UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION

In re:	)	
	)	
Frisby Technologies, Inc.	)	Case No. 03-50158
	)	
Debtor.	)	
	)	
	)	
Official Committee of Unsecured Creditors,	)	Ad. Proc. No. 03-6090
	)	
Plaintiff,	)	
	)	
vs.	)	
	)	
Fin.Part International S.A., and Musi Investments, S.A.,	)	
	)	
Defendants.	)	
	)	

ORDER GRANTING MOTION TO SET ASIDE ENTRY OF DEFAULT

THIS MATTER came on before the court on September 10, 2003 upon the motion by Fin.Part International S.A. and Musi Investments, S.A. to set aside the entry of default and, in the alternative, for extension of time to answer. Appearing before the court was Thomas W. Waldrep, Jr., attorney for the Defendants, and Stephani Wilson Humrickhouse, attorney for Official Committee of Unsecured Creditors. For the reasons stated herein, the court will grant the Defendants' motion to set aside the entry of default.

FACTS

On January 16, 2003, Frisby Technologies, Inc. (the "Debtor") filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code. By order dated February 4, 2003, the

court appointed an official committee of unsecured creditors (the "Committee"), and subsequently approved the employment of Ms. Humrickhouse as counsel for the Committee.

At the time of the filing of the petition, the Debtor appeared to be burdened with two layers of secured debt. The first layer of secured debt was held by Damad Holding AG, a corporation organized under the laws of Switzerland, and Bluwat AG, a corporation also organized under the laws of Switzerland (collectively the "Swiss Lender"). These debt obligations are evidenced by loan and security agreements dated January 23, 2002. Under these agreements, the Debtor became liable to Damad in the sum of $750,000.00 and to Bluwat in the sum of $500,000.00. The balances owed to these parties as of the date of filing was $750,000.00 and $500,000.00, together with accrued interest. The Swiss Lender alleges that it is secured by a first lien on all accounts, inventory, equipment, fixtures, and general intangibles of the Debtor (the "Collateral").

The second layer of secured debt was held by Fin.Part International, SA, a corporation organized under the laws of Luxembourg, and Musi Investments, SA, a corporation also organized under the laws of Luxembourg (collectively referred to as the "Defendants"). These debt obligations were incurred on June 3, 2002 and are evidenced by loan and security agreements with Fin.Part in the amount of $300,000.00, and Musi in the amount of $300,000.00 (later amended to increase the principal amount to $350,000.00). Both the Fin.Part and the Musi agreements provide that the obligations of the Debtor are convertible into shares of common stock of the Debtor. At the time of these loans, Fin.Part was the holder of 17.1% of the outstanding common stock of the Debtor and Musi was the holder of 27.4% of the outstanding common stock of the Debtor. The Defendants allege that these loans are secured by liens on the

Collateral, second to the Swiss Lender.

The present action arises as an adversary proceeding filed by the Committee seeking to characterize any and all claims by the Plaintiffs as equity contributions to the Debtor and to subordinate to all other secured and unsecured claims against the Debtor. The Complaint was filed on May 21, 2003 and, on May 23, 2003, a Summons was issued by the Clerk of Court. The Summons states "You are summoned and required to submit a motion or answer to the complaint which is attached to this summons to the clerk of the bankruptcy court within 30 days after the date of issuance of this summons." Two days before filing the Complaint, Ms. Humrickhouse mailed a courtesy copy of the complaint to the Defendants' counsel of record in the underlying bankruptcy proceeding, Robert Smits, along with correspondence inquiring whether Mr. Smits could accept service on behalf of his client. Ms. Humrickhouse followed up via telephone on May 27, 2003, and Mr. Smits represented that he would consult with his client. Hearing no response from Mr. Smits, on June 11, 2003, Ms. Humrickhouse telephoned again and Mr. Smits notified her that he could not accept service on behalf of the Defendants.

On June 18, 2003, twenty six days after the Summons was issued, the Committee served the Summons and the Complaint by means of first class mail and Federal Express. In addition, on June 19, 2003, the Committee requested that the clerk mail the Summons and the Complaint to the Defendants in Luxembourg, via certified mail, return receipt requested. While Rule 7004(e) provides that a summons and complaint be deposited in the mail within ten days after the summons is issued, this rule does not apply to service in a foreign country. F.R.B.P. 7004(e). The return receipts indicate that Fin.Part received service on July 3, 2003 and Musi received service on July 2, 2003, over a week after the deadline to submit an answer.

On July 1, 2003, an Amended Summons was issued by the Clerk. The Amended Summons was issued in error, apparently in an attempt to change the date for the pretrial hearing. On July 23, 2003, counsel for the Committee served the Amended Summons by first class mail.

On July 25, 2003, the clerk filed an Affidavit of Service for each Defendant based upon the initial Summons. On August 21, 2003, the Clerk entered default against the Defendants. At the time that the default was entered, there was no evidence of service of the Amended Summons in the file. On August 27, 2003, the Defendants filed an Answer to the Complaint and the present motion seeking to set aside the entry of default.

