from other creditors and stockholders as the price of their assent to a plan." Securities and Exchange Commission, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective Reorganization Committees, Part VIII at 121 (1940); *see Young v. Higbee,* 324 U.S. at 211 n. 10, 65 S.Ct. at 598 n. 10.

In the case at bar, Japonica, by acquiring a blocking position, has defeated the debtor's plan and can defeat any other plan and thereby obstruct a "fair and feasible reorganization." *Id.* at 211, 65 S.Ct. at 598. Japonica, like Hilton in the *Waco* case, bought a blocking position after the debtor proposed its plan of reorganization. In *Waco,* Hilton's objective was to force Waco to reestablish Hilton's interest in the hotel. In the instant case, Japonica's interest is to take over and control the debtor. Section 1126(e) and its predecessor were intended to enable the court to disqualify the votes of parties who engage in such conduct.

In a subsequent case interpreting section 203 of the Bankruptcy Act, the Circuit Court of Appeals for the Second Circuit held that the purchase of claims for the purpose of securing approval or rejection of a plan of reorganization is not per se bad faith:

> The mere fact that a purchase of creditors' interests is for ... securing the approval or rejection of a plan does not of itself amount to 'bad faith.' When that purchase is in aid of an interest other than an interest as a creditor, such purchases may amount to 'bad faith' under section 203 of the Bankruptcy Act.

In re P–R Holding Corp., 147 F.2d 895, 897 (2d Cir.1945). Bankruptcy courts interpreting section 1126(e) have quoted this language with approval. *In re Gilbert,* 104 B.R. 206 (Bankr.W.D.Mo.1989); *In re MacLeod Co., Inc.,* 63 B.R. 654 (Bankr.S.D. Ohio 1986). Although Lederman testified that he voted against the plan for economic reasons, the court does not find the economic reasons offered by Japonica creditable. We find that Japonica acted "in aid of an interest other than an interest as a creditor...." *In re P–R Holding,* 147 F.2d at 897. The overriding fact that causes this court to reach this conclusion is that Japonica chose to buy claims which gave it unique control over the debtor and the process. With one minor exception, Japonica purchased its claims—and became a creditor—after the debtor's disclosure statement was approved. Japonica knew what it was getting into when it purchased its claims. Japonica is a voluntary claimant. If Japonica was unsatisfied by the proposed distribution, it had the option of not becoming a creditor. Japonica could have proposed its plan without buying these claims.

1. The Court Finds that Japonica Acted in Bad Faith

[1] Japonica's actions with respect to the purchase of claims were in bad faith. Notwithstanding Japonica's allegedly longstanding interest in the debtor, Japonica filed its plan of reorganization at the eleventh hour.[7] Notwithstanding Japonica's allegedly longstanding interest in the debtor, Japonica did not purchase significant claims until the voting period on the debtor's plan. Japonica was also at this time a proponent of a plan. The particular claims that Japonica purchased, and the manner in which they were purchased, can be used to determine their intent. Japonica purchased a clear blocking position in Class 2.AI.2, the secured bank lenders. Because that class was the most senior class, a negative vote in that class made confirmation extremely difficult, if not impossible. Japonica paid approximately 80% of the face amount for the first five claims in Class 2.AI.2. As Japonica approached ownership of 33% in amount of this class, it paid 85% of the face amount for the next claim, that of First National Bank of Boston. It then purchased the claim of Continental Bank for *95% of the face amount.* This gave Japonica 33.87% of the amount of Class

7. Bankruptcy Rule 3016 provides that "[a] party in interest, other than the debtor, who is authorized to file a plan under § 1121(c) ... may file a plan *at any time before the conclusion of the hearing on the disclosure statement....*" (emphasis added). Japonica filed its plan of reorganization on January 24, 1990—the last day of the hearing on the debtor's disclosure statement.

2.AI.2 claims. Thereafter, Japonica purchased one more bank claim, but only for 82% of the face amount. If Japonica purchased bank claims solely for economic purposes, it would not have paid 95% of the face amount and then returned to an 82% purchase. Instead, it purchased almost exactly the amount required to block the plan of reorganization.

Lederman was a bankruptcy lawyer who clearly understood the significance of 33⅓% of a class. The court finds from these facts Japonica's purpose was control and was in bad faith. Japonica recited to the court that it wanted to provide cash to creditors. Japonica's plan proposes to pay cash to creditors, but with a portion held back pending resolution of unresolved claims. Because the court believed this recitation, the court granted additional time to Japonica for its plan. However, the court was misled. Japonica's purpose was control and so we find.

Similarly, Japonica purchased only enough claims in Class 4.AI.2 to block an affirmative vote by that class. That class follows Class 2.AI.2 in priority. Thus, Japonica purchased a blocking position in the two highest classes which were impaired, ensuring that the debtor could not confirm its plan of reorganization. Again, we note that the two classes in which Japonica purchased claims have directly opposite interests with respect to the bank litigation. The court is hard pressed to characterize Japonica's actions as merely furthering their own economic interests.

[2] Votes must be designated when the court determines that the "creditor has cast his vote with an 'ulterior purpose' aimed at gaining some advantage to which he would not otherwise be entitled in his position." *In re Gilbert,* 104 B.R. at 216; *see also Insinger Machine Co. v. Federal Support Co. (In re Federal Support Co.),* 859 F.2d 17 (4th Cir.1988).

In *In re MacLeod,* 63 B.R. at 656, the bankruptcy court designated the votes of dissenting creditors who were competitors because the court concluded that those votes were cast for the "ulterior purpose of destroying or injuring debtor in its business so that the interests of the competing business ... could be furthered." Although the debtor and Japonica are not engaged in competing businesses, the court finds *In re MacLeod* analogous to the case sub judice. Japonica and the debtor were proponents of competing plans of reorganization. Japonica's stated purpose was to take over the debtor. To do so, it was necessary for Japonica to block confirmation of the debtor's plan of reorganization. Thus, the court concludes that Japonica's actions were for an ulterior motive.

Under chapter 11, creditors and interest holders vote for or against a plan of reorganization, after adequate disclosure, if such vote is in their best economic interests. If, as in the instant case, an outsider to the process can purchase a blocking position, those creditors and interest holders are disenfranchised. If competing plans of reorganization are pending, the court must consider the preferences of the creditors and interest holders. If a plan proponent, such as Japonica, can purchase a blocking position, the votes of the other creditors and interest holders are rendered meaningless. Moreover, Japonica, who chose to become a creditor, should not have veto control over the reorganization process. The court does not believe that such a result was intended by Congress. Therefore, for all of the reasons stated above, the court designates the votes of Japonica pursuant to 11 U.S.C. § 1126(e) in Class 2.AI.2 and Class 4.AI.2.

C. *The Alleged Milligan Conspiracy*

Prior to voting on the debtor's plan of reorganization, various creditors expressed concern about the liquidity and stability of the stock they would receive under the debtor's plan. Those creditors, particularly the secured lenders, emphasized the need for an orderly sale mechanism for creditors who did not wish to hold the stock long-term. They feared that large blocks of stock would be sold soon after the plan was consummated and as a result of these big sales, the market would be flooded and the price of the stock would be depressed. The unsecured creditors also feared the banks

could cause a control transaction to occur, defeating the purpose of the reorganization plan and making the warrants worthless.

From depositions it appears that in late January 1990, Charles O'Hanlon, a representative of Mellon Bank, N.A., the agent for the consortium of 26 banks that comprised the secured lenders, met in Florida with representatives of the debtor, including James D. Milligan, the chief executive officer of Sunbeam and the chairman, chief executive officer, and chief executive officer-designate of the reorganized AI, to discuss, inter alia, the concerns of the secured lenders about the liquidity of the stock and request a mechanism for sale of the stock by those banks that would want to sell. At that meeting, O'Hanlon asked Milligan and Samuel H. Iapalucci, the vice president and chief financial officer, to help locate prospective purchasers of the reorganization stock. O'Hanlon and Milligan both agreed that neither Milligan nor the debtor should actually be involved in the sale or purchase of the stock. However, an officer of Standard Chartered Bank testified that John Elwood, the director of reorganization for the debtor, advised him of the possibility of a buyer of the when-issued shares. Deposition of David W. Robie, 22–25. An officer of National Westminster Bank testified about a similar conversation with Anthony Munson, the treasurer of the debtor. Deposition of Michael E. Mahoney, 23–24.

Although the exact chronology is unclear from the record, Milligan had discussions with various potential investors familiar to him, including Melvyn Klein, Daniel Lufkin,[8] and the Belzberg Brothers of Canada, concerning purchase of the reorganization securities. O'Hanlon and Gerald Shapiro, chairperson of the Creditors' Committee, had agreed that "DLJ" would be acceptable.[9] At some time, Milligan advised Lawrence M. v. D. Schloss of DLJ that he had spoken with representatives of GKH Partners, who had indicated interest in purchasing the reorganization securities upon their issuance.

On March 7, 1990, at a meeting in Lufkin's office in New York City, Milligan told Lufkin that the aforementioned investors, and others, had "a desire to own equity in whatever company I ran, and that creditors had expressed a desire to sell equity, and they had selected or intended to indicate that DLJ could act as an agent on behalf of would-be purchasers...." Milligan Deposition, 121–22. Iapalucci was also present at that meeting; he explained the plan, including the "poison pill" or change of control provision. That provision provides that no entity or entities acting in concert could acquire more than 30% of the when-issued stock without the offer being made to all shareholders. *Id.* at 128–32. The next day, Milligan, Iapalucci, representatives of DLJ, and representatives of GKH met at DLJ's offices. Shortly after that meeting, as part of their due diligence, representatives of DLJ and GKH toured

8. Lufkin is the secured lenders' designated member of the board of directors of the reorganized debtor. Because of his failure to cooperate with discovery attempts, the court bars him from serving on the board of directors.

9. DLJ is well known to this court; on two previous occasions during the course of this bankruptcy, DLJ attempted to acquire the debtor. On November 2, 1988, the debtor entered into a letter of intent and preliminary agreement with DLJ, by which DLJ would acquire the debtor. Thereafter, a competing proposal was submitted by Paul S. Levy, Peter A. Joseph, and Angus C. Littlejohn (the "Levy Group"). The court instructed the debtor to consider the bid of the Levy Group and the responsive bid of DLJ. The debtor selected the revised DLJ proposal and entered into a revised letter of intent with DLJ on November 16, 1988.
The Levy Group then submitted another proposal which the debtor rejected. However, shortly before the meeting of the debtor's board of directors to approve the final DLJ proposal, DLJ informed the debtor that it had reached an agreement with the Levy group to sell them two major business units of the debtor. The debtor then moved to void the agreement with DLJ.
On or about February 22, 1989, the debtor entered into an agreement and plan of merger with a company formed by DLJ. Milligan was a participant with DLJ in the plan and was to have been the chief executive officer and a director of the company formed by DLJ. The transaction between the debtor and DLJ was never consummated because the debtor failed to meet certain projections. However, the debtor retained Milligan as a consultant, and later made him president of Sunbeam Corp.

various facilities of the debtor. Milligan participated in those tours.

On or about March 16, 1990, DLJ advised those secured lenders who had not sold their claims that a "group of investors has proposed buying when-issued stock from the individual AI Secured Banks. The proposed purchase price is $6.25 per share." Thereafter, Schloss advised the bank group's financial advisor, Houlihan Lokey Howard & Zukin ("Houlihan Lokey") of the outline of the plan to purchase the when-issued stock. Houlihan Lokey then notified all of the banks, and provided DLJ with the names and addresses of the contact people for each of the members of the bank group.

DLJ acted as the agent for those investors. Deposition of Frank E. Krepp (Pittsburgh National Bank), 26; Mahoney Deposition, 30. The identities of those investors were undisclosed at the time of the offer. Deposition of Charles F. O'Hanlon, III, 87; Deposition of Harvey L. Peckins (Bank of New York), 88; Robie Deposition, 32. The DLJ offer was made to every member of Class 2.AI.2 who had not assigned its claim to Japonica. DLJ, acting on behalf of its investors, negotiated individually with each bank that was interested in selling its when-issued shares, ultimately entering into Stock Purchase Agreements with the following banks: Bank of America National Trust and Savings Association; Bank of New York; Commerzbank Aktiengesellschaft; Citizens and Southern National Bank; M & I Marshall & Illsley Bank; Bank One; Manufacturers Hanover Trust Company; Barclays Bank PLC; Bayerische Vereinsbank AG; The Bank of Tokyo Trust Company Moia Group Ltd.; Pittsburgh National Bank; and First American Bank. Neither Milligan nor any other representative of the debtor were involved in the negotiations. O'Hanlon Deposition, 131, 183–84; Deposition of Samuel H. Iapalucci (4/12/90, p.m.), 51, 83, 130; Krepp Deposition, 23, 26, 77, 107; Milligan Deposition, 63, 85; Robie Deposition; Deposition of Lawrence M. v. D. Schloss, 62–63.

The stock purchase agreements did not require the banks to vote in favor of the debtor's plan. Deposition of Eren Hussein (Barclay's Bank), 32; Krepp Deposition, 22–23; Mahoney Deposition, 47; Peckins Deposition, 80–82; Robie Deposition, 32. In fact, some of the banks required a specific provision to that effect in their stock purchase agreements. Krepp Deposition, 22–23, 69–70, 78–79, 97–98, 100; Mahoney Deposition, 47. However, the stock purchase agreements required the banks to use their "best efforts" to effectuate such agreements. Three banks which did not enter into stock purchase agreements voted in favor of the debtor's plan.[10]

Prior to March 16, 1990, the debtor had arranged a meeting with Swiss Volksbank. That meeting was requested by Swiss Volksbank, Milligan Deposition, 157, and was intended as a discussion of the company and the plan of reorganization. On the morning of March 19, 1990, the following people met with representatives of Swiss Volksbank: Oliver Travers, the chairman and chief executive officer of the debtor; Munson; Robert Martin of Smith Barney Harris & Upham, the debtor's financial advisor; and M. Weston Chapman of DLJ.[11] At that meeting, counsel for Swiss Volksbank indicated to Chapman that the Swiss noteholders were interested in selling their stock; they did not want to hold stock in a reorganized company. Deposition of Mark Weston Chapman, 21–22, 25–26. None of those parties offered to purchase any of the reorganization stock of the Swiss noteholders, although Chapman raised that possibility at another meeting later that day. Swiss Volksbank stated that they had received an offer from Japonica, so that time was of the essence. *Id.* at 26–27; Travers Deposition, 68. DLJ and the Swiss Volksbank did not enter into a stock purchase agreement, but it appears that they began the process. As stated

10. Morgan Guaranty Trust Company of New York, Standard Chartered Bank, and Grant Street National Bank (the successor-in-interest to Mellon Bank, N.A.).

11. When Travers left for Switzerland, he was unaware that a representative of DLJ would be attending that meeting; he did not learn that fact until he was en route.

above, Japonica ultimately purchased a significant portion of the Swiss Franc notes.

As of March 30, 1990, when the voting on the debtor's plan concluded, the court had not approved Japonica's disclosure statement. Therefore, creditors and interest holders could only vote for, or against, the debtor's plan. The court approved the Japonica disclosure statement on May 3, 1990.

1. Votes in Favor of the Plan Will Not Be Designated

The motions to designate which Japonica and the Equity committee have filed seek to designate all votes filed in favor of the debtor's plan. Japonica and the Equity Committee assert that the transactions involving DLJ, Milligan, and the secured lenders were not disclosed, in violation of 11 U.S.C. § 1125. Japonica and the Equity Committee contend that the other creditors would not have voted for the debtor's plan if they had known about the alleged "Milligan conspiracy." They assert that the purpose of the transaction was to take control of the debtor and entrench Milligan and certain debtor executives as the management. Japonica and the Equity Committee further assert that such control of the debtor was to be obtained without paying a premium to other creditors. Japonica and the Equity Committee also assert that the debtor has discriminated against certain creditors and the equity holders as a result of the attempted transaction with DLJ. Japonica and the Equity Committee further assert that the debtor's plan was proposed in bad faith, in contravention of 11 U.S.C. § 1123. In this connection, the parties agree that many of the issues raised in these two motions overlap with objections to confirmation.

[3, 4] Although the court will not designate all votes on the debtor's plan of reorganization, as requested by Japonica and the Equity Committee, certain activities and matters which the court finds objectionable will be dealt with in the context of confirmation. Section 1126(e) provides that the court may designate the votes of "any entity whose acceptance or rejection ... was not in good faith, or was not solicited or procured in good faith...." Even if the court should hold that the attempted transaction between DLJ and the banks was not in good faith, the court cannot disqualify the votes of the other remaining claimants who knew nothing about the transaction. The remedy under 11 U.S.C. § 1126(e) is to disqualify acceptances or rejections that have been improperly solicited. *Trans World Airlines, Inc. v. Texaco, Inc. (In re Texaco, Inc.)*, 81 B.R. 813 (Bankr.S.D.N.Y. 1988). Simply stated, the court should designate the votes of only those creditors or interest holders who were engaged in wrongdoing. There is no authority for designating the votes of innocent creditors or interest holders.[12]

[5] Nor do we find sufficient grounds for designating the votes of the banks that accepted the various offers. Although we are concerned by the conduct of DLJ and the secured banks, we cannot conclude that the banks voted "in aid of an interest other than an interest as a creditor...." *In re P-R Holding*, 147 F.2d at 897. Unlike Japonica, the banks have been parties to this case since that fateful Saturday afternoon in February 1988. Similarly, we cannot conclude that the banks acted for an improper or ulterior motive. *In re Pine Hill Collieries Co.*, 46 F.Supp. 669 (E.D.Pa. 1942). The banks voted for the debtor's plan because they thought it to be in their best interest. The banks favored the debtor's plan even without the possibility of selling their shares. Mahoney Deposition, 47; Hussein Deposition, 32; Krepp Deposition, 21–22; Deposition of Gev F. Nentin (Manufacturers Hanover Trust Company), 102–103; Deposition of Craig Wolf (Citizens and Southern Bank), 26–28. Notwithstanding their concerns about the liquidity of the reorganization shares, the banks intended to vote for the debtor's plan of reorganization. Hussein Deposition, 39–40; Deposition of Robert TenHave (Commerz-

12. It should be noted that the Creditors' Committee has indicated its continuing support of the debtor's plan, notwithstanding the matters of which Japonica and the Equity Committee complain.

bank) 20; Krepp Deposition, 42–43; O'Hanlon Deposition, 43–46. Although some of the aforementioned testimony may have been self-serving, it is consistent with the representations made in court over the last several months. An earlier, similar, permutation of the present plan of reorganization was a joint submission of the debtor and the bank group, although the plan of reorganization sub judice was not filed jointly with the bank group.[13] The court finds that the attempted transaction between DLJ and the banks did not cause the banks to change their intended votes for the debtor's plan. Moreover, three banks that did not enter into agreements with DLJ voted in favor of the debtor's plan and their votes would be sufficient to carry the class.

It must also be emphasized that the contemplated purchase price for the when-issued shares, $6.25, was not a premium. It fell within the range of estimates that previously had been made of the value of the when-issued shares, and is consistent with the court's determination of value, discussed below. It should be noted that Japonica later purchased the claims of Class 4.AI.2 at a price equivalent to $7 per share.

However, because it appears to the court that the transactions with DLJ may have permitted DLJ or others to take control of the debtor, the court treats these matters as objections to confirmation. The court does not view those events as a "Milligan conspiracy," although it finds the process inept and ill-timed and lacking disclosure.

All of the parties know that this reorganization has been a fragile process. Consensus has been virtually unattainable. The court questions the thought given to these activities which could upset the delicate process. The third involvement of DLJ is incredible, in light of this court's oft-stated disgust with their earlier failed efforts.

Nevertheless, the court denies the motions of Japonica and the Equity Committee to designate all other votes in favor of the debtor's plan. Later in the context of confirmation, the court will resolve the matters it finds inequitable.

II. THE COMPLAINT OF THE BANKS FOR EQUITABLE RELIEF AND TO RESTRAIN JAPONICA AND ITS AFFILIATES

On April 14, 1989 Japonica announced a tender offer for all claims in Class 7.AI.1, the subordinated debt, and for certain of the claims in Class 5.CH.1, Chemetron general unsecured claims. This tender offer was held open until May 16, 1990. Through the tender offer, Japonica acquired approximately 62% of the claims in Class 7.AI.1 and 36% of the debentures in Class 5.CH.1.

On May 3, 1990 the court approved Japonica's disclosure statement. The court notes that on that date Japonica's tender offer was still outstanding. Therefore, from the approval of its disclosure statement on May 3, 1990, until the expiration of the tender offer, May 16, 1990, Japonica was soliciting claims outside its plan while it was a proponent both before and after it had an approved disclosure statement.

The court further notes that on June 7, 1990 Japonica purchased the claims of several insurance companies in Class 4.AI.2, senior unsecured claims. Those creditors had voted against Japonica's plan. Thereafter, on June 8, 1990, the final day for voting on Japonica's plan, those insurance companies moved for leave to change their vote. Japonica purchased those claims for $7.00 per share—more than the $6.42 per share which was offered by the Japonica plan.

The results of the balloting on Japonica's plan were filed with the court on June 21, 1990. Three classes of creditors and one class of interest holders did not accept the Japonica plan. The Japonica plan voting results appear as follows:

13. Based on the representations of counsel, all of the banks agreed to file the joint stock plan. Subsequently, a few of the banks decided against the joint stock plan. However, the banks continued to support the debtor's plan.

Class	% of the Voters	% of the Dollars
2.AI.2	36	38
4.AI.2	87	17
5.AI	84	80
5.CH.1	92	66
7.AI.1	88	95
8.AI.1	92	N/A
8.AI.2	74	N/A
9.AI.1	47	N/A

It should be noted again at this point that Japonica's plan was allowed to go forward for voting by creditors because it promised a cash payout to the creditors. Although the court believed the debtor's plan could be confirmed, creditors had consistently expressed strong interest in receiving cash rather than stock. Therefore, the court indulged Japonica and allowed it to go forward with its plan. The Japonica cash plan failed to win the approval of three classes of creditors and cannot be confirmed.

While the above balloting transpired, Japonica was permitted to perform due diligence of the debtor pursuant to an order of court dated March 15, 1990, which Japonica requested. Although there was an early dispute prior to the order regarding the debtor's cooperation with Japonica, on the whole it appears that the debtor more than complied with this court's order. In fact, the debtor provided Japonica with office space and use of other facilities at their general office in Pittsburgh. On June 11, 1990, M. Bruce McCullough, Esq., the debtor's chief bankruptcy counsel, informed Japonica that their due diligence process was terminated and that they would have to leave the debtor's general office at the end of that business day.

On June 12, 1990, a group of 16 banks commenced an adversary action, at Adversary No. 90-260, against Japonica and its affiliates. That action seeks, inter alia, the following equitable relief: enjoining Japonica from interfering with the management or exercising control over the business or property of the debtor; requiring that all distributions to Japonica be held as security for the performance of certain obligations under the certificate of reorganization of the reorganized debtor and enjoining Japonica from exercising control over the reorganized debtor; prohibiting Japonica from designating directors of the reorganized debtor; limiting the distribution to Japonica to the lesser of the amount they paid to purchase the claims or the distribution provided in their plan; or, equitably subordinating the claims purchased by Japonica to all other claims.

The defendants have answered and raised counterclaims and third party claims. The court separated the trial of issues arising under the adversary complaint from the counterclaims and third party complaint and limited the hearing to matters that were related to the confirmation of the debtor's plan of reorganization. Japonica demanded a jury trial; the court denied that request.

In a factually related matter, the debtor's motion to designate, the court found that Japonica entered upon a course of conduct designed to gain control of the debtor. The facts in this proceeding reinforce the court's finding of bad faith conduct of Japonica to further manipulate the bankruptcy process by the strategic purchase of claims. The court intends to issue an injunction related to the issues of control and governance.

A. *Public Tender Offer of the Subordinated Debentures While Japonica Was a Proponent of a Plan*

[6] Japonica, a proponent of a plan, chose an "end run" around the bankruptcy process by purchasing through its public tender offer approximately 62% of a class. Before the Japonica disclosure statement was approved, Japonica launched a public tender offer for all claims in Class 7.AI.1 and for certain of the claims in Class 5.CH.1. The tender offer expired during the voting period for the Japonica plan. Pursuant to its tender offer, Japonica acquired approximately 62% of Class 7.AI.1 and 36% of the debentures in Class 5.CH.1.

Japonica did not receive this court's approval for its tender offer. As a plan proponent, Japonica could not have solicited acceptances until a disclosure statement had been approved. 11 U.S.C. § 1125(b). Japonica's action caused discriminatory treatment among members of the same class, in violation of 11 U.S.C. § 1123(a)(4).

Those who accepted the Japonica tender offer received immediate cash. Those creditors who did not would receive their distribution at a later undetermined date, pursuant to the "official" Japonica plan. Those creditors would receive potentially more cash, but subject to an undesired holdback.

During this period, Japonica had incompatible and inconsistent roles. Japonica made an offer to purchase the claims of Class 7.AI.1. Japonica was also a plan proponent with an offer to that class. The court finds that Japonica acted in bad faith by offering to provide a settlement to a class of claimholders in the absence of a confirmed plan. By doing so, Japonica did not comply with the letter or the spirit of the Bankruptcy Code.

[7] It is beyond dispute that a debtor may not pay creditors outside of a plan of reorganization. Other courts have held that such attempts were an impermissible circumvention of the Bankruptcy Code. *See Pension Benefit Guaranty Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.),* 700 F.2d 935, 940 (5th Cir.1983) ("The debtor and the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan...."); *Official Committee of Equity Security Holders v. Mabey (In re A.H. Robins Co.),* 832 F.2d 299, 300 (4th Cir.1987), *cert. denied,* 485 U.S. 962, 108 S.Ct. 1228, 99 L.Ed.2d 428 (1988) ("The disbursement of such funds [to certain unsecured creditors] prior to the confirmation of a plan of reorganization ... would violate the Bankruptcy Code.")

In a prior opinion in this case, this court declared that the assignment of claims "allows a third party to do something which the debtor cannot" before confirmation of a plan because of the constraints of sections 1125 and 1129. *In re Allegheny International, Inc.,* 100 B.R. 241, 243 (Bankr.W.D. Pa.1988). Although the court was critical of the process, the court allowed the trading in claims because the purchasers of claims there were speculators who were using their own resources. Under the special facts of this case, the court cannot apply the same distinction to Japonica. The earlier purchasers of claims were not proponents of a plan—Japonica is!

Japonica's strategic purchases of claims in strategic classes to advance the position of the proponent is not acceptable and constitutes at least bad faith, if not an unlawful act, in the pursuit of confirmation of its plan. 11 U.S.C. § 1129(a)(3).

As the above cited opinion indicated, the result would have been different if the claims purchasers had inside knowledge. Referring to the 1983 Advisory Committee Note to Rule 3001(e), the court stated that, "[w]e recognize that the cases cited therein involved breaches of fiduciary duty. A breach of fiduciary duty implies inside knowledge." *Id.* at 243. As already discussed, Japonica had vast knowledge of the most intimate details of this company unmatched by any other creditor. Japonica possessed all the knowledge of an insider.

Most important, if Japonica had made a substantially similar tender offer to this class as part of its own plan, the plan would not meet the fair and equitable test of senior classes which might reject the plan. Nor would such a plan provision meet the "best interests of creditors test" of 11 U.S.C. § 1129(a)(7)(A) if a single senior creditor objected. By providing that class with immediate cash, the plan would not be fair and equitable to other classes with higher priority who are burdened by a holdback provision. The control tactic of this tender offer itself was extremely inequitable. It placed unfair choices upon the debenture holders. It constitutes bad faith. The class of debenture holders had already voted overwhelmingly for the debtor's plan. During the Japonica disclosure hearing in open court, Fidata Trust Company New York ("Fidata"), the indenture trustee, indicated strong opposition to the Japonica plan. Fidata objected to the lower distribution compared to the debtor's plan and the holdback provisions of the Japonica plan. Further, they objected to the distribution of immediate cash to shareholders who were junior to them. It is almost certain that the "fair and equitable" standard on cram down and the best inter-

est of creditors test by a single creditor would be raised at confirmation.

Further, although the tender offer provided the immediate possibility of cash, the total amount of debentures to be purchased, if any, was not disclosed or committed. These creditors had to speculate if Japonica would only purchase a blocking position. Would there be more delay? The tender offer, if included in the plan, would not be adequate disclosure under 11 U.S.C. § 1125. The debenture class was forced to face a real dilemma—cash now, but in indefinite amounts, or more delay related to confirmation of the Japonica plan. The debenture holders were coerced into selling their claims. This constitutes bad faith.

B. *Purchase of Senior Claims in Class 4.AI.2 and 5.CH.1 by a Proponent*

Prior to the close of balloting on June 8, 1990, the insurance companies held approximately 35% of the amount of the claims in Class 4.AI.2 and rejected the Japonica plan. These negative votes precluded the confirmation of the Japonica plan. The Japonica plan offered claimants in Class 4.AI.2 87% of their pre-petition claims. When the holdback provisions are considered, the distribution could be reduced to 70%.

Pursuant to assignment agreements dated June 8, 1990 between the insurance companies and Japonica, Japonica purchased the claims of the insurance companies in Class 4.AI.2 for 93.2% of their pre-petition claim. This price was in excess of 6% more than the highest amount to be distributed under the Japonica plan and in excess of 23% more if the holdbacks are considered. Japonica paid more directly to purchase the claims than offered by their plan. This was a naked attempt to purchase votes.

The insurance companies pursuant to the assignment agreement were required to move for leave to change or withdraw their ballots. The court denied this motion.

On June 8, 1990, after purchasing these claims, Japonica also proposed a modification of their plan as it affects Class 4.AI.2, ostensibly to provide the entire class with the same benefit! This modification proposes to pay 94.86% of the pre-petition debt. Recall that earlier in this case, in March of 1990, during the balloting period on the debtor's plan, Japonica had purchased $31 million of the 7¾ Swiss Franc Notes for 66% of the pre-petition claims. These claimants are in the same class. The modification that Japonica proposes will pay back to Japonica a handsome profit on the claims that it purchased. Japonica has provided no explanation that new capital will be made available from third parties. Japonica intends to use the debtor's existing cash, assets, and debt to fund this modification. This is *chutzpah* with a vengeance. It is also bad faith.

These facts are close to those in *In re P-R Holding Corp.*, 147 F.2d at 897. In that case, two non-creditors purchased claims to ensure the success of a plan of reorganization beneficial to them. The court held that the purchase of claims "in aid of an interest other than an interest as a creditor ... may amount to 'bad faith'.... [C]ertainly there is 'bad faith' when those purchases result in a discrimination in favor of the creditors selling their interests." *See also In re Featherworks Corp.*, 36 B.R. 460, 463 (E.D.N.Y.1984) ("The other creditors, all of whom had already voted, were not similarly afforded a chance to convert their claims to immediate cash.... [T]he court does not believe that the law countenances vote trafficking and assertedly otherwise innocent self-dealing *after the votes have been cast.*")

The conduct here is even more offensive than in *P-R Holding.* Here, the sellers were members of the Creditors' Committee and they owed a fiduciary duty to other class members. The purchasers in *P-R Holding* offered to forego the benefits of the claims which they had wrongfully acquired and thereby increase the distributions to others. Here, after having committed a wrongful act, Japonica proposes to pay themselves handsomely under an outrageous view of equity. We find bad faith.

C. *Japonica Partners as a Proponent of a Plan Sought and Received Inside Information and Should be Treated as a Fiduciary and an Insider*

[8] Japonica argues that they are not insiders, as that is defined in 11 U.S.C.

§ 101(30).[14] It is clear to this court that Congress intended that an insider includes "one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with the debtor." S.Rep. No. 989, 95th Cong., 2d Sess. 25 (1978); H.R.Rep. No. 595, 95th Cong., 1st Sess. 312 (1979), U.S.Code Cong. & Admin. News 1978, pp. 5787, 5810, 6269 (legislative history to 11 U.S.C. § 101(30)).

The rules of construction for the Bankruptcy Code specifically state that the terms "includes" and "including" "are not limiting." 11 U.S.C. § 102(3). The use of the term "insider" at 11 U.S.C. § 101(30) provides an illustrative, rather than an exhaustive list of the persons or entities which may qualify as insiders of the debtor. *In re Henderson*, 96 B.R. 820, 824–25 (Bankr.E.D.Tenn.1989).

As a proponent, Japonica sought an order of court to conduct "due diligence" which it needed to obtain bank financing to implement its plan. Japonica had complained that the debtor was not cooperative and that the additional data was required to confirm the public information which Japonica already possessed. This due diligence would be accomplished over a period of time as short as seven days. Transcript, January 25, 1990, at 243; Transcript, March 2, 1990, at 16, 101, 103, 105–106, 143.

A very different story was developed at trial. The testimony of F. Ann Ross–Ray, Esq., was clear, definite and compelling. Over a three-month period, from March 16, 1990 to approximately June 11, 1990, Lederman, Paul B. Kazarian, and William Webber, along with their associates, requested and received the full cooperation of the debtor in obtaining information. It is clear that they received a great volume of information that was not available to other creditors, shareholders, and the general public. This delivery of information was voluminous and thorough. This type of information is available only to insiders. At first Japonica dealt only with Ross–Ray; later they grew bolder and went directly to employees to obtain information they desired.

It is true, as Japonica argues, that they did not have actual control or legal decision making power. However, it is also true that they attempted to influence, in not very subtle ways, decisions made by the debtor. This was especially so when they regarded the decisions as important to their possible future administration. For example, they became deeply involved in the debtor's insurance coverage and the disposal of certain assets.

The testimony of Lewis U. Davis, Jr., Esq., was also clear and convincing. The debtor desired to prevent a loss of value to the enterprise and to provide for an orderly transition in the event that Japonica obtained control under Japonica's plan or under the debtor's plan. The debtor cooperated far beyond the requirement of the March 15, 1990 Order.

Davis testified that on or about June 11, 1990, after the insurance claims had been purchased, Lederman, in the name of Japonica, demanded that a principal of Japonica, Paul B. Kazarian, be named chairman of the board of directors of the debtor, and that Lederman, the other principal, be appointed general counsel and chief administrative officer. Lederman further demanded that Milligan be made to resign so that he could be replaced by Webber, Japonica's designee. Japonica caused to be issued press releases announcing that it now controlled the debtor. Under the pretext of performing due diligence, it is clear that Japonica exploited its special access to information, personnel and the premises of the debtor to attempt to assert its influence and control. Japonica's actual behavior was a breach of this court's order and of bankruptcy principles. In addition, it was

14. Section 101(30) in pertinent part, provides that "'insider' includes ...

(B) if the debtor is a corporation—

(i) director of the debtor;

(ii) officer of the debtor;

(iii) person in control of the debtor;

(iv) partnership in which the debtor is a general partner;

(v) general partner of the debtor; or

(vi) relative of a general partner, director, officer, or person in control of the debtor ..."

disquieting, rude, overbearing and disruptive of employee-management relations.

Japonica sought and received inside information as a proponent of a plan. This court finds as a matter of fact that Japonica is an insider and a fiduciary for purpose of this reorganization.

In addition, the banks urge the court to find Japonica to be in violation of the automatic stay. 11 U.S.C. § 362(a)(3). The debtor has promptly remedied these events by denying Japonica's demands, evicting them from the office space at the debtor's headquarters, and limiting their access to information to written requests. Japonica may have also caused employee relationships to be harmed, but those issues are left for another day, should these events contribute to this plan not being consummated.

The following incident is also illustrative of Japonica's new-found arrogance. At a telephone conference on June 21, 1990, after the close of balloting, Japonica refused to make the results of the balloting available to creditors, even though Japonica had promised to do so and even though Japonica had been receiving the daily results from the entity tabulating the ballots. At the confirmation hearing on June 28, 1990, dramatically at 10:00 A.M. the courtroom door opened and the results were revealed. This behavior illustrates the arrogance with which Japonica and their attorneys have treated the court, and it lends credence to the testimony of Davis and Ross-Ray.

The court finds that Japonica has engaged in a pervasive pattern of bad faith designed to control the debtor and manipulate the bankruptcy process. Its actions are a clear violation of the purposes of chapter 11. All of the above actions of Japonica provide this court with ample grounds to impose restraints and sanctions.

D. *The Purpose of Chapter 11 Versus Control Profit*

A noted commentator suggests that the ultimate intent of bankruptcy is to maximize results for all creditors:

> The basic problem that bankruptcy law is designed to handle, both as a normative matter and as a positive matter, is that the system of individual creditor remedies may be bad for the creditors as a group when there are not enough assets to go around. Because creditors have conflicting rights, there is a tendency in their debt-collection efforts to make a bad situation worse. Bankruptcy law responds to this problem.
>
> . . . . .
>
> Bankruptcy provides a way to make these diverse individuals act as one, by imposing a *collective* and *compulsory* proceeding on them.
>
> . . . . .
>
> This is the historically recognized purpose of bankruptcy law and perhaps is none too controversial in itself.

T. Jackson, *The Logic and Limits of Bankruptcy Law*, 10–13 (1986). The purpose of reorganization is to offer an opportunity to maximize results for all creditors and interest holders. Japonica's actions and statements make abundantly clear that it is "control" and "control profit" that they seek. This control profit will not be shared through a reorganization plan with all creditors and all interest holders. A control profit will be shared by only Japonica and their affiliates. Japonica intends to use its newly acquired control to extract economic profit for itself, not to maximize the results for all creditors.

Trading in claims to achieve profits on a specific claim may not be destructive of the reorganization process (a) when both buyer and seller are informed; (b) when the purchaser is willing to hold the claim until distribution; and, (c) when the original claimant does not wish to hold the claim or needs immediate cash. However, the technical provisions of the Code, such as the automatic stay, are designed to achieve the purposes of the reorganization process and to maximize results for all creditors. These provisions are not designed to create delay and pressure claimants to sell. Delay reduces the value of claims. Japonica has deliberately created delay which has improved their ability to buy claims.

The confirmation process enables creditors to modify themselves. The purpose is to increase the pool of value for all creditors and shareholders. Here, Japonica clearly attempts to deprive creditors of the control premium by a manipulation of the reorganization process through the strategic purchase of claims. Acquiring claims with the clear purpose of achieving control of the debtor, thereby earning a control profit, does not maximize the result for all creditors. Such action manipulates the process.

E. *The Control Provision*

[9] As a result of the negotiations with various constituents prior to the filing of the debtors' plan, the debtor included a provision in the Certificate of Incorporation of Sunbeam/Oster Companies, Inc., that would ensure that any premiums paid to acquire control of the debtor would be shared with all stockholders. *See* Debtor's Joint Stock Plan of Reorganization, Exhibit A. Many creditors feared that banks would use their position as the largest stockholder to control the reorganized debtor.

The Control Transaction provision, contained in Article Sixth of the Certificate of Incorporation, states that in the event of a Control Transaction any time during the period ending two years after the effective date, any holder of common stock of the corporation may "put" his or her shares to the "Controlling Person" (i.e., demand that the Controlling Person purchase those shares) prior to or within forty-five days after certain notice requirements are met.

A Controlling Person means "any person who has or has the right to acquire, or any group of persons acting in concert for purposes of voting their shares that has or has the right to acquire, voting power over shares of Common Stock of the Corporation that would entitle the holders thereof to cast at least 30% of the votes that all Holders of Common Stock would be entitled to cast in an election of directors...." *Id.* The definition of Controlling Person excludes inter alia any person who received common stock pursuant to the plan "unless either (x) such person acquires additional shares of Common Stock for the actual purpose of exercising control over the Corporation, or (y) in any event, such person acquires beneficial ownership *in excess of 45% of the Common Stock of* the Corporation." *Id.* (emphasis added).

We find that in the event that such shares are "put" to the Controlling Person, the Controlling Person is required to pay to such holder an amount equal to the highest per share price paid in acquiring any share of common stock beneficially owned (after the Effective Date and before the end of the forty-five day period) by the Controlling Person. Thus, any premium price paid for control must also be shared with other stockholders. The consideration to be paid to such holders of common stock who "put" their shares to the Controlling Person shall be in cash or the same form as was previously paid in order to acquire shares of common stock which are beneficially owned by the Controlling Person. The Control Transaction provision further provides that, to the extent shares of common stock beneficially owned by the Controlling Person were acquired as a result of distributions under the plan, such shares will be deemed to have been acquired with cash.

Japonica's objections to these provisions, as a matter of law, have little merit. First, Japonica complains that the warrants to be issued to holders pursuant to the plan are counted for purposes of determining whether a person meets the threshold requirement for being deemed a "Controlling Person." Then Japonica objects that neither the exclusion for shares issued pursuant to the plan of reorganization nor the definition of Control Transaction contains an exception for shares purchased on the exercise of the warrants issued pursuant to the plan. Japonica believes that the exercise of warrants issued for purchase of common stock could give rise to an obligation to allow all other shareholders in the corporation to "put" their shares to a Controlling Person. This is not an accurate interpretation of the Control Transaction provision.

This provision provides that at all times the warrants are to be counted for the purposes of determining whether a person is a Controlling Person. However, once the warrants have been exercised, they do not exist and the new stock is counted in the place of the previous warrants. For example, if a stock and warrant holder is determined to own 29% of the company, 9% of which is in the form of warrants and later such person exercises all 9% of those warrants to purchase shares of common stock, such shares of common stock would be counted in the place of the warrants and that person would continue to be viewed as owning 29% of the company.

Japonica also objects that "[t]he Control Transaction provisions may result in different treatment for creditors in the same class," in violation of 11 U.S.C. § 1123(a)(4). There is nothing in the Control Transaction provision that will result in different treatment to creditors within the same class. Japonica uses the example of a creditor in Class 7.AI.1 who holds significant claims in that class as well as claims in other classes, so that the creditor holds warrants and stock sufficient to meet the threshold for causing such person to be deemed to be a Controlling Person. It should be noted that at the time of the hearing on the debtor's disclosure statement in January 1990, and at the end of balloting, there was no creditor that would have received, under the provision in which shares and warrants were to be counted, beneficial ownership in excess of 45% of the common stock of the corporation. Since that time, Japonica has voluntarily purchased claims in various classes which are to receive stock and warrants.

Japonica also objects, at ¶¶ 23–24 of their supplemental objections, to the effect that the Control Transaction provision would have on holders of claims in Class 2.AI.2, the Allegheny Secured Bank Claims. Evidently at the time this objection was raised, Japonica knew that when it completed its plan to purchase claims, it would have acquired a significant amount of claims in Class 7.AI.1 which, after distribution, would be counted with Japonica's holdings at Class 2.AI.2 and Class 4.AI.2, the Allegheny Senior Unsecured Claims. It is clear that Japonica understood and correctly feared the effect that the Control Transaction provision would have on their attempt to control the debtor by this means. The court and other creditors did not appreciate Japonica's concern because they did not know of Japonica's intent. These objections raised by Japonica to the Control Transaction provision are not well-founded.

Actually, Japonica objected to the debtor's plan before it had purchased enough claims to trigger the Control Transaction provision. It appears that its intent to breach that provision may have been long formed. From written and oral objections at the hearing on the debtor's disclosure statement, it is clear that Japonica knew of the intent of these provisions in advance of their claims purchases and accepted the risk that these control provisions could be applied to them.

Japonica has indicated it will not observe the control provisions of the debtor's plan. The banks ask that those provisions be enforced. This court believes it is appropriate to enforce the control provision for at least three reasons. First, because the court believes that the provisions are enforceable under both Pennsylvania and Delaware law; second, because they are separately enforceable as part of the debtor's plan of reorganization which has been approved by the requisite classes; and, third and most important, Japonica's inequitable and bad faith behavior, found above, requires that the intent and substance of these control provisions be enforced as a sanction upon Japonica.

The court intends to mold an injunction to carry out the intent of these control transaction provisions on Japonica by at least denying Japonica's right to vote their shares, unless forty-five days from the date of this confirmation order, Japonica indicates the ability and the agreement to accept the "puts."

F. *Section 105 and the Inherent Powers of a Bankruptcy Court Provide the Necessary Power to Grant Orders for Appropriate Relief*

Justice Douglas wrote eloquently about the equity powers of a bankruptcy court:

> 'A court of equity may ... in the exercise of the jurisdiction committed to it grant or deny relief upon performance of a condition which will safeguard the public interest.' ... These principles are a part of the control which the court has over the whole process of formulation and approval of plans of composition or reorganization.... The responsibility of the court entails scrutiny of the circumstances surrounding the acceptances, the special or ulterior motives which may have induced them, the time of acquiring the claims so voting, the amount paid therefor, and the like.
>
> . . . . .
>
> Where such investigation discloses the existence of unfair dealing, a breach of fiduciary obligations, profiting from a trust, special benefits for the reorganizers, *or the need for protection of investors against an inside few, or of one class of investors from the encroachments of another, the court has ample power to adjust the remedy to meet the need.* The requirement of full, unequivocal disclosure; the limitation of the vote to the amount paid for the securities (citation omitted); the separate classification of claimants (citation omitted); the complete subordination of some claims (citations omitted), indicate the range and type of the power which a court of bankruptcy may exercise in these proceedings. *That power is ample for the exigencies of varying situations.* It is not dependent on express statutory provisions. It inheres in the jurisdiction of a court of bankruptcy.

American United Mut. Life Ins. Co. v. City of Avon Park, 311 U.S. 138, 145–46, 61 S.Ct. 157, 161–62, 85 L.Ed. 91 (emphasis added) (quoting *Securities and Exchange Commission v. United States Realty & Improvement Co.,* 310 U.S. 434, 455, 60 S.Ct. 1044, 1053, 84 L.Ed. 1293 (1940)); *see also Young v. Higbee Co.,* 324 U.S. 204, 214, 65 S.Ct. 594, 599–600, 89 L.Ed. 890 (1945) ("Courts of bankruptcy are courts of equity and exercise all equitable powers unless prohibited by the Bankruptcy Act."); *Pepper v. Litton,* 308 U.S. 295, 307–08, 60 S.Ct. 238, 245–46, 84 L.Ed. 281 (1939) ("In the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate.") Bankruptcy courts may "look through the form to the substances of any particular transaction and may contrive new remedies where those in law are inadequate." *State of Ohio v. Collins (In re Madeline Marie Nursing Homes),* 694 F.2d 433, 436 (6th Cir.1982) (quoting 1 *Collier on Bankruptcy,* ¶ 2.09 (14th ed. 1974)). Thus, the court faced with the unusual situation in this case has "ample power" to formulate appropriate remedies.

The court's equity powers are codified at section 105 of the Bankruptcy Code, 11 U.S.C. § 105. That section empowers the court to "issue any order, process, or judgment necessary or appropriate to carry out the provisions of" the Bankruptcy Code and is an extremely broad grant of authority to do what is necessary to aid its jurisdiction over a bankruptcy case. 2 *Collier on Bankruptcy* ¶ 105.02 (15th ed. 1981).

For example, in *In re Gaslight Club, Inc.,* 782 F.2d 767, 770 (7th Cir.1986), the court recognized that section 105's grant of power included "considerable authority to interfere with the management of a debtor corporation in order to protect the creditors' interests." Numerous other decisions are in accord. In *In re Lifeguard Indus., Inc.,* 37 B.R. 3, 17–18 (Bankr.S.D.Ohio 1983), the court, upon finding that "best interests of creditors" would not be served by allowing a new slate of officers who were inexperienced to take over day-to-day operations, ordered the board of directors not to interfere with existing management.

In *In re Alrac Corp.,* 1 Bankr.Ct.Dec. 1504 (CRR) (Bankr.D.Conn.1975), a case under the former Bankruptcy Act, the court enjoined stockholders from calling an annual meeting pending consummation of a plan. The plan provided for the issuance of new common shares to creditors, who would then be able to elect new directors. The annual meeting had "the potential of possible interference with consummation of

the arrangement if an administration 'unfriendly' to the creditors were installed. This would clearly be inconsistent with the program envisioned in the plan and accepted by creditors and should be restrained." *Id.* at 1506. In the instant case, the creditors did not vote for a plan that would defeat the control provision and impose minority status upon them.

In *In re Johns-Manville Corp.*, 66 B.R. 517 (Bankr.S.D.N.Y.1986), the bankruptcy court enjoined a suit by the equity committee in Delaware state court to compel a shareholders' meeting at which new directors would be elected. The equity committee members had envisioned the election of new directors who would oppose a consensual reorganization plan that had been developed. The court adhered to this result upon remand from the Second Circuit, which had held that because of the importance of the right to a shareholders' meeting to elect new directors under state law, that right could only be overridden by a "showing of clear abuse" and irreparable injury. *In re Johns-Manville Corp.*, 801 F.2d 60, 64 (2d Cir.1986). Such abuse by Japonica has been shown in the findings of the court outlined above.

Moreover, in *Johns-Manville Corp.*, the need to appoint a trustee or to liquidate in chapter 7, with disastrous consequences, loomed as distinct possibilities. *Id.* at 537–39. That is a possible consequence in this case also.

In addition, bankruptcy courts have used their equitable powers under section 105 to "assure the orderly conduct of the reorganization proceedings," *In re Baldwin-United Corp. Litigation*, 765 F.2d 343, 348 (2d Cir.1985); to prevent activities which would delay or thwart efforts to reorganize the debtor, *A.H. Robins Co. v. Piccinin*, 788 F.2d 994, 1008 (4th Cir.1986), *cert. denied*, 479 U.S. 876, 107 S.Ct. 251, 93 L.Ed.2d 177 (1986); and to block actions which tend to "defeat or impair its jurisdiction." *In re Wingspread Corp.*, 92 B.R. 87, 92 (Bankr.S.D.N.Y.1988).

[10] Equitable relief under section 105 also is appropriate to prevent "end runs" on the bankruptcy process. For example, the "power to enjoin assures that a creditor may not do indirectly that which he is forbidden to do directly." *In re Otero Mills, Inc.*, 21 B.R. 777, 778 (Bankr.D.N.M.), *aff'd*, 25 B.R. 1018 (D.N.M.1982). Japonica has done indirectly what they could not do directly.

[11] Japonica has interfered with management and attempted to seize control of the debtor. Japonica has abused and manipulated the bankruptcy process. Japonica has unilaterally resorted to out-of-court measures to impose its will upon the debtor and creditors in a manner not permitted by the Code. Japonica's actions are a grave threat to the prospect of prompt and successful reorganization.

This court is compelled by the facts and by the purpose of bankruptcy reorganization and the law to grant equitable relief in the instant case. Historically, in response to this kind of conduct, bankruptcy courts have granted a wide range of relief. However, in the use of this broad power, this court will exercise only such power as will accomplish the objective of the reorganization consistent with the intended provisions of the plan and disclosure statement and on the basis on which the plan was accepted.

Shares to be distributed to Japonica or their affiliates shall be held in trust by the debtor and shall not be entitled to vote on any matter while in trust or owned by Japonica. Japonica, however, may enjoy the other benefits of ownership, such as dividends and proceeds from sale. If, within 45 days from the date of this order, and subject to approval by this court, Japonica establishes with the debtor that it has the ability to respond to puts from all other shareholders and warrant holders at $7.00 per share and $1.53 per warrant, then the debtor and Japonica are to facilitate the purchase transaction and an orderly change in control. If, within 45 days, Japonica does not agree, or does not establish its ability to accept the put of shares and warrants, then the trust of its shares shall continue for three years. Japonica may choose to continue to own the shares or may set in motion with the cooperation of the reorganized debtor and the consent of

this court an orderly sale of such shares to parties who consent to the Control Transaction provision.

The remedies this court has selected do not deny at this time the bargain Japonica may have achieved on its trading in claims. The remedies are designed to deny control and the control profit through the denial of the voting power of those shares.

III. VALUATION AND CRAMDOWN

[12] The equity holders in this case consist of three classes, which follow in the order of priority: Class 8.AI.1, the $2.19 preference shares; Class 8.AI.2, the $11.25 preferred shares; and, Class 9.AI.1, the common shares. Under the plan of reorganization, all three classes are impaired. Those classes are to receive warrants.[15] Class 8.AI.1 and Class 9.AI.1 accepted the plan; Class 8.AI.2 rejected the plan.

Section 1129(b) of the Bankruptcy Code, 11 U.S.C. § 1129(b), empowers the court to confirm a plan of reorganization, notwithstanding the nonacceptance of the plan by one or more classes of creditors or interest holders. In bankruptcy jurisprudence, this process is known as "cramdown." To cram down a plan on a dissenting class, the court must determine that "the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). With respect to a dissenting class of interests, a plan is fair and equitable if the following requirements are satisfied:

> (i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or
>
> (ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

11 U.S.C. § 1129(b)(2)(C). Paragraph (ii) of the above quoted section is a restatement of the absolute priority rule.

Because Class 8.AI.2, the preferred shares, was the only nonaccepting class of interests, that class "must receive the reorganization 'value of their interest,' or junior interests must be cancelled." 5 Collier on Bankruptcy ¶ 1129.03[4][e] (15th ed. 1989). To determine whether Class 8.AI.2 may be forced to accept the plan and to determine whether Class 8.AI.2 has received a proper distribution as the value for their interest before Class 9.AI.1 can participate in the distribution, the court must determine the value of the securities to be issued.

A. *Valuation*

The court heard extensive testimony on valuation as part of the confirmation hearings. The debtor directed its financial advisor, Smith Barney, Harris, Upham & Co. ("Smith Barney") to prepare a valuation of the reorganization securities. Smith Barney also prepared, at the direction of the debtor, a valuation analysis of the debtor's operating businesses to be used in a liquidation analysis. A summary of this valuation appears in the debtor's disclosure statement. Smith Barney estimated that the enterprise value of the debtor ranged from $510 million to $570 million and the liquidation value of the operating business-

15. Section 7.16 of the plan of reorganization provides that if any class of equity holders rejects the plan, then that class and any junior class would not receive any distribution. The warrants intended for those classes would be distributed to Class 7.AI.1. Thus, under section 7.16 of the plan, Class 8.AI.2 and Class 9.AI.1 are not entitled to any distribution. However, section 7.16 also provides that if the court "finds that the foregoing Distributions are not permitted under the Bankruptcy Code then the 'absolute priority' rules of Bankruptcy Code Section 1129(b) shall be followed."

The court finds section 7.16 discriminatory. Moreover, as the Equity Committee points out, there is no authority in the Bankruptcy Code for discriminating against classes who vote against a plan of reorganization. Therefore, the absolute priority rule shall be followed.

es ranged from $510 million to $550 million. The resultant values of the reorganization shares were $6.33 to $7 per share of the new common stock and zero to $1.53 for the warrants.

At the confirmation hearing, Robert C. Martin, the Managing Director of the Financial Restructuring Group at Smith Barney, testified for the debtor about the valuation process his firm conducted.[16] Martin testified that Smith Barney, inter alia, reviewed public financial statements, analyzed financial and operating data, prepared discounted cash flow analyses, analyzed individual operating businesses, considered comparable companies that were publicly traded, considered comparable mergers and acquisitions, considered economic and industry data, interviewed senior management, reviewed the stock plan, and performed various other analyses. In addition, Smith Barney considered the results of the extensive solicitation of prospective purchasers of the debtor's businesses, which occurred in August 1988. Smith Barney had conducted that solicitation process and thus was intimately familiar with it.

Smith Barney calculated the net income valuation by taking the debtor's projected net income for the next three years, applying an "appropriate" predetermined multiplier, reducing the results to present values as of March 31, 1990, and dividing by the number of shares to be issued to arrive at the price range per share.

As part of its analysis, Smith Barney thoroughly reviewed six other appliance companies which it considered to be comparable to the debtor. As a part of its analysis, Smith Barney determined the appropriate multiples based on market capitalization and based on adjusted market value. For market capitalization, the multiple was the price-earnings ratio, which ranged from 10.2 to 13.3. For the adjusted market value, the range of multiples for earnings before interest and taxes ("EBIT") was 5.0 to 14.4; the range of multiples for earnings before interest, taxes, depreciation, and amortization ("EBITDA") was 4.6 to 9.7.

Martin further testified that the appropriate multiple for the net income valuation, based on the multiples for the comparable companies and other factors, was 11.5, which was approximately the mid-point for the comparable companies. Based on the debtor issuing 45 million shares of stock,[17] Smith Barney determined the net income valuation by multiplying the projected earnings for 1991, 1992, and 1993 ($40.8 million, $49.6 million, and $59.5 million, respectively) by 11.5. The product of that calculation was $469.2 million for 1991, $570.4 million for 1992, and $685.4 million for 1993. Those amounts were then reduced to their present value as of March 31, 1990. Smith Barney thought it appropriate to apply a discount factor because of the following factors: the debtor was in a turnaround situation that involved certain unique risks, the debtor had used aggressive projections of sales and income and there were risks of failing to meet such projections, the debtor had failed to meet past projections, the risk the market would apply to securities of an appliance manufacturer emerging from bankruptcy, the return that investors seek for such risk, the return investors may receive in other turnaround situations, the return on leveraged buy-outs, and the possibility that the stock may not be well received in the marketplace. In light of all of these special factors, Smith Barney determined that the appropriate discount rate to determine present value was 25% or 30%. When this rate was applied, it resulted in the stock having a range of value from $5.73 to $7.32.

Martin testified that Smith Barney also performed the above analysis for earnings before interest and taxes. Smith Barney used a multiple of 7.5; the range of multiples for comparable companies was 5.0 to 9.4. Using the same discount factor, the price per share ranged from $6.44 to $7.81.

16. Over the objection of the Equity Committee, the court qualified Martin as an expert witness.

17. The debtor anticipated issuing more shares of stock, but improved cash flow increased the cash available for distribution, thus reducing the number of shares to be issued.

The debtor also adduced the testimony of John Mueller, a vice president of Whitman, Heffernan, Rhein & Co. ("Whitman Heffernan"), the former investment banker for the Equity Committee.[18] Mueller testified that he carefully reviewed the methodology of Smith Barney, opined that the procedures Smith Barney used were proper, and concurred with Smith Barney's valuation.

James Burroughs, a vice president and the manager of the Industrial Organization Group of Charles River Associates ("CRA"), the Equity Committee's current investment banker, and Peter Butler, senior financial consultant to CRA, testified for the Equity Committee. Burroughs testified that CRA valued the debtor by using a discounted cash flow analysis, and that such analysis resulted in a valuation between $723.5 million and $793.2 million. Burroughs testified that the discounted cash flow analysis involves three components: forecasting the cash flow of the debtor for a reasonable period; determining the cash flow for the "residual" or "terminal" value—the point after the projection period when it is assumed that no further changes will occur; and, selecting an appropriate discount rate. CRA's calculations were based on the debtor's forecasts of cash that were set forth in the disclosure statement. Both experts used the debtor's projections as shown on the disclosure statement. Burroughs believed that the discounted cash flow method was the superior method of valuation because the only source of value of an asset to its owner is the cash that the owner can attain from that asset.

Butler's testimony involved further criticism of Smith Barney's methods. He opined that earnings before interest, taxes, depreciation and amortization was a superior method to earnings before interest and taxes. He further opined that Smith Barney undervalued certain non-operating losses and the debtor's foreign subsidiaries. This later criticism did not appear to be well founded.

There is economic authority to support the valuation methods of Smith Barney and CRA. The court qualified both Martin and Burroughs as expert witnesses, and found them both credible. Moreover, the basic approaches of Smith Barney and CRA were more alike than dissimilar. However, the court adopts the valuation of Smith Barney. There was a major weakness in CRA's analysis. To reach the conclusion that the reorganization stock would trade at $12 per share, Burroughs used a discount rate for present value of only 13.4%. Burroughs did not fully consider the possibility that the debtor would fail to meet its forecasts. Further, they made no provision for the market attaching a speculative quality to the debtor's ability to achieve its projections. It is undisputed that the debtor has consistently failed to meet its projections prior to and since the filing of bankruptcy. Burroughs theorized and presented some evidence that the new reorganized stock would perform better than the market. Burroughs used a "beta" value, the measure of the riskiness of the enterprise being valued relative to the stock market as a whole,[19] of .73 to 1.07, depending on the year. CRA determined the beta for the debtor by examining the betas of the companies which it considered comparable. However, CRA failed to establish that the beta values upon which it relied would be applicable to the debtor's projections. The factors it utilized were the actual results of companies which were successful. The uncertainty of a successful turnaround is still present.

B. *Cram Down and Exclusion of Equity Holders from the Management of the Reorganized Debtor*

Based on Smith Barney's valuation, there is insufficient value for distribution to all of the equity interests. At the time the

18. For reasons that are not in the record, the Equity Committee terminated the services of Whitman Heffernan.

19. For example, if a stock goes up twice as much as the stock market when the market goes up, and down twice as much when the market goes down, it has a beta of two. If the stock moves in synchrony with the market, it has a beta of one.

disclosure statement was approved, claims against the estate were over $722 million. The debtor has since reduced claims to approximately $711 million and continues to reduce the claims through negotiation or litigation. Even so, Smith Barney has estimated the value of the debtor as $510 million to $570 million. Therefore, there is insufficient value to satisfy all creditors and interest holders. Under the absolute priority rule, Class 9.AI.1 would not be entitled to a distribution. The plan could be crammed down by diverting the value intended for Class 9.AI.1 to Class 8.AI.2.

In light of Smith Barney's valuation and the amount of outstanding claims, a cramdown on any class of equity appears to be an academic discussion. There is insufficient present value to satisfy all claims of creditors. The class of creditors with the lowest priority, Class 7.AI.1, will receive part of its distribution in warrants, which, as Smith Barney concedes, may have zero value. However, Smith Barney's (and CRA's) valuation did not value the bank litigation. The Equity Committee is a party to that action and shareholders could potentially benefit. The plan of reorganization proposes and requires the settlement of that litigation. One of the reasons the equity classes were offered warrants was to reduce all litigation. It is clear that absent the bank litigation there would be no value to distribute to equity. As a quid pro quo for settling that suit and for reducing litigation, interest holders were offered warrants. Pursuant to a simple cram down, Class 9.AI.1 is not entitled to any distribution. However, Class 9.AI.1 is entitled to receive warrants, in return for the settlement of the bank litigation.

Among their objections to confirmation of the plan, the Equity Committee complains that various provisions of the plan of reorganization violate 11 U.S.C. § 1123(a)(7). That provision provides that the plan of reorganization "contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor...." As discussed at length above, there is insufficient enterprise value to allow a distribution to the equity holders, other than the warrants. Because present equity holders will not obtain stock in the reorganized debtor, it is not unfair to exclude present equity holders from selecting directors of the reorganized debtor or participating in the committee overseeing the reorganized debtor. When their warrants are exercised for shares, they will receive appropriate rights as shareholders.

IV. OTHER OBJECTIONS TO CONFIRMATION

The plan of reorganization proposes, inter alia, to settle the adversary action by the Creditors' Committee and Equity Committee against the secured bank lenders, at Adversary No. 88-186. The Equity Committee objects to the settlement.

The Equity Committee also objects to the payment of interest to creditors in Class 5.SB.7. In a related matter, Cowen & Company ("Cowen") and Amroc Investments, L.P. ("Amroc") object to the nonpayment of interest to creditors in Classes 5.SB.1 and 5.AL.1.

The court must also respond, in the context of an objection to confirmation, to the matters raised by Japonica and the Equity Committee in their motions to designate.

Finally, Elliott Associates, L.P. ("Elliott") objects to its treatment under the plan of reorganization. The court will address these issues seriatim.

A. *Specific Findings of Fact and Conclusions of Law On the Settlement of Adversary Proceeding No. 88-0186 and Its Inclusion in the Debtor's Plan*

1. History of the Litigation

Immediately following the first petitions for relief in February 1988, AI, in the exercise of its business judgment, entered into an Adequate Protection Agreement with the consortium of 26 banks who were the debtor's pre-petition lenders (the

"banks").[20] In the agreement, AI agreed not to commence any action against the banks and recognized that the banks' liens were valid. This court approved the agreement and in a Memorandum Opinion dated March 11, 1988 expressly permitted AI to recognize the validity of the banks' liens, without prejudice to the rights of other constituents to raise and contest the validity of these liens. In May 1988, the Creditors' Committee commenced an action containing eleven counts on behalf of AI against the banks, at Adversary No. 88–186.

The complaint alleges that the banks are liable to AI for (i) fraudulent transfers under state and federal law, (ii) preferential transfers to alleged insiders, (iii) equitable subordination, and (iv) breach of a duty to act in good faith and deal fairly. The relief sought includes (a) return of $400 million paid to the banks prior to the bankruptcy filing; (b) invalidation or subordination of the banks' remaining liens which collateralize the approximately $220 million remaining to be paid; (c) punitive damages of $880 million; (d) return of a $500,000 fee paid to the banks in December 1986 in connection with the postponement of the due date of a periodic payment; (e) return of other fees and reimbursement for interest, costs and counsel fees; and, (f) such other relief as the bankruptcy court deems appropriate.

The banks have denied the allegations of the complaint, and asserted various affirmative defenses. Upon the motion of the Equity Committee, this court granted the Equity Committee the right to intervene, but only with respect to Counts X and XI. *Official Committee of Unsecured Creditors of Allegheny International, Inc. v. Mellon, Bank, N.A. (In re Allegheny International, Inc.),* 93 B.R. 903 (Bankr.W.D.Pa.1988), *rev'd in part,* 107 B.R. 518 (W.D.Pa.1989). On appeal, the district court on November 15, 1989 granted the Equity Committee the general right to intervene on all counts. The banks have appealed the intervention order. The Equity Committee did not file a separate complaint but adopted the pleadings of the complaint as filed by the Creditors' Committee and has not sought to amend or supplement those pleadings.

Very early in this case the court recognized that this litigation would have a crucial role in the bargaining related to any plan of reorganization. When the debtors decided not to pursue these causes of action, this court invited the Creditors' Committee to pursue them. Even so, this court has held that the causes of action asserted in this complaint are derivative in nature. *Id.* On July 12, 1988 the banks successfully moved to compel joinder of the debtor as a party defendant. This court said, "[b]ecause we view this case as a derivative action, we will grant the Mellon group's motion to compel joinder." *Id.* at 905. It is not disputed that a derivative action is a suit to enforce a corporate cause of action. *See also Price v. Gurney,* 324 U.S. 100, 105, 65 S.Ct. 513, 516, 89 L.Ed. 776 (1945). After October of 1988, the parties have not disputed the derivative nature of the complaint in the bankruptcy court.

On October 10, 1989, the banks moved for partial judgment on the pleadings and for partial summary judgment dismissing Counts X and XI. Those counts assert theories of equitable subordination and breach of duty of good faith and fair dealing, respectively. The banks argue that Count X should be dismissed as to the Equity Committee as a matter of law because 11 U.S.C. § 510(c) does not permit the subordination of a creditor's claim to an equity holder's interest. The banks further argue that both Counts X and XI are insufficient as a matter of law and on the facts and should be dismissed.[21]

2. The Settlement

After many months of extensive discovery and negotiations, a settlement of the litigation has been proposed as an inte-

20. Mellon Bank, N.A. was the agent for the consortium.

21. The banks have submitted affidavits of the senior management of AI in support of their motion for judgment as to those counts.

gral part of the debtor's plan (and as a part of the rival Japonica plan). The negotiations were conducted between the Creditors' Committee, which was advised by its special counsel and regular counsel, and the banks and their counsel. The negotiating parties had the benefit of input from the debtor and debtor's counsel regarding a range of settlement terms. However, the Equity Committee does not join in the settlement. Because this litigation has been clearly adversarial, the court is satisfied that the negotiations were conducted entirely at arm's length.

The settlement provides for (1) the litigation to be dismissed with prejudice, (2) the debtor to indemnify the banks to the extent of $3 million for claims arising out of or relating to the loan transactions, and (3) the delivery by AI to the banks of a general release. In return, the banks have agreed to forego the following claims: (a) approximately $39 million of their $57 million claim for post-petition interest accrued as of February 28, 1990; (b) all post-petition interest accruing thereafter at a rate of approximately $2 million per month; and, (c) all costs of defense for this action, for which they would otherwise seek payment pursuant to the terms of their credit agreements with AI.

It is clear that this settlement is an integral part of the debtor's plan of reorganization. Consummation of the settlement is conditioned upon confirmation of the plan, and similarly, confirmation of the plan is a condition upon consummation of the settlement.

The proposed settlement includes the following benefits: (1) significant monetary concessions by the banks; (2) the elimination of substantial expenses to the estate that otherwise would be incurred if the litigation continued through trial and subsequent appeals; (3) the elimination of the risk of a verdict unfavorable to plaintiffs if the litigation should proceed to trial; (4) the substantial limitation of claims by the banks for post-petition interest and litigation fees if they are successful in their defense; and (5) the ability to proceed with the reorganization without the risk of delay arising from the litigation.

The settlement has the support of the debtor, the Creditors' Committee and the banks. It is very significant that the class of common stockholders, 9.AI.1, and the preferred stock class, 8.AI.1, have voted in favor of the plan, thereby signifying their approval of the settlement as well. One of the classes of preferred stock, Class 8.AI.1, voted 58% in favor, although this does not constitute acceptance under 11 U.S.C. § 1126(c). Absent bankruptcy, a simple majority of a class has some weight.

It is clear to the court that this settlement is of great benefit to the estate, the creditors, and equity holders.

3. Standards for Approval of Settlement in Bankruptcy

[13] The Bankruptcy Code, 11 U.S.C. § 1129(a)(1), provides that a plan may be confirmed only if it complies with the provisions of Title 11. A plan may provide for compromise of litigation. 11 U.S.C. § 1123(b)(3)(A). Even when an impaired class of claims or interests does not accept the plan, the court may approve the settlement and the plan if the court determines that the plan is fair and equitable to those impaired classes. 11 U.S.C. § 1129(b)(1).

[14] This court has discretion to approve a settlement as part of a reorganization plan. Even so, there are limits to a court's discretion in approving a settlement. This court is guided by the case law which teaches that a compromise should be approved if it is fair and equitable. *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424, 88 S.Ct. 1157, 1163, 20 L.Ed.2d 1 (1968); *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir.), *cert. denied*, 469 U.S. 880, 105 S.Ct. 244, 83 L.Ed.2d 182 (1984); *In re Texaco, Inc.*, 84 B.R. 893, 901 (Bank.S.D.N.Y.1988). The court must reach an "informed, independent judgment" supported by the factual background underlying the litigation and bankruptcy. *Texaco*, 84 B.R. at 901.

The courts that have addressed this problem are in substantial agreement as to the

factors a bankruptcy judge must consider in evaluating a settlement. As stated in *In re Grant Broadcasting of Philadelphia, Inc.*, 71 B.R. 390, 395 (Bankr.E.D.Pa.1987), the factors are "(a) [t]he probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; (d) the paramount interest of the creditors and a proper deference to their reasonable views...." *See also In re American Reserve Corp.*, 841 F.2d 159, 161 (7th Cir. 1987); *In re A & C Properties*, 784 F.2d 1377, 1382 (9th Cir.1986), *cert. denied*, 479 U.S. 854, 107 S.Ct. 189, 93 L.Ed.2d 122 (1986); *In re Energy Cooperative*, 886 F.2d 921, 927 (7th Cir.1989). A further consideration, enunciated by the Supreme Court in *TMT Trailer* is "the need to compare the terms of the compromise with the likely rewards of litigation." 390 U.S. at 425, 88 S.Ct. at 1163.

The court in *In re Texaco* followed *TMT Trailer* when it confirmed a reorganization plan providing for compromise of a judgment in excess of $11 billion. The *Texaco* decision sets forth the following criteria to be considered:

1. The balance between the likelihood of plaintiff's or defendant's success should the case go to trial vis-a-vis the concrete present and future benefits held forth by the settlement without the expense and delay of a trial and subsequent appellate procedures.
2. The prospect of complex and protracted litigation if the settlement is not approved.
3. The proportion of the class members who do not object or who affirmatively support the proposed settlement.
4. The competency and experience of counsel who support the settlement.
5. The relative benefits to be received by individuals or groups within the class.
6. The nature and breadth of releases to be obtained by the directors and officers as a result of the settlement.
7. The extent to which the settlement is truly the product of arms-length bargaining, and not of fraud or collusion.

Texaco, 84 B.R. at 902.

In order to apply the factors outlined above, this court analyzed the necessary factual background as developed (a) from the proposed findings of fact and conclusions of law of the banks, the Creditors' Committee and the Equity Committee, (b) from a review of the written discovery, documents, depositions of proposed witnesses and similar discovery materials, (c) from the representation of attorneys who investigated the facts, and (d) from argument of attorneys concerning those legal issues. Finally, the court considered the likelihood of success of proving these facts and establishing the legal issues.

This court has read and studied the proposed findings of facts and conclusions of law submitted by the litigants many times. It would not add to the analysis for this court to evaluate in writing each of the disputed facts and conclusions of law. Each count would require a lengthy written analysis. However, the court did evaluate the ease or difficulty of establishing disputed facts, and it did consider the facts proposed as favorable as possible to the party urging such a fact when considering the applicable law. The court is reminded that it is a settlement that is before the court and that a simple majority of the parties involved in the dispute have favored the settlement. In fact, except for one class of preferred, a two-thirds majority has favored the settlement as part of the confirmation of the plan. The burden is on the objecting party to demonstrate that this law suit would provide more than the plan proposes and more than in a chapter 7. To do so, the objecting party must demonstrate the value of the law suit. They have not convinced the court of such value.

[15] In considering the fairness and reasonableness of such a settlement, this court is not required to perform an exact valuation of each issue. The court is not required to conduct a mini trial of the facts. The appellate courts have not required the use of a rigid mathematical for-

mula to set dollar values. To do so "would create an illusion of certainty where none exists and place an impracticable burden on the whole ... [settlement] process." *In re Energy Cooperative*, 886 F.2d at 929, (quoting *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R.R. Co.*, 318 U.S. 523, 565–66, 63 S.Ct. 727, 749–50, 87 L.Ed. 959 (1943)).

The cases teach us that this court must determine "whether or not the terms of the proposed compromise fall within the reasonable range of litigation possibilities." *Texaco*, 84 B.R. at 902 (quoting *In re New York, New Haven & Hartford R. Co.*, 632 F.2d 955, 960 (2d Cir.1980), *cert. denied*, 449 U.S. 1062, 101 S.Ct. 786, 66 L.Ed.2d 605 (1980)). The court concludes that the compromise between the banks and the Creditors' Committee representing AI's interests falls within that reasonable range and is fair.

4. Summary of Historical Facts From Early 1972 Through 1986

In the 1970's, AI pursued a strategy of acquisition of consumer products and high technology industrial products and divestiture of the cyclical, labor-capital intensive steel business. In about 1982 AI found itself with a very high level of debt and low profits. It had acquired many operational inefficiencies. AI believed those were due to the number of disparate businesses it owned, high overhead, and a high level of preferred dividends. Between 1982 and 1986, AI carried out a number of divestitures. However, the funds obtained were not used for reducing debt. The cash was used to pay interest expenses and preferred and common dividends. The debtor attempted to retire this expensive preferred stock through purchases largely financed by bank borrowing. During 1984 and 1985, AI individually and separately negotiated lines of credit with many domestic and foreign banks and other lenders.

In October 1985 when the debtor took a write down of approximately $75 million from losses related to real estate and oil and gas investments, the lending parties became alarmed. The public press commented fully on many of the debtor's poor management practices. The sophisticated financial community became aware of AI's problems.

In the fall of 1985, the debtor undertook a review of its activities and hired Merrill–Lynch to study and recommend improvements. Project Keystone resulted. Thereafter the debtor decided to focus on certain "core" businesses centered around consumer products and to divest various other businesses. The evidence offered is convincing that this strategy was not unduly influenced by the banks.

As part of this restructuring, the debtor desired to change from the separate uncommitted short term financing to more committed financing. In October of 1986, the debtor requested that Mellon Bank investigate creating a committed multi-bank lender facility. Following necessary negotiating and business forecasting, the debtor and the banks entered into two revolving credit facilities, a short term one-year facility and a long term two-year facility (collectively referred to as the "loan revolver agreements"). Those agreements are at the center of this dispute.

The previous individual loans were unsecured. The amount of these borrowings was approximately $602 million. As a result of the above negotiations, the banks obtained concessions from the debtor in the form of a pledge of the stock of all of the operating subsidiaries. The agreements also gave the banks rights over certain aspects of the debtor's business and the right to be paid from the divestiture.

During the negotiations, the president of Mellon, George F. Farrell, was a member of the Board of Directors of AI. Mellon acted as the agent for the other banks and led the negotiations. On these facts, this court would easily find that it was clearly inappropriate for Farrell to serve on the debtor's board. Robert F. Buckley, CEO of the debtor, had also served on Mellon's board.

