and in the best interests of the estate, and falls well within the range of litigation possibilities. If approved, the Settlement Agreement will resolve disputed claims to the funds in the Reserve Accounts while allowing more than 21,000 consumers to pass through this bankruptcy case with their pre-petition state law rights intact.

30. The proposed settlements will resolve not only the Dealers' claims that the funds in the Reserve Accounts are trust funds held for their benefit, but myriad other claims asserted by the Dealers. Such claims include claims for: (1) the Dealers' payment and processing of claims tendered by consumers in the API Program, (2) the Dealers' procurement of reinsurance coverage packages for the outstanding VSCs, (3) alleged misrepresentations made to the Dealers with respect to Marathon's purported coverage of the API Program, and (4) losses incurred by the Dealers in terms of lost business as a result of API's failure to perform under the VSCs.

31. These disputes are the proper subject of a settlement considered under Rule 9019. *Depoister v. Mary M. Holloway Found.*, 36 F.3d 582, 585-88 (7th Cir. 1994). In *Depoister*, the Seventh Circuit held that the Bankruptcy Court had properly approved a settlement pursuant to Rule 9019(a), without reference to 11 U.S.C. § 363 or other provisions of the Bankruptcy Code, and without having conducted an evidentiary hearing. In approving the settlement as in the best interest of the debtor's estate, the Bankruptcy Court reviewed the nature of the opposing claims and determined that (1) the estate's chances in prevailing in the disputed claims were low, (2) litigation in the absence of the proposed settlement would generate substantial legal fees that would deplete assets of the estate available for distributions to other creditors, (3) the process of evaluating the potential effects of the settlement on the other creditors was speculative at best, (4) the only party objecting to the proposed compromise had no tangible interest in the outcome, and (5) the trustee, an experienced bankruptcy practitioner, approved the compromise. *Id.* at 587.

32. The Seventh Circuit held that in view of the Bankruptcy Court's consideration of those factors, the Bankruptcy Court had "apprised himself of all facts necessary to evaluate the settlement and make an informed and independent judgment about the settlement." *Id.* at 587-88,

quoting *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424-34 (1968); *In re Am. Reserve Corp.*, 841 F.2d 159, 162 (7th Cir. 1987).

33. Similarly, there are sufficient facts before this Court to allow the approval of the Settlement Agreement. The benefits to API's estate of approval of the Settlement Agreement are manifold. First, if consummated, the settlements will allow more than 21,000 consumers to receive, in large part, the benefit of their bargain with API by making approximately \$7 million, that was generated from the sale of VSCs to those consumers, available for the payment of their valid repair claims. Absent bankruptcy, these same funds would have been available to pay the claims of these same consumers. Bankruptcy is not intended to expand a creditor's pre-petition rights, but to honor those rights in an equitable way. The Settlement Agreement accomplishes just that.

34. Thus, the proposed settlement will preserve the prepetition rights under state law of the Dealers and their consumers with respect to the funds in the Reserve Accounts. *See Butner v. United States*, 440 U.S. 48, 55 (1978). The funds in the Reserve Accounts were generated from VSCs and Dealer Agreements, pursuant to which those funds were to be allocated for (a) the payment of the claims of the consumers who purchased the subject VSCs, and (b) under the MPP Addendum, upon the expiration of the VSCs, to the Dealers who sold the VSCs. The Settlement Agreement preserves those prepetition rights as nearly as possible, while at the same time making substantial funds available to the estate to maximize the recovery of other creditors.

35. As in *Depoister*, the process of evaluating the potential effects of the Settlement Agreement on consumer creditors other than the Dealers' customers is speculative. However, it is certain that these other consumers will receive more as a result of the proposed settlement in the form of the approximately \$750,000 in settlement proceeds, and the additional amounts that

may be generated from the use of the settlement proceeds. Absent the proposed agreement, it is possible that the Dealers could prevail in their argument that the funds in the Reserve Accounts are trust funds held for their benefit, in which case all of the settlement proceeds would be excluded from the estate, and no funds would be available to pay consumers.

36. Furthermore, the Settlement Agreement will help facilitate confirmation of a plan. The proposed settlements will generate funds necessary for the responsible and expeditious administration of the estate, facilitate further agreements to ensure the protection of API's remaining creditors, substantially reduce the size of the creditor body, and thereby reduce the cost of the plan solicitation and balloting process. The Settlement Agreement will therefore foster a plan that maximizes value to all creditors. *See In re The Drexel Burnham Lambert Group, Inc.*, 130 B.R. 910, 926-27 (S.D.N.Y. 1991) ("the Settlement is the necessary first step toward confirmation of the Plan."); *In re Crowthers McCall Pattern, Inc.*, 114 B.R. 877, 888-90 (Bankr. S.D.N.Y. 1990).

37. Moreover, to the extent that approval of the Settlement Agreement implicates the use of property of the estate, the Trustee has articulated sound business reasons for her proposed use of the Reserve Accounts in satisfaction of 11 U.S.C. § 363. *See, e.g., Schipper*, 933 F.2d at 515. Under Section 363, the Trustee may use property of the estate outside the ordinary course of business if she has an "articulated business justification," provides adequate notice to creditors, and a hearing is held at which creditors have an opportunity to object. *Id.*, quoting *In re Continental Airlines*, 780 F.2d 1223, 1226 (5th Cir. 1986). The Trustee's proposed settlements will ensure that more than 21,000 API consumers, whose purchase of the VSCs generated the funds in the Reserve Accounts, will receive payment for their valid repair claims; will protect the Dealers who sold the VSCs generating those funds against potential litigation; preserve the

Dealers' relationships with their customers; and will generate approximately \$750,000 for the benefit of API's estate. The Trustee respectfully submits that these are sound business reasons justifying approval of the proposed settlement.