DISCUSSION

The Defendants seek to set aside the entry of default pursuant to Rule 55(c) of the Federal Rules of Civil Procedure. Rule 55(c) of the Federal Rules of Civil Procedure, made applicable to these proceedings by Federal Rule of Bankruptcy Procedure 7055, states that "[f]or good cause shown the court may set aside an entry of default." Fed.R.Civ.P. 55(c). In their motion, the Defendants contend that the Plaintiff failed to comply with the requirements of Rule 4 of the Federal Rules of Civil Procedure, which governs the service of process upon individuals in a foreign country. The Defendants argue that the failure of the Plaintiff to serve the Defendants properly constitutes "cause" sufficient to set aside the entry of default.[1] In the alternative, the Defendants have requested an enlargement of time to answer.

In determining whether there is "good cause" to set aside an entry of default, the court should consider several factors including whether the defaulting party has acted with reasonable

[1] In the motion that is before the court, the Defendants did not include a motion to dismiss under Rule 12(b)(2).

diligence in seeking to set aside the default, whether the defaulting party presents meritorious defenses, and whether the party will be substantially prejudiced if the default is not set aside. See Lolatchy v. Arthur Murray, Inc., 816 F.2d 951, 954 (4th Cir. 1987); United States v. Eastern Metal Prods. & Fabricators, Inc., 112 F.R.D. 685, 690 (M.D.N.C. 1986); St. Jude Scheepvaart USA, Inc. v. EMED Shipping, Ltd., 2001 WL 604183, *3 (M.D.N.C. 2001).

The court should also consider the personal responsibility of the party, the willfulness of the default and the availability of less drastic sanctions. Lolatchy, 816 F.2d at 953; see also United States v. $10,000.00 in U.S. Currency, 2002 WL 1009734, *3 (M.D.N.C. 2002). Finally, Rule 55(c) must be "liberally construed in order to provide relief from the onerous consequences of defaults and default judgments." Lolatchy, 816 F.2d at 954 (citing United States v. Moradi, 673 F.2d 725, 727 (4th Cir. 1982). "Any doubts about whether relief should be granted should be resolved in favor of setting aside the default so that the case may be heard on the merits." Tolson v. Hodge, 411 F.2d 123, 130 (4th Cir. 1969).

In this case, the most significant factor that weighs in favor of granting of the Defendants' motion is the existence of numerous procedural errors which have occurred, through no fault of either party. First, the initial Summons that was issued by the clerk contained several errors. The pretrial hearing was set for the wrong date, but more importantly, the time period allowed for the Defendants to file an answer or motion was incorrect. Rule 7012 of the Federal Rules of Bankruptcy Procedure provides:

> If a complaint is duly served, the defendant shall serve an answer within 30 days after the issuance of the summons, except when a different time is prescribed by the court. The court *shall* prescribe the time for service of the answer when service of a complaint is made by publication or upon a party in a foreign country.

F.R.B.P. Rule 7012 (emphasis added). In this instance, the court failed to prescribe the time for service of the answer for the Defendants, both of whom were parties in a foreign country. A time period allowing 30 days from the issuance of the summons to file an answer was improper, as is evidenced by the fact that the affidavit of service indicates that the summons was not received until *after* the 30 day period had expired.

This initial error was compounded when the clerk issued an Amended Summons, which corrected the date of the pretrial hearing, but again, indicated that an answer must be filed within 30 days of the date of issuance. An Amended Summons should never had been issued by the clerk to correct a pretrial hearing date. Ordinarily, a hearing date is changed by simply sending a notice of the new date. Finally, the entry of default entered by the clerk was based upon evidence of service of the first Summons. At the time of the entry of default, the Amended Summons had been issued, replacing the initial Summons, yet there was no evidence in the file that the Amended Summons had been served.

Turning to the other factors set forth above, the court notes that counsel acted with reasonable promptness in seeking to set aside the entry of default. Counsel for the Defendants was retained on the afternoon of August 25, 2003. On the morning of August 26, 2003, counsel for the Defendants contacted counsel for the Plaintiffs to request an extension of time to answer, and the present motion and answer were filed the next day, on August 27, 2003. The Defendant's motion to set aside was filed just six days after the entry of default by the Bankruptcy Clerk.

Finally, the Plaintiff has not identified any significant danger of prejudice to it if the entry of default is vacated. Prejudice is not found from delay alone or from the fact that the defaulting party will be permitted to defend on the merits. Johnson v. Dayton Elec. Mfg. Co., 140 F.3d 781, 785 (8th Cir.1998). There is no indication in the record that the delay will lead to loss of evidence or increased difficulties in discovery. In contrast, for the Defendants, there is no more severe sanction than the entry of a default judgment against a party. At this point in the case, the classification of the Defendants' approximately $600,000 claim as equity without allowing for the opportunity to offer a defense on the merits of the case is would severely prejudice the Defendants.

After consideration of the factors and circumstances of the case, the court finds good cause to set aside the Entry of Default. Accordingly, it is ORDERED that the Defendant's Motion to Set Aside the Entry of Default is GRANTED. It is FURTHER ORDERED that the Motion by the Plaintiff for Default Judgment against Fin. Part and the Motion by the Plaintiff for Default Judgment against MUSI are denied as moot.

This the 15th day of September 2003.

CATHARINE R. CARRUTHERS

Catharine R. Carruthers
United States Bankruptcy Judge