The new loan revolver agreements were tightly drawn. It is clear that the banks had become aware of, and concerned about, the debtor's financial distress and operational losses. It is also true that the debtor

did not achieve its own goals for the remaining core operations which it intended to retain. The debtor conducted the divestitures under pressure to comply with the revolving loan agreements. The plaintiffs attack some of those divestitures as resulting in fire sale prices. Those facts will be difficult to prove at trial.

It will also be difficult for the plaintiffs to prove that the banks planned, originated, and implemented this scheme as a deliberate effort to disadvantage the other creditors, shareholders, and the debtor. The debtor could have chosen another course of action. The debtor's counsel warned the debtor of the legal pitfalls of the revolver loan agreements.

As of the filing of the debtor's petition in February 1988, the bank debt had been reduced from $602 million to $221 million. Moreover, it is also clear that the banks improved their position by obtaining collateral. The priority position of a secured creditor provides the banks with a definite advantage in a bankruptcy distribution and outside of bankruptcy. This settlement significantly diminishes that advantage.

The plaintiffs' ability to recover under several of the causes of action is dependent on the disputed fact of the debtor's solvency. The plaintiffs believe they can establish insolvency as of May of 1986. The result of such an attempt is uncertain. In support of this assertion, the court notes that in March of 1987 First Boston Corporation announced a tender offer of $24.60 for common shares, $20.00 per share for the $2.19 preference shares and $87.50 for the $11.25 preferred shares.[22] Factual and legal evidence of insolvency will be a difficult issue to establish.

[16] The issue of equitable subordination is also risky for the plaintiff. The plain language of 11 U.S.C. § 510(c)[23] does not support the Equity Committee's legal position and makes them dependent on common law doctrines. The doctrine of subordination is remedial, not penal, and is applied only to the extent necessary to offset specific harm caused by inequitable conduct. This court believes that the alleged inequitable conduct is largely comprised of the banks' superior knowledge because of a possible breach by Farrell of his duty as a fiduciary. The court views the evidence offered on the issue of deliberately harmful conduct as not convincing. The court also views the debtor's historically poor performance as a significant factor in this matter. It is clear that the banks improved their position. The remedy of holding the banks as unsecured creditors and denying interest to the banks would be appropriate. That is largely what this settlement accomplishes.

The Equity Committee asserts in Count XI that the banks are liable for Farrell's and Mellon's tortious conduct. The Equity Committee contends that because they have not consented to this settlement this count cannot be settled. These claims have been labeled a "lender liability" claim. Although these causes of action are described by principles frequently used in tort, Count XI of the complaint alleges a claim based upon contract and may not be an action in tort in Pennsylvania.

As stated earlier, the court believes this is a derivative action being brought by the committees on behalf of the debtor. This court by confirming the debtor's plan and agreeing to this settlement binds the creditors and shareholders. As stated above, a

22. Alas, Spear Leeds & Kellogg, the dominant member of the Equity Committee, refused to tender its shares and is credited with defeating the proposed merger with First Boston. Ansberry *When Will Somebody—Anybody—Rescue Battered Allegheny?*, Wall St.J., April 14, 1990 at 1, Col. 6.

23. Section 510(c) of the Bankruptcy Code, 11 U.S.C. § 510(c) provides as follows:

> 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.

majority of the Equity Committee's clients also have agreed.

5. The Settlement is Fair and Reasonable

[17] The banks have substantial exposure in this action; the debtor and creditors have exposure if this action fails. The settlement meets the criteria set forth in *Texaco* and the other cases discussed above. The court finds that the proposed settlement of the litigation, as an integral element of the debtor's plan of reorganization, is fair and reasonable.

Texaco asked whether there is an appropriate balance reached between the likelihood of success for plaintiff at trial and the concrete present benefits of a settlement. The court believes that the proper balance has been reached and is within the range of reasonableness. The benefits of the settlement are substantial. Those benefits include significant monetary concessions from the banks, as discussed above. Another benefit is the avoidance of further litigation expense. It should be noted that the special counsel hired to conduct this specific litigation for the Creditors' Committee has requested $1.7 million in fees and the Equity Committee's special counsel has requested $600,000 thus far. The parties will incur much greater expenses if this litigation continues. By settling this litigation, the debtor also avoids claims by the banks for additional amounts. If the litigation continues and the banks are successful, they will assert claims for additional post-petition interest through the date that the plan is confirmed and for fees incurred in connection with their defense. Finally, settling this litigation permits the reorganization to conclude. The settlement is an essential element of the debtor's plan. If a settlement is not achieved, the debtor's plan cannot be consummated, and it might be impossible to consummate any plan of reorganization.[24]

In addition to the foregoing, it is significant that the settlement, insofar as it is embodied in the debtor's plan, has received the support of the debtor, the Creditors' Committee and the banks, and has received a two-thirds affirmative vote by the holders of common stock and the senior issue of preferred stock and a simple majority affirmative vote by the junior class of preferred stock. This broad support weighs in favor of approval of the settlement.

The court observes that although the common stock class has voted in favor of the debtor's plan, the Equity Committee, the intervenor plaintiff in this action, opposes the settlement. It is clear that the equity holders have priority behind all creditors in priority of distribution. This court concludes that it is unreasonable to expect that a result could be reached that is large enough to allow the debtor to make all creditors whole and also provide additional compensation to equity holders. Moreover, the Equity Committee's opposition is in conflict with the expressed views of two of its three constituencies and perhaps all three.

The competency of counsel supporting the settlement is a factor to be weighed. The settlement is supported by counsel for the Creditors Committee, including special litigation counsel, and counsel for the debtor. The competence of counsel has not been challenged.

The final criterion is the extent to which the settlement is truly the product of arm's length negotiations and not of fraud or collusion. The court is convinced that the negotiations between the banks and the Creditors' Committee were at arm's length.

The court finds the settlement before the court is within the range of reasonableness required for approval.

B. *The Structured Settlement at Class 5.SB.7*

[18] Included in the debtor's plan is a structured settlement with the members of Class 5.SB.7.[25] The structured settlement

24. The Japonica Plan requires a settlement as well.

25. Class 5.SB.7 (Sunbeam Institutional Unsecured Claims) consists of all unsecured non-priority claims for borrowed money against Sunbeam held by a financial institution. The members of this class are Prudential Insurance Company of America, Third National Bank of Nash-

provides that the debtors will pay holders of claims in Class 5.SB.7 the full amount of their allowed claims in cash on the effective date of the plan. The settlement provides for an additional $23.75 million in cash to be distributed to Class 5.SB.7 on the effective date in settlement of certain claims and litigation. The claims of this class consist of, in addition to principle, related post-petition charges, expenses, and monthly interest of approximately $34.54 million. Additionally, the settlement further provides for additional interest of $900,000 per month beginning April 1, 1990, and continuing until the effective date of the plan. The cumulative interest accrued at the coupon rate alone is $23.6 million and is increasing monthly. The settlement largely agrees to pay post-petition interest.

On October 11, 1985 Prudential and Sunbeam executed a loan agreement which provided for payment of interest and also expenses.[26] These claims for additional charges, expenses and interest arise from that loan agreement.

The Equity Committee has opposed the structured settlement. The Equity Committee contends that (1) section 502(b) prohibits payment of post-petition interest; (2) Congress did not intend to allow post-petition interest in chapter 11 situations; (3) if Prudential were entitled to post-petition interest, it should not be entitled to the default rate it claims but the statutory rate of interest in Pennsylvania; and, (4) the structured settlement is not within the range of reasonableness.

In order to determine the reasonableness of this settlement, this court must again look to the factors set forth in *In re Texaco, Inc.* Those factors will not be repeated here. The most important factor is the likelihood of success should the issue of interest be decided at trial. Prudential (the majority claimholder in Class 5.SB.7) has filed a complaint to determine the extent of the interest owed to them under the loan agreement. The Equity Committee contends that the members of Class 5.SB.7 are not entitled to any interest because these claimants are not secured.

[19] As a general rule, accrual of interest on a debt is suspended upon the filing of a petition in bankruptcy. *Nicholas v. United States,* 384 U.S. 678, 86 S.Ct. 1674, 16 L.Ed.2d 853 (1966). In general, insolvent debtors are not required to pay post-petition interest to unsecured creditors. However, numerous courts have found that where the debtor proves to be solvent, post-petition interest which accrues on unsecured claims may be allowed. *In re A & L Properties,* 96 B.R. 287 (Bankr.C.D. Cal.1988); *see also, In re San Joaquin Estates, Inc.,* 64 B.R. 534 (9th Cir.1986); *In re Manville Forest Products Corp.,* 43 B.R. 293 (Bankr.S.D.N.Y.1984), *aff'd in part,* 60 B.R. 403 (S.D.N.Y.1986); *In re Boston and Maine Corp.,* 719 F.2d 493 (1st Cir.1983), *cert. denied,* 466 U.S. 938, 104 S.Ct. 1913, 80 L.Ed.2d 461 (1984); *Debentureholders Protective Comm. of Continental Investment Corp. v. Continental Investment Corp.,* 679 F.2d 264 (1st Cir.), *cert. denied,* 459 U.S. 894, 103 S.Ct. 192, 74 L.Ed.2d 155 (1982). By most measures, Sunbeam has been solvent.

In 1984, a similar fact situation occurred in the Johns–Manville Corporation case. Creditors of Manville Forest Products Corporation requested post-petition interest

ville, Government Employees Insurance Company ("GEICO"), and First Wisconsin Trust Company.

26. 9.B *Expenses.* The Company agrees ... to pay, and save you harmless against liability for the payment of, all out-of-pocket expenses arising in connection with this transaction, including all taxes, together in each case with interest and penalties, if any, and any income tax payable by you in respect of any reimbursement therefor, which may be payable in respect of the execution and delivery of this Agreement or the execution, delivery or acquisition of any Note issued under or pursuant to this Agreement, all printing costs and the reasonable fees and expenses of your special counsel in connection with this Agreement and any proposed or actual modification thereof or any proposed or actual consent thereunder and the cost and expenses, including reasonable attorneys' fees, incurred by you in enforcing any of your rights hereunder, including without limitation costs and expenses incurred in any bankruptcy proceeding. The obligations of the Company under this paragraph 9B shall survive transfer by you and payment of any Note.

from the solvent subsidiary. The court found as follows:

> [W]here the debtor's estate is sufficient to pay the interest which accrues after the filing date, 'it would seem inappropriate to return to the debtor a surplus of his assets after accommodation of all claims without a distribution to the creditors of accrued interest to the date of payment of the claims by the trustee.' Therefore, where the debtor is solvent, the bankruptcy rule is that post-petition interest which accrues on unsecured claims which are allowable against the debtor's estate will be paid in full before any money is allowed to revert back to the debtor or its shareholders.

In re Manville Forest Products Corp., 43 B.R. 293, 300 (Bankr.S.D.N.Y.1984), *aff'd in part*, 60 B.R. 403 (S.D.N.Y.1986) *quoting* 3 *Collier on Bankruptcy*, ¶ 502.02 at 503–33 (15th ed. 1984). The court then stated that the solvent subsidiary was obligated to pay post-petition interest to lenders on both its secured and unsecured obligations. *Id.* at 300.

The court is convinced that Prudential and the other members of Class 5.SB.7 would succeed on the issue of interest if it were to be tried. The settlement merely gives Class 5.SB.7 interest without the enormous cost of additional litigation.

The Equity Committee contends that even if class 5.SB.7 is entitled to post-petition interest, they would only be entitled to the Pennsylvania statutory rate of 6%. We are not convinced of this contention. "[W]ith respect to creditors who had bargained for a rate of interest ... the bargained-for rate would apply." *In re A & L Properties*, 96 B.R. 287, 289 (Bankr.C.D. Cal.1988). It has also been held that the contractual provision for interest applies post-petition where the estate proves to be solvent. *Debentureholders Protective Comm. of Continental Investment Corp. v. Continental Investment Corp.*, 679 F.2d 264, 269 (1st Cir.), *cert. denied*, 459 U.S. 894, 103 S.Ct. 192, 74 L.Ed.2d 155 (1982).

For the above-stated reasons, this court finds that the settlement between the debtor and Class 5.SB.7 is within the range of reasonableness.

C. *The Objections of Cowen & Company and Amroc Investments, L.P.*

[20] Cowen and Amroc, both general unsecured creditors of Sunbeam and Almet, object to confirmation. Both have been classified in Classes 5.SB.1 and 5.AL.1 and under the debtor's plan are scheduled to receive 100% of the allowed amounts of such claims. Pursuant to section 7.05 of the debtor's plan, the holder of claims in Classes 5.SB.1 and 5.AL.1 have the right to seek payment of post-petition interest by the timely filing of a "Post-petition Interest Declaration" and a final order of the court.

Cowen and Amroc contend that they are subject to disparate treatment and that this constitutes discrimination against "smaller Sunbeam creditors." They allege that there is no difference between themselves and the members of Class 5.SB.7, who have entered into a settlement with the debtor (see the Structured Settlement discussed supra) and those who must request their interest separately. Both creditors overlook the fact that there is a major difference between these classes. The members of Class 5.SB.7 have contractual loan agreements providing for interest, whereas the members of Class 5.SB.1 and 5.AL.1 do not have a contractual agreement that provides for interest. In large part they are trade creditors.

It has been held that "there is no requirement within section 1122 or elsewhere in the Code that *all* substantially similar claims be included within a particular class." *In re Rochem, Ltd.*, 58 B.R. 641, at 642 (Bankr.D.N.J.1985) (emphasis added). "As a general rule the classification in a plan should not do substantial violence to any claimant's interest." *In re LaBlanc*, 622 F.2d 872, 879 (5th Cir.1980). Placing Cowen and Amroc into classes where they receive 100% of their allowed claim and must request post-petition interest does not "do substantial violence" to their interest.

The court determines that a decision by the court about entitlement to post-petition interest would be premature at this time.

None of the claimants in these classes have filed a "Post-petition Interest Declaration." This court finds that the creditors in Classes 5.SB.1 and 5.AL.1 have not been discriminated against by requiring them to make an application. When they file an application for a "Post-petition Interest Declaration," a judicial determination concerning interest will be made. Adequate notice should be provided to interested parties and the Official Committee of Unsecured Creditors of Sunbeam Corporation. The decision rendered upon the first interest declaration may be res judicata upon all others filed and similarly situated.

D. *The Equity Committee's and Japonica's Objection to Confirmation Based on the Actions of Milligan and DLJ*

In the analysis of the Japonica and Equity motions to designate which the court denied above, the court promised a further look at the same events as an objection to confirmation. The facts are not in dispute. The purposes and intent of the parties are in dispute. The objectors argued that these purchases were an attempt to entrench the management of Milligan and to ensure control. The defendants argue that this was an attempt to provide liquidity and to provide stability for future shareholders. In any case, Milligan is an insider and it was not appropriate for insiders to participate in these arrangements without disclosure to other creditors. The court is sympathetic to the desire by various potential shareholders for stability and order in the market. The court is not supportive of entrenching any particular management or conversely permitting a control profit not to be widely shared.

The Control Transaction provision, which comes into effect when a Controlling Person owns 30% of the shares, attempts to deal with the problem. That provision is no longer adequate for that purpose. Because the court intends to impose a non-voting limitation on the Japonica shares, a much smaller number of shares could control the reorganized company. Japonica is estimated to control approximately 50%. Thus, 30% would equate to approximately 60% of the remaining stock.

As part of the confirmation process and as a response to Milligan's involvement and the possibility that control was the objective of DLJ and their affiliates, the triggering 30% control provision is reduced to 15% for as long as the Japonica shares do not have the right to vote.

A plan of reorganization which distributes shares is inherently forward looking. The debtor's plan utilizes a distribution of shares. The debtor's projected sales and profit turnaround is an inherent part of this plan. In this fact situation, these shares carry the hope of future improvement. Warrants even more than shares carry this hope of improvement. A control change could prevent these benefits from being fully realized by shareholders, and also by warrant holders. The debtor is directed to place at least a three-year period of life on the warrants.

Because of the limited number of bank claimants and the large amount of their debt ($186 million), the control provisions in the charter were initially designed to prevent the banks from effecting a change in control and benefitting uniquely.

Even though it now applies principally to Japonica, the court deems it appropriate to continue to achieve this result as part of the confirmation process. As a sanction for the involvement of Milligan and DLJ in this process, the bank agreements entered into with DLJ and others for the purpose of selling issued shares at $6.25 are avoided.

The debtor may develop a procedure to lock up these blocks of stock and to create a facility permitting the orderly sale of shares to the general investing public. The court will retain jurisdiction to insure that these developments are consistent with the plan. A change in control not related to the performance of the debtor is to be discouraged. The new Board of Directors is to be specifically enjoined from permitting such a change without protecting the minority shareholders' and warrant holders' interests.

Japonica will be denied the right to vote its shares for at least three years. Japonica will be enjoined from selling its shares to parties who do not agree in advance to abide by the control provisions. Japonica's voluntary divestiture below 45% or below 30% will not expiate its bad faith activities. Japonica's shares will remain with the debtor in trust for as long as the Japonica shares cannot be voted. The control provision is lowered to 15%. The DLJ/bank contracts to purchase when issued shares at $6.25 are avoided as inconsistent with the control provision and because they were not properly disclosed.

E. *The Objection of Elliott Associates, L.P. to Confirmation of the Debtor's Joint Plan*

Elliott is an investment fund which purchased approximately 10% of the Chemetron Corporation 9% debentures due 1994. Elliott purchased the debentures long after Chemetron filed bankruptcy. It is a creditor in Class 5.CH.1. The debentures were issued pursuant to an indenture dated September 1, 1969 prior to the Chemetron acquisition by the AI. Class 5.CH.1 is an impaired class and has accepted the plan.

Elliott objects to confirmation of plan of reorganization. The objection sets forth that the plan violates the best interest of creditors test under 11 U.S.C. § 1129(a)(7), that the plan was not proposed in good faith, and that the plan contains an impermissible cramdown provision.

1. Best Interest of Creditors Test

[21] Section 1129(a)(7) of the Bankruptcy Code sets forth the best interest of creditors test which requires that each holder of a claim in an impaired class of creditors must either accept the plan or receive under the plan property of a value, as of the effective date of the plan, that is not less than the amount such holder would receive under a chapter 7 liquidation.

The debtor's disclosure statement contains a liquidation analysis at Exhibit 14 and at page IX-4 which sets forth what creditors would receive in a chapter 7 liquidation. The debtor's experts testified in support of these values and the court has adopted these values. (See Section III supra.) Under the debtor's liquidation analysis creditors of Chemetron would receive 27% to 29% of the value of their claims. Under the plan, Chemetron creditors are receiving 93.2% of the value of their claims, using a $7.00 per share value of the reorganization securities.

Elliott argues that the investment banker for the Creditors' Committee has opined that the initial trading price of the stock may be lower than the value set forth in the debtor's disclosure statement. Therefore, Elliott contends that the value of the property they are receiving, as of the effective date, may be less than under a chapter 7 liquidation. The recovery to Chemetron at 27–29% would be roughly equivalent to a $2.03–$2.18 per share. Thus, for Chemetron creditors to receive less than they would receive in a chapter 7 liquidation, the stock would have to trade below $2.02 per share. This court finds that the shares are valued properly at $7.00 per share; the shares are not likely to trade at such low levels.

Elliott further argues that if only Chemetron were liquidated, Class 5.CH.1 would receive a 100% distribution; Elliott contends that the debtor's liquidation analysis is flawed; other corporate parts of the debtor need not be liquidated for a proper chapter 7 liquidation analysis. Elliott argues somewhat obtusely that liquidation should be analyzed as though the debtor's plan was confirmed with only Chemetron liquidated. Elliott believes that under such a scenario, Chemetron creditors would then receive the same distribution proposed for Class 5.AI.1, General Unsecured Creditors. Class 5.AI.1 consists of $48.2 million of claims which are to receive 3,476,000 shares valued at $7.00 per share. This amounts to a 60.5% recovery under the plan. However, Elliott fails to consider that it would result in 6.4–6.9% on liquidation of AI.

The debtor's plan has not placed the Chemetron claimants in the unsecured class. The plan has treated Chemetron claims in a separate class because they are only derivative of an unsecured claim and

must share with other unliquidated claims. Adding $185 million of intercompany claims to the unsecured Class 5.AI.1 would increase this class by 4.8 times and would amount to rewriting the plan.

It is obvious that creditors in classes with higher priority than the Chemetron claimants would be diluted by such action. Those creditors accepted less than full value of their claims in a plan which included the plan's treatment of the Chemetron claims. Elliott argues for the benefit of only part of the confirmation bargain that it otherwise wishes to defeat. The court could not, as part of confirmation, modify the debtor's plan and order such a distribution to the Chemetron claimants.

It is clear from the objection that Elliott does not fully comprehend the debtor's plan. Chemetron is not being liquidated. Chemetron will continue to have an intercompany claim against the reorganized debtor. The intercompany claim is being reinstated in the plan.

Chemetron is a nonoperating company with one asset, an intercompany claim against AI of approximately $185 million. There are approximately $36.2 million of known liquidated claimants at Chemetron and the plan provides a 93.2% distribution at $7 per share to them. Elliott ignores the fact that there are other substantial claims against Chemetron that are not liquidated! The debtor established that there are approximately 8 superfund sites and the McGeon Nuclear site that have large potential environmental claims, in addition to the $36 million of liquidated claims. The intercompany claim upon which Elliott relies is also liable for these claims. The debtor is reinstating these large unliquidated claims and proposing to pay the liquidated claims such as Elliott. If these unliquidated claims are reinstated, the debtor expects over time that their liability could be managed better and may even be reduced. If they are liquidated now, the United States could raise claims as high as $200 to $600 million and prevent any distribution to the Chemetron claimants. The assurance of a reliable financial entity, such as the reorganized debtor, and reinstatement has satisfied the environmental claimants. Chemetron alone could not provide such assurance.

In addition, there are claims of retirees, product liability claims and various industrial revenue bond claims at Chemetron that would require liquidation before distribution could be made to the $36.2 million of known Chemetron claims. Elliott improperly analyzed these unliquidated liabilities in relation to the $185 million intercompany claim. The debtor's evidence on the matter of unliquidated claims was creditable.

Further, the Creditors' Committee believes that the affairs of Chemetron are so intertwined with AI that substantive consolidation is the correct equitable result. It is clear the Creditors' Committee will object to the payment of this intercompany claim on that basis. Any separate liquidation of Chemetron will substantially delay the distribution to Chemetron claimants and could defeat their payment.

Elliott's analysis is seriously defective. Because the class into which Chemetron's intercompany claim could be classified is receiving a distribution of 60.5%, Elliott has calculated that 60.5% of $185 million, or $111 million, should be available for distribution to the liquidated Chemetron claimants. At best it would need to be shared with the unliquidated claims above.

More important, if the plan is not confirmed, upon liquidation, the unsecured creditors of Class 5.AI.1 would receive 6.4–6.9% (see Disclosure Statement, IX–4), not 60.5%; 6.9% of $185 million, approximately $13 million, is available. The debtor estimated that Class 5.CH.1 consisting of the liquidated $36.2 million claims would receive 93.2% under the plan and they estimate only 27–29% on liquidation. Even that analysis, however, does not account for the unliquidated claims such as environmental, retirees, etc. Without a reorganized debtor, a liquidation of AI or Chemetron or both will produce much less than 27–29% for the Chemetron claims.

The court finds that Chemetron creditors are receiving substantially more than they would under a chapter 7 liquidation and that the plan thus satisfies the "best inter-

est" test of § 1129(a)(7). Elliott's objection with regard to the best interest of creditors test must be overruled.

2. Good Faith Objections

Elliott contends that the provision of the plan which requires the withdrawal of the plan as to Chemetron if Chemetron creditors do not vote to accept the plan was not proposed in good faith. As a practical matter, in a complex chapter 11 with subsidiary debtors such as this, the only method to confirm the plan, if creditors of any subsidiary did not accept, is to withdraw the plan as to that subsidiary debtor and propose an alternative treatment. Clearly, such provision was included for the purpose of assuring a confirmable plan and was made in good faith. It is moot, however, since the Chemetron class accepted the plan.

Elliott further objects that the intention of the Creditors' Committee to object to the Chemetron intercompany receivable was not in good faith. The statement merely reflected the already pending Motion for Substantive Consolidation and was required to disclose to all creditors of Chemetron that the Motion for Substantive Consolidation would not be dismissed in the event that such creditors rejected the plan. Moreover, consistent with its statement of intention on April 30, 1990, the Creditors' Committee filed its Motion for Substantive Consolidation and Objection to the Chemetron Intercompany Claims. Despite the debtor's assertions about the intercompany receivable, it has been and remains the position of the Creditors' Committee that Chemetron is merely a shell corporation which long ago had been merged with AI and the intercompany receivable was not an asset of the Chemetron estate. Rather, the Creditors' Committee asserts that the Chemetron and AI estates should be treated as one, and the Chemetron creditors should not receive treatment superior to the creditors of AI. This objection is denied.

3. Impermissible Cramdown

The allegation set forth by Elliott with regard to the impermissible cramdown has been rendered moot by virtue of the fact that the class of creditors at Chemetron voted to accept the debtor's plan. The objection is also misplaced because the plan does not provide for the cramdown of Chemetron, but merely provides that the plan would be withdrawn as to Chemetron and that Allegheny would have to provide for alternative treatment for Chemetron creditors in the future.

The rationale for providing that the Chemetron creditors would not receive a distribution is based upon the fact that the intercompany receivable upon which their distribution depends is a disputed claim. This treatment is consistent with the treatment of other disputed claims in the plan. No creditor whose claim is disputed shall receive a distribution under the plan until their claim is resolved. Thus this objection is unfounded.

V. CONCLUSION

The court believes that the preceding discussion addresses all substantial objections to confirmation. Other matters are addressed in the Order of Confirmation. The court finds that the debtor's plan of reorganization fully satisfies the requirements of 11 U.S.C. § 1129.

An appropriate order is attached.

CONFIRMATION ORDER

WHEREAS, the above memorandum has made findings of fact and conclusions of law as to disputed matters;

WHEREAS, the Debtors' Joint Stock Plan of Reorganization dated December 29, 1989, filed by the Debtors on December 29, 1989, as amended by the Debtor's Joint Stock Plan of Reorganization filed by the debtors on February 2, 1990 (hereinafter referred to as the "Joint Stock Plan"), having been transmitted to creditors and equity security holders; and

WHEREAS, the court has determined after hearing on notice that:

1. The rejections of the Joint Stock Plan filed by Japonica Partners, L.P. ("Japonica") and their affiliates should be designated pursuant to 11 U.S.C. § 1126(e) and that votes cast against the plan were not in good faith and were not solicited or pro-

cured in good faith and in accordance with the provisions of Title 11 of the United States Code; and, therefore, the court finds that Class 2.AI.2 Allegheny Secured Bank Claims and Class 4.AI.2 Allegheny Senior Unsecured Claims have accepted the plan;

2. The Joint Stock Plan does not discriminate unfairly, and is fair and equitable, with respect to the class of the holders of the issued and outstanding $11.25 Convertible Preferred Stock, Class 8.AI.2, the only impaired class of claims or interests which did not accept the Joint Stock Plan;

3. Pursuant to the provisions of Article 7.16, Cramdown of the Plan, the court has found that the "foregoing distributions are not permitted" and further that the settlement of the bank litigation requires that Class 8.AI.2 shall receive the warrants as provided by acceptance of the Joint Stock Plan and that Class 9.AI.1 Allegheny Common Stock shall also receive warrants as provided by acceptance of the debtors' plan;

4. The Joint Stock Plan has been accepted in writing by the creditors and equity security holders whose acceptance is required by law;

5. The debtors filed modifications to the Joint Stock Plan on July 5, 1990, which, by virtue of this court's orders of April 30, 1990, at Motion Nos. 90–2505M and 90–2877M were deemed accepted by all creditors and equity security holders who accepted the Joint Stock Plan (the Joint Stock Plan as so modified being hereinafter referred to as the "Joint Stock Plan");

6. The provisions of Chapter 11 of the Code have been complied with; the Joint Stock Plan has been proposed in good faith and not by any means forbidden by law;

7. Each holder of a claim or interest has accepted the Joint Stock Plan or will receive or retain property of a value, as of the effective date of the Joint Stock Plan, that is not less than the amount that such holder would receive or retain if the Debtor against which or in which the holder holds its claim or interest were liquidated under Chapter 7 of the Code on such date;

8. All payments made or promised by the Debtors or by persons issuing securities or acquiring property under the Joint Stock Plan or by any other person for services or for costs and expenses in, or in connection with, the Joint Stock Plan and incident to the case, have been fully disclosed to the court and are reasonable or, if to be fixed after confirmation of the Joint Stock Plan, will be subject to the approval of the Court;

9. The identity, qualifications, and affiliates of the persons who are to be directors or officers or voting trustees, if any, of a Debtor, or a successor to the Debtor under the Joint Stock Plan, after confirmation of the Joint Stock Plan, have been fully disclosed, and the appointment of such persons to such offices, or their continuance therein, is equitable and consistent with the interests of the creditors and equity security holders and with public policy and their names are as nominated by management, William M.R. Maple, James Milligan and Samuel Iapalucci, and as nominated by the Banks, in Class 2.AI.2, John R. Isaac, Jr., L. Gerald Tarantino, and as nominated by the Unsecured Creditors, Roderick M. Hills and R. Guy Boyle;

10. The identity of any insider that will be employed or retained by the debtor, and his compensation, have been fully disclosed except that the compensation by distribution of shares as disclosed in the Disclosure Statement is not allowed;

11. Confirmation of the Joint Stock Plan is not likely to be followed by the liquidation or the need for further financial reorganization, of any of the debtors or any successor to any of the debtors under the Joint Stock Plan;

12. The debtors have filed their Schedule of Rejected Executory Contracts and their Schedule of Assumed Contracts pursuant to Article IX, Section 9.01 of the Joint Stock Plan;

13. The Joint Stock Plan incorporates the settlement, compromise, and dismissal with prejudice of all claims in the action pending in this court at Adversary Proceeding 88–186 against Mellon Bank, N.A. and other secured lenders to Allegheny. The

settlement, compromise, and dismissal with prejudice of Adversary Proceeding No. 88–186 (the "Bank Dismissal") is conditioned upon the Joint Stock Plan and the Joint Stock Plan is conditioned upon the settlement, compromise and dismissal of Adversary Proceeding No. 88–186. If the Joint Stock Plan is withdrawn for Allegheny, then the Bank Dismissal shall become null and void and this order shall not prejudice the rights of any person with respect to the Adversary Proceeding. The court finds that the proposed settlement and compromise is in the best interests of the estate and that the terms thereof fall within the reasonable range of litigation possibilities. Accordingly, the settlement, compromise and dismissal with prejudice of the Adversary Proceeding is approved and that the provisions of Exhibit D are hereby adopted for that purpose;

14. The court has carefully reviewed the joint application of the Official Committee of Unsecured Creditors of Sunbeam Corporation ("Sunbeam"), Almet/Lawnlite, Sunbeam Holdings Corporation, and Chemetron Corporation; The Prudential Insurance Company of America, and the Debtors in support of the Structured Settlement of claims of certain creditors of Sunbeam classified as Class 5.SB.7, as well as the record and memoranda of law submitted at Adversary Proceeding No. 88–395 (the "Prudential Adversary") and court adopts as its finding the data in Exhibit B and the court finds that the Structured Settlement is in the best interest of the Debtors' estates and falls within the range of reasonableness. Accordingly, the court hereby approves the Structured Settlement;

15. The provisions of Exhibits A, B, C and D attached to Joint Stock Plan as shown in the Disclosure are specifically adopted and incorporated here as part of findings related to the Order of Confirmation;

IT IS ORDERED THAT:

1. The Joint Stock Plan, filed at docket no. 6530 on February 2, 1990, as amended by Debtors' Modifications to Joint Stock Plan of Reorganization Dated December 29, 1989 as Amended, Filed February 2, 1990, filed at docket no. 7871 on July 5, 1990, which is incorporated by reference, is confirmed;

2. The debtors are discharged effective on the effective date from any claim and any "debt" (as that term is defined in Code Section 101(11) that arose before the confirmation date, except for claims or debts which are reinstated by the express provisions of the Joint Stock Plan), and the Debtors' liabilities in respect thereof are extinguished completely, whether reduced to judgment or not, liquidated or unliquidated, contingent or noncontingent, asserted or unasserted, fixed or not, matured or unmatured, disputed or undisputed, legal or equitable, known or unknown, that arose from any agreement of any of the debtors entered into or obligation of any of the Debtors incurred before the confirmation date, or from any conduct of any of the debtors prior to the confirmation date, or that otherwise arose before the confirmation date, including, without limitation, all interest, if any, on any such debts, whether such interest accrued before or after the date of commencement of the relevant reorganization case, and including, without limitation, all debts based upon or arising out of any liability of a kind specified in Code Section 502(g), 502(h) and 502(i), whether or not a proof of claim is filed or deemed filed under Code Section 501, such claim is allowed under Code Section 502, or the holder of such claim has accepted the Joint Stock Plan, and (b) each of the debtor's liabilities for such claims and debts are limited to the amounts such Debtor is paying or causing to be paid pursuant to the Joint Stock Plan and pursuant to promissory notes and accompanying contracts with respect to holders of allowed secured claims;

3. The Joint Stock Plan does not provide for the liquidation of all or substantially all of the property of any of the Debtors;

4. The provisions of the Joint Stock Plan and this Confirmation Order are nonseverable and mutually dependent;

5. All executory contracts (including, without limitation, product, patent, trademark, and know-how licenses) and unex-

pired leases assumed by any of the Debtors during the reorganization cases or under the Joint Stock Plan shall be assigned and transferred to, and remain in full force and effect for the benefit of, the respective reorganized company notwithstanding any provision in such contracts or leases (including those described in Code Sections 365(b)(2) and (f)) that prohibits such assignment or transfer or that enables or requires termination of such contract or leases;

6. This court, notwithstanding entry of this Confirmation Order, shall retain jurisdiction to (a) hear any action initiated by the reorganized companies seeking to avoid or attack, as fraudulent or preferential transfers, under Code Sections 544, 547, 548 or 550, prepetition transfers or conveyances of the Debtors' assets and (b) any claim for postpetition interest as specified in a timely filed postpetition interest declaration and (c) as provided in Section 10.03 of the Joint Stock Plan;

7. Except as otherwise expressly provided in the Joint Stock Plan, on the effective date each reorganized company will be vested with all of the property of its estate free and clear of all claims, liens, encumbrances, charges and other interests of creditors and equity security holders, and may operate its businesses free and clear of any restrictions imposed by the Code or by the court; provided, however, that each debtor shall continue as a debtor-in-possession under the code until the effective date, and, thereafter, each debtor may operate its businesses free of any restrictions imposed by the Code or by the court;

8. No Claims for postpetition interest may be heard by the court unless such postpetition interest claims are specified in a timely filed postpetition interest declaration. The Debtor is to provide a proper notice to such creditors as provided in section 7.05 of the Plan.

9. No extraordinary compensation or reimbursement of expenses will be awarded to any person required to file a binding compensation estimate (i) who does not file a timely binding compensation estimate, or (ii) in excess of the amount set forth in a timely binding compensation estimate as provided in 7.07 of the plan;

10. All common stock to be issued pursuant to the Joint Stock Plan shall be validly issued, fully paid and nonassessable. By reason of Section 1145 of the Code, the Convertible Asset Sale Certificates, the Warrants to be issued under the Joint Stock Plan and the common stock issuable upon exercise of the Warrant and the Convertible Asset Sale Certificates shall be exempt from registration under Section 5 of the Securities Act of 1933, as amended, and any state or local law requiring registration for offer or sale of a security;

11. The action pending at Adversary No. 88–186 as provided in Section 5.04(a) of the Joint Stock Plan shall be dismissed on the effective date, with prejudice, and such settlement and dismissal is reasonable and in good faith and is hereby approved;

12. All claims by any party that were or could have been asserted in the motion of the Official Committee of Unsecured Creditors of Allegheny International, Inc. for substantive consolidation (Motion No. 88–5652M) including the objection raised by Chemetron at Motion No. 90–3260M, among Allegheny, Sunbeam and any other Debtor reorganized pursuant to the Joint Stock Plan are dismissed with prejudice effective on the effective date;

13. Except as otherwise provided in this order, on the effective date this order acts as a full and complete release and discharge by the Debtors and by any and all third parties including, without limitation, creditors, shareholders, or any other party in interest, of the indenture trustees and the members and ex officio members of the official committees appointed in this case, their respective representatives, agents, employees, and counsel from any further obligation and from any and all manner of action and actions, causes of action, claims, obligations, suits, debts, sums of money, accounts, reckonings, covenants, contracts, controversies, agreements, promises, damages, judgments, and demands whatsoever, whether in law or in equity, which the Debtor or any such third parties had, may in the future have, or now has, whether

known or unknown, contingent or absolute arising from any actions taken or not taken in such capacity as an indenture trustee or as a member of one of the official committees, including any negligent action or inaction, provided that nothing in this order shall be deemed a release of any claims against those insurance companies which held claims in Class 4.AI.2 relating to breach of their fiduciary duties. The court adopts Exhibit C Release for this purpose;

14. No later than the effective date, the Banks and Allegheny are directed and instructed to take any and all actions which may be necessary or appropriate to consummate the Bank Dismissal approved hereby and to implement said Bank Dismissal, including but not limited to the execution of the Release, a copy of which is attached to the Joint Stock Plan as Exhibit C;

15. The court retains jurisdiction to enforce the provisions of this order and the Bank Dismissal approved herein except as provided in Exhibit C;

16. All persons (including those persons holding Senior Indebtedness as that term is defined in the Public Subordinated Debt Trust Indentures) are permanently enjoined from enforcing or seeking to enforce any claimed contractual subordination rights with respect to distributions to the holders of the Public Subordinated Debt and to the Indenture Trustee;

17. The Structured Settlement of claims of certain creditors of Sunbeam, classified as Class 5.SB.7, is hereby approved;

18. In response to the litigation at Adversary Proceeding 90–260 and the findings of fact and conclusion of law made in the memorandum above and pursuant to authority granted in 11 U.S.C. § 105, all shares to be distributed to Japonica or their affiliates shall be held in trust by the Debtors for three years and shall *not* be entitled to vote on any matter while in trust or owned by Japonica during those three years; however, Japonica may enjoy the other benefit of ownership such as dividends and proceeds from sales;

If within forty-five days or less from the date of this order (*i.e.* on or before August 27, 1990) Japonica agrees to the provisions and establishes the ability to respond to the shareholders' "puts" at $7 per share and $1.53 per warrant, then the Debtors and Japonica, upon motion to this court, shall promptly facilitate the purchase transactions and orderly change in control of the Reorganized Debtor. If Japonica does not so establish its agreement and ability within 45 days, the trust of Japonica shares shall continue for three years. During that time, the shares owned by Japonica are not entitled to vote while owned by Japonica or parties with which Japonica is affiliated. Japonica may choose to continue to own the shares or set in motion, with the cooperation of the Debtor or the Reorganized Debtor and the consent of this court, an orderly sale of such shares to third parties who shall be required to consent to the control provisions and the Order of Confirmation. Upon such sale, these shares shall be entitled to vote.

19. Because the Japonica shares shall not be entitled to vote and because Japonica owns or controls 45 to 50% of the total shares and further because of the undisclosed involvement of insiders, innocent or otherwise, with the Banks, Donaldson, Lufkin & Jenrette ("DLJ") and its affiliates; the control provisions of the charter of the Reorganized Debtor are reduced to 15% of the total shares for so long as Japonica owns any shares or for at least three years whichever is longer. This 15% provision shall apply to all shareholders including employees or insiders who are promised shares but have not received them.

20. Pursuant to 11 U.S.C. § 105, the contracts between DLJ and their affiliates and the Banks for when-issued shares are avoided and of no effect;

21. Any change in control (15% or more) for at least three years shall also trigger a put provision as to the warrants for a value of at least $1.53 per warrant.

22. The contractual provisions for payment to James D. Milligan of those shares which were to be paid to him on a time vesting basis over three years in exchange for him waiving his rights to his annual

salary are not approved. The Debtors have withdrawn these provisions. The Debtors intend to recommend to the Board of Directors of the Reorganized Company that all shares to be paid to Milligan be paid on the basis of performance. The new agreement is to be submitted by the outside Directors of the Reorganized Company. These changed provisions are to be submitted to creditors on Service List 6; objections may then be raised and a hearing conducted.

23. All duplicative objections to confirmation which have been raised which are similar to those issues discussed in the memorandum are decided similarly and denied;

24. The objections raised by Finalco Inc., First National Bank of Chicago, and Sovran Bank are considered matters to be first decided in procedures for objection to claims. The Debtors are to schedule hearings promptly. The substance of these disputes are not decided here except to determine that they do not constitute an objection to confirmation at this time;

25. By approving the Joint Stock Plan, holders of Class 7.AI.1 (Allegheny Subordinated Debenture Claims) accept the resolution of the dispute over original issue discount set forth in Section 7.17 of the Joint Stock Plan. Such section provides that this court's Memorandum Opinion and Order of Court of May 18, 1989 (the "OID order"), at docket No. 4658, which has been appealed to the United States District Court for the Western District of Pennsylvania (the "appeal"), shall become a final order. All parties to the appeal are directed to withdraw their respective appeals to permit the OID order to become a final order.

26. All remaining objections are denied.

All parties are granted five days, until July 17, 1990, to raise matters which have been inadvertently omitted or not properly addressed in the order, for which a hearing is set on July 19, 1990 at 9:30 A.M. in Room 1603 Federal Building, Pittsburgh, PA 15222.

All parties are granted until July 23, 1990 to raise motions to reconsider substantive matters for which a hearing is set for July 26, 1990 at 9:30 A.M. in Room 1603 Federal Building, Pittsburgh, PA 15222.

ON MOTION FOR RECONSIDERATION

The matters presently before the court are the motions for reconsideration filed by the debtor,[1] the secured bank lenders (the "banks"), Fidata Trust Company New York ("Fidata"), the Official Committee of Equity Security Holders of Allegheny International, Inc. (the "Equity Committee"), and Cowen & Co. ("Cowen"). The movants seek reconsideration of this court's Memorandum Opinion and Order of Court of July 12, 1990 (the "Memorandum Opinion and Order"). In addition, the court will address certain matters which the debtor, the Equity Committee, and the banks previously raised as technical matters, but which the court considered in the nature of motions for reconsideration. For the reasons set forth below, the debtor's motion is granted; the banks' motion is granted in part and denied in part. The motions of Fidata and the Equity Committee are denied. Cowen's motion is denied as untimely.

I. *The Debtor's Motion*

The debtor requests that paragraph 22 of the confirmation order, which deals with the time vesting of shares to be paid to the management of the reorganized debtor, be clarified to indicate that it applies only to James D. Milligan, the chief executive officer designate of the reorganized debtor. In drafting the confirmation order, the court intended to apply those provisions only to the top executives, rather than to all employees across-the-board. Therefore, paragraph 22 is modified, as requested by the debtor.

In a previous filing, the debtor requested that paragraph 24 be modified to delete references to the Jasper County Board of Supervisors ("Jasper County") and the Sec-

1. In this opinion, the court refers to Allegheny International, Inc., Sunbeam Corporation, Sunbeam Holdings, Inc., Almet/Lawnlite, Inc., Chemetron Corporation, and ten of the fourteen subsidiaries that filed for chapter 11 relief on May 3, 1988 collectively as the debtor.

retary of the Department of Revenue and Taxation of the State of Louisiana (the "Secretary"). Paragraph 24 deals with miscellaneous objections to confirmation which the court construed as matters related to the allowance of claims. In its objection, Jasper contends that an unexpired lease from Jasper to Sunbeam may not be assumed by the plan of reorganization, because the lease was automatically rejected pursuant to 11 U.S.C. § 365(d)(4). However, the court extended the time to assume or reject unexpired leases until confirmation of the plan of reorganization. Therefore, the complaint of Jasper was not related to allowance of a claim and should be deleted from paragraph 24.

The objections of the Secretary relate to the interest rate and frequency of deferred payments under the plan. Thus, the Secretary's objections are not related to a claim and should be deleted from paragraph 24. Moreover, the applicable provisions of the plan of reorganization do not violate 11 U.S.C. § 1129(a)(9)(C).

II. *Fidata's Motion*

Fidata seeks reconsideration of the court's ruling on section 7.16 of the plan, which Fidata refers to as the "clawback" provision. Section 7.16 provides that if any class of equity security holders does not accept the plan, than the warrants due to that class—and any junior class—revert to Class 7.AI.1, the subordinated debt. The court struck such provision as discriminatory, and held that Class 8.AI.2 and Class 9.AI.1, the classes affected by section 7.16, should receive the distribution contemplated by the plan of reorganization.

Fidata complains that section 7.16 was a carefully negotiated and drafted attempt to provide value to equity holders to induce them to vote for the plan, thereby avoiding cramdown and the attendant valuation process. Because Class 8.AI.2 did not vote for the plan, valuation and cramdown occurred. The manner in which the court approved the cramdown denied Fidata the benefit of its bargain. Fidata contends that section 7.16 is not prohibited by the Bankruptcy Code and does not constitute "unfair discrimination," as that term is used in 11 U.S.C. § 1129.

This is a unique problem. It is clear to the court that under the absolute priority rule, there is insufficient value to provide a distribution to all classes of equity holders. However, as the court discussed at length in the Memorandum Opinion, the equity holders were also offered these same warrants for settling, inter alia, the litigation against the banks (Adversary No. 88-186). The valuation which the court accepted, as well as the valuation urged by the Equity Committee, did not separately consider the value of the bank settlement, even though the plan of reorganization proposes and requires the settlement of that action. Moreover, one of the reasons the equity classes were offered warrants was to reduce all litigation. If the court views the distribution of warrants as the result of the bank settlement, the warrants given to the equity security holders were not "taken away" from Class 7.AI.1, the subordinated debt holders. Moreover, if the settlement of the action against the banks is not consummated, the reorganization cannot be consummated. Such a result would be deleterious to all classes, including Class 7.AI.1.

In retrospect, rather than hold that section 7.16 was "discriminatory," the court could have used different terminology. Nevertheless, section 7.16 remains unacceptable to the court for the reasons stated above.

III. *The Banks' Motion*

In response to the banks' adversary proceeding against Japonica Partners, L.P. ("Japonica"), the court imposed a trust on the stock to be received by Japonica under the plan of reorganization. The Memorandum Opinion did not specifically provide for the treatment of any cash distributions to Japonica for its bank claims. The banks request that any cash distributed to Japonica under the plan also be held in trust to ensure that the banks can enforce potential judgments against Japonica. The banks also suggest that the Memorandum Opinion and Order are unclear as to whether

another control purchaser would have to purchase Japonica's shares and whether other stock holders can sell blocks of shares. The banks also complain that the Order grants warrant holders the right to receive $1.53 per share in a control transaction, irrespective of the amount paid for the common stock of the reorganized debtor in such a transaction.

As stated in the Memorandum Opinion and Order, the court used its injunctive power in as limited a manner as was appropriate, and did not intend to deprive Japonica of all of the benefits of its various bargains. Therefore, Japonica may put its shares in the event of a control transaction by another entity. However, because of this court's clear statement that the best chance to maximize recovery for all creditors and present equity holders lies in a turnaround by the debtor, which is estimated to take three years, control transactions are especially discouraged for three years. Creditors should not be deprived of the benefit of a turnaround. Any control transaction must strictly comply with the control transaction provisions set forth in the certificate of reorganization of the reorganized debtor, as modified by the Memorandum Opinion and Order of Court. With respect to the banks' concern about distribution of cash to Japonica, the court modifies the Memorandum Opinion and Order to hold that Japonica shall not receive any distribution of cash during the pendency of an appeal by Japonica. With respect to the banks' complaint that the Memorandum Opinion and Order imposes a minimum purchase price for the warrants, but not for the shares, the court does not see the need to similarly protect shareholders since they will elect directors to the board of the reorganized debtor.

Of a technical nature, the banks suggest that paragraph 13 of the Order of Court, which provides, inter alia, for a release of claims against members of the official committees, be modified to exclude from the release possible breaches of fiduciary duties by certain former holders of claims in Class 4.AI.2 who sold their claims to Japonica. The banks also suggest that paragraph 9, which names the directors of the reorganized debtor, be modified because it fails to designate the class of directors for each of the directors nominated by the banks. The banks desire to indicate that one of their nominees, L. Gerald Tarantino, be placed into the third class of directors. Both of the modifications mentioned in this paragraph are approved. However, the events related to the sale of claims by members of the Official Committee of Unsecured Creditors of Allegheny International, Inc. (the "Creditors' Committee") are not covered by paragraph 13. The court does not decide whether those events are, or are not, breaches of fiduciary duties.

IV. *The Equity Committee's Motion*

The Equity Committee continues to challenge the methods and results of the valuation of the debtor by the debtor's financial advisor, Smith Barney, Harris, Upham & Co ("Smith Barney"). The Equity Committee, inter alia, suggests that the court erred by failing to include the $170 million in excess working capital of the debtor in determining valuation. With respect to this objection, the court notes that such excess working capital was included in Smith Barney's valuation. With respect to the Equity Committees's other objections concerning valuation, the court affirms its decision, as set forth in the Memorandum Opinion. The court notes again that although Charles River Associates ("CRA"), the Equity Committee's financial advisor, properly used the debtor's projections, it did not consider the inherent business risk of achieving those projections. In comparing companies which had emerged from chapter 11 to the debtor, CRA did not use the projections of those companies. Rather, CRA used actual performance versus stock price. In the instant case, CRA is treating the debtor's projections as *having been realized!* CRA did not adjust their factor to account for such risk.

The Equity Committee also argues that the court erred by holding that 11 U.S.C. § 1126(e) does not empower the court to designate the votes of innocent creditors and interest holders. Section 1126(e) provides that "the court *may* designate" the

votes "of any entity ... whose acceptance was not solicited or procured in good faith...." (emphasis added). Even if the court adopts the interpretation of section 1126(e) urged by the Equity Committee, the court will not designate the votes in favor of the debtor's plan of reorganization. Although the court was critical of the attempted transaction between Donaldson Lufkin & Jenrette Securities Corp. ("DLJ") and the banks, there was insufficient evidence of bad faith by the debtor or James D. Milligan. Even though the court criticized the attempted transaction between DLJ and the banks as "inept and ill-timed," and imposed appropriate sanctions, the court did not make a finding of bad faith. Rather, the court found clear and convincing evidence that the banks would have voted for the debtor's plan even without the opportunity to sell their when-issued shares. The Creditors' Committee had also indicated its continuing support of the debtor's plan, notwithstanding the matters of which the Equity Committee complains. Therefore, the court affirms its decision not to exercise its discretion to designate the votes in favor of the debtor's plan.

V. *Cowen's Motion*

The Memorandum Opinion and Order of Court set July 23, 1990 as the deadline for moving for reconsideration. Cowen attempted to serve its motion by telecopier on that date. Cowen was under the mistaken belief that filing by telecopier was permissible in the instant case. It is not. Therefore, Cowen did not file a timely motion. Cowen has moved for leave to file its motion for reconsideration nunc pro tunc, but the circumstances related by Cowen do not constitute excusable neglect. Therefore, Cowen's motion for leave to file its motion nunc pro tunc is denied. Cowen's motion for reconsideration is denied as untimely. However, the court does not believe that Cowen has been prejudiced, since the substantive matters underlying its motion will be heard in connection with post-petition interest applications.

In re JEANNETTE CORPORATION, t/a Jeannette Glass, Debtor.

JEANNETTE CORPORATION, t/a Jeannette Glass, Objector,

v.

Ronald L. GILARDI, Attorney for Multiple Claimants, Barry R. Johnson, Charles Ventura, Donna Lavella, William Lukasiewicz, Phyllis Taylor, Lorraine M. Lukasiewicz, Catherine Loughner, Erma R. Butler, Ella Piovesan, Theresa Vagasky, Charles Kovach, James Bassinger, Mary A. Loughner, Denis M. Sillett, Marcy Ann Zlotkowski, Sabina Zlotkowski, Thelma Wise, Betty Stephens, Barry Madorma, Judy Klimek, Doreen Brooks, Regis Bodnar, James P. Bartley, Lizabeth A. Bartley, Carol Sawhill, Joan C. Bogart, Bernard Kammerdiener, Ronald Uveges, Joseph Hiznaneck, Cheryl Blackburn, Jason C. Myers, Dan F. Dean, Dora M. Bricker, Anne Dumnich, Russel J. Smith, Eleanora J. Chicotella, Christine C. Uhall, Patricia A. Peters, Martin L. Harbaugh, Marvis B. Cindrick, Linda N. Burtner, Edward Brinker, Kathy L. Zgonc, Irene H. Johnson, Dennis Bollinger, Nicholas J. Zellem, Russell W. Wallis, Darla K. Maruscak, Cheryl L. Woods, Dolores L. Clair, Jane L. Gsell, Thelma J. Kurz, Cheryl L. Walters, Margie Budesky, Domenick D. Tedeski, Paula Knouse, Scarlett Francis, Harry E. Fontana, Patricia A. Schutter, Ruth M. Kifer, Barbara A. Dietrich, Thomas G. Ventura, Andrew M. Tlumac, Nancy B. Doran, Aretha J. Wessel and Judy M. Llewellyn, Claimants.

Bankruptcy No. 82-3265.

Claim Nos. 68, 91-106, 113-126, 136, 142, 167-170, 208-212, 238, 239, 352, 353, 355, 391-393, 397-401, 414, 416, 463, 518-522, 525, 526, 553 and 554.

United States Bankruptcy Court,
W.D. Pennsylvania.

Aug. 17, 1990.

Former employees, who were terminated within 90 days of debtor employer's

jection constituted a breach that ended the contracts' application to sales of natural gas between the parties. Consequently, the jurisdiction of FERC to regulate these sales ended then. Because a substantial and material consideration of the Natural Gas Act, the Natural Gas Policy Act, and the Decontrol Act is not required to resolve the case, Section 157(d) does not provide for mandatory withdrawal. The Withdrawal Motion will therefore be denied.

An order will be entered in accordance with this Memorandum Opinion.

In re ALLEGHENY INTERNATIONAL, INC., Sunbeam Corporation, Sunbeam Holdings, Inc., Almet/Lawnlite, Inc., and Chemetron Corporation, et al., Debtors.

Bankruptcy No. 88–448 JLC.
Motion Nos. 91–1473M, 91–1574M, 91–1522M, 91–1523M, 91–1530M, 91–1531M, 91–2534M and 91–2898M.

United States Bankruptcy Court, W.D. Pennsylvania.

March 21, 1991.

On Motion to Alter or Amend, and Other Matters Aug. 16, 1991.

Counsel for Chapter 11 debtor filed petition for final compensation and requested bonus, and reorganized debtor objected. The Bankruptcy Court, Joseph L. Cosetti, J., held that: (1) provision of confirmed Chapter 11 plan did not permit counsel to be paid by debtor at higher contractual rate agreed to by debtor without court approval, and; on motion to alter or amend, the Court further held that: (2) professional fees obtained in mergers and acquisition and hostile takeover activities are not comparable market rate for professional fees in Chapter 11 case; (3) counsel was not entitled to bonus compensation; and (4) counsel for debtor and creditor, which obtained control of debtor, would be sanctioned $10,000 and $5,000, respectively, for failing to obtain approval of professional fees prior to payment of fees.

So ordered.

1. Bankruptcy ⚷3200

Provision of confirmed Chapter 11 plan indicating that debtor's counsel would be paid at higher of contractual rates agreed to by debtor or rates as court may allow did not permit counsel to be paid by debtor at higher contractual rate agreed to by debtor without court approval, and in violation of court's actual orders; in order to remedy mistake in paying such higher amount, counsel would be required to turn over to clerk of bankruptcy court over $500,000 and recalculate its fee petitions. Bankr.Code, 11 U.S.C.A. § 1129(a)(4).

2. Bankruptcy ⚷3560

Requirement for confirmation of Chapter 11 plan that any payment by defendant or debtor for services or costs in connection with case be approved by, or subject to approval of, court, as reasonable, also applies to reorganized debtor. Bankr.Code, 11 U.S.C.A. § 1129(a)(4).

3. Bankruptcy ⚷3560

Professional costs and expenses incurred by creditor beginning when it filed its plan of reorganization and continuing throughout consummation of Chapter 11 debtor's plan and activities relating to closing case were subject to Bankruptcy Code provision permitting confirmation of plan only if payments for services or costs in connection with case have been approved or are subject to approval of court as reasonable. Bankr.Code, 11 U.S.C.A. § 1129(a)(4).

On Motion to Alter or Amend

4. Bankruptcy ⚷3200

Counsel for Chapter 11 debtor was not entitled to have increased its rates set in prior bankruptcy court orders based on discovery that creditor, which hired profes-

sionals initially as creditor for purpose of taking control of debtor and which had been reimbursed by reorganized debtor, had voluntarily paid higher rates to its professionals; counsel had, without court order or approval, been paid fees at contract rates above court approved hourly rates. Bankr.Code, 11 U.S.C.A. § 1129(a)(4).

5. Bankruptcy ⇨3160, 3192

Professional fees obtained in mergers and acquisition and hostile takeover activities are not comparable market rate for professional fees in Chapter 11 case, in light of important differences; investment bankers and attorneys in merger and acquisitions are free to negotiate for themselves with their principals the amount they will be paid, Chapter 11 proceedings are by definition judicial proceeding with purpose of maximizing results for all creditors, and professionals are fiduciaries in bankruptcy process. Bankr.Code, 11 U.S.C.A. § 1129(a)(4).

6. Bankruptcy ⇨3155

In bankruptcy process professionals are fiduciaries, not only to parties they represent but also to court; professionals must be capable of proving that all actions taken are ethical and accomplished in good faith.

7. Bankruptcy ⇨3204

Reorganized Chapter 11 debtor's agreement in settlement not to object to any fee application applied only to those fees which were approved or allowed by court, and did not prohibit it from objecting to attorney fees at contractual rates exceeding rates approved by court. Bankr. Code, 11 U.S.C.A. § 1129(a)(4).

8. Bankruptcy ⇨3160, 3200

Bankruptcy court is not bound by any agreement concerning fees by professionals or any other interested party. Bankr. Code, 11 U.S.C.A. § 1129(a)(4).

9. Bankruptcy ⇨3200

Counsel for Chapter 11 debtor would be required to return to reorganized debtor all amounts which were paid to counsel in excess of court approved rates, totaling $1,111,151.17.

10. Bankruptcy ⇨3197

Although counsel for Chapter 11 debtor provided services of high quality and achieved quite good results considering litigiousness of case, results were not rare or exceptional so as to entitle counsel to requested $2,700,000.00 bonus compensation.

11. Bankruptcy ⇨3197

Bonus awards are allowable only in rare and exceptional cases.

12. Bankruptcy ⇨3160, 3197

Bankruptcy court should not grant bonus compensation to professional who violates bankruptcy court's specific orders regarding professional fees.

13. Bankruptcy ⇨3172, 3200

Creditor, which hired professionals to aid it in its ultimately successful attempt to gain control of Chapter 11 debtor, was not entitled to compensation from reorganized debtor for such work performed by professionals prior to consummation without application to and approval by court, and thus, counsel would be required to return money received from debtor; creditor received reorganized debtor's approval of fees immediately upon consummation of reorganization plan and was paid without court approval. Bankr.Code, 11 U.S.C.A. § 1129(a)(4).

14. Bankruptcy ⇨2187

Counsel for Chapter 11 debtor and for creditor, which obtained control of debtor, would be sanctioned $10,000 and $5,000, respectively, to be paid to Clerk of Bankruptcy Court within 20 days, for failing to obtain approval of professional fees prior to payment of fees. Bankr.Code, 11 U.S.C.A. § 1129(a)(4).

Lewis Davis, M. Bruce McCollough, George L. Cass, Buchanan Ingersoll, P.C., Pittsburgh, Pa., for debtors.

Cynthia Baker, Fried, Frank, Harris, Schriver & Jacobson, New York City, for Japonica/Sunbeam-Oster.

Michael Lederman, Sunbeam–Oster Co., Inc., Joseph A. Katarincic, Katarincic & Salmon, Dennis J. Lewis, Cohen & Grigsby, Pittsburgh, Pa., for Sunbeam–Oster.

Douglas A. Campbell, Campbell & Levine, Pittsburgh, Pa., for Sunbeam Unsecured.

Andrew J. Levander, Shereff, Friedman, Hoffman & Goodman, David M. LeMay, Hughes, Hubbard & Reed, New York City, for Japonica.

Robert G. Sable, Sable, Makoroff, Sherman & Gusky, Pittsburgh, Pa., for AI Unsecured Creditors.

Larry D. Henin, Olwine, Connelly, Chase, O'Donnell & Weyher, New York City, for AI Equity Committee.

MEMORANDUM OPINION

JOSEPH L. COSETTI, Bankruptcy Judge.

The matters presently before this Court are the fee petitions for final compensation of Buchanan Ingersoll, P.C., including the request for $2,700,000.00 in bonus compensation and the objections raised by the Reorganized Debtor.

Buchanan Ingersoll (hereinafter "BI") was hired by the Debtor and began work on the above-captioned case in February 1988. The initial review of all the fee petitions, including BI's fee petitions for the period from February 1988 to April 1989, resulted in a Memorandum Opinion and Order of Court dated December 14, 1989. The December 14, 1989 Opinion considered hourly rates extensively for this case. The Court limited BI's requested hourly rates and the hourly rates of other professionals. BI was ordered to recalculate its fee petitions and certify to the Court that the recalculation was consistent with the Memorandum Opinion. BI recalculated and certified the appropriate amount of money consistent with the Memorandum Opinion and the Court ordered such amounts to be paid.

Confirmation of the Debtor's Plan of Reorganization initially occurred on July 12, 1990. After certain parties appealed the confirmation, settlement negotiations initiated an amendment of the Plan which was finally confirmed on August 3, 1990.

On September 11, 1990, this Court again reviewed the fee petitions of all professionals including BI's fee petitions from the approximate period of May 1989 to April 1990. For the year commencing January 1, 1990 the Court allowed a 5% increase in all hourly rates as allowed in the December 14, 1989 Memorandum Opinion and Order of Court. Again, all professionals were ordered to recalculate the amounts pursuant to the December 14, 1989 Memorandum Opinion and Order of Court, as further modified by the Memorandum Opinion and Order of Court dated September 11, 1990. In September 1990, Samuel H. Iapalucci, certified that BI's fees and expenses were recalculated "in accordance with this Court's Order of September 11, 1990 as to hours and disbursements, *and with the terms of the Debtors' confirmed Plan as to applicable rates.*"

On August 7, 1990, BI requested of the Debtor, Allegheny International, the balance of fees due for the period of February 1988 through April 1989. This amount appears to represent the difference between the court-approved hourly rates and the hourly rates originally requested by BI. On August 8, 1990, the Debtors paid to BI the sum of $586,758.48. This payment was made without notice or approval of this Court.

On February 7, 1991, this Court reviewed the fee petitions of BI from May 1990 to September 1990 and ordered BI to recalculate those fee petitions "subject to the modifications in the Memorandum Opinion and Order of Court dated December 14, 1989, as further modified by the Memorandum Opinion and Order of Court dated September 11, 1990...." The Certification which was filed for the fee petitions from May 1990 to September 1990 states that the recalculation of fees was "computed in accordance with this Court's Order of February 7, 1991 as to hours and disbursements, *and with the terms of the Debtors confirmed Plan as applicable rates.*"

[1] BI argues that Section 4.02 of the Plan provides for BI to be paid their contractual rates. Implied in this argument is an override of this Court's findings as to hourly rates to be charged for this case. Section 4.02 of the states:

> Administrative Claims for fees and expenses of professionals retained by the Debtors, pursuant to Section 327 of the Code, shall be compensated at the higher of the contractual rates agreed to by the Debtors or such rates as the Court may allow.

BI argues that it had an agreement with the Debtor to be paid at the higher of the contractual rate agreed to by the Debtor or such rate as the Court may allow. This agreement about hourly rates was not presented to the Court nor is it alleged that such an agreement had been approved by this Court.

It is clear to the Court that this interpretation of Section 4.02 of the Plan must fail. No provision of a plan of reorganization can violate the clear statutory language of 11 U.S.C. Section 1129(a)(4). Bankruptcy Code section 1129(a)(4) specifically prevents the Court from approving a plan of reorganization unless all costs and expenses in connection with the case are subject to approval by the Court as being reasonable. The reason Congress has required this approval by the Court is to insure reasonableness, maximize the results for creditors and to prevent administrative creditors, who are granted priority, from overreaching.

Section 4.02 of the Debtor's Plan of Reorganization *cannot* negate either this Court's actual orders or a specific requirement of confirmation. This Court specifically ordered BI to recalculate its fee petitions in accordance with the December 14, 1989 Memorandum Opinion and Order of Court, as modified by the Memorandum Opinion and Order of Court dated September 11, 1990. The Order did not state that BI was to recalculate its fee petitions in accordance with the Debtor's Plan of Reorganization. The Court was not aware of the changed language used in the certifications submitted by BI.

Clearly the Debtor's payment to BI over the court-approved amount was not approved by this court and as carried out was not subject to court approval. If in fact there was an agreement between BI and the Debtor or the Reorganized Debtor, the Court did not approve such agreement, as it was required to do by the Bankruptcy Code. If the intention of the parties in drafting the language of Section 4.02 of the Plan of Reorganization was to avoid specific court orders to the contrary or to avoid review by the Court, then this Court should not have confirmed the Plan.

We need not revoke confirmation to correct this problem. However, in order to remedy this mistake, BI is to turn over the sum of $586,824.48 to the Clerk of the Bankruptcy Court. In addition, BI is to recalculate its fee petitions for the time period of *May 1989 through December 1990.* These recalculations are to include a summary sheet listing the hours for each attorney, his or her hourly rate, the fees charged for that attorney, and the amount allowed for each attorney by this Court's December 14, 1989 and September 11, 1990 Memorandum Opinions.

The Reorganized Debtor has alleged that BI has charged the Debtor's estate $35.00 per hour for "Project Assistants" and that these "Project Assistants" are in fact secretaries. If so, those requested expenses were disallowed in the December 14, 1989 Memorandum Opinion.

After recalculating the time period of *May 1989 through April 1990* BI is to turn over to the Clerk of the Bankruptcy Court all sums which were disallowed by this Court and were paid by the Debtor through the mistaken recalculation. These sums of money will be held by the Clerk of the Court until such time as the Court can determine the proper disposition of the funds.

The issue of whether BI is entitled to 2.7 million dollars in bonus compensation and what additional monies are to be paid on fee applications from May 1990 through December 1990 will be addressed when BI has filed the necessary corrections and re-

calculations as provided in this Memorandum Opinion.

[2, 3] This action has caused the Court to study 11 U.S.C. Section 1129(a)(4) and we conclude that the Reorganized Debtor is also subject to these same provisions of 11 U.S.C. Section 1129(a)(4). The language of that Bankruptcy Code section provides:

> (a) The court shall confirm a plan only if all of the following requirements are met:
>
> (4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.

We interpret this provision to include professional costs and expenses incurred by Japonica beginning January 24, 1990, when it filed its Plan of Reorganization and continuing throughout the consummation of the Debtor's Plan and current activities related to closing the case. Therefore, the Court orders the Reorganized Debtor to account for any and all payments made to professionals in connection with this case which the Court has not approved as reasonable. The Reorganized Debtor may exclude professionals which were hired in the ordinary course and which the Court specifically allowed to be paid without filing a fee application. However, this Order specifically does include, but is not limited to, professionals such as Fried, Frank, Harris, Schriver & Jacobson; Katarincic & Salmon; Shereff, Friedman, Hoffman & Goodman; Hughes, Hubbard & Reed and various investment bankers, etc....

Further, Mr. Samuel H. Iapalucci shall explain to the Court his failure to comply with the Orders of this Court under pain of contempt.

The integrity of this Court's Orders are at stake in this matter and the Court is offended by these actions. The United States Trustee is invited to participate in these matters.

ON MOTION TO ALTER OR AMEND, AND OTHER MATTERS

The matters presently before this Court are the Motion of the United States Trustee to disgorge fees and impose sanctions upon Buchanan Ingersoll, P.C.; the fee petitions for final compensation of Buchanan Ingersoll, P.C., including the request for $2,700,000.00 in bonus compensation; the objections raised by the Reorganized Debtor in regards to the bonus compensation; and Buchanan Ingersoll's Motion to Alter, Amend and Modify Judgment and to Reconsider the Memorandum Opinion and Order of March 21, 1991 as well as underlying interim orders of December 14, 1989, September 11, 1990 and March 28, 1991.

I. Facts.

The Court does not commence this analysis on a clean slate. This case commenced in February 1988 and numerous matters have been adjudicated since that time. The initial review of all the fee petitions, including BI's fee petitions for the period from February 1988 to April 1989, resulted in a Memorandum Opinion and Order of Court dated December 14, 1989. The December 14, 1989 Opinion included an in camera review of AI's previous payments to BI for the year prior to the filing of the bankruptcy petition. The hourly rates which the Court allowed BI and others were substantially similar to the rates AI had previously paid prior to bankruptcy. This Court stated in the December 14, 1989 Memorandum Opinion that counsel "should expect to receive similar rates from a bankruptcy estate."

The Court's practice after reviewing fees was to order all professionals to recalculate their fee petitions and certify to the Court that the recalculation was consistent with the Memorandum Opinion. BI recalculated and certified the appropriate amount of money consistent with the Memorandum Opinion and the Court ordered such amounts to be paid.

Confirmation of the Debtor's Plan of Reorganization occurred on July 12, 1990. The litigation related to confirmation was

extensive. Various parties appealed, or threatened to appeal, the confirmation. Settlement negotiations sponsored by Japonica Partners were initiated and an amendment (or settlement) of the Plan was finally confirmed on August 3, 1990.

On September 11, 1990, this Court again reviewed the fee petitions of all professionals including BI's fee petitions from the approximate period of May 1989 to April 1990. For the year commencing January 1, 1990 the Court allowed a 5% increase in all hourly rates as allowed in the December 14, 1989 Memorandum Opinion and Order of Court. Again, professionals were ordered to recalculate the amounts pursuant to the December 14, 1989 Memorandum Opinion and Order of Court, as further modified by the Memorandum Opinion and Order of Court dated September 11, 1990. In September 1990, Samuel H. Iapalucci, certified that BI's fees and expenses were recalculated "in accordance with this Court's Order of September 11, 1990 as to hours and disbursements, *and with the terms of the Debtors' confirmed Plan as to applicable rates.*" The Reorganized Debtor has objected to this change.

On August 7, 1990, without Court order or approval, BI requested of the Debtor, Allegheny International, the balance of fees due for the period of February 1988 through April 1989. This amount appears to represent the difference between the court-approved hourly rates and the hourly rates originally requested by BI. On August 8, 1990, the Debtors paid to BI the sum of $586,758.48. This payment was made without notice to any party involved in the case. Court approval was not sought for this payment.

On February 7, 1991, this Court reviewed the fee petitions of BI from May 1990 to September 1990 and ordered BI to recalculate those fee petitions "subject to the modifications in the Memorandum Opinion and Order of Court dated December 14, 1989, as further modified by the Memorandum Opinion and Order of Court dated September 11, 1990...." The Certification which was filed for the fee petitions from May 1990 to September 1990 states that the recalculation of fees was "computed in accordance with this Court's Order of February 7, 1991 as to hours and disbursements, *and with the terms of the Debtors confirmed Plan as applicable rates.*"

BI argues that Section 4.02 of the Plan provides for BI to be paid their contractual rates. Implied in this argument is the concept that a Confirmed Plan can override this Court's findings as to hourly rates to be charged for this case and the resulting order. Section 4.02 of the states:

> Administrative Claims for fees and expenses of professionals retained by the Debtors, pursuant to Section 327 of the Code, shall be compensated at the higher of the contractual rates agreed to by the Debtors or such rates as the Court may allow.

BI argues that it had an agreement with the Debtor to be paid at the higher of its contractual rate agreed to by the Debtor or such rate as the Court may allow. This alleged agreement was based on an alleged oral agreement.

This Court became aware of these events during a final fee hearing which was held on March 18, 1991. In response to this new information, this Court issued the March 21, 1991 Memorandum Opinion and Order of Court which instructed BI to turn over the August 8, 1990 payment to the Clerk of the Bankruptcy Court and to recalculate various fee applications which had been overpaid in the amount of $684,421.23. The Court has allowed additional time for the turnover of the payment until all matters involving BI's fees have been resolved by this Court.

In response to the March 21, 1991 Memorandum Opinion, the United States Trustee filed a Motion to Disgorge Fees and Impose Sanctions upon Buchanan Ingersoll for its violation of court orders.

II. Buchanan Ingersoll's Motion to Alter, Amend and Modify Judgment.

[4] BI responded to the previous opinion by filing a Motion to Alter, Amend and Modify Judgment and to Reconsider the Memorandum Opinion and Order of March 21, 1991 as well as underlying Interim Or-

ders of December 14, 1989, September 11, 1990 and March 28, 1991.

The rates the Court found to be the costs of comparable services in non bankruptcy situations in Western Pennsylvania may not be the rates which are prevalent in other metropolitan areas or which may have become comparable nationally in large Chapter 11 cases. For example, through the proceedings the Court has learned that Japonica voluntarily paid higher rates to its professionals than this Court authorized for other professionals paid by the estate. Japonica hired these professionals initially as a creditor. Albeit for the purpose of taking control of the Debtor and for which it has been reimbursed by the Reorganized Debtor.

Buchanan Ingersoll now argues that all of the previous opinions should be reconsidered because of these new facts namely that Japonica voluntarily paid its attorney's higher rates and that these rates reflect the market rates. If BI had raised the evidence of Japonica's higher rates before it exercised self help, such evidence and argument would have had some merit. The Court is not suggesting that such evidence would establish the comparable rates. Actually the information was learned on the Court's own motion and was not raised until the Reorganized Debtor objected to BI's self help methods. BI's argument loses its power coming after the fact.

[5] The Court observes that it is the hourly rates for professional fees associated with merger and acquisition and hostile takeover activities that are now being urged upon Bankruptcy Courts as the comparable market rate for professional fees in Chapter 11. The Court believes there are important differences between the two processes and that the professional fees obtained in mergers and acquisition and hostile takeover activities are not comparable for Chapter 11 cases.

The fees received by investment bankers and attorneys representing parties in merger and acquisition are frequently contingent upon the success of the acquisition. The investment bankers and attorneys in mergers and acquisitions are free to negotiate for themselves with their principals the amounts they will be paid. Their selection and participation in the engagement is not predicated upon their objectivity.

Chapter 11 proceedings are by definition judicial proceedings. The purpose of a Chapter 11 proceeding is to maximize the results for all creditors. Merger and acquisition proceedings are not judicial proceedings. Their purpose is to maximize the result for the movant. At best, the standard of ethics involved in the mergers and acquisitions process is the standard of the market place. However, that is not the standard expected of fiduciaries in the judicial process.

[6] In the case of *Pepper v. Litton,* 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939) the Supreme Court stated what the duties of a fiduciary are in a corporate situation. "He who in such a fiduciary position cannot serve himself first and his cestui second. He cannot manipulate the affairs of his corporation to their detriment and in disregard of the standards of common decency and honesty." *Id.* 60 S.Ct. at 247. The Supreme Court has also held that a trustee breached his fiduciary duties when he invested estate funds in an effort to create profit for himself. *Magruder v. Drury,* 235 U.S. 106, 35 S.Ct. 77, 59 L.Ed. 151 (1914). This Court has previously stated:

> A fiduciary's dealings with those it represents are subject to rigorous scrutiny. Where any of its transactions are challenged, the burden is on the fiduciary not only to prove the good faith of the challenged transaction but also to show its inherent fairness from the viewpoint of those that the fiduciary represents. [citation omitted].

In re Mesta Mach. Co., 67 B.R. 151 (Bkrtcy.W.D.Pa.1986). In the bankruptcy process the professionals are fiduciaries, not only to the parties they represent but also to the court. The professionals must be capable of proving that all actions taken are ethical and accomplished in good faith. Justice Cardozo stated that:

> [m]any forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden by those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. * * * Only thus has the level of conduct for fiduciaries been kept a level higher than that trodden by the crowd.

Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545, 546 (1928).