38. This Court has previously approved substantially similar settlement agreements between the Trustee and other dealers and other entities. *See* Order Approving Trustee's Settlement With Dealers Financial Services, LLC entered on August 22, 2007 [Docket No. 330]; Order Approving Trustee's Settlement With Certain Dealers entered on October 30, 2007 [Docket No. 460]; Order Approving Trustee's Settlement With The Herb Chambers Companies entered on October 30, 2007 [Docket No. 461]; Order Approving Settlement Agreement Between the Trustee and The Travelers Indemnity Company entered on November 6, 2007 [Docket No. 463].¹

39. In fact, the relief sought by the Trustee in this motion is identical to the relief this Court granted in the Order Approving Trustee's Settlement With Certain Dealers entered on October 30, 2007 [Docket No. 460].

40. At the combined hearing held on October 30, 2007 on the Trustee's motions to approve her settlements with Certain Dealers, The Herb Chambers Companies, and The Travelers Indemnity Company, this Court held that each of the proposed settlements were fair and equitable and in the best interests of API's bankruptcy estate. (A copy of the relevant pages of the transcript of the October 30 hearing ("Tr.") are attached hereto as Exhibit I.) The Court stated in relevant part:

¹ On November 8, 2007, the Director of Insurance of the State of Illinois (the "Director") filed notices of appeal in connection with this Court's orders entered on October 30, 2007 [Docket Nos. 460, 461 and 463]. The Trustee believes that the Director's appeals lack merit, and that the Director lacks standing to prosecute such appeals.

. . . I believe that to the extent that [consumers] have an interest in those funds [in reserve accounts], for them to be applied for the purpose of helping API carry out a contract, I think the trustee has absolutely carried out their [sic] responsibility in entering into these transactions which allow the consumers to get the benefit of the bargain. And those funds are being used for that purpose. (Tr., p. 70)

* * *

The bottom line is that I have looked at these agreements very carefully and I have decided that each of the settlements is fair, equitable, reasonable, and makes sense for the estate. And that is the primary reason I'm going to approve them. As I mentioned earlier, I myself was concerned about the notice issue, but upon further reflection I'm not going to require additional notice. (*Id.*, p. 71)

* * *

. . . [T]he allocation of funds proposed in the [Travelers] settlement represents a very reasonable resolution of this issue under which the trustee gets close to \$1 million, (which it would only get under the contracts if the dealers went out of business), the consumers get the full value they bargained for with a comprehensive agreement by Travelers to pay all claims covered by the vehicle service contracts, and the dealers get the rest, which is also consistent with what the contracts provide. Although an individual consumer whose dealer's contract doesn't contain language creating an escrow fund with a right to refund of money left after the VSC could object, after examining the contract language and having reviewed case law regarding escrows under Illinois law and Section 540 of the Bankruptcy Code, I would not refuse to approve the settlement anyway because I believe it is a reasonable allocation of the funds under the developing facts and law and fair to all involved. It also accomplishes what the Director of Insurance says is his primary goal, giving consumers the benefit of the bargain under the VSCs.

The fact that some consumers have contracts from dealers who are in a less favorable position does not make this an unfair resolution. In fact, the trustee is getting a significant benefit for the estate from this settlement. Without it, if the issues were litigated, the trustee might end up with no money from these accounts because none of the dealers would have gone out of business. The resolution reached by the parties to the Travelers' settlement is well within the range of possible litigation outcomes.

In addition, the financial stake of the individual consumer creditors [who did not receive individual notice by mail of the settlements] is not large enough to make it likely that they would participate in a hearing on the settlement even if they received notice. The individual would have to understand the complex part of the bankruptcy law and how Illinois law impacts the analysis of the treatment of escrows. It's highly unlikely that the layperson would understand the issues,

and the cost of hiring counsel who understands bankruptcy law would be greater than the amount at stake for the individual consumer. Therefore notice to the individual consumers would be a futile exercise that would deplete the limited assets of the estate, diverting the money coming into the estate away from getting vehicle service protection for the remaining consumers in the case. See *Fogel versus Zell*, 221 F.3d at 955 at 963, Seventh Circuit, 2000, recognizing that circumstances like numerous small claimants can justify giving less notice than notice by mail to each individual creditor. (*Id.*, pp. 74-76)

41. Notice of this Motion has been posted on the Bankruptcy Court-approved website maintained by the Trustee in this bankruptcy case, and provided to the U.S. Trustee, API and its affiliates, counsel for the Official Committee of Unsecured Creditors, API's twenty largest creditors as listed in API's bankruptcy petition, all parties that have requested notice of all pleadings filed in the Bankruptcy Case, and the Attorney General of each state in which VSCs and GPRs were sold. The Trustee requests that the limited notice of this Motion be deemed sufficient and further notice of the Motion be waived.

WHEREFORE, the Trustee respectfully requests entry of an order:

- A. Authorizing the Trustee to enter into agreements with the Dealers, substantially in the form set forth in the Settlement Agreement, and authorizing the transfer of funds as set forth therein;
- B. Approving the limited notice of the Motion as sufficient; and

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C. Granting such other and further relief as this Court deems just.

Respectfully submitted,

FRANCES GECKER, not individually, but as
Chapter 11 Trustee for AUTOMOTIVE
PROFESSIONALS, INC.

By: /s/ Micah R. Krohn
One of her attorneys

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Dated: November 30, 2007