In the mergers and acquisition/hostile takeover process, the payment of professionals is often contingent upon the success or result of the process. Payment in these situations is not necessarily related to professional competence or the services rendered but to brute financial power and the victory and, more importantly, the control which such power achieves. The new power base provides a ready source of payment for the fees. I believe the large fees associated with such activities may tend to cloud the judgment of such professionals. This Court would not find such activity fiduciary in nature. At best, it is the standard of the market place.

This situation should not become the standard in Chapter 11 proceedings. In Chapter 11, professionals are provided by statute with a administrative priority. This priority provides a distinct advantage over creditors. In return, Chapter 11 professionals are required to be objective in their dealings with all parties. The promise or agreement of a large fee would give the professional a private interest in the outcome of the case. Such agreement would prevent the a court from allowing that professional to participate in the process.

The Allegheny International case is frequently discussed on the lecture circuit as an example of a hostile takeover through the buying of claims and unfortunately as an example of what the future holds for Chapter 11. Earlier in this case the Debtors also proposed a plan and introduced investment bankers who attempted their own merger and acquisition strategy. In both the Debtor's and Japonica's merger and acquisition attempts, the Court observed that the ethics of the market place began to creep into the Chapter 11 process. This Court is compelled to maintain the fiduciary standards of a Chapter 11 proceeding. In keeping with those standards, professionals in a Chapter 11 are to be paid only in accordance with the Bankruptcy Code. 11 U.S.C. § 1129(a)(4).

Perhaps the hostility and free wheeling atmosphere which developed during the claims dispute or hostile takeover provided BI with reason to expect that Japonica would dispute its fees and delay payment. This fear may or may not have been justified. Evidently, BI believed it was compelled to negotiate with Japonica over its fees. BI believes that it had negotiated with the Debtor to receive the higher rates. Nevertheless, BI's self help cannot be permitted.

The Bankruptcy Code, specifically 11 U.S.C. Section 1129(a)(4), clearly requires that all fees be reasonable and that the Court make such a determination a condition of confirmation of the plan. The law is abundantly clear as to the Court's authority and duty to review fees. *See In re McDonald Bros. Const., Inc.,* 114 B.R. 989 (Bankr.N.D.Ill.1990) and *In re Chapel Gate Apartments, Ltd.,* 64 B.R. 569 (Bankr. N.D.Tex.1986). Nothing that has been submitted in the numerous briefs or in the arguments which cause the Court to change it's interpretation of Section 1129(a)(4).

BI maintains that the Court's lodestar amount was error and therefore all previous opinions should be reconsidered. BI argues that the proper lodestar is the applicant's normal billing rates. This Court follows the Supreme Court's definition of lodestar: "the number of hours reasonably expended on the litigation times a *reasonable hourly rate.*" *Blum v. Stenson,* 465

U.S. 886, 888, 104 S.Ct. 1541, 1544, 79 L.Ed.2d 891 (1984) (emphasis added). In setting the rates the Court attempted to allow amounts similar to the rates the Debtor had previously paid to BI. The previous Memorandum Opinions and Orders of Court dated December 14, 1989, September 11, 1990, March 28, 1991, and March 21, 1991 are reaffirmed and now made final by this Memorandum Opinion and Orders of Court.

The Court does agree that until this final fee order is entered, the previous orders were interim orders and were not easily appealable. The entry of this Court's final fee orders provides an opportunity for such an appeal.

[7, 8] BI also argues that the Reorganized Debtor agreed in the settlement not to object to any fee applications. The Reorganized Debtor contends that this agreement not to object to fees only applied to those fees which were approved or allowed by this Court. The settlement clearly states that the Reorganized Debtor would not object to court approved or allowed fees. In any event, the Court cannot and is not bound by any agreement concerning fees by professionals or any other interested party.

III. Buchanan Ingersoll's Fee Application For May to September 1990.

[9] BI has submitted a fee application for the months of May 1990 to September 1990. BI requests $1,248,553.00 in compensation and $115,341.92 in expenses. The Reorganized Debtor has recalculated the compensation request in accordance with the December 14, 1989 and September 11, 1990 Memorandum Opinions and Orders of Court. The Court allowed amount from May 1990 to September 1990 for compensation is $981,440.84 and for expenses is $115,341.92.

The Reorganized Debtor maintains that 75% of the requested fees and expenses were paid to BI for the period of May 1990 to September 1990. Therefore, BI is entitled to a credit in the amount of $160,094.54.

However, BI must return to the Reorganized Debtor all amounts which were paid to BI in excess of the Court approved rates. The amount is as follows:

2/88–4/89	$586,824.48
5/89–4/90	$684,421.23
5/90–9/90	(160,094.54)
Overpayment	$1,111,151.17

Buchanan Ingersoll is to pay this amount of overpayment to the Reorganized Debtor within twenty (20) days of this Memorandum Opinion and Order of Court. In addition, an appropriate member of the firm shall properly certify that this action has in fact taken place.

By letter, the Court requested that the Reorganized Debtor confirm the amounts of overpayment. In response, the Reorganized Debtor has alleged that BI is still holding an additional $500,000.00 which represents the retainer wired to it on February 18, 1988. This allegation was not included in previous pleadings, therefore, the record is not sufficient in the present action for the Court to make a determination with regards to this retainer.

IV. Buchanan Ingersoll's Request For Bonus Compensation.

[10, 11] BI has requested $2,700,000.00 in bonus compensation. Bonus awards are only allowable in rare and exceptional cases. *In re Penn–Dixie Industries, Inc.*, 18 B.R. 834, 835 (S.D.N.Y.1982). BI provided services of high quality and the results achieved in this case were quite good considering the litigiousness of the case but the results were not rare or exceptional.

[12] Additionally, the Court should not grant bonus compensation to a professional who violated this Court's specific Orders regarding fees. The self help initiated by BI is cause enough to deny any bonus compensation.

V. Japonica's Fees.

[13] Upon the Court's own motion, and in accordance with the March 21, 1991 Memorandum Opinion and Order of Court, we find that Japonica must also observe 11 U.S.C. Section 1129(a)(4). Initially, Japoni-

ca hired its professionals as a creditor and privately agreed to compensate those professionals for the work they accomplished. The Court is not required to approve the retention or review the fee applications of a creditor's professionals.

However, Section 1129(a)(4) does apply to the payments which Japonica requested and received from the Reorganized Debtor in order to reimburse themselves for their expenses and professional fees. Japonica has not requested approval of these payments. Again, Japonica asks this Court to apply the standard of the market place. Although the rules of the market place may again apply post-bankruptcy, Japonica cannot receive its expenses for work performed prior to the consummation without an application and approval from the Court. Japonica received the Reorganized Debtor's approval of these fees immediately upon consummation of the Plan of Reorganization. The timing of this act and the type of expenses and services paid removes it from a post-bankruptcy activity. Court approval was not requested.

The Reorganized Debtor suggests that it is pointless to require Japonica to return the money because the Reorganized Debtor can accomplish the same act through a dividend. Perhaps this is so, however, all shareholders would be entitled to such a dividend. There are a few minority shareholders who would entitled to that dividend. There are also corporate requirements and tax implications which would result from a declaration of such a dividend. The Court is not approving nor denying the issuance of such a dividend, however the payment to Japonica which attempted to reimburse it for its expenses is not permitted under 11 U.S.C. Section 1129(a)(4).

Japonica argues further that the independent directors made the determination to reimburse Japonica. However, the fact that this approval occurred on the very day of consummation when the Reorganized Debtor had no corporate history clearly shows that this was a payment made for services and costs to reimburse Japonica and its professionals in connection with the case without court approval. "Independent" directors of a reorganized debtor have no authority to violate 11 U.S.C. Section 1129(a)(4).

Additionally and as a minimum, disclosure of Japonica's intent to do this act should have been made at the time of the requested amendment of the July 12, 1990 Confirmation Order. Even so, disclosure would not preclude this Court from determining the reasonableness of the Japonica fee request. Japonica is to return all the money it received for its reimbursement of professional fees and its related investment banking fees to the Reorganized Debtor.

VI. The United States Trustee's Motion For Sanctions.

[14] The United States Trustee has been faithful to the role Congress anticipated when it created the office and should be commended.

The posture of the case makes meaningful sanctions difficult. The Court has given the appropriate sanctions a great deal of thought. In a Chapter 7 proceeding, a second distribution to creditors in order of priority would have been an appropriate sanction. Such a sanction would have benefitted creditors for whom both Japonica and BI were acting as fiduciaries.

Under the confirmed plan, creditors bargained for $7.00 per share and allowed creditors have received that bargain. Perhaps if creditors had the additional information they might have bargained for more. However, further distribution of these recovered fees would raise several problems in a consummated Chapter 11 case.

Therefore, as a remedy for the self help action taken by Buchanan Ingersoll and the violation of specific orders of this Court, a sanction of $10,000.00 is ordered to be paid by Buchanan Ingersoll to the Clerk of the United States Bankruptcy Court for the Western District of Pennsylvania within twenty (20) days of this Memorandum Opinion and Order of Court.

Japonica is also sanctioned and ordered to pay $5,000.00 to the Clerk of the United

States Bankruptcy Court for the Western District of Pennsylvania within twenty (20) days of this Memorandum Opinion and Order of Court for failure to request approval of the of the fees paid by the Reorganized Debtor in accordance with 11 U.S.C. Section 1129(a)(4).

In re Michael J. STEFANO and Jacque A. Stefano, Debtors.

GNC COMMUNITY FEDERAL CREDIT UNION, Movant,

v.

Michael J. STEFANO and Jacque A. Stefano, Respondents.

Bankruptcy No. 90-3600PGH.
Motion No. 91-1805.

United States Bankruptcy Court,
W.D. Pennsylvania.

Dec. 20, 1991.

Mortgagee filed motion for relief from the automatic stay in Chapter 7 case. The Bankruptcy Court, Warren W. Bentz, J., held that: (1) debtors were not bound by statement of intention indicating that they would reaffirm the mortgage debt; (2) debtors could remain in possession of the mortgaged premises and continue to make payments in accordance with the original mortgage without reaffirmation or redemption; and (3) "due on bankruptcy" clause in mortgage was unenforceable.

Motion denied.

1. Bankruptcy ⚷3415

Reaffirmation agreement is negotiated and fully voluntary agreement by both debtor and creditor; therefore, court cannot compel parties to enter into reaffirmation agreement. Bankr.Code, 11 U.S.C.A. §§ 521, 524(c).

2. Bankruptcy ⚷3415

Chapter 7 debtors were not bound by statement of intention which indicated that they would reaffirm mortgage debt and could not be compelled to execute reaffirmation agreement. Bankr.Code, 11 U.S.C.A. §§ 521, 524(c).

3. Bankruptcy ⚷3415

Chapter 7 debtors options with regard to mortgaged property were not limited to surrendering the property, redeeming the property, and reaffirming the mortgage debt; rather, debtors could remain in possession of the premises and continue to make payments in accordance with the original mortgage without reaffirmation or redemption. Bankr.Code, 11 U.S.C.A. § 521.

4. Bankruptcy ⚷3109

"Due on bankruptcy" clause in mortgage was unenforceable.

James C. Warmbrodt, Pittsburgh, Pa., for debtors.

Robert J. Colaizzi, Pittsburgh, Pa., for GNC Community Federal Credit Union.

OPINION [1]

WARREN W. BENTZ, Bankruptcy Judge.

Background

This matter is before the Court on GNC Community Federal Credit Union's ("GNC") Motion for Relief from the Automatic Stay ("Motion").

GNC asserts that 1) Michael J. Stefano and Jacque A. Stefano (the "Debtors") have no equity in their residence, the property which secures GNC's debt; 2) the Debtors have failed to remit regular monthly payments; 3) the Debtors have failed to adequately protect GNC's interest by either reaffirming the debt, surrendering the collateral or redeeming the collateral; and 4) the filing of a petition in bank-

1. This Opinion constitutes this Court's findings of fact and conclusions of law.

view district court orders denying qualified immunity motions pending further discovery. *See Maxey by Maxey v. Fulton,* 890 F.2d 279 (10th Cir.1989); *Boulos v. Wilson,* 834 F.2d 504 (5th Cir.1987). However, they have done so in specialized circumstances: where the defendant's immunity claim turns at least partially on a factual question, the district court is unable to rule on the immunity defense without further clarification of the facts, and the discovery order is narrowly tailored to uncover only those facts needed to rule on the immunity issue. *See Maxey,* 890 F.2d at 282–83; *Boulos,* 834 F.2d at 507. These decisions still support the proposition that where further factfinding is unnecessary to decide defendants' legal arguments, defendants should not be put to the expense of discovery. *See Maxey,* 890 F.2d at 282; *Boulos,* 834 F.2d at 507.

In this case, the district court did not postpone its decision on defendants' legal arguments in order to permit limited discovery related solely to the immunity issue. Such a course would have been inappropriate since plaintiffs' claims do not turn on factual questions and further discovery was not required in order to evaluate defendants' arguments under the first prong of the qualified immunity doctrine.

Instead, the district court reviewed defendants' arguments and expressly rejected them on the basis that plaintiffs "might" be able to establish that they have a constitutionally protected right regarding their relationship with Elizabeth. This legal conclusion was wrong. Moreover, it is reviewable as an interlocutory order because it conclusively determines the disputed question of whether the individual defendants violated plaintiffs' clearly established rights. In refusing to review these legal conclusions by dismissing the appeal, the majority deprives defendants who have not violated clearly established rights of their right to have the case immediately dismissed.

I would therefore hold that we have jurisdiction to review the court's decision, regardless of its inclusion of the "without prejudice" language, and would reverse. The opportunity for defendants to renew their legal arguments *after* broad based discovery still denies them the full protection they are rightfully due under the qualified immunity doctrine.

I respectfully dissent.

In re BUSY BEAVER BUILDING CENTERS, INC.

Kirkpatrick & Lockhart, Appellant.*

No. 92–3566.

United States Court of Appeals,
Third Circuit.

Submitted Under Third Circuit
L.A.R. 34.1(a)
May 13, 1993.

Decided March 11, 1994.

Counsel of Chapter 11 debtor sought reconsideration of denial of portions of its fee application. The Bankruptcy Court, Judith K. Fitzgerald, J., 133 B.R. 753, determined that clerical services were not compensable and directed counsel to file amended petition excluding charges for such services. The United States District Court for the Western District of Pennsylvania Donald E. Ziegler, C.J., affirmed, and counsel appealed. The Court of Appeals, Becker, Circuit Judge, held that: (1) Bankruptcy Court has power and duty to sua sponte review fee applications; (2) if Bankruptcy Court plans to disallow certain items of compensation, "good faith applicant" has right to hearing; and (3) Bankruptcy Code permits compensation for relatively low level paralegal services if and only if analogous nonbankruptcy clients agree to pay for the same, and then only at that rate.

Vacated and remanded with directions.

* Per Fed.R.App.P. 12(a).

1. Bankruptcy ⚖3168, 3204

Bankruptcy court has power and duty to review fee applications, notwithstanding absence of objection by United States Trustee, creditors, or other interested party. Bankr. Code, 11 U.S.C.A. §§ 105(a), 330(a); Fed. Rules Bankr.Proc.Rule 2017(b), 11 U.S.C.A.; 28 U.S.C.A. § 586(a)(3)(A).

2. Bankruptcy ⚖3008.1

It is not United States Trustee's (UST) responsibility to review all fee applications, since Congress plainly only delegated to the UST the discretion to review fee applications. 28 U.S.C.A. § 586(a)(3).

3. Bankruptcy ⚖3193

In setting attorney fees, bankruptcy court or district court are not intended to become enmeshed in meticulous analysis of every detailed facet of professional representation; inquiry into adequacy of fee should not assume massive proportions so as to perhaps even dwarf case in chief. Bankr. Code, 11 U.S.C.A. § 330(a).

4. Bankruptcy ⚖3167, 3203(1)

It is not befitting stature of federal bankruptcy judge to spend wasteful hours pouring over fee applications to tabulate and cross reference unorganized billing statements.

5. Bankruptcy ⚖3203(1)

Specificity requirement of local bankruptcy rule for the Western District of Pennsylvania does not require fee applicants to substantiate fact that work performed by paralegals necessitated exercise of independent professional judgment; however, such information is pertinent to court's evaluation of rate of compensation paralegal has earned, and thus information should be included in fee application. Bankr.Code, 11 U.S.C.A. § 330(a); Fed.Rules Bankr.Proc.Rule 2016(a), 11 U.S.C.A.; U.S.Bankr.Ct.Rules W.D.Pa., Rule 9016.1.

6. Bankruptcy ⚖3166.1, 3202.1

If bankruptcy court plans to disallow certain items of compensation for professionals, Bankruptcy Code section on compensation of professionals on its face first contemplates applicant's right to hearing. Bankr. Code, 11 U.S.C.A. §§ 329(b), 330(a); Fed. Rules Bankr.Proc.Rule 2017(b), 11 U.S.C.A.

7. Bankruptcy ⚖3166.1, 3202.1

If court disallows fees of "good faith applicant," defined as fee applicant who in good faith attempts to comply with applicable rules governing format and substance of fee applications, Bankruptcy Code, and perhaps even dictates of due process, mandate that bankruptcy court allow fee applicant opportunity, should it be requested, to present evidence or argument that fee application meets prerequisites for compensation; canons of fairness militate against forfeiture of requested fee simply because court's audit of application uncovers some ambiguity or objection. Bankr.Code, 11 U.S.C.A. §§ 329(b), 330(a); Fed.Rules Bankr.Proc.Rule 2017(b), 11 U.S.C.A.; U.S.C.A. Const.Amend. 5.

See publication Words and Phrases for other judicial constructions and definitions.

8. Bankruptcy ⚖3168, 3204

To make hearing meaningful prior to disallowance of portion of fee request, bankruptcy court should first apprise applicant of particular questions and objections it harbors, a role which adversary in statutory fee case would typically play. Bankr.Code, 11 U.S.C.A. §§ 329(b), 330(a); Fed.Rules Bankr.Proc.Rule 2017(b), 11 U.S.C.A.

9. Bankruptcy ⚖3167, 3202.1

If after initial review bankruptcy court determines that information provided by good faith fee applicant does not allow for reliable determination of compensability, it may allow professional reasonable time to supplement with either more detailed description of questionable services, or with memorandum of points and authorities in support of application; if bankruptcy court at any time denies some amount of requested compensation, and if it determines applicant sought in good faith to comply with specificity requirements, it should notify applicant of its particular reasons for denying fees and, upon timely request allow applicant the occasion to defend fee application with legal arguments or evidence at hearing. Bankr.Code,

11 U.S.C.A. §§ 329(b), 330(a); Fed.Rules Bankr.Proc.Rule 2017(b), 11 U.S.C.A.

10. Bankruptcy ⚬=3169, 3205

Bankruptcy court, when confronted with undisputed, credible, contrary evidence of marketing practices in record, may not rely solely on its own judgment to designate services as either clerical or paraprofessional and to allow or disallow compensation for those services on basis of such designation alone. Bankr.Code, 11 U.S.C.A. § 330.

11. Bankruptcy ⚬=3170, 3204

Principal purpose of amendments to Bankruptcy Code section on compensation of professionals was to compensate bankruptcy attorneys at same level as nonbankruptcy attorneys, and clearest path to that goal is to rely on the market, subject to modification that court will, in practical terms, act as surrogate for estate, reviewing fee applications as sophisticated nonbankruptcy client would review legal bills. Bankr.Code, 11 U.S.C.A. § 330.

12. Bankruptcy ⚬=3187(4)

Type of service performed by paralegal, including whether it is clerical, affects rate of compensation, and not compensability vel non. Bankr.Code, 11 U.S.C.A. § 330(a)(1).

13. Bankruptcy ⚬=3160, 3193

Although each factor enumerated by statute retains independent significance in determining fee for professional, cost of comparable services factor has overarching role to act as guide to value of services rendered, given their nature and extent. Bankr.Code, 11 U.S.C.A. § 330(a).

14. Bankruptcy ⚬=3187(4)

Bankruptcy court should review fee applications not for whether each particular service undertaken by paralegal is clerical or professional by nature, but for whether nonbankruptcy attorneys typically charge and collect from their clients for that particular service when performed by member of that profession, and rates charged and collected therefor. Bankr.Code, 11 U.S.C.A. § 330(a).

15. Constitutional Law ⚬=70.3(4)

When in our constitutional republic predominated by legislative branch, a statute is constitutional, courts are not at liberty to substitute their favored policies for those Congress enacts, no matter how unwise the court finds them to be.

16. Bankruptcy ⚬=3159, 3187(2)

Classification of services as clerical or nonclerical does not decide questions of compensability of professional under Bankruptcy Code, as clerical services may be compensated in proper context. Bankr.Code, 11 U.S.C.A. § 330(a).

17. Bankruptcy ⚬=3187(4), 3199

Market-driven approach of Bankruptcy Code section on compensation of professionals permits compensation for relatively low-level paralegal services if and only if analogous nonbankruptcy clients agree to pay for the same, and then only at that rate; question is not what type of services expert believes are properly performed by paraprofessional, but for what type of services nonbankruptcy market recompenses paraprofessional. Bankr.Code, 11 U.S.C.A. § 330.

18. Bankruptcy ⚬=3196, 3199

In keeping with market approach, it is critical that bankruptcy courts allow attorneys the same leeway in types of tasks billed for at their, and their paralegals', established rates as nonbankruptcy clients permit their attorneys and their attorneys' paralegals; bankruptcy judge, typically far removed from economics of law practice and the exigencies of making recurring business judgment about most prudent and cost-effective method for performing given task with adequate assurances of quality in a developing, competitive legal market, is generally not well equipped to review subjectively law firm's allocation of responsibilities and billing practices. Bankr. Code, 11 U.S.C.A. § 330(a).

19. Bankruptcy ⚬=3187(4), 3199

Like any sophisticated consumer of legal services, bankruptcy court should compare cost of equivalent practitioners of art, including billing structures, as well as applicant's billing practices with equivalent clients; which legal or paralegal services are properly

included as overhead of attorney fees, then, are presumably reflected accurately in services for which attorneys charge their nonbankruptcy clients, and market billing practices include not only whether comparable nonbankruptcy firms typically charge particular task to their clients as paralegal services, but market rate at which such services are provided. Bankr.Code, 11 U.S.C.A. § 330(a).

20. Bankruptcy ⚷3193, 3202.1

Bankruptcy judge's experience with fee petitions and his or her expert judgment pertaining to appropriate billing practices, founded on understanding of legal profession, will be starting point for any analysis verifying market rates, if any, for select clerical services; bankruptcy judge should use his or her experience and expertise to locate questionable charges and fees, and, once having questioned charge or fee, may properly require applicant to meet burden to prove that market would recompense applicant for that charge. Bankr.Code, 11 U.S.C.A. § 330(a).

21. Bankruptcy ⚷3205

Once bankruptcy court questions particular fee or charge, bankruptcy court should carefully consider relevant, competent evidence submitted with fee application, provided as supplement to fee application, or presented at hearing, even if evidence directly contradicts bankruptcy court's own judgment; if bankruptcy court discounts any evidence presented by applicant, court should to extent practicable make findings of fact and provide reasoned explanations in record to facilitate review. Bankr.Code, 11 U.S.C.A. § 330(a).

22. Bankruptcy ⚷3203(1)

Upon appointment or selection of debtor's counsel, bankruptcy court, as basis for adjudging reasonableness of charges for services, might request that counsel provide court with confirmed, detailed schedule of fees that counsel actually charges to bankruptcy clients, and, where possible, to nonbankruptcy clients as well, including types of paralegal services for which counsel bills and rates for such services, before counsel commences representing debtor. Bankr.Code, 11 U.S.C.A. § 329(a).

23. Bankruptcy ⚷3187(4), 3199

Even under market-driven framework of analysis for professional fees, some services paralegals perform at some firms may go uncompensated; at least absent justifying circumstances, such as time pressures not brought on by lack of diligence, excusable nonavailability of less experienced employee, or inability to delegate task efficiently, experienced attorney doing clerk's work should be paid clerk's wages. Bankr.Code, 11 U.S.C.A. § 330(a).

24. Bankruptcy ⚷3192, 3199

Because Bankruptcy Code does not entitle debtor's attorneys to higher compensation than that earned by nonbankruptcy attorneys, bankruptcy court should review fee application to ensure that applicant exercises same "billing judgment" as do nonbankruptcy attorneys by, for example, writing off unproductive research time, duplicative services, redundant costs precipitated by overstaffing, or other expenses with regard to which the professional generally assumes the cost as overhead in corresponding nonbankruptcy matters or for which analogous nonbankruptcy clients typically decline to pay. Bankr.Code, 11 U.S.C.A. § 330(a).

25. Bankruptcy ⚷3192

Principle of responsible billing applies not only to selection of which classification of employee within law firm should perform given task, but also to what genre of law firm should represent debtor; run of the mill bankruptcy case does not warrant lofty fees of nationally renowned law firm, and reasonable debtor concerned with economical administration of estate in such case would refrain from retaining overqualified counsel. Bankr.Code, 11 U.S.C.A. § 330(a).

26. Bankruptcy ⚷3196

Reasonable hourly rate of debtor's attorney has cap based on expected and actual complexity of case, a cap which, while flexible, should stave off clear abuses; to be fair to professional, bankruptcy court should dispose of such problems as early as practical, preferably before debtor retains professional. Bankr.Code, 11 U.S.C.A. § 330(a).

27. Bankruptcy ⚷3194

While bankruptcy fees are commonly calculated using lodestar method, Bankruptcy Code section on professional fees does not ossify the lodestar approach as point of departure in fee determination; with rise of competitive pressures and ceaseless evolution of legal community, law practitioners may be expected to adapt to changed circumstances by developing alternative billing practices and methods, and strength of market approach embraced by such section is that such new developments, including regional variations, will automatically percolate up through bankruptcy fee allotments. Bankr.Code, 11 U.S.C.A. § 330.

Joy F. Conti, Paula A. Schmeck, Scott E. Westwood, Kirkpatrick & Lockhart, Pittsburgh, PA, for appellant, Kirkpatrick & Lockhart.

Robert P. Simons, Klett, Lieber, Rooney & Schorling, Pittsburgh, PA, for amici-curiae, Nat. Federation of Paralegal Associations, Inc., et al.

Before: BECKER, HUTCHINSON, and ROTH, Circuit Judges.

OPINION OF THE COURT

BECKER, Circuit Judge.

Appellant Kirkpatrick & Lockhart ("K & L") provided legal services for the debtor Busy Beaver Building Centers, Inc. ("Busy Beaver"), in its Chapter 11 Bankruptcy proceedings, *see* 11 U.S.C.A. §§ 101–1330 (1993), before the United States Bankruptcy Court for the Western District of Pennsylvania. On February 25, 1991, after K & L had submitted one of its interim fee petitions to the bankruptcy court pursuant to § 331 of the Bankruptcy Code ("Code"), the bankruptcy court sua sponte issued an order disallowing certain requested items of compensation for services rendered by K & L paralegals which the court characterized as constituting "purely clerical functions." Upon K & L's motion for reconsideration, the bankruptcy court held an evidentiary hearing to consider testimony regarding the disallowed fees.

In a December 5, 1991 Order accompanying a published memorandum opinion, the court determined that clerical services are not compensable under § 330(a) of the Code, and directed K & L to file an amended fee petition excluding charges or fees for clerical functions or services. *In re Busy Beaver Bldg. Ctrs., Inc.*, 133 B.R. 753, 758 (Bankr. W.D.Pa.1991). The district court affirmed the bankruptcy court's decision, and this uncontested appeal followed.[1] K & L has been litigating the matters raised in this appeal, from the bankruptcy court up through this Court, without compensation from its client Busy Beaver.

K & L's appeal requires us to address two fee-determination questions of considerable importance in the bankruptcy field which no court of appeals has ever decided. First, does a bankruptcy court have the power and obligation to review fee applications which have not been the subject of an objection by a party in interest or the United States trustee? We conclude that it does. Second, what standard should a court employ to determine whether specific paralegal services are compensable? After a thorough examination of the issue, we opt for an objective standard which incorporates the practices in the non-bankruptcy legal market. Accordingly, we will vacate the district court's order and remand for further proceedings.

I. FACTS AND PROCEDURAL HISTORY

A. *The Facts*

Busy Beaver, a regional chain of do-it-yourself home center stores, filed a voluntary Chapter 11 petition for bankruptcy on December 12, 1990.[2] The bankruptcy court authorized K & L to represent Busy Beaver as

1. We attempted to secure the services of a practicing lawyer or law professor to act as *amicus curiae* in support of the position of the bankruptcy court and district court but, despite several months of effort, were unsuccessful.

2. Busy Beaver's reorganization proved successful when on March 31, 1992 the bankruptcy court confirmed its amended plan of reorganization.

its legal counsel. Like most law firms in the modern era of competitive legal markets, K & L strives to increase its efficiency and control its clients' legal costs, and to that end employs paralegals to perform paraprofessional services in connection with its rendition of legal services. As is the case with attorneys' services, K & L charges clients fees for paralegals' services based on each paralegal's individual skill and expertise.

From time to time during the pendency of Busy Beaver's bankruptcy petition, K & L filed with the bankruptcy court applications for interim compensation for services rendered by its professionals and paraprofessionals, and for the actual and necessary expenses it incurred in its representation. *See* 11 U.S.C.A. § 331 (1993). In many bankruptcy proceedings, courts grant such fee applications as a routine matter without the applicant encountering opposition from the court or any party in interest. But this application received considered attention, and on February 25, 1991, the bankruptcy court sua sponte issued an order denying compensation for certain services performed by paraprofessionals because, according to the court, they represented "purely clerical functions which are not compensable and which constitute normal overhead." Order, No. 90–03924 JKF, at 1 (Bankr.W.D.Pa. Feb. 25, 1991). The bankruptcy court declined to recognize as compensable paraprofessional services itemizations for several sorts of activities: filing motions at the bankruptcy court; preparing and organizing motions, pleadings, and documents for hearings; preparing and tabbing binders for hearings; distributing documents and other materials to creditors; and drafting and finalizing transmittal letters. *Id.* at 1–2; *accord* 133 B.R. at 755.

On April 16, 1991, in response to K & L's motion for reconsideration,[3] the bankruptcy court held an evidentiary hearing. A representative of the Office of the United States Trustee appeared at the hearing and subsequently filed a brief in opposition to K & L's motion for reconsideration, and a representative of *amicus curiae* the National Federation of Paralegal Associations, Inc. appeared and subsequently filed a brief in support of K & L's motion for reconsideration. At the hearing K & L proffered an affidavit and adduced testimony from six highly qualified witnesses, some of whom were experts on the subject of paralegals' training and responsibilities and others of whom were senior attorneys responsible for delegating legal assignments.

K & L proffered extensive testimony that paralegals, and not legal secretaries, typically organize and maintain forms, pleadings, and files, maintain calendars and tickler systems, mail and distribute pleadings and other correspondence, and perform the other sorts of activities the bankruptcy court had found non-compensable. The witnesses explained that paralegals are assigned these tasks because they require the exercise of professional judgment. With respect to the calendar and tickler system, for example, a K & L witness testified that a paralegal is expected not only to just know what a date is, but to understand the importance of the date and to follow up to make sure that the attorney gets timely notice of the date's approach and that either the attorney or the paralegal meets the deadline, "so it is a matter of exercising some judgment, not just dropping off a date or a reminder." To take another example, a different expert witness testified that a paralegal is charged with filing a motion because that task "involves making sure that all the proper exhibits and affidavits are there, appropriately [signed, collated, and] marked, that the Court gets the right copies, that all named parties or parties in interest get the appropriate copies, and that filing deadlines are maintained," and that a legal secretary cannot be relied upon to perform the task properly because "you have to have someone who knows what [he or she is] reading and knows the importance of what [he or she is] working on."

The same witness testified that a paralegal would need to exercise professional judgment

3. Indicative of the lack of adversariness in many bankruptcy fee proceedings, counsel for the unsecured creditors' committee joined K & L in seeking reconsideration and requested the bankruptcy court to disburse compensation to K & L for all the paralegal services included in its fee application.

to organize files because organizing a file "doesn't just mean alphabetize, that means put it together in a format that the attorney can use at the time of trial and so that means that the person has to sit down, read the documents and make a judgment as to where it will be most effectively placed, where it goes logically, where it goes legally." She summarized: "The role of the paralegal is to diminish the involvement of the attorney in these more mundane tasks." A senior partner at K & L specifically explained the tasks for which the bankruptcy court had disallowed compensation and described how each involved some exercise of professional judgment. Other testimony focused not just on the rationales for utilizing paralegals, but also on the expanding role paralegals play in the legal profession today.

Taken as a whole, the evidence K & L proffered at the hearing showed that paralegals ordinarily perform services similar to those the bankruptcy court disallowed; that law firms [4] typically bill such services to their non-bankruptcy clients, who typically pay for them; and that if the court were to disallow paralegal assistance on such matters the paralegal profession would suffer a major setback, and attorneys would instead perform those services but at a greater expense to the debtor's estate.

B. *The Bankruptcy Court's Decision*

After the evidentiary hearing, in a memorandum opinion dated December 5, 1991, the bankruptcy court again held clerical services uncompensable under § 330(a) of the Code and instructed K & L to file an amended fee application omitting charges or fees for clerical functions or services. *In re Busy Beaver Bldg. Ctrs.*, 133 B.R. 753, 758 (Bankr.W.D.Pa. 1991). From its postulate that the Code allows paralegals to be compensated only for "tasks which require an exercise of professional judgment," the court reasoned that "clerical or routine services" are not compensable as they "do not usually require [the exercise of professional] judgment." *Id.* at 756.

The evidentiary hearing persuaded the bankruptcy court that many of the disallowed services at issue require the exercise of professional judgment, but it nevertheless refused to grant K & L its requested fees for two reasons. First, the court concluded that K & L had not provided sufficient information in its fee application for the court to reach that conclusion earlier (before the evidentiary hearing). The court explained pointedly that it would require fee applicants to comply with the specificity requirements of Local Bankruptcy Rule of Procedure 9016.1 and that it generally would not hold an evidentiary hearing in the future to permit fee applicants to elucidate the specifics of services rendered. Thus, if the applicant failed its burden of proving compensability in the fee application, compensation would be denied. *Id.* at 757–58. Second, at least with respect to some of the disallowed services, the court reasoned that the evidentiary hearing had focused generally on paralegals' training and duties but had not sufficiently explicated the nature of the particular tasks for which the court had denied compensation. That is, K & L had failed to prove beyond question that each task "required independent [professional] judgment and decision-making," the purported precondition to obtaining compensation for those services. *Id.* at 757–58 & n. 3.

C. *The District Court's Decision*

The district court on K & L's appeal agreed with the bankruptcy court that clerical services are never compensable under § 330 because they are accounted for in the attorneys' hourly rates, even if non-bankruptcy clients compensate law firms for such services. Mem. op. at 5–6. The court emphasized that a professional or paraprofessional may be compensated only for services commensurate with his or her skill, so if either were to perform a task not requiring the exercise of a level of judgment or skill upon which his or her level of compensation is predicated, the court would not award fees for that person's efforts under § 330. Mem. op. at 6–7. It agreed with K & L that Congress intended to allow bankruptcy attor-

4. Throughout this opinion we use the shorthand "firm" to include all attorneys, whether employed in law partnerships, by professional corporations, or as solo practitioners.

neys to charge competitive fees, but worried that the estate would be overcharged if attorneys or paralegals were compensated for services rendered more efficiently (cheaply) by legal secretaries. Mem. op. at 8–9.

The district court did recognize that in some instances the billing of clerical services can be customary—and compensable—if clerical overhead is not also included in the professional's fee, but it did not apply the theory to this case or describe how a court should determine whether or not clerical services are subsumed within overhead. Mem. op. at 7–8. The linchpin of the court's reasoning rested on the putative capacity of a non-bankruptcy client to challenge a legal bill by refusing payment, requesting a modification, or threatening termination of the attorney-client relationship, whereas it believed that the bankruptcy court can review fee applications only for abuses. Mem. op. at 8.

D. *Jurisdiction and Scope of Review*

The bankruptcy court had subject matter jurisdiction pursuant to 28 U.S.C.A. §§ 157, 1334(b) (1993); the district court exercised its discretionary appellate jurisdiction pursuant to 28 U.S.C.A. § 158(a) (1993); and this Court has appellate jurisdiction pursuant to 28 U.S.C.A. § 158(d) (1993). We exercise plenary review over the bankruptcy court's and district court's conclusions of law. *E.g., Sapos v. Provident Inst. of Savings,* 967 F.2d 918, 922 (3d Cir.1992).

II. THE REVIEW OF FEE APPLICATIONS

A. *Does the Bankruptcy Court Have the Power and Duty to Review Fee Applications Sua Sponte?*

[1] Because the bankruptcy court reduced the paralegal fee request sua sponte we must first consider whether it possessed the power to do so. Under § 330(a) of the Code, bankruptcy courts *may* award reasonable compensation for actual, necessary services rendered by the attorney and by paraprofessionals employed by the attorney, the reasonableness to be based on (i) the nature of the services, (ii) the extent of the services, (iii) the value of the services, (iv) the time spent on the services, and (v) the cost of comparable services in non-bankruptcy cases. 11 U.S.C.A. § 330(a) (1993).[5] The district and bankruptcy courts in this circuit have divided over the question whether bankruptcy courts have the authority to review fee applications when no party objects. One group of decisions holds that a bankruptcy court does have the power (or both the power and the duty) to do so, whereas the other group holds that the court has a restricted scope of review or no power to review under those circumstances.[6] No court of appeals

5. Section 330(a) provides in pertinent part:

(a) After notice to any parties in interest and to the United States trustee and a hearing, ... the court may award ... to a professional person employed under section 327 or 1103 of this title, or to the debtor's attorney—

(1) reasonable compensation for actual, necessary services rendered by such ... professional person, or attorney, as the case may be, and by any paraprofessional persons employed by such ... professional person, or attorney, as the case may be, based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title....

11 U.S.C.A. § 330(a) (1993).

6. *Compare In re Gulph Woods Corp.,* 150 B.R. 603, 605–06 & n. 5 (E.D.Pa.1993) (bankruptcy court has the power and the duty to review fee applications independently), *In re Paul,* 141 B.R. 299, 301, 302 (E.D.Pa.1992) (same), *In re Metro Transp. Co.,* 107 B.R. 50, 53 (E.D.Pa.1989) (same), *In re Peter J. Schmitt Co.,* 154 B.R. 632, 634 (Bankr.D.Del.1993) (same), *In re Evans,* 153 B.R. 960, 967–68 (Bankr.E.D.Pa.1993) (same), *In re Rheam of Ind., Inc.,* 137 B.R. 151, 155–59 (Bankr.E.D.Pa.) (*"Rheam IV"*) (same), *vacated,* 142 B.R. 698 (E.D.Pa.1992) (*"Rheam V"*), *In re Leedy Mortg. Co.,* 126 B.R. 907, 915–16 (Bankr. E.D.Pa.1991) (same), *In re Sounds Distrib. Corp.,* 122 B.R. 952, 957 (Bankr.W.D.Pa.1991) (same), *In re Rheam of Ind., Inc.,* 133 B.R. 325, 330–33 (E.D.Pa.1991) (*"Rheam III"*) (bankruptcy court has the power to review fee applications independently), *In re National Paragon Corp.,* 87 B.R. 11, 13 (E.D.Pa.1988) (same), *In re J.A. & L.C. Brown Co.,* 75 B.R. 539, 539–40 (E.D.Pa.1987) (same) *and In re Patronek,* 121 B.R. 728, 729–30 & n. 4 (Bankr.E.D.Pa.1990) (same) *with In re Jensen's Interiors, Inc.,* 132 B.R. 105, 106 (E.D.Pa.1991) (bankruptcy court lacks the authority to reduce attorneys' fees sua sponte), *In re Pendleton,* No. 90-1091, 1990 WL 29645, at *1 (E.D.Pa. Mar. 15, 1990) (same), *In re T & D Tool, Inc.,* 132 B.R. 525, 526, 528 n. 1 (E.D.Pa.1991) (same), *In re Rheam of Ind., Inc.,* 142 B.R. 698, 700 (E.D.Pa.1992) (*"Rheam V"*) (bankruptcy

has yet explicitly decided this important question.

We think the answer is straightforward. Rule 2017(b) expressly spells out the power of the bankruptcy court to review fee applications (with respect to a debtor's attorney) on its own initiative, providing that:

> on the court's own initiative, the court after notice and a hearing may determine whether any payment of money or transfer of property, or any agreement therefor, by the debtor to an attorney after entry of an order for relief in a case under the Code is excessive ... if the payment, transfer, or agreement is for services in any way related to the case.

FED.R.BANKR.P. 2017(b) (West Supp.1993). In our view, this result follows also simply from the wording of § 330(a), which states that "the court *may award*" reasonable compensation—language which imbues the court with discretionary authority. Finally, we read § 105(a) of the Code as providing clear and compelling authority for the bankruptcy court's sua sponte review of fee or expense applications. That section provides in part:

> No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement orders or rules, or to prevent an abuse of process.

11 U.S.C.A. § 105(a) (1993).

Beyond possessing the power, we think the bankruptcy court has a *duty* to review fee applications, notwithstanding the absence of objections by the United States trustee ("UST"), creditors, or any other interested party, a duty which the Code does not expressly lay out but which we believe derives from the court's inherent obligation to monitor the debtor's estate and to serve the public interest. *See* 11 U.S.C.A. § 105(a); *see also In re Martin,* 817 F.2d 175, 180 (1st Cir.1987) (referring to the "bankruptcy court's fundamental responsibility to monitor the integrity of the proceedings before it"); *In re Wonder Corp. of America,* 82 B.R. 186, 191 (D.Conn.1988) (recognizing the "overarching policy of avoiding the waste of the debtor's estate"). Viewed in juxtaposition with its inherent responsibility for its judicial actions, the court's statutory obligation to sign off on fee applications strengthens our conviction. *See In re Metro Transp. Co.,* 107 B.R. 50, 53 (E.D.Pa.1989); *In re Temple Retirement Community, Inc.,* 97 B.R. 333, 337 (Bankr.W.D.Tex.1989) (referring to the bankruptcy court's "duty to preserve the integrity of the court" by "independently determining that court authorization for the fees is warranted" before signing an order awarding fees). This view was eloquently expressed by the bankruptcy court in *In re Evans,* 153 B.R. 960 (Bankr.E.D.Pa.1993):

> [T]he integrity of the bankruptcy system ... is at stake in the issue of a bankruptcy judge's performance of the duty to review fee applications sua sponte. The public expects, and has a right to expect, that an order of a court is a judge's certification that the result is proper and justified under the law.... Nothing better serves to allay [public perceptions that high professional fees unduly drive up bankruptcy costs] than the recognition that a bankruptcy judge, before a fee application is approved, is obliged to [review it carefully] and find it personally acceptable, irrespective of the (always welcomed) observation of the [United States trustee] or other interested parties.

Id. at 968; *accord Rheam IV,* 137 B.R. at 159.

Indeed, section 330 shares with "fund-in-court" cases a salient feature—"the potential for conflicts of interest between the attorneys seeking compensation and their clients"—which imposes upon the bankruptcy court "an independent duty to scrutinize fee applications." *Cunningham v. City of McKeesport,* 753 F.2d 262, 267 (3d Cir.1985), *vacated on other grounds,* 478 U.S. 1015, 106 S.Ct. 3324, 92 L.Ed.2d 731 (1986), *reinstated,* 807 F.2d 49 (3d Cir.1986), *cert. denied,* 481

court's discretion to deny fees is more limited when the application is unopposed) *and In re Delaware River Stevedores, Inc.,* 147 B.R. 864, 868–70 (Bankr.E.D.Pa.1992) (same). *Fleet v. United States Consumer Council,* No. 89–7527, 1990 WL 18926, at *1 (E.D.Pa. Feb. 23, 1990) appears to have been a statutory fee case, see *In re Fleet,* 95 B.R. 319, 336–37 (E.D.Pa.1989).

U.S. 1049, 107 S.Ct. 2179, 95 L.Ed.2d 836 (1987). Bankruptcy cases do not, on the other hand, share a common bond with "statutory fee" cases. In that genre of cases, the adversarial nature of the proceedings, the result of the losing parties' obligation to bear the burden of the fees awarded, guarantees that someone other than the court will closely review the fee request and will bring to the court's attention potential deficiencies, hence ensuring a more precise fee award. *See In re Gulph Woods Corp.*, 150 B.R. 603, 606 (E.D.Pa.1993); *Cunningham*, 753 F.2d at 267 (holding that a district court may not sua sponte reduce attorney fees in a civil rights suit except with respect to matters over which the judge possesses special knowledge); *McDonald v. McCarthy*, 966 F.2d 112, 118–19 (3d Cir.1992) (reaffirming *Cunningham*); *Bell v. United Princeton Properties*, 884 F.2d 713, 719 (3d Cir.1989) (applying *Cunningham* to a settlement agreement in an Employee Retirement Income Security Act of 1974 ("ERISA") suit). We agree with *In re Rheam of Ind., Inc.*, 133 B.R. 325, 331 (E.D.Pa.1991) ("*Rheam III*") that for the various reasons enumerated *infra* at 842–43, "[t]he same is not true in bankruptcy proceedings."

Some courts have reasoned that the UST, not the bankruptcy court, has the duty to review fee applications. Congress has clearly delegated to the UST the discretion to assure that fee awards and expense reimbursements are reasonable, a delegation which may at first blush appear exclusive. *See* 28 U.S.C.A. § 586(a)(3)(A) (1993);[7] *see also* FED.R.BANKR.P. 2017 advisory comm. notes (West Supp.1993) ("It is consistent with [the trustee's supervisory and monitoring] role to expect the United States trustee to ... file motions relating to excessive fees pursuant to § 329 of the Code."); *In re Jensen's Interiors, Inc.*, 132 B.R. 105, 105–06 (E.D.Pa.1991). In practice, however, perhaps because hampered by insufficient resources or distracted by other administrative duties, *see In re Rheam of Ind., Inc.*, 137 B.R. 151, 156 (Bankr.E.D.Pa.1992) ("*Rheam IV*") (quoting *In re Leedy Mortg. Co.*, 126 B.R. 907, 915–16 (Bankr.E.D.Pa.1991)), *vacated*, 142 B.R. 698 (E.D.Pa.1992) ("*Rheam V*"); *Rheam III*, 133 B.R. at 332, the UST reviews fee applications with insufficient uniformity and zeal to allow the bankruptcy court to abstain from its obligation to review fee applications under § 330, *see Rheam IV*, 137 B.R. at 157 n. 3 ("[I]n this jurisdiction, the UST has left the area of review of fee applications almost exclusively to this court.").

[2] It is not the trustee's responsibility to review all fee applications, since Congress plainly only delegated to the trustee the *discretion* to review a fee application. *See* 28 U.S.C.A. § 586(a)(3) (1993). Thus we think that Congress' grant of authority to the UST to challenge fee petitions merely bestows the UST with standing and/or encourages the UST to do so; it in no way signifies by negative implication that the bankruptcy court is without the power and duty to review fee applications independently when the UST does not object. Unless the parties in interest or the bankruptcy courts take on this task, many if not most fee applications would receive no effective review.

Moroever, at least before some benches, objections to fee applications by parties other than the UST are also relatively uncommon. *See, e.g., Rheam IV*, 137 B.R. at 157 n. 3; *In re Nor–Les Sales, Inc.*, 32 B.R. 900, 902 (Bankr.E.D.Mich.1983) ("Seldom are objections lodged to fee requests."), *modified sub nom. Stark & Reagan, P.C. v. Nor–Les Sales*, 53 B.R. 442 (E.D.Mich.1984); *In re Pettibone Corp.*, 74 B.R. 293, 300 (Bankr. N.D.Ill.1987) (same); *In re Jensen–Farley*

7. That section provides in pertinent part:

(a) Each United States trustee, within the region for which such United States trustee is appointed, shall—

. . . . .

(3) supervise the administration of cases and trustees in cases under chapter 7, 11, or 13 of title 11 by, whenever the United States trustee considers it to be appropriate—

(A) monitoring applications for compensation and reimbursement filed under section 330 of title 11 and, whenever the United States trustee deems it to be appropriate, filing with the court comments with respect to any of such applications[.]

. . . . .

28 U.S.C.A. § 586(a) (1993).

Pictures, Inc., 47 B.R. 557, 585 n. 39 (Bankr. D.Utah 1985) (same); American Bankruptcy Institute, *American Bankruptcy Institute National Report on Professional Compensation in Bankruptcy Cases* § 5.1, at 53 (G.D. Warner rep. 1991) [hereinafter "*ABI National Report*"]. The debtor will often not object to its attorney's fee application because the fees will frequently be derived from its creditors' award rather than its own assets, *see In re Temple Retirement Community*, 97 B.R. at 337, or in any case it may be "in no position to make an objective judgment as to the value of the legal services involved, [and it may lack the] inclination to object to whatever fee is requested by the attorney who has made it possible for [it] to continue business," *In re Hamilton Hardware Co.*, 11 B.R. 326, 329–30 (Bankr.E.D.Mich.1981).

Attorneys for the creditors may also be reluctant to oppose fee requests, whether because of perceived professional courtesy, *see In re Hamilton Hardware Co.*, 11 B.R. at 330 n. 1 (observing that continuing associations in the relatively closed Bankruptcy Bar "foster[ ] a club atmosphere which militates against effective client representation in matters relating to compensation"); fear of retaliation, *see In re Jensen–Farley Pictures, Inc.*, 47 B.R. 557, 585 n. 39 (Bankr.D.Utah 1985) ("Objections to fee requests often invite retaliation. . . ."); *ABI National Report, supra*, § 5.2, at 40; *cf. In re Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1255 (5th Cir.1986) (referring to "a conspiracy of silence" with regard to contesting fee applications); the expectation that the expense of challenging fee applications is not cost-justified because of a creditor's modest interest in each dollar the estate saves, *Rheam III*, 133 B.R. at 331–32; and/or the fact that, should it lose, the creditor's reward for fighting that battle may be a smaller distribution due to its indirect obligation to pay a proportionate share of the fee applicant's fees ascribable to the defense of his or her fee request, *see infra* at 847 & n. 17 (discussing split of authority regarding whether time spent pursuing fees is compensable). *See In re Ginji Corp.*, 117 B.R. 983, 989 (Bankr.D.Nev.1990). Consequently, the task of reviewing fee applications falls by default onto the bankruptcy courts.

We are keenly aware that many bankruptcy courts have bemoaned their duty to review fee applications as a thankless, onerous burden, one which consumes a significant share of a bankruptcy judge's time, *see* Gordon Bermant, Patricia A. Lombard & Elizabeth C. Wiggins, *A Day in the Life: The Federal Judicial Center's 1988–89 Bankruptcy Court Time Study*, 65 Am.Bankr.L.J. 491, 513–14 (1991). But in holding that bankruptcy courts have an independent duty to review fee applications even absent objections, we find support in legions of cases decided by bankruptcy and district courts spanning nearly two-thirds of all federal districts [8] as

8. *See, e.g., In re Cascade Oil Co.*, 126 B.R. 99, 106 (D.Kan.1991); *In re NRG Resources, Inc.*, 64 B.R. 643, 650 (W.D.La.1986); *In re Ralph Marcantoni & Sons*, 62 B.R. 245, 247 (D.Md.1986); *Cohen & Thiros, P.C. v. Keen Enters., Inc.*, 44 B.R. 570, 574–75 (N.D.Ind.1984); *In re Colonial Distrib. Co.*, 314 F.Supp. 418, 420 (D.S.C.1970) (pre-amendments); *In re Maruko, Inc.*, 160 B.R. 633, 637 (Bankr.S.D.Cal.1993); *In re Corporacion de Servicios Medico–Hospitalarios de Fajardo, Inc.*, 155 B.R. 1, 1 (Bankr.D.P.R.1993); *In re Peter J. Schmitt Co.*, 154 B.R. 632, 634 (Bankr. D.Del.1993); *In re Evans*, 153 B.R. 960, 967–68 (Bankr.E.D.Pa.1993); *In re Costello*, 150 B.R. 675, 677 (Bankr.E.D.Ky.1992); *In re Bonneville Pac. Corp.*, 147 B.R. 803, 805 (Bankr.D.Utah 1992); *In re East Peoria Hotel Corp.*, 145 B.R. 956, 959 (Bankr.C.D.Ill.1991); *In re Scoggins*, 142 B.R. 940, 943 (Bankr.D.Or.1992); *In re Gillett Holdings, Inc.*, 137 B.R. 475, 480 (Bankr. D.Colo.1992); *In re Wilde Horse Enters., Inc.*, 136 B.R. 830, 839 (Bankr.C.D.Cal.1991); *In re Bank of New England Corp.*, 134 B.R. 450, 453 (Bankr.D.Mass.1991), *aff'd*, 142 B.R. 584 (D.Mass.1992); *In re Bennett*, 133 B.R. 374, 377 (Bankr.N.D.Tex.1991); *In re Viscount Furniture Corp.*, 133 B.R. 360, 362 (Bankr.N.D.Miss.1991); *In re Saturley*, 131 B.R. 509, 516 (Bankr.D.Me. 1991); *In re Gold Seal Prods. Co.*, 128 B.R. 822, 827 & n. 3 (Bankr.N.D.Ala.1991); *In re Sounds Distrib. Corp.*, 122 B.R. 952, 957 (Bankr.W.D.Pa. 1991); *In re Amstar Ambulance Serv., Inc.*, 120 B.R. 391, 394 (Bankr.N.D.W.Va.1990); *In re Zenith Lab., Inc.*, 119 B.R. 51, 54 (Bankr.D.N.J. 1990); *In re Great Sweats, Inc.*, 113 B.R. 240, 242 (Bankr.E.D.Va.1990); *In re Gary Fairbanks, Inc.*, 111 B.R. 809, 811 (Bankr.N.D.Iowa 1990); *In re Oberreich*, 109 B.R. 936, 937 (Bankr. E.D.Wis.1990); *In re Crimson Inv., N.V.*, 109 B.R. 397, 400 (Bankr.D.Ariz.1989); *In re Bilgutay*, 108 B.R. 333, 336 n. 2 (Bankr.M.D.Fla. 1989); *In re Inslaw, Inc.*, 106 B.R. 331, 333–34 (Bankr.D.D.C.1989); *In re Kroh Bros. Dev. Co.*, 105 B.R. 515, 520 (Bankr.W.D.Mo.1989); *In re Hogg*, 103 B.R. 207, 209 (Bankr.D.S.D.1988); *In re Command Servs. Corp.*, 102 B.R. 905, 910

well as in the writings of several renowned commentators.[9] We find additional support in the legislative history to the 1978 amendments to the Code[10] and in a number of court of appeals' decisions (including one from this Court) cogently resolving related points.[11] Disagreeable as the chore may be, the bankruptcy court must protect the estate, lest overreaching attorneys or other professionals drain it of wealth which by right should inure to the benefit of unsecured creditors. *See, e.g., Cohen & Thiros, P.C. v. Keen Enters., Inc.,* 44 B.R. 570, 573 (N.D.Ind.1984).

[3, 4] That said, we deem it necessary at this juncture to restate in this context what we have stressed in another: that we

(Bankr.N.D.N.Y.1989); *In re Washington Mfg. Co.,* 101 B.R. 944, 950 (Bankr.M.D.Tenn.1989); *In re Mayes,* 101 B.R. 494, 496 (Bankr. W.D.Mich.1988); *In re Tennessee Valley Ctr. for Minority Econ. Dev.,* 99 B.R. 845, 847 (Bankr. W.D.Tenn.1989); *In re Florida Brethren Homes, Inc.,* 97 B.R. 652, 653 n. 2 (Bankr.S.D.Fla.1989); *In re Temple Retirement Community,* 97 B.R. 333, 336, 338 (Bankr.W.D.Tex.1989); *In re Reed,* 95 B.R. 626, 628 (Bankr.E.D.Ark.1988); *In re Public Serv. Co. of N.H.,* 93 B.R. 823, 827 (Bankr. D.N.H.1988); *In re Gulf Consol. Servs., Inc.,* 91 B.R. 414, 415 (Bankr.S.D.Tex.1988); *In re Ross,* 88 B.R. 471, 474–75 (Bankr.M.D.Ga.1988); *In re Garber,* 88 B.R. 15, 16 (Bankr.D.R.I.1988); *In re Pothoven,* 84 B.R. 579, 583 (Bankr.S.D.Iowa 1988); *In re Watkins Glen Grand Prix Corp.,* 81 B.R. 232, 234 n. 5 (Bankr.W.D.N.Y.1988); *In re Jessee,* 77 B.R. 59, 61 (Bankr.W.D.Va.1987); *In re Pettibone Corp.,* 74 B.R. 293, 299–300 (Bankr. N.D.Ill.1987); *In re Westfall,* 73 B.R. 186, 189 & n. 1 (Bankr.W.D.Ark.1986); *In re Mansfield Tire & Rubber Co.,* 65 B.R. 446, 455 (Bankr.N.D.Ohio 1986); *In re Esar Ventures,* 62 B.R. 204, 205 (Bankr.D.Haw.1986); *In re Cuisine Mag., Inc.,* 61 B.R. 210, 219 (Bankr.S.D.N.Y.1986); *In re Thomas, Inc.,* 43 B.R. 510, 511 (Bankr.D.Mass. 1984); *In re Four Star Terminals, Inc.,* 42 B.R. 419, 426 n. 1 (Bankr.D.Alaska 1984); *In re Daylight Transp., Inc.,* 42 B.R. 20, 21, 26 (Bankr. E.D.N.Y.1984); *In re Watson Seafood & Poultry Co.,* 40 B.R. 436, 438 (Bankr.E.D.N.C.1984); *In re Garnas,* 40 B.R. 140, 141 (Bankr.D.N.D.1984); *In re Wilson Foods Corp.,* 36 B.R. 317, 320 (Bankr.W.D.Okla.1984); *In re Nor–Les Sales, Inc.,* 32 B.R. 900, 902 (Bankr.E.D.Mich.1983), *modified sub nom. Stark & Reagan, P.C. v. Nor–Les Sales,* 53 B.R. 442 (E.D.Mich.1984); *In re International Coins & Currency, Inc.,* 26 B.R. 256, 260 (Bankr.D.Vt.1982); *In re Liberal Mkt., Inc.,* 24 B.R. 653, 657 (Bankr.S.D.Ohio 1982); *In re Crutcher Transfer Line, Inc.,* 20 B.R. 705, 710 (Bankr.W.D.Ky.1982); *see also In re Gulf Hills Dev. Corp.,* 60 B.R. 366, 366, 368 (S.D.Miss. 1985). *But see In re Jensen's Interiors, Inc.,* 132 B.R. 105, 106 (E.D.Pa.1991); *In re Pendleton,* No. 90–1091, 1990 WL 29645 (E.D.Pa. March 15, 1990); *cf. In re Rheam of Ind., Inc.,* 142 B.R. 698, 700 (E.D.Pa.1992) (*"Rheam V"*) (bankruptcy court's discretion is more circumscribed when no party objects); *In re T & D Tool, Inc.,* 132 B.R. 525, 526 (E.D.Pa.1991) (same); *In re Peoples Sav. & Inv., Inc.,* 103 B.R. 264, 274 (Bankr. E.D.Okla.1989) (same).

9. *E.g.,* 2 COLLIER ON BANKRUPTCY ¶ 330.05[2][a], at 330–37 (15th ed. Lawrence P. King ed. 1993) ("[T]he ultimate responsibility for assessing the reasonableness of compensation awarded to professionals and other officers of the estate remains ... with the judiciary."); R.E. GINSBURG, BANKRUPTCY ¶ 4501 (1985) ("Even if no party in interest objects ... the court should review the application to make sure the compensation sought has been earned and is reasonable."); *see also* Harold Lavien, *Fees as Seen from the Bankruptcy Bench,* 89 COM.L.J. 136, 138 (1984).

10. The Joint Explanatory Statement, which described the floor managers' compromise on the Bankruptcy Reform Act of 1978 to both chambers, explains: "Attorneys' fees in bankruptcy cases can be quite large and *should be closely examined by the court.*" 124 CONG. REC. 32,394 (1978) (Joint Explanatory Statement) (remarks of Rep. Edwards) (emphasis added), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6442; *accord* 124 CONG. REC. 33,994 (1978) (Joint Explanatory Statement) (remarks of Sen. DeConcini), *reprinted in* 1978 U.S.C.C.A.N. 6505, 6511.

11. *See In re York Int'l Bldg., Inc.,* 527 F.2d 1061, 1068 (9th Cir.1975) (dicta) ("The district courts have a duty to examine carefully all claims presented even though no objections have been filed."); *In re Beverly Mfg. Corp.,* 841 F.2d 365, 369, 370 (11th Cir.1988) (stating that a bankruptcy court must hold an evidentiary hearing on its own motion when the petitions for compensation inadequately develop the factual basis for the fee awards); *In re Meade Land & Dev. Co.,* 527 F.2d 280, 284 (3d Cir.1975) (dicta) (stating in a case where counsel applied for just shy of 250 hours of compensation without breaking down the charges that, "absent unusual circumstances, it is the court's independent obligation to give credit only where there are supporting documents, even in cases where no interested parties raise objections to the claim"); *see also In re Callister,* 673 F.2d 305, 307 (10th Cir.1982) (" '[A]ll expenses of administration must receive the court's final scrutiny and appraisal.' " (quoting 2 COLLIER ON BANKRUPTCY ¶ 331.03 (5th ed. 1981))); *Jordan v. Mark IV Hair Styles, Inc.,* 806 F.2d 695, 697 (6th Cir.1986) (holding that a district court has to review an award of attorneys' fees in a civil rights class action suit for reasonableness, even absent an objection, because the attorney representing the class holds a position of public trust (quoting 3B MOORE'S FEDERAL PRACTICE ¶ 23.91, at 23–568 (1978))).

do not intend that a district [or bankruptcy] court, in setting an attorney['s] fee, become enmeshed in a meticulous analysis of every detailed facet of the professional representation. It ... is not our intention that the inquiry into the adequacy of the fee assume massive proportions, perhaps even dwarfing the case in chief.

Lindy Bros. Builders, Inc. v. American Radiator & Std. Sanitary Corp., 540 F.2d 102, 116 (3d Cir.1976) (in banc) ("*Lindy II*"). Because its time is precious, the reviewing court need only correct reasonably discernible abuses, not pin down to the nearest dollar the precise fee to which the professional is ideally entitled.[12] At all events, the bankruptcy and district courts here acted properly in reviewing K & L's fee request despite the absence of any objection.

B. *Did K & L Forfeit Its Right to Compensation for Time Spent by Its Paralegals by Failing to Meet the Specificity Requirements of the Local Rule?*

[5] The bankruptcy court apparently ruled that, because K & L did not meet the specificity requirements of applicable bankruptcy rules, including Local Bankruptcy Rule of Procedure 9016.1, it forfeited its right to compensation. *See In re Busy Beaver*, 133 B.R. at 757–58. We do not doubt the applicant's duty to submit fee applications with enough detail to enable the court to reach an informed decision—one necessarily grounded in complete, coherent information—as to whether the requested compensation is justified. *E.g., In re Nucorp Energy, Inc.*, 764 F.2d 655, 658 (9th Cir.1985); *In re Temple Retirement Community, Inc.*, 97 B.R. at 339 (collecting cases); *see* FED. R.BANKR.P. 2016(a).[13] But the bankruptcy court did not specify the precise shortcomings of K & L's fee application. Even if, as seems to be the case, the court was unable to discern whether the work the paralegals performed necessitated the exercise of independent paraprofessional judgment (information we believe pertinent to the court's evaluation of the rate of compensation the paralegal has earned and thus information which we agree should be included in a fee application), we do not read *Rule 9016.1* as specifying that fee applicants must substantiate this fact.[14]

[6, 7] In any event, we are convinced that if the bankruptcy court plans to disallow certain items of compensation, § 330(a) on its face first contemplates the applicant's right to a hearing.[15] We understand that a court

12. We also think it not befitting the stature of a federal bankruptcy judge to spend wasteful hours poring over fee applications to tabulate and cross-reference unorganized billing statements. Bankruptcy courts might consider prescribing procedures for the submission of organized, coherent, readable fee applications. Guidance may be found in Alan Hirsch & Diane Sheehey, *The Award and Management of Attorneys' Fees in the Federal Courts* (Federal Judicial Center, Washington, D.C. forthcoming 1994). Moreover, today one can readily find computer software which automatically summarizes, correlates, and in other ways renders comprehensible involved legal bills. Perhaps the bankruptcy courts should consider requiring professionals submitting lengthy fee applications to submit them also on a computer disk in a format readable by a specified commercially available computer program, or simply requiring the professionals to tabulate the fee requests in several different conducive ways, such as by person, by day, and by activity/assignment.

13. The relevant portion of that Rule provides:

Application for Compensation or Reimbursement. An entity seeking interim or final compensation for services ... from the estate shall file an application setting forth a detailed statement of (1) the services rendered [and] time expended ..., and (2) the amounts requested. FED.R.BANKR.P. 2016(a).

14. The relevant portion of the local Rule states:

All entries shall conform to the following:

1. List each service or task separately and state the amount of time expended in its performance;

2. Identify the subject matter of any correspondence or phone call and the party with whom you have communicated if the service involves telephone and/or written correspondence;

3. Identify where appropriate, and in the interest of clarity, the subject matter of any hearing or trial with specificity including the case, or adversary number if the service involved is attendance at a hearing or trial;

4. Identify any pleading with specificity if the service involves preparation of a pleading[.]

LOCAL BANKR.R.P. 9016.1 (W.D.Pa.1992).

15. Section 330(a) begins "[a]fter notice ... and a hearing," a phrase Rule 2017(b) also contains. Section 102(1) of the Code defines it thus:

may simply wish to note its specific concerns, if any, and allow the fee applicant a reasonable opportunity to supplement his or her fee application in response thereto before holding an oral hearing, as hearings on a routine matter like compensation for services might overwhelm already swollen calendars. *See, e.g., Cohen & Thiros,* 44 B.R. at 573 (bankruptcy court allowed fee applicant two opportunities to supplement its fee petition); *In re Garrison Liquors, Inc.,* 108 B.R. 561, 566 (Bankr.D.Md.1989) (allowing fee applicant to supplement the application); *cf. In re Pettibone Corp.,* 74 B.R. 293, 300–01 (Bankr. N.D.Ill.1987) (holding the ordinary standards for reconsideration apply when a fee applicant seeks to supplement the fee application after a full hearing). But if the court does disallow fees of a "good-faith applicant," the Code, *see* §§ 329(b), 330(a); *see also* Rule 2017(b)—and perhaps even the dictates of due process, *see* U.S. CONST., amend. V—mandates that the court allow the fee applicant an opportunity, should it be requested, to present evidence or argument that the fee application meets the prerequisites for compensation; canons of fairness militate against forfeiture of the requested fees simply because the court's audit of the application uncovers some ambiguity or objection.[16] By good-faith applicant we mean to refer to a fee applicant who reasonably and in good faith attempts to comply with the applicable rules governing the format and substance of fee applications.

[8] To make the hearing meaningful, the court should first apprise the applicant of the particular questions and objections it harbors, a role which the adversary in a statutory fee case would typically play. *See Rheam IV,* 137 B.R. at 155 (stating that the court holds hearings whenever, but only when, it has questions about the fee application). Contrary to a typical adversarial proceeding,

"[A]fter notice and a hearing", or a similar phrase—
(A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but
(B) authorizes an act without an actual hearing if such notice is given properly and if—
(i) such a hearing is not requested timely by a party in interest; or
(ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act....
11 U.S.C.A. § 102(1) (1993).

16. *See, e.g., In re Beverly Mfg. Corp.,* 841 F.2d 365, 370 (11th Cir.1988) ("If there are disputed issues of fact, an evidentiary hearing *must* be held to facilitate their resolution." (emphasis in original, citation omitted)); *In re U.S. Golf Corp.,* 639 F.2d 1197, 1202 (5th Cir.1981) ("the judge must hold an evidentiary hearing if there are any disputed factual issues"); *In re Paul,* 141 B.R. 299, 301 (E.D.Pa.1992) ("If the [Bankruptcy Court] has concerns about the amount sought or the hours or nature of work performed, it must hold a hearing, as required under § 330 of the [Code], in order to afford the attorney an opportunity to present his or her position and respond to the Court's questions about the application. The Bankruptcy Court ... may not reduce the amount sought without a hearing."); *see also Blum v. Stenson,* 465 U.S. 886, 892 n. 5, 104 S.Ct. 1541, 1545 n. 5, 79 L.Ed.2d 891 (1984); *Cunningham,* 753 F.2d at 266–67; *Lindy Bros. Builders, Inc. v. American Radiator & Std. Sanitary Corp.,* 487 F.2d 161, 167 (3d Cir.1973) ("*Lindy I*"), *appeal after remand,* 540 F.2d 102 (3d Cir.1976) (in banc) ("*Lindy II*"). *Blum v. Witco Chem. Corp.,* 829 F.2d 367, 377 (3d Cir.1987) is not controlling. That case involved a grant of attorneys' fees to the prevailing plaintiff in a suit brought under the Age Discrimination in Employment Act of 1967, *see* 29 U.S.C. § 626(b). The defendant objected to the award of the fees on the ground, *inter alia,* that the district court failed to hold an evidentiary hearing. This Court held that failure did not constitute reversible error because there were no legally cognizable questions of fact disputed by the parties which required a further development of the facts. *Id.* at 377–78. That result followed, however, from a characterization of disputes over fees arising from fee shifting statutes as adversarial litigation, *see supra* at 841–42, whereas the same is not true in bankruptcy proceedings for the reasons set forth *supra* at 842–43. Indeed, a bankruptcy court, when it disallows certain fees, simulates the role of an adversary, albeit to a circumscribed degree, requiring that any "disputed" matter be resolved at a fair hearing. *See* 11 U.S.C.A. § 330(a) (1993).

At the hearing, held after notice of the court's concerns and/or objections, the court should allow the applicant a reasonable opportunity to present legal arguments and/or evidence, as the case may be, to clarify or supplement the petition and accompanying affidavit. Of course, the anatomy of the hearing lies within the sound discretion of the bankruptcy judge, and would not necessarily require the presentation of oral testimony. For example, the type of hearing which "is appropriate in the particular circumstances" might simply be an oral hearing (whether in court or more informally, as by teleconference) at which the applicant submits argument based upon the papers. The essential point is that the court should give counsel a *meaningful* opportunity to be heard.

when the bankruptcy court clothed in its administrative robe fulfills its duty to review a fee application without the applicant being present, the applicant cannot possibly know what evidence or legal theories the court is contemplating when it decides to disallow certain fees. Unless the applicant is afforded an opportunity to rebut or contest the court's conclusions, the applicant would unfairly and undesirably be deprived of the chance to respond to and assuage the court's questions and concerns. Besides, the bankruptcy bar might well react to a regime offering the applicant no chance to respond to the court's concerns by spending an inordinate amount of time preparing overly detailed fee applications, which time might be billable to the estate,[17] in an effort to anticipate all the idiosyncracies and inconsistencies of review the divers bankruptcy judges might exhibit.

[9] In sum, if after initial review the bankruptcy court determines that, while the fee applicant made a good faith effort to comply with the particularization requirements of § 330(a), Rule 2016(a), and applicable local rules, either the information provided does not allow for a reliable determination of compensability (because it is too vague or otherwise), or that the court would benefit from legal argument, it may allow the professional a reasonable time to supplement the application with either a more detailed description of the questionable services, or with a memorandum of points and authorities in support of the application, respectively. If the bankruptcy court at any time, irrespective of any opportunity to supplement, denies some amount of the requested compensation, and if it determines the applicant sought in good faith to comply with the aforementioned specificity requirements, it should notify the applicant of its particular reasons for denying the fees, and, should he or she make a timely request for one, allow the professional the occasion to defend his or her fee application with legal arguments and/or evidence (of market practices, etc.) at a hearing. Moreover, if after the hearing the court adheres to its views and disallows some of the requested compensation, it should enter sufficient findings of fact and conclusions of law in the

17. *Compare, e.g., In re Nucorp Energy,* 764 F.2d at 658–59 & n. 4 (holding such time compensable), *In re Braswell Motor Freight Lines, Inc.,* 630 F.2d 348, 351 (5th Cir.1980), *In re Bryant,* 111 B.R. 474, 480 (E.D.Pa.1990) *and In re J.A. & L.C. Brown Co.,* 75 B.R. 539, 540 (E.D.Pa.1987) *with, e.g., In re Central R.R. Co. of N.J.,* 477 F.Supp. 1228, 1233 (D.N.J.1979) (holding such time noncompensable), *In re Alan I.W. Frank Corp.,* 71 B.R. 585, 586 (Bankr.E.D.Pa.1987) *and In re Shaffer–Gordon Assocs., Inc.,* 68 B.R. 344, 349–50 (Bankr.E.D.Pa.1986). *See In re Chicago Lutheran Hosp. Ass'n,* 89 B.R. 719, 736 (Bankr.N.D.Ill.1988) (noting the split of authority); *In re Vogue,* 92 B.R. 717, 719 (Bankr.E.D.Mich.1988) (same).

In *In re Vogue,* 92 B.R. at 720, the court applied a market-oriented approach:

> The question is really factual in nature ...: Do attorneys normally bill their clients for the time spent in preparing their bill [or] the time spent meeting with a client to explain, discuss, negotiate or haggle over (the practical equivalent of appearing in court on a fee application) their bill?

The court realized, too, that certain procedures for bill approval unique to bankruptcy cases may alter the answer to the above questions to the extent that the bankruptcy procedures are materially more onerous, but the court concluded that the fee applicant in the case before it had failed to proffer any evidence of either a practice of billing such services in non-bankruptcy cases, or of material differences between non-bankruptcy and bankruptcy review procedures (as the court would require before it would grant compensation for such work if non-bankruptcy clients did not pay for such work). *See id.* at 720, 724. Thus, for example, if a fee applicant can demonstrate that non-bankruptcy clients require substantially less documentation and are considerably more deferential to the professional's exercise of judgment concerning which fees are billable (resulting in considerable savings of effort defending bills), etc., the court could meet § 330's mandate of competitive incomes by compensating the attorney for the excess average time spent preparing fee applications to satisfy the bankruptcy court over the average time spent on preparing bills for similar services for comparable non-bankruptcy clients. *Cf. Pawlak v. Greenawalt,* 713 F.2d 972 at 983 (3rd Cir.1983) ("[I]f attorneys are required to litigate for their fees but are not compensated for the time spent on such litigation, their effective rates will be reduced correspondingly.").

Of course, to prevent "double counting," the fee applicant would not also be able to include in his or her hourly rate an extra (in comparison to non-bankruptcy attorneys) overhead charge based on time spent preparing bankruptcy fee applications. The foremost aspiration of § 330 is that bankruptcy attorneys earn neither less, nor more, than their non-bankruptcy counterparts. *See In re Manoa Fin. Co.,* 853 F.2d 687, 691 (9th Cir.1988).

record to facilitate appellate review. *See, e.g., In re Paul,* 141 B.R. at 302; *In re Conston Corp.,* No. 91–7176, 1992 WL 55694, at *1–*2 (E.D.Pa. Mar. 17, 1992); *In re Rusty Jones,* 134 B.R. at 333; *In re Paster,* 119 B.R. 468, 470 (E.D.Pa.1990); *cf. Hensley v. Eckerhart,* 461 U.S. 424, 437, 103 S.Ct. 1933, 1941, 76 L.Ed.2d 40 (1983) (plurality). We trust that throughout this process the UST will, when the trustee considers it appropriate, file comments with the court.

III. THE QUESTION OF "CLERICAL SERVICES," AND THE STANDARD FOR ASSESSING THE REASONABLENESS OF FEES

A. *Introduction*

[10, 11] The district court determined that certain enumerated services were clerical in nature, and then disallowed remuneration therefor on the basis that, as a matter of law, *all* clerical services are included as overhead in attorneys' fees.[18] We disapprove of any approach that allows a court confronted with undisputed, credible, contrary evidence of market practices in the record to rely solely on its own judgment to designate services as either clerical or paraprofessional and to allow or disallow compensation for those services on the basis of such designation alone. As we demonstrate below, the principal purpose of the 1978 amendments to § 330 was to compensate bankruptcy attorneys at the same level as non-bankruptcy attorneys. The clearest path to that goal is to rely on the market, subject to the modification that the court will, in practical terms, act as a surrogate for the estate, reviewing the fee application much as a sophisticated non-bankruptcy client would review a legal bill. This modification is driven by the fact that, realistically speaking, the legal market functions imperfectly in bankruptcy, as the debtor "client" and other interested parties are often unable or unwilling to contest the fees charged. *See supra* at 842–43. The most remarkable impact of market reliance under § 330 is that the court's review of fee applications becomes primarily an exercise in fact-finding, with relatively little room for the application of inflexible legal rules.

B. *The Teachings of the Statutory Text and Legislative History*

[12] Section 330(a) on its face does not set up a bar to compensation for clerical services and, moreover, does not even by its terms differentiate clerical from non-clerical services. Instead, the statute focuses on *who* performs a service, and expressly provides that a court may award reasonable compensation for all actual, necessary services performed by the designated eligible fee award recipients (professionals and their paraprofessionals).[19] In drafting the statute to describe the covered services as "actual" and "necessary," Congress chose not to add the further qualifier that these services also be "professional" or "non-clerical" in nature. Instead, the statute provides that, once having determined the service provider is an eligible recipient, the amount of the compensation—its reasonableness—is to be "based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title." 11 U.S.C.A.

18. Although, as presaged *supra* at 840, the district court did cite two cases remunerating a fee applicant for clerical services (*In re Wolverine Knitting Mills, Inc.,* 107 B.R. 546, 547 (Bankr. E.D.Mich.1989) and *In re Miguel,* 123 B.R. 634, 637, 640 (Bankr.E.D.Cal.1991)), it distinguished those cases without explanation, apparently on the ground that it may be customary for trustees and accountants (the types of professionals with which those cases dealt), but not attorneys, to bill for clerical services separately rather than incorporate them into overhead. Mem. op. at 8.

19. Not being confronted with the question, we express no view about whether legal secretaries can be deemed "paraprofessionals" within the meaning of § 330(a). We do note, though, that the Supreme Court has intimated that the term "reasonable *attorney's* fee" may encompass separate charges for secretarial services. *See Missouri v. Jenkins,* 491 U.S. 274, 287 n. 9, 109 S.Ct. 2463, 2471 n. 9, 105 L.Ed.2d 229 (1989) ("The safeguard against the billing *at a profit* of secretarial services ... is the discipline of the market." (emphasis added)); *id.* at 288 n. 10, 109 S.Ct. at 2471 n. 10 ("[P]urely clerical or secretarial tasks should not be billed *at a paralegal rate,* regardless of who performs them." (emphasis added)). Of course, even if legal secretaries are included within the term paraprofessionals, the market may not compensate firms for the sorts of services legal secretaries perform.

§ 330(a)(1) (1993), *quoted supra* at 840 n. 5. Thus we think the statute plainly specifies that the type of service performed by a paralegal (including whether it is clerical) affects the *rate* of compensation, not compensability *vel non*. *Cf. Baughman v. Wilson Freight Forwarding Co.,* 583 F.2d 1208, 1217 (3d Cir.1978). Neither the bankruptcy nor the district court in this case advanced a reason for departing from the plain import of this statute, and we have uncovered no persuasive reason to do so.[20] *Cf. Union Bank v. Wolas,* — U.S. —, —, 112 S.Ct. 527, 531, 116 L.Ed.2d 514 (1991) (interpreting § 547(c) of the Code).

[13] As just stated, the type of service affects the reasonableness of the rate of compensation sought by a professional or paraprofessional under § 330(a). Of the five factors enumerated in the statute as bearing on the reasonableness of the compensation, all but one take into account the categorization of the service as clerical or paraprofessional: the (i) nature, (ii) extent, and (iii) value of the services, and (iv) the cost of comparable services. We think that although each factor enumerated by § 330(a) retains independent significance, the cost of comparable services factor has an overarching role to act as a guide to the value of the services rendered given their nature and extent. In combination, these four factors—with the principal emphasis being on the cost of comparable services (market rates)—essentially provide the basis for computing the "reasonable hourly rate" used in the "lodestar" calculations familiar to fund-in-court cases and statutory fee-shifting provisions.[21] *See generally* Third Circuit Task Force, *Court Awarded Attorney's Fees, Report of the Third Circuit Task Force,* 108 F.R.D. 237 (1985).

[14] The remaining § 330(a) factor—the time spent on such services—is a sibling of the lodestar approach's reasonable hours component. Thus, according to the market approach we believe that the Code dictates, *cf. Missouri v. Jenkins,* 491 U.S. 274, 283, 109 S.Ct. 2463, 2469, 105 L.Ed.2d 229 (1989) ("[A]ttorney's fees awarded under [fee-shifting] statute[s] are to be based on market rates for the services rendered."), the bankruptcy court should review fee applications not for whether each particular service undertaken by a paralegal is clerical or paraprofessional by nature, but for whether non-bankruptcy attorneys typically charge and collect from their clients fees for that particular service when performed by a member of that profession, and the rates charged and collected therefor.

The legislative history of § 330, which stems from the Bankruptcy Reform Act of 1978, P.L. No. 95–598, 92 Stat. 2549 (1978), rather than counseling a departure from the statute's plain object, amply reinforces it. The unambiguous policy inspiring § 330(a), expressed most clearly in the House Report accompanying House Bill 8200, H.R. 8200, 95th Cong., 1st Sess. (1977), is that professionals and paraprofessionals in bankruptcy cases should earn the same income as their non-bankruptcy counterparts. *See* H.R.REP. No. 595, 95th Cong., 1st Sess. 330 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5963, 6286.[22] The history nowhere speaks of com-

20. We understand that this Court stated in *In re Meade Land & Dev. Co.,* 527 F.2d 280, 284 (3d Cir.1975) that "non-legal services are not compensable." That opinion was decided before the 1978 Act, when under the Bankruptcy Act of 1898 the principle of economy of the estate rather than the cost of comparable services was the foremost consideration. *See infra* 849–51 & nn. 23 & 24.

21. The most familiar formula courts in this circuit use to calculate attorneys' fees is undoubtedly the "lodestar" approach, an approach with its roots in common fund cases and fee-shifting statutes. Under the lodestar analysis, a court first establishes a reasonable hourly rate (corresponding to the value of the services and the cost of comparable services in § 330(a)(1)) for each set of compensable services (corresponding to the nature of the services in § 330(a)(1)), and then multiplies each rate by the reasonable number of hours of compensable work included in each respective set (corresponding to the time and extent of the services in § 330(a)(1)). *Cf. Hensley v. Eckerhart,* 461 U.S. 424, 433, 103 S.Ct. 1933, 1939, 76 L.Ed.2d 40 (1983) (plurality).

22. We include the House Committee on the Judiciary's full explanation of § 330(a):

> Section 330 authorizes compensation for services and reimbursement of officers of the estate. It also prescribes the standards on which the amount of compensation is to be determined. As noted above, the compensation allowable under this section is subject to

pensating professionals or paraprofessionals solely for those services which just a professional or paraprofessional can provide, but instead repeatedly refers to the billing practices of nonbankruptcy professionals, justified by the goal of retaining competent legal representation for the debtor. Congress rather clearly intended to "provid[e] sufficient economic incentive [to lure competent bankruptcy specialists] to practice in the bankruptcy courts." *In re McCombs,* 751 F.2d 286, 288 (8th Cir.1984). Congress determined, it appears, that on average the gain to the estate of employing able, experienced, expert counsel would outweigh the expense to the estate of doing so, and that unless the estate paid competitive sums it could not retain such counsel on a regular basis. With this congressional determination we are in no position to quarrel.

It is true that, before the 1978 amendments, the Code favored economy of the estate over competitive compensation to debtors' attorneys. *See, e.g., In re Manoa Fin. Co.,* 853 F.2d 687, 689 (9th Cir.1988). Vestiges of this principle are found in the Senate Committee on the Judiciary's Report accompanying the pre-conference version of the 1978 amendments in the Senate, a report upon which the bankruptcy court in this case placed decisive reliance.[23] *See In re Busy Beaver,* 133 B.R. at 756; *accord In re Four Star Terminals,* 42 B.R. at 430. Yet besides the fact that the section of the Senate Report

the maxima set out in sections 326, 328, and 329. The compensation is to be reasonable, for actual necessary services rendered, based on the time, the nature, the extent, and the value of the services rendered, and on the cost of comparable services other than in a case under the bankruptcy code. The effect of the last provision is to overrule *In re Beverly Crest Convalescent Hospital, Inc.,* 548 F.2d 817 (9th Cir.1976, as amended 1977), which set an arbitrary limit on fees payable, based on the amount of a district judge's salary, and other, similar cases that require fees to be determined based on notions of conservation of the estate and economy of administration. If that case were allowed to stand, attorneys that could earn much higher incomes in other fields would leave the bankruptcy area. Bankruptcy specialists, who enable the system to operate smoothly, efficiently, and expeditiously, would be driven elsewhere, and the bankruptcy field would be occupied by those who could not find other work and those who practice bankruptcy law only occasionally almost as a public service. Bankruptcy fees that are lower than fees in other areas of the legal profession may operate properly when the attorneys appearing in bankruptcy cases do so intermittently, because a low fee in a small segment of a practice can be absorbed by other work. Bankruptcy specialists, however, if required to accept fees in all of their cases that are consistently lower than fees they could receive elsewhere, will not remain in the bankruptcy field.

This subsection provides for reimbursement of actual, necessary expenses. It further provides for compensation of paraprofessionals employed by professional persons employed by the estate of the debtor. The provision is included to reduce the cost of administering bankruptcy cases. In nonbankruptcy areas, attorneys are able to charge for a paraprofessional's time on an hourly basis, and not include it in overhead. If a similar practice does not pertain in bankruptcy cases, then the attorney will be less inclined to use paraprofessionals even where the work involved could easily be handled by an attorney's assistant, at much lower cost to the estate. This provision is designed to encourage attorneys to use paraprofessional assistance where possible, and to insure that the estate, not the attorney, will bear the cost, to the benefit of both the estate and the attorneys involved.

H.R.Rep. No. 595 at 329–30, *reprinted in* 1978 U.S.C.C.A.N. at 6286.

23. That report provided in pertinent part:

[E]conomy in administration is the basic objective....

The reference to "the cost of comparable services" in a nonbankruptcy case [in § 330] is not intended as a change of existing law. In a bankruptcy case fees are not a matter for private agreement. There is inherent a "public interest" that "must be considered in awarding fees," *Massachusetts Mutual Life Insurance Co. v. Brock,* 405 F.2d 429, 432 (C.A.5 1968), *cert. denied,* 395 U.S. 906 [89 S.Ct. 1748, 23 L.Ed.2d 220] ([1969]). An allowance is the result of a balance struck between moderation in the interest of the estate and its security holders and the need to be "generous enough to encourage" lawyers and others to render the necessary and exacting services that bankruptcy cases often require, *In re Yale Express System, Inc.,* 366 F.Supp. 1376, 1381 (S.D.N.Y. 1973). The rates for similar kinds of services in private employment is one element, among others, in that balance. Compensation in private employment noted in subsection (a) is a point of reference, not a controlling determinant of what shall be allowed in bankruptcy cases.

S.Rep. No. 989, 95th Cong., 2d Sess. 40 (1978) (footnote omitted), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5826.

espousing the outmoded notion of economy of the estate is fundamentally at odds with both the House Report *and* the text of the amended statute, the Senate itself in later debate expressly and forcefully rejected that portion of its earlier report, meaning that a court should not rely on it as authority at all.[24]

[15] Some bankruptcy courts have justified departures from the statute's transparent mandate on the ground that preserving the debtor's estate is of greater import than compensating attorneys for their paralegals' fees. Were the statute's meaning and purpose ambiguous, we might find room to agree with them. But here Congress has unmistakably and expressly made a policy choice favoring full compensation for debtors' attorneys over greater proportionate compensation to the debtors' creditors, and when in our constitutional republic a statute is constitutional, courts are not at liberty to substitute their favored policies for those Congress enacts, no matter how unwise the court finds them to be.[25]

[16] In conclusion, the classification of services as clerical or non-clerical does not decide the question of compensability under § 330: clerical services may be compensated in the proper context. *See In re Wolverine Knitting Mills, Inc.,* 107 B.R. 546, 547 (Bankr.E.D.Mich.1989) (compensating accountant for clerical services after applicant demonstrated it had long billed clerical time to all its clients); *In re Stanley,* 120 B.R. 409, 415 (Bankr.E.D.Tex.1990) (holding clerical services are compensable if properly documented); *cf. In re First Software Corp.,* 79 B.R. 108, 119, 123 (Bankr.D.Mass.1987) (awarding a paralegal reduced compensation for checking the docket and court dates, ordering and obtaining documents from court, delivering papers, updating files, running errands, making telephone calls, and directing mail). We reiterate that the factors which § 330(a) prescribes primarily affect the *magnitude* of compensation for such services, whether rendered by a professional or paraprofessional.

C. *The Application of the Market Approach to the Role of Paralegals in Bankruptcy Proceedings*

The past two decades have witnessed a remarkable transformation of the legal market, converting once loyal and steadfast clients into sophisticated consumers of legal

24. Specifically, the Joint Explanatory Statement read by the respective floor managers in each chamber of Congress provided in this regard:

> Section 330(a) contains the standard of compensation adopted in H.R. 8200 as passed by the House rather than the contrary standard contained in the Senate amendment.... [B]ankruptcy legal services are entitled to command the same competency of counsel as other cases. In that light, the policy of this section is to compensate attorneys and other professionals serving in a case under title [11] at the same rate as the attorney or other professional would be compensated for performing comparable services other than in a case under title [11]. *Contrary language in the Senate report accompanying S. 2266 is rejected,* and *Massachusetts Mutual Life Insurance Company v. Brock,* 405 F.2d 429, 432 (5th Cir.1968) is overruled. Notions of economy of the estate in fixing fees are outdated and have no place in a bankruptcy code.

124 Cong.Rec. 33,994 (1978) (Joint Explanatory Statement) (remarks of Sen. DeConcini) (emphasis added), *reprinted in* 1978 U.S.C.C.A.N. 6505, 6511. The slight differences between the Senate and House versions of the Joint Explanatory Statement are not manifested in the above excerpt, see the identical language at 124 Cong.Rec. 32,394–95 (1978) (Joint Explanatory Statement) (remarks of Rep. Edwards), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6442. We accord the Joint Explanatory Statement the weight due a conference report, as in this instance the statement fulfilled that role. *See* 124 Cong.Rec. 32,392 (1978) (Joint Explanatory Statement) (remarks of Rep. Edwards), *reprinted in* 1978 U.S.C.C.A.N. at 6437; 124 Cong.Rec. 33,992 (1978) (Joint Explanatory Statement) (remarks of Sen. DeConcini), *reprinted in* 1978 U.S.C.C.A.N. at 6505–06.

25. *See, e.g., Tennessee Valley Auth. v. Hill,* 437 U.S. 153, 194–95, 98 S.Ct. 2279, 2302, 57 L.Ed.2d 117 (1978) ("Once the meaning of an enactment is discerned and its constitutionality determined, the judicial process comes to an end. We do not sit as a committee of review, nor are we vested with the power of a veto."); *cf. Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 748, 95 S.Ct. 1917, 1931, 44 L.Ed.2d 539 (1975) ("[I]f Congress ha[s] legislated the elements of a private cause of action for damages, the duty of the Judicial Branch [is] to administer the law which Congress enacted; the Judiciary may not circumscribe a right which Congress has conferred because of any disagreement it might have with Congress about the wisdom of creating so expansive a liability.").

products in a competitive legal marketplace. A critical component of this transformed legal market is the incorporation of paralegals providing a wide range of legal services into the law firm tapestry, a component brought about by the cost-effectiveness of employing an intermediate level of professional to handle matters beyond the ken of the average legal secretary but not demanding the full education, experience, or skill of a licensed attorney. *See, e.g.,* New Jersey State Bar Ass'n, *The Evolving Role of the Paralegal* 12 (1991). The availability of paralegals is a positive development from the point of view of conserving the debtor's estate, and we expect that, when feasible, members of the bar representing debtors will engage paralegals and other support staff when they are able to render legal services efficiently yet effectively, with the objective of alleviating the diminution of the estate's assets. *See, e.g., In re Temple Retirement Community,* 97 B.R. at 339; H.R.Rep. No. 595 at 330, *reprinted in* 1978 U.S.C.C.A.N. at 6286; S.Rep. No. 989 at 41, *reprinted in* 1978 U.S.C.C.A.N. at 5827.

[17] The bankruptcy court was concerned that the tasks for which K & L charged for its paralegals' time did not require the exercise of professional judgment, and that compensation for such services would unfairly burden the estate. As is true with recently graduated attorneys, entry-level paralegals perform the more mundane tasks in the paralegal work spectrum, some of which may resemble those tasks generally deemed "clerical" in nature. Yet even with these tasks, paralegals may have to bring their training or experience to bear, thereby relieving attorneys of the burden of extensive supervision and ensuring the proper completion of tasks involving the exercise, *or potential exercise,* of some paraprofessional judgment. Of course, the appropriate rate the attorney will command for paralegal services will ordinarily parallel the paralegal's credentials and the degree of experience, knowledge, and skill the task at hand calls for. *See infra* at 855 n. 34; *cf. Jenkins,* 491 U.S. at 288, n. 10, 109 S.Ct. at 2471 n. 10 ("*[P]urely* clerical or secretarial tasks should not be billed *at a paralegal rate,* regardless of who performs them." (emphasis added)). The short of it is that the market-driven approach of § 330 permits compensation for relatively low-level paralegal services if and only if analogous non-bankruptcy clients agree to pay for the same, and then only at that rate.[26]

The bankruptcy court held that clerical services—those services not requiring the exercise of professional legal judgment—must be included in "overhead."[27] *See* 133 B.R. at 756. We cannot agree that in all cases the general ability of a legal secretary to perform some particular task determines whether a paralegal or a legal secretary is the appropriate, read most efficient, employee to perform it at any given instant. At times temporal constraints may foreclose the delegation option. At other times a paralegal—or, for

26. K & L contends, as does *amicus curiae* the National Federation of Paralegal Associations, Inc., that the types of services the district court disallowed are the types of services for which paralegals are trained and that they are within the scope of paralegal's responsibilities as defined by National Federation of Paralegal Associations, Inc., *Paralegal Responsibilities* at 1–2. Br. for Appellant at 23 n. 9, 35; Br. for *Amicus Curiae* National Federation of Paralegal Assocs., Inc. at 11. But this contention misses the point, for the germane question under § 330 is not what types of services an institution or an expert believes is proper for a paraprofessional to perform, but rather is what types of services the non-bankruptcy market recompenses a paraprofessional for.

27. Overhead for purposes of bankruptcy reimbursement has been defined as "all continuous administrative or general costs or expenses incident to the operation of the firm which cannot be attributed to a particular client or case." *In re Wildman,* 72 B.R. 700, 731 (Bankr.N.D.Ill.1987). Without adopting or rejecting that definition (as we think a market inquiry, not a legal definition, is the cornerstone of compensability and hence the discernment of which items and services a law firm may charge for, *see In re Miguel,* 123 B.R. 634, 637 (Bankr.E.D.Cal.1991) ("Understanding the fee structure of the industry, and of the individual practitioner, is critical to determining how the overhead expenses are included and recovered.")), we observe that it would exclude from overhead, for example, secretarial services whenever the secretary could attribute his or her time to particular clients. This would be true for a great many secretarial services, including typing, filing, and photocopying, as there is no reason to think a secretary cannot log his or her time just as well as can an attorney.

that matter, an attorney—can more productively complete a clerical task, such as photocopying documents, than can a legal secretary.

For example, the combination of the paralegal's effort in retaining and instructing a legal secretary with the legal secretary's effort in performing the task may exceed the paralegal's effort in performing the task alone.[28] Or, a legal secretary may lack the judgment needed in selecting and collating the documents to copy, and the expense of having a paralegal or attorney first instruct the legal secretary and then review his or her work for thoroughness and accuracy combined with the legal secretary's time (albeit subsumed within overhead) may exceed the expense of having the paralegal or attorney personally perform the task in the first place. Or, a legal secretary may simply be unavailable in time to meet a pressing deadline.[29] Generally speaking, attorneys commonly perform intermittent tasks not calling for their particular level of expertise, and nonetheless present non-bankruptcy clients with bills reflecting a single ("blended") hourly rate. *See In re Vogue,* 92 B.R. at 718–19.

[18] In keeping with the market approach, it is critical that courts allow attorneys the same leeway in the types of tasks billed for at their (and their paralegals') established rate as non-bankruptcy clients permit their attorneys (and their attorneys' paralegals), or Congress' manifest intent to provide fully competitive income to bankruptcy attorneys would be transgressed. *Cf. Jenkins,* 491 U.S. at 287, 109 S.Ct. at 2471. A bankruptcy judge, typically far removed from the economics of law practice and the exigencies of making recurring business judgments about the most prudent and cost-effective method for performing a given task with adequate assurances of quality in a developing, competitive legal market, is generally not well-equipped to review subjectively the law firm's allocation of responsibilities and billing practices.

[19] Like any sophisticated consumer of legal services, the bankruptcy court should compare the costs of "equivalent" practitioners of the art (including their billing structures) as well as the applicant's billing practices with "equivalent" clients. Which legal or paralegal services are properly included as the overhead of attorneys' fees, then, are presumably reflected accurately in the services for which attorneys charge their non-bankruptcy clients.[30] The market billing

28. The cost of having the legal secretary perform the task is relevant even when not itemized and separately billed to the client because an improvement in overall productivity accomplished by efficiently allocating tasks between the various occupations employed in a law firm will reduce overall secretarial labor costs and, in an efficient market, correspondingly reduce the overhead component for secretarial labor in that firm's attorneys' fees.

29. Indeed, K & L contends that some of the disallowed paralegal services illustrate precisely this point. In particular, it argues that the bankruptcy court entered numerous interim orders at the commencement of Busy Beaver's petition authorizing Busy Beaver to continue its day-to-day operations—orders pertaining to the use of cash collateral, the continuation of customer policies, the payment of pre-petition wages and employee benefits, the ability to honor pre-petition deposits and credit card charge backs, the retention of counsel, etc.—and directed K & L to serve the interim motions and related orders overnight on various creditor groups composed of up to 120 creditors. K & L argues that "[i]n order to comply timely with the Bankruptcy Court's direction, the paralegal's role was to ensure that the appropriate pleadings and orders were served upon the creditors to whom the Bankruptcy Court had directed service to be made," that "[c]ollating the appropriate documentation involved the paralegals providing services which had intertwined professional and clerical components," and that "[t]he critical timing and need to ensure compliance with service requirements would not have permitted the delegation of the responsibilities *solely* to legal secretaries." Br. of Appellant at 7.

30. We find that the Supreme Court's reasoning concerning compensation for paralegals under civil rights fee-shifting statutes transfers smoothly to the bankruptcy context:

> All else being equal, the hourly fee charged by an attorney whose rates include paralegal work in her hourly fee, or who bills separately for the work of paralegals at cost, will be higher than the hourly fee charged by an attorney competing in the same market who bills separately for the work of paralegals at "market rates." In other words, the prevailing "market rate" for attorney time is not independent of the manner in which paralegal time is accounted for. Thus, if the prevailing practice

practices include not only whether comparable non-bankruptcy firms typically charge the particular task to their clients as paralegal services, but the market rate at which such services are provided. *See Lindy Bros. Builders, Inc. v. American Radiator & Std. Sanitary Corp.*, 487 F.2d 161, 167 (3d Cir. 1973) ("*Lindy I*") (stating "the court may find that the reasonable rate of compensation [for the same person] differs for different activities"), *appeal after remand*, 540 F.2d 102 (3d Cir.1976) (in banc) ("*Lindy II*"); *In re Fine Paper Antitrust Litig.*, 751 F.2d 562, 591 (3d Cir.1984) (same).

[20] Although this case does not present us with a pressing need to define precisely how a bankruptcy court should verify the market rates, if any, for select clerical services, we observe that certainly a bankruptcy judge's experience with fee petitions and his or her expert judgment pertaining to appropriate billing practices, founded on an understanding of the legal profession, will be the *starting point* for any analysis.[31] By starting point we mean to suggest that a bankruptcy judge should use his or her experience and expertise to locate the questionable charges and fees, and once having questioned a charge or fee may properly require the applicant to meet the burden to prove the market would recompense him or her for that charge.

[21] Then the court should carefully consider relevant, competent evidence submitted with the fee application, provided as a supplement to the fee application, or presented at a hearing, *see supra* Part II.B, even if the evidence directly contradicts the court's own judgment. *See In re Continental Ill. Sec. Litig.*, 962 F.2d 566, 570 (7th Cir.1992) ("Markets know market values better than judges do.").[32] Of course, if the bankruptcy court discounts any evidence presented by the fee applicant, *see In re York Int'l Bldg., Inc.*, 527 F.2d 1061, 1068 (9th Cir.1975) (stating that courts "are themselves experts on the value of services rendered in a bankruptcy proceeding and are not bound by the evidence offered"); *Brown v. Culpepper*, 561 F.2d 1177, 1177–78 (5th Cir.1977) (per curiam) (same), the court should to the extent practicable make findings of fact and provide reasoned explanations in the record to facilitate review, *see, e.g., In re Rusty Jones, Inc.*, 134 B.R. 321, 333 (Bankr.N.D.Ill.1991).

[22] As another basis for adjudging the reasonableness of charges for services, upon

> in a given community were to bill paralegal time separately at market rates, fees awarded the attorney at market rates for attorney time would not be fully compensatory if the court refused to compensate hours billed by paralegals or did so only at "cost." Similarly, the fee awarded would be too high if the court accepted separate billing for paralegal hours in a market where that was not the custom.

Jenkins, 491 U.S. at 286–87, 109 S.Ct. at 2471 (footnote omitted); *see In re Temple Retirement Community*, 97 B.R. at 342; *In re Four Star Terminals, Inc.*, 42 B.R. 419, 426 n. 1 (Bankr.D.Alaska 1984) ("[T]hose law firms who bill for such items as secretarial time and file maintenance by paralegals may expect to find their hourly rates reduced to take into account the reduction in their out-of-pocket expenditures for overhead."). A witness at the April 16 evidentiary hearing testified to as much, reasoning that if paralegal services were not billed to particular clients, the attorneys' hourly rate would increase and some clients would indirectly pay for paraprofessional services incurred by other clients, who would pay too little for the services they received. In a competitive legal market, a specific firm's practices will often prove the best guide regarding which services are subsumed in the attorneys' fees as overhead and which are not.

31. *See, e.g., In re Patronek*, 121 B.R. 728, 730–31 (Bankr.E.D.Pa.1990); *In re Kroh Bros. Dev. Co.*, 105 B.R. 515, 520 (Bankr.W.D.Mo.1989); *In re Carter*, 101 B.R. 170, 172 (Bankr.D.S.D.1989); *In re Gulf Consol. Servs.*, 91 B.R. 414, 415 (Bankr.S.D.Tex.1988); *In re Pothoven*, 84 B.R. 579, 583 (Bankr.S.D.Iowa 1988).

32. Judge Posner, who penned *In re Continental Illinois Securities Litigation*, wrote in the context of reversing a district court for discounting attorneys' hourly rates from those that the attorneys regularly billed:

> It is apparent what the district judge's mistake was. He thought he knew the value of the class lawyers' legal services better than the market did.... He may have been right in some ethical or philosophical sense of "value" but it is not the function of judges in fee litigation to determine the equivalent of the medieval just price. It is to determine what the lawyer would receive if he were selling his services in the market rather than being paid by court order.

962 F.2d at 568.

appointment or selection of the debtor's counsel a bankruptcy court might request that counsel provide the court with a confirmed, detailed schedule of fees which counsel actually charges to bankruptcy clients, and where possible to non-bankruptcy clients as well, including the types of paralegal services for which he or she bills and the rates therefor, before he or she commences representing the debtor. *See* 11 U.S.C.A. § 329(a) (1993).[33]

[23] We understand that even under this market-driven framework, some services paralegals now perform at some firms may go uncompensated. K & L argues that in those cases economic considerations will drive firms to have attorneys perform the disallowed tasks. Both the district and bankruptcy courts rejected this argument, explaining that if a service is not compensable to a paralegal, it most likely will also not be compensable to an attorney. We entirely agree with that conclusion. At least absent justifying circumstances (such as time pressures not brought on by a lack of diligence, the excusable non-availability of a less experienced employee, or an inability to delegate the task efficiently, perhaps because the learning curve renders effective delegation infeasible), "[w]hen an experienced attorney does clerk's work, he or she should be paid clerk's wages." *In re Vogue,* 92 B.R. at 718.[34] Section 330(a) is not coy about this matter, but states expressly that how much compensation is reasonable depends on the nature and value of the services, as measured by the cost of comparable services.

[24–26] Finally, because § 330(a) does not entitle debtors' attorneys to any *higher* compensation than that earned by non-bank-

33. That section provides in relevant part:

> Any attorney representing a debtor in a case under this title, or in connection with such a case, ... shall file with the court a statement of the compensation paid or agreed to be paid, if such payment or agreement was made after one year before the date of the filing of the petition, for services rendered or to be rendered in contemplation of or in connection with the case by such attorney
>
> ....

11 U.S.C.A. § 329(a) (1993).

34. *See, e.g., In re Office Prods. of America, Inc.,* 136 B.R. 964, 977 (Bankr.W.D.Tex.1992) (reducing billing rate for attorney who delivered documents); *In re Oakes,* 135 B.R. 511, 514 (Bankr. N.D.Ohio 1991) (compensating counsel at paralegal rates for tasks which a paralegal or an office staff member could perform); *In re Ginji Corp.,* 117 B.R. 983, 993–94 (Bankr.D.Nev.1990) (same); *In re Amatex Corp.,* 70 B.R. 624, 627 (Bankr.E.D.Pa.1985) (same); *In re Associated Grocers of Colo., Inc.,* 137 B.R. 413, 425 (Bankr. D.Colo.1990) (holding only a party with the necessary level of experience should perform a given task and compensation should consequently be set at that level); *In re Rusty Jones, Inc.,* 134 B.R. 321, 334 (Bankr.N.D.Ill.1991) (same); *In re Belknap, Inc.,* 103 B.R. 842, 845 (Bankr.W.D.Ky. 1989) (importuning senior partners not to perform services "which could be as competently performed by associates or paralegals"); *In re Pothoven,* 84 B.R. 579, 585 (Bankr.S.D.Iowa 1988) ("[W]ork done by a senior partner that a beginning associate or paralegal could do will be compensated at a lower rate."); *In re Malden Mills, Inc.,* 42 B.R. 476, 481 (Bankr.D.Mass. 1984) (reducing attorney's fees because experienced counsel charging high rates should delegate tasks not requiring his or her sophistication to junior, less expensive attorneys—"counsel cannot be paid expert rates for routine services"); *cf. Delaware Valley Citizens' Council for Clean Air v. Pennsylvania,* 762 F.2d 272, 279 (3d Cir.1985) (awarding able and experienced counsel fees under the Clean Air Act at paralegal rates for work which was "mundane or minor in character"), *modified,* 478 U.S. 546, 106 S.Ct. 3088, 92 L.Ed.2d 439 (1986); *In re Fine Paper Antitrust Litig.,* 751 F.2d 562, 591–93 (3d Cir.1984) (awarding partners compensation under the equitable fund doctrine in a class action at an associate attorney level for "tasks which are customarily performed by junior associates or paralegals"); *Ursic v. Bethlehem Mines,* 719 F.2d 670, 677 (3d Cir.1983) (statutory fee case under ERISA) ("Nor do we approve the wasteful use of highly skilled and highly priced talent for matters easily delegable to non-professionals or less experienced associates. Routine tasks, if performed by senior partners in large firms, should not be billed at their usual rates. A Michelangelo should not charge Sistine Chapel rates for painting a farmer's barn."); *In re Meade Land & Dev. Co.,* 527 F.2d at 285 (stating an attorney is entitled to compensation only for services which "could colorably constitute the type of services one would reasonably expect an attorney to perform under the circumstances"); *Cohen & Thiros,* 44 B.R. at 573 ("[M]inisterial legal work is compensated at rates lower than truly legal service."); *Johnson v. Georgia Highway Express, Inc.,* 488 F.2d 714, 717 (5th Cir.1974) ("[N]on-legal work may command a lesser rate. Its dollar value is not enhanced just because a lawyer does it.").

ruptcy attorneys, *In re Manoa Fin. Co.*, 853 F.2d at 690, the court should review a fee application to ensure the applicant exercises the same "billing judgment" as do non-bankruptcy attorneys by, for example, writing off unproductive research time, duplicative services, redundant costs precipitated by overstaffing, or other expenses with regard to which the professional generally assumes the cost as overhead in corresponding non-bankruptcy matters, or for which analogous non-bankruptcy clients typically decline to pay. *See* 11 U.S.C.A. § 330(a) (allowing a court to award compensation for "actual, necessary services"); *In re Automobile Warranty Corp.*, 138 B.R. 72, 79 (Bankr.D.Colo.1991); *cf. Hensley*, 461 U.S. at 434, 103 S.Ct. at 1939–40 (plurality).[35]

[27] While bankruptcy fees are commonly calculated using the lodestar method, we note in closing that, contrary to the apparent view of the Sixth Circuit Court of Appeals, *see In re Boddy*, 950 F.2d 334, 337 (6th Cir.1991), § 330 by no means ossifies the lodestar approach as the point of departure in fee determinations. We refer to it here because the product of an hourly rate by the number of hours worked to this day remains the overwhelmingly prevailing billing method within the market for most legal services. But with the rise of competitive pressures and the ceaseless evolution of the legal community, we may expect to witness law practitioners adapt to the changed circumstances by developing alternative billing practices and methods.[36] The strength of the market approach Congress embraced with § 330 is that these developments, including regional variations, will automatically percolate up through bankruptcy fee allotments. While § 330 is not an engine for implementing innovative billing strategies, it will readily accommodate alternative practices once comfortably established in the realm of comparable non-bankruptcy legal services.

IV. CONCLUSION

Because neither the bankruptcy court nor the district court applied the correct legal standard, the district court's opinion and order will be vacated and the case remanded to the district court with directions to remand to the bankruptcy court with instructions to reconsider K & L's initial fee application in light of the foregoing opinion.

35. The aforementioned principle of responsible billing applies not only to the selection of which classification of employee within a law firm should perform a given task, but also to what genre of law firm should represent the debtor. A run-of-the-mill bankruptcy case does not warrant the lofty fees of nationally-renowned law firms, *see In re Vogue*, 92 B.R. at 718, and a reasonable debtor concerned with the economical administration of the estate in such a case would refrain from retaining over-qualified counsel. In other words, the reasonable hourly rate has a cap based on the expected and actual complexity of the case, a cap which, while flexible, should stave off clear abuses. *Compare In re Waldoff's Inc.*, 132 B.R. 329, 335 (Bankr.S.D.Miss.1991) (substantially reducing out-of-state counsel's fees to match prevailing local rates because the complexities of the case did not warrant retention of a law firm charging counsel's requested rates) *and In re Casull*, 139 B.R. 525, 528 (Bankr.D.Colo.1992) (reducing fees found excessive "considering the nature and complexity of the issues dealt with") *with In re Robertson Cos.*, 123 B.R. 616, 619 (Bankr.D.N.D.1990) (awarding out-of-state law firm its locally prevailing rate, which far exceeded local bankruptcy rates, in light of the size and complexity of the case) *and In re Frontier Airlines, Inc.*, 74 B.R. 973, 976–77 (Bankr.D.Colo.1987) (same). To be fair to the professional, the court should dispose of this problem as early as practical, preferably before the debtor retains the professional.

36. *See generally* Robert E. Litan & Steven C. Salop, *Reforming the Lawyer–Client Relationship Through Alternative Billing Methods*, JUDICATURE, Jan.–Feb. 1994, at 191; Steven Brill, *Replacing the Hourly Rate*, Am. LAW., Sep. 1992, at 6; Deborah Graham, *Billing Methods: Firms Begin to Tinker*, LEGAL TIMES, May 20, 1985, at 1.

concur with the conclusion of Chief Judge Twardowski that we should not make "the self-settled nature of the trust the *sine qua non* of our analysis." *Hysick, supra,* 90 B.R. at 775.

[7] Where a debtor's access to trust funds is conditioned upon termination of employment, death, or disability, then an otherwise valid spendthrift trust will be enforceable. *Hysick, supra,* 90 B.R. at 776. However, a debtor's access to his IRA funds is not conditioned upon such dire consequences. The possible imposition of a ten (10%) percent tax penalty does not substantially limit the debtor's access to or control over his IRAs. *See Goff, supra,* 706 F.2d at 589 (ten (10%) percent tax penalty for withdrawal of funds in Keogh Plan is an insufficient limitation on control to render same a spendthrift trust fund). Bankruptcy courts considering this issue have thus concluded that IRAs do not qualify as spendthrift trusts and hence are not excluded from property of the estate by operation of Section 541(c)(2). *Heisey, supra; Gillett, supra; In re Schwartz,* 58 B.R. 606 (Bankr.N.D.Iowa 1984); and *Howerton, supra. Cf. In re Dunn,* 5 B.R. 156 (Bankr.N.D.Tex.1980) (decided under Bankruptcy Act). In light of the degree of control which the Debtor may exercise over the assets in his IRA accounts, we conclude that the IRA Agreements in issue do not place restrictions on the transfer of Debtor's assets which would be enforceable under Pennsylvania spendthrift trust law.

E. CONCLUSION

For the reasons set forth above, we conclude that 11 U.S.C. § 541(c)(2) only excludes, from property of the debtor's estate, a restriction on the transfer of a debtor's beneficial interest in a trust which would be enforceable under state spendthrift trust law. While the IRA Agreements in issue contain "spendthrift" provisions purporting to restrict a creditor's rights to attach funds in the IRAs, given the degree of control which the Debtor enjoys with respect to his IRA accounts, we conclude that these IRAs are not enforceable spendthrift trusts under Pennsylvania spendthrift trust law. We do not here address the issue of whether the Debtor's IRAs are exempt from attachment under 42 Pa.C.S. § 8124(b)(1)(vii). We conclude only that the Debtor's IRAs are property of his bankruptcy estate. An appropriate Order will be entered.

ORDER

AND NOW, this 18th day of January, 1989, after consideration of the Stipulation of Facts and respective Briefs submitted by the Debtor and Trustee relative to the Trustee's Objections to the Debtor's claims of exemptions in this matter, it is hereby

ORDERED AND DECREED that the Debtor's request to exclude his IRAs from property of the bankruptcy estate pursuant to 11 U.S.C. § 541(c)(2) is DENIED.

In re METRO COMMUNICATIONS, INC., t/a Metrosports, Debtor.

MELLON BANK, N.A., Plaintiff,

v.

METRO COMMUNICATIONS, INC., t/a Metrosports, Debtor-in-Possession, and The Pacific-10 Conference, Defendants,

v.

The COMMITTEE OF UNSECURED CREDITORS, Intervenor.

Bankruptcy No. 85-552.
Adv. No. 86-104.

United States Bankruptcy Court,
W.D. Pennsylvania.

Feb. 10, 1989.

Bank which had made loans to corporate debtor sought determination of secured status, and intervening committee of unsecured creditors averred various transfers made to bank had to be avoided for

benefit of estate as preferential payments, fraudulent conveyances, and/or improvidently made postpetition transfers, and alleged original acquisition of corporate debtor by shell holding company was fraudulent conveyance subject to avoidance. The Bankruptcy Court, Bernard Markovitz, J., held that: (1) any reperfection of creditor's secured status that occurred in Pennsylvania within 90 days prior to bankruptcy filing by corporate debtor constituted impermissible preference that had to be avoided, and accordingly, any postpetition payments made pursuant to alleged perfected status, including court-ordered adequate protection payments, had to be vacated and/or reversed as improvidently paid; (2) ordinary course of business exception to transfer avoidance did not apply to transfers made within preference period on loans; and (3) leveraged buyout was fraudulent conveyance that had to be avoided.

Ordered accordingly.

1. Secured Transactions ⚷98

Corporate debtor's chief executive office moved from Maryland to Pennsylvania some time before October 1984, and financing statements filed in Pennsylvania in February 1985 accordingly did not operate to continue any perfected status, but rather, at most reperfected creditor's secured status, under Pennsylvania law. 13 Pa.C.S.A. § 9103(c)(4, 5); U.C.C. § 9–103 comment.

2. Bankruptcy ⚷2603

Any reperfection of creditor's secured status that occurred in Pennsylvania within 90 days prior to bankruptcy filing by corporate debtor constituted impermissible preference that had to be avoided, and accordingly, any postpetition payments made pursuant to alleged perfected status, including court-ordered adequate protection payments, had to be vacated and/or reversed as improvidently paid. Bankr.Code, 11 U.S.C.A. § 547.

3. Bankruptcy ⚷2616(1)

Payments made by corporate debtor to creditor within 90–day preference period were not protected from avoidance under ordinary course of business exception; leveraged buyout/stock purchase loan by creditor bank was not in ordinary course of debtor's broadcast and/or advertising business, payments on LBO/stock purchase, working capital, and letter of credit loans during preference period were made in sporadic and hurried manner and some were in unusual amounts, and no evidence was offered regarding industry standards relating to payments in ordinary course of business, so creditor bank had not met its burden of showing payments were made according to ordinary business terms. Bankr.Code, 11 U.S.C.A. § 547(c)(2).

4. Bankruptcy ⚷2616(4)

To establish payments made during 90–day preference period were made according to ordinary business terms, for purposes of ordinary course of business exception to transfer avoidance, consistency of practices in relation to industry counterparts had to be examined. Bankr.Code, 11 U.S.C.A. § 547(c)(2).

5. Bankruptcy ⚷2645

Statute providing for avoidance of fraudulent transfers and obligations is applicable to leveraged buyouts; the statute refers to any transfer, and leveraged buyout is transfer of interest in property. Bankr.Code, 11 U.S.C.A. § 548.

6. Bankruptcy ⚷2645

Acquisition of corporate debtor through leveraged buyout by shell holding company was fraudulent conveyance subject to avoidance; debtor corporation guaranteed $1.85 million loan granted to parent holding company, that money was used to purchase corporate debtor's shares from debtor's former shareholders, parent holding company had no assets except debtor, and debtor was insolvent, as it had $1.85 million debt for which it had pledged all of its assets and for which it had received no part of the $1.85 million. Bankr.Code, 11 U.S.C.A. § 548.

Kenneth P. Simon, Simon & Simon, Pittsburgh, Pa., for intervenor, committee of unsecured creditors.

George M. Cheever, Kirkpatrick & Lockhart, Pittsburgh, Pa., for plaintiff, Mellon Bank, N.A.

Stephen J. Laidhold, Lampl, Sable, Makoroff & Libenson, Pittsburgh, Pa., for debtor.

Charles J. Vollmer, Pollard, Walker & Vollmer, Pittsburgh, Pa., for PAC-10 Conference.

Stephen I. Goldring, Pittsburgh, Pa., Asst. U.S. Trustee.

MEMORANDUM OPINION

BERNARD MARKOVITZ, Bankruptcy Judge.

Before the Court is Mellon Bank's ("Mellon") *Complaint to Determine Secured Status.*[1] The Committee of Unsecured Creditors ("Committee"), as Intervenor,[2] has answered said Complaint, averring that various transfers made to Mellon must be avoided for the benefit of the estate, as being preferential payments, fraudulent conveyances, and/or improvidently-made postpetition transfers. Specifically, the parties agree that Debtor's chief executive office moved from Rockville, Maryland to Pittsburgh, Pennsylvania, at some time between April 6, 1984 and March 15, 1985. Mellon's secured status depends upon a factual finding that the change in chief executive office occurred on or after October 5, 1984. The Committee challenges this contention, asserting that the move occurred much earlier than October 5, 1984, and that Mellon's security lapsed before the necessary financing statements were filed. Additionally, the Committee charges that the transactions involving Debtor and Mellon rendered Debtor insolvent and/or left Debtor with an unreasonably small capital, thereby constituting a fraudulent transfer. If findings to that effect were entered, certain postpetition adequate protection Orders, submitted by Debtor and Mellon, would of necessity be vacated as having been entered improvidently. Mellon denies these allegations, asserting, *inter alia,* that Debtor was neither rendered insolvent nor left with an insufficient capital base as a result of the transactions by and between the parties.

Trial was conducted with each party presenting in excess of sixty (60) exhibits; numerous witnesses were examined. The parties have briefed the issues, and have submitted proposed findings of fact and conclusions of law. After thorough analysis of the credible testimony, both oral and documentary, we find that Mellon is not a secured creditor, having failed to meet its burden of proof as to its perfected status. Therefore, any payments made to Mellon postpetition were and are inappropriate transfers. Additionally, any payments made within ninety (90) days prior to Debtor's bankruptcy filing were preferential payments and do not fall within any of the enumerated exceptions of § 547(c). Finally, we find that Debtor's guaranty of the Mellon loan to its parent was a fraudulent conveyance.

Debtor and Mellon will be directed to compile a complete and accurate accounting of all payments, made by Debtor to Mellon on behalf of itself or any of its related entities, or made by any other party to Mellon using Debtor's funds, and Mellon will be required to disgorge same, with legal interest from the date of receipt.

FACTS

Debtor was a Maryland corporation, with its chief executive office at 6151 Executive Boulevard, Rockville, Maryland, 20852, and was in the business of television and radio sports syndication. With the exception of actual production, Debtor was engaged in all aspects of the business most significantly in the acquisition of broadcast rights, and advertising sales. Debtor had its own officers and employees and was an autonomous organization.

1. This action constitutes a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (F), (H), (K), and (O).

2. Defendants in this case, The PAC-10 Conference, have entered into a settlement agreement with Plaintiff. Approval of same by this Court has been held in abeyance pending the outcome of the instant proceedings.

In April of 1984, Debtor was acquired in a leveraged buyout by a holding company called Total Communications, Inc. ("TCI"), a wholly-owned subsidiary of Total Communication Systems, Co. ("TCS"). TCI was a shell corporation, having no assets or liabilities, and was created for the specific purpose of this transaction.[3] In order to conduct this transaction the parties entered into various loan, guaranty and suretyship agreements with Mellon. On April 6, 1984, TCI received a loan of $1,850,000.00 to finance its purchase of Debtor's stock; all of Debtor's present and future assets, including its stock, served as collateral for this loan. Debtor also executed a guaranty and suretyship agreement for this TCI loan.[4]

Debtor received a $2,300,000.00 working capital loan under a line of credit agreement, for which it was primarily liable, also dated April 6, 1984. TCI, TCS, and Mass Communication and Management, Ltd. ("MCM"), parent of TCS, guaranteed this loan; again, however, the actual security for this loan was Debtor's present and future assets. A formal security agreement between Debtor and Mellon was also executed on April 6, 1984. All of the above-mentioned documents, executed on April 6, 1984, were signed by Leonard L. Klompus ("Klompus") on behalf of Debtor, and Nelson L. Goldberg ("Goldberg") on behalf of TCI, TCS, and MCM. UCC-1 financing statements were filed in the appropriate state and local offices in Maryland. Those financing statements, dated *April 5*, 1984, the day prior to the actual loan transaction, were signed by *Goldberg* on behalf of *Debtor.*[5]

On September 7, 1984, Debtor and Mellon entered into a letter of credit agreement to finance Debtor's purchase of broadcast rights for the PAC-10 Conference football season. Draws upon these letters of credit created a demand loan between Mellon and Debtor. This loan was also secured by the security agreement executed April 6, 1984, and was guaranteed by TCI, TCS and MCM.

During the course of events following Debtor's acquisition by TCI, a transfer of power began to occur, from Klompus to Goldberg, from Rockville to Pittsburgh, until the Rockville office was closed and the employees therein, including Klompus, were released.

This transfer of power began gradually, and then proceeded rapidly. The seeds of its inception were planted even before the acquisition was finalized. In a letter dated February 28, 1984, from TCS counsel to Mellon, the union of Debtor and TCS was discussed in great detail. Apparently TCS was providing Mellon with an introduction to Debtor as an investment interest. The relationship is described as offering "... substantial opportunities for Nelson [Goldberg]." *Committee Exhibit 63,* and describing the importance of Debtor to TCS, as employing "... several experienced managers who will provide management depth for the *new organization.*" *Id.* (emphasis added).

Additional insight into the transformation is provided by the "Employer's Quarterly Federal Tax Return" forms filed on Debtor's behalf. On April 3, 1984, before the acquisition occurred, William Eitze, Debtor's comptroller, prepared and filed said return from Rockville. However, the quarterly return dated July 31, 1984 is signed by Diana Acre, a TCS employee, situate in Pittsburgh. *Mellon Exhibit 16.* By July 30, 1984, Acre was the person authorized to file the quarterly employment reports with the State of Maryland, *Mellon Exhibit 15,* and the State of Califor-

3. The Mellon loan was originally made to TCS, and was approved in March 1984. Approximately ten (10) days after the transaction occurred, TCS was replaced with TCI as borrower. Said change was approved by Mellon.

4. At no time prior to the acquisition did TCI or TCS request an *audited* financial statement regarding Debtor's financial status.

5. It appears to this Court that even the *original* security interest may never have been properly perfected. When Goldberg executed the financing statement on behalf of Debtor, he was not yet connected to Debtor in any way. It is axiomatic that a financing statement is invalid unless *signed by the Debtor.* The financing statements signed on April 5, 1984, were *not* signed by Debtor.

nia tax returns, for the employee in the Los Angeles office. *Mellon Exhibit 19.*

In June of 1984 it became apparent that the controls were being passed from Maryland to Pennsylvania. By letter dated June 13, Eitze informed Martin Singer, a vice president at TCS, that he (Singer) would soon need to address certain financial relationships in Maryland. *Committee Exhibit 64.* Eitze was cognizant that he would soon be leaving Debtor's employ, and in fact, was gone by July 14, 1984.

Undoubtedly the metamorphosis was nearly complete on July 12, 1984, when Goldberg and Klompus issued a joint press release announcing the formation of TCS/Metrosports. In that announcement, the following explanation was offered:

> TCS/Metrosports will be *headquartered* out of TCS' New Kensington, PA location (just outside of Pittsburgh), and will *operate offices* in Rockville, MD; New York, NY; and Los Angeles, CA. Goldberg will serve as chairman of the board and chief executive officer. Klompus will serve as president.

Committee Exhibit 65. (emphasis added).

In August of 1984 Gail Schelat ("Schelat"), a former Mellon loan officer, became the Chief Financial Officer of both TCS and Debtor. Ms. Schelat's work station was Pittsburgh. On September 5, 1984 Schelat advised Mellon that the Debtor, TCS and Media Sales Corporation, the advertising arm of this conglomerate, would be sharing the use of a wholesale lock box, and that all customers would be advised of the change in procedure for remittance of accounts receivable. *Mellon Exhibit 67.* In fact, Debtor's invoices issued subsequently bore the following notice:

> Please Remit to:
> TCS/METRO
> P.O. BOX 371273
> PITTSBURGH, PA 15251

By October of 1984 Schelat had replaced Klompus in all but ministerial acts as regards the administration of Debtor. In fact, on October 3, 1984 Schelat, on behalf of Debtor, executed the Football Telecast Agreement between Debtor and the Naval Academy; this was the type of activity which was previously handled almost exclusively by Klompus. *Mellon Exhibit 24.* Two days later, Schelat wrote a letter to counsel for the Big East Conference, emphasizing the necessity for *her authorization* in all aspects of its relationships with TCS and Debtor.

> To ensure that everything proceeds smoothly and there are no misunderstandings I should be copied on all correspondence and *I must confirm* any agreements relating to our relationship, *in both TCS Productions and Metrosports.*

Committee Exhibit 27. (emphasis added).

When Debtor's bankruptcy was commenced on March 15, 1985, Schelat signed the Unsworn Declaration Under Penalty of Perjury, averring that Debtor had been a resident of Pennsylvania for the preceding 180 days, or since September 15, 1984.

The greatest overall indication of the change in the relationship between TCS and Debtor is the parallel change in the relationship between Goldberg and Klompus, as revealed in Klompus' weekly status reports to Goldberg. Supposedly, Klompus was merely required to provide Goldberg with a highlight of the week's activities; however, even the first report, dated April 20, 1984, provides insight that Klompus no longer had the last word:

> I have enclosed the University of Oklahoma bid spec for you ...
>
> As per your request, we successfully negotiated a 90–day termination ...
>
> Everything is on hold pending your meetings ...
>
> I need your approval regarding the 1984 PGA Southern Open Golf Tournament ...

Committee Exhibit 5.

Future reports eliminate any doubt that Klompus was working *for* Goldberg rather than *with* him. In his May 4, 1984 status report, he advised Goldberg of the team effort being made by him and the others in the Rockville office to meet Goldberg's projections:

... *we* are going to work very hard to increase the bottom line to the 30–40% that *you* are looking for.

Committee Exhibit 6. (emphasis added.)

By the middle of May, Klompus was speaking to Goldberg on a daily basis. *Committee Exhibit 7.* As time wore on, Klompus' reports became less executive and administrative, and more sales-oriented:

We worked today on getting all of the information in regards to the sales that you need.

Committee Exhibit 8. See also, Committee Exhibit 10, which highlights an extensive West Coast sales trip and contemplates weekly return visits. By July 20, 1984, Klompus' entire report dealt with sales. *Committee Exhibit 11. See also, Committee Exhibit 13,* wherein Klompus states:

I am now spending the majority of my day on sales, either with Media Sales or independently ...

Again, in my emphasis to selling, I have been spending most of my time doing that.

These weekly reports also indicate that by August of 1984 all contracts for trade and talent were being generated by TCS counsel and were being executed in Pittsburgh; Klompus, and the remaining Rockville staff, had resigned themselves to a lesser status:

Pursuant to our discussion on Monday, *your* decision on how to handle Media Sales at this point with *us* taking all of our time now in working in sales, *it is your decision on how to go.*

Committee Exhibit 14.

By September the Rockville office had no more executive authority; it was merely a large sales arm of the Pittsburgh hub.

The payments by and among the various parties fall into at least two (2) categories: prepetition payments within the preference period, and postpetition payments. During the ninety (90) days prior to the Debtor's bankruptcy filing, the following total payments were received by Mellon:[6]

TCI Loan	$ 39,641.04
Debtor–Line of Credit	94,685.94
Debtor–Demand Note	26,263.35
TCS Loans	95,036.62
	$255,626.95

After Debtor's bankruptcy filing, Mellon received the following payments:[7]

TCI Loan	$ 133,378.20
Debtor–Line of Credit	155,139.85
Debtor–Demand Note	1,522,779.45[8]
TCS Loans	260,961.21
	$2,068,258.71

At this time we are unable to determine the precise amount actually paid from Debtor's funds as opposed to those funds which came from TCS. It does appear that a substantial sum was transferred postpetition from Debtor to TCS.[9]

ANALYSIS

[1] Mellon's Complaint was brought as an assertion of its secured status. It therefore has the burden of proving same by a preponderance of the evidence. We are initially directed by Mellon to the Uniform Commercial Code, as adopted in Pennsylvania, specifically 13 Pa.C.S.A. § 9103(c), which discusses the perfection of security interests in multi-state transactions. Mellon contends that its perfected secured status arises pursuant to § 9103(c)(4) and (5) which states in pertinent part as follows:

(4) A debtor shall be deemed located...., at his chief executive office if he has more than one place of business....

6. These numbers are based on figures provided in the parties' exhibits and may or may not be complete.

7. See Note 6.

8. Includes two Court-ordered "adequate protection" payments, dated October 24, 1985 and February 10, 1986, which were based upon Consent Orders averring Mellon's secured status.

9. Debtor's accounting provided in the main bankruptcy case at Docket Number 204, dated July 25, 1986, indicates postpetition payments to TCS totaling $719,000.00, of which $155,850.00 is directly attributable to interest expense.

(5) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the location of the debtor to another jurisdiction or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change.

There is no dispute that at the time of the April acquisition by TCI, the Debtor's chief executive office was located in Rockville, Maryland. It is also agreed that by the end of December, Debtor's chief executive office was situated in Pittsburgh, Pennsylvania. The issue at bar revolves around the date upon which this transfer occurred. If the move occurred on or after October 5, 1984, Mellon has a perfected security interest in all of Debtor's assets.[10] If the change of chief executive office occurred prior to October 5, 1984, Mellon's perfection would have lapsed, and the filing of financing statements in Pennsylvania would constitute a re-perfection, rather than a continuation of the earlier perfected status. The import of that distinction becomes clear when one realizes that the Pennsylvania UCC filings occurred within the ninety (90) days preceding Debtor's bankruptcy filing. Therefore, if the financing statements created a new perfection rather than a continued status, that new perfection would constitute a preferential transfer under the Bankruptcy Code, 11 U.S.C. § 547, and would be avoidable.

The Official Comments to Section 9–103 explain the phrase "chief executive office", which is otherwise undefined in the context of the UCC:

"Chief executive office" does not mean the place of incorporation; it means the place from which in fact the debtor manages the main part of his business operations. This is the place where persons dealing with the debtor would normally look for credit information.

While very few courts have analyzed this issue, the Ninth and Tenth Circuits have rendered decisions, and reached their respective conclusions using very similar analyses. Both have rejected earlier decisions, such as *Tatelbaum v. Commerce Investment Co.*, 257 Md. 194, 262 A.2d 494 (1970), which relied almost exclusively on the "volume of business" test (i.e. the chief place of business is where the majority of the business is conducted.)

Significantly, it appears that both circuit courts place great weight on the change in the Code's language from "chief place of business" (original) to "chief executive office" (amended). *In re Golf Course Builders Leasing, Inc.*, 768 F.2d 1167, 1170 (10th Cir.1985); *In re J.A. Thompson & Sons, Inc.*, 665 F.2d 941, 950 (9th Cir.1982). Each Court notes that the focus has been realigned to "...the location which serves as *executive headquarters* for the debtor's multi-state operation, and not on the location which generates the largest business volume." *Id.* (emphasis added).

Both courts have also employed a two-part test to determine the location of a debtor's chief executive office, as developed from the earlier quoted language of the drafter's Committee Notes:

(1) from which place does the debtor *manage* the main part of its business operations; and

(2) where would creditors reasonably be expected to search for *credit information?*

Golf Course, 768 F.2d at 1170; *Thompson*, 665 F.2d at 949. (emphasis added).

Numerous factual indicia were considered by these courts in making their decisions; they can be categorized as follows:

(1) existence of office autonomy;

(2) location of officers and directors;

(3) office from which the annual report is generated;

10. However, even this conclusion is questionable—See note 5.

(4) location of financial records, including bookkeeping functions, tax preparation and maintenance of payroll;
(5) office from which business is negotiated and contracts are executed;
(6) location which generates greatest revenues;
(7) area in which majority of debtor's creditors are located; and
(8) location from which primary accounting and legal services are rendered.

In analyzing the instant case, these factors will be addressed seriatim.

1. Existence of Office Autonomy

At the time of Debtor's acquisition by TCI, the Rockville office was autonomous: it had its own officers, comptroller, financial and marketing staff. All decisions were made and finalized in Rockville, Maryland. Over time, from April through early October, Debtor's Rockville office suffered a loss of that autonomy. Goldberg and Schelat, Chief Executive Officer and Chief Financial Officer respectively, took gradual but steadily increasing control of the Debtor's business. Eitze, Debtor's comptroller, knew in June of 1984 that he would soon be released and was "laid off" in July. Thereafter, all accounting information was transmitted to the accounting department in Pittsburgh for processing. Schelat was hired in August; from that point forward, she and her staff handled the financial aspects of Debtor's business.

During that same time frame, April through early October, Klompus began to lose control over contract negotiation and decision making in general; with Schelat taking final authority for contracts and Goldberg making all major decisions, Klompus was reduced to an advertising salesman by the end of August. Goldberg began to lose faith in Klompus, and therefore, took his power away.[11] That Goldberg could in fact *take* the power is a prime indication that Rockville was no longer an autonomous office. To the contrary, the power and control were found in Pittsburgh, Pennsylvania.

2. Location of Officers and Directors

The major officers were effectively split between Pittsburgh and Rockville: Goldberg, the CEO and Chairman of the Board was located in Pittsburgh; Klompus, the President, was in Rockville; Schelat, the CFO, was situated in Pittsburgh; Cherner–Klompus and Karlsson, both vice presidents, were located in Rockville.

The weight of the evidence indicates that Goldberg and Schelat had the ultimate control well before October 5, 1984. As earlier noted, Klompus' weekly reports and daily conversations with Goldberg provide significant insight, as does Schelat's testimony that she was hired by Goldberg in August specifically to oversee and review Klompus' activities. Klompus pursued sales and ran various business errands in Rockville, Maryland; however, the management of the bulk of Debtor's business operations, and the only place to secure credit information, was found in Pittsburgh, Pennsylvania.

3. Annual Report Generation

No testimony was provided on this issue. We have no indication that any annual report was ever generated. The likelihood of same is reduced by the fact that the Debtor filed bankruptcy less than one year after the acquisition occurred. However, from the testimony and exhibits offered, it is clear to the Court that had such a document been considered, surely the "powers" of this corporation, located in Pittsburgh, would have made the decision whether or not to issue such a document, and would have had substantial input regarding substance and/or content. Some of the employees in Maryland would have supplied a portion of the information; however, its genesis and exodus would stem from Pittsburgh.

4. Location of Financial Records Including Bookkeeping, Taxes and Payroll

At the time of the April–1984 acquisition, all of Debtor's financial records were kept in Rockville, and were handled by Eitze.

11. At some time after December 14, 1984, a lawsuit was instituted against Klompus and others by Mass Communications and Management, TCS and TCI. That suit has since been dismissed.

When he left in July–1984, all financial duties were turned over to the Pittsburgh accounting office.

Schelat arrived in August–1984 and took primary responsibility for all financial aspects of Debtor's business including, but not limited to, accounts payable and receivable; general ledgers; and balance sheets and financial statements. Tax preparations were delegated by Schelat to other Pittsburgh staff, primarily William Jackson, controller, and Diana Acre, a bookkeeper.

We are unable to make a determination as to payroll preparation, in large part because the testimony was very limited. However, Schelat testified that her salary expense was shared between TCS and Debtor, although she was listed on TCS' payroll.

5. Office From Which Business Is Negotiated And Contracts Are Executed

Plaintiff attempted to give the impression that after the acquisition Klompus was still the Debtor and the Debtor was still Klompus. This conclusion is not supported by the credible factual data.

Originally Klompus handled all contract rights and most negotiations, with any legal aspects of same being channeled through Maryland counsel. As time progressed, Klompus was required to clear all negotiations through Goldberg, and often met or spoke with Goldberg before and after negotiating sessions. After Schelat was hired by Goldberg, in August of 1984, she became extensively involved in the negotiation process, and her approval was *required* on all contracts—even those previously negotiated by Klompus.

Additionally, TCS' counsel, Robert Krause, became more and more involved in negotiating and drafting contracts between Debtor and others; eventually, Krause handled all matters of legal import.

6. Location Which Generates Greatest Revenues

In April of 1984 Rockville generated all of the Debtor's revenues as all accounts were handled there. By early September a lock box arrangement had been installed with Mellon. All TCS, Metro, and Media Sales receipts were directed to said lock box and credited to appropriate parties. However, we have no real testimony as to which office *actually* generated the greatest revenues.

7. Location of Creditors

This item is not really applicable as Debtor had creditors all over the country (i.e. advertisers, individual schools, college conferences, television and radio stations) and ascertaining a central location is not feasible.

8. Location From Which Primary Accounting and Legal Services Are Rendered

The Debtor originally employed Maryland and Washington, D.C. attorneys and accountants to handle all legal and tax matters, with Eitze handling day-to-day financials "in house". After the acquisition by TCS, Krause began to perform all of the Debtor's legal work as it related to negotiations and contracts, with local Maryland counsel handling certain specific lawsuits and other various and sundry court proceedings.

Similarly, after the departure of Eitze, all accounting was transferred to Pittsburgh, with Schelat and her staff handling most financials and receiving outside tax and/or audit assistance from Touche Ross' Pittsburgh office.

[2] Based upon the foregoing, it is clear that at least some time before October, and most apparently by late August, Debtor's "chief executive office" had moved from Rockville, Maryland to Pittsburgh, Pennsylvania. Therefore, Mellon's UCC–1 financing statements, filed in Pennsylvania on February 1st, 4th and 5th, 1985, did not operate to continue any perfected status; rather, said filing *re*-perfected Mellon's secured status.[12] Since this re-perfection

12. As stated *supra*, at Note 5, there is good cause to argue that Mellon was never properly perfected until the Pennsylvania filings occurred. Since they are the avoidable preferential transfers, there may never have been proper perfection between Debtor and Mellon. For the pur-

constitutes a transfer of the Debtor's property, and since it occurred within ninety (90) days prior to Debtor's bankruptcy filing, Mellon's perfection is an impermissible preference and must be avoided. By the same analysis, any postpetition payments made pursuant to said perfected status, including but not limited to the court-ordered adequate protection payments, must be vacated and/or reversed as having been improvidently paid.

[3] Mellon contends that it remains entitled to retain those payments made by Debtor within the ninety (90) day preference period; it claims that said payments fall within the exception found at § 547(c)(2), commonly called the "ordinary course" exception, which states as follows:

> (c) The trustee may not avoid under this section a transfer—
>
> (2) to the extent that such transfer was—
>
> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
>
> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
>
> (C) made according to ordinary business terms; ...

The three (3) questions which are raised by this exception are properly phrased, in our present scenario, in the following manner:

> (1) Was the *original* debt incurred in the ordinary course of business of both Debtor and Mellon?
>
> (2) Were the payments by Debtor to Mellon during the ninety (90) day period, made in the ordinary course of business of both Debtor and Mellon?
>
> (3) Were the payments by Debtor to Mellon during the ninety (90) day period made according to ordinary business terms?

See, In re Vunovich, 74 B.R. 629 (Bankr.D. Kan.1987).

In order to succeed on the exception, Mellon must supply this Court with a preponderance of proof, enabling affirmative answers to *all three* questions. *WJM, Inc. v. Massachusetts Dept. of Public Welfare,* 840 F.2d 996 (1st Cir.1988); *In re RDC Corporation,* 88 B.R. 97 (Bankr.W.D.La. 1988); *In re First Software Corp.,* 81 B.R. 211 (Bankr.D.Mass.1988); *In re Cleveland Graphic Reproduction, Inc.,* 78 B.R. 819 (Bankr.N.D.Ohio 1987); *In re Antinarelli Enterprises, Inc.,* 76 B.R. 247 (Bankr.D. Mass.1987).

While the answers to these questions rest in large part upon factual determinations, it is important to evaluate those facts with an eye toward the overall purpose of this exception, which is:

> ... to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy.

H.R.Rep. No. 95–595, 95th Cong., 1st Sess. 373 (1977); S.Rep. No. 95–989, 95th Cong., 2d Sess. 88 (1978), U.S.Code Cong. & Admin.News 1978, pp. 5787, 5874, 6329. *See also, WJM, Inc., supra; First Software, supra; Cleveland Graphic, supra; In re Day Telecommunications, Inc.,* 70 B.R. 904 (Bankr.E.D.N.C.1987).

> (1) Was the *original* debt incurred in the ordinary course of business of both Debtor and Mellon?

As a banking institution, Mellon makes loans on a daily basis for a multitude of purposes. It would therefore appear that all three (3) loans, i.e. the LBO/stock purchase, the working capital, and the PAC–10 letter of credit, were made in Mellon's ordinary course of business.

Whether these loans were made in Debtor's ordinary course of business is another question entirely. Debtor was in the broadcasting and advertising business; only if these loan transactions were normally conducted as part of Debtor's broadcast and/or advertising business should they be considered within the ordinary course of its business. *In re Daikin Miami Overseas, Inc.,* 65 B.R. 396 (Bankr.S.D.

pose of continuity, we refer to it above as "reperfection".

Fla.1986). Arguably, the letter of credit and working capital loans fall within this caveat, although it is unclear whether Debtor regularly borrowed funds for working capital or obtained letter of credit financing for broadcast right acquisitions. In any event, however, the LBO/stock purchase loan is highly extraordinary in nature and no company's borrowing to allow for the purchase of its own stock could ever be considered part of the ordinary course of its business.

(2) Were the payments by Debtor to Mellon during the ninety (90) day period, made in the ordinary course of business of both Debtor and Mellon?

As stated previously, the condition of Debtor's financial records leaves a great deal to be desired. However, through use of certain bank records, we are able to construct a pattern, if not a precise dollar figure. Each loan will be discussed separately for factual purposes.

The LBO/stock purchase loan was constructed to be paid on a monthly basis, with payments due on the 17th of each month. From May 1984 through September 1984 payments were made by Debtor each month, within two (2) weeks after the due date. The October 17, 1984 payment was not made until November 16, 1984. During the preference period, from December 15, 1984 through March 15, 1985, payments became very tardy and uneven. The November 17, 1984 billing was paid on January 1, 1985. The December 17, 1984 billing was paid on February 7, 1985. The January 17, 1985 and February 17, 1985 billings were paid in one lump sum on March 15, 1985, the day of the bankruptcy filing. This account was regularly paid by check; the March 15, 1985 payment was made by wire transfer.

LBO/Stock Purchase Loan Payments

Payment Due	Payment Made	Amount Paid
05-17-84	05-31-84	$20,370.22
06-17-84	06-25-84	21,381.14
07-17-84	07-26-84	21,027.33
08-17-84	08-21-84	21,937.16
09-17-84	09-21-84	21,937.16
10-17-84	11-16-84	20,964.14
11-17-84	01-11-85	20,660.86
12-17-84	02-07-85	18,967.54
01-17-85 and 02-17-85	03-15-85	36,519.36

The working capital loan was also drawn to be payable on a monthly basis. Again the payment due date was the 17th of each month. Initially Debtor made all payments within nine (9) days after said due date. The October 1984 payment was one (1) month late and thereafter, during the preference period, payments were two (2) months in arrears. Two (2) payments were made in March 1985; the second was again sent by wire transfer on March 15, 1985, the date of the bankruptcy filing. The normal payment method on this loan was by corporate check.

Working Capital Loan Payments

Payment Due	Payment Made	Amount Paid
06-17-84	06-25-84	$27,147.54
07-17-84	07-26-84	26,142.08
08-17-84	08-21-84	27,273.22
09-17-84	09-21-84	27,273.22
10-17-84	11-16-84	26,063.52
11-17-84	01-14-85	25,702.19
12-17-84	02-07-85	23,581.29
01-17-85	03-04-85	22,953.82
02-17-85	03-15-85	22,448.64

The bank's records relating to the letter of credit demand loan were far less complete; the only figures available relate directly to the preference period. The payment due date on this loan was the first day of each month. The payments for January 1, 1985 and February 1, 1985 were made on March 1, 1985 and March 15, 1985, respectively. The means by which the March 1, 1985 payment was made is unknown; however, Debtor's course of dealing was payment by check. Again, however, the March 15, 1985 payment was accomplished by wire transfer.

Letter Of Credit Demand Loan Payments

Payment Due	Payment Made	Amount Paid
01-01-85	03-01-85	$ 8,247.94
02-01-85	03-15-85	18,015.41

Lateness of payments is a key factor in deciding whether payments fall within the parameters of the ordinary course of business exception. Several courts have held that untimely payments are outside the ordinary course of business and are therefore avoidable. *Marathon Oil Co. v. Flatau,* 785 F.2d 1563 (11th Cir.1986); *In re RDC Corp., supra.* In each case the payments which began as normal, regular, and ordinary course became sporadic and hurried.

Indeed, Mellon received at least $76,983.41 on the very day the bankruptcy was filed and an additional $31,201.76 within two (2) weeks prior thereto. While the payment on the working capital loan appeared to be "normal" in amount, the other payments made on that date were nearly twice that of a "regular" payment. Payments of unusual size and/or made in any unusual manner are also considered outside the ordinary course. *See Marathon Oil Co., supra; In re RDC Corporation, supra; In re Antinarelli Enterprises, Inc., supra; In re Vunovich, supra; In re Bourgeois,* 58 B.R. 657 (Bankr.W.D.La.1986).

(3) Were the payments by Debtor to Mellon during the ninety (90) day period, made according to ordinary business terms?

[4] This element has been handled in two (2) different fashions by the Courts which have discussed this exception. The majority of said Courts limit their analysis to the manner and timing of payments between the individual parties. *See Matter of Unimet Corporation,* 85 B.R. 450 (Bankr.N.D.Ohio 1988), and cases cited therein. The minority approach is to examine this element from a broader perspective, i.e. determining the consistency of the parties' practices in relation to their industry counterparts. *Id.* The rationale for this view was aptly stated by the Court in *In re Steel Improvement Company,* 79 B.R. 681, 684 (Bankr.E.D.Mich.1987):

> The difficulty with the majority approach is that either it ignores subparagraph (C) of Section 547(c)(2) and thereby makes it a nullity, or it interprets subparagraph (C) to require the same showing as subparagraph (B) and thereby makes it superfluous ...

Viewing subparagraph (C) as an element separate and distinct from subparagraph (B) is required. In the case at bar no testimony or evidence was offered regarding industry standards relating to payments in the ordinary course. Therefore, Mellon has not met its burden as to this element.

In summary then, the LBO/stock purchase loan fails to meet any of the criteria necessary to fall within the section 547(c)(2) exception. The other two loans fail to meet two of the three requirements. Therefore, the exception is inapplicable.

The Committee has raised a counterclaim in this adversary proceeding, asserting that the original acquisition of Debtor by TCI was a fraudulent conveyance, which must also be avoided. It has alleged violations of § 548(a)(2)(A) and (B)(i) or (ii), which states in pertinent part:

> (a) The trustee may avoid ... any obligation incurred by the debtor, ... on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily— ...
>
> (2)(A) received less than a reasonably equivalent value in exchange for such ... obligation; *and*
>
> (B)(i) was insolvent on the date that ... such obligation was incurred, or became insolvent as a result of such ... obligation; [or]
>
> (ii) was engaged in business ... or was about to engage in business ... for which any property remaining with the debtor was an unreasonably small capital; ...

[5] We begin by asserting that Section 548 of the Bankruptcy Code is applicable to leveraged buyouts. The language of § 548 refers to *any* transfer, and a leveraged buyout is, by its very terms, a transfer of an interest in property. *See Matter of Ohio Corrugating Co.,* 70 B.R. 920 (Bankr. N.D.Ohio 1987). Additionally, § 548 parallels, in many respects, the Uniform Fraudulent Conveyances Act ("UFCA"), as adopted in Pennsylvania, 39 P.S. § 351 *et seq.* (Purdon's); and it appears that in most instances, those cases which analyze the various state law expressions of the UFCA will be applicable in cases brought specifically under § 548.

[6] The burden of proving all elements of this allegation rests with the Committee, *In re Morris Communications NC Inc.,* 75 B.R. 619 (Bankr.W.D.N.C.1987); *In re Uhlmeyer,* 67 B.R. 977 (Bankr.D.Ariz.1986); *In re Coors of North Mississippi, Inc.,* 66 B.R. 845 (Bankr.N.D.Miss.1986); because

the allegations of § 548(a)(2) involve constructive fraud as opposed to actual fraud, the Committee must prove its elements by a preponderance of the evidence. In order to prevail, the Committee must prove the following:

1) the Debtor incurred an obligation;
2) the debt was incurred within one year prior to the bankruptcy filing;
3) in exchange for incurring the obligation, debtor received less than a reasonably equivalent value; and
4) the Debtor was either insolvent or severely undercapitalized on the transfer date, or was so rendered by the transfer.

See In re Ohio Corrugating Co., 91 B.R. 430 (Bankr.N.D.Ohio 1988); *In re Butcher,* 72 B.R. 447 (Bankr.E.D.Tenn.1987).

The parties admit that Debtor incurred obligations on April 6, 1984, including the $2.3 million line of credit loan, and a guaranty of the $1.85 million loan incurred by its parent. The parties further agree that these obligations were incurred within one (1) year prior to Debtor's bankruptcy filing. Therefore, the Committee must prove that Debtor received less than a reasonably equivalent value for the obligations incurred *and* that Debtor was or became insolvent or undercapitalized.

The intent behind the fraudulent conveyance provision of the Bankruptcy Code is to preserve the estate assets for the benefit of the creditors. *See Matter of Ohio Corrugating Co.,* 70 B.R. at 927. In the instant case we find a group of loans to affiliated corporations along with cross-guaranties. Such guaranties can be categorized by three (3) different classifications:

A. a downstream guaranty, wherein the parent guarantees a subsidiary's obligation;
B. a cross-stream guaranty, wherein a subsidiary guarantees the obligation of its sister corporation; and
C. an upstream guaranty, wherein a subsidiary guarantees the parent's obligation.

See Carl, Fraudulent Transfer Attacks on Guaranties in Bankruptcy, 60 Am. Bankr.L.J. 109 (1986).

The instant case involves no cross-stream guaranties. Additionally, downstream guaranties, such as TCI, TCS and MCM's guaranties of Debtor's line of credit loan, are generally believed to be given for reasonably equivalent value, because the parent is the sole stockholder of the principal debtor, and any benefit received by the subsidiary is also a benefit to the parent. *In re W.T. Grant Co.,* 699 F.2d 599 (2nd Cir.1983); *In re Augie/Restivo Baking Co. Ltd.,* 87 B.R. 242 (Bankr.E.D.N.Y.1988); *In re Lawrence Paperboard Corp.,* 76 B.R. 866 (Bankr.D.Mass.1987). Upstream guaranties, on the other hand, are not very well protected. Transfers by a debtor which operate solely or principally to benefit an affiliated entity will constitute fraudulent transfers when the other elements of a fraudulent transfer are present. *Rubin v. Manufacturers Hanover Trust,* 661 F.2d 979 (2nd Cir.1981); *In re Lawrence Paperboard, supra; In re Holly Hill Medical Center, Inc.,* 44 B.R. 253 (Bankr.M.D.Fla. 1984). These same courts, and others, recognize that indirect benefits *may* furnish fair consideration, *provided,* however, that the value received by Debtor is *reasonably equal* to the value of the obligation given. *Rubin, supra; Klein v. Tabatchnick,* 610 F.2d 1043 (2nd Cir.1979); *Mandel v. Scanlon,* 426 F.Supp. 519 (W.D.Pa.1977); *Ohio Corrugating, supra; Lawrence Paperboard, supra.*

In the case at bar Debtor guaranteed a $1.85 million loan granted to its parent, TCI. TCI used said money to purchase Debtor's shares from Debtor's former shareholders. TCI collateralized the loan by pledging Debtor's stock, Debtor's guaranty and Debtor's security interest in all of its unencumbered assets. Debtor therefore has given up its stock and all other assets in exchange for $1.85 million of allegedly contingent debt. However, the contingent nature of said debt is illusory. TCI is a shell; a holding company. It had no assets of any kind except the Debtor, and the only means of debt repayment

which ever existed was assumption of the obligation by Debtor.

Mellon asserts that Debtor received *more* than reasonably equivalent value because it obtained a $2.3 million line of credit. Such circular logic merely begs the question, because all that Debtor really received was the opportunity to incur an additional $2.3 million of debt. If Debtor drew against the line of credit, and it did, Debtor would have a present cash asset. Debtor would also have a newly created identical liability, which would soon be greater than the asset due to accruing interest. It is clear that Debtor incurred an obligation for which it received *substantially less* than a reasonably equivalent value in exchange.

The only remaining element is Debtor's insolvency or undercapitalization. Many of the courts discussing this issue have developed complicated formulae and descriptions to determine if a debtor was insolvent or undercapitalized, or was so rendered by the transaction. Some analyze vast financial data in terms of "generally-accepted accounting principles." None of that is necessary in the instant case. By clear logic the very transactions themselves caused a *serious* case of insolvency, which has been defined under the Code as "when the sum of [its] debts is greater than all of [its] property, at a fair valuation." 11 U.S.C. § 101(31)(A). *See also, Ohio Corrugating,* 91 B.R. at 436; *In re Join-in International (USA) Ltd.,* 56 B.R. 555 (Bankr.S.D.N.Y. 1986).

On April 6, 1984, Debtor had a $1.85 million debt, for which it had pledged all of its assets and for which Debtor received no part of the actual $1.85 million. Debtor's former shareholders were paid $1.85 million in exchange for their shares of stock. If, as is often stated, fair market value is the sum a willing buyer will pay a willing seller in an arm's-length transaction, then Debtor's stock had a fair valuation of $1.85 million. Debtor pledged its stock *and* all of its remaining unencumbered assets as collateral for said $1.85 million loan guaranty. For all intents and purposes, Debtor was now liable for payment of the principal and interest on the loan, the proceeds of which it did not receive and the funding for which it did not have. A clearer case of insolvency would be difficult to construct.

Having found that the Committee has proved all of the necessary elements, we hold that the leveraged buyout among the parties to the action was a fraudulent conveyance which must be avoided.

An appropriate Order will be issued.

ORDER OF COURT

AND NOW, at Pittsburgh in said District this 10th day of February, 1989, in accordance with the foregoing Memorandum Opinion of this date evenwith, it is hereby ORDERED, ADJUDGED and DECREED as follows:

(1) Plaintiff, Mellon Bank, does not possess a valid security interest in Debtor's assets;

(2) As a result thereof, Debtor and Mellon must compile a complete and accurate accounting of all payments made by Debtor to Mellon, on behalf of itself or any of its related entities, or made by any other party to Mellon, using Debtor's funds;

(3) Debtor and Mellon will file said accounting with the Court within sixty (60) days of the date of this Order;

(4) Concurrently with said filing, Mellon will disgorge the sums so discovered, with legal interest from date of receipt, to the Bankruptcy Court Registry.

IT IS FURTHER ORDERED that the original transaction among the parties, dated April 5 and/or 6, 1984, involving the leveraged buyout of Debtor's stock was a fraudulent transfer and BE and IS hereby AVOIDED.

ORDER

AND NOW, this 5th day of SEPTEMBER, 1990, in accordance with the accompanying Memorandum of this Court,

IT IS ORDERED THAT:

1. The valuation of the 1989 Grand Prix Se automobile shall be determined as of the date debtors file a Chapter 13 repayment plan, for the purpose of establishing the amount of GMAC's secured claim.

2. The appropriate valuation method to be used in determining the value of an automobile pursuant to 11 U.S.C. § 1325 and § 506 shall be the amount that is the average of the wholesale and retail value as set forth in the N.A.D.A. official used car guide, with appropriate adjustments for mileage and various options.

3. The interest to be paid upon the debt owed to GMAC over the term of debtors' plan shall be the contract rate of 12.25%.

4. Debtors have demonstrated sufficient cause to justify extension of their Chapter 13 repayment plan to a term of sixty (60) months.

In re METRO COMMUNICATIONS, INC., t/a Metrosports, Debtor.

MELLON BANK, N.A., Plaintiff,

v.

METRO COMMUNICATIONS, INC., t/a Metrosports, Debtor-in-Possession, and the Pacific-10 Conference, Defendants,

v.

The COMMITTEE OF UNSECURED CREDITORS, Intervenor.

Civ. A. 89-0782.
Bankruptcy No. 85-552.

United States District Court,
W.D. Pennsylvania.

Feb. 12, 1991.

Bank which financed leveraged buyout of Chapter 11 debtor's stock brought adversary proceeding to determine validity, priority, and extent of its security interest, and unofficial unsecured creditor's committee intervened seeking to avoid alleged preferences and fraudulent conveyances. The Bankruptcy Court, 95 B.R. 921, amended 135 B.R. 17, found that transaction was preferential and fraudulent conveyance. Bank appealed. The United States District Court for the Western District of Pennsylvania, Ziegler, J., held that: (1) determination that bank's reperfection of its secured status constituted preferential transfer was not clearly erroneous; (2) burden of proving avoidability of transfer was properly placed on committee of unsecured creditors; (3) determination that debtor received less than reasonably equivalent value in exchange for guaranty of loan obligations of its parents and was insolvent after guaranty was issued was not clearly erroneous; (4) Bankruptcy Court's order requiring bank to disgorge all payments by debtor to bank was not overbroad; and (5) award of interest from date of transfer was not proper absent allegations of fraud or misconduct by bank.

Affirmed in part; reversed in part.

Reversed and remanded, 945 F.2d 635.

1. Bankruptcy ⚷3782, 3786

Findings of fact by bankruptcy court shall not be set aside unless district court determines that such findings are clearly erroneous, and due regard shall be given to opportunity of bankruptcy court to judge credibility of witnesses; bankruptcy court's conclusions of law, however, are subject to plenary review. Fed.Rules Bankr.Proc. Rule 8013, 11 U.S.C.A.

2. Bankruptcy ⚷3787

Factual findings underlying bankruptcy court's determination that creditor's reperfection of its secured status constituted transfer of debtor's property within 90 days prior to debtor's bankruptcy petition were not clearly erroneous; thus, reperfection was preferential transfer avoidable under Bankruptcy Code. Bankr.Code, 11 U.S.C.A. § 547.

3. Bankruptcy ⚷2726(6)

Burden of proving avoidability of preferential transfer under Bankruptcy Code

was properly placed on committee of unsecured creditors. Bankr.Code, 11 U.S.C.A. §§ 547, 547(g).

4. Bankruptcy ⚬═3787

Factual findings of bankruptcy court that debtor received less than reasonable equivalent value in exchange for guaranty of loan obligations of its parent and that debtor was insolvent after guaranty was issued were not clearly erroneous; thus, original acquisition of debtor by parent constituted fraudulent conveyance avoidable under Bankruptcy Code. Bankr.Code, 11 U.S.C.A. §§ 548, 548(a)(2).

5. Bankruptcy ⚬═3787

Factual findings underlying bankruptcy court's determination that committee of unsecured creditors met its burden of proving that all payments to creditor within 90 days prior to debtor's bankruptcy petition were preferential transfers avoidable under Bankruptcy Code were not clearly erroneous. Bankr.Code, 11 U.S.C.A. § 547(b).

6. Bankruptcy ⚬═2729

Bankruptcy court's order requiring creditor to disgorge all payments by debtor to creditor was not overbroad.

7. Interest ⚬═39(2.20)

Decision to award prejudgment interest is within sound discretion of bankruptcy court.

8. Bankruptcy ⚬═2729
Interest ⚬═39(1)

Bankruptcy court's award of interest from date of preferential transfer from debtor to bank was improper, where there was no allegations of fraud or misconduct by bank.

9. Bankruptcy ⚬═2729
Interest ⚬═39(1)

Interest is calculated from date of transfer where transferee acts fraudulently or in bad faith.

George M. Cheever, Denise K. Chamberlain, for plaintiff.

Kenneth P. Simon, for Unsecured Creditors. Robert G. Sable, for Metro Communications, Inc. Charles J. Volmer, for The Pacific–10 Conf.

ORDER OF COURT

ZIEGLER, District Judge.

AND NOW, this 12th day of February, 1991, after consideration of the appeal of Mellon Bank, N.A. ("Mellon") and Grant Street National Bank ("GSNB"), from the Opinion and Order of the United States Bankruptcy Court for the Western District of Pennsylvania dated February 10, 1989, 95 B.R. 921, as amended by the Order dated April 4, 1989, 135 B.R. 17.

[1–9] The court finds as follows:

1. Findings of facts by the bankruptcy court shall not be set aside unless the district court determines that such findings are clearly erroneous and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of witnesses. The bankruptcy court's conclusions of law, however, are subject to plenary review. Bankruptcy Rule 8013; *Brown v. Pennsylvania State Employees Credit Union,* 851 F.2d 81, 84 (3d Cir.1988).

2. The factual findings underlying the Bankruptcy Court's determination that Mellon's re-perfection of its secured status constituted a transfer of debtor's property within ninety (90) days prior to debtor's bankruptcy petition are not clearly erroneous. Thus, the Bankruptcy Court properly determined that Mellon's re-perfection was a preferential transfer avoidable under 11 U.S.C. § 547. We reject appellants' contention that the Bankruptcy Court improperly placed the burden of proof on Mellon. In fact, Mellon concedes that it had the burden of proving perfection of its secured status. *See* Reply Brief for Appellants, at 2. The burden of proving the avoidability of the transfer under 11 U.S.C. § 547 was properly placed on The Committee of Unsecured Creditors ("Committee"). 11 U.S.C. § 547(g). Further, we reject appellants' contention that the Bankruptcy Court erred in suggesting, as an alternative basis for its ruling, that Mellon's original financing statements were improperly filed, since this did not serve as the basis for the Bankruptcy Court's ruling. *See In re Metro Communications,*

Inc., 95 B.R. 921, 919–30 (Bankr.W.D.Pa. 1989).

3. The factual findings of the Bankruptcy Court that the debtor received less than reasonably equivalent value in exchange for the guaranty of loan obligations of its parent, Total Communications, Inc. ("TCI"), and that debtor was insolvent after the guaranty was issued are not clearly erroneous. Therefore, the Bankruptcy Court properly determined that the Committee met its burden of proof under 11 U.S.C. § 548 to establish that the original acquisition of debtor by TCI constituted a fraudulent conveyance avoidable under 11 U.S.C. § 548(a)(2).

4. The factual findings underlying the Bankruptcy Court's determination that the Committee met its burden of proving that all payments by debtor to Mellon within ninety (90) days prior to debtor's bankruptcy petition were preferential transfers avoidable under 11 U.S.C. § 547(b) are not clearly erroneous.

5. We reject appellants' contention that the Bankruptcy Court's Order requiring Mellon to disgorge all payments by debtor to Mellon is overbroad. In fact, the Bankruptcy Court entered the Amended Order dated April 4, 1989 upon the motion of Mellon and GSNB to clarify the scope of the Order dated February 10, 1989. Moreover, the Committee concedes that payments by debtor to Mellon on other obligations not raised in these proceedings are beyond the scope of the above-captioned action.

6. With respect to the award of interest, the decision to award prejudgment interest is within the sound discretion of the bankruptcy court. *In re Art Shirt Ltd., Inc.*, 93 B.R. 333, 342 (E.D.Pa.1988). It is settled that interest awarded in voidable preference and fraudulent conveyance actions is computed from the date of demand for return, or in the absence of a demand, from the date of the suit's commencement. *See e.g., Smith v. Mark Twain National Bank*, 805 F.2d 278, 291 (8th Cir.1986); *Palmer v. Radio Corp.*, 453 F.2d 1133, 1140 (5th Cir.1971); *In re Universal Clearing House Co.*, 60 B.R. 985, 1002 (D.Utah 1986). Interest is calculated from the date of the transfer where the transferee acts fraudulently or in bad faith. *See In re Southern Industrial Banking Corp.*, 87 B.R. 518, 522 (Bankr.E.D.Tenn.1988). Here, there were no allegations of fraud or misconduct requiring an award of interest from date of transfer and, thus, the Bankruptcy Court's award of interest will be reversed.

IT IS THEREFORE ORDERED that paragraph 1(d) of the Order of the Bankruptcy Court dated April 4, 1989, insofar as it orders legal interest from date of receipt, be and hereby is reversed,

IT IS FURTHER ORDERED that in accordance with the Bankruptcy Court's Order dated April 4, 1989, Mellon shall disgorge the sums discovered, with legal interest from the date of commencement of the within action, to the Registry of the Bankruptcy Court.

IT IS FURTHER ORDERED that the Order of the Bankruptcy Court dated February 10, 1989, as amended by the Order dated April 4, 1989, be and hereby is affirmed in all other respects.

In re METRO COMMUNICATIONS, INC., t/a Metrosports, Debtor.

MELLON BANK, N.A., Plaintiff,

v.

METRO COMMUNICATIONS, INC., t/a Metrosports, Debtor-in-Possession, and the Pacific-10 Conference, Defendants,

v.

The COMMITTEE OF UNSECURED CREDITORS, Intervenor.

Bankruptcy No. 85–552.
Adv. No. 86–104.

United States Bankruptcy Court, W.D. Pennsylvania.

April 4, 1989.

Kenneth P. Simon, Simon & Simon, Pittsburgh, Pa., for intervenor/Committee of Unsecured Creditors.

Inc., 95 B.R. 921, 919–30 (Bankr.W.D.Pa. 1989).

3. The factual findings of the Bankruptcy Court that the debtor received less than reasonably equivalent value in exchange for the guaranty of loan obligations of its parent, Total Communications, Inc. ("TCI"), and that debtor was insolvent after the guaranty was issued are not clearly erroneous. Therefore, the Bankruptcy Court properly determined that the Committee met its burden of proof under 11 U.S.C. § 548 to establish that the original acquisition of debtor by TCI constituted a fraudulent conveyance avoidable under 11 U.S.C. § 548(a)(2).

4. The factual findings underlying the Bankruptcy Court's determination that the Committee met its burden of proving that all payments by debtor to Mellon within ninety (90) days prior to debtor's bankruptcy petition were preferential transfers avoidable under 11 U.S.C. § 547(b) are not clearly erroneous.

5. We reject appellants' contention that the Bankruptcy Court's Order requiring Mellon to disgorge all payments by debtor to Mellon is overbroad. In fact, the Bankruptcy Court entered the Amended Order dated April 4, 1989 upon the motion of Mellon and GSNB to clarify the scope of the Order dated February 10, 1989. Moreover, the Committee concedes that payments by debtor to Mellon on other obligations not raised in these proceedings are beyond the scope of the above-captioned action.

6. With respect to the award of interest, the decision to award prejudgment interest is within the sound discretion of the bankruptcy court. *In re Art Shirt Ltd., Inc.*, 93 B.R. 333, 342 (E.D.Pa.1988). It is settled that interest awarded in voidable preference and fraudulent conveyance actions is computed from the date of demand for return, or in the absence of a demand, from the date of the suit's commencement. *See e.g., Smith v. Mark Twain National Bank*, 805 F.2d 278, 291 (8th Cir.1986); *Palmer v. Radio Corp.*, 453 F.2d 1133, 1140 (5th Cir.1971); *In re Universal Clearing House Co.*, 60 B.R. 985, 1002 (D.Utah 1986). Interest is calculated from the date of the transfer where the transferee acts fraudulently or in bad faith. *See In re Southern Industrial Banking Corp.*, 87 B.R. 518, 522 (Bankr.E.D.Tenn.1988). Here, there were no allegations of fraud or misconduct requiring an award of interest from date of transfer and, thus, the Bankruptcy Court's award of interest will be reversed.

IT IS THEREFORE ORDERED that paragraph 1(d) of the Order of the Bankruptcy Court dated April 4, 1989, insofar as it orders legal interest from date of receipt, be and hereby is reversed,

IT IS FURTHER ORDERED that in accordance with the Bankruptcy Court's Order dated April 4, 1989, Mellon shall disgorge the sums discovered, with legal interest from the date of commencement of the within action, to the Registry of the Bankruptcy Court.

IT IS FURTHER ORDERED that the Order of the Bankruptcy Court dated February 10, 1989, as amended by the Order dated April 4, 1989, be and hereby is affirmed in all other respects.

In re METRO COMMUNICATIONS, INC., t/a Metrosports, Debtor.

MELLON BANK, N.A., Plaintiff,

v.

METRO COMMUNICATIONS, INC., t/a Metrosports, Debtor-in-Possession, and the Pacific-10 Conference, Defendants,

v.

The COMMITTEE OF UNSECURED CREDITORS, Intervenor.

Bankruptcy No. 85-552.
Adv. No. 86-104.

United States Bankruptcy Court,
W.D. Pennsylvania.

April 4, 1989.

Kenneth P. Simon, Simon & Simon, Pittsburgh, Pa., for intervenor/Committee of Unsecured Creditors.

George M. Cheever, Kirkpatrick & Lockhart, Pittsburgh, Pa., for plaintiff/Mellon Bank, N.A.

Stephen J. Laidhold, Sable, Makoroff & Libenson, Pittsburgh, Pa., for debtor.

Charles J. Vollmer, Pollard, Walker & Vollmer, Pittsburgh, Pa., for PAC-10 Conference.

Stephen I. Goldring, Asst. U.S. Trustee, Pittsburgh, Pa.

AMENDED ORDER OF COURT

Bernard Markovitz, Bankruptcy Judge.

AND NOW, at Pittsburgh in said District this 4th day of April, 1989 upon consideration of: (1) the motion of Grant Street National Bank (In Liquidation), as successor in interest to Mellon Bank, N.A. in the instant adversary proceeding, to Amend the Judgment Order of this Court dated February 10, 1989, 95 B.R. 921; (2) the Committee's Motion To Strike Grant Street National Bank's Motion To Amend Judgment; and (3) the Response thereto of Mellon Bank, N.A. and Grant Street National Bank (In Liquidation), it is hereby ORDERED, ADJUDGED and DECREED that effective this date evenwith, Grant Street National Bank (In Liquidation) is joined in this action as an additional plaintiff and counterclaim defendant.

IT IS FURTHER ORDERED that:

(1) the decretal portions of this Court's Order of February 10, 1989 are hereby amended, as follows:

(a) Plaintiff, Mellon Bank, does not possess a valid security interest in Debtor's assets;

(b) As a result thereof, Debtor and Mellon must compile a complete and accurate accounting of all payments made by Debtor to Mellon, on behalf of itself or any of its related entities, or made by any other party to Mellon, using Debtor's funds;

(c) Debtor and Mellon will file said accounting with the Court within sixty (60) days of the date of this Order;

(d) Concurrently with said filing, Mellon will disgorge the sums so discovered, with legal interest from date of receipt, to the Bankruptcy Court Registry, except to the extent that such sums represent payments received by Mellon more than ninety (90) days prior to March 15, 1985 for application against Debtor's obligations in respect of the Letter of Credit Agreement dated September 7, 1984 and the $2,300,000.00 working capital loan under the Line of Credit Agreement dated April 6, 1984; and

(2) the original transaction among the parties, dated April 5 and/or 6, 1984, involving the leveraged buyout of Debtor's stock was a fraudulent transfer and BE and IS hereby AVOIDED.

Nothing in this Order shall be interpreted as an extension of time within which to file an appeal; no such request has been made or granted.

In re ARMSTRONG STORE FIXTURES CORPORATION, Debtor.

In re CUSTOM CONCEPTS, INC., Debtor.

In re BENTLEY INDUSTRIES, INC., Debtor.

Bankruptcy Nos. 91-2942-BM, 91-4235-BM and 91-4264-BM.
Motion No. 91-7779M.

United States Bankruptcy Court, W.D. Pennsylvania.

Jan. 2, 1992.

Unions filed motion to pay claims in debtor-employers' Chapter 11 cases. The Bankruptcy Court, Bernard Markovitz, J., held that: (1) debtors' failure to pay wages and various benefits due and owing to their employees under collective bargaining agreements effected unilateral alteration of agreements in violation of Bankruptcy

Belleville v. Parrillo's, Inc., 83 N.J. 309, 316, 416 A.2d 388, 391–92 (1980) (citations omitted). Thus, Chez Sez may not use the property for any use other than retail sales and services. Since the district court found that video booths were not a retail use, it concluded that appellants were prohibited, under New Jersey law, from operating video booths on this particular property.

Appellants argue that their constitutional rights have been violated because the Board interpreted the Ordinance as prohibiting video booths in all of Union Township. The district court, however, found the more plausible interpretation of the Ordinance to be that video booths are permitted in any zone where theaters are permitted. Under this interpretation, while Chez Sez could not operate a "theater" in its present location, since that would be an expansion of a nonconforming use, it could operate such theaters elsewhere in the Township.

Appellants, however, are not seeking to operate elsewhere in Union Township. The only relief they seek is to be able to operate video booths on this particular property. Appellants never attempted to operate video booths at another location nor did they ever express any intent to do so. Thus, even if the state court were to find that video booths are permitted elsewhere in Union Township, as the district court predicts, appellants would not be entitled to the relief they are seeking.

In sum, the district court found that video booths are likely to be permitted elsewhere in Union Township. The district court also found that Chez Sez was prohibited from operating video booths on this particular property because New Jersey law prohibits the expansion of a nonconforming use. Under such circumstances, the district court's refusal to grant a preliminary injunction allowing appellants to operate video booths in their present location was neither an abuse of discretion nor an error of law. We will therefore affirm the order of the district court denying appellants' motion for a preliminary injunction.

VI.

We conclude that the district court properly abstained pursuant to the *Pullman* doctrine, and that the district court properly denied appellants' motion for a preliminary injunction. We will therefore affirm the decision of the district court.

MELLON BANK, N.A., Appellant in No. 91–3160,

v.

METRO COMMUNICATIONS, INC. t/a Metrosports, debtor-in-possession, and The Pacific 10 Conference

v.

The COMMITTEE OF UNSECURED CREDITORS, Intervenor in District Court,

Grant Street National Bank (in liquidation), Appellant in No. 91–3105.

Nos. 91–3105 and 91–3160.

United States Court of Appeals, Third Circuit.

Argued July 8, 1991.

Decided Sept. 25, 1991.

As Amended Sept. 26, Oct. 1 and Oct. 28, 1991.

Bank which financed leveraged buyout of Chapter 11 debtor's stock brought adversary proceeding to determine validity, priority, and extent of its security interest, and official unsecured creditors committee intervened, seeking to avoid alleged preferences and fraudulent conveyances. The United States Bankruptcy Court for the Western District of Pennsylvania, 95 B.R. 921, Bernard Markovitz, J., found that the transaction was preferential and a fraudulent conveyance, and the District Court, Donald E. Ziegler, J., affirmed. On appeal,

the Court of Appeals, Rosenn, Circuit Judge, held that: (1) committee failed to establish that debtor's chief executive office changed its location pursuant to leveraged buyout of debtor, before October 5, 1984, and thus, creditor's refilings were timely, continuing its earlier perfected status, and were not a reperfection within 90–day preference period, and (2) committee failed to establish that debtor received less than reasonably equivalent value in exchange for its guarantee and security interest, and thus failed to show that guarantee and security interest collateralizing guarantee was a fraudulent conveyance.

Reversed and remanded with instructions.

1. Bankruptcy ⇐3773

Bankruptcy court order holding that bank's security interest in Chapter 11 debtor's assets was voidable as preference and that debtor's guarantee of acquisition loan and grant of security interest pursuant to leveraged buyout transaction was fraudulent conveyance was not filed, and thus, ten-day appeal period did not commence until bankruptcy court certified order; bank had instituted original action against another creditor and order did not purport to settle bank's claims against that creditor. Fed.Rules Civ.Proc.Rule 54(b), 28 U.S.C.A.; Fed.Rules Bankr.Proc.Rule 7054, 11 U.S.C.A.

2. Secured Transactions ⇐101

Evidence failed to establish that Chapter 11 debtor's chief executive office changed its location, pursuant to leveraged buyout of debtor, before October 5, 1984, and thus, creditor's refilings were timely under Pennsylvania law, continuing its earlier perfected status, and were not a reperfection within 90–day preference period under the Bankruptcy Code; main activity of debtor remained centered in its prior office until office closed in December, 1984, letter had listed prior office as headquarters until December 1, 1984, and debtor announced that its operations were being consolidated in new location effective December 3, 1984. Bankr.Code, 11 U.S.C.A. § 547(b); 13 Pa. C.S.A. § 9103(c).

3. Secured Transactions ⇐101

Evidence failed to establish that debtor changed its chief executive office from Maryland to Pennsylvania, pursuant to leveraged buyout of debtor, more than four months prior to creditor's refiling of its security interest in Pennsylvania, and thus, refiling was a continuation of earlier perfected status, rather than reperfection, under Pennsylvania's version of the Uniform Commercial Code. 13 Pa.C.S.A. § 9103(c).

4. Bankruptcy ⇐3782, 3786

Court of Appeals reviews bankruptcy court's findings of fact under clearly erroneous standard, whereas its conclusions of law are subject to plenary review.

5. Bankruptcy ⇐3780

Mixed questions of law and fact decided by bankruptcy court are subject to mixed standard of review by Court of Appeals, which accepts trial court's findings of historical or narrative facts unless clearly erroneous, but exercises plenary review of trial court's choice and interpretation of legal precepts and its application of those precepts to the historical facts.

6. Bankruptcy ⇐2726(6)

Secured creditor satisfied burden of proof of its secured status by showing that it properly filed financing statements in Pennsylvania prior to debtor's filing under Chapter 11, thus placing on debtor any burden of proving that transfer was avoidable as preference. Bankr.Code, 11 U.S.C.A. §§ 502(a), 547, 547(b, g); 13 Pa. C.S.A. § 9103(c).

7. Secured Transactions ⇐98

When one corporation is acquired by another, nature of inquiry as to location of chief executive office, for purposes of determining whether and when refiling of financing statement in Pennsylvania is required, must necessarily be tailored to that situation; ascertaining location of headquarters of wholly owned subsidiary necessarily differs from determining location of chief executive office of single corporation.

13 Pa.C.S.A. § 9103(c); U.C.C. § 9–103 comment.

8. Corporations ⚖1.7(2)

There is presumption that a corporation, even when it is wholly owned subsidiary of another, is a separate entity.

9. Bankruptcy ⚖2645

Constructive fraud section of the Bankruptcy Code's fraudulent transfer provision is sufficiently broad to encompass leveraged buyout transaction that falls within its terms. Bankr.Code, 11 U.S.C.A. §§ 101, 548, 548(a)(2).

10. Bankruptcy ⚖2650(2)

Unsecured creditors committee failed to establish that Chapter 11 debtor, which was acquired by shell company in leveraged buyout, received less than reasonably equivalent value in exchange for its guarantee and security interest, and thus failed to show that debtor's guarantee and security interest collateralizing guarantee of loan used to buy out debtor's shareholders was a fraudulent conveyance under the Bankruptcy Code; committee introduced no evidence to show that ability to obtain credit and synergistic strength expected from merger were not of reasonably equivalent value. Bankr.Code, 11 U.S.C.A. § 548(a)(2)(A).

11. Bankruptcy ⚖2650(2)

In evaluating whether reasonably equivalent value has been given debtor, for fraudulent conveyance purposes, indirect benefits may also be evaluated, and indirect economic benefits must be measured and then compared to obligations that debtor incurred; touchstone is whether transaction conferred realizable commercial value on debtor reasonably equivalent to commercial value of assets transferred, so that when debtor is going concern and its realizable going concern value after transaction is equal to or exceeds its going concern value before transaction, "reasonably equivalent value" has been received. Bankr.Code, 11 U.S.C.A. § 548(a)(2)(A), (a)(2)(B)(i).

See publication Words and Phrases for other judicial constructions and definitions.

12. Bankruptcy ⚖2643

Even assuming Chapter 11 debtor's fair market value was the $1.85 million of a loan it guaranteed pursuant to leveraged buyout of debtor's shareholders, guarantees by coguarantors should have been counted as reducing debtor's liability to something less than such amount, for purpose of determining whether, for fraudulent conveyance purposes, debtor was insolvent at time of buyout. Bankr.Code, 11 U.S.C.A. § 548(a)(2)(A), (a)(2)(B)(i).

13. Bankruptcy ⚖2727(3)

Evidence was insufficient to establish that $1.85 million loan, pursuant to which debtor's stock was acquired in leveraged buyout, and accompanying security interest in debtor's assets rendered debtor insolvent, for purposes of determining whether debtor's guarantee and security interest were fraudulent conveyances under the Bankruptcy Code; debtor's balance sheet showed improvement after transaction despite liability for bank loans and demonstrated that loans did not render debtor insolvent. Bankr.Code, 11 U.S.C.A. § 548(a)(2)(A), (a)(2)(B)(i).

George M. Cheever, (Argued), Kirkpatrick & Lockhart, Pittsburgh, Pa., for Grant Street Nat. Bank.

Denise K. Chamberlain (Argued), Mellon Bank, N.A., Pittsburgh, Pa., for Mellon Bank, N.A.

Phillip S. Simon (Argued), Kenneth P. Simon, Simon & Simon, Pittsburgh, Pa., for Committee of Unsecured Creditors.

Before STAPLETON, HUTCHINSON, and ROSENN, Circuit Judges.

OPINION OF THE COURT

ROSENN, Circuit Judge.

This appeal, arising in the context of a failed leveraged buyout, had its roots in the congenial climate of mergers and acquisitions that beguiled corporate America during the decade of the nineteen-eighties. The appeal raises important questions regarding a bankruptcy trustee's avoidance

powers under 11 U.S.C. §§ 547(b) and 548(a)(2) of the bankruptcy code. The debtor is Metro Communications (Metro), the corporation acquired in the leveraged buyout. Mellon Bank, N.A. (Mellon or Bank) financed the acquisition; Mellon lent the acquiror 1.85 million dollars to purchase all of the capital stock of the target corporation, Metro. Metro guaranteed and secured the acquisition loan with substantially all of its assets. Simultaneously with the leveraged buyout, Mellon extended a 2.3 million dollar credit line to Metro. At a later date, Mellon extended another 2.25 million dollars to Metro in the form of letters of credit. These loans were also collateralized by the security interest in substantially all of Metro's assets. Within a year of the leveraged buyout, Metro filed a bankruptcy petition under chapter 11.

The bankruptcy court held that Mellon's security interest in the three loans constituted a voidable preference under 11 U.S.C. § 547(b), finding that Mellon's security interest lapsed because it failed to re-file financing statements within four months of Metro's change in the location of its headquarters and that the refiling of the financing statements at the debtor's new location during the ninety day period preceding the filing of the bankruptcy petition constituted a voidable preference. Furthermore, the court held that Metro's guaranty of the acquisition loan and the execution of a security interest in connection therewith constituted a fraudulent conveyance under 11 U.S.C. § 548(a)(2). We reverse.

I.

Metro Communications, also known as Metrosports, the debtor, had been in the business of television and radio sports syndication for about ten years prior to its bankruptcy. Metro, incorporated in Maryland in 1972, originally had its headquarters in Rockville, Maryland. Its business included acquiring the rights to broadcast sporting events, contracting with radio and television stations for such broadcasts, and selling rights to advertise during the broadcasts.

In April of 1984, Metro's stockholders sold all of their capital stock to Total Communications, Inc. (TCI), a wholly owned subsidiary of Total Communication Systems Co. (TCS). The principals of TCI created it solely for the purpose of acquiring the stock of Metro and becoming its sole shareholder. TCS, in turn, is the wholly owned subsidiary of Mass Communication and Management, Ltd. (MCM). These affiliated corporations were in the business of syndicating and producing television programs of college athletic events. TCS owned and operated mobile television production studios used in the broadcasting of athletic events nationally.

TCI acquired Metro for the purpose of creating a synergy of complementary services; Metro, as the buyer and seller of broadcasting rights, contracted regularly with companies, such as TCS, to produce and broadcast the athletic events. The two companies, TCS and Metro, developed a joint marketing concept known as TCS/Metro, and issued press releases and other promotional materials which stressed that the companies were working as a joint venture, joining their strengths and "working as a team."

To finance the purchase of the Metro stock, TCI borrowed $1,850,000 from Mellon on April 6, 1984. On the same day, Mellon loaned Metro $2,300,000 for use as working capital under a line of credit agreement. Pursuant to guaranty and suretyship agreements dated April 6, 1984, TCI guaranteed the repayment of the loan to Metro, Metro guaranteed the repayment of the loan to TCI, and TCS and MCM jointly guaranteed the repayment of both loans.

In addition to the guarantees, Metro entered into an agreement dated April 6, 1984, with Mellon Bank wherein Metro conveyed to the Bank a security interest in substantially all of Metro's property, including its general intangibles and accounts receivable. The security agreement provided that the collateral secured "all ... indebtedness, obligations and liabilities of [Metro] to the Bank, now or hereafter existing, including but not limited to those

arising under the Guaranty, and those arising under the Metrosports Loan Agreement."

On September 7, 1984, Metro and Mellon entered into a Letter of Credit Agreement to finance Metro's purchase of broadcast rights for the PAC-10 Conference football season. The Letter of Credit Agreement provided that Mellon's reimbursement rights were secured under the April 6, 1984 security agreement between Mellon and Metro and guaranteed by TCI, TCS, and MCM. Between December 18, 1984 and January 2, 1985, Mellon disbursed the full $2,250,000 face amount of the letters of credit in response to the PAC-10's drawing requests. The following chart summarizes the loans received and guaranties made by Metro:

TRANSACTION	DATE	AMOUNT
Guaranty of Acquisition Loan	4/6/84	$1,850,000
Working Capital Line of Credit	4/6/84	$2,300,000
PAC-10 Letter of Credit	12/18/84	$2,250,000

The Bank perfected its security interests in the collateral pledged by Metro by filing UCC-1 financing statements in the Maryland State Department of Assessment and Taxation on April 9, 1984 and the Clerk's Office of the Circuit Court of Montgomery County, Maryland, on April 17, 1984. The Bank filed additional UCC-1 financing statements in the appropriate offices in Pennsylvania on February 1 to and including February 5, 1985.

On March 12, 1985, PAC-10 filed a complaint against Metro, TCS, and various related entities in the United States District Court for the Northern District of California, alleging breaches of various agreements covering the broadcasting of PAC-10 basketball and football games. Simultaneously with the filing of the complaint, PAC-10 obtained an *ex parte* order which permitted pre-judgment attachment of Metro's assets. Pursuant to the order, PAC-10 attached certain outstanding accounts receivable of Metro. Three days later, on March 15, 1985, Metro filed a petition for reorganization under Chapter 11 of the Bankruptcy Code.

On January 30, 1986, the Bank filed an adversary proceeding against Metro and PAC-10 to determine the validity, priority, and extent of the Bank's security interest and to ascertain the parties' respective rights in an escrow account which PAC-10 had attempted to attach. The Official Unsecured Creditor's Committee ("the Committee") intervened, claiming that the Bank had received preferential transfers pursuant to 11 U.S.C. § 547(b) and that a fraudulent conveyance had occurred pursuant to 11 U.S.C. § 548(a)(2).

PAC-10, Metro and the Bank have agreed to a settlement of their disputes over the escrow account and have presented their settlement to the bankruptcy court for approval. The bankruptcy court has stated that it will defer ruling on the proposed settlement until this appeal is resolved.

Prior Court Proceedings

After a two-day bench trial, the bankruptcy court on February 10, 1989, filed an opinion and order holding that the Bank's security interest in Metro's assets was voidable under 11 U.S.C. § 547(b) and that Metro's guaranty of the acquisition loan and the grant of the security interest was a fraudulent conveyance under 11 U.S.C. § 548(a)(2). *In re Metro Communications, Inc.*, 95 B.R. 921 (Bankr.W.D.Pa. 1989). The court ordered the Bank and Metro to file an accounting, showing all amounts subject to disgorgement. In October of 1988, after the bench trial but before the bankruptcy court filed its decision, Mellon assigned all its claims against Metro to Grant Street National Bank (GSNB), which is now in liquidation. On February 17, 1989, counsel for Mellon and GSNB (to-

gether, the Banks) filed a motion to amend the February 10, 1989 order under Rule 59(e) of the Federal Rules of Civil Procedure. That motion, filed on behalf of GSNB as successor in interest to Mellon, sought to exclude from the scope of the bankruptcy court's order payments made by Metro to Mellon with respect to loans made directly to Metro from Mellon more than 90 days prior to Metro's bankruptcy filing.

On February 27, 1989, GSNB filed its Notice of Unconditional Assignment of Claim to it by Mellon Bank. The bankruptcy court issued a second order on April 4, 1989, permitting GSNB to intervene in the adversary proceeding as an additional plaintiff and amending its February 10, 1989 order in accordance with the relief requested. On April 10, 1989, the Banks filed their notice of appeal in the district court.

In a third order, dated May 15, 1989, the bankruptcy court expressly directed the entry of a final judgment on its prior order of February 10, 1989, as amended April 4, 1989, and certified it under Fed.R.Civ.P. 54(b) for appeal to the district court, stating that certification was in the interest of fostering a speedy, economical and orderly resolution of the appeal. The Banks filed a supplementary joint notice of appeal within 10 days after the docketing of this May 15 order.

On February 12, 1991, the district court entered an order affirming the bankruptcy court's rulings in all respects except for the award of pre-judgment interest. Mellon and GSNB each appealed to this court; we consolidated the appeals.

II.

A. *Jurisdiction*

[1] The threshold question that must be answered is whether this court possesses jurisdiction to hear this appeal. The Committee argues that both this court and the district court lacked jurisdiction because of the failure to file a timely appeal. The Committee contends that the motion to amend judgment filed on February 17, 1989, did not serve to toll the ten-day period for filing a notice of appeal from the bankruptcy's February 10, 1989 order. The Committee claims that, consequently, the notice of appeal filed on April 10, 1989, was untimely.

The Committee alleges that the motion to amend was ineffective because GSNB filed it as a successor in interest to Mellon Bank. The Committee argues that GSNB cannot be considered a "party in interest" because it filed its notice of unconditional assignment with the bankruptcy court only after filing the motion to amend and also after the expiration of the ten-day appeal period.

The Banks correctly point out that this argument turns on the mistaken premise that the February 10, 1989 order constituted a final judgment and thus the ten-day appeal period began on that date. However, the February 10, 1989 order was not a final judgment. Mellon Bank instituted the original suit against PAC-10. The February 10th order did not purport to settle Mellon's claims as to PAC-10 and thus the judgment was not final as to all claims and as to all parties as required for appeal. *See Andrews v. United States,* 373 U.S. 334, 340, 83 S.Ct. 1236, 1239-40, 10 L.Ed.2d 383 (1963) (rule of finality requires that the judgment be final as to all parties as well as causes of action to be appealable). Indeed, the bankruptcy court has deferred ruling on the settlement of Mellon, Metro, and PAC-10 pending the resolution of this appeal.

The February 10th order became appealable only when the bankruptcy court certified it pursuant to Federal Rule of Civil Procedure 54(b) (made applicable to bankruptcy proceedings by Bankruptcy Rule 7054). The Banks filed a supplementary joint notice of appeal within ten days of the bankruptcy court's certification. Thus, regardless of whether GSNB had standing to file a motion to amend the February 10th order, the district court, as well as this court, had jurisdiction to hear the appeal.

B. *Voidable Preference Under Section 547*

[2] The bankruptcy court concluded that Mellon Bank's security interest sup-

porting the three loans—the acquisition loan, the working capital loan, and the letter of credit loan—constituted a voidable preference under 11 U.S.C. § 547(b). The court determined that the perfection of this security interest constituted a voidable preference because Mellon untimely refiled its financing statements in the debtor's new location.

The purpose of section 547 of the Bankruptcy Code is to prevent preferences of certain creditors so that the debtor's assets may be fairly distributed among all creditors, not merely those that are favored. *Kapela v. Newman*, 649 F.2d 887 (1st Cir. 1981). Section 547 provides, in relevant part, that:

> the trustee may avoid any transfer of an interest of the debtor in property—
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owned by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made—
>
> (A) on or within 90 days before the date of the filing of the petition ...
>
> (5) that enables such creditor to receive more than such creditor would receive if—
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). Assuming, for the moment, that the perfection of a security interest constitutes a transfer of an interest of the debtor in property, the crucial issue in the present case is whether the perfection occurred within the 90 day period prior to the filing of the bankruptcy petition.

[3] Whether the transfer occurred within the 90 day period turns on whether Mellon untimely refiled its security interest in Pennsylvania. 13 Pa.C.S.A. § 9103(c) governs the perfection of security interests in multi-state transactions. In pertinent part, it provides:

> (4) A debtor shall be deemed located ... at his chief executive office if he has more than one place of business ...
>
> (5) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the location of the debtor to another jurisdiction or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change.

The parties agree that at the time of the leveraged buyout, Metro had its chief executive office in Rockville, Maryland. Mellon filed in the appropriate offices in Maryland in April of 1984, thus perfecting its security interest. The issue is whether Mellon's refiling in Pennsylvania was within four months of the Metro's transfer of its chief executive office to Pittsburgh.

If the debtor moved its headquarters to Pennsylvania on or after October 5, 1984, Mellon's security interest in Metro's assets remained perfected. If the change of the chief executive office occurred prior to October 5, 1984, the lien of Mellon's statements would have lapsed, and the filing statements in Pennsylvania would constitute a reperfection rather than a continuation of the earlier perfected status. If the refilings constituted a reperfection, that new perfection occurred within the 90 day period of section 547 and is thus vulnerable to attack.

[4, 5] The bankruptcy court determined that Metro moved its office "at least some time before October, and most apparently by late August." This court reviews the bankruptcy court's findings of fact under a clearly erroneous standard, whereas its conclusions of law are subject to plenary review. *In re Jersey City Medical Center*, 817 F.2d 1055, 1059 (3rd Cir.1987). However, mixed questions of law and fact, such as the ultimate determination of when and what constituted a relocation of the chief

executive offices of a corporation, is a conclusion of law or, at least, a mixed question of law and fact. We are therefore not limited to the "clearly erroneous" standard, but must exercise a mixed standard of review. We accept the trial court's finding of historical or narrative facts unless clearly erroneous, but exercise "plenary review of the trial court's choice and interpretation of legal precepts and its application of those precepts to the historical facts." *Universal Minerals, Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 101–02 (3rd Cir.1981).

[6] The preliminary and significant legal question that must be discussed is the allocation of the burden of proof. The bankruptcy court explicitly placed the burden of proving that Mellon's security interest did not constitute a voidable preference under section 547 on Mellon. The court reasoned that because Mellon's complaint asserted its secured status, it therefore had the burden of proving the same by the preponderance of the evidence. Although this statement is in and of itself correct, the bankruptcy court failed to realize that Mellon had satisfied that burden of proof by showing it properly filed financing statements made in Pennsylvania prior to the debtor's filing under Chapter 11. *See* 11 U.S.C. § 502(a).

The bankruptcy court erred in holding that Mellon had to prove that its security interest was *not* a voidable preference under section 547 in order to establish its secured status. This ruling is in direct contravention with the allocation of the burden of proof statutorily provided for in section 547(g) which states that *"the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section."* 11 U.S.C. § 547(g) (West Supp.1991) (emphasis supplied). The bankruptcy court's erroneous legal conclusion that Mellon had the burden of proof to sustain the validity of its security interest under section 547 materially permeated its factual findings.

Turning to the bankruptcy court's factual findings as to when Metro moved its chief executive office, it appears that the court utilized the correct definition. The Official Comments to section 9–103 explains that the "chief executive office does not mean the place of incorporation; it means the place from which in fact the debtor manages the main part of his business operations. This is the place where persons dealing with the debtor would normally look for credit information." Courts have used this language to develop a two-part test to determine the location of a debtor's chief executive office:

> (1) from which place does the debtor manage the main part of its business operations; and
>
> (2) where would creditors reasonably be expected to search for credit information?

In re Golf Course Builders Leasing, Inc., 768 F.2d 1167, 1170 (10th Cir.1985); *In re J.A. Thompson & Son, Inc.*, 665 F.2d 941, 949 (9th Cir.1982).

The bankruptcy court's application of this definition, however, is questionable. The Banks rightly criticize the court's mechanistic application of factors deemed relevant in other cases. *See In re Golf Course Builders*, 768 F.2d at 1170; *In re J.A. Thompson*, 665 F.2d at 949. The Official Comment to section 9–103 envisions a realistic test asking simply "where does the debtor manage the main part of its business" because that is where creditors are likely to search for information. To artificially break down that question into rigidly applied tests violates the practical nature of the inquiry as envisioned by the Uniform Commercial Code.

[7] The Banks correctly point out that when one corporation is acquired by another, the nature of the inquiry as to the location of the chief executive office must necessarily be tailored to that situation. Ascertaining the location of the headquarters of a wholly-owned subsidiary necessarily differs from determining the location of the chief executive office of a single corporation. Re-examining the evidence presented below with more illumination than that enjoyed by the bankruptcy court, it becomes apparent that the bankruptcy court basically concluded that Metro, over time, came under the control of its parent

corporation, TCS, and thus Metro's headquarters became those of TCS. This conclusion is neither legally nor factually accurate.

[8] The bankruptcy court's analysis is flawed in several respects. First, there is a presumption that a corporation, even when it is a wholly owned subsidiary of another, is a separate entity. The law recognizes the legal distinction of affiliated corporations as do business people. To require creditors to analyze and understand the internal power structure of related corporations to determine whether the wholly owned subsidiary was "truly independent" from its parent corporation is misplaced and would introduce great uncertainty into commercial transactions, especially with respect to the filing of financing statements.

The inappropriateness of the focus of the bankruptcy court's inquiry is underscored by the evidence it relied upon. The court found relevant internal memoranda allegedly revealing the "transfer of power [that] began gradually, and then proceeded rapidly." To require creditors to scrutinize internal documents to determine the "reality" of the power structure of affiliated corporations is impractical, imprudent, and unwarranted. If, as it must be, the focus of the inquiry is shifted from analyzing the relationship between the parent corporation and its subsidiary to where Metro, the debtor, in fact had its headquarters, overwhelming evidence supports the conclusion that Metro's chief executive office remained in Rockville, Maryland until it announced the transfer in the press in December of 1984.

As previously stated, Metro's business was the acquisition of syndication rights to sporting events as well as the sale of advertising. The bankruptcy court did not find that the activities of obtaining contracts and selling advertising were no longer centered in the Rockville office, but that these activities, over time, became subject to the final approval of Goldberg, the CEO and Chairman of the Board located in Pittsburgh.[1] The court stated that "[b]y September the Rockville office had no more executive authority; it was merely a large sales arm of the Pittsburgh hub." 95 B.R. at 926. Once again, however, to require the creditors of a corporation to speculate as to who is calling the final shots is impractical and irrelevant. The "main part" of Metro's activities was the acquisition of syndication rights and the sale of advertising; this activity remained centered in the Rockville office until it was closed in December of 1984.

Much evidence readily available to creditors and of a more objective nature demonstrated that Metro maintained its headquarters in Rockville until December of 1984. Most importantly, contracts for syndication rights list Rockville as the principal office as late as October 5, 1984. Tax forms filed in the beginning of 1985 list Rockville as the headquarters. Metro's own letterhead lists Rockville as headquarters until December 1, 1984. Representatives of athletic conferences and colleges continued to deal directly with the Rockville office at least through early October 1984. On October 5, 1984, the Big East Conference wrote to Gail Schelat, the chief financial officer of both TCS and Metro, confirming contract negotiations. That letter, however, was addressed to the Rockville office. All of this evidence strongly supports Rockville as the "place where persons dealing with the debtor would normally look for credit information." Official Comment to § 9–103.

The only relevant piece of evidence in support of the court's conclusion that Metro's headquarters moved prior to October 5, 1984, was the July 12, 1984, newspaper announcement that stated that "TCS/Metrosports will be headquartered out of

1. The evidence does show that accounting and financial services were consolidated in the Pittsburgh office shortly after the leveraged buyout. However, the location of these services is secondary to the main business of Metro corporation—obtaining syndication rights and selling advertising. Thus, the location of these services is not determinative. Moreover, it has become common practice for affiliated corporations to consolidate financial services for the corporate group in one location. The whereabouts of this streamlined accounting service does not give us much information about the location of the headquarters for each corporation.

TCS's New Kensington, PA location." However, this announcement meant only that joint ventures embarked on by the newly related corporations would be coordinated out of the Pennsylvania location. Moreover, the effective date is not stated. The language used is telling—that the joint ventures will be "headquartered out of *TCS's New Kensington, PA location.*" Even this announcement did not imply that Metrosports, a separate corporate entity, had an office in New Kensington. Indeed, on the next page of the announcement, Metrosports' location is listed as Rockville, MD.

Finally, the most telling piece of evidence is not even mentioned by the bankruptcy court. On November 19, 1984, Metro announced that TCS/Metrosports was consolidating its operations and that accordingly, Metro's headquarters, "previously in Rockville, Maryland" were being moved to Pittsburgh "*effective on December 3, 1984,*" and that "the firm expect[ed] to complete its consolidation of office and staff ... by December 31, 1984." (Emphasis supplied). Thus, the bankruptcy court's conclusion is directly contrary to the debtor's public announcement as to the location of its own headquarters.

In sum, the bankruptcy court's conclusion that Metro shifted its headquarters "at least some time before October" is fraught with error. First, the court impermissibly shifted the burden of proof. Second, the court engaged in an irrelevant inquiry as to the internal balance of power between corporate executives and whether the subsidiary corporation operations were controlled by the parent corporation. Third, the court ignored considerably critical evidence that Metro continued to handle negotiation of syndication contracts, Metro's central line of business primarily out of the Rockville office until at least October 5, 1984. Finally, the court disregarded the news release stating that Metro's headquarters would be moved on December 3, 1984. For these reasons, we conclude that the bankruptcy court erred in its mixed finding of fact and conclusion of law that Metro's headquarters moved "at least some time before October." [2]

In any event, we need not decide the question whether the reperfection of a security interest in Pennsylvania during the 90 day preference period could be susceptible to attack under section 547(b) in light of our holding that the bankruptcy court erred in its ultimate mixed finding of fact and conclusion of law that the debtor's headquarters moved prior to October 5, 1984.

C. *Fraudulent Transfer Under Section 548(a)(2)*

[9] The bankruptcy court held that Metro's guaranty and the security interest collateralizing the guaranty of the 1.85 million dollar loan to TCI which was used to buy out Metro's shareholders constituted a fraudulent conveyance under 11 U.S.C. § 548(a)(2). It is unclear whether the bankruptcy court meant this to be an alternative holding to its voiding of Mellon's security interest under section 547. At any rate, we must reach this question in light of our decision that the security interest did not constitute a voidable preference.

The present law of fraudulent conveyances has ancient roots. Section 548 is derived from the Statute of 13 Elizabeth passed by Parliament in 1571. The statute was aimed at a practice by which overburdened debtors placed their assets in friendly hands thereby frustrating creditors' at-

2. Moreover, the Committee did not put forth any evidence to satisfy the other required element of section 547, namely, that the creditor received more than it would have under the circumstances of section 547(b)(5). Subsection (b)(5) requires that the trustee show that the transfer had the effect of giving the creditor a greater return on his debt than would have been the case had the transfer not taken place and there had been a distribution under the liquidation provisions of the Bankruptcy Code. *In re Rude,* 122 B.R. 533, 535 (Bkrtcy E.D.Wis. 1990). In the present case, it is likely that a security interest would give Mellon Bank a distinct advantage over what it would otherwise receive in a hypothetical chapter 7 liquidation distribution, yet, the bankruptcy court failed to discuss this issue. Under these circumstances, it appears that the Committee has not satisfied its statutorily provided burden of proof as to all the required elements of section 547(b).

tempts to satisfy their claims against the debtor. After the creditors had abandoned the effort to recover on their claims, the debtor would obtain a reconveyance of the property that had been transferred. Such transactions operated as a fraud against the debtor's creditors because the debtor's estate was depleted without exchanging property of similar value from which the creditors' claims could be satisfied.

The current embodiment of the law of fraudulent conveyances, section 548(a) provides, in full, that:

> the trustee may avoid any transfer of an interest of the debtor in property, that was made or incurred on or within one year before the date of filing of the petition, if the debtor voluntarily or involuntarily—
>
> (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
>
> (2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (b)(i) was insolvent on the date that such transfer or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
>
> (iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

Subsection (a)(1) deals with actual fraud; the trustee is required to prove actual intent to defraud the debtor's creditors. Subsection (a)(2) addresses constructive fraud; the fraud on the creditors will be presumed if certain objective criteria are met. In this case, the Committee has made no allegations of intentional fraud. There is no evidence of any intention on the part of the parties to hinder or delay creditors or to commit any fraud. The bankruptcy court here held that Metro engaged in constructive fraud within the terms of section 548(a)(2).

At first glance, it seems difficult to reconcile the original purpose of the fraudulent conveyance laws with what has become a common, arms-length transaction—the leveraged buyout, or in business parlance, the LBO. Where there exists no intentional fraud, setting aside the security interest of a lender who has indisputably *given* reasonably equivalent value, cash for a promise to repay a loan, appears to be a patent anomaly. As one commentator has stated, "[a] firm that incurs obligations in the course of a buyout does not seem at all like the Elizabethan deadbeat who sells his sheep to his brother for a pittance." Baird & Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 Vand.L.Rev. 829, 852 (1985). Nonetheless, a thorough understanding of the typical LBO transaction reveals that there is a potential for abuse of the debtor's creditors, particularly those who are unsecured, when a company is purchased through an LBO.

Although the formal structure of LBOs may differ, the substance of LBOs follow a general pattern. A leveraged buyout refers to the acquisition of a company ("target corporation") in which a substantial portion of the purchase price paid for the stock of a target corporation is borrowed and where the loan is secured by the target corporation's assets. Commonly, the acquiror invests little or no equity. Thus, a fundamental feature of leveraged buyouts is that equity is exchanged for debt.

TCI's acquisition of the target Metro followed the typical pattern: Mellon extended a loan of 1.85 million dollars to TCI for the purchase of Metro; Metro guaranteed the loan and secured it with its assets, thus significantly adding to its debt structure. TCS and MCM, the parent and grandparent corporations of TCI also guaranteed the acquisition loan.

The effect of an LBO is that a corporation's shareholders are replaced by secured creditors. Put simply, stockholders' equity is supplanted by corporate debt. The level

of risk facing the newly structured corporation rises significantly due to the increased debt to equity ratio. This added risk is borne primarily by the unsecured creditors, those who will most likely not be paid in the event of bankruptcy. The lender, which normally assumes a senior, secured position vis-a-vis other creditors, is at risk only to the extent that the loan is under-collateralized. An LBO may be attractive to the buyer, seller, and lender because the structure of the transaction could allow all parties to the buyout to shift most of the risk of loss to other creditors of the corporation if the provisions of section 548(a)(2) were not applied.

The selling shareholders receive direct benefit in the LBO transaction as they are cashed out, usually at a price above the price the shares were trading shortly before the acquisition is announced. The new purchaser also benefits from the transaction by thereby achieving ownership of the corporation. The lender is attracted by the higher interest rates and fees usually associated with LBOs. The target corporation, however, receives no direct benefit to offset the greater risk of now operating as a highly leveraged corporation. As legal scholars have noted, the target firm may not at all reflect the Elizabethan deadbeat, but may in fact wind up as the sacrificial lamb. Wahl & Wahl, *Fraudulent Conveyance Law and Leveraged Buyouts*, 16 William Mitchell L.Rev. 343, 353 (1990).

The reasonableness of the remedy provided by section 548(a)(2) has been questioned. *See, e.g.,* Carlson, *Leveraged Buyouts in Bankruptcy*, 20 Georgia L.Rev. 73 (1985) (lenders should have good faith defense of section 548(c) despite language requiring lender to have given value to the debtor). However, because the fraudulent conveyance laws are intended to protect the debtor's creditors, a lender cannot hide behind the position, although sympathetic, that it has parted with reasonable value. The purpose of the laws is estate preservation; thus, the question whether the debtor *received* reasonable value must be determined from the standpoint of the creditors. *But cf., In re Greenbrook Carpet Co., Inc.*, 722 F.2d 659, 661 (11th Cir.1984) (court held that although bank knew that corporation would immediately re-lend proceeds of the loan to principal shareholders to purchase a company in return for unsecured note, the issue under section 548 was "whether the *bank* received more consideration than it was due"); *Kupetz v. Wolf*, 845 F.2d 842, 847 (9th Cir.1988) (court refused to apply section 548(a)(2) to force selling shareholders to disgorge the payments they received where there was no indication of actual intent to defraud and no knowledge of the LBO structure used to purchase their shares).

Moreover, the statutory language provides no exception for the leveraged buyout transaction. Section 548 applies to "any transfer of an interest of the debtor in property." The definitional section of the Act states that transfer means "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property." 11 U.S.C. § 101(54). This definitional language is sufficiently broad to encompass a leveraged buyout transaction that falls within its terms. We therefore turn to the analysis of the particular requirements of section 548.

Reasonably Equivalent Value

[10, 11] Section 548(a)(2)(A) requires the trustee to show that the debtor received "less than a reasonably equivalent value." Because Metro did not receive the proceeds of the acquisition loan, it did not receive any direct benefits from extending the guaranty and security interest collaterizing that guaranty. However, in evaluating whether reasonably equivalent value has been given the debtor under section 548, indirect benefits may also be evaluated. If the consideration Metro received from the transaction, even though indirect, approximates the value it gave TCI, this can satisfy the terms of the statute. *See Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979, 991 (2nd Cir.1981) (although transfers solely for the benefit of third parties do not furnish fair consideration, the transaction's benefit to the debtor need

not be direct and may come through a third party). These indirect economic benefits must be measured and then compared to the obligations that the bankrupt incurred. Here, as well as in determining insolvency under section 548(a)(2)(B)(i), it is appropriate to take into account intangible assets not carried on the debtor's balance sheet, including, *inter alia*, good will. *See Mutual Life Ins. Co. v. Menin*, 115 F.2d 975, 977 (2d Cir.1940), *cert. denied*, 313 U.S. 578, 61 S.Ct. 1096, 85 L.Ed. 1536 (1941) (debtor's good will is property asset which may be sold in bankruptcy proceedings); see also *In re Da-Sota Elevator Co.*, 939 F.2d 654, 656 (8th Cir.1991). The touchstone is whether the transaction conferred realizable commercial value on the debtor reasonably equivalent to the realizable commercial value of the assets transferred. Thus, when the debtor is a going concern and its realizable going concern value after the transaction is equal to or exceeds its going concern value before the transaction, reasonably equivalent value has been received.

The bankruptcy court rejected Mellon's argument that one of the indirect benefits that Metro received as a result of the LBO was the ability to borrow working capital from Mellon. The court reasoned that the 2.3 million dollar credit line extended contemporaneously with the 1.85 million dollar loan to TCI amounted to a *liability* because "all that Debtor really received was the opportunity to incur an additional $2.3 million of debt." The court concluded that because of accruing interest, Metro received "substantially less than a reasonably equivalent value in exchange." 95 B.R. at 934. This analysis is flawed. The ability to borrow money has considerable value in the commercial world. To quantify that value, however, is difficult. Quantification depends upon the business opportunities the additional credit makes available to the borrowing corporation and on other imponderables in the operation or expansion of its business.

The bankruptcy court also did not account for the value created by the LBO itself. The Banks cite what appears to be legitimate and reasonable expectation that the affiliation of these two corporations, TCS and Metro, would produce a strong synergy. Through the LBO, Metro established a permanent relationship with a production company with highly sophisticated equipment and an experienced and reputable production and technical staff. The complementary nature of the two corporations' businesses would appear to create a stronger and more profitable combination. What was unpredicted, however, was the Supreme Court's decision in *National Collegiate Athletic Assoc. v. Board of Regents of the University of Oklahoma*, 468 U.S. 85, 104 S.Ct. 2948, 82 L.Ed.2d 70 (1984), which Mellon points to as the reason for Metro's dramatic and unforeseen decline. Mellon alleges that the Court's holding that certain NCAA restrictions imposed on the broadcasting of college football games of member NCAA institutions violated antitrust laws had the unexpected result of increasing competition and severely decreasing revenues from advertising. The problem universal to all LBOs—transactions characterized by their high debt relative to equity interest—is that they are less able to weather temporary financial storms because debt demands are less flexible than equity interest.

Thus, the indirect benefits to Metro of this guaranty were the ability to obtain substantial credit due to its new association with the TCS corporate group and the synergy expected to result from the combination of these corporations.[3] The value,

3. John L. Phillips, a consultant in the telecommunications industry and a certified public accountant formerly employed by Price, Waterhouse & Co., who actively assisted with the management of Total Communications, Inc., explained the benefits to be derived by the companies involved in the LBO. Speaking specifically about the benefits to be derived by Metro, he testified:

> The benefits to Metro again were quite clear. Metro had a history of having to negotiate for facilities ... and by having a facility like Total Communications Systems ... it had a reputation of being—of having state of the art quality production equipment and it also had a reputation of having better than average production—quality production people. So this would add to Metrosports in terms of being able to in some cases upgrade the quali-

however, of the synergy obtained in the corporations' affiliation and the value of obtaining the credit are difficult to quantify in dollars without the aid of expert witnesses. Regrettably, no such testimony was forthcoming in this case.

The value of consideration received must be compared to the value given by the debtor to determine whether the debtor received less than reasonably equivalent value. The bankruptcy court correctly found that the contingent nature of the debt was illusory because TCI had no assets of any kind except the debtor. The parties do not dispute that TCI was merely a shell corporation formed for the sole purpose of acquiring Metro. All parties, including the lender, assumed that Metro would be servicing the debt.

However, the court ignored the value of guarantees made by TCS and MCM. In valuing the cost of Metro's guaranty, the right of contribution from co-guarantors needs to be balanced against the amount of debt for which Metro is liable. Carl, *Fraudulent Transfer Attacks on Guaranties in Bankruptcy,* 60 Amer.Bank.L.J. 109, 114 (1986) ("If there are multiple guarantors of the same obligation, the right of contribution entitles a paying guarantor to have its co-guarantors pay it their proportionate share of the principal debt it paid.") Thus, the value of the guaranty, 1.85 million dollars, must be reduced to the extent contribution was available at the time of the loan from Metro's co-guarantors.

No evidence, however, has been offered regarding the value of these rights to contribution. We do know that the assets of the guaranteeing corporations were sufficiently valuable to justify an immediate additional loan by Mellon to TCS of 2.3 million dollars and letters of credit for an additional 2.25 million dollars. These loans enabled Metro, as demonstrated by its balance sheet of June 30, 1984, immediately to achieve a very sharp rise in its broadcasting rights amounting to a grand total of $26,240,705. Although the ability to obtain credit is the lifeblood of the commercial world and governmental operational survival, and the synergystic strength expected from the merger here, no doubt had value, the Committee introduced no evidence to support its burden of showing that Metro received less than reasonably equivalent value in exchange for its guaranty and security interest. The Committee acted on the blind assumption that they had no value and the bankruptcy court agreed.

Insolvency or Undercapitalization

[12] Under section 548, not only must the Committee prove that the debtor did not receive reasonably equivalent value, the Committee must also prove that the debtor was "insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer." 11 U.S.C. § 548(a)(2)(B)(i). The bankruptcy court swiftly concluded that Metro was rendered insolvent by the LBO, stating that clear logic showed that "the very transactions themselves caused a *serious* case of insolvency." 95 B.R. at 934.

The bankruptcy code defines insolvency as a "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation." 11 U.S.C. § 101(31)(A). This test is frequently described as the "balance sheet test." The debtor's assets and liabilities are tallied at fair valuation to determine whether the corporation's debts exceed its assets. Under section 548, insolvency is to be measured at the time the debtor transferred value or incurred an obligation. In present case, Metro's solvency must be measured on April 6, 1984, the date on

ty of its production work associated with its programming and in other cases establishing a consistency of quality because of being able to use in many respects the same people. This is very valuable to any syndicator or someone who owns rights, programming rights. It's very valuable in terms of being able to go to advertisers, okay, and to stations and be able to say, I'm going to be able to deliver you a consistency of quality of production. The other aspect of benefit to Metrosports, you don't have to be a genius to see, it received working capital.

Q. Through the loans from Mellon Bank?
A. Right. Which, of course, proved to be needed.

which Metro guaranteed the acquisition loan.

The bankruptcy court reasoned that the LBO rendered Metro insolvent because it assumed that the 1.85 million paid to the former shareholders of Metro reflected the fair market value of Metro and that Metro's pledge of its stock and assets in equal amount necessarily rendered it insolvent. The court stated:

> Debtor's former shareholders were paid $1.85 million in exchange for their shares of stock. If, as is often stated, fair market value is the sum a willing buyer will pay a willing seller in an arm's-length transaction, then Debtor's stock had a fair valuation of $1.85 million. Debtor pledged its stock *and* all of its remaining unencumbered assets as collateral for said $1.85 loan guaranty. For all intents and purposes, Debtor was now liable for payment of the principal and interest on the loan, the proceeds of which it did not receive and the funding for which it did not have. A clearer case of insolvency would be difficult to construct.

In re Metro, 95 B.R. at 934. Thus, the court concluded in one short paragraph that the transaction rendered Metro insolvent. Not only is the bankruptcy court surprisingly cavalier in fashioning what amounts to a *per se* rule that LBO loans collateralized with the target's assets are fraudulent, the court's analysis is flawed by several fundamental errors.

First, even assuming that Metro's fair market value was 1.85 million dollars, the guaranties of TCS and MCM should have been counted as reducing Metro's liability to something below 1.85 million dollars. Second, the court erred in stating that Metro "pledged its stock *and* all of its remaining unencumbered assets." Metro, of course, cannot, and did not, pledge its own stock as the corporation's stock was held by another entity—TCI. The bankruptcy court thus, in essence, double counted when it stated that Metro pledged stock as well as assets. For these reasons, as well as reasons we discuss below, the bankruptcy court's superficial analysis fails to show that the guaranty of the acquisition loan rendered Metro insolvent.

[13] The record is sparse with respect to the financial condition of Metro at the time of the two loans on April 6, 1984, of 1.85 million dollars to accomplish the stock purchase and 2.3 million dollars for working capital. James Canavan, assistant vice-president of Mellon, testified that the loans would not have been made without the guaranty and surety agreements of TCM and TCS. Although we do not have a financial statement of Metro for April 6, 1984, Metro's corporate income tax return with accompanying balance sheet for the period ending April 16, 1984, shows the total assets of the company and liabilities without the Mellon loans of April 6, 1984. The income tax return, prepared on a cash basis, does not report accounts receivable or accounts payable and, therefore, is incomplete. Nonetheless, it does reflect that the corporation had a net worth of $133,873 at the time and was not insolvent. Thus, it appears that the purchaser of the capital stock of Metro paid primarily for goodwill.[4] In the absence of any evidence as to the value of the accounts receivable and the sum owing on the accounts payable, and no proof of the value of Metro's rights to contribution, one cannot determine on this record whether the guaranty of the 1.85 million dollar loan and the accompanying security interest rendered the corporation insolvent.

4. Goodwill is the difference between the value of the consideration given and the fair market value of the Company's identifiable net assets. E.R. Brownslee, K. Ferrs, M.C. Haskins, *Corporate Financing Reporting*, 144 (1990).

Although the purchaser obtained little value in tangible assets, TCI secured much more in solid expectations of the Company's future potential after the infusion of needed working capital and the benefits of the synergism effectuated by the permanent combination of three operating companies, MCM, TCS, and Metro. As for Mellon, apparently it looked for collateralization of its loans to its security interest in Metro's potential profits after the synergistic effects of the combination of the corporations and the infusion of new working capital and, most importantly, to the guaranty and surety agreements of MCM and TCS, not to the security interest in Metro's limited assets.

When we examine the balance sheet of June 30, 1984, prepared on an accrual basis, after the ingestion of 2.3 million dollars working capital and the expansion of the company's broadcasting rights, we find accounts receivable of $1,828,016 and accounts payable of $762,745. The corporations' assets have now shot up to an aggregate $28,370,697 consisting primarily of broadcasting rights, and its liabilities amounted to $27,684,167, comprised principally of obligations under its broadcast rights and bank loans of $3,500,000. The net worth of the company shows improvement—now $343,265—despite the liability of the bank loans and demonstrates that the Mellon loans did not render Metro insolvent, even without considering the value of the guarantees of TCS and MCM, but improved its financial condition.

We conclude that the Committee failed to satisfy its burden of proving that Metro was insolvent on the date of the transfer or became insolvent as a result of the transfer. As the Committee did not raise the issue of unreasonably small capital or the debtor's intent to incur debts beyond its ability to pay, we need not discuss these issues. Thus, we hold that the guaranty and security interest securing the acquisition loan did not constitute a fraudulent conveyance as provided by section 548 of the bankruptcy code.

III.

In sum, we conclude that the bankruptcy court erred in its conclusion that the debtor's chief executive office was relocated prior to October 5, 1984, and thus Mellon's refiling of its financing statements in the debtor's new location did not constitute a voidable preference under section 547(b). We also hold that the Committee failed to satisfy its burden of proof in showing that Metro failed to receive reasonably equivalent value when it executed the guaranty and security interest of the acquisition loan and that the loan rendered it insolvent under section 548(a)(2). Accordingly, the order of the district court will be reversed insofar as it affirms the order of the bankruptcy court of February 10, 1989, as amended, and the case will be remanded to the district court with instructions to reverse the foregoing order of the bankruptcy court. Costs taxed to the appellees.

UNITED STATES of America

v.

FRIERSON, Jerome, Appellant.

No. 90–3382.

United States Court of Appeals,
Third Circuit.

Argued Nov. 15, 1990.

Decided Oct. 1, 1991.

Defendant was convicted in the United States District Court for the District of Delaware, Joseph J. Longobardi, Chief Judge, of bank robbery by intimidation, and he appealed. The Court of Appeals, Stapleton, Circuit Judge, held that: (1) sentencing court must consider all relevant criminal conduct in determining offense characteristics, and (2) defendant's voluntary statement denying that he was armed during robbery could be relied upon by court to deny defendant two level reduction for acceptance of responsibility.

Affirmed.

Garth, Circuit Judge, concurred, dissented and filed opinion.

1. Criminal Law ⚷1313(2)

Specific offense characteristics used to increase or decrease base offense level must be proved by preponderance of evidence. U.S.S.G. § 1B1.1 et seq., 18 U.S.C.A.App.

2. Criminal Law ⚷1245(1)

In determining whether specific offense characteristic applies, for purpose of determining base offense level, sentencing

In re RIVER ENTERTAINMENT CO., Debtor.

Ardi Limited Partnership, Plaintiff,

v.

The Buncher Company, Defendant/Third Party Plaintiff,

v.

River Entertainment Co., Third Party Defendant.

Bankruptcy No. 07–024515JAD.
Adversary No. 10–2495JAD.

United States Bankruptcy Court, W.D. Pennsylvania.

March 30, 2012.

Background: State court cause of action for conversion of barge facility in which former Chapter 11 debtor claimed ownership interest was removed to federal court for trial as adversary proceeding in reopened case, and parties cross-moved for summary judgment. Debtor and related partnership entity filed supplemental brief in which they belatedly questioned court's authority to adjudicate conversion claim.

Holdings: The Bankruptcy Court, Jeffery A. Deller, J., held that:

(1) language in consent order approved by bankruptcy court required debtor to completely remove barge facility from location where it was moored and connected by bridges and utility lines to riverbank land owned by lessor in order to maintain interest therein;

(2) removal of bridges and utility lines, without more, was not "complete remov[al of] barge facility from its current location";

(3) by failing to timely remove barge facility from location where it was moored, debtor lost any interest therein and could not maintain conversion action when lessor subsequently demolished barge facility;

(4) even assuming that conversion action would lie, it had to be brought within two years of commencement of demolition work;

(5) bankruptcy court had authority to finally adjudicate state law conversion claim, the crux of which depended on interpretation of its prior consent order; and

(6) even assuming that court lacked authority to adjudicate conversion claim, parties impliedly consented thereto.

Debtor's and affiliated entity's motion denied; lessor's cross-motion granted.

1. Conversion and Civil Theft ⚷100

Under Pennsylvania law, "conversion" is deprivation of another's right of property in, or use or possession of, chattel, or other interference therewith, without the owner's consent and without lawful justification.

See publication Words and Phrases for other judicial constructions and definitions.

2. Conversion and Civil Theft ⚷124

Under Pennsylvania law, when party has no right to possession of property at time of alleged conversion, cause of action for conversion will fail as matter of law.

3. Bankruptcy ⚷2164.1

Language in consent order approved by bankruptcy court, which required Chapter 11 debtor, in order to maintain ownership interest in barge facility that was moored in river and attached by bridges and utility lines to riverbank land owned by lessor, to give notice, on or before 60 days from date of order, of its intent to completely remove barge facility from its current location, which removal had to be accomplished within 90 days of

date of order, did not allow debtor to maintain interest in barge facility simply by giving notice of its intent to remove within 60-day time frame specified in order if removal was not actually accomplished within 90-day time frame, something that was made manifest by additional language in consent order specifying that, "upon such removal, [lessor] will relinquish any claim or interest in the barge facility."

4. Bankruptcy ⚷2164.1

In order to "completely remove the barge facility from its current location," within meaning of bankruptcy consent order allowing Chapter 11 debtor to maintain ownership interest in barge facility that included both a restaurant and night club only by accomplishing such removal, at its expense, within 90 days of consent order, it was not enough for debtor simply to remove bridges and utility lines which connected facility to riverbank land owned by lessor, if facility was still moored in its current location.

See publication Words and Phrases for other judicial constructions and definitions.

5. Bankruptcy ⚷2164.1

Conversion and Civil Theft ⚷124

By failing to timely remove barge facility from location where it was moored and connected, by bridges and utility lines, to riverbank land owned by lessor, Chapter 11 debtor lost all interest therein pursuant to terms of bankruptcy court's consent order, such that it no longer had any right to possession at time of lessor's demolition of facility and could not maintain cause of action under Ohio law for lessor's alleged conversion.

6. Conversion and Civil Theft ⚷153

Conversion actions in Pennsylvania are subject to two-year statute of limitations. 42 Pa.C.S.A. § 5524(7).

7. Limitation of Actions ⚷43

Under Pennsylvania law, statute of limitations begins to accrue when the first significant event necessary to make a claim suable occurs.

8. Limitation of Actions ⚷55(5)

Even assuming that lessee still had rights in barge facility, of kind required under Pennsylvania law to maintain cause of action for conversion, at time of its demolition by lessor of riverbank land to which it was attached, two-year statute of limitations upon such a cause of action began to run as of commencement of demolition work, the first significant event necessary to make lessee's conversion claim suable. 42 Pa.C.S.A. § 5524(7).

9. Bankruptcy ⚷2049, 2056

Bankruptcy court had authority to finally adjudicate state law conversion claim asserted by former Chapter 11 debtor in reopened case, where crux of claim depended on whether debtor still had any interest in barge facility attached to riverbank land owned by lessor at time of lessor's demolition of facility, a question conclusively resolved by interpreting prior consent order of bankruptcy court dealing with ownership issue; debtor's conversion claim was not independent state law cause of action, but one which "stemmed" from bankruptcy proceeding.

10. Bankruptcy ⚷2058.1

Given degree of control exercised by Article III judges over bankruptcy courts, structural protections of Article III are not implicated by bankruptcy statutory scheme, such that parties may effectively consent to final adjudication of matters by non-Article III bankruptcy courts.

11. Bankruptcy ⚷2058.1

Consent will apply to permit final adjudication by non-Article III bankruptcy courts of non-core and core matters alike.

12. Bankruptcy ⚷2058.1

Consent to adjudication of common law claims by non-Article III bankruptcy court may be implied from the action, or inaction, of parties to proceeding.

13. Bankruptcy ⚷2058.1

Even assuming that bankruptcy court lacked authority to constitutionally adjudicate state law conversion claim asserted by former Chapter 11 debtor in reopened case, despite fact that crux of claim depended on interpretation of bankruptcy court's consent order dealing with ownership of allegedly converted asset, debtor and its related entity impliedly consented to bankruptcy court's adjudication of claim by conceding, at hearing on motion to reopen case, that claim could be tried and finally adjudicated in bankruptcy court, through statements of their counsel, on subject of removal of conversion action to bankruptcy court, that he had "no preference" where cause of action was tried, and by continuing, for period of more than eight months, to litigate matter in bankruptcy court.

Robert O. Lampl, Pittsburgh, PA, for Debtor/Plaintiff/Third Party Defendant.

Robert D. Finkel, Manion McDonough & Lucas, Pittsburgh, PA, for Defendant/Third Party Plaintiff.

MEMORANDUM OPINION

JEFFERY A. DELLER, Bankruptcy Judge.

The matters before the Court are dueling motions for summary judgment. One *Motion for Summary Judgment* is jointly filed by the Plaintiff, ARDI Limited Partnership ("ARDI"), and the Debtor/Third Party Defendant, River Entertainment Co. ("River Entertainment"). Pursuant to their *Motion for Summary Judgment,* the movants seek the entry of an order granting ARDI's complaint for conversion of certain assets. Defendant/Third Party Plaintiff The Buncher Company ("Buncher") has also filed a *Motion for Summary Judgment.* Pursuant to its motion, Buncher seeks dismissal of that complaint against it. At the center of these motions is a dispute regarding the enforcement of a prior consent order entered by this Court, that will resolve the issue of the ownership and alleged conversion of a certain barge facility moored along the Allegheny River in Pittsburgh, Pennsylvania. For the reasons expressed below, the *Motion for Summary Judgment* filed by Buncher shall be granted and the *Motion for Summary Judgment* jointly filed by ARDI and River Entertainment shall be denied.

I.

The Debtor in this case, River Entertainment, operated an entertainment complex commonly known as "The Boardwalk" which included a nightclub and restaurant on a barge facility for approximately seventeen years. The Boardwalk was operated in two buildings which, along with other "Improvements", sat atop four separate barges that were structurally bound together (the "Barge Facility"). The Barge Facility was moored in the Allegheny River in Pittsburgh, Pennsylvania and was connected to the land by several bridges and utility lines. Buncher owned the adjacent land that allowed access to the Barge Facility. Buncher also held various permits issued by the Department of Environmental Protection that allowed for the mooring of the Barge Facility in the Allegheny River.

Buncher and River Entertainment entered into a Facility Lease Agreement that provided for the lease of the Barge Facili-

ty and for the benefits conferred by the various permits that allowed the Barge Facility to be moored in the Allegheny River.[1] (*See* Doc. # 35, *Buncher's Motion for Summary Judgment,* Ex. "1".) ARDI, along with several other entities, signed a Joinder to the Facility Lease Agreement.[2] (*Id.*) According to counsel for ARDI and River Entertainment, there was common ownership of the two entities. (*See* Case No. 07–24515JAD, Doc. # 75, p. 28). For purposes of convenience, the Debtor/Third Party Defendant River Entertainment and Plaintiff ARDI shall be referred to collectively as "ARDI" for the remainder of this Opinion.

Pursuant to the Facility Lease Agreement, ownership of the Barge Facility vested in ARDI during the term of the lease. (*See* Doc. # 35, *Buncher's Motion for Summary Judgment,* Exhibit "1", ¶ 16.2). If an event of default occurred and was continuing at the end of the lease term, ownership of the Barge Facility then would vest in Buncher without further action. (*Id.*) If there was no default at the conclusion of the lease term, title to the Barge Facility would remain in the name of ARDI. (*Id.* at ¶ 16.3.) At that point, ARDI was then, at its sole expense, required to remove the Barge Facility within sixty (60) days following the lease expiration. (*Id.*) If the Barge Facility remained after that sixty day period, it was deemed to be abandoned and would become the property of Buncher. (*Id.*)

On July 16, 2007, the Debtor filed a voluntary Chapter 11 case. On April 3, 2008, a hearing was held on its Disclosure Statement and Plan.[3] Title to the Barge Facility and its fate were at issue in the case. At the April 3, 2008 hearing, ARDI and Buncher entered into a Consent Order regarding the Barge Facility.[4] The Consent Order bore similarities to the Facility Lease Agreement in terms of a timetable and manner of disposition of the Barge Facility. The Consent Order provided in relevant part at paragraph 3:

1. River Entertainment has asserted that it held the permits that allowed for the Barge Facility mooring. This is disputed by Buncher and the evidence of record is that such permits were not in the name of River Entertainment in its own right. Rather, the "Water Permits" were held by Buncher and were leased to River Entertainment as part of the Facility Lease Agreement. (*See* Doc. # 35, *Motion for Summary Judgment*, Affidavit of Dino DePaulo, ¶¶ 3, 4.)

2. Beyond executing a Joinder to the Facility Lease Agreement, the role of ARDI to this summary judgment proceeding is unclear. The Complaint filed in state court by ARDI asserts that it "owned" the Barge Facility. There is nothing of record in this proceeding beyond the bald assertion that would support that contention. The Disclosure Statement filed in this bankruptcy case states that River Entertainment subleased the property to ARDI who in turn subleased it to yet another entity. (*See* Doc. # 44, unnumbered p. 2.) However, no documentation is of record. The Plan of Reorganization states that ARDI owns the Barge Facility (*see* Doc. # 43); however, Buncher disputes this assertion. (*See* Adv. No. 10–2495, Doc. # 5, ¶¶ 23–24).

3. At the time of the April 3, 2008 hearing, this case was presided over by the Honorable Bernard Markovitz.

4. ARDI continued its occupation of the premises after the filing. On November 1, 2007, Buncher sought relief from stay and sought to compel the Debtor to vacate and return possession of the leased premises. Relief from stay was granted to Buncher to pursue an ejectment action and ARDI was ordered to vacate the premises within ten days. Reconsideration of that order was sought by ARDI. An evidentiary hearing was set for September 3, 2008 on the question of title to the Barge Facility and personal property on the leased premises in connection with the relief from stay motion. The entry of the Consent Order eliminated the need for the September 3 hearing.

> If an agreement with a buyer or user, as referenced in Paragraph 2, is not executed within sixty (60) days of the date of this Order, then Debtor and ARDI shall either: A) on or before the date that is sixty (60) days after the date of this Order, give notice to the Buncher Company that they will, at their sole cost and expense, fully and completely remove the Barge facility from its current location including payment of all insurance, security and other costs, which removal shall be accomplished within the date that is ninety (90) days from the date of this Order.* or B) if the notice is not timely given, the Debtor and ARDI shall be deemed to have abandoned the Barge facility to the Buncher Co. and relinquished all rights and interest therein on the date that is sixty (60) from the date of this order. In either event, the bankruptcy case shall be dismissed pursuant to this Order, except that the Court shall retain jurisdiction for any enforcement of or dispute under this Order.
>
> *and upon such removal, the Buncher Co. will relinquish any claim or interest in the Barge facility.

(*See* Doc. # 38, *Plaintiff's Motion for Summary Judgment,* Ex. A.). The Consent Order also provided that this Court would retain jurisdiction to enforce the Consent Order or resolve any dispute under the Consent Order. (*Id.*)

Pursuant to the Consent Order, ARDI was required to notify Buncher within sixty days, or on or before June 3, 2008, whether or not it had found a buyer for the Barge Facility. If there was no proposed buyer, ARDI was required to completely remove the Barge Facility on or before July 3, 2008. Alternatively, ARDI could do nothing and relinquish any claim or interest in the Barge Facility, which would be effective June 3, 2008.

On May 30, 2008, counsel for ARDI sent notice to Buncher that there was no proposed buyer for the Barge Facility and that ARDI intended to proceed with removing it. Specifically, counsel stated that the Debtor "will, at its sole cost and expense, **fully and completely remove the barge facility from its current location,** including payment of all insurance, security and other costs." (*See* Doc. # 38, *Plaintiff's Motion for Summary Judgment,* Exhibit "B") (emphasis added).

After notice was provided that the Barge Facility would be "fully and completely removed", ARDI proceeded to remove only the bridges and utility lines that provided land access and utility service to the Barge Facility. In its complaint filed in state court and in its *Motion for Summary Judgment,* ARDI alleges that it removed the bridges on August 6, 2008. (*See* Doc. # 38, ¶ 11). However, Buncher asserts that this is in error and that the bridge removal occurred on July 6, 2008. ARDI admitted to the July 6, 2008 date when it was asserted by Buncher in its Statement of Undisputed Facts (*see* Doc. # 37, *Statement of Undisputed Facts,* ¶ 15; Doc. # 47, *Response To Statement of Undisputed Facts,* ¶ 15). In either event, the record demonstrates that the bridge removal occurred *after* the July 3, 2008 deadline for full and complete removal.

On July 7, 2008, Buncher sent a letter to counsel for ARDI stating that ARDI had failed to comply with the Consent Order because ARDI had not removed the Barge Facility. Further, the letter notified ARDI that any rights ARDI may have possessed in the Barge Facility were forfeited due to ARDI's failure to timely remove the Barge Facility. On July 9, 2008, Buncher again wrote to counsel for ARDI reiterating its position that it had not complied with the Consent Order and that ARDI had forfeited any rights in the

Barge Facility. Buncher further advised that it would proceed with the dismantling and removal of the Barge Facility.

A final letter was sent by Buncher to counsel for ARDI dated July 24, 2008 again advising of Buncher's position that ARDI had failed to comply with the Consent Order, thereby entitling Buncher to dismantle and remove the Barge Facility. The letter also advised that Buncher would begin the demolition process on July 28, 2008 and if there was any objection by ARDI, it should file a motion with the bankruptcy court.

ARDI did not respond to the July 24, 2008 letter. Nor did it file an objection to the demolition with this Court. Buncher subsequently proceeded to have the Barge Facility dismantled and fully removed. No action was taken by ARDI upon receiving notice prior to, during or after removal of the Barge Facility by Buncher.

Subject to a retention of jurisdiction over any dispute relating to the Consent Order, the bankruptcy case was ultimately dismissed on June 3, 2008. (*See* Case No. 07–24515JAD, Doc. # 60, *Notice to Creditors and Other Parties in Interest*). On August 2, 2010, approximately two years later, a complaint was filed by ARDI against Buncher in the Court of Common Pleas of Allegheny County alleging conversion of the Barge Facility and seeking punitive damages. The complaint was removed to this Court by Buncher on September 9, 2010 and the bankruptcy case was reopened.[5] During the course of this adversary proceeding, a third party complaint was filed against ARDI by Buncher.

The parties have each filed motions for summary judgment and supporting briefs. The motions have been orally argued and the matter is now ripe for adjudication.

II.

Motions for summary judgment in adversary proceedings are governed by Fed. R. Bankr.P. 7056 which makes Fed. R.Civ.P. 56 applicable in the instant adversary proceeding. The rule provides, in relevant part, that summary judgment should be rendered "if movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R.Civ.P. 56(a). In considering a motion for summary judgment, the Court may rely upon the contents of the pleadings, the discovery and disclosure materials on file, and any affidavits. *See* Fed.R.Civ.P. 56(c). A dispute of material fact is "genuine" if a reasonable jury could return a verdict for the nonmoving party. *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Upon the moving party meeting its burden, the burden shifts to the nonmoving party who must "do more than simply show that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.,* 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986).

While ARDI characterizes the instant proceeding as the adjudication of its state law action for conversion, both summary judgment motions before the Court hinge entirely on the enforcement of the Consent Order. Indeed, the parties agree that the Consent Order dictates their respective rights and interests in the Barge Facility.

[1, 2] In Pennsylvania, conversion "is the deprivation of another's right of property in, or use or possession of a chattel, or other interference therewith without the owners consent and without lawful justifi-

5. The count for punitive damages was dismissed on December 20, 2010 pursuant to a Motion to Dismiss filed by Buncher. (*See* Doc. # 16).

cation." *Prudential Ins. Co. of America v. Stella,* 994 F.Supp. 318, 323 (E.D.Pa.1998) (citing cases, including *Universal Premium v. York Bank & Trust Co.,* 69 F.3d 695, 704 (3d Cir.1995)). Where a plaintiff has no right to possession of property at the time of the alleged conversion, the Plaintiff's action for conversion will fail as a matter of law. *See Krajewski v. American Honda Finance Corp.,* 557 F.Supp.2d 596, 607–608 (E.D.Pa.2008) (citing *Eisenhauer v. Clock Towers Assocs.,* 399 Pa.Super. 238, 582 A.2d 33, 36 (1990)). Upon a review of the Consent Order and the confessed acts of the parties, this Court finds there is no genuine dispute that ARDI abandoned all ownership rights in the Barge Facility to Buncher prior to commencing its conversion action. Therefore, this Court will grant Buncher's *Motion for Summary Judgment* and dismiss the conversion complaint asserted by ARDI.

III.

The Consent Order required ARDI to either: 1) "execute an agreement with a buyer or user" of the Barge Facility on or before June 3, 2008; or 2) "completely remove" the Barge Facility on or before July 3, 2008. If ARDI accomplished neither of these acts, the Consent Order was clear that ARDI would be "deemed to have abandoned" all rights and interest in the Barge Facility to Buncher effective June 3, 2008.

ARDI urges this Court to read the Consent Order to mean that because ARDI gave notice prior to June 3, 2008 that it intended to remove the Barge Facility, ARDI had not abandoned its interest in the Barge Facility. ARDI also alleges that by removing the bridges and utility lines which connected the Barge Facility to the land, it rendered the Barge Facility a "vessel" under "federal law and regulations" and thus the Barge was "completely remove[d]" as required by the Consent Order. This Court finds both of ARDI's interpretations of the Consent Order to be without merit.

[3] The Court does not find ARDI's reading of the Consent Order, that it could prevent abandonment by merely notifying Buncher of its intent to remove the Barge Facility, to be accurate or persuasive. ARDI's interpretation ignores the language denoted by the asterisk at what would otherwise be the conclusion of the sentence in paragraph (3)(A). This additional language states that only upon "such removal", will Buncher relinquish its claim or interest in the Barge Facility. "Such removal" refers back to the earlier part of the sentence in (3)(A) requiring ARDI to "fully and completely" remove the Barge Facility by July 3, 2008. Thus under the plain language in the Consent Order, ARDI's mere notice of its intent to move the Barge Facility did not prevent abandonment of any interest it had in the Barge Facility to Buncher.

[4] ARDI's suggestion that removal of the bridges and utility lines constituted "full and complete removal" of the Barge Facility is also contrary to the plain language of the Consent Order. The language of the Consent Order clearly provides that removal of the Barge Facility would be nothing less than removing "the Barge facility **from its current location** . . . ." (Emphasis added). Merely allowing the Barge Facility to remain where it was moored does not remove it "from its current location".

Not only does the language of the Order itself bely the argument set forth by ARDI, but ARDI's own action—and inaction—contradict its argument. At the hearing held on April 3, 2008, counsel for ARDI stated "If they'll [Buncher] let it go, I think if we had a reasonable period of time, **we'll take it away,** at worst case."

(*See* Doc. # 52, Ex. A, p. 26) (emphasis added). Further, the agreement between the parties was set forth on the record by counsel for Buncher who described that:

COUNSEL: What we've agreed, Your Honor, is that for a period of sixty days, the debtor and ARDI will see if they can identify a buyer or user for this facility and within that sixty-day period, if we have produced an agreement on terms acceptable to the parties, including The Buncher Company, then we will return to this court in sixty days for the confirmation of the plan.

If we don't have such an agreement within sixty days, then, by that sixtieth day, the debtor and Arty [sic] will have the option to either give notice to The Buncher Company that they will remove, fully and completely, the barge facility and will get that done within ninety days from today—from the date of this order—

THE COURT: From today?

COUNSEL: Right. They'll have an extra thirty days to do the removal. Or, if they don't give that notice within the sixty days that they're going to do that, then they're deemed to have abandoned the barge facility—

THE COURT: On the sixty-first day?

COUNSEL: Correct, Your Honor—to The Buncher Company and then Buncher will accomplish the removal. And in those circumstances, the bankruptcy case will be dismissed because there won't be any plan for us to come back to and confirm.

See id., Ex. A, pp. 32–33.

Counsel for ARDI did not object, clarify, modify or in any way dispute the agreement as stated on the record. For these reasons, the Court finds ARDI's alleged interpretation of the Consent Order to be without merit.[6]

[5] Having failed to timely remove the Barge Facility pursuant to the Consent Order, ARDI did not have any right to possession of it. Without a right to possession of the Barge Facility, ARDI is precluded from successfully asserting an action for conversion, as there could be no interference with that right by Buncher. *See Serafini v. Mariani,* No. 3: CV–08–0469, 2010 WL 1342926, *7 (M.D.Pa., Mar. 31, 2010) ("[W]here, as here, a party has not retained an ownership interest in the property delivered to another, it may not maintain an action for conversion of that property.")

[6–8] In the alternative, there is no genuine dispute of material fact that ARDI's conversion action is barred by the statute of limitations. Conversion actions in Pennsylvania are subject to a two year statute of limitations as set forth in 42 Pa.C.S.A. § 5524(7). *See Shonberger v. Oswell,* 365 Pa.Super. 481, 530 A.2d 112, 114 (1987) ("Conversion is an action at law and is, therefore, subject to the two-year statute of limitations.") The statute of limitations begins to accrue when the " 'the first significant event necessary to make the claim suable' occurs." *Lake v. Arnold,* 232 F.3d 360, 366 (3d Cir.2000) (citations omitted). There is no genuine dispute that ARDI's complaint was filed on August 2, 2010, which is two years after Buncher commenced demolition of the Barge Facility on July 28, 2008.

While ARDI asserts that the two year period began to run on August 6, 2008, ARDI has not pointed to anything that would contravene the July 24, 2008 letter

6. Because the Court finds that ARDI failed to comply with the Consent Order, it need not address Buncher's assertion that following several defaults by ARDI, Buncher was the owner of the Barge Facility pursuant to the Facility Lease Agreement.

by Buncher stating that demolition was set to commence on July 28, or the Affidavit of Dino DePaulo (Assistant Vice President of Leasing and Property Management for Buncher), stating that "on July 28, 2008 the demolition work commenced." (*See* Doc. # 35, *Affidavit of Dino DePaulo,* ¶ 14). In an Affidavit filed by Thomas Jayson ("part owner of both River Entertainment Company and ARDI, LP"), Mr. Jayson only denies witnessing "any removal efforts on July 28, 2008", not that removal commenced on that date. Thus, Mr. Jayson's denial is insufficient to show a genuine dispute of material fact. *Matsushita Elec.,* 475 U.S. at 586, 106 S.Ct. 1348 (the non-moving party must do more than show that there is some metaphysical doubt as to the material facts).

Accordingly, Buncher's request for dismissal of the conversion complaint must be granted, and ARDI's *Motion for Summary Judgment* will be denied.

IV.

[9] In a supplemental brief, ARDI relies on the recent Supreme Court decision in *Stern v. Marshall,* ––– U.S. ––––, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), in attempting to argue that this Court lacks the ability to enter a final judgment both on its claim and Buncher's counterclaims. This Court cannot accept ARDI's assertion for two reasons. First, *Stern* does not apply in the instant matter as resolution of the current proceeding is entirely dependent on this Court's interpretation and enforcement of its own Consent Order, and is **not** dependent upon the adjudication of an independent state-law cause of action. Second, even in the event that *Stern* was found to apply, both parties have effectively consented to the entry of a final judgment by this Court.

ARDI contends that this Court does not have authority to hear the competing claims or enter final judgment because "the pending actions are state common law claims, do not stem from the bankruptcy proceeding and will not be resolved by resolution of the claim filed by Buncher against the Debtor. . . ." (Doc. # 52, pp. 3–4). ARDI incorrectly alleges that its common law claim does not "stem" from the bankruptcy proceeding.

In *Stern,* the Supreme Court held that bankruptcy courts lack the constitutional authority to enter a final judgment on a state law tort counterclaim, when the adjudication of that counterclaim would not "necessarily be resolved in the claims allowance process." *Stern,* 131 S.Ct. at 2618. In its analysis, the Supreme Court explained that the constitutional issue arose because of the separation of powers principles implicated in Article III of the United States Constitution, and the nature of the "core" counterclaim asserted in *Stern.*

Under Article III, the "judicial power of the United States" must vest **exclusively** in judges that enjoy lifetime tenure and protection from salary diminution, known as Article III judges. U.S. Const. Art. III, § 1. As bankruptcy judges are Article I judges, occupying positions created by Congress, they are forbidden from exercising this "judicial power". The Supreme Court noted that with regard to the counterclaim asserted in *Stern,* Congress "exceeded" the limits of Article III, by enabling bankruptcy courts to "issue final judgments" which may only be reviewed by Article III judges under "the usual limited appellate standards" requiring "marked deference . . . to the bankruptcy judges' findings of fact." [7] *Stern,* 131 S.Ct. at 2610–11 (citations omitted).

7. This "deference" arises from Federal Rules of Bankruptcy Procedure 8013 and 7052

The *Stern* opinion also acknowledged the limited nature of this constitutional issue in recognizing that Article III only prevents Congress from "withdraw[ing] from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty." *Stern,* 131 S.Ct. at 2609 (quoting *Murray's Lessee v. Hoboken Land & Improvement Co.,* 59 U.S. 272, 18 How. 272, 284, 15 L.Ed. 372 (1856)). Such matters are commonly known as Article III cases and controversies. The Supreme Court then explained that the final adjudication of matters which could be categorized as involving "public rights" would not offend Article III. *Id.* at 2612 (citations omitted). In discussing the scope of this "public rights exception" the Supreme Court stated that this exception was limited "to cases in which the claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert government agency is deemed essential to a limited regulatory objective within the agency's authority." *Id.* at 2613.

Thus, the question decided in *Stern* was "a 'narrow' one", as the Supreme Court held that Congress had only exceeded its authority in "one isolated respect", i.e. providing bankruptcy courts with the ability to finally adjudicate state law tort counterclaims to a proof of claim, absent consent of the parties. *Id.* at 2620. In fact, the Supreme Court's entire public rights analysis in *Stern* occurred from the viewpoint of whether the specific state law tort counterclaim asserted fell into any of Supreme Court's admittedly "varied formulations" of the public rights exception.[8] *Id.* at 2614. To interpret the *Stern* opinion in any broader sense would "meaningfully change[ ] the division of labor" between the bankruptcy courts and the district courts, contrary to the stated intent of the Supreme Court. *Id.* at 2620.

Applying this narrow interpretation, *Stern* is plainly inapposite to the matter before the Court. Despite its origination as a state law claim for conversion, the instant matter hinges entirely on this Court's ability to interpret and enforce the terms of its own Consent Order. The entry of the Consent Order was the intended resolution of several issues in the bankruptcy which had the Barge Facility and its disposition at their root. This Court has already concluded that because ARDI did not remove the Barge Facility and, thus, did **not** have a "right to immediate possession" of the Barge Facility, ARDI is incapable of successfully asserting a claim for conversion as a matter of law. The filing of the defective action in state court does not serve to sever ARDI from its obligations and agreements it entered into under the Consent Order, nor does it divest this Court of its ability to interpret the terms of its own Order.[9] In

(adopting Fed.R.Civ.P. 52(a)(6)), which require that the a bankruptcy court's findings of fact "shall not be set aside unless clearly erroneous." *See* Fed. R. Bankr.P. 7052, 8013.

8. The Supreme Court in *Stern* admitted that its past "discussion of the public rights exception ... has not been entirely consistent." *Stern*, 131 S.Ct. at 2611.

9. Through the language of the Consent Order the bankruptcy court specifically retained jurisdiction "for any enforcement of or dispute under this Order." (*See* Case No. 07–24515JAD, Doc. # 56, *Order of Court*). The conversion action clearly implicated a dispute under the Order, thereby resting jurisdiction with the bankruptcy court. In the notice of dismissal sent to creditors, jurisdiction was specifically retained for enforcement of, or a dispute regarding, the Consent Order. (*See* Case No. 07–24515JAD, Doc. # 60, *Notice to Creditors and Parties in Interest*). Bankruptcy courts have jurisdiction to enforce their own prior orders. *See Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 129 S.Ct. 2195, 2205, 174

fact, the Consent Order itself operates as res judicata with respect to any claims that ARDI may have to the Barge Facility. *See Katchen v. Landy,* 382 U.S. 323, 334–35, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966).

It is clear that the Consent Order could and, in fact, did "arise in" the bankruptcy proceeding. Therefore, this Court finds that because the crux of actual dispute is the interpretation of the Consent Order, this matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O). *See Factory Mut. Ins. Co. v. Panda Energy Int'l, Inc. (In re Hereford Biofuels, L.P),* 2012 Bankr.LEXIS 22, *3–4 (Bankr. N.D.Tex.2012) (holding that the court could finally adjudicate an adversary proceeding where the interpretation of its previously entered sale order was at the "crux" of the dispute between the two non-debtor parties to the adversary). As such, the narrow holding in *Stern* simply does not apply to this Court's ability to finally adjudicate the matter before it. *See Moore v. Paladini (In re CD Liquidation Co., LLC),* 462 B.R. 124, at 135–36 (Bankr. D.Del.2011) (finding that *Stern* did not apply to bar the bankruptcy court from enforcing the terms of its own confirmation order which enjoined a plaintiff from filing a derivative suit in district court).

V.

Even if the holding in *Stern* did apply to the instant matter, this Court finds that both parties have consented to entry of final judgment by the bankruptcy court. This Court further concludes that such consent is sufficient to allow this Court to hear and finally determine the instant matter, regardless of whether it is statutorily defined as "core" or "non-core".

To determine whether, and to what extent, consent to bankruptcy court adjudication remains viable following the *Stern* decision, courts must answer three questions: A) are parties capable of waiving their right to adjudication of an Article III case or controversy by an Article III tribunal? B) is the matter of a type that may be adjudicated based on consent? and C) can consent can be implied from the acts or inaction of the parties in question?

A.

In determining whether parties are capable of consenting to final adjudication of a case or controversy by a non-Article III tribunal, courts must consider both the personal and structural protections of Article III.[10] *See Pacemaker Diagnostic Clinic of America, Inc. v. Instromedix, Inc.,* 725 F.2d 537, 541 (9th Cir.1984) (citing *Chadha v. INS,* 634 F.2d 408, 422, 431 (9th Cir. 1980), *aff'd,* 462 U.S. 919, 103 S.Ct. 2764, 77 L.Ed.2d 317 (1983)).

The Supreme Court has consistently upheld a litigant's ability to waive its "personal" right to have its matter heard by an Article III judge. *See Peretz v. United States,* 501 U.S. 923, 936, 111 S.Ct. 2661, 115 L.Ed.2d 808 (1991) ("[L]itigants may waive their personal right to have an Article III judge preside over a civil trial.") (citing *Commodity Futures Trading*

L.Ed.2d 99 (2009). *Cf. In re Washington Mut., Inc.,* 461 B.R. 200, 214–15 (the right of bankruptcy courts to exercise jurisdiction over settlements is supported by historical practice).

10. The Supreme Court in *Stern* recognized these two protections as well. *See Stern,* 131 S.Ct. at 2609 ("Separation-of-powers principles are intended, in part, to protect each branch of government from incursion by the others. Yet the dynamic between and among the branches is not the only object of the Constitution's concern. The structural principles secured by the separation of powers protect the individual as well.") (quoting *Bond v. United States,* ––– U.S. ––––, 131 S.Ct. 2355, 2364, 180 L.Ed.2d 269 (2011)).

Comm'n v. Schor, 478 U.S. 833, 848, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986)).

However, the Supreme Court has simultaneously concluded that the separation of powers principles implicated in the "structural" protections of Article III, are beyond the ability of individual parties to waive. *See e.g., Commodity Futures Trading Comm'n v. Schor,* 478 U.S. 833, 850, 106 S.Ct. 3245, 92 L.Ed.2d 675 (1986) (finding that parties cannot cure the constitutional defect in permitted non-Article III tribunals to exercise the "judicial power of the United States" through consent, the same as they cannot consent to extend the subject-matter jurisdiction of the courts); *Peretz,* 501 U.S. at 937–39, 111 S.Ct. 2661.

[10] Despite this conclusion, the Supreme Court has repeatedly upheld final adjudication by non-Article III tribunals when it has concluded that the structural protections of Article III are not implicated. *See Peretz,* 501 U.S. at 937–39, 111 S.Ct. 2661; *Schor,* 478 U.S. at 851–52, 106 S.Ct. 3245. Whether the structural protections of Article are "implicated", depends primarily on the degree of control exercised by Article III judges over of the non-Article III tribunal in question. *See e.g., Peretz,* 501 U.S. at 937–39, 111 S.Ct. 2661; *United States v. Raddatz,* 447 U.S. 667, 685–86, 100 S.Ct. 2406, 65 L.Ed.2d 424 (1980) (Blackmun, J., concurring). This Court finds that based on the degree of control exercised by Article III judges over bankruptcy courts, the structural protections of Article III are not implicated in the bankruptcy statutory scheme and, therefore, parties may effectively consent to final adjudication of matters by non-Article III bankruptcy courts.

In *Peretz v. United States,* the Supreme Court held that there was no constitutional defect when, following the consent of the parties, a district court judge delegates the duty of conducting voir dire in a felony proceeding to a magistrate judge, because no structural protections were implicated. *Peretz v. United States,* 501 U.S. 923, 111 S.Ct. 2661, 115 L.Ed.2d 808 (1991). In so concluding, the Court recognized that under the Magistrate's Act, Article III judges maintained a substantial amount of control over both the magistrate judges and the matters delegated to them. *Id.* at 937–38, 111 S.Ct. 2661. Specifically, the Court noted that district court judges were responsible for appointing magistrate judges, removing them from office, and maintaining plenary authority over what matters were delegated to the magistrate judges once they were appointed. *Id.* at 937–39, 111 S.Ct. 2661. Citing *United States v. Raddatz,* 447 U.S. 667, 100 S.Ct. 2406, 65 L.Ed.2d 424 (1980), the Supreme Court held that because the entire process of magistrate adjudication "takes place under the district court's total control and jurisdiction," there was no danger that the structural protections of Article III would be violated. *Id.* at 937, 100 S.Ct. 2406.

Similar to the Magistrates Act, the current statutory scheme in bankruptcy provides Article III judges with substantial "control" over the bankruptcy courts. For example, bankruptcy judges are appointed and subject to removal by Article III judges. *See* 28 U.S.C. § 152(a), (e). Article III judges also have the ability to withdraw the reference of cases to the bankruptcy courts upon a motion of any party-in-interest, or *sua sponte* for "cause shown". *See* 28 U.S.C. § 157(d). Certainly "cause shown" would include the fact that the civil litigation at issue is an Article III case or controversy. Perhaps most importantly, motions to withdraw the reference must be heard by Article III district court judges, ensuring all parties access to an Article III forum. *See* Fed R. Bankr.P. 5011(a). Consequently it is an

Article III judge that has plenary authority over the matter if he or she chooses to exercise such authority.

There is, however, one distinction between the statutory scheme for magistrates under 28 U.S.C. § 636(b)(3) as described in *Peretz,* and the statutory scheme in bankruptcy with regard to core matters. While section 636(b)(3) of the Judiciary Code does not contain an express provision for de novo review by an Article III court, the Supreme Court found that "nothing in the statute precludes a district court" from reviewing the magistrate's judges determinations de novo, if such review was requested. *See Peretz,* 501 U.S. at 939, 111 S.Ct. 2661. The jurisdictional scheme in bankruptcy, however, does allow for Article III judges to engage in ordinary appellate review of the findings of fact entered by the bankruptcy courts with regard to core matters. *See* Fed. R. Bankr.P. 7052 and 8013.[14] But, for Article III cases and controversies heard in the bankruptcy courts, post-*Stern,* that appellate review is de novo as a matter of Constitutional law when litigants do not consent to entry of a final judgment by the bankruptcy court. Where consent is present, the Supreme Court has recognized the ability of Article I judges to finally adjudicate civil matters absent de novo review by any Article III court.[15] *See Roell v. Withrow,* 538 U.S. 580, 590–91, 123 S.Ct. 1696, 155 L.Ed.2d 775 (2003). As the majority in *Roell* wrote:

> We think the better rule is to accept implied consent where, as here, the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case before the Magistrate Judge. Inferring consent in these circumstances thus checks the risk of gamesmanship by depriving parties of the luxury of waiting for the outcome before denying the magistrate judge's authority. Judicial efficiency is served; the Article III right is substantially honored.

Id. at 590, 123 S.Ct. 1696. Nothing in *Stern* abrogates this precept.

Where the parties have consented, the scope of review provisions contained in the Bankruptcy Code and Magistrate's Act are identical. Under section 636(c)(1) of Title 28, full-time magistrate judges may hear and enter judgment on any civil proceeding "[u]pon the consent of the parties. . . ." *Id.* Similarly, pursuant to 28 U.S.C. § 157(c)(2), bankruptcy courts may hear and determine any non-core matter "with the consent of all the parties to the proceeding. . . ." *Id.* The constitutionality of the Magistrate's Act which permits parties to consent to final adjudication of civil matters by non-Article III magistrate judges has been consistently upheld. *See In re Olde Prairie Block Owner, LLC,* 457 B.R. 692, 701 (Bankr.N.D.Ill.2011) (citing cases from the United States Courts of Appeals for the First,[16] Second,[17] Third,[18]

14. Federal Rule of Civil Procedure 52(a)(6) (adopted by Fed. R. Bankr.P. 7052) states "Findings of fact, whether based on oral or other evidence, must not be set aside unless clearly erroneous, and the reviewing court must give due regard to the trial court's opportunity to judge the witnesses' credibility." Fed.R.Civ.P. 52(a)(6).

15. Additionally, the Supreme Court has held that such a requirement does not, in and of itself, run afoul of the Article III requirement. *See Crowell v. Benson,* 285 U.S. 22, 51, 52 S.Ct. 285, 76 L.Ed. 598 (1932) ("[T]here is no requirement that, in order to maintain the essential attributes of the judicial power, all determinations of fact in constitutional courts shall be made by judges.").

16. *Goldstein v. Kelleher,* 728 F.2d 32, 34–35 (1st Cir.1984).

17. *Collins v. Foreman,* 729 F.2d 108, 109 (2d Cir.1984).

Fourth,[19] Fifth,[20] Sixth,[21] Seventh,[22] Eighth,[23] Ninth [24] and D.C.[25] Circuits); *In re Safety Harbor Resort and Spa,* 456 B.R. 703, 718 (Bankr.M.D.Fla.2011) ("Although no court has addressed the constitutionality of [28 U.S.C. § 157(c)(2)], ten circuit courts of appeal have upheld the constitutionality of the Federal Magistrate Statute. . . .").

As the structural protections of Article III appear not to be implicated or eroded in the bankruptcy scheme when the parties consent, this Court can easily conclude that a party's waiver of the personal protections of Article III is sufficient to allow bankruptcy courts to finally adjudicate Article III cases and controversies. To find otherwise would be to completely ignore recent Supreme Court precedent in cases upholding the constitutionality of the Magistrate's Act. *See Menotte v. United States (In re Custom Contractors, LLC*), 462 B.R. 901, 910 (Bankr.S.D.Fla.2011) (*quoting Olde Prairie Block Owner, LLC,* 457 B.R. 692, 701 (Bankr.N.D.Ill.2011)). Such a finding would also ignore the portion of the *Stern* opinion wherein the Supreme Court reaffirmed the viability of the consent provisions with regard to non-core matters under 28 U.S.C. § 157(c)(2). *Stern,* 131 S.Ct. at 2607–08.[26] Thus, consent of the parties does permit non-Article III bankruptcy courts to finally adjudicate Article III cases and controversies.

B.

[11] With regard to the second question, this Court finds that consent will apply to permit final adjudication by non-Article III bankruptcy courts of non-core and core matters alike.

There is no dispute that bankruptcy courts may finally adjudicate non-core matters upon the consent of all parties to the proceeding. This ability is codified at 28 U.S.C. § 157(c)(2), and was recognized by the Supreme Court in *Stern. See Stern,* 131 S.Ct. at 2607–08.

Following a need created by *Stern,* it also appears that an extension of the consent provision contained in 28 U.S.C. § 157(c)(2) to core matters is both logical and appropriate. *See Bayonne Medical Center v. Bayonne/Omni Dev., LLC (In re Bayonne Medical Center),* Bankr.No. 07–15195, Adv. No. 09–1689, 2011 WL

18. *Wharton–Thomas v. United States,* 721 F.2d 922, 924–930 (3d Cir.1983).

19. *Gairola v. Va. Dep't of Gen. Servs.,* 753 F.2d 1281, 1284–85 (4th Cir.1985).

20. *Puryear v. Ede's, Ltd.,* 731 F.2d 1153, 1154 (5th Cir.1984).

21. *K.M.C. Co., Inc. v. Irving Trust Co.,* 757 F.2d 752, 755 (6th Cir.1985).

22. *Geras v. Lafayette Display Fixtures, Inc.,* 742 F.2d 1037, 1038 (7th Cir.1984).

23. *Lehman Bros. Kuhn Loeb, Inc. v. Clark Oil & Ref. Corp.,* 739 F.2d 1313, 1314 (8th Cir. 1984) (en banc).

24. *Pacemaker Diagnostic Clinic of America, Inc. v. Instromedix, Inc.,* 725 F.2d 537, 540 (9th Cir.1984) (en banc).

25. *Fields v. Wash. Metro. Area Transit Auth.,* 743 F.2d 890, 893, 240 U.S.App. D.C. 46 (D.C.Cir.1984).

26. At least one court has found support for this proposition based on the Supreme Court's endorsement of the entry of final decisions by non-Article III arbitrators, where the parties have contractually agreed to binding arbitration of their case or controversy. *See Oxford Expositions, LLC v. Questex Media Group, LLC (In re Oxford Expositions, LLC),* Case No. 10–16218–DWH, Adv. No. 11–01095–DWH, 2011 WL 4054872, *8 (Bankr. N.D.Miss. Sept. 12, 2011) (citing generally *AT&T Mobility, LLC v. Concepcion,* ––– U.S. ––––, 131 S.Ct. 1740, 179 L.Ed.2d 742 (2011)).

5900960, *7 (Bankr.D.N.J. Nov. 1, 2011) (unpublished decision) (holding that by expressly consenting to final adjudication by the bankruptcy court as to all non-core matters, the liquidating trustee had also consented to final adjudication of statutorily designated "core" matters).

Prior to *Stern* bankruptcy courts maintained the ability to finally adjudicate all core matters regardless of consent. Therefore, because there was no reason for a "consent" provision to exist, the lack of such a provision is without consequence. Additionally, all of the structural protections present in the bankruptcy jurisdictional scheme with regard to non-core matters are present with regard to core matters as well. For example, Article III judges maintain the same control over bankruptcy judges regardless of whether the bankruptcy judge is hearing a core or non-core matter, and parties retain the right to seek withdrawal of the reference regardless of whether the opposing party has defined the matter as core or non-core in its pleadings. *See* 28 U.S.C. §§ 152(a)–(c), 157(a). In addition, it seems only logical that a statutory scheme which provides bankruptcy courts with the ability to finally adjudicate matters "related to" a bankruptcy case via consent should apply to matters that purportedly "arise in" or "arise under" the same. As a result, this Court concludes that consent applies to provide bankruptcy courts with the ability to finally adjudicate both statutorily defined core and non-core matters brought before them.[27]

C.

[12] Finally, this Court finds that consent can be implied from the action (or inaction) of the parties to a proceeding.

Stern clearly stands for the proposition that consent can be implied through the statements of a party and by a party's delay in contesting the ability of a non-Article III tribunal to adjudicate the action. *See Stern,* 131 S.Ct. at 2607–08. Indeed, the Supreme Court determined that through his actions, statements acquiescing to adjudication by the bankruptcy court, and failure to object to bankruptcy court adjudication, the claimant in *Stern* had implicitly consented to the bankruptcy court hearing and determining his non-core defamation claim, and waived any arguments to the contrary. *See id.* Moreover, the Supreme Court concluded that

27. Some courts have found that the *Stern* holding creates a nominal third category of matters consisting of Article III cases and controversies, which are statutorily defined as core but that must be subject to de novo review by an Article III judge. Following *Stern,* several courts have held that this "third category" of matters must treated as non-core. *See e.g., Reed v. Linehan (In re Soporex, Inc.),* 463 B.R. 344, 364–65 (Bankr.N.D.Tex. 2011) (finding that nothing prevents bankruptcy courts from issuing proposed findings of fact and conclusions of law with regard to core proceedings, which, following Stern, may no longer be finally adjudicated by a bankruptcy judge); *Field v. Lindell (In re The Mortgage Store, Inc.),* 464 B.R. 421, 427–28 (D.Haw.2011) (finding that if a bankruptcy court is not permitted to enter a final judgment on certain core proceedings, it should enter findings and recommendations as under 28 U.S.C. § 157(c)(1)); *Paloian v. Am. Express Co. (In re Canopy Fin., Inc.),* 464 B.R. 770, 775 (N.D.Ill.2011) (finding that the Supreme Court indicated in the Stern decision that matters which have been removed from "core" jurisdiction should relegated to the category of "related to" matters); *In re Olde Prairie Block Owner, LLC,* 457 B.R. 692, 700 (Bankr.N.D.Ill.2011) (finding that counterclaims like those adjudicated in *Stern* must be treated as non-core proceedings). These courts have, therefore, logically concluded that once treated as non-core, this third category is subject to the consent provision of 28 U.S.C. § 157(c)(2). *See id.* This Court agrees and, thus, finds that to the extent such a "third category" of matters exists, consent of the parties will suffice to permit final adjudication by bankruptcy courts.

through the claimant's statements that he was "more than pleased" and "happy to litigate" his defamation claim in the bankruptcy court, the claimant in *Stern* had impliedly consented to final adjudication by the bankruptcy court. *Id.*

Stern was not the first time in recent years that the Supreme Court has recognized implied consent to final adjudication by a non-Article III tribunal. In *Roell v. Withrow,* 538 U.S. 580, 123 S.Ct. 1696, 155 L.Ed.2d 775 (2003), the Supreme Court held that consent to the entry of a final judgment by a non-Article III magistrate judge can be inferred from a party's conduct during litigation. *Roell,* 538 U.S. at 591, 123 S.Ct. 1696. The majority in *Roell* reasoned that by continuing to appear before a full-time magistrate judge after being advised of their right to have the matter adjudicated by a district court judge, two members of a prison medical staff had "clearly implied their consent" to final adjudication of the matter by the magistrate judge in question. *Id.* at 586, 123 S.Ct. 1696.

In both *Stern* and *Roell,* the Supreme Court also recognized the inherent danger in allowing a party that had consistently appeared before a tribunal without protest to suddenly change its position, and assert that the tribunal in question no longer maintains the ability to finally adjudicate the matter before it. In *Roell,* the Supreme Court concluded that inferring consent was appropriate under the circumstances because it "checks the risk of gamesmanship by depriving parties of the luxury of waiting for the outcome before denying the magistrate judge's authority." *Roell,* 538 U.S. at 590, 123 S.Ct. 1696. In *Stern* the Supreme Court went further and actually criticized the claimant's attempt to "sandbag" the bankruptcy court by belatedly raising the objection **after** he had spent over two years litigating his claim in the bankruptcy court without complaint. *Stern,* 131 S.Ct. at 2608. The Supreme Court went on to say that if the claimant believed that the bankruptcy court did not maintain the constitutional authority to finally adjudicate his defamation claim "he should have said so- and said so promptly." *Id.* at 2608.

Since the *Stern* decision, several other courts have persuasively concluded that a party may impliedly consent to final adjudication of certain matters by a non-Article III bankruptcy court. *See e.g., Custom Contractors,* 462 B.R. at 909 (concluding that by litigating for more than an year without filing a motion to withdraw the reference, the IRS impliedly consented to final adjudication of a trustee's complaint to recover allegedly fraudulent transfers); *Hawaii Nat'l Bancshares, Inc. v. Sunra Coffee LLC (In re Sunra Coffee LLC),* Bankr.No. 09–01909, Adv. No. 10–90009, 2011 WL 4963155, *5–6 (Bankr.D.Haw. Oct. 18, 2011) (concluding that a guarantor had impliedly consented to final adjudication of a complaint in foreclosure by the bankruptcy court when he failed to respond to either the notice of removal or motion for deficiency judgment filed in the case) (citations omitted). This Court agrees.

Thus, following clear precedent established by the Supreme Court, this Court must recognize implied consent as a viable means of consenting to final adjudication of Article III cases and controversies by a non-Article III bankruptcy court.

D.

[13] Applying the facts of the instant case to the consent analysis above, it is clear that both parties consented to adjudication of this action before this Court.

Initially, Buncher removed the pending case to this Court and has never challenged the ability of this Court to adjudi-

cate the matters before it. (*See* Adv. No. 10–2495–JAD, Doc. # 1).[28]

With regard to ARDI, consent is clear from statements made on the record as well as its inaction as the case proceeded in this forum. At the hearing on the *Motion to Reopen Bankruptcy Case to Enforce Bankruptcy Court Order,* Counsel for ARDI conceded that the action in question could be tried and finally adjudicated by the bankruptcy court. Once the Honorable M. Bruce McCullough[29] offered his opinion from the bench that the question of whether or not the Barge Facility had been removed was a matter of interpreting the bankruptcy court's prior order, Counsel for ARDI stated that he "had no preference on courts." (*See* Audio Recording of Hearing Held in Courtroom B, September 7, 2010 (3:35–3:36 PM)). At no point subsequent to this hearing did ARDI move to have the matter remanded to state court or seek to withdraw the reference.

In addition, ARDI twice consented in writing to have this Court finally adjudicate the non-core matters between ARDI and Buncher.[30] The first written consent was contained in the *Joint Discovery Plan and Statement of Estimated Time of Trial Dated February 1, 2011,* wherein the parties agreed that "[i]f the matter upon which the above-captioned adversary proceeding is a non-core matter ... the parties *do* consent to the entry Final Order ..." by the bankruptcy court. (*See* Doc. # 25, ¶ 12) (emphasis in original). ARDI later re-affirmed its consent in a *Joint Discovery Plan and Statement of Estimated Time of Trial* with regard to the third party complaint filed by Buncher against ARDI stating specifically that the parties "resubmit, reaffirm and adopt the Joint Discovery Plan and Statement of Estimated Time of Trial previously submitted...." (*See* Doc. # 41).

This Court finds that through its pleadings, statements of counsel, and by continuing to litigate this matter over a period of eight months without moving to remand the action to state court or seeking to withdraw the reference, ARDI has consented to final adjudication of all core and non-core matters by this Court.[31] Once

28. Buncher has also consented through the *Joint Discovery Plan and Statement of Estimated Time of Trial Dated February 1, 2011* and the later filed *Joint Discovery Plan and Statement of Estimated Time of Trial.* (*See* Adv. No. 10–2495–JAD, Doc. # 25, ¶ 12 and Doc. # 41).

29. On August 30, 2010, the involvement of the Honorable Bernard Markovitz was terminated and the Debtor's main bankruptcy case was transferred to the Honorable M. Bruce McCullough. (*See* Case No. 07–24515–JAD, Doc. # 66). Following the passing of Judge McCullough, the instant bankruptcy proceeding was assigned to this Court pursuant to General Order 2010–09.

30. Counsel for ARDI did request a jury trial in the original Complaint filed in state court (*See* Adv. No. 10–2495, Doc. # 1, Exhibit "C"). Counsel also raised his jury trial request at the hearing to reopen the bankruptcy case held September 7, 2010. (*See* Audio Recording of Hearing Held in Courtroom B, September 7, 2010) (3:35–3:36 PM) ("I guess the jury part will be in front of the district court."). However, as part of the *Joint Discovery Plan and Statement of Estimated Time of Trial Dated February 1, 2011,* Counsel gave his express consent to have any jury trial requested conducted by this Court. (*See* Doc. # 25, ¶ 11). Therefore, Counsel's jury trial demand does not alter this Court's Article III analysis in the present action.

31. As this court has previously concluded that both express and implied consent of the parties suffice to permit final adjudication by a non-Article III bankruptcy court, there is no need to split hairs by determining whether a party's consent to final adjudication of non-core matters by the bankruptcy court constitutes express or implied consent as to the final adjudication of statutorily defined core matters.

ARDI provided its consent, it could not be withdrawn without a showing of good cause. *See Bayonne Medical Center,* 2011 WL 5900960, at *6; *Olde Prairie Block Owner,* 457 B.R. at 702 (citing *Carter v. Sea Land Servs., Inc.,* 816 F.2d 1018, 1021 (5th Cir.1987)). No such good cause has been shown or articulated.

VI.

For the reasons expressed above, the Court finds that there are no genuine disputes of material fact and, as a matter of law, ARDI is not entitled to a judgment on its cause of action for conversion by virtue of the enforcement of the Court's Consent Order dated April 3, 2008. Because the Consent Order precludes the claim for conversion, the motion for summary judgment seeking dismissal of the complaint filed by Buncher shall be granted. An Order consistent with this *Memorandum Opinion* shall be entered.

In re Lamont L. GILLIAM, Sr., Debtor.

Paul T. Bair, Plaintiff,

v.

Lamont L. Gilliam, Sr., Defendant.

Bankruptcy No. 10–27336–CMB.
Adversary No. 11–02221–CMB.

United States Bankruptcy Court,
W.D. Pennsylvania.

April 2, 2012.

Background: Pro se judgment creditor filed adversary complaint against Chapter 7 debtor, seeking determination that prepetition judgment debt for rent due under the parties' residential lease was nondischargeable.

Holdings: The Bankruptcy Court, Carlota M. Böhm, J., held that:

(1) the judgment debt did not fall within the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, and

(2) the judgment debt did not fall within the discharge exception for debts for willful and malicious injury.

Complaint denied.

1. Bankruptcy ⟹3403(1), 3405(13)

Creditor seeking to establish an exception to discharge bears the burden of proof by a preponderance of the evidence. 11 U.S.C.A. § 523.

2. Bankruptcy ⟹3372.4, 3372.36

Prepetition judgment debt for rent owed by Chapter 7 debtor under a residential lease did not fall within the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud; judgment creditor did not allege any fraudulent conduct or representations by debtor with respect to obtaining the residential lease and the creation of the debt but, rather, accused debtor of falsely representing his income after-the-fact in his bankruptcy case, and to the extent that judgment creditor asserted that debtor misrepresented income in his earlier bankruptcy case, judgment creditor introduced no evidence of his reliance on that information in connection with the creation of the subject debt. 11 U.S.C.A. § 523(a)(2).

3. Bankruptcy ⟹3372.10

Fraud or false representation of a debtor is not actionable under the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud unless the subject of the debt that is sought to be declared nondischarge-

tary Chapter 13 plan operating to the detriment of the debtor's children.

In re Hammonds, 729 F.2d at 1394–95. Further safeguards are provided in the AFDC statute. If DPW is displeased with the parent's use of the AFDC benefits, the AFDC statutes provides certain remedies, including counseling the parent, providing a guardian for the children, or imposing a criminal or civil penalty. 42 U.S.C. § 605.

Finally, the Court notes that the success of a Chapter 13 plan often times depends on an income attachment order. *In re Sampson,* 95 B.R. at 68 (80 percent success of plan if there is an order for payment, 20 percent when there is not); *In re Barron,* 85 B.R. at 607 n. 14; Transcript at 21, 80–81 (Defeo prefers to pay her debts through wage order attachment because "I have a lot of problems in—too much for my head and I want them to just do that so I won't forget it.").

The bankruptcy court's order that DPW must comply with the income attachment orders will be affirmed.

In re I.D. CRAIG SERVICE CORPORATION, Debtor,

Objection of Pittsburgh Steelers Sports, Inc. to Sale.

Bankruptcy No. 89–00640–JKF.
Motion No. 90–6028M.

United States Bankruptcy Court, W.D. Pennsylvania.

March 31, 1992.

Owner of professional football club objected to Chapter 7 trustee's motion to sell renewal rights for season tickets for home games. The Bankruptcy Court, Judith K. Fitzgerald, J., held that: (1) club had created in season ticket holders an expectancy interest in renewal rights; (2) renewal rights constituted estate property that trustee could sell; (3) sale of renewal rights was not subject to Pennsylvania's antiscalping law; and (4) renewal rights did not constitute executory contract that had to be assumed by trustee within 60 days of conversion from Chapter 11 to Chapter 7.

So ordered.

1. Bankruptcy ⚷2532

All interests of debtor are estate property, regardless of their nature. Bankr. Code, 11 U.S.C.A. § 541.

2. Theaters and Shows ⚷4

Fact that each season ticket for professional football games was revocable license did not mean that owner of football club could deny Chapter 7 trustee's request to transfer his season ticket holder status or refuse to recognize that status in his transferees; evidence established that, during club's 60–year history, game admission had been refused upon presentment of ticket only if ticket was one which had been reported as lost or stolen or if person seeking admittance behaved in disruptive manner or had been observed buying ticket from scalper.

3. Theaters and Shows ⚷4

Under Pennsylvania law, owner of professional football club created in season ticket holders a valuable expectancy interest in renewal rights, where both renewal and transfer of season ticket rights had always been automatic and routine.

4. Bankruptcy ⚷2535(1)

Renewal rights attendant to transferable season ticket holder status for professional football games constituted estate property was that subject to sale by Chapter 7 trustee; expectancy interest in season ticket transfers and renewals had been created, fostered and honored by professional football club for many years. Bankr.Code, 11 U.S.C.A. § 541.

5. Bankruptcy ⚷2535(1)

Even if season tickets for professional football games were not in Chapter 7 trust-

ee's name, trustee would have right to exercise debtor's option to transfer tickets to third parties.

6. Estoppel ⟹52(8)

Professional football club was equitably estopped from claiming that Chapter 7 trustee did not have right to transfer renewal rights for season tickets for professional football club's home games, where club, over past 60 years, had intentionally created, encouraged and promoted expectation that all season ticket holders of record would have opportunity to renew their status on annual basis and would be able to transfer that status upon written request and payment of nominal transfer fee, and any policy on part of club of limiting number of transfers to one per year from any one account had been abandoned.

7. Theaters and Shows ⟹4

Neither general public, those on waiting list to purchase season tickets for professional football club's home games, nor club acting on behalf of public or those on waiting list, could object to Chapter 7 trustee's sale of renewal rights for season tickets, inasmuch as club admitted that not all lapsed accounts were used to elevate those on waiting list to season ticket holder status, and thus any harm to public or those on waiting list from trustee's sale was entirely hypothetical.

8. Theaters and Shows ⟹4

Right of registered season ticket holder for professional football games to annual renewal of season ticket did not constitute "evidence of the right of entry to any place of amusement," and thus sale of renewal right was not subject to Pennsylvania's antiscalping law. 4 P.S. § 202.

See publication Words and Phrases for other judicial constructions and definitions.

9. Bankruptcy ⟹3008

Statute providing that trustee shall manage and operate property in his possession according to requirements of valid laws of state in which such property is situated in same manner that owner or possessor thereof would be bound to do if in possession thereof does not have result of requiring trustee to obey the law only when public health and safety are implicated. 28 U.S.C.A. § 959(b).

10. Bankruptcy ⟹3027

Chapter 7 trustee had to file motion seeking court approval for expenditure necessary to exercise debtor's right to purchase tickets for professional football game, where, at time of purchase, there was no operating business and thus it was impossible for expenditure to have been in ordinary course of business. Bankr.Code, 11 U.S.C.A. § 363.

11. Bankruptcy ⟹3008

Chapter 7 trustee, as fiduciary, is required to adhere to strictest letter of the law in all his dealings with respect to estate.

12. Bankruptcy ⟹3027

Chapter 7 trustee's exercise of debtor's right to purchase season tickets for professional football games would not be voided, even though trustee was required to, but did not, file motion seeking court approval for expenditure; trustee resold tickets for face value, and there was no economic harm to estate, other than any costs and fees associated with litigation brought by owner of professional football club.

13. Bankruptcy ⟹3103(2)

Renewal rights for season tickets for professional football club's home games did not constitute prepetition executory contract which Chapter 7 trustee would have to assume within 60 days of conversion from Chapter 11 to Chapter 7. Bankr. Code, 11 U.S.C.A. § 365.

Charles E. Bobinis, and Owen W. Katz, Bernstein & Bernstein, P.C., Pittsburgh, Pa., for trustee Joseph J. Bernstein.

William Schorling, Klett, Lieber, Rooney & Schorling, Pittsburgh, Pa., for objector Pittsburgh Steelers Sports, Inc.

MEMORANDUM OPINION

JUDITH K. FITZGERALD, Bankruptcy Judge.

The matter before the court is the objection of Pittsburgh Steelers Sports, Inc.

(hereafter "Sports, Inc.") to a portion of the motion to sell filed by Joseph J. Bernstein, Trustee (hereafter Trustee). The motion involves the sale of Trustee's status as a season ticket holder which carries with it annual opportunities to acquire season tickets of the Pittsburgh Steelers Football Club's home games. There was no objection to the sale of the season tickets themselves and that portion of the sale is not at issue herein.

INTRODUCTION [1]

[1] What at the outset appeared to be a simple objection to sale has been complicated by the amorphous nature of the interest which Trustee sold. Season ticket holder status historically has included an automatic annual purchase offer and the right to transfer the status via a written request and payment of a five dollar transfer fee. This bundle of prerogatives is referred to, as it was at the sale, as "renewal rights". Despite the difficulty of defining its character, *all* interests of the debtor are estate property under 11 U.S.C. § 541, regardless of their nature, and, in any given case, the trustee must determine whether the interest has sufficient value to the estate to warrant a sale. *See* 11 U.S.C. § 541(d) (property to which debtor holds legal title is estate property to the extent of that title). *See also id.* at § 541(a) (the estate includes "*all* legal or equitable interests of the debtor in property") (emphasis added).

On August 16, 1990, shortly before the first home exhibition game, Trustee filed a motion to conduct an expedited sale of season tickets for the 1990–91 Pittsburgh Steelers home football games.[2] The motion was granted and the sale was conducted on August 28, 1990. Trustee sold fourteen tickets in six separate lots. Five lots consisted of two seats each and one lot consisted of four seats. Trustee also moved to sell the renewal rights associated with each season ticket. Historically, season tickets to home games have been offered to the season ticket holder of record on an annual basis. Trustee's position is that this practice evidences the existence of rights in the holder to renew the season tickets. While it disputes Trustee's ability to sell the renewal rights, Sports, Inc. concedes that it permits season ticket holders to transfer their record status to any other person or entity upon written request and payment of a five dollar transfer fee.

Sports, Inc. objects to the sale of the renewal rights alleging that the sale violates the Pennsylvania anti-scalping law. *See* 4 P.S. § 201 et seq. Sports, Inc. also alleges that Trustee is precluded from selling the renewal rights because they constitute an executory contract which Trustee failed to assume within sixty days after the case was converted to chapter 7. *See* 11 U.S.C. § 365(d)(1) (prepetition executory contract regarding personalty deemed rejected in a chapter 7 if not assumed within sixty days after the order for relief). Sports, Inc. further maintains that within the past decade it instituted a policy to limit to one the number of transfers which season ticket holders are allowed to make from their accounts and, therefore, it is not required to honor Trustee's request to transfer the tickets from his name to those of the six buyers. However, based on the testimony and evidence adduced at trial as well as the briefs and arguments of the parties and the court's independent legal research, Sports, Inc.'s objections will be overruled and the sale of the tickets and the renewal rights will be confirmed to the successful bidders.[3]

1. Some of the recited facts were stipulated by the parties. Others are as found by the court. *See* Stipulation, Docket Entry 642 in conjunction with Trustee's Memorandum of Law in Opposition to the Objection, Docket Entry 635.

2. The tickets originally were in Debtor's name but the 1990 season tickets issued after this case was filed were in the name of the chapter 7 trustee "c/o Joseph Bernstein". *See* Deposition of Geraldine R. Glenn (hereafter Glenn Deposition), Vol. I, September 20, 1990, Exhibit 5. *See also* Trustee's Memorandum of Law in Opposition to the Objection, Exhibit 10.

3. Harry Jones, president and majority shareholder of Debtor, objected to the sale by letter of August 20, 1990, on the ground that a motion to dismiss the bankruptcy petition was pending. The motion to dismiss was denied by separate opinion and order and so this objection is dismissed as moot. Jones also requested that Trustee be removed for various reasons but alleged no facts in support of his allegations and

DISCUSSION

Revocable License

Since 1933 Sports, Inc. has had season ticket holders. Its renewal policy has remained unchanged since 1972, according to the testimony of Daniel M. Rooney, President and Chief Executive Officer of Pittsburgh Steelers Sports, Inc. That is, it has offered its registered holders season tickets to Pittsburgh Steelers home football games annually and, as long as the holder of record continues to purchase season tickets, he retains the status. There is a waiting list for the opportunity to purchase.

There are 59,429 seats in Three Rivers Stadium in Pittsburgh, Pennsylvania, where the Steelers play their home games. Other seats include 1,200 box seats and the capacity of the Allegheny Club, a private facility, in which a section is set aside to provide ticket purchasing members the opportunity to watch the games from the comfort of the club. At the time of trial there were 55,000 season tickets issued representing approximately ninety-five per cent of the available seats. *See* Stipulation at ¶ 1(a). In addition, those on the waiting list have an opportunity to purchase a total of three thousand tickets to individual games. Deposition of Geraldine Glenn, Volume I, September 20, 1990, (hereafter Glenn Deposition, Vol. I) at 51–60. *See also* Stipulation at ¶ 1(b). Any tickets not sold in that manner are offered to the general public on May 21 of each year. *See* Stipulation at ¶ 1(b). The May 21 sale is publicly advertised by Sports, Inc. but it has not advertised any other ticket sales in the past eighteen years. Sports, Inc. has not licensed any independent person or agency to sell tickets and all are sold through its ticket office.[4] Approximately two thousand tickets are kept by Sports, Inc. to be distributed at management's discretion, to visiting teams, to Steeler personnel and players, or as complimentary passes.

Since at least 1977 all individual tickets, whether sold per game or in a season ticket package, contain identical printed information. Each contains, inter alia, the following limitation:

> This ticket is a revocable license and may be revoked and admission refused upon refunding the printed price thereon. This ticket may not be resold at a premium....

Memorandum in Support of the Objection of the Pittsburgh Steelers Sports, Inc., Exhibit B. Sports, Inc. argues that because each ticket alone is a revocable license, Sports, Inc. is not bound to offer the opportunity to buy season tickets in the future to the successful bidders at Trustee's sale.

The Steelers Season Ticket Holder Handbook (hereafter Handbook) is the only written document containing ticket policy about transfer and renewal. The Handbook is distributed to all season ticket holders. It has been in effect without change since 1982 and the same renewal policy has existed since 1972 in that every registered holder automatically receives an annual offer to purchase season tickets and receives the tickets upon payment of the purchase price.[5] The only reference which could be construed to refer to revocation of season ticket holder status is indirect, appears in the Handbook under the heading "Game Day", and provides that

> Rowdy and inconsiderate behavior such as: standing in the aisles and behind the

provided no basis for this request at the hearing on the sale. We are aware of no justification for the removal of Trustee and, therefore, this objection is dismissed as well. Jones further stated that "this Court should enter an automatic stay" until the propriety of the sale is resolved. The court declined to do so at the sale hearing.

4. The testimony established that Sports, Inc. recognizes that ticket holders sometimes resell particular game tickets and has no objection to and exercises no control over that secondary market. Although there was testimony regarding occasional efforts to police that market through responses to newspaper advertisements, these efforts have never disclosed information that caused Sports, Inc. to take action to halt the sales.

5. The sole exception to this practice involved Daniel Ofchinick, a convicted felon. The renewal offer was withdrawn based on a set of unique circumstances which are not applicable herein.

last row of seats, profane and/or abusive language in the Stadium is cause for ejection. *Repeated offenses can result in the loss of ticket privileges.* (Emphasis added).

Response of Trustee to the Objection, Exhibit 1.[6]

The testimony established one other instance which may lead Sports, Inc. to revoke the status. Sports, Inc.'s communications director, Joseph Gordon, testified that, although there is no premium payable for acquiring the status, all season ticket holders must buy the tickets to the home preseason games. Those fans who have balked at doing so have been threatened with the loss of their status. There was no other evidence or testimony proffered regarding revocation or termination of the right to retain season ticket holder status.

[2] The fact that each ticket is a revocable license is not disputed. However, the conclusion does not follow that, because each single ticket is a revocable license, Sports, Inc. can either deny Trustee's request to transfer his season ticket holder status or refuse to recognize that status in his transferees. In the case law which Sports, Inc. argues is applicable, the revocable license concept has been applied in suits by ticket holders where, for example, events have been canceled or where the plaintiff's expected admission has been thwarted for some reason beyond management's control. *See, e.g., Bickett v. Buffalo Bills, Inc.,* 122 Misc.2d 880, 472 N.Y.S.2d 245 (Sup.Ct.1983) (baseball games canceled because of strike); *Horney v. Nixon,* 213 Pa. 20, 61 A. 1088 (1905) (fire commission ordered seats for which plaintiffs had tickets to be removed for safety reasons); *Miller v. Pittsburgh Athletic Co.,* 91 Pa.Super. 229 (1927) (orders for World Series tickets filled by lot). None of the cases cited are apposite to the termination of season ticket holder status. Furthermore, the cases and the testimony adduced in the instant matter concerned only individual game admissions, not season ticket holder status renewal. The evidence established that, during the sixty year history of Sports, Inc., game admission has been refused, upon presentment of a ticket, only if the ticket was one which had been reported as lost or stolen or if the person seeking admittance behaved in a disruptive manner or had been observed buying the ticket from a scalper.[7] None of the cited events exist in this case and none concerned or are relevant to renewal rights.

The game tickets themselves and the right to renew the season tickets are two separate and distinct interests of this estate. This concept may be illustrated by analogy to the interest that the holder of a liquor license enjoys. Although, by statute in Pennsylvania, liquor licenses are privileges and not property, the rights attendant to the licenses are routinely sold and the licenses themselves transferred through sales in bankruptcy cases. *See* 47 Pa.Stat.Ann. § 4–468.

The United States Court of Appeals for the Third Circuit recently addressed the issue of renewal rights under a liquor license in *In re Nejberger,* 934 F.2d 1300 (3d Cir.1991). The court noted the value of liquor licenses in bankruptcy cases. *Id.* at 1302. *See also* 47 Pa.Stat.Ann. § 4–468(b.1). The court stated that they are within the broad definition of property enunciated by § 541 of the Bankruptcy Code and are property of the estate. 934 F.2d at 1302. *See* 11 U.S.C. § 541; 47 Pa.Stat.Ann. § 4–468. When the *Nejberger* bankruptcy was filed, the debtor's interest was limited. Simply stated, he had a renewal application pending with the Pennsylvania Liquor Control Board with the attendant opportunity to have that application considered by the Board. The Court of Appeals found that the Pennsylvania Liquor Code creates "an expectation that so long as a new license has not been

6. We need not decide whether "ticket privileges" include the opportunity to retain season ticket holder status because the described "repeated offenses" are not applicable to this case.

7. A scalper is someone who resells a ticket at a premium rather than at face value. No testimony or evidence was offered to illuminate the manner in which Sports, Inc. identifies a scalper by observation.

issued to fill a quota vacancy, the Board will consider the application for renewal." 934 F.2d at 1303. In *Nejberger* the debtor did not hold the renewal right as such but merely an expectation of the right to apply for renewal. *Id.*[8] Nonetheless, the court held that

> [t]he fact that [the] expectation is merely the right to apply for renewal does not prevent it from being a valuable interest which becomes part of the bankruptcy estate.

Id.[9]

[3–5] We find that *Nejberger* is similar to this case and that the *Nejberger* analysis applies to the instant situation. Although liquor licenses are regulated and controlled by statute and, therefore, are distinguishable from the property interests at bar, the interest found by the Court of Appeals in *Nejberger* is the closest we have found in the reported case law to the instant one. Indeed, whereas in *Nejberger* the debtor's interest was merely the right to apply for renewal, in the case at hand the Trustee holds the right to receive the renewal opportunity by virtue of Sports, Inc.'s longstanding practice. In *Nejberger* the burden to reapply was on the debtor. Here, no burden to act was on Trustee. Rather, the solicitation to renew originates each year from Sports, Inc. On receipt, Trustee could let the opportunity to purchase pass or he could accept. Upon acceptance of the renewal offer by payment of the price requested, however, Trustee reacquired his status as season ticket holder for the year with the right to receive the solicitation to purchase the following season. When he reacquired his season ticket holder status he also retained his right to transfer that status by virtue of Sports, Inc.'s uniformly applied policy of honoring such requests. By its conduct Sports, Inc. has created in season ticket holders, and, therefore, in this Trustee, an expectancy interest in the renewal rights which is as valuable as that in *Nejberger.*

With respect to season tickets, both renewal and transfer have always been automatic and routine. The expectancy interest in season ticket transfers and renewals has been created, fostered and honored by Sports, Inc. for many years. Even if *Nejberger* were not applicable to this case, the fact remains that the renewal rights attendant to the transferable season ticket holder status held by Trustee are valuable assets of this estate and subject to sale. The fact that the sale produced interested bidders willing to purchase the season ticket holder status with its associated renewal rights confirms that there is value. Value also is evidenced by the existence of a waiting list for season tickets because once registered holder status is achieved, it is automatically renewed as long as the holder pays for each year's season tickets and pre-season game tickets and takes no action to transfer the status to another. The renewal rights, therefore, are "appropriately considered property of the estate within the broad definition of section 541" of the Bankruptcy Code. *Id.* at 1302. Trustee, standing in the shoes of the Debtor, accepted Sports, Inc.'s solicitation to renew his season ticket holder status in early 1990 by paying for the season tickets. When he did so he retained all rights attendant to that status including (a) the right to receive the solicitation to purchase season tickets in the following season and (b) the right to transfer that status upon payment of the

8. The Liquor Control Board's renewal of the liquor license in *Nejberger* was contingent on the debtor's payment of taxes but the court noted that the prepetition tax obligation could not be used as a basis for denying the renewal. 934 F.2d at 1303. In the case at bar the right to receive the renewal offer in the following year is contingent on the payment of the current season's full ticket price and the purchase of the pre-season tickets in the current year. Those contingencies were satisfied.

9. Although the Liquor Control Board could exercise its discretion in reviewing a renewal application, the Court of Appeals noted that because "a liquor license has value and is transferable ... the Board could issue a renewal license to the trustee who might request a transfer to a third party." *Id.* at 1303–04. In the case at bar Sports, Inc. has never refused a renewal or transfer of season ticket holder status except in the circumstances cited in text. No justification has been offered to bar Trustee in this liquidation from selling a valuable property interest of the estate.

five dollar transfer fee and submission of a written request to Sports, Inc. Under *Nejberger*, Trustee may transfer the rights attendant to his season ticket holder status as well as the tickets because the status includes the valuable expectancy interest of the renewal rights.[10] The Bankruptcy Code requires Trustee to examine estate assets and to determine their proper disposition. Having concluded that there was value in the season ticket holder status, i.e., the renewal rights, Trustee brought this motion to sell in an effort to maximize proceeds to be distributed to creditors. 11 U.S.C. § 704(1).[11]

Transfer Policy

In addition to the principles enumerated in *Nejberger* the testimony and evidence in this case also militate in favor of the transfer of Trustee's season ticket holder status with its renewal rights. Since at least 1972, Sports, Inc. has effected transfer of renewal rights from one person or entity to another whenever the registered season ticket holder submits a written request. In the late 1970s the payment of a five dollar handling fee was introduced as an additional requirement. Upon receipt of the payment and the request, Sports, Inc. merely changes its records to reflect the new subscriber's name and address. Thereafter, the annual solicitation is sent to the new registered holder.

The only departure from this practice occurred in 1979 when, in the course of financing the construction of additional seating for Three Rivers Stadium, Sports, Inc. entered into contracts with various entities or persons to "purchase" the new seats for six hundred dollars apiece. As an inducement to purchase, Sports, Inc. executed separate contracts with each purchaser for the use of the "purchased" seat for five years. *See* Deposition of Geraldine Glenn, Volume II, September 24, 1990, (hereafter Glenn Deposition, Vol. II) Exhibit 18. However, these contracts contained an express nonassignability clause. One of the purchasers was a company called Seal–Pac Controls, Inc., which later filed bankruptcy. In the Seal–Pac case an auction sale of the estate's season tickets to Steeler games was conducted in the bankruptcy court on a lump sum basis. Sports, Inc. thereafter effected a transfer on its season ticket holder register to the buyers. Despite the nonassignability clause, the renewal rights specified in the contracts were sold as well as the season tickets.[12] This is evidenced by letters of record which refer to transfer of accounts and all "right, title and interest" in the contracts. *See* Glenn Deposition, Vol. I, Exhibit 12. Sports, Inc. asserts that the sales are distinguishable in

10. Even if the season tickets were not in Trustee's name, he would have the right to exercise Debtor's option to transfer the tickets to third parties. *In re Nejberger*, 934 F.2d at 1304. Although *Nejberger* dealt with statutorily created expectancy interests, other cases discuss contractually created ones. *See, e.g., West American Insurance Co. v. Park*, 933 F.2d 1236, 1240 (3d Cir.1991) (equitable estoppel prohibits an insurer from using "the explicit language of an insurance policy to defeat the reasonable expectations of the insured.") The fact is that in this case the expectancy interest arose from the offer and acceptance of season tickets, the transfer policy expressed in the Handbook, and sixty years of practice.

11. Trustee in this chapter 7 case had four choices with respect to the season tickets. He could have done nothing when the tickets were offered for sale in which case the season ticket holder status would have expired and the tickets would have reverted to Sports, Inc. for nonpayment. Sports, Inc. then could have disposed of them as it wished. Trustee's second option was to purchase the tickets and to sell only the tickets themselves. In this situation, following its practice, Sports, Inc. would have renewed the offer to Trustee to purchase the tickets in the next season at which time Trustee would have been faced with the same options. Trustee's third choice was to purchase the tickets, sell only the tickets and request the transfer from his name to those of the buyers without selling the renewal rights. Finally, Trustee could purchase the tickets, sell them *and* his renewal rights and then exercise the prerogative to transfer the tickets from his name to those of the buyers after the sale. Trustee exercised this last option in an effort to maximize the dividend to be paid to unsecured creditors. (There were no allegations that any liens exist against these assets.)

12. The evidence in the instant matter did not disclose the actual price paid but referred only to a "lump sum".

that Seal-Pac held the seats pursuant to a contract which included renewal rights. This argument is without merit inasmuch as the 1979 contract expressly prohibited assignment of the contracts or rights thereunder. *See* Glenn Deposition, Vol. II, Exhibit 18. Nonetheless, the sale was consummated without objection by Sports, Inc. The case at hand has no such obstacle to the sale of renewal rights.

Equitable Estoppel

[6] The doctrine of equitable estoppel is applied when a party intentionally "induces another to believe that certain facts exist and the other justifiably relies and acts upon such belief" and will be prejudiced if the first is permitted to contradict the expectations it has created. *Straup v. Times Herald*, 283 Pa.Super. 58, 71, 423 A.2d 713, 720 (1980) (petition for allowance of appeal denied 1981). The Superior Court of Pennsylvania explained the concept:

> Reduced to its essence, equitable estoppel is a doctrine of fundamental fairness intended to preclude a party from depriving another of a reasonable expectation, when the party inducing the expectation knew or should have known that the other would rely to his detriment upon that conduct.

Id. See also West American Insurance Company v. Park, 933 F.2d 1236, 1240 (3d Cir.1991) (equitable estoppel applies to prohibit an insurer from using "the explicit language of an insurance policy to defeat the reasonable expectations of the insured.")

Over the past sixty years, Sports, Inc. intentionally created, encouraged and promoted the expectation that all season ticket holders of record will have the opportunity to renew their status on an annual basis and will be able to transfer that status upon written request and payment of a nominal transfer fee.

Sports, Inc. argues that to transfer the tickets from Trustee's name to the buyers' names would be unfair to those who have been on the waiting list for season tickets, some for as long as ten years. However, there was no evidence or testimony adduced at trial that these tickets actually would go to those on the waiting list if permitted to revert to Sports, Inc. To the contrary, the testimony was that, although approximately one hundred season ticket accounts lapse each year,[13] Glenn Deposition, Vol. I at 45, not all are offered to those on the waiting list. A minimum of fifty season tickets are withheld by Sports, Inc. to be distributed to others, in its unfettered discretion. Glenn Deposition, Vol. II at 25. Also, Sports, Inc. transfers registration on written request of season ticket holders of record to anyone, again bypassing the waiting list, without inquiring as to the nature of the transfer as between the ticket holders, i.e., sale, gift, devise, etc. Thus we perceive Sports, Inc.'s cry of "fans' rights" as a red herring.

[7] Sports, Inc. attempts to advance alleged rights of third parties, i.e., members of the ticket buying public, including those on the season ticket waiting list. Neither the general public nor those on the waiting list could object to this sale inasmuch as their claim to the tickets would be tenuous at best in light of Sports, Inc.'s description, through the testimony of its witnesses and its exhibits, regarding its practices with respect to lapsed season tickets. Sports, Inc. admits that not all lapsed accounts are used to elevate those on the waiting list to season ticket holder status. Any harm these third parties might allege would be entirely hypothetical. Based on this record, they would not have standing to challenge the sale because there is no evidence of an "injury in fact and a substantial likelihood that the judicial relief requested will prevent or redress the claimed injury." *Marchezak v. McKinley*, 607 F.2d 37, 39 (3d Cir.1979) citing *Duke Power Co. v. Carolina Environmental Study Group, Inc.*, 438 U.S. 59, 79, 98 S.Ct. 2620, 2633, 57 L.Ed.2d 595 (1978). *See Allen v. Wright*, 468 U.S. 737, 751, 104 S.Ct. 3315, 3324, 82 L.Ed.2d 556 (1984). Because the third parties have not become season ticket holders, they have acquired no rights to the season

13. Two to four tickets go to each name on the list. Glenn Deposition, Vol. II at 65.

tickets or to season ticket holder status. Sports, Inc. *a fortiori* lacks standing to assert their rights. *Cf., Bowman v. Wilson,* 672 F.2d 1145, 1152–53 (3d. Cir.1982) ("[f]or a person who himself can allege injury in fact" to raise another's constitutional rights there must be a close relationship between the two parties, the activity the litigant wants to pursue must "be inextricably bound up with the constitutional rights" of the other and there must be an obstacle to the third party asserting its rights).[14]

To prohibit Trustee from transferring his status as season ticket holder would not be likely to provide relief to Sports, Inc. or its fans inasmuch as the harm it seeks to prevent, i.e., interference with the waiting list, is perpetrated by Sports, Inc. itself through its failure to adhere strictly to the waiting list hierarchy. *See Marchezak v. McKinley,* 607 F.2d at 39 (the relief requested must be shown to prevent or redress the claimed injury). Furthermore, the transfer of season ticket holder status without interference or objection by Sports, Inc. is and has been common practice for many years. Sports, Inc. has promoted and facilitated easy transfers as a service to its customers and as a method of ensuring a sold-out stadium and replacement of fans. It is in Sports, Inc.'s interest to permit transfers as requested by customers inasmuch as it ensures that the tickets are purchased. The home games must be sold out if they are to be televised locally. Rooney testified that more than fifty percent of Sports, Inc.'s revenue comes from the television advertising aired during the football games.

Sports, Inc. offered evidence that other ball teams impose restrictions on, or prohibit outright, renewals or transfers. *See, e.g.,* Glenn Deposition, Vol. I, Exhibits 6, 11. This evidence apparently was intended to support its argument that it has the right to refuse Trustee's request for transfer or to refuse to offer the buyers season tickets in the future once the transfer is accomplished. However, the evidence is irrelevant and not dispositive because only Sports, Inc.'s practices and policies are at issue. The testimony and documents established that Sports, Inc.'s policies and practices are not the same as those of the other ball clubs. Sports, Inc.'s transfer policy, as written in the Handbook, is that "The season ticket holder of record may transfer ownership." [15] *See* Glenn Deposition, Vol. I, at 8.

The testimony established that all that is required to effect the transfer is a written request from the season ticket holder to Sports, Inc. and a five dollar transfer fee. Rooney explained that in the early 1980s a new policy was initiated to limit the number of transfers to one per year from any one account. Rooney testified that this policy was instituted because each season ticket holder wants "benefits" such as the Press and Radio Guide that Sports, Inc. distributes to season ticket holders. However, he testified that the main problem with multiple transfers is one of bookkeeping. Joseph Gordon, Sports, Inc.'s communications director, testified that this policy was initiated around 1980.[16] How-

14. Although *Bowman v. Wilson* addresses essentially the assertion of a constitutional right, the principles apply to statutory rights as well. *See,* 672 F.2d at 1152, n. 13.

15. The attorney for Sports, Inc. argued that Trustee's claim of "ownership" of season tickets was misplaced inasmuch as the Trustee culled the term from the imprecise speech of Geraldine Glenn during the course of her deposition. We do not credit this argument inasmuch as the Handbook which is distributed to all season ticket holders (1) refers twice to the holder of the tickets as the "owner" (2) contains a section captioned "SEASON TICKET OWNERSHIP" and (3) defines the season ticket holder as the "owner of season tickets". It also provides that "season ticket holders of record may transfer ownership." Glenn Deposition, Vol. I, Exhibit 1. *See also id.* at Exhibit 15 (letter from Pittsburgh Steelers Ticket Office to John Markey stating, in pertinent part, "This account is registered under National Annealing Box Co. and cannot be changed without written authorization from the Owner and Corporate Officers indicating they give up the rights to said tickets and transfer ownership to you.")

16. Geraldine Glenn testified that requests for ticket transfers increased in 1983 because of a 1982 ballplayers' strike. Glenn Deposition, Vol. I, at 84. This testimony is not inconsistent with Joseph Gordon's testimony that the policy went into effect "around 1980".

ever, Gordon was quick to state that Sports, Inc. attempts to accommodate customers and that the policy is not enforced equally. He testified that there are few examples of record of a refusal to effectuate a requested transfer, none of which are based on the alleged "one transfer" policy. Transfers have been refused occasionally when the request was not made by the season ticket holder of record or when the transfer fee was not paid. Sports, Inc. accommodates its customers even when a transfer request arrives too late in the season. In that event the transfer is not executed but the requester is invited to reapply at the appropriate time. Glenn Deposition, Vol. I, Exhibit 18. These examples are contrary to and distinguishable from Sports, Inc.'s position in the instant case and clearly illustrate the policy of Sports, Inc. to effect transfers routinely and automatically.[17] The Handbook itself refers to the right to transfer season ticket holder status and contains no restrictions. *See* Response of Trustee to the Objection, Exhibit 1.

We conclude from the evidence and testimony that the limitation on transfers was intended to ease the bookkeeping function when the policy was instituted, but customer satisfaction was and is dominant and the policy has not been enforced since at least 1987. In addition, there was no testimony or evidence offered of Sports, Inc.'s insistence upon the one transfer rule. In fact, the testimony and evidence provided several examples of rather complicated transfers which were allowed. For example, in 1990 sixty season tickets were transferred from one account to seventeen accounts. Glenn Deposition, Vol. II, Exhibit 3. One month later another request, characterized by Sports, Inc. as "special", was honored to transfer eight of those same tickets to four more accounts. *Id.* at Exhibit 4. Furthermore, there was evidence of other transfers which were not alleged to be "special cases", to-wit:

> the transfer of 34 tickets from one account to fourteen accounts; (Glenn Deposition, Vol. II, Exhibit 5)
>
> the transfer of six tickets from one account to three accounts; *Id.* at Exhibit 6)
>
> the transfer of eight tickets from one account to three accounts; (*Id.* at Exhibit 7)
>
> the transfer of sixteen tickets from one account to eight accounts; (*Id.* at Exhibit 8)
>
> the transfer of sixteen tickets from one account to five accounts. (*Id.* at Exhibit 9).

Most of the transfers in evidence occurred between the years 1987 and 1990. These examples effectively rebut the testimony that since about 1980 Sports, Inc.'s policy has been to limit transfers from one account to only one other. Therefore, we find that, if such a restriction ever existed, it was abolished or has been ignored at least since 1987. No valid reason has been advanced by Sports, Inc. to justify a refusal to honor Trustee's transfer request.

The Anti-scalping Law

[8] Sports, Inc. maintains that this sale violates the anti-scalping law which prohibits the resale of

> any tickets of admission, or any other evidence of the right of entry to any place of amusement, at a price higher than the established price fixed by the owners of such place of amusement, without having first obtained a license to so resell or engage in such business from the licensor ...

4 Pa.Stat. § 202.

It is not disputed that the tickets in this case have been sold for their face value and so the statute has not been violated with respect to that portion of the sale. The question remains whether the sale of

17. In addition to requests such as Trustee's, Geraldine Glenn's testimony established that transfer requests from decedents' estates are honored "routinely" and "historically". Glenn Deposition, Vol. II, at 16–17. Ms. Glenn's testimony also alludes to one incident in which a transfer was refused because a premium was to be paid for the transfer. *See* Glenn Deposition, Vol. I, at 73–78 and Exhibits 13 and 14. However, the testimony and exhibits are entirely inconclusive in that no facts were stated and the nature of the transaction cannot be ascertained from the record.

Trustee's status as registered season ticket holder which encompasses the annual renewal of season tickets is subject to the statute and we conclude that it is not. The renewal opportunity is not "evidence of the right of entry to any place of amusement". 4 Pa.Stat. § 202. The individual tickets themselves are the only "evidence of the right of entry" and they were sold at face value. Season ticket holder status is evidence only of the right to receive the offer to purchase the season tickets from year to year. Thus, what Trustee actually is selling, although termed "renewal rights" throughout the course of these proceedings, is the "record title" to the status of registered season ticket holder which entails the entitlement to receive Sports, Inc.'s offer to purchase season tickets each year. *See* Handbook, *supra.*[18] For the foregoing reasons we find that the sale in the instant case does not violate the Pennsylvania anti-scalping law.

[9] Trustee argues that he does not need to obtain a license because the statutory requirement that trustees adhere to all applicable laws applies only to those laws which concern health and safety.[19] Section 959(b) of Title 28, U.S.C., provides, in pertinent part, that

> ...a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

The majority view is that § 959 does not apply in chapter 7 cases where the trustee does not operate or manage a business but liquidates assets. *See, e.g., Matter of Borne Chemical Co., Inc.,* 54 B.R. 126, 135 (Bankr.D.N.J.1984). It is arguable that liquidation entails management but the cases that espouse this view are in the minority and frequently deal with public welfare. *See In re Wall and Tube Metal Products Co.,* 831 F.2d 118, 122 (6th Cir.1987) (whether trustee is reorganizing or liquidating is inconsequential especially in critical context of public welfare). The cases referring to public health and safety most often involve environmental issues and trustees have been precluded from abandoning contaminated assets when public health and safety might be endangered by such a course of action. *See, e.g., Midlantic National Bank v. New Jersey Dept. of Environmental Protection,* 474 U.S. 494, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986). We find unpersuasive the proposition that trustees need obey the law only when public health and safety are implicated but we need not decide in this case whether a chapter 7 trustee is bound by § 959 because we conclude that the sale of assets at issue does not violate the anti-scalping law.

[10–12] Nonetheless, we are constrained to note that a trustee must follow the Bankruptcy Code in all respects, something which Trustee failed to do when he expended estate funds out of the ordinary course of business without court authority. *See* 11 U.S.C. § 363. In a chapter 7 liquidation, which was the state of this case when the balance was paid on the 1990 tickets, there was no operating business and it is impossible for the expenditure to

18. Trustee's sale of renewal rights in this case is akin to the practice of the University of Pittsburgh described by witness Joseph Gordon. The University imposes charges on its patrons over and above the ticket price for football game seats in prime locations. The extra amount is paid for the location of the seat and not for the right of entry to the stadium. The ticket holder thus holds two interests: the right to be admitted to the game, evidenced by the ticket, and the right to sit in a choice seat, for example, on the fifty yard line in row 2. In the instant case the right to admission to an individual game and the right to be offered a subscription to season tickets in the following year are separate interests.

19. Trustee also argues that tickets are often sold for a premium and cites newspaper advertisements placed by ticket holders seeking ticket buyers. *See* Respondent's Trial Exhibit 1. The advertisements are devoid of information that would tend to support this argument and we find no probative value in this evidence.

have been in the ordinary course.[20] Therefore, Trustee was required by § 363 to file a motion seeking court approval for the expenditure necessary to purchase the tickets. As a fiduciary he is required to adhere to the strictest letter of the law in all his dealings with respect to the estate. The facts established that Trustee purchased the tickets before filing this motion to sell so we cannot undo the error. Moreover, Trustee sold the tickets for face value and there is no economic harm to the estate other than any costs and fees associated with the instant litigation. To avoid diminution of the estate and to enforce the statutory mandates imposed upon estate fiduciaries the court will carefully scrutinize any request for Trustee's counsel fees, if one is made related to the sale of the renewal rights or the trial and briefing of this matter.

Executory Contract

[13] The unfortunate use of the term "renewal rights" rather than "record title" created a number of issues which otherwise may not exist. In addition to those already discussed, there remains Sports, Inc.'s contention that Trustee cannot sell the renewal rights because they represent an executory contract which Trustee did not move to assume within sixty days of his appointment as required by § 365. The bankruptcy was filed as a chapter 11 on March 13, 1989, and the Trustee was appointed ten days later. In a chapter 11 an executory contract of personalty must be assumed or rejected by the time a plan of reorganization is confirmed. Section 365(d)(1) requires assumption within sixty days of the conversion to chapter 7, a date which passed without assumption. However, we conclude that the failure to assume is not dispositive in that the asset at issue does not constitute a prepetition executory contract and, hence, § 365 is not applicable.

The most widely accepted definition of an executory contract is one under which the obligations of both parties "are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other". *Sharon Steel Corp. v. National Fuel Gas Distribution Corp.*, 872 F.2d 36, 39 (3d Cir.1989) citing Countryman, *Executory Contracts in Bankruptcy*, 57 Minn. L.Rev. 439, 460 (1973). In the case at hand there is no substantial performance due by at least one side, i.e., Trustee. Once season ticket holder status is achieved by paying for season tickets, Sports, Inc. has an obligation to offer the holder the *opportunity* to purchase season tickets the following year, but the holder has no obligation to make the purchase. However, once it does, the offer and acceptance process is complete and the only obligation remaining is Sports, Inc.'s to offer the season tickets the following year. The absence of any obligation on behalf of the other party renders the contract nonexecutory. There is no further obligation on the part of the registered holder. Having accepted payment, Sports, Inc., by virtue of its own policies and the expectancy interest it created, must make the offer to purchase annually to its registered holders but, at that point in the process, there is no longer substantial performance due by *both* sides.[21] *Cf. Oxford Royal Mushroom Products, Inc.*, 45 B.R. 792 (Bankr.E.D.Pa. 1985) (a contract is not made executory when the only obligation remaining in the transaction is that of one side to pay money).

Furthermore, the evidence established that Trustee's season ticket holder status,

20. Section 721 of Title 11 permits the court to "authorize the trustee to operate the business of the debtor for a limited period, if such operation is in the best interest of the estate and consistent with the orderly liquidation of the estate." There was no authorization extant by the time Trustee bought the tickets and brought the sale. This case was converted from chapter 11 to chapter 7 on this Trustee's motion, Trustee having been appointed during the chapter 11 phase.

21. We express no opinion on the obligation, if any, (contractual or otherwise) of Sports, Inc. to offer season tickets to anyone. We find only that, based on Sports, Inc.'s prior practice, the expectancy interest created thereby and the offer in this case which has been accepted by this trustee, Sports, Inc. is obliged to honor Trustee's request to transfer his season ticket holder status to the buyers.

although in existence prepetition, was recreated postpetition by Sports, Inc. The offer and acceptance which gave rise to the matter under discussion both occurred postpetition. Section 365 governs assumption or rejection of *prepetition* executory contracts and is inapplicable to postpetition contracts. Moreover, as further indicia of whether there is an executory contract, we consider that one purpose of § 365 is to afford a party to a contract from which the estate will derive no benefit, and, hence, which it "rejects", the ability to participate as a claimant in any distribution to unsecured creditors. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U.Colo.L.Rev. 845, 866–78 (1988). The rejection of the provision at issue would afford no damage claim to Sports, Inc. because there is no obligation by any season ticket holder, including Trustee, to continue to retain that status.

SUMMARY

We find that the season ticket holders' interest in season ticket renewal may be better termed an expectancy interest rather than a contractual interest. *See In re Nejberger, supra.* The expectancy interest has been created and fostered by Sports, Inc. in the public, including season ticket holders, by virtue of Sports, Inc.'s long practice of offering to renew season tickets to the current registered holder on an annual basis.[22] *See West American Insurance Co. v. Park, supra; Straup v. Times Herald, supra.* The Debtor's estate held that expectancy interest, as does Trustee at this juncture and, upon completion of the transfer formalities, so will the buyers. The ticket renewals encompassed in the expectancy interest have been shown to have value and are property of the estate under § 541 of the Bankruptcy Code. *In re Nejberger*, 934 F.2d at 1302. As such, the rights are subject to sale by Trustee. The knowledge that they will have the first opportunity to renew their seats next season is part of the inducement to fans to buy season tickets. Even if season ticket holders do not attend all games or the team has a losing season, they realize that next year's performance might be better and they will have the first opportunity to buy tickets which are in very high demand. This, in addition to the fact that only a few single Steeler game tickets may be available to the public at large in any given year, is at least part of the reason that season tickets with their renewal rights are in demand.[23] *See* page 493, *supra.* Because the sale of renewal rights is not the sale of evidence of admission to an event, the sale herein does not violate the Pennsylvania anti-scalping law.

Sports, Inc.'s offer to Trustee to purchase season tickets was not a qualified or limited offer. It was the same as every other offer made for the last sixty years to its season ticket holders.[24] No justification has been advanced for the application of a different procedure or principle where the interest to be sold has value for the estate.

22. Trustee argued that Sports, Inc. is bound to honor the transfer of renewal rights because a course of dealing has been established over the course of the past sixty years. A course of dealing has been defined as prior conduct between parties to a particular transaction which reasonably can be construed to establish an understanding. *H.R. Woolridge Co. v. Smith*, 5 Pa.D. & C.3d 230 (Clearfield Co., Pa.1978). The evidence does not disclose previous dealings between Sports, Inc. and the buyers, but the Debtor, and Trustee through the Debtor, was a season ticket holder for many years. Thus, Trustee legitimately expects to have his transfer request honored by Sports, Inc. and so it must be. The expectancy which Sports, Inc. created requires it to accord to Trustee the same treatment it has provided all other season ticket holders. Concerning expectancy rights of those on the waiting list, we note that if those on the waiting list have an expectancy interest at all, it is only to be offered an opportunity to buy season tickets when and if they become available and when and if Sports, Inc. so desires to make the offer. There is no expectancy as to the events which might lead to the availability of season tickets.

23. In addition to enabling it to receive revenue from television advertising during sold out games, the sale of season tickets means that Sports, Inc. has money in hand early on and does not have to wait game to game to determine if a sell-out exists.

24. The exception concerned the 1979 seat construction contracts.

sale proceeds denied. Furthermore, these legal theories were not raised at the hearing. Plaintiffs did *not* seek, in presenting their case, to avoid Kossman's liens pursuant to 11 U.S.C. §§ 545(3) and (4). Rather, Plaintiffs sought at the hearing to defeat the liens by evidence which was intended to show that they had complied with the notice requirements of 68 Pa.C.S.A. § 250.403 by posting notice of Sheraden's security interest in the equipment on a visible part thereof. Such evidence would *not* tend to establish that Kossman's liens are avoidable pursuant to 11 U.S.C. §§ 545(3) and (4).

Furthermore, it would appear that when the late Judge Gibson issued the Order of February 28, 1984, granting Kossman relief from stay, that the Court implicitly intended thereby to permit Kossman to distrain and to retain the proceeds derived from selling Debtors' equipment and furniture. Contrary to Debtors' contention, it is unlikely that the Court intended to lift the automatic stay to allow the landlord to take judgment, inventory the items, and distrain the personalty only to permit the Debtors thereafter to avoid same.

By negative implication, implicit in the February 28, 1984 Order, the Court permitted the actions and refused to permit the avoidance thereof. That decision of this Court in February of 1984, whether right or wrong, went unchallenged and now constitutes the law of the case. This Court is bound by same.

Appropriate Orders will be issued.

ORDER OF COURT

AND NOW at Pittsburgh in said District this 7th day of September, 1989, in accordance with the foregoing Memorandum Opinion of this same date, it is hereby ORDERED, ADJUDGED and DECREED that:

(1) The claim of Paul Kossman to the sale proceeds in the above-captioned case is GRANTED; and the claim of Sheraden Bank to the sale proceeds in the above-captioned case is DENIED;

(2) The distribution of expenses of sale in the sum of $1,131.45; attorneys' fees and costs in the sum of $1,928.60; and the balance available in the sum of $3,462.95 to Paul Kossman is authorized and APPROVED; and

(3) Counsel for Debtor, The Egg Crate, Inc., are authorized to disburse the funds as set forth above.

ORDER OF COURT

AND NOW at Pittsburgh in said District this 7th day of September, 1989, in accordance with the foregoing Memorandum Opinion of this same date, it is hereby ORDERED, ADJUDGED and DECREED that:

(1) The claim of Paul Kossman to the sale proceeds in the above-captioned case is GRANTED; and the claim of Sheraden Bank to the sale proceeds in the above-captioned case is DENIED;

(2) The distribution of expenses of sale in the sum of $1,045.59; attorneys' fees and costs in the sum of $2,967.85; and the balance available in the sum of $4,153.26 to Paul Kossman is authorized and APPROVED; and

(3) Counsel for Debtor, The Chicken Coop, Inc., are authorized to disburse the funds as set forth above.

In re Emily DAVIS, a/k/a Emily Winn, Debtor.

Robert J. TAYLOR, Trustee, Plaintiff,

v.

FREELAND & KRONZ, a partnership; Wendell G. Freeland; Richard F. Kronz; and Emily Davis, Defendants.

Bankruptcy No. 84-2291.
Adv. No. 88-0446.

United States Bankruptcy Court, W.D. Pennsylvania.

Sept. 7, 1989.

Chapter 7 trustee brought suit seeking to avoid postpetition transfers and to recov-

er property transferred based on Chapter 7 debtor's settlement of employment discrimination suit. The Bankruptcy Court, Bernard Markovitz, J., held that: (1) failure of party to object to claimed exemption requires allowance of exemption only if exemption has statutory basis, and (2) percentage of Chapter 7 debtor's settlement of employment discrimination suit for "tort claims" plus interest at prevailing legal rate from date of initial transfer could not be claimed exempt under Bankruptcy Code as compensation for loss of future earnings, despite debtor's contention that such portion of settlement in reality was for lost wages but was described as being tort claims in order to avoid payment of applicable taxes.

Motion granted in part and denied in part.

1. Bankruptcy ⊂=2793

When debtor's claimed exemption is upheld by bankruptcy court, property so exempted no longer is considered property of estate. Bankr.Code, 11 U.S.C.A. § 522.

2. Bankruptcy ⊂=2799

Bankruptcy Code provision that, unless party objects, property claimed as exempt is exempt implicitly contains additional requirement that there be statutory basis for claimed exemption before failure of any party to timely object to claimed exemption as legal effect; failure to timely object does not automatically result in allowance of exemption as declared. Bankr.Code, 11 U.S.C.A. §§ 522, 522(b, *l*).

3. Bankruptcy ⊂=2781

Value of settlement of Chapter 7 debtor's employment discrimination suit as of date petition was filed, for purpose of determining amount that could be claimed exempt, was $110,000; settlement agreement ultimately entered had value of about $110,000. Bankr.Code, 11 U.S.C.A. § 522(a)(2).

4. Bankruptcy ⊂=2781

Percentage of Chapter 7 debtor's settlement of employment discrimination suit for "tort claims" plus interest at prevailing legal rate from date of initial transfer could not be claimed exempt under Bankruptcy Code as compensation for loss of future earnings, despite debtor's contention that such portion of settlement in reality was for lost wages but was described as being tort claims in order to avoid payment of applicable taxes. Bankr.Code, 11 U.S.C.A. § 522(d)(11).

5. Estoppel ⊂=68(2)

Debtor and debtor's attorneys, who took position in prior employment discrimination suit brought by debtor that portion of settlement was for tort losses, were judicially estopped in debtor's Chapter 7 case from asserting that settlement was really for lost wages, for purpose of debtor's claim that portion of settlement was exempt as compensation for loss of future earnings. Bankr.Code, 11 U.S.C.A. § 522(d)(11).

6. Bankruptcy ⊂=2802

Bankruptcy court declined to order that trustee be paid portion of settlement received by Chapter 7 debtor, in employment discrimination suit, in excess of that required to pay all of debtor's creditors with interest as well as legal fees and costs of trustee, even if it could not be claimed as exempt, based on trustee's failure to timely object to debtor's claimed exemption of proceeds; turning over remainder of assets to trustee would permit trustee to deduct additional fees for administering additional assets, even though remainder would ultimately be returned to debtor and debtor's attorneys. Bankr.Code, 11 U.S.C.A. § 522(d), (d)(11).

Stanley E. Levine, Campbell & Levine, Pittsburgh, Pa., for debtor/defendant.

Gary W. Short, Pittsburgh, Pa., for plaintiff.

Kenneth P. Simon, Simon & Simon, Pittsburgh, Pa., for defendants, Freeland & Kronz, Wendell G. Freeland and Richard F. Kronz.

Robert J. Taylor, Ambridge, Pa., Trustee.

MEMORANDUM OPINION

BERNARD MARKOVITZ, Bankruptcy Judge.

Before the Court is the Trustee's *Complaint To Avoid Post-Petition Transfers, And To Recover The Property Transferred Or The Value Of Such Property.* Specifically, Robert J. Taylor, Trustee ("Trustee") seeks to avoid and recover certain postpetition transfers of the proceeds of the settlement of a legal action brought by Emily Davis ("Debtor") against Trans World Airlines ("TWA").

The Trustee contends that the payment of that portion of the settlement which was allocated to lost wages suffered by Debtor prior to the bankruptcy filing is "property of the estate" and consequently, any transfer thereof is avoidable pursuant to 11 U.S.C. § 549(a). The Trustee further claims that, pursuant to 11 U.S.C. § 550(a), he is entitled to recover $67,349.00, plus interest, which sum is the alleged value of the estate's interest in the cause of action at the time the bankruptcy petition was filed.

Defendants argue that the proceeds of the settlement are not "property of the estate". In the alternative, Defendants aver that if they were estate assets, said assets were exempted by Debtor. Defendants opine that as no party in interest, including the Trustee, has objected to the exemption of the cause of action, said exemption, whether having a statutory basis or not, should be permitted.

The Court has heard the testimony of the parties, reviewed all of the exhibits, and researched the law, and now finds that the Trustee may avoid and recover $23,483.75, plus interest. Said sum will be sufficient to pay all creditors one hundred percent (100%) of their claims plus interest, if interest is appropriate. In addition, excess funds will be available for payment of appropriate administrative fees and costs. Any sum not utilized will be returned to Defendants.

FACTS

Debtor filed a voluntary petition under Chapter 7 of the Bankruptcy Code on October 24, 1984. At the time of the filing, Debtor was pursuing a legal action against TWA alleging employment discrimination. Debtor had filed a complaint in April of 1978 with the Pittsburgh Human Relations Commission ("Commission") in which she alleged that TWA had discriminated against her in denying promotions on account of her race and sex.

The Commission found in favor of Debtor on December 16, 1980. It did not, however, award damages at that time; rather, it directed TWA to submit further information in order that the amount of damages might be determined.

TWA appealed the Commission's decision to the Court of Common Pleas of Allegheny County, Pennsylvania. At that point, prior counsel's representation was terminated and the law firm of Freeland & Kronz was retained to represent the Debtor. The Commission's decision was reversed by the Court of Common Pleas on September 23, 1981.

Debtor appealed this decision to the Commonwealth Court of Pennsylvania, which reversed the decision of the Court of Common Pleas, and reinstated the decision of the Commission on June 27, 1983.

TWA then petitioned the Pennsylvania Supreme Court for an Allowance of Appeal, which was granted in November of 1983. The decision of the Commonwealth Court was affirmed on November 29, 1984 by an equally divided vote of the Supreme Court. Mr. Justice Papadakos, who as a Common Pleas Judge had previously reversed the decision of the Commission, did not participate in the decision.

TWA thereafter petitioned the Pennsylvania Supreme Court to permit it to file an Application For Reargument Out Of Time. The Application was allowed and the matter was reargued on September 16, 1986. On October 1, 1986, the Supreme Court concluded that reargument had been improvidently granted and dismissed the appeal of TWA.

Debtor's cause of action against TWA was before the Pennsylvania Supreme

Court for the first time when she filed her Chapter 7 voluntary petition on October 24, 1984. The appeal by TWA had been briefed and argued, but was not decided until approximately five (5) weeks later.

Debtor listed the proceeds of the legal action against TWA with an unknown value on Bankruptcy Schedule B-2. She also claimed the proceeds of the cause of action as exempt on Schedule B-4 pursuant to 11 U.S.C. §§ 522(b) and (d) and listed its value as "unknown". In addition, Debtor stated on Schedule A-2 that there were no creditors holding security and on Schedule A-3 listed a total of $11,069.59 in liquidated and undisputed liabilities to unsecured creditors.

Robert F. Taylor, Esq., was appointed Interim Trustee on November 26, 1984, and he presided over a Section 341(a) Meeting of Creditors on January 4, 1985. Debtor and her bankruptcy counsel attended the meeting and they indicated a possible recovery in the cause of action against TWA of $90,000.00. The Proceeding Memo prepared by the Trustee evidenced Debtor and/or Debtor's counsel's acknowledgement of the litigation and its potential value, and noted that the matter was on appeal at that time.

The Trustee, on various occasions prior to and subsequent to the time frame for objecting to exemptions, advised Debtor of his legal position that the cause of action was an asset of the estate; however, on no occasion did he perform the obvious, namely, formally object to the exemption of this estate asset.

Debtor received a discharge from bankruptcy on October 16, 1985; however, the case has never been closed.

On September 11, 1987, Debtor executed a settlement agreement with TWA which had a value approximating $110,000.00. Debtor granted TWA a release of all claims against it in consideration of $95,000.00 in cash, plus other valuable consideration (travel vouchers) worth approximately $15,000.00.

According to the precise and agreed upon terms of the settlement contract negotiated by the parties, the consideration to Debtor was to be "... paid, allocated, and apportioned ..." as follows:

(1) $23,483.75, less applicable taxes, was to be paid to Debtor "as and for back pay or front pay";

(2) An additional $23,483.75 was to be paid to Debtor "... as and for all alleged tort claims or any other claims not represented (sic) asserted wage losses"; and

(3) $63,032.50 was to be paid to Debtor and Freeland & Kronz for attorney's fees and costs. Of this amount, $48,032.50 was to be paid in cash. The remaining $15,000.00 consisted of "miscellaneous charge orders" (i.e., travel vouchers) which could be used either by Freeland & Kronz or their designees for the purchase of air transportation from TWA.

On September 17, 1987, TWA issued a check payable to Debtor and Freeland & Kronz in the amount of $71,516.25, in satisfaction of those portions of the settlement allocated to tort claims ($23,483.75) and to attorney's fees and costs ($48,032.50).

On September 21, 1987 TWA issued another check, payable to Debtor, in satisfaction of that portion of the settlement allocated to back pay or front pay. The check was in the amount of $16,614.75, with the remaining $6,689.00 deducted for taxes.

On October 21, 1987 Freeland & Kronz disbursed the check for $71,516.25 as follows: $32,159.50 was distributed to Debtor; the remaining $39,356.75 was distributed to Freeland & Kronz.

Freeland & Kronz also received, pursuant to the settlement, $15,000.00 worth of travel vouchers. It retained $7,500.00 worth of them and assigned the remaining $7,500.00 worth to Debtor for her own use.

The Trustee sent a letter to Freeland & Kronz on May 2, 1988, requesting information on the status of Debtor's cause of action. Richard Kronz informed the Trustee of the settlement on May 6, 1988.

On October 8, 1988, the Trustee commenced the present adversary proceeding by filing a Complaint To Avoid Post-Peti-

tion Transfers, And To Recover The Property Distributed Or The Value Of Such Property.

ANALYSIS

With certain exceptions not relevant here, the trustee may avoid any postpetition transfer of "property of the estate" of a debtor that is not authorized under the Code or by the Court. 11 U.S.C. § 549(a). In addition, the trustee may recover, for the benefit of the estate, either the property transferred or the value of such property from the initial transferee or any immediate transferee of such initial transferee. 11 U.S.C. § 550(a).

11 U.S.C. § 541 defines, with substantial specificity, what kinds of property are "property of the estate". Congress intended a broad range of property to be brought into the estate. *U.S. v. Whiting Pools,* 462 U.S. 198, 204, 103 S.Ct. 2309, 2313, 76 L.Ed.2d 515 (1983). Section 541 includes all kinds of property, both tangible and intangible, cause of action, and all other forms of property formerly specified in Section 70(a) of the old Bankruptcy Act. 4 Collier on Bankruptcy ¶ 541.01 at 541–5 (15th ed. 1989), *citing to* H.R.Rep. No. 595, 95th Cong., 1st Sess. 367–68 (1977); S.Rep. No. 989, 95th Cong., 2d Sess. 82–3 (1978), U.S.Code Cong. & Admin.News 1978, p. 5787. It even includes property needed for a debtor's fresh start. *Warren v. G.M. Scott & Sons,* 34 B.R. 543, 544 (Bankr.S.D. Ohio 1983).

[1] Once property is included in the bankruptcy estate, the debtor may exempt it pursuant to 11 U.S.C. § 522. The Bankruptcy Court must then determine what property may be exempted and what remains property of the estate. *See* 4 Collier on Bankruptcy ¶ 541.01 at 541–6 (15th ed. 1989). When a claimed exemption is upheld by the court, the property so exempted no longer is considered property of the estate. *See In re Gagnard,* 17 B.R. 811, 813 (Bankr.D.La.1982).

Defendants contend that the proceeds of the settlement were exempted from Debtor's estate, and hence are not subject to 11 U.S.C. §§ 549(a) and 550(a), as neither the Trustee, nor any other party in interest, ever objected to Debtor's claimed exemption in the proceeds of the cause of action.

11 U.S.C. § 522(*l*) provides in relevant part that:

> The debtor shall file a list of property that the debtor claims as exempt under subsection (b) of this section.... Unless a party in interest objects, the property claimed as exempt is exempt.

There is a significant difference of opinion among those courts which have considered the matter as to whether a claimed exemption that is not objected to in a timely manner by a party in interest is thereby granted in every instance.

[2] Some courts have held that failure of any party in interest to timely object to a claimed exemption results in allowance of the exemption *as declared. See In re Grossman,* 80 B.R. 311 (Bankr.E.D.Pa. 1987); *In re Hawn,* 69 B.R. 567 (Bankr.E. D.Tenn.1987); *In re Hahn,* 60 B.R. 69 (Bankr.D.Minn.1986); *In re Kretzer,* 48 B.R. 585 (Bankr.D.Nev.1985); *Matter of Thomas,* 43 B.R. 201 (Bankr.M.D.Ga.1984); *Matter of Wiesner,* 39 B.R. 963 (Bankr.W. D.Wis.1984); *Matter of Gullickson,* 39 B.R. 922 (Bankr.W.D.Wis.1984).

Other courts have voiced concern that rigid enforcement of § 522(*l*), without further qualification, would permit what is tantamount to "exemption by declaration". They construe this subsection as implicitly containing the additional requirement that there be a statutory basis for the claimed exemption before the failure of any party in interest to timely object to it has any legal effect. *See Matter of Dembs,* 757 F.2d 777 (6th Cir.1985); *In re Rollins,* 63 B.R. 780 (Bankr.E.D.Tenn.1986); *In re Bennett,* 36 B.R. 893 (Bankr.W.D.Ky.1984).

Although plausible arguments can be made in support of either of these positions, this Court is convinced that the view articulated in *In re Bennett, supra* at 894–95, is the superior view. The Court is persuaded by the explicit incorporation by reference in subsection (1) of the provisions of subsection (b), which limits exemptions to:

> "... any property that is exempt *under federal law* ... or *state law* or *local law* that is applicable on the date of the filing of the petition."

11 U.S.C. § 522(b) (Emphasis added.)

If Debtor may select in any manner her exemptions, then no purpose is served by the inclusion of the emphasized terms. We decline to determine that Congress inserted the terms but refused to grant them meaning.

There are also policy considerations which make the latter view the better one. The former view would encourage certain debtors of questionable integrity to claim *all* of their property as exempt, thereby leaving it to the trustee and creditors to challenge such claims. Orderly administration of such debtors' estates would be difficult, if not impossible, and uncertainty and constant litigation, if not outright chaos, would result. *See In re Bennett, supra.* The debtor could gamble that the trustee would be inept and/or negligent in fulfilling his mandated duties. If correct, the debtor would collect ill-gotten gain while his creditors suffered the loss. Again, this surely would not be the congressional intent.

[3] Both sides have urged this Court to disregard the language of the settlement agreement in determining the precise nature of the settlement. They instead urge this Court to characterize the settlement in ways which are fanciful at best, and require leaps of imagination which the Court is unwilling to make. The only acceptable basis for determining the meaning of the settlement is found in the language used therein.

Defendants correctly point out that the value of any interest in property which a debtor wishes to exempt must be ascertained as of the date the bankruptcy petition was filed. *See* 11 U.S.C. § 522(a)(2). They strenuously argue that the value of the cause of action against TWA, as of October 24, 1984, was approximately $10,000.00.

Before Debtor filed her voluntary petition, the Commonwealth Court of Pennsylvania had reversed the unfavorable decision of the Court of Common Pleas and had reinstated the favorable decision of the Commission. The Commonwealth Court of Pennsylvania determined that TWA owed the Debtor a sum of money.

In addition, although damages had not yet been determined, Debtor and her bankruptcy counsel stated on January 4, 1985, at the first meeting of creditors, that she anticipated a recovery of $90,000.00. This belies the contention made at trial that the cause of action had a value of merely $10,000.00 as of October 24, 1984.

The Court finds that the value of the cause of action on October 24, 1984 was $110,000.00. John Meyer, Esq., at the time an associate of Freeland & Kronz, testified that the attitude of his employer at that time was that their client's cause of action had great value. Over 500 hours were ultimately expended on the case. Moreover, Freeland & Kronz at no time ever suggested to their client that she settle the action for such a nominal amount of $10,000.00. That Debtor was able to realize the full value of her cause of action is further evidence of its value.

[4] Debtor, in her Schedule B-4, refers to § 522(d) in support of the claimed exemption. In particular, she appears to rely upon 11 U.S.C. § 522(d)(11), which exempts:

> [a] payment in compensation of loss of future earnings of the debtor ... to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

There is no statutory basis for that portion of the $71,516.25 postpetition cash payment by TWA to Freeland & Kronz and Debtor for "... tort claims or any other claims not represented (sic) wage losses". The Trustee may avoid and recover from Freeland & Kronz (as initial transferee) and Debtor (as the immediate transferee of Freeland & Kronz) $23,483.75, that portion of the settlement allocated for so-called "tort claims", plus interest at the prevailing legal rate, from the date of the initial transfer on September 17, 1987.

Defendant testified that this portion of the settlement in reality was for lost

wages, but was described as being for tort claims in order to avoid payment of applicable taxes. As far as can be determined, no taxes were ever withheld or ultimately paid for this portion of the settlement. Neither Defendant can now argue that it really was for lost wages and therefore may be exempted pursuant to 11 U.S.C. § 522(d)(11). In effect, they are utilizing a knife and averring that it only cuts one way. As Defendants treated this payment as a tort recovery and failed and/or refused to pay taxes on it, this Court feels constrained to and must order that it be returned to the Trustee. There is no statutory basis permitting an exemption of this "tort recovery".

[5] Also, Defendants are prevented by the doctrine of judicial estoppel from asserting in the present proceeding that this portion of the settlement was actually for lost wages. The doctrine of judicial estoppel is applicable at any time that a litigant plays "... fast and loose with the courts ...". *Scarano v. Central R. Co. of New Jersey,* 203 F.2d 510, 513 (3rd Cir.1953). According to the doctrine, "a party may be precluded by a prior position taken in litigation from later adopting an inconsistent position in the course of a judicial proceeding". *Id.* Defendants unquestionably took the position in the previous legal action that that portion of the settlement now under discussion was for tort losses. It was to their benefit and in their interest to do so. Consequently, they cannot now be heard to maintain that it is really for lost wages. They made their choice and are bound thereto.

As has been indicated, when Debtor filed her voluntary Chapter 7 petition on October 24, 1984, she listed a total of $11,069.59 in liquidated and undisputed liabilities on Schedule A-3. Requiring Defendants to return the $23,483.75 portion of the settlement for averred tort losses will produce a *res* sufficient to pay all of Debtor's creditors, with interest, as well as the legal fees and costs incurred by counsel to the Trustee for prosecuting the present action.

[6] Consequently, it is not necessary for this Court to also determine whether any of the remaining portions of the settlement should be returned to the Trustee. Even supposing for the moment that some or all of the remainder also should be returned, this Court declines to do so. As all of Debtor's creditors will be paid in full, the remainder ultimately would be returned to Defendants by the Trustee, after said Trustee deducted additional fees for administering the additional assets. This Court, however, is unwilling to allow the Trustee to so benefit from his own dereliction of duty and/or ignorance of bankruptcy law in failing to object in a timely fashion to Debtor's claimed exemption for the proceeds of her lawsuit against TWA. Had the Trustee acted with knowledge and/or diligence, the present action, in all likelihood, never would have arisen.

An appropriate Order will be issued.

ORDER OF COURT

AND NOW at Pittsburgh in said District this 7th day of September, 1989, in accordance with the foregoing Memorandum Opinion of this same date, it is hereby ORDERED, ADJUDGED and DECREED that Defendants Emily Davis and Freeland & Kronz, return to Plaintiff Robert J. Taylor, Trustee, the amount of $23,483.75, plus interest at the prevailing legal rate.

In re James R. GREELEY, Debtor.

Timothy ANDERSON, Plaintiff,

v.

James R. GREELEY, Larry Slagle d/b/a Slagle Service, Defendants.

Bankruptcy No. 87-249E.
Adv. No. 87-0074.

United States Bankruptcy Court,
W.D. Pennsylvania.

Sept. 29, 1989.

Debtor's former partner claimed interest in truck. The Bankruptcy Court, War-

eight (8%) percent. Debtors arrived at this figure by computing the average of various rates published in the May 17, 1990 edition of the Wall Street Journal.[1] As debtors' plan does not comply with the law in this district, which is that unless the parties can establish the exact amount of the creditor's cost of funds in its business borrowing, the proper rate of interest to be applied under 11 U.S.C. § 1325(a)(5)(B)(ii) is the rate of yield for Treasury bills due to mature on the date the debtors' plan terminates plus one percent,[2] *In re Mitchell,* 77 B.R. 524, 529 (Bankr.E.D.Pa.1987);[3] *Collier on Bankruptcy,* 15th Ed., ¶ 1325.06 at 1325-40—1325-42, we sustain Signal's objection to confirmation.

An appropriate order follows.

ORDER

AND NOW, this 13th day of September, 1990, it is ORDERED that the objection filed by Signal Consumer Discount Company to confirmation of debtors' chapter 13 plan is SUSTAINED.

In re Emily DAVIS, a/k/a Emily Winn, Debtor.

Robert J. TAYLOR, Trustee, Plaintiff,

v.

FREELAND & KRONZ, a partnership, Wendell G. Freeland, Richard F. Kronz and Emily Davis, Defendants.

Civ. A. No. 89-2156.
Bankruptcy No. 84-2291.
Adv. No. 88-446.

United States District Court,
W.D. Pennsylvania.

Sept. 7, 1990.

Chapter 7 trustee brought suit seeking to avoid postpetition transfers and to recover property transferred based on debtor's settlement of employment discrimination suit. The United States Bankruptcy Court for the Western District of Pennsylvania, Bernard Markovitz, J., 105 B.R. 288, ordered debtor and her counsel to return proceeds allocated for settlement of tort claims. Debtor and her counsel appealed. The District Court, Bloch, J., held that: (1) failure of trustee to timely object to debtor's claimed exemption in proceeds of lawsuit did not render proceeds exempt, where there was no statutory basis for claiming as exempt that part of proceeds which represented recovery for tort claims; (2) Bankruptcy Court did not commit reversible error in valuing lawsuit without specific reference to attorney's lien; and (3) doctrine of judicial estoppel barred debtor and counsel from asserting in bankruptcy proceed-

1. The rates published in the May 17, 1990 edition of the Wall Street Journal, appended to the parties' Stipulation of Facts as Exhibit F, did not include the rate of yield for Treasury bills due to mature on the date debtors' plan terminates.

2. We decline to apply the rate of interest specified in the parties' contract because the cases which adopted this approach, *see, In re Einspahr,* 30 B.R. 356 (Bankr.E.D.Pa.1983); *In re Evans,* 20 B.R. 175, 177 (Bankr.E.D.Pa.1982), were decided prior to the Bankruptcy Amendments and Federal Judgeship Act of 1984 and therefore, did not consider the fact that during the legislative process leading to the enactment of the 1984 Amendments, Congress specifically considered an amendment requiring the contract rate of interest to be paid and rejected it. *Collier on Bankruptcy,* 15th Ed., ¶ 1325.06 at 1325-40—1325-41.

3. As the issue is not before us today, we express no opinion regarding the proper rate of interest to be applied in the chapter 11 context under 11 U.S.C. § 1129(b)(2)(A)(i)(II), however, we note that Collier appears to advocate that different approaches be applied in the chapter 11 and chapter 13 contexts. *Collier on Bankruptcy,* 15th Ed., ¶ 1129.03 at 1129-83, ¶ 1325.06 at 1325-40—1325-42.

ing that portion of settlement, which had been allocated for tort claims in lawsuit, in reality represented pension benefits.

Affirmed.

1. Bankruptcy ⇐2794

Provision of Bankruptcy Code stating that property claimed as exempt is exempt unless party in interest objects contains additional implicit requirement that there be statutory basis for claimed exemption before failure of any person in interest to timely object to it has any legal effect. Bankr.Code, 11 U.S.C.A. § 522(*l*).

2. Bankruptcy ⇐2801

Trustee's failure to timely object to debtor's claimed exemption in proceeds of lawsuit did not render proceeds exempt, where there was no statutory basis for claiming as exempt that part of proceeds which represented recovery for tort claims. Bankr.Code, 11 U.S.C.A. § 522(b, *l*); Bankruptcy Rule 4003(b), 11 U.S.C.A.

3. Bankruptcy ⇐2556

Bankruptcy court did not commit reversible error in valuing debtor's lawsuit without specific reference to attorney's lien, where bankruptcy court avoided only a portion of amount transferred to debtor and her counsel for settlement, and thus allowed for full amount of attorney's lien.

4. Estoppel ⇐68(2)

Doctrine of judicial estoppel barred debtor from asserting in bankruptcy proceeding that portion of settlement, which had been allocated for tort claims in lawsuit, in reality represented pension benefits, and thus that portion of settlement was exempt, despite debtor's contention that settlement described that portion of settlement as being for tort claims only to avoid payment of applicable taxes.

Gary W. Short, appellee, Pittsburgh, Pa., for plaintiff.

Stanley E. Levine, Kenneth P. Simons, appellants, Pittsburgh, Pa., for defendants.

MEMORANDUM OPINION

BLOCH, District Judge.

In this bankruptcy action, defendants appeal the decision of the bankruptcy court allowing the trustee of the bankruptcy estate of Emily Davis (the debtor) to recover certain post-petition transfers. For the reasons that follow, this Court affirms the award of the bankruptcy court.

I. Facts

The debtor filed a voluntary petition under Chapter 7 of the Bankruptcy Code (the Code) on October 24, 1984. At the time of the filing, the debtor was pursuing a legal action against her employer, Trans World Airlines (TWA). In a complaint filed with the Pittsburgh Human Relations Commission (Commission), the debtor alleged that TWA had discriminated against her in denying her promotions on the basis of her race and sex. The Commission found in the debtor's favor on December 16, 1980, but did not award damages at that time. When TWA appealed the Commission's decision to the Court of Common Pleas of Allegheny County, Pennsylvania, the debtor retained defendant Freeland & Kronz to represent her.

The Court of Common Pleas reversed the Commission's decision on September 23, 1981. The debtor appealed the decision to the Commonwealth Court of Pennsylvania, which reversed the decision of the Court of Common Pleas and reinstated the Commission's decision. TWA was then granted an allowance of appeal by the Pennsylvania Supreme Court. The Pennsylvania Supreme Court, however, had not rendered a decision at the time that the debtor filed her petition.[1]

In her schedule of assets and liabilities, the debtor listed the proceeds of the TWA lawsuit with an unknown value on Bank-

1. The decision of the Commonwealth Court was affirmed on November 29, 1984. The Pennsylvania Supreme Court later granted TWA's petition for reargument. On October 1, 1986, the Court concluded that reargument had been improvidently granted and dismissed TWA's appeal.

ruptcy Schedule B–2. The debtor also claimed the proceeds of the cause of action as exempt on Schedule B–4 pursuant to 11 U.S.C. §§ 522(b) and (d), and listed its value as unknown. The debtor stated on Schedule A–2 that there were no creditors holding security. The debtor listed a total of $11,069.59 in liquidated and undisputed liabilities to unsecured creditors on Schedule A–3.

On January 4, 1985, the trustee presided over a § 341(a) meeting of creditors. The debtor and her counsel attended the meeting and indicated a possible recovery of $90,000 in the TWA lawsuit. Although the trustee advised the debtor on several occasions of his opinion that the cause of action from the TWA lawsuit was an asset of the estate, he failed to formally object to the exemption within the 30–day time period required by Bankruptcy Rule 4003(b).

On September 11, 1987, the debtor executed a settlement agreement with TWA which had a value approximating $110,000. The debtor granted TWA a release of all claims against it in consideration of $95,000 in cash, plus other valuable consideration (travel vouchers) worth approximately $15,000. The settlement agreement provided that the consideration was to be paid as follows:

(1) $23,483.75, less applicable taxes, was to be paid to the debtor "as and for back pay and front pay";

(2) an additional $23,483.75 was to be paid to debtor "... as and for all alleged tort claims or any other claims not represented (sic) asserted wage losses"; and

(3) $63,032.50 was to be paid to debtor and Freeland & Kronz for attorney's fees and costs. Of this amount, $48,032.50 was to be paid in cash. The remaining $15,000 consisted of "miscellaneous charge orders" (i.e., travel vouchers) which could be used either by Freeland & Kronz or their designees for the purchase of air transportation from TWA.

When the trustee sent a letter to Freeland & Kronz requesting information on the status of the debtor's cause of action, Richard Kronz informed him of the settlement. On October 6, 1988, the trustee filed a complaint to avoid post-petition transfers and to recover property distributed or the value of such property. On September 7, 1989, the bankruptcy court ordered the defendants to return to the trustee $23,483.75, plus interest. That sum represented the proceeds allocated for the settlement of tort claims.

II. Discussion

[1, 2] The appellants first argue that the bankruptcy court erred as a matter of law when it allowed the trustee to recover proceeds of the debtor's TWA lawsuit which the debtor had claimed as exempt. The debtor's exemption claim was made pursuant to § 522(*l*) of the Bankruptcy Code, which provides:

> The Debtor shall file a list of property that the Debtor claims as exempt under subsection (b) of this section.... Unless a party in interest objects, the property claimed as exempt on such list is exempt.

11 U.S.C. § 522(*l*). The time limit for objecting to a claim of exemption is set forth in Bankruptcy Rule 4003(b):

> The Trustee or any creditor may file objections to the list of property claimed as exempt within 30 days after the conclusion of the meeting of creditors held pursuant to Rule 2003(a) or the filing of any amendment to the list unless, within such period, further time is granted by the court.

Because the trustee did not file objections to the debtor's claimed exemption within 30 days as required by Bankruptcy Rule 4003(b), the appellants argue that the proceeds of the debtor's lawsuit are exempt.

The bankruptcy court recognized that there is a difference of opinion among those courts which have considered the question whether a claimed exemption that is not objected to in a timely manner by a party in interest is thereby granted in every instance:

> Some courts have held that failure of any party in interest to timely object to a claimed exemption results in allowance of the objection *as declared. See In re Grossman,* 80 B.R. 311 (Bankr.E.D.Pa. 1987); *In re Hawn,* 69 B.R. 567 (Bankr.

E.D.Tenn.1987); *In re Hahn*, 60 B.R. 69 (Bankr.D.Minn.1986); *In re Kretzer*, 48 B.R. 585 (Bankr.D.Nev.1985); *Matter of Thomas*, 43 B.R. 201 (Bankr.M.D.Ga. 1984); *Matter of Wiesner*, 39 B.R. 963 (Bankr.W.D.Wis.1984); *Matter of Gullickson*, 39 B.R. 922 (Bankr.W.D.Wis. 1984).

Other courts have voiced concern that rigid enforcement of § 522(1), without further qualification, would permit what is tantamount to "exemption by declaration." They construe this subsection as implicitly containing the additional requirement that there be a statutory basis for the claimed exemption before the failure of any party in interest to timely object to it has any legal effect. *See Matter of Dembs*, 757 F.2d 777 (6th Cir. 1985); *In re Rollins*, 63 B.R. 780 (Bankr. E.D.Tenn.1986); *In re Bennett*, 36 B.R. 893 (Bankr.W.D.Ky.1984).

In re Davis, 105 B.R. 288, 292 (W.D.Pa. 1989).

Several factors persuaded the bankruptcy court to conclude that the latter view, as articulated in *In re Bennett*, was the better view. First, the bankruptcy court was persuaded by the explicit incorporation by reference in § 522(*l*) of § 522(b), which limits exemptions to "any property that is exempt under federal law ... or state law or local law that is applicable on the date of the filing of the petition." 11 U.S.C. § 522(b). The bankruptcy court concluded that no purpose would be served by § 522(b) if a debtor could select in any manner her exemptions. *In re Davis*, 105 B.R. at 293. Second, the bankruptcy court's decision was based upon policy considerations. The bankruptcy court concluded that the view articulated in *In re Grossman* would encourage debtors to claim all of their property as exempt, thereby hindering the orderly administration of the debtor's estates. *Id.*

This Court is similarly persuaded that § 522(*l*) contains the additional requirement that there be a statutory basis for a claimed exemption before the failure of any person in interest to timely object to it has any legal effect. In the present case, there was no statutory basis for claiming as exempt that part of the lawsuit's proceeds which represented recovery for tort claims. Allowing the debtor to recover proceeds for which there was no statutory basis would render § 522(b) negatory. Furthermore, the orderly administration of the debtor's estate would not be advanced by allowing her to claim as exempt any value which she had simply designated "unknown." If she were allowed to do so, the burden would shift to the trustee to insure that there was a statutory basis for each claimed exemption. If, as in the instant case, the trustee failed to dispute a claimed exemption,[2] the debtor's action essentially would amount to an exemption by declaration.

[3] The appellants next argue that the bankruptcy court erred as a matter of law when it included in its valuation of the debtor's cause of action attorney's fees which were incurred post-petition. The appellants argue that because they had a lien against certain of the proceeds, the estate could not recover those proceeds. In addition, the appellants contend that the bankruptcy court was clearly erroneous when it included in its valuation of the debtor's cause of action attorney's fees which were a separate element of a settlement made almost two years after the discharge, partially incurred post-petition and never claimed by the trustee. This Court, however, need not determine whether appellants had a valid lien against certain proceeds. By avoiding only $23,483.75 of the

2. Of the cases cited by the bankruptcy court for the proposition that failure to timely object to a claimed exemption results in allowance of the exemption as declared, only *In re Grossman*, 80 B.R. 311 (Bankr.E.D.Pa.1987), provides a rationale which incorporates more than a restatement of the express terms of § 522(1). In *Grossman*, the Court stated that "in most instances outlandish exemptions will be discovered" because the "trustee is permitted to object to objection claims, presides over the meeting of the creditors ... where exemption claims should be reviewed, and has a fiduciary obligation to protect the interests of creditors." 80 B.R. at 313. In the present case, this safeguard did not exist. Although the trustee advised the debtor before the deadline for making an objection that the cause of action was an asset of the estate, he failed to timely object to the debtor's claimed exemption.

$71,516.25 transferred, the bankruptcy court allowed for the full amount of the attorney's lien. Therefore, the bankruptcy court did not commit reversible error in valuing the lawsuit at $110,000 without specific reference to an attorney's lien.

[4] The appellants' final argument is that the bankruptcy court erred as a matter of law in holding that the doctrine of judicial estoppel prevented the appellants from asserting in the bankruptcy proceeding that a portion of the settlement, which had been allocated for tort claims in the TWA lawsuit, represented pension benefits. During the bankruptcy proceeding, "[d]efendant testified that this portion of the settlement in reality was for lost wages, but was described as being for tort claims in order to avoid payment of applicable taxes." *Davis,* 105 B.R. at 293–94. However, appellants now apparently seek to characterize the portion of the settlement differently because recovery for tort claims is not exemptable.

The general principle of judicial estoppel is that " '[a] party to litigation will not be permitted to assume inconsistent or mutually contradictory positions with respect to the same matter in the same ... suit[s].' " *Scarano v. Central R. Co. of New Jersey,* 203 F.2d 510, 513 (3d Cir.1953). Appellants have assumed inconsistent positions with respect to the proceeds from the TWA lawsuit. Appellants now maintain that the reason for the mischaracterization of the proceeds was to avoid income tax liability. Appellants cite *City of Kingsport v. Steel & Roof Structure, Inc.,* 500 F.2d 617, 620 (6th Cir.1974), for the proposition that the doctrine of judicial estoppel does not apply to settlement agreements. In *City of Kingsport,* the Court held that because of the settlement of the plaintiff's case, the defense of the bar of statute of limitations was never decided and, therefore, no estoppel could exist. However, in the present case, the appellants assumed a position with regard to the proceeds of the TWA lawsuit during the first suit, and the proceeds were ultimately allocated pursuant to that characterization. Appellants may not now assume a contradictory position with regard to the proceeds allocated for tort claims.[3]

For the foregoing reasons, this Court affirms the order of the bankruptcy court directing the appellants to return to the trustee $23,483.75, plus interest at the prevailing legal rate.

An appropriate Order will be issued.

In re ALLEGHENY INTERNATIONAL, INC., Sunbeam Corporation, Sunbeam Holdings, Inc., Almet/Lawnlite Inc., and Chemetron Corporation, Debtors.

Claim of Cindy M. FRANCESCHELLI et al.

Bankruptcy No. 88–00448.
Motion No. 89–6162–M.
Claim Nos. 5925–5930.

United States Bankruptcy Court, W.D. Pennsylvania.

May 8, 1990.

Severance pay claims were filed by former full-time, salaried employees of employer which had filed Chapter 11 case. The Bankruptcy Court, Joseph L. Cosetti, Chief Judge, held that: (1) if employment contract allows for all terminated employees to receive severance pay equal to their salaries for a specified period of time, the entire sum is entitled to be treated as having administrative priority in employer's bankruptcy case; (2) where only employees who have served for certain period of time are entitled to severance pay and amount

3. Appellants seek to recharacterize the proceeds as being for pension benefits. Appellants argue that a "major component of the debtor's claim against TWA was for pension benefits." Having reviewed the record on appeal, this Court finds that the settlement did not, in fact, represent pension loss.

F.2d 1084, 1149–50 (3d Cir.1990) (admitting a taped conversation to show the relationships among co-conspirators), *cert. denied,* — U.S. —, 111 S.Ct. 2009, 114 L.Ed.2d 98 (1991); *United States v. O'Leary,* 739 F.2d 135, 136 (3d Cir.1984) (admitting other-acts evidence to provide background information and parties' acquaintanceship), *cert. denied,* 469 U.S. 1107, 105 S.Ct. 782, 83 L.Ed.2d 776 (1985); *United States v. Simmons,* 679 F.2d 1042, 1050 (3d Cir.1982) (admitting other-acts evidence occurring before the crime at issue to establish background information and a continuing relationship between the defendants), *cert. denied,* 462 U.S. 1134, 103 S.Ct. 3117, 77 L.Ed.2d 1370 (1983); *see also United States v. Jordan,* 722 F.2d 353, 356 (7th Cir.1983) (referring to the various circuits that have admitted evidence of prior bad acts when those acts have explained the circumstances, background, or development of the crime charged, or "completed the story of the crime on trial").

[19] Apart from meeting the standard of Fed.R.Evid. 404(b), however, other-acts evidence must be also be evaluated against the unfair prejudice standard of Fed.R. Evid. 403. Thus, a court may exclude logically relevant other-acts evidence if its probative value is substantially outweighed by the risk of undue prejudice. *Scarfo,* 850 F.2d at 1019; *United States v. Driggs,* 823 F.2d 52, 54 (3d Cir.1987). We have emphasized, however, the need for "judicial restraint" when an appellate court is reviewing a trial court's Rule 403 analysis. *Long,* 574 F.2d at 767. *See e.g., United States v. Dansker,* 537 F.2d 40, 58 (3d Cir.1976) (upholding district court's admission of other-acts evidence describing a relationship between the witness and the defendants), *cert. denied,* 429 U.S. 1038, 97 S.Ct. 732, 50 L.Ed.2d 748 (1977).

[20] We believe that the district court properly admitted evidence of Mr. Harris's prior acts, particularly his history of violence toward Mrs. Harris. Testimony about Mr. Harris's attempts to strangle and stab Mrs. Harris were highly probative in demonstrating his motive and intent as well as establishing that his wife's death was not accidental or suicidal. Moreover, Mr. Harris's statements that he would kill Mrs. Harris in a place other than St. Kitts were probative of Mr. Harris's intent, preparation, and the development of the crime charged. It also tended to prove that Mrs. Harris did not simply disappear from the area voluntarily.

Our primary inquiry, then, is whether the other-acts evidence "is probative of a material issue other than character." *Huddleston v. United States,* 485 U.S. at 686, 108 S.Ct. at 1499. We agree with the district court that the other-acts evidence was relevant, probative of many proper purposes, and not unfairly prejudicial. We find no abuse of discretion under Rule 403.

V. CONCLUSION

We will affirm the district court's denial of Mr. Harris's motion for acquittal. We hold that there was sufficient evidence to establish the corpus delicti for the jury's verdict of murder in the first degree and of possession of a dangerous weapon during the commission of a crime of violence. Moreover, the district court properly admitted evidence of Mr. Harris's past acts of violence toward the victim.

Robert TAYLOR, Appellee,

v.

FREELAND & KRONZ; Wendell G. Freeland; Richard F. Kronz, Appellants.

No. 90–3696.

United States Court of Appeals, Third Circuit.

Argued Feb. 28, 1991.

Decided July 8, 1991.

Chapter 7 debtor claimed exemption in potential proceeds from pending employ-

ment discrimination suit, no formal objection was filed, and debtor then settled suit. The United States Bankruptcy Court for the Western District of Pennsylvania, 105 B.R. 288, ordered debtor and her counsel in discrimination suit to return amount awarded in settlement for release of tort claims, and counsel appealed. The United States District Court for the Western District of Pennsylvania, 118 B.R. 272, Alan N. Bloch, J., affirmed. Counsel appealed. The Court of Appeals, Stapleton, Circuit Judge, held that property claimed as exempt by debtor is exempt in absence of objection filed within 30 days after creditors' meeting or filing of amendment to exemption list, even though claimed exemption may be invalid.

Reversed.

1. Bankruptcy ⊜2801

Property claimed as exempt by debtor is exempt in absence of objection filed within 30 days after creditors' meeting or filing of amendment to exemption list, even though claimed exemption may be invalid. Bankr.Code, 11 U.S.C.A. § 522(*l*); Bankruptcy Rule 4003(b), 11 U.S.C.A.

2. Bankruptcy ⊜2799

Potential proceeds of pending employment discrimination suit claimed as exempt by debtor were exempt, where no formal objection to claimed exemption was ever filed, even though bankruptcy trustee had mailed letter advising debtor and her counsel in discrimination suit that net proceeds of lawsuit were asset of bankruptcy estate. Bankr.Code, 11 U.S.C.A. § 522(*l*); Bankruptcy Rule 4003(b), 11 U.S.C.A.

Gary W. Short (argued), Pittsburgh, Pa., for appellee.

Kenneth P. Simon, Phillip S. Simon (argued), Simon & Simon, Pittsburgh, Pa., for appellants.

Before STAPLETON and ALITO, Circuit Judges, and CAHN, District Judge.*

OPINION OF THE COURT

STAPLETON, Circuit Judge:

This Chapter 7 bankruptcy case calls for us to interpret section 522 of the Bankruptcy Code. 11 U.S.C. § 522 (1988). Section 522(*l*) requires that a trustee or other party in interest file with the bankruptcy court any objections to property exemptions claimed by the debtor. In the absence of a filed objection, the property claimed as exempt by the debtor is exempt. The trustee in this case never filed an objection to the exemptions claimed by the debtor. Nevertheless, the bankruptcy court ordered the debtor and her attorneys to pay the trustee the value of part of the property the debtor had claimed as exempt. The district court affirmed. Because we conclude that such a result is unwarranted under the clear language of the Bankruptcy Code and Bankruptcy Rules, we will reverse the order of the district court.

I.

On October 24, 1984, Emily Davis filed a voluntary petition for bankruptcy under Chapter 7 of the Bankruptcy Code. Her total liabilities were $11,069.59. With her petition for bankruptcy, Davis filed the required "schedules" of her property. On Schedule B-2, on which the debtor lists personal property, Davis cited the potential proceeds of a discrimination lawsuit she had brought against TWA which was then pending on appeal. She indicated the value as "unknown." On Schedule B-4, on which a debtor claims property as exempt, Davis again identified the potential proceeds of the TWA lawsuit and listed the value as "unknown."

On November 26, 1984, Robert Taylor was appointed trustee in the bankruptcy proceeding. On January 4, 1985, Taylor conducted the statutorily required section

* Honorable Edward N. Cahn, United States District Judge for the Eastern District of Pennsylvania, sitting by designation.

341(a) meeting of the creditors of Davis' estate. *See* 11 U.S.C. § 341(a) (1988). Davis and her counsel attended and indicated a possible recovery of $90,000 in the case against TWA.

On January 7, 1985, Taylor mailed a letter to Wendell Freeland and Richard Kronz of Freeland & Kronz, Davis' counsel in the pending TWA suit, advising them that the net proceeds of the lawsuit were an asset of the bankruptcy estate. However, neither Taylor nor any party in interest ever filed with the court a formal objection to Davis' claimed exemptions.

On September 11, 1987, Davis executed a settlement agreement with TWA under which TWA was to pay Davis $110,000. Of this amount, $23,483.75 was allocated to Davis for "back pay or front pay," $23,483.75 to Davis for release of all alleged tort and other claims against TWA, and $63,032.50 to Freeland & Kronz for attorney's fees and costs. On September 17, 1987, TWA issued a check for $71,516.25 payable to Davis and Freeland & Kronz. This check covered the release of tort claims and the attorney's fees. On September 21, 1987, TWA issued another check, payable to Davis, for $16,614.75, which was the amount of her back and front pay after deduction for taxes. TWA also distributed $15,000 worth of travel vouchers to Freeland & Kronz pursuant to the settlement agreement.

On May 2, 1988, Taylor sent a letter to Freeland & Kronz requesting information on the status of Davis' cause of action against TWA. On May 6, 1988, Kronz informed Taylor of the settlement. On October 4, 1988, Taylor filed a complaint against Davis, Freeland & Kronz, Wendell Freeland, and Richard Kronz in the bankruptcy court to avoid post-petition transfers and to recover either the property transferred or the value of such property. On September 7, 1989, the United States Bankruptcy Court for the Western District of Pennsylvania ordered the defendants to return $23,483.75 plus interest to Taylor. 105 B.R. 288 (Bankr.W.D.Pa.1989). This represented the amount awarded in the TWA settlement for release of tort claims. Freeland & Kronz and the individuals Wendell Freeland and Richard Kronz (hereinafter Freeland & Kronz) appealed to the district court. On September 7, 1990, the United States District Court for the Western District of Pennsylvania affirmed the bankruptcy court's order. 118 B.R. 272 (W.D.Pa.1990). Freeland & Kronz filed a notice of appeal in this court from the district court's order.

The bankruptcy court had jurisdiction pursuant to 28 U.S.C. § 157. The district court had jurisdiction over the appeal pursuant to 28 U.S.C. § 158(a). We have jurisdiction pursuant to 28 U.S.C. § 158(d) over the appeal from the order of the district court.

II.

[1] The issue raised by this appeal is whether the bankruptcy court and the district court correctly interpreted section 522(*l*). Freeland & Kronz claims that the proceeds of Davis' TWA suit are exempt because Davis claimed them as exempt and no party in interest filed a timely objection to the claimed exemptions. Taylor argues that claimed exemptions that are invalid under section 522(b) cannot be considered valid solely because no party in interest filed an objection with the court. We exercise plenary review of this question of law. *Dawson v. United States*, 894 F.2d 70, 72 (3d Cir.1990).

The statutory background is not complicated. Once the bankruptcy estate is created, the debtor may exempt certain property from it pursuant to section 522. If the trustee or another party in interest objects to a claimed exemption, the bankruptcy court must determine pursuant to section 522(b)—the subsection that specifies the allowable exemptions—what property is exempt and what property remains property of the estate. When a claimed exemption is upheld by the court, the property so exempted is no longer considered property of the bankruptcy estate.

As noted, a threshold requirement must be met before the court may consider the validity of the claimed exemptions. Section 522(*l*) states: "The debtor shall file a list

of property that the debtor claims as exempt under subsection (b) of this section.... Unless a party in interest objects, the property claimed as exempt on such list is exempt." The Bankruptcy Rules, which took effect on August 1, 1983, flesh out the statutory requirements. Bankruptcy Rule 4003(b) provides: "The trustee or any creditor may file objections to the list of property claimed as exempt within 30 days after the conclusion of the meeting of creditors held pursuant to Rule 2003(a) or the filing of any amendment of the list unless, within such period, further time is granted by the court." Bankruptcy Rule 9006(b)(3) allows enlargement of the time period for taking action under certain bankruptcy rules, but specifically states that the court "may enlarge the time for taking action under Rule[ ] ... 4003(b) ... only to the extent and under the conditions stated in those rules."

The statute and rule establish a strict procedure for objections to claimed exemptions. Their import is clear and they admit of no exception. Unless the trustee or another party in interest objects to the debtor's claimed exemptions within the thirty-day period following the creditors' meeting or the amendment, the property claimed as exempt by the debtor is exempt. No provision of the Code provides that the failure to object is excused when the debtor's exemption claim is not advanced "in good faith," nor is there an exception provided for situations where a claimed exemption has only a questionable basis in section 522(b).

Despite the seemingly clear statutory scheme, the courts have not been unanimous in interpreting section 522(*l*). Courts have taken three different approaches to this issue. Under the first, the "literal" approach, a court will not examine the merits of a claimed exemption if an objection is not filed within the time allowed. *See, e.g., In Re Bradlow,* 119 B.R. 330 (Bankr.S.D.Fla.1990); *In re Duncan,* 107 B.R. 754 (Bankr.W.D.Okla.1988); *Doyle v. Grossman (In re Grossman),* 80 B.R. 311 (Bankr.E.D.Pa.1987) (citing earlier decisions by bankruptcy courts reaching the same result); *In re Payton,* 73 B.R. 31 (Bankr.W.D.Tex.1987).

Under the second approach, an objection is not necessary if the debtor's claimed exemption is invalid under section 522(b). *See, e.g., Stutterheim v. First State Bank, Alemena, KS (In re Stutterheim),* 109 B.R. 1010 (D.Kan.1989); *In re Staniforth,* 116 B.R. 127 (Bankr.W.D.Wis.1990); *In re Velis,* 109 B.R. 64 (Bankr.D.N.J.1989), *aff'd,* 123 B.R. 497 (D.N.J.1991); *In re Bennett,* 36 B.R. 893 (Bankr.W.D.Ky.1984). The *Bennett* court set forth the equitable considerations that other courts adopting this approach have found persuasive. The court first noted that, read literally, the statute is clear that unless a party objects the debtor's claimed exemptions are exempt. But the court refused to follow this language: "we are unable to give the expected legal effect to statutory language which, standing alone, seems perfectly clear." *Bennett,* 36 B.R. at 894. If it accepted such a reading, the court declared, the result would be "exemption by declaration," and we "would revert to the law of the streets, with bare possession constituting not nine, but ten, parts of the law; orderly administration of estates would be replaced by uncertainty and constant litigation if not outright anarchy." *Id.* at 895.

The third approach occupies a middle ground between the literal reading of the statute and *Bennett.* Under this approach, a court is to examine a claimed exemption, even when no timely objection has been formally filed, to determine if there exists a "good-faith statutory basis" for the claimed exemption. If there is a good-faith basis, the exemption is allowed; if there is not a good-faith basis, the exemption is not allowed. Two federal courts of appeals have adopted this approach. *See In re Peterson,* 920 F.2d 1389 (8th Cir.1990); *Munoz v. Dembs (Matter of Dembs),* 757 F.2d 777 (6th Cir.1985); *see also In re Indvik,* 118 B.R. 993 (Bankr.N.D.Iowa 1990).

In *Dembs,* the Sixth Circuit stated that the "clear import of [Rule 4003(b)] and of section 522(*l*) is that objections to claimed

exemptions must be made within thirty days after the creditors' meeting or any amendment, or they are waived." *Dembs,* 757 F.2d at 780. But the court did not end its discussion there: "We do not mean by this to endorse 'exemption by declaration'; there must be a good-faith statutory basis for exemption, and in that respect we fully approve *In re Bennett.*" *Id.* In *Peterson,* the Eighth Circuit agreed with the Sixth Circuit's analysis. Although noting that "Rule 4003(b) establishes a bright-line, thirty-day limit for objections to claimed exemptions," the court adopted the bad-faith exception to avoid the "undesirable effects of 'exemption by declaration.'" *Peterson,* 920 F.2d at 1393. Thus, the court held that, despite the absence of a timely objection, a court must examine the merits of a claimed exemption to determine if it was made in good faith.

In the instant case, both the bankruptcy court and the district court followed *Bennett.* The bankruptcy court, though noting that "plausible arguments" could be made in support of a literal reading of the statute, concluded that *Bennett* represents the "superior view." 105 B.R. at 292. The court relied on section 522(b), which states that a debtor may exempt property that is exempt under federal, state, or local law. The court stated that this language would be superfluous if section 522(*l*) were given its literal effect. *Id.* at 292–93. The bankruptcy court also cited policy reasons in support of its position. A literal reading would provide an incentive for debtors of questionable propriety to claim all of their property as exempt. *Id.* at 293. The district court agreed with the bankruptcy court's analysis and result, stating that a contrary holding would lead to "exemption by declaration." 118 B.R. at 275.

III.

We respectfully disagree with the conclusion reached by the courts below and by the Courts of Appeals for the Sixth and Eighth Circuits. We will adhere to the clear and orderly scheme Congress enacted for property exemption determinations and hold that in the absence of an objection filed within thirty days after the section 341(a) creditors' meeting or the filing of an amendment to the exemption list, property claimed as exempt by the debtor is exempt.

A.

Our task is "to interpret the rules neither liberally nor stingily, but only, as best we can, according to their apparent intent. Where that intent is to provide leeway, a permissive construction is the right one; where it is to be strict, a permissive construction is wrong." *Torres v. Oakland Scavenger Co.,* 487 U.S. 312, 319, 108 S.Ct. 2405, 2410, 101 L.Ed.2d 285 (1988) (Scalia, J., concurring). As we have explained earlier, the text of section 522(*l*) and Rule 4003(b) could not be much clearer in stating without exception that property claimed as exempt by the debtor is exempt unless a timely objection is filed with the court by a party in interest. That all but resolves this case, for the general rule of statutory interpretation is that where "the terms of a statute [are] unambiguous, judicial inquiry is complete except in rare and exceptional circumstances." *Demarest v. Manspeaker,* — U.S. ——, 111 S.Ct. 599, 604, 112 L.Ed.2d 608 (1991). Such circumstances are present only in the "rare" case where "the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters," *United States v. Ron Pair Enterprises,* Inc., 489 U.S. 235, 242, 109 S.Ct. 1026, 1031, 103 L.Ed.2d 290 (1989) (quoting *Griffin v. Oceanic Contractors, Inc.,* 458 U.S. 564, 571, 102 S.Ct. 3245, 3250, 73 L.Ed.2d 973 (1982)); in other words, a result "so bizarre that Congress 'could not have intended' it." *Demarest,* 111 S.Ct. at 604 (quoting *Griffin,* 458 U.S. at 575, 102 S.Ct. at 3252).

This case is not one of the "rare" cases. The literal interpretation of section 522(*l*) and Rule 4003(b) produces a result—not allowing a party in interest to object to a debtor's claimed exemptions after the time period for doing so has elapsed—that is not "demonstrably at odds with the intentions of the drafters." The text of the statute and rule, the legislative history, and a comparison of the present statute and rule with

the statute and rule previously in effect all indicate that Congress intended a strict rule: a party in interest must file a timely objection, or the property claimed as exempt by the debtor is exempt.

The text is of course the best indication of Congress' intent, *West Virginia Univ. Hosp., Inc. v. Casey,* — U.S. —, 111 S.Ct. 1138, 1147, 113 L.Ed.2d 68 (1991), and the text here admits of no exceptions to the bright-line procedural rule. Furthermore, the evolution of the bankruptcy laws suggests that Congress intended to shift the burden of objection from the debtor to the other parties in interest. The pre–1978 version of the bankruptcy laws and former Bankruptcy Rule 403 required the trustee to file a report which separated allowable exemption claims from those not allowable. The burden was then on the debtor and the creditors to object within 15 days. If the debtor and creditor failed to object within 15 days, only the exemptions reported by the trustee were allowed. The Advisory Committee Note to present Rule 4003 states, "[t]he Code changes the thrust of [the former rule] by making it the burden of the debtor to list his exemptions and the burden of parties in interest to raise objections in the absence of which 'the property claimed as exempt on such list is exempt.'" Fed.R.Bankr. 4003 advisory committee's note (quoting 11 U.S.C. § 522(*l*)).

An examination of the legislative materials accompanying section 522 yields Taylor no better result. The House Report states: "Subsection (*l*) requires the debtor to file a list of property that he claims as exempt from the property of the estate. Absent an objection to the list, the property is exempted." H.R.Rep. No. 595, 95th Cong., 2d Sess. 363, *reprinted in* 1978 U.S.Code Cong. & Admin.News 5963, 6319. Nothing in the legislative materials suggests that any exceptions to this bright-line rule were intended.

Congress intended a strict rule, and the result achieved by following the strict textual requirement is not a result "demonstrably at odds" with that intent. In fact, only by allowing an exception to the strict rule would we cause a result demonstrably at odds with the legislative intent.

B.

The courts that have departed from the statutory language have identified a number of policy factors that, in the opinion of those courts, support a non-literal reading of the statute and rule. Before we address them, we first note that even if we were authorized to disagree with Congress on the basis of our policy views, it is not clear that we would do so here. A strong policy rationale supports the literal approach. The time limits and obligations established by section 522(*l*) and Rule 4003(b) serve the dual purposes of finality and certainty. In the bankruptcy context, the need for finality and certainty is especially acute. *See Hoos & Co. v. Dynamics Corp. of America,* 570 F.2d 433, 439 (2d Cir.1978); *Grossman,* 80 B.R. at 314–15; *see also* Scalia, *The Rule of Law as a Law of Rules,* 56 U.Chi.L.Rev. 1175, 1178–79 (1989) ("Even in simpler times uncertainty has been regarded as incompatible with the Rule of Law."). This need is reflected by Bankruptcy Rule 9006, which states that "[i]n the interest of prompt administration of bankruptcy cases certain time periods may not be extended." Fed.R.Bankr. 9006 advisory committee's note. Thus, where there is a date when the parties' rights can be finally determined—in this case, thirty days after the creditors' meeting if no objection is filed—the parties can proceed from that date knowing which property is property of the estate and which property belongs to the debtor. The debtor from that day forward can treat exempted property as his or her own and is not forced to wait until some unknown future date when the trustee or another party in interest might haul the debtor into court seeking that property.

We turn now to some of the policy considerations that other courts have cited in support of an exception to a literal interpretation of the statute. It is true, as the Eighth Circuit noted, that strict compliance with section 522(*l*) and Rule 4003(b) might in certain cases provide the debtor with an

"undeserved windfall." *Peterson,* 920 F.2d at 1393. That is true of enforcement of all procedural rules, yet the Supreme Court has not been willing to disregard a clear procedural rule simply out of an ex post concern for fairness in the individual case. For example, in *Torres,* 487 U.S. at 312, 108 S.Ct. at 2405, a case presenting more compelling circumstances than the instant case for relaxing a bright-line procedural rule, the Supreme Court decided that the failure to list one of the appellants on the notice of appeal in accordance with Civil Rule 3(c) deprived the appellate court of jurisdiction over that appellant's case. Justice Marshall stated for the Court, "We recognize that construing Rule 3(c) as a jurisdictional prerequisite leads to a harsh result in this case, but we are convinced that the harshness of our construction is 'imposed by the legislature and not by the judicial process.'" *Id.* at 318, 108 S.Ct. at 2409. Compliance with section 522(*l*) and Rule 4003(b) may lead in certain cases to an undeserved windfall for the debtor. But we, like the Supreme Court, will not disturb the clear language of the statute and rule to prevent a windfall.

The courts departing from the statutory language have also expressed concern that a literal reading would lead to a system of "exemption by declaration" whereby the debtor would have incentive to claim all property as exempt in the hope that no party in interest would object. *See, e.g., Bennett,* 36 B.R. at 895. Inserting an exception into section 522 in order to achieve this policy goal ignores two safeguards that already ensure that debtors have little or no incentive to claim all of their property as exempt. First, and most importantly, Bankruptcy Rule 9011, which is analogous to Rule 11 of the Civil Rules, forbids bad faith exemption claims and authorizes sanctions for violation of this prohibition. Rule 9011 should act as the primary deterrent against debtors engaging in bad faith exemption claims. Second, no external impediment prevents a trustee or other party in interest from filing objections to the claimed exemptions. The only hindrance is such a party's neglect. Thus, in the vast majority of cases, overzealous claims of exemptions by a debtor will serve only to induce the enmity of the other parties and of the court.

The bankruptcy court in the instant case stated that a literal reading of section 522(*l*) would render section 522(b) superfluous. 105 B.R. at 292–92. We disagree. Once an exemption has been claimed, a two-step approach applies. The threshold requirement, which is imposed by section 522(*l*) is a timely objection by a party in interest. If such an objection is filed, *then* the bankruptcy court is to decide if the claimed exemption fits into one of the categories listed in section 522(b). Section 522(b) is not rendered superfluous by a literal reading of section 522(*l*); it will be involved in almost all cases—those where a party in interest properly objects. Indeed, the bankruptcy court's reading of the statute would render section 522(*l*) meaningless.

IV.

[2] Absent a timely filed objection, the property claimed by a debtor as exempt under section 522 of the Bankruptcy Code is exempt. In this case, Davis the debtor claimed the potential proceeds of her then-pending lawsuit against TWA as exempt. No objection to that claimed exemption was filed with the court by any party in interest. The proceeds of the TWA suit are thus exempt. Because we find for Freeland & Kronz on this issue, we need not decide other issues it has raised. We will reverse the order of the district court.

It is one thing to insist on an unequivocal waiver of sovereign immunity. It is quite another "to impute to Congress a desire for incoherence" as a basis for rejecting an explicit waiver. *Keifer & Keifer v. Reconstruction Finance Corporation,* 306 U.S. 381, 394, 59 S.Ct. 516, 520, 83 L.Ed. 784 (1939); *Franchise Tax Bd. of California v. Postal Service,* 467 U.S. 512, 524, 104 S.Ct. 2549, 2556, 81 L.Ed.2d 446 (1984). Cf. *Canadian Aviator, supra,* 324 U.S. at 225, 65 S.Ct., at 644–645. That is what the majority does today. "Surely the interest in requiring the Congress ⌊636 to draft its legislation with greater clarity or precision does not justify a refusal to make a good-faith effort to ascertain the actual meaning of the message it tried to convey in a statutory provision that is already on the books." *Nordic Village,* 503 U.S., at 45, 112 S.Ct., at 1020 (STEVENS, J., dissenting).

The unambiguous language of the federal facilities and citizen suit provisions of the CWA clearly contemplate a waiver of immunity as to suit for civil damages, and "once Congress has waived sovereign immunity over certain subject matter, the Court should be careful not to 'assume the authority to narrow the waiver that Congress intended.'" *Ardestani v. INS,* 502 U.S. 129, 137, 112 S.Ct. 515, 520, 116 L.Ed.2d 496 (1991), quoting *United States v. Kubrick,* 444 U.S. 111, 118, 100 S.Ct. 352, 62 L.Ed.2d 259 (1979); *Irwin v. Department of Veterans Affairs,* 498 U.S. 89, 94, 111 S.Ct. 453, 457, 112 L.Ed.2d 435 (1990).

II

Turning to the RCRA, I agree with the majority and with the Court of Appeals that the RCRA federal facilities provision does not effect an unambiguous waiver of immunity from civil penalties, 42 U.S.C. § 6961. See *ante,* at 1639–1640. The section makes no reference to civil penalties and, instead, waives immunity for "any such injunctive relief." This language comports with the Government's claim that the waiver is intended to reach only coercive and not punitive sanctions. The provision certainly does not unequivocally encompass civil penalties. Therefore, I join Part II–C of the Court's opinion.

However, I would find a waiver under RCRA's citizen suit provision, 42 U.S.C. § 6972(a), see *ante,* at 1634, which is very similar to the citizen suit provision in the CWA, for the reasons I have explained above. See Part I–A–1, *supra.*

III

The job of this Court is to determine what a statute says, not whether it could have been drafted more artfully. In these cases, the federal facilities and citizen suit provisions of the ⌊637 CWA and the citizen suit provision of the RCRA unambiguously waive the Federal Government's immunity from civil penalties. That is all the law requires.

503 U.S. 638, 118 L.Ed.2d 280

⌊638 **TAYLOR**

v.

FREELAND & KRONZ et al.

No. 91–571.

Argued March 2, 1992.

Decided April 21, 1992.

Chapter 7 debtor claimed exemption in potential proceeds from pending employment discrimination suit, no formal objection was filed, and debtor then settled suit. The United States Bankruptcy Court for the Western District of Pennsylvania, 105 B.R. 288, ordered debtor and discrimination suit counsel to turn over proceeds to trustee, and appeal was taken. The District Court, Alan N. Bloch, J., 118 B.R. 272, affirmed, and further

appeal was taken. The Court of Appeals for the Third Circuit, 938 F.2d 420, reversed, and certiorari review was sought. The Supreme Court, Justice Thomas, held that a Chapter 7 trustee could not contest the validity of claimed exemption after 30–day period for objecting had expired and no extension had been obtained, even though debtor had no colorable basis for claiming exemption.

Affirmed.

Justice Stevens dissented and filed opinion.

1. Bankruptcy ⟹2801

Chapter 7 trustee could not contest validity of claimed exemption after 30–day period for objecting had expired and no extension had been obtained, even though debtor had no colorable basis for claiming exemption. Bankr.Code, 11 U.S.C.A. § 522(*l*); Fed.Rules Bankr.Proc.Rule 4003(b), 11 U.S.C.A.

2. Bankruptcy ⟹3770

Federal Courts ⟹461

Supreme Court would not consider argument raised for first time in opening brief on merits, which had not been raised or resolved in lower courts, absent showing of unusual circumstances. U.S.Sup.Ct.Rules 14.1(a), 24.1(a), 28 U.S.C.A.

Syllabus *

On the schedule she filed pursuant to § 522(*l*) of the Bankruptcy Code, debtor Davis listed as exempt property the expected proceeds from her pending employment discrimination suit. Petitioner Taylor, the trustee of Davis' bankruptcy estate, did not object to the claimed exemption within the 30–day period allowed by Federal Rule of Bankruptcy Procedure 4003(b). However, upon later learning that the discrimination suit had been settled for a substantial sum, Taylor filed a complaint in the Bankruptcy Court against respondents, Davis' attorneys in that suit, demanding that they turn over settlement proceeds as property of Davis' estate. Concluding that Davis had no statutory basis for claiming the proceeds as exempt, the court ordered respondents to "return" to Taylor a sum sufficient to pay off all of Davis' unpaid creditors, and the District Court affirmed. The Court of Appeals reversed, holding that the Bankruptcy Court had erred because Davis had claimed the money in question as exempt, and Taylor had failed to object to the claimed exemption in a timely manner.

Held: A trustee may not contest the validity of a claimed exemption after the Rule 4003(b) 30–day period has expired, even though the debtor had no colorable basis for claiming the exemption. Pp. 1647–1649.

(a) Because the parties agree that Davis did not have a statutory right to exempt more than a small portion of the lawsuit proceeds, let alone the full amount, Taylor apparently could have made a valid objection under § 522(*l*)—which provides, *inter alia*, that "property claimed as exempt ... is exempt" "[u]nless a party in interest objects," but does not specify the time for objecting—if he had acted promptly under Rule 4003(b)—which establishes the 30–day objections period for trustees and creditors "unless, within such period, further time is granted by the court." Pp. 1647–1648.

(b) However, Taylor's failure to promptly object precludes him from challenging the validity of the exemption at this time, regardless of whether or not Davis had a colorable statutory basis for claiming it. By negative implication, Rule 4003(b) indicates that a trustee may not object after 30 days unless a further extension of time is granted. Because no such extension was allowed by the Bankruptcy Court in this case, § 522(*l*) has made the settlement proceeds exempt. This Court ⌊639 rejects Taylor's argument that, in order to discourage debtors from claiming

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

meritless exemptions merely in hopes that no one will object, a court may invalidate an exemption after expiration of the 30–day period where the debtor did not have a good-faith or reasonably disputable basis for claiming it. To the extent that the various Code and Rules provisions aimed at penalizing debtors and their attorneys for improper conduct fail to limit bad-faith exemption claims, Congress, rather than this Court, may rewrite § 522(*l*) to include a good-faith requirement. Pp. 1648–1649.

(c) Taylor's assertion that § 105(a) of the Code permits courts to disallow exemptions not claimed in good faith despite the absence of timely objections to such exemptions will not be considered by this Court, since that argument was first raised in Taylor's opening brief on the merits and was neither raised nor resolved in the lower courts. P. 1649.

938 F.2d 420 (CA 3 1991), affirmed.

THOMAS, J., delivered the opinion of the Court, in which REHNQUIST, C.J., and WHITE, BLACKMUN, O'CONNOR, SCALIA, KENNEDY, and SOUTER, JJ., joined. STEVENS, J., filed a dissenting opinion, *post*, p. 1649.

Timothy B. Dyk, Washington, D.C., for petitioner.

Phillip S. Simon, Pittsburgh, Pa., for respondents.

Justice THOMAS delivered the opinion of the Court.

Section 522(*l*) of the Bankruptcy Code requires a debtor to file a list of the property that the debtor claims as statutorily exempt from distribution to creditors. Federal Rule of Bankruptcy Procedure 4003 affords creditors and the bankruptcy trustee 30 days to object to claimed exemptions. We must decide in this case whether the trustee may contest the validity of an exemption after the 30–day period if the debtor had no colorable basis for claiming the exemption.

640I

The debtor in this case, Emily Davis, declared bankruptcy while she was pursuing an employment discrimination claim in the state courts. The relevant proceedings began in 1978 when Davis filed a complaint with the Pittsburgh Commission on Human Relations. Davis alleged that her employer, Trans World Airlines (TWA), had denied her promotions on the basis of her race and sex. The Commission held for Davis as to liability but did not calculate the damages owed by TWA. The Pennsylvania Court of Common Pleas reversed the Commission, but the Pennsylvania Commonwealth Court reversed that court and reinstated the Commission's determination of liability. TWA next appealed to the Pennsylvania Supreme Court.

In October 1984, while that appeal was pending, Davis filed a Chapter 7 bankruptcy petition. Petitioner, Robert J. Taylor, became the trustee of Davis' bankruptcy estate. Respondents, Wendell G. Freeland, Richard F. Kronz, and their law firm, represented Davis in the discrimination suit. On a schedule filed with the Bankruptcy Court, Davis claimed as exempt property the money that she expected to win in her discrimination suit against TWA. She described this property as "Proceeds from lawsuit—[Davis] v. TWA" and "Claim for lost wages" and listed its value as "unknown." App. 18.

Performing his duty as a trustee, Taylor held the required initial meeting of creditors in January 1985. See 11 U.S.C. § 341; Fed. Rule Bkrtcy. Proc. 2003(a). At this meeting, respondents told Taylor that they estimated that Davis might win $90,000 in her suit against TWA. Several days after the meeting, Taylor wrote a letter to respondents telling them that he considered the potential proceeds of the lawsuit to be property of Davis' bankruptcy estate. He also asked respondents for more details about the suit. Respondents described the procedural pos-

ture of the case and expressed optimism that they might settle with TWA for $110,000.

⌊641Taylor decided not to object to the claimed exemption. The record reveals that Taylor doubted that the lawsuit had any value. Taylor at one point explained: "I have had past experience in examining debtors...[.] [M]any of them ... indicate they have potential lawsuits.... [M]any of them do not turn out to be advantageous and ... many of them might wind up settling far within the exemption limitation." App. 52. Taylor also said that he thought Davis' discrimination claim against TWA might be a "nullity." *Id.*, at 58.

Taylor proved mistaken. In October 1986, the Pennsylvania Supreme Court affirmed the Commonwealth Court's determination that TWA had discriminated against Davis. In a subsequent settlement of the issue of damages, TWA agreed to pay Davis a total of $110,000. TWA paid part of this amount by issuing a check made to both Davis and respondents for $71,000. Davis apparently signed this check over to respondents in payment of their fees. TWA paid the remainder of the $110,000 by other means. Upon learning of the settlement, Taylor filed a complaint against respondents in the Bankruptcy Court. He demanded that respondents turn over the money that they had received from Davis because he considered it property of Davis' bankruptcy estate. Respondents argued that they could keep the fees because Davis had claimed the proceeds of the lawsuit as exempt.

The Bankruptcy Court sided with Taylor. It concluded that Davis had "no statutory basis" for claiming the proceeds of the lawsuit as exempt and ordered respondents to "return" approximately $23,000 to Taylor, a sum sufficient to pay off all of Davis' unpaid creditors. *In re Davis*, 105 B.R. 288 (Bkrtcy. Ct. WD Pa.1989). The District Court affirmed, *In re Davis*, 118 B.R. 272 (WD Pa.1990), but the Court of Appeals for the Third Circuit reversed, 938 F.2d 420 (1991). The Court of Appeals held that the Bankruptcy Court could not require respondents to turn over the money because Davis had claimed it as exempt, and Taylor had failed to ⌊642object to the claimed exemption in a timely manner. We granted certiorari, 502 U.S. 976, 112 S.Ct. 632, 116 L.Ed.2d 602 (1991), and now affirm.

II

When a debtor files a bankruptcy petition, all of his property becomes property of a bankruptcy estate. See 11 U.S.C. § 541. The Code, however, allows the debtor to prevent the distribution of certain property by claiming it as exempt. Section 522(b) allowed Davis to choose the exemptions afforded by state law or the federal exemptions listed in § 522(d). Section 522(*l*) states the procedure for claiming exemptions and objecting to claimed exemptions as follows:

> "The debtor shall file a list of property that the debtor claims as exempt under subsection (b) of this section.... Unless a party in interest objects, the property claimed as exempt on such list is exempt."

Although § 522(*l*) itself does not specify the time for objecting to a claimed exemption, Federal Rule of Bankruptcy Procedure 4003(b) provides in part:

> "The trustee or any creditor may file objections to the list of property claimed as exempt within 30 days after the conclusion of the meeting of creditors held pursuant to Rule 2003(a) ... unless, within such period, further time is granted by the court."

In this case, as noted, Davis claimed the proceeds from her employment discrimination lawsuit as exempt by listing them in the schedule that she filed under § 522(*l*). The parties agree that Davis did not have a right to exempt more than a small portion of these proceeds either under state law or under the federal exemptions specified in § 522(d). Davis in fact claimed the full amount as exempt. Taylor, as a result, apparently could have made a valid objection under § 522(*l*) and Rule 4003 if he had acted

promptly. We hold, however, that his failure to do so prevents him from challenging the validity of the exemption now.

⊥643A

Taylor acknowledges that Rule 4003(b) establishes a 30–day period for objecting to exemptions and that § 522(*l*) states that "[u]nless a party in interest objects, the property claimed as exempt . . . is exempt." He argues, nonetheless, that his failure to object does not preclude him from challenging the exemption at this time. In Taylor's view, § 522(*l*) and Rule 4003(b) serve only to narrow judicial inquiry into the validity of an exemption after 30 days, not to preclude judicial inquiry altogether. In particular, he maintains that courts may invalidate a claimed exemption after expiration of the 30–day period if the debtor did not have a good-faith or reasonably disputable basis for claiming it. In this case, Taylor asserts, Davis did not have a colorable basis for claiming all of the lawsuit proceeds as exempt and thus lacked good faith.

Taylor justifies his interpretation of § 522(*l*) by arguing that requiring debtors to file claims in good faith will discourage them from claiming meritless exemptions merely in hopes that no one will object. Taylor does not stand alone in this reading of § 522(b). Several Courts of Appeals have adopted the same position upon similar reasoning. See *In re Peterson,* 920 F.2d 1389, 1393–1394 (CA8 1990); *In re Dembs,* 757 F.2d 777, 780 (CA6 1985); *In re Sherk,* 918 F.2d 1170, 1174 (CA5 1990).

[1] We reject Taylor's argument. Davis claimed the lawsuit proceeds as exempt on a list filed with the Bankruptcy Court. Section 522(*l*), to repeat, says that "[u]nless a party in interest objects, the property claimed as exempt on such list is exempt." Rule 4003(b) gives the trustee and creditors 30 days from the initial creditors' meeting to object. By negative implication, the Rule indicates that creditors may not object after 30 days "unless, within such period, further time is granted by the court." The Bankruptcy Court did not extend the 30–day period. Section 522(*l*) therefore has made the property exempt. Taylor cannot contest the ex⊥emption644 at this time whether or not Davis had a colorable statutory basis for claiming it.

Deadlines may lead to unwelcome results, but they prompt parties to act and they produce finality. In this case, despite what respondents repeatedly told him, Taylor did not object to the claimed exemption. If Taylor did not know the value of the potential proceeds of the lawsuit, he could have sought a hearing on the issue, see Rule 4003(c), or he could have asked the Bankruptcy Court for an extension of time to object, see Rule 4003(b). Having done neither, Taylor cannot now seek to deprive Davis and respondents of the exemption.

Taylor suggests that our holding will create improper incentives. He asserts that it will lead debtors to claim property exempt on the chance that the trustee and creditors, for whatever reason, will fail to object to the claimed exemption on time. He asserts that only a requirement of good faith can prevent what the Eighth Circuit has termed "exemption by declaration." *Peterson, supra,* at 1393. This concern, however, does not cause us to alter our interpretation of § 522(*l*).

Debtors and their attorneys face penalties under various provisions for engaging in improper conduct in bankruptcy proceedings. See, *e.g.,* 11 U.S.C. § 727(a)(4)(B) (authorizing denial of discharge for presenting fraudulent claims); Rule 1008 (requiring filings to "be verified or contain an unsworn declaration" of truthfulness under penalty of perjury); Rule 9011 (authorizing sanctions for signing certain documents not "well grounded in fact and . . . warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law"); 18 U.S.C. § 152 (imposing criminal penalties for fraud in bankruptcy cases). These provisions may limit bad-faith claims of exemptions by debtors. To the extent that they do not, Congress may enact comparable provi-

sions to address the difficulties that Taylor predicts will ⌊645follow our decision. We have no authority to limit the application of § 522(*l*) to exemptions claimed in good faith.

B

Taylor also asserts that courts may consider the validity of the exemption under a different provision of the Bankruptcy Code, 11 U.S.C. § 105(a), despite his failure to object in a timely manner. That provision states:

> "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. *No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action* or making any determination necessary or appropriate to enforce or implement court orders or rules, or *to prevent an abuse of process.*" *Ibid.* (emphasis added).

Although Taylor stresses that he is not asserting that courts in bankruptcy have broad authorization to do equity in derogation of the Code and Rules, he maintains that § 105 permits courts to disallow exemptions not claimed in good faith. Several courts have accepted this position. See, *e.g., Ragsdale v. Genesco, Inc.,* 674 F.2d 277, 278 (CA4 1982); *In re Staniforth,* 116 B.R. 127, 131 (Bkrtcy. Ct. WD Wis.1990); *In re Budinsky,* No. 90–01099, 1991 WL 105640 (WD Pa., June 10, 1991).

[2] We decline to consider § 105(a) in this case because Taylor raised the argument for the first time in his opening brief on the merits. Our Rule 14.1(a) makes clear that "[o]nly the questions set forth in the petition [for certiorari], or fairly included therein, will be considered by the Court," and our Rule 24.1(a) states that a brief on the merits should not "raise additional questions or change the substance of the questions already presented" in the petition. See *Yee v. Escondido,* 503 U.S. 519, 535, 112 S.Ct. 1522, 1532, 118 L.Ed.2d 153 (1992). In addition, we have ⌊646said that "[o]rdinarily, this Court does not decide questions not raised or resolved in the lower court[s]." *Youakim v. Miller,* 425 U.S. 231, 234, 96 S.Ct. 1399, 1401, 47 L.Ed.2d 701 (1976) (*per curiam*). These principles help to maintain the integrity of the process of certiorari. Cf. *Oklahoma City v. Tuttle,* 471 U.S. 808, 816, 105 S.Ct. 2427, 2432, 85 L.Ed.2d 791 (1985). The Court decides which questions to consider through well-established procedures; allowing the able counsel who argue before us to alter these questions or to devise additional questions at the last minute would thwart this system. We see no "unusual circumstances" that warrant addressing Taylor's § 105(a) argument at this time. *Berkemer v. McCarty,* 468 U.S. 420, 443, n. 38, 104 S.Ct. 3138, 3152, n. 38, 82 L.Ed.2d 317 (1984).

The judgment of the Court of Appeals is

Affirmed.

Justice STEVENS, dissenting.

The Court states that it has "no authority to limit the application of § 522(*l*) to exemptions claimed in good faith." *Ante,* at 1649. It does not deny, however, that it has ample authority to hold that the doctrine of equitable tolling applies to the 30–day limitations period in Federal Rule of Bankruptcy Procedure 4003(b).[1] In my view, such a result is supported not only by strong equitable considerations, but also by the common law, the widespread practice of the bankruptcy courts, and the text of § 522(b).

1. 4003(b) provides:

"The trustee or any creditor may file objections to the list of property claimed as exempt within 30 days after the conclusion of the meeting of creditors held pursuant to Rule 2003(a) or the filing of any amendment to the list or supplemental schedules unless, within such period, further time is granted by the court. Copies of the objections shall be delivered or mailed to the trustee and to the person filing the list and the attorney for such person."

I

Rule 4003, which is derived from § 522(*l*) of the Code and in part from former Bankruptcy Rule 403, shifted the emphasis647 of the earlier Rule, placing the burden on the debtor to list her exemptions and the burden on the parties in interest to raise objections. Rule 4003(b) in particular fills a gap that remains in § 522(*l*), which is silent as to the time in which parties in interest must file their objections. Rule 4003(b) provides for a 30-day period for objections. Although the adoption of Rule 4003 has furthered the interest in orderly administration, there is no suggestion that it was put into effect in order to avoid prejudice to the debtor. Thus, there is no identifiable reason why ordinary tolling principles that apply in other contexts should not also apply in bankruptcy proceedings; indeed, the generally equitable character of bankruptcy makes it especially appropriate to apply such rules in this context.

It is familiar learning that the harsh consequences of federal statutes of limitations have been avoided at times by relying on either fraudulent concealment or undiscovered fraud to toll the period of limitation. For example, in *Bailey v. Glover,* 21 Wall. 342, 349–350, 22 L.Ed. 636 (1875), the Court described two situations in which the "strict letter of general statutes of limitation" would not be followed, *id.,* at 347. The first situation is "where the ignorance of the fraud has been produced by affirmative acts of the guilty party in concealing the facts," and the second is "where the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part." *Id.,* at 347–348. The former involves fraudulent concealment; the latter defines undiscovered fraud. The Court concluded in *Bailey* that fraudulent concealment, which was at issue in that case, tolls the running of the statute of limitations when the fraud "has been concealed, or is of such character as to conceal itself." *Id.,* at 349–350. To hold otherwise, reasoned the Court, would "make the law which was designed to prevent fraud the means by which it is made successful and secure." *Id.,* at 349. In *Holmberg v. Armbrecht,* 327 U.S. 392, 397, 66 S.Ct. 582, 585, 90 L.Ed. 743 (1946), the Court extended the reach of this tolling doctrine when 648it observed that it is to be "read into every federal statute of limitation." [2]

In this case, even if there was no fraud, and even if it is assumed that the trustee failed to exercise due diligence, it remains true that the parties injured by the trustee's failure to object within the 30-day period are innocent creditors. Moreover, it is apparently undisputed that there was no legitimate basis for the claim of an exemption for the entire award. See *ante,* at 1647. Under these circumstances, unless the debtor could establish some prejudice caused by the trustee's failure to object promptly, I would hold that the filing of a frivolous claim for an exemption is tantamount to fraud for purposes of deciding when the 30-day period begins to run.

II

This, in essence, is also the position adopted by numerous Bankruptcy Courts and three Courts of Appeals.[3] Over a period

2. The tolling of a statute of limitations is not limited to cases of fraud. In medical malpractice suits, for example, this Court has long endorsed the view that the statute of limitations will not bar the claim of one who was "blameless[ly] ignoran[t]" of his injury; rather, the statute of limitations will not begin to run until he has knowledge of his injury. *Urie v. Thompson,* 337 U.S. 163, 170, 69 S.Ct. 1018, 1024, 93 L.Ed. 1282 (1949).

3. Some Bankruptcy Courts, however, have read the statute and Rule narrowly and have refused to examine any exemption in the absence of a timely objection. See, *e.g., In re Bradlow,* 119 B.R. 330, 331 (Bkrtcy.Ct.SD Fla.1990); *In re Duncan,* 107 B.R. 754 (Bkrtcy.Ct. WD Okla. 1988); *In re Payton,* 73 B.R. 31, 32 (Bkrtcy.Ct. WD Tex.1987); *In re Kretzer,* 48 B.R. 585, 587 (Bkrtcy.Ct.Nev.1985); *In re Gullickson,* 39 B.R. 922 (Bkrtcy.Ct. WD Wis.1984). Although the court in *In re Hawn,* 69 B.R. 567 (Bkrtcy.Ct. ED Tenn.1987), took a similar view, it at least recog-

of years, they have held that the failure to make a timely objection is not dispositive, Rule 4003(b) notwithstanding. For example, in *In re Hackett*, 13 B.R. 755, 756 (Bkrtcy.Ct. ED Pa.1981), the court explained that "[e]quitable₆₄₉ considerations dictate that a debtor should not be allowed exemptions to which she is obviously not entitled." This view was echoed in *In re Rollins*, 63 B.R. 780, 783–784 (Bkrtcy.Ct. ED Tenn.1986): "[T]he debtor cannot make property exempt simply by claiming it as exempt when there is no apparent legal basis for the exemption. In that situation, the trustee's failure to object to the claim of exemption within the time limit of Rule 4003(b) does not create an exemption." More recently, the court in *In re Ehr*, 116 B.R. 665, 667 (Bkrtcy.Ct. ED Wis.1988), reaffirmed this approach, as did the court in *In re Staniforth*, 116 B.R. 127, 130 (Bkrtcy.Ct. WD Wis.1990). As one court explained: "Read strictly, Rule 4003 and Section 522(*l*) support appellants' position concerning waiver. But, most courts have not followed appellants' interpretation of these provisions. Instead, most courts hold that an exemption must have an apparent legal basis for an exemption to overcome an untimely objection." *In re Stutterheim*, 109 B.R. 1010, 1012 (Kan.1989).

The equitable principles that motivated these Bankruptcy Courts are best encapsulated by the court in *In re Bennett*, 36 B.R. 893 (Bkrtcy.Ct. WD Ky.1984). There, the court explained that to apply Rule 4003(b) rigidly would be to encourage a debtor to claim that all of her property was exempt, thus leaving it to the trustee and creditors to sift through the myriad claimed exemptions to assess their validity. Such a policy would result in reversion to "the law of the streets, with bare possession constituting not nine, but ten, parts of the law; orderly administration of estates would be replaced by uncertainty and constant litigation if not outright anarchy." *Id.*, at 895.[4]

₆₅₀Although several Courts of Appeals and Bankruptcy Courts did not go as far as these courts, preferring instead in the case of an untimely objection to examine a claimed exemption to determine if there was a "good-faith statutory basis" for the exemption, they nevertheless eschewed the literal reading of the statute and rule adopted by the Court today. They did so because they believed it was important to strike a proper balance between avoiding the undesirable effect of "exemption by declaration" and yet not permitting a trustee "another bite at the debtor's apple where the debtor has claimed certain property exempt in good faith." *In re Peterson*, 920 F.2d 1389, 1393–1394 (CA8 1990); see *In re Sherk*, 918 F.2d 1170, 1174 (CA5 1990); *In re Dembs*, 757 F.2d 777, 780 (CA6 1985).

Here, the trustee would succeed under either approach. Whether the court is always permitted to entertain an objection to a claimed exemption (at least until the case is closed)[5] when the claimed exemption is invalid or whether the court can do so only if the claimed exemption lacks a good-faith statutory basis would mean that in this case the court could review the debtor's claimed exemption. Here, the parties acknowledge that the debtor could not claim a statutory basis for her claimed exemption for the full

nized that the result might be different if there had been "evidence that the debtor fraudulently or negligently concealed any facts from the trustee or any creditors." *Id.*, at 568.

4. Bankruptcy courts would understandably be reluctant to encourage a policy that would contribute to the overburdening of the bankruptcy court system. As counsel for the trustee explained: "Last year there were 880,000 bankruptcy filings, 291 bankruptcy judges to deal with all of those filings, and a real need on the part of the bankruptcy courts to rely on the good faith of debtors in claiming exemptions, otherwise the whole system would collapse." Tr. of Oral Arg. 13. For example, this trustee alone "had approximately two or three hundred of these cases a year, which ... is typical of bankruptcy trustees all across the country." *Id.*, at 15.

5. The parties have stipulated that the debtor's case has never been closed. App. 56.

award because neither backpay nor tort recovery is exempt under § 522(d)(5).

III

The practice of these lower courts has been motivated not only by equitable considerations, but also by the requirement set forth in § 522(b). Section 522(*l*) explicitly provides that "[t]he debtor shall file a list of property that the debtor ⌊651claims as exempt under subsection (b) of this section." Subsection (b) limits exemptions claimed by the debtor to "any property that is exempt under federal law ... or State or local law that is applicable on the date of the filing of the petition." 11 U.S.C. § 522(b)(2)(A). When a debtor claims exemptions that do not even arguably satisfy this condition,[6] there is good reason to hold that the filing does not comply with § 522 and therefore the 30-day objection period does not begin to run. As one court noted: "[I]f Debtor may select in any manner her exemptions, then no purpose is served by the inclusion of the ... terms." *In re Kingsbury,* 124 B.R. 146, 148, n. 9 (Bkrtcy.Ct.Me. 1991). It declined to conclude that Congress added the requirements that the property be exempted "under federal law ... or state law or local law" but "refused to grant them meaning." *Ibid.* (emphasis omitted).

IV

The Court's disposition of this case is straightforward. Because it regards the meaning of the statute and Rule as "plain," that is the end of the case. I have no doubt, however, that if the debtor or the trustee were guilty of fraud, the Court would readily ignore what it now treats as the insurmountable barrier of "plain meaning." The equities in this case are not as strong as if fraud were implicated, but our power to reach a just result despite the "plain meaning" barrier is exactly the same as it was in *Bailey v. Glover,* 21 ⌊652Wall. 342, 22 L.Ed. 636 (1875). Here, as in *Bailey,* we should be guided by the common-law principles that have supported the tolling of other statutes of limitations, and, in addition, by the experience of bankruptcy courts that have recognized the need for a similar rule to achieve both equitable results and fair administration in cases of this kind. In my view, it is a mistake to adopt a "strict letter" approach, *id.,* at 347, when justice requires a more searching inquiry. Accordingly, I respectfully dissent.

6. The debtor's claimed exemptions in this case not only failed to satisfy any statutory basis, but also failed to provide even the basic information necessary to inform the trustee adequately about the exemption. For example, the debtor indicated on her Schedule B-4 Property Claimed As Exempt form that she was claiming the "[p]roceeds from lawsuit," but that the value was "unknown." App. 14-15. Although the value of the full award ended up amounting to $110,000, and only an amount of approximately $24,000 was required to satisfy the claims of all of her creditors, the debtor never amended her schedule to reflect the precise value of the award.

503 U.S. 653, 118 L.Ed.2d 293

⌊653James GOMEZ and Daniel Vasquez

v.

UNITED STATES DISTRICT COURT FOR the NORTHERN DISTRICT OF CALIFORNIA, et al.

No. A-767.

April 21, 1992.

The Court of Appeals for the Ninth Circuit issued orders staying execution of prisoner convicted of capital murder in state court. Application was made to vacate stay of execution. The Supreme Court held that claim that execution by cyanide gas was cruel and unusual punishment was not required to be considered, as it had not been properly raised in earlier petitions for habeas corpus.

as an implicit requirement that an employee work for debtor on or after January 1 of the year subsequent to that first year's employment in order to be eligible for vacation for that day. If an employee does not work for debtor at anytime during 1992, for instance, they likewise are not entitled to vacation with pay for 1992. UE has not shown that the phrase "eligible for vacation" should be read differently in the second sentence of Paragraph 2 and, accordingly, a convincing argument is made that there is no eligibility for vacation with pay in 1992.

Repeating the process offers no resolution. To the contrary, repeating the process convinces this writer that the party arguing at that point has a plausible position. Therefore, we must conclude in light of the court's intellectual uncertainty that the language of the paragraphs and the language of the particular sentences in Paragraph 2 as they relate to Paragraph 1 is ambiguous.

[7, 8] When a contract provision is ambiguous, the court must determine what the parties intended by considering all relevant extrinsic evidence. *See Washington Hospital*, 889 F.2d at 1302. The parties prior course of conduct may be relevant in this regard. *See Langer v. Monarch Life Insurance Co.*, 879 F.2d 75, 81 (3d Cir. 1989).

[9] Prior conduct of the parties to the collective bargaining agreement at issue here compels the inference that they intended that an employee was entitled to vacation with pay for a given year only if they were actively employed by debtor for at least one day during that year.

[10] Several employees were terminated from their employment prior to 1991 after they had worked for debtor for the required number of weeks to qualify for vacation with pay during the following year. None of them, however, received vacation pay for the following year even though they had met all other requirements for vacation with pay.

Had it been the intention of UE and debtor that these employees would receive vacation pay for the following year even though they had not been employed by debtor during that subsequent year, it is reasonable to expect that UE would have contested debtor's failure to pay them. UE, however, took no action with regard to this matter. The explanation that they lacked knowledge of the termination of a member rings hollow. They certainly knew that their union dues and fringe check-off ended with the termination of their union brother or sister.

The most reasonable inference is that UE and debtor intended that any employee covered by the collective bargaining agreement was entitled to vacation with pay only if they were employed by debtor during the year in which vacation with pay was sought.

The trustee's objection will be sustained because none of the employees belonging to UE worked for debtor at any time during 1992. The right to vacation with pay had *not* accrued when the bankruptcy petition was filed.

An appropriate order shall be issued.

In re Emily DAVIS, a/k/a Emily Winn, Debtor.

Robert J. TAYLOR, Trustee, Plaintiff,

v.

FREELAND & KRONZ, Wendell G. Freeland, Richard F. Kronz, and Emily Davis, Defendants.

Bankruptcy No. 84–2291–BM.
Adv. No. 88–0446–BM.

United States Bankruptcy Court,
W.D. Pennsylvania.

Feb. 16, 1993.

Chapter 7 trustee filed adversary proceeding against debtor and debtor's em-

ployment discrimination counsel seeking turnover of proceeds of settlement of lawsuit. The Bankruptcy Court, 105 B.R. 288, ordered debtor and counsel to turn over to trustee sum of $23,487.75 plus interest. Pending codefendant's appeal of decision, the trustee moved to amend judgment to add postjudgment interest. An amended judgment against debtor was issued to reflect postjudgment interest. Debtor moved to vacate judgment on ground that judgment against codefendant had been reversed on appeal by the Third Circuit Court of Appeals and affirmed by the United States Supreme Court. The Bankruptcy Court, Bernard Markovitz, J., held that: (1) amended judgment against debtor would not be vacated on ground of lack of proper notice since notice was mailed to debtor at last known address and served upon attorney of record at his place of business; (2) adverse judgment which was successfully appealed by codefendant remained law of case as far as nonappealing debtor, absent showing of unusual circumstances or compelling reasons; and (3) judgment would not be vacated on ground that it would be unfair and inequitable to permit judgment against debtor to stand when judgment against her codefendant had been reversed on appeal.

Motion denied.

1. Federal Civil Procedure ⚷2647.1

As general rule, rule authorizing relief from judgment cannot be used as substitute for appeal; it may not be used to relieve party of erroneous ruling when that party has made considered choice not to pursue appeal. Fed.Rules Civ.Proc.Rule 60(b), 28 U.S.C.A.; Fed.Rules Bankr.Proc. Rule 9024, 11 U.S.C.A.

2. Federal Civil Procedure ⚷2646

Motions for relief from judgment pursuant to Rule 60(b) are directed to sound discretion of trial court; denial of such relief will be set aside only upon showing of abuse of discretion except in case of void judgment. Fed.Rules Civ.Proc.Rule 60(b), 28 U.S.C.A.; Fed.Rules Bankr.Proc.Rule 9024, 11 U.S.C.A.

3. Federal Civil Procedure ⚷2642

Court has no discretion and must set aside void judgment.

4. Federal Civil Procedure ⚷2660

Court cannot set aside or modify final judgment it had issued previously and enter new and different judgment without giving prior notice to all affected parties; failure to give such notice renders judgment void.

5. Federal Civil Procedure ⚷2392

Void judgment imposes no binding obligation upon parties and is legally ineffective.

6. Federal Civil Procedure ⚷2660

Amended judgment against debtor for postjudgment interest pursuant to trustee's motion was not void so as to justify vacating judgment on ground that debtor did not receive proper notice of motion or of hearing held on motion, where service was made by mailing copy of motion and notice of hearing to debtor's last known address by first class mail and there was no indication that debtor had changed her address and service was made upon debtor's attorney at his place of business and there was no indication that attorney of record did not actually receive copy or that he was no longer debtor's attorney at time of service. Fed.Rules Civ.Proc.Rules 5(b), 60(b), 28 U.S.C.A.; Fed.Rules Bankr.Proc.Rules 7005, 9024, 11 U.S.C.A.

7. Federal Civil Procedure ⚷2655

Reversal of judgment as result of successful appeal brought by codefendant of debtor in turnover action by bankruptcy trustee did not justify vacating judgment against debtor who elected not to appeal original judgment, absent showing of unusual or compelling factors justifying departure from doctrine of law of case. Fed. Rules Civ.Proc.Rule 60(b)(5), 28 U.S.C.A.

8. Courts ⚷99(1)

Federal Civil Procedure ⚷2642

Adverse judgment which is successfully appealed by one codefendant but not by other codefendant remains law of case as far as codefendant who did not appeal is

concerned, and Rule 60(b) does not provide avenue for relieving nonappealing codefendant from adverse judgment. Fed. Rules Civ.Proc.Rule 60(b), 28 U.S.C.A.

9. Federal Civil Procedure ⚬=2641

Party who elected not to appeal is deemed to have waived right to challenge that decision at later time.

10. Courts ⚬=99(1)

Barring showing of unusual circumstances or compelling reasons, reconsideration of prior decision in same case is precluded by doctrine of law of case.

11. Federal Civil Procedure ⚬=2655

Amended judgment against debtor for postjudgment interest was not "based" on prior judgment against debtor in turnover proceeding so as to justify setting aside of amended judgment on ground that prior judgment was reversed on appeal, where amended judgment was based on prior decision against debtor in same case rather than in different case. Fed.Rules Civ.Proc. Rule 60(b)(5), 28 U.S.C.A.

See publication Words and Phrases for other judicial constructions and definitions.

12. Federal Civil Procedure ⚬=2655

Rule authorizing relief from judgment on ground that prior judgment on which it is based has been reversed or vacated is limited to cases in which judgment or order which one seeks to have vacated or set aside is "based" on prior judgment or determination having res judicata or collateral estoppel effect. Fed.Rules Civ.Proc. Rule 60(b)(5), 28 U.S.C.A.

13. Judgment ⚬=634

Res judicata and collateral estoppel apply where decision or finding in one case determines decision or issue in a different case; they do not apply to decisions in same case.

14. Federal Civil Procedure ⚬=2655

Application of rule authorizing relief from judgment when prior judgment on which it is based has been reversed or vacated is limited to situations in which decision or finding in one case is predetermined by decision or finding in another case. Fed.Rules Civ.Proc.Rule 60(b)(5), 28 U.S.C.A.

15. Federal Civil Procedure ⚬=2655

Amended judgment against debtor for postjudgment interest would not be vacated on ground that it would be unfair and unequitable to permit judgment against debtor to stand when judgment against her codefendants in turnover proceeding had been reversed on appeal, where debtor made calculated and deliberate choice not to appeal judgment against her and failed to identify any exceptional circumstances justifying relieving her from judgment for justice to be accomplished, and it would be unfair and inequitable to debtor's creditors to vacate judgment against her even though judgment was reversed as to others on technicality. Fed.Rules Civ.Proc.Rule 60(b)(6), 28 U.S.C.A.

16. Federal Civil Procedure ⚬=2655

As general matter, party will not be granted relief from judgment pursuant to rule authorizing relief for any other reason justifying relief, even though relief from judgment might have been obtained had party taken appeal. Fed.Rules Civ.Proc. Rule 60(b)(6), 28 U.S.C.A.

17. Federal Civil Procedure ⚬=2651.1

Rule authorizing relief from judgment for any other reason justifying relief vests court with authority to vacate judgment when such action is appropriate to accomplish justice; relief from judgment pursuant to rule is extraordinary relief and may be granted only upon showing of exceptional circumstances. Fed.Rules Civ.Proc.Rule 60(b)(6), 28 U.S.C.A.

18. Federal Civil Procedure ⚬=2651.1

Showing that litigant who has successfully appealed adverse judgment has fared better than colitigant who elected not to appeal does not justify relief from judgment pursuant to rule authorizing relief for any other reason. Fed.Rules Civ.Proc.Rule 60(b)(6), 28 U.S.C.A.

L. Lawrence Hodge, Pittsburgh, PA, for debtor.

Gary W. Short, Pittsburgh, PA, for trustee.

MEMORANDUM OPINION

BERNARD MARKOVITZ, Bankruptcy Judge.

Debtor Emily Davis requests that a judgment against her issued by this court on September 5, 1991 be vacated pursuant to FED.R.CIV.P. 60(b)(4), (5), and/or (6). Debtor asserts that the judgment should be vacated because it is void; because a prior judgment upon which it was based has been reversed; and because it would be unfair and inequitable to permit the judgment against her to stand when the judgment against her co-defendants was reversed on appeal.

The trustee opposes the motion and denies that there are good grounds for vacating the judgment.

Debtor's motion will be denied for reasons set forth below.

–I–

FACTS

Debtor filed a voluntary chapter 7 petition on October 24, 1984. Her address at the time was listed as: 1720 Pierce Street, Aliquippa, Pennsylvania. On Schedule B-4, Exemptions, debtor claimed the proceeds of a pending lawsuit against Trans World Airlines ("TWA") as exempt pursuant to 11 U.S.C. Sections 522(b) and (d). The value of the lawsuit was listed as "unknown". The trustee did not formally object to the claimed exemption.

On October 16, 1985, debtor received a discharge. An appeal in the lawsuit against TWA was still pending at that time.

Approximately two (2) years later, on September 11, 1987, debtor and TWA settled the lawsuit for $110,000.00. Shortly thereafter, TWA issued a check to debtor and another check to the law firm of Freeland & Kronz ("F & K"), debtor's counsel in the lawsuit against TWA.

On October 8, 1988, the trustee commenced the present adversary action against debtor, F & K, Wendell Freeland, and Richard Kronz. The trustee sought to avoid postpetition transfers of estate property and to recover them for the benefit of debtor's creditors. Debtor's address had changed in the four (4) years since she had filed for bankruptcy. A copy of the complaint and a summons were served upon her at: 1762 Skyline Drive, Pittsburgh, Pennsylvania. Copies were also served upon debtor's bankruptcy counsel, Stanley Levine, Esq., at: 3100 Grant Building, Pittsburgh, Pennsylvania.

Trial on the adversary action was conducted on July 5, 1989. Debtor still resided at the time of trial at the Skyline Drive address.

Judgment was entered against F & K, Wendell Freeland, Richard Kronz, and debtor on September 7, 1989. They were directed to turn over to the trustee the sum of $23,487.75 plus interest. *In re Davis,* 105 B.R. 288 (Bankr.W.D.Pa.1989). This sum was sufficient to pay all unsecured claims in full without interest and pay the attorney to the trustee a modest fee. No sum was included for the trustee as his failure to timely object had necessitated this adversary action. Thereafter, the court reasoned, the debtor could pursue her "fresh start" debt-free after sharing approximately $86,500.00 with her attorney.

F & K, Wendell Freeland, and Richard Kronz ("appellants") filed a timely notice of appeal to the district court of the judgment against them. Debtor did *not* appeal the judgment as it pertained to her.

An order denying the appeal and affirming the judgment of this court was issued by the district court on September 7, 1990. *In re Davis,* 118 B.R. 272 (W.D.Pa.1990). Appellants thereupon filed a timely appeal of the decision of the district court with the United States Court of Appeals for the Third Circuit ("Third Circuit").

On March 13, 1991, while the appeal before the Third Circuit was pending, the trustee filed in this court an amended praecipe to enter judgment. The trustee sought to amend the judgment of this court which had been issued on September 7,

1989 to reflect post-judgment interest at the rate of 7.68%. No action on the trustee's motion was taken by this court at that time because of the pending appeal to the Third Circuit.

A judgment reversing the order of the district court was issued by the Third Circuit on July 8, 1991. *Taylor v. Freeland & Kronz,* 938 F.2d 420 (3d Cir.1991). The court held in pertinent part as follows:

> Absent a timely filed objection, the property claimed by a debtor as exempt under section 522 of the Bankruptcy Code is exempt. In this case, Davis the debtor claimed the potential proceeds of her then-pending lawsuit against TWA as exempt. No objection to that claimed exemption was filed with the court by any party in interest. The proceeds of the TWA lawsuit are thus exempt. Because we find for *Freeland & Kronz* on this issue, we need not decide other issues it has raised. We will reverse the order of the district court. (Emphasis added.)

938 F.2d at 426. The trustee thereupon filed a timely petition for a writ of certiorari to the United States Supreme Court. Since petitioner Emily Davis took no appeal, no determination of her liability was rendered by the Third Circuit. As she was not before the court, no order of reversal was issued as it relates to her.

An order was issued by this court on August 8, 1991 scheduling a hearing for September 5, 1991 on the trustee's motion to amend judgment which the trustee had filed on March 13, 1991. The Supreme Court had not yet determined whether it would grant certiorari with respect to the trustee's appeal.

On August 14, 1991, the trustee filed a certificate of service with respect to the hearing scheduled for September 5, 1991. The trustee certified that a copy of the order scheduling the hearing and a copy of the motion had been served on August 12, 1991 on debtor, on her counsel in the adversary action, on F & K, and on F & K's counsel. Notice had been sent to debtor by first class mail at: 1720 Pierce Street, Aliquippa, Pennsylvania, the address listed on her bankruptcy petition. Notice was sent to her counsel in the adversary action, Stanley Levine, Esq., at: 3100 Grant Building, Pittsburgh, Pennsylvania.

The trustee subsequently came to realize that notice had been sent to debtor at the wrong address. On August 21, 1991, the trustee filed another certificate of service certifying that a copy of the motion and the scheduling order for September 5, 1991 hearing had been sent to debtor that day by first class mail at: 1762 Skyline Drive, Pittsburgh, Pennsylvania, the address at which debtor resided when trial of the above adversary action was held.

A hearing was held as scheduled on the trustee's motion on September 5, 1991. Counsel for the trustee and counsel for F & K appeared. Neither debtor nor her counsel appeared at the hearing. An amended judgment against debtor was issued that same day in the amount of $30,440.23 to reflect post-judgment interest. Judgment was not entered against F & K, Wendell Freeland, or Richard Kronz in light of the decision by the Third Circuit on July 8, 1991.

The United States Supreme Court granted certiorari on November 27, 1991 in the appeal filed by the trustee. *See Taylor v. Freeland & Kronz,* — U.S. ——, 112 S.Ct. 632, 116 L.Ed.2d 602 (1991). On April 12, 1992, the Supreme Court affirmed the judgment of the Third Circuit and held that the trustee's failure to object in a timely manner to debtor's claimed exemption, even though that claim was meritless and without colorable basis in law, precluded the trustee from contesting the validity of the exemption. *See Taylor v. Freeland & Kronz,* — U.S. ——, 112 S.Ct. 1644, 1647–48, 118 L.Ed.2d 280 (1992).

On December 16, 1992, debtor filed a motion to vacate the judgment of September 5, 1992. A hearing on the motion was held on January 26, 1993.

–II–

ANALYSIS

Debtor asserts that the judgment against her issued on September 5, 1991 should be

set aside pursuant to FED.R.CIV.P. 60(b)(4), (5), and (6). She argues that the judgment against her is void, and accordingly must be vacated pursuant to Rule 60(b)(4), because she did not receive notice of the trustee's motion or of the hearing held on September 5, 1991. Debtor further insists that the judgment should be vacated pursuant to Rule 60(b)(5) because the prior judgment of September 7, 1989, upon which it was based, had been reversed on appeal. Finally, debtor maintains that the judgment should be vacated pursuant to Rule 60(b)(6) because it would be unfair and inequitable to allow the judgment against her to stand when the judgment against appellants had been reversed on appeal.

Each of these arguments is without merit. Debtor's request that the judgment against her issued on September 5, 1991 be vacated shall be denied.

A) Rule 60(b)(4).

FED.R.CIV.P. 60(b) applies, with certain exceptions not here relevant, to adversary proceedings. *See* Bankruptcy Rule 9024. It provides in pertinent parts as follows:

> On motion and upon such terms as are just, the court may relieve a party ... from a final order, judgment, or proceeding for the following reasons: .... (4) the judgment is void; (5) ... a prior judgment upon which it is based has been reversed or otherwise vacated....; or (6) any other reason justifying relief from the operation of the judgment....

[1] As a general matter, Rule 60(b) cannot be used as a substitute for appeal. It may not be used to relieve a party of an erroneous ruling when that party has made a considered choice not to pursue an appeal. *See Ackermann v. U.S.,* 340 U.S. 193, 198, 71 S.Ct. 209, 211–12, 95 L.Ed. 207 (1950).

[2, 3] Motions brought pursuant to Rule 60(b) are directed to the sound discretion of the trial court. Denial of such relief will be set aside only upon a showing of abuse of discretion. *See Recreational Properties, Inc. v. Southwest Mortgage Corp.,* 804 F.2d 311, 314 (5th Cir.1986). The one exception is for a void judgment. The court has no discretion and must set it aside. *Id.*

[4, 5] A court cannot set aside or modify a final judgment it had issued previously and enter a new and different judgment without giving prior notice to all affected parties. *See Wetmore v. Karrick,* 205 U.S. 141, 27 S.Ct. 434, 51 L.Ed. 745 (1907). Failure to give such notice renders the judgment void. *Id.* A void judgment imposes no binding obligation upon the parties and is legally ineffective. *See Kalb v. Feuerstein,* 308 U.S. 433, 60 S.Ct. 343, 84 L.Ed. 370 (1940).

[6] Debtor's reliance upon *Wetmore* in support of her request that the judgment issued on September 5, 1991 be vacated pursuant to Rule 60(b)(4) is inappropriate. Unlike the affected party in *Wetmore,* debtor and/or her counsel in the adversary proceeding received prior actual notice of the trustee's motion and of the hearing on the motion scheduled for September 5, 1991.

Debtor asserts in an unsworn affidavit that she never received actual notice of the trustee's motion or of the hearing held on September 5, 1991. The court is not persuaded by debtor's self-serving denial.

Service was made in accordance with FED.R.CIV.P. Rule 5(b), which pertains to service of pleadings and of other matters in adversary actions. *See* Bankruptcy Rule 7005. Rule 5(b) provides in pertinent part as follows:

> Whenever under these rules service is required or permitted to be made upon a party represented by an attorney the service shall be made upon the attorney unless service upon the party is ordered by the court. Service upon the attorney or upon a party shall be made by delivering a copy to the attorney or party *or by mailing it to the attorney or party at the attorney's or party's last known address.... Service by mail is complete upon mailing.* (Emphasis added.)

As has been noted, a copy of the trustee's motion and notice of the hearing on it scheduled for September 5, 1991 were sent

to debtor on August 21, 1991 by first class mail at her last known address. There is no indication that debtor had changed her address once again. As far as can be determined from the record, debtor still resides at: 1762 Skyline Drive, Pittsburgh, Pennsylvania.[1]

Furthermore, even if *debtor* did not receive notice of the matter, her contention that proper notice was not received must be rejected. A copy of the motion and of the notice of hearing on it also were sent by first class mail on August 12, 1991 to her attorney in the adversary action at his place of business. There is no allegation or indication that her attorney of record did not actually receive a copy of the motion and the order scheduling a hearing. In addition, there is nothing in the record to indicate he was no longer her attorney at that time.

B) Rule 60(b)(5).

[7] Debtor insists that the judgment against her issued on September 5, 1991 should be vacated pursuant to Rule 60(b)(5) because the judgment of September 7, 1989 upon which it is based was reversed on appeal.

Reliance upon Rule 60(b)(5) is inappropriate for several reasons.

As has been noted, debtor chose *not* to appeal the judgment against her that was issued on September 7, 1989. The subsequent reversal was the result of a successful appeal brought by her co-defendants in the adversary action.

[8] An adverse judgment which is successfully appealed by one co-defendant but not by another co-defendant remains *the law of the case* as far as the co-defendant who did not appeal is concerned. Rule 60(b) does not provide an avenue for relieving the non-appealing co-defendant from the adverse judgment. *See Annat v. Beard,* 277 F.2d 554, 559 (5th Cir.), *cert. denied,* 364 U.S. 908, 81 S.Ct. 270, 5 L.Ed.2d 223 (1960). In other words, the decision as to the non-appealing co-defendant stands. The reversal applies only to the judgment as it pertains to the co-defendants who successfully appealed.

[9, 10] The party who elected not to appeal is deemed to have waived the right to challenge that decision at a later time. *See Williamsburg Wax Museum v. Historic Figures, Inc.,* 810 F.2d 243, 250 (DC Cir. 1987). Barring a showing of unusual circumstances or compelling reasons, reconsideration of a prior decision in the same case is precluded by the doctrine of the law of the case. *See Wzorek v. City of Chicago,* 906 F.2d 1180, 1185 (7th Cir.1990). There are no unusual or compelling factors in this case which justify a departure from the doctrine of the law of the case.[2]

[11] Moreover, although the judgment issued on September 5, 1991 unquestionably is "based" on the judgment issued on September 7, 1989, it is *not* "based" on the judgment of September 7, 1989 in the requisite sense.

[12, 13] Rule 60(b)(5) is limited to cases in which the judgment or order which one seeks to have vacated or set aside is "based" on a prior judgment or determination having *res judicata* or *collateral estoppel* effect. *See Marshall v. Board of Education, Bergenfield, N.J.,* 575 F.2d 417, 424 (3d Cir.1978). *Res judicata* and *collateral estoppel* apply where a decision or finding *in one case* determines the decision or an issue in a *different case.* They do *not* apply to decisions in the same case. *See In re Justice Oaks II, Ltd.,* 898 F.2d 1544, 1549–50 n. 3 (11th Cir.), *cert. den.,* 498 U.S. 959, 111 S.Ct. 387, 112 L.Ed.2d 398 (1990).

[14] In short, application of Rule 60(b)(5) is limited to situations in which a decision or finding in one case is predeter-

1. Moreover, the motion itself clearly apprised debtor of the relief sought by the trustee. The motion unequivocally states that the trustee sought to have the judgment issued on September 7, 1989 amended to include accrued post-judgment interest at the annual rate of 7.68%.

2. Debtor has cited to what she contends are compelling circumstances which justify vacating the judgment against her. These circumstances will be discussed when debtor's reliance upon Rule 60(b)(6) is examined.

mined by a decision or finding in another case. The judgment issued on September 5, 1991 was *not* "based" on (or predetermined by) a decision reached in *another* case. Rather, it was based on a prior decision against debtor reached in the *same* case.[3]

C) Rule 60(b)(6).

[15] Finally, debtor argues that the judgment should be vacated pursuant to Rule 60(b)(6) because it would be unfair and inequitable to permit the judgment against her to stand when the judgment against her co-defendants has been reversed on appeal. This argument is even less persuasive than the arguments previously discussed and must be rejected.

[16] As a general matter, a party will *not* be granted relief from judgment pursuant to Rule 60(b)(6) even though relief from the judgment might have been obtained had they taken an appeal. *See Ackermann*, 340 U.S. at 198, 71 S.Ct. at 211–12:

> Petitioner made a considered choice not to appeal, apparently because he did not feel that an appeal would prove to be worth what he thought was a required sacrifice of his home. His choice was a risk, but calculated and deliberate and such as follows a free choice. Petitioner cannot be relieved of such a choice because hindsight seems to indicate to him that his decision not to appeal was probably wrong.... There must be an end to litigation some day, and free, calculated, deliberate choices are not to be relieved from.

[17] Rule 60(b)(6) vests a court with authority to vacate a judgment when such action is appropriate to accomplish justice. *See Klapprott v. U.S.*, 335 U.S. 601, 614–15, 69 S.Ct. 384, 390, 93 L.Ed. 266 (1949). Relief from judgment pursuant to Rule 60(b)(6) is extraordinary relief and may be granted only upon a showing of exceptional circumstances. *See In re Fine Paper Antitrust Litigation*, 840 F.2d 188, 194 (3d Cir.1988).

Debtor's request that the judgment of September 5, 1991 be vacated pursuant to Rule 60(b)(6) must be rejected for several reasons.

To begin with, debtor made a calculated and deliberate choice not to appeal the judgment against her that was entered on September 7, 1989. *Ackermann*, if it is to remain vital, dictates that debtor is stuck with that judgment even though hindsight shows that she probably would have been successful had she appealed the judgment.

Also, debtor has not identified any exceptional circumstances which would justify relieving her from that judgment in order for justice to be accomplished. The only "exceptional circumstance" cited by debtor is that it would be unfair and inequitable to allow the judgment against her to stand when judgment against her co-defendants was vacated as a result of their successful appeal.

[18] This "exceptional circumstance" is insufficient for a variety of reasons to justify vacating the judgment against debtor. A showing that a litigant who has successfully appealed an adverse judgment has fared better than a co-litigant who elected not to appeal does not justify relief pursuant to Rule 60(b)(6). *See In re Fine Paper Antitrust Litigation*, 840 F.2d at 194.

Moreover, the success of debtor's co-defendants on appeal does *not* even compel the conclusion that it would be "unfair or inequitable" to permit the judgment against debtor to stand. Had the Supreme Court held that the claimed exemption was proper, this inference *perhaps* would be justified. The Supreme Court, however, did not so hold. Rather, it held only that the trustee's action was *barred* because he had failed to object to the claimed exemption in a timely manner. Moreover, the parties agreed and the Supreme Court determined:

3. All of the cases cited by debtor in support of her request for relief pursuant to Rule 60(b)(5) involve situations in which a judgment in one case predetermined the outcome in a different case. The analysis just presented indicates that this is necessary for the granting of relief pursuant to Rule 60(b)(5) and is not coincidental.

... "that Davis did not have a right to exempt more than a small portion of these proceeds either under state law or under the federal exemptions specified in § 522(d). Davis in fact claimed the full amount as exempt. Taylor, as a result, apparently could have made a valid objection under § 522(1) and Rule 4003 if he had acted promptly."

Taylor, — U.S. at ——-——, 112 S.Ct. at 1647–48. Indeed, had the trustee acted promptly the exemption claimed by debtor would not have been allowed as it lacked merit. Accordingly, it would be unfair and inequitable to debtor's creditors to vacate the judgment against her even though the judgment was reversed as to others.

An appropriate order shall be issued.

In re Brian F. LEYDET, Sr. and Ann Marie Leydet, Debtors.

T. Garry LaROSSA, Donna J. Hall, Trustee, Objectors,

v.

Brian F. LEYDET, Sr., and Ann Marie Leydet, Debtors.

Bankruptcy No. 91-25434-T.

United States Bankruptcy Court,
E.D. Virginia,
Norfolk Division.

Jan. 15, 1993.

After the Chapter 11 debtors' case was converted to Chapter 7, objections were filed to one debtor's claimed exemption in stock. The Bankruptcy Court, Douglas O. Tice, Jr., J., held that new 30-day period for objecting to exemptions arose upon conversion of the debtors' case, and, thus, objections were timely.

So ordered.

1. Bankruptcy ⚷3594

New meeting of creditors is required upon conversion from Chapter 11 to Chapter 7. Bankr.Code, 11 U.S.C.A. § 341(a).

2. Bankruptcy ⚷3594

New creditors meeting held after conversion from Chapter 11 to Chapter 7 is not continuation or extension of meeting of creditors in the Chapter 11 proceeding, but is separate and distinct meeting in which new trustee must be selected. Bankr. Code, 11 U.S.C.A. §§ 341(a), 348(e).

3. Bankruptcy ⚷3024, 3594

"Meeting of creditors" referred to in Bankruptcy Rule providing that objections to exemptions may be filed within 30 days after the meeting of creditors includes the meeting of creditors held when a case is converted from Chapter 11 to Chapter 7; therefore, a new 30-day period for objecting to exemptions was created when the debtors' case was converted from Chapter 11 to Chapter 7. Fed.Rules Bankr.Proc. Rules 1019(2), 4003(b), 11 U.S.C.A.

James H. Walsh, Patrick L. Hayden, E. Lynn Lewis, McGuire, Woods, Battle & Boothe, Norfolk, VA, for T. Garry LaRossa.

Donna J. Hall, Virginia Beach, VA, trustee.

Jacqueline A. Hoskins, Virginia Beach, VA, for debtors.

MEMORANDUM OPINION

DOUGLAS O. TICE, Jr., Bankruptcy Judge.

This case came before the court on January 7 and 8, 1993, for hearing on objections to debtors' claim of exemptions, which were filed by T. Garry LaRossa and the chapter 7 trustee, Donna J. Hall. At the conclusion of the hearing the court ruled from the bench on a number of issues. This opinion supplements the court's bench

ORDERED that the Bankruptcy Court is hereby AFFIRMED. The Clerk is directed to mark this matter CLOSED.

James MOODY, Trustee of the Estate of Jeannette Corporation, et al., Plaintiffs,

v.

SECURITY PACIFIC BUSINESS CREDIT, INC., et al., Defendants,

v.

Frank W. STOREY and Calvin McCracken, individuals, Third-Party Defendants.

Civ. A. No. 83-2383.

United States District Court, W.D. Pennsylvania.

May 29, 1991.

Chapter 7 trustee instituted action to recover in excess of $12 million from participants in leveraged buyout of corporate debtor, alleging fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act and Bankruptcy Code, and unlawful dividend and/or distribution of corporate assets in violation of Pennsylvania statutes. The District Court, Diamond, J., held that: (1) conveyances involved in leveraged buyout were not intentionally fraudulent, for purposes of Pennsylvania Act; (2) leveraged buyout did not involve constructive fraud, within meaning of Pennsylvania Act; (3) trustee failed to establish that leveraged buyout should be set aside under fraudulent conveyance provisions of Bankruptcy Code; and (4) trustee failed to prove that unlawful dividend and/or distribution of corporation's assets took place as result of leveraged buyout transaction.

So ordered.

1. Bankruptcy ⟹2649

Corporations ⟹542(1)

Lender acted without fraudulent intent in agreeing to provide financing for buyer's acquisition of corporation, for purpose of determining whether leveraged buyout of debtor corporation constituted fraudulent conveyance under Pennsylvania law or Bankruptcy Code; lender, based upon its investigation of proposed transaction and its substantial experience with similar kinds of transactions, had reasonably expected that corporation would operate profitably after acquisition. Bankr.Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 356, 357.

2. Bankruptcy ⟹2649

Corporations ⟹542(1)

Seller of debtor corporation knew that transaction would be leveraged for substantial part of purchase price at time of closing, for purpose of determining whether leveraged buyout constituted fraudulent conveyance under Pennsylvania law or Bankruptcy Code; seller had rejected buyer's stock redemption proposal, which clearly demonstrated buyer's intent to leverage the transaction, buyer had told seller's officials that he intended to encumber corporation's assets, seller and lender entered into intercreditor agreement regarding their security interests in corporation's assets, and seller's officials were present at closing and preclosing. Bankr.Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 356, 357.

3. Bankruptcy ⟹2650(1)

Corporations ⟹542(1)

Present fair salable value of debtor corporation's receivables after leveraged buyout transaction was approximately $8.3 million, for purpose of determining whether leveraged buyout constituted fraudulent conveyance under Pennsylvania law or Bankruptcy Code, where corporation actually collected at least $8.3 million on accounts receivable that were outstanding at time of transaction, and over $7 million of that amount was collected within three months of transaction. Bankr.Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 356, 357.

4. Bankruptcy ⇨2650(1)
Corporations ⇨542(1)

Present fair salable value of debtor corporation's inventory following leveraged buyout transaction would be calculated by using either "alternate standard reserve" carried on seller's financial records or on analysis of extent to which inventory might not have been sold or used profitably in period following transaction, for purpose of determining whether leveraged buyout constituted fraudulent conveyance under Pennsylvania law or Bankruptcy Code. Bankr.Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 356, 357.

5. Bankruptcy ⇨2650(1)
Corporations ⇨542(1)

Debtor corporation's property, plant and equipment did not lack net worth at time of leveraged buyout, but instead had worth of at least $5 to $6 million, for purpose of determining whether leveraged buyout constituted fraudulent conveyance under Pennsylvania law or Bankruptcy Code, where corporation had carried its property, plant and equipment on its books and records at value of over $17 million, such assets of corporation and its subsidiaries were disposed of in transactions in which consideration totaled in excess of $9 million under extremely unfavorable sale conditions, including several transactions associated with bankruptcy proceedings, and corporation's parent had expended substantial amounts over three-year period on capital additions and maintenance. Bankr. Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 356, 357.

6. Bankruptcy ⇨2643
Corporations ⇨542(1)

Fact that present fair salable values of assets of debtor corporation and its subsidiaries following leveraged buyout transaction exceeded their liabilities by at least $1 to $2 million supported conclusion that corporation was solvent after transaction, for purpose of determining whether leveraged buyout constituted fraudulent conveyance under Pennsylvania law or Bankruptcy Code. Bankr.Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 356, 357.

7. Bankruptcy ⇨2641
Corporations ⇨542(1)

Leveraged buyout transaction did not leave debtor corporation with unreasonably small capital with which to conduct business, for purpose of determining whether leveraged buyout constituted fraudulent conveyance under Pennsylvania law or Bankruptcy Code; corporation still had positive net working capital, plus access to additional credit, after transaction, and corporation had gone full cycle of 12 months during which corporation had paid out to vendors, other creditors, and employees over $75 million, had always met its payroll, had positive cash flows, and had substantial inventory for coming peak season, without using up its total availability on revolving credit facility. Bankr.Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 356, 357.

8. Bankruptcy ⇨2641
Corporations ⇨542(1)

Debtor corporation's adoption of new creditor payment policy following leveraged buyout transaction did not justify finding that corporation was left with unreasonably small capital as result of transaction, for purpose of determining whether leveraged buyout constituted fraudulent conveyance under Pennsylvania law or Bankruptcy Code, where new policy was implemented in face of dramatically changed and unforeseen market conditions. Bankr.Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 356, 357.

9. Bankruptcy ⇨2649
Corporations ⇨542(1)

Substantial increase in debtor corporation's month-end accounts payable balance in one-month period following leveraged buyout transaction did not show that participants in transaction intended to hinder, delay and defraud corporation's creditors, and that corporation was left with unreasonably small capital, for purpose of determining whether leveraged buyout constituted fraudulent conveyance under Pennsylvania law or Bankruptcy Code; reasonable explanation for rise in payables balance was combination of adoption of longer payment policy for creditors with increased

production by corporation. Bankr.Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 356, 357.

10. Bankruptcy ⟹2151

Chapter 7 trustee could attack leveraged buyout of corporate debtor as being fraudulent conveyance under Pennsylvania law pursuant to provision of Bankruptcy Code allowing trustee to stand in shoes of corporate debtor's unsecured creditors, where a bank constituted unsecured creditor of debtor both as of date of leveraged buyout and date of bankruptcy filing. Bankr.Code, 11 U.S.C.A. § 544(b); 39 P.S. §§ 356, 357.

11. Corporations ⟹542(1)

Fraudulent conveyance laws apply to leveraged buyout of corporation.

12. Fraudulent Conveyances ⟹298(1)

Plaintiff bears burden under Pennsylvania Uniform Fraudulent Conveyance Act of demonstrating intent to defraud through clear and convincing evidence. 39 P.S. § 357.

13. Fraudulent Conveyances ⟹298(1)

Plaintiff may meet his burden under Pennsylvania Uniform Fraudulent Conveyance Act of demonstrating intent to defraud by introducing evidence which supports inference of intent. 39 P.S. § 357.

14. Fraudulent Conveyances ⟹273

Intent to defraud may be inferred from subsequent conduct, for purposes of Pennsylvania Uniform Fraudulent Conveyance Act. 39 P.S. § 357.

15. Corporations ⟹542(1)

Participants in leveraged buyout of corporation did not know or believe that corporation's creditors could not be paid, and did not intend to hinder, defraud, or delay creditors, for purpose of determining liability under Pennsylvania Uniform Fraudulent Conveyance Act, even though transfers made by corporation as part of leveraged buyout were without fair consideration; participants expected corporation to succeed under buyer's management and under financing agreement which buyer had entered into with lender. 39 P.S. § 357.

16. Corporations ⟹542(1)

Fact that investors in buyer of corporation through leveraged buyout transaction took relatively large bonuses for themselves and granted bonuses to others, rented luxury automobile for corporation's new president, and had paid one investor's invoices earlier than those of other creditors, did not prove intent to hinder, delay, or defraud creditors, for purpose of determining whether leveraged buyout constituted fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act. 39 P.S. § 357.

17. Corporations ⟹542(1)

Corporate debtor's Chapter 7 trustee failed to show that leveraged buyout constituted fraudulent conveyance under Pennsylvania statute providing that every conveyance made and every obligation incurred without fair consideration, when person making conveyance or entering into obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors; although transfers were made without fair consideration, participants in leveraged buyout intended and believed that corporation would prosper and would be able to pay its debts in timely manner. 39 P.S. § 356.

18. Corporations ⟹542(1)

In determining whether leveraged buyout transaction constituted constructively fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, various steps in leveraged buyout would be "collapsed" and treated as one integral transaction, where lender never would have made initial unsecured loan to buyer without being assured of first security interest in all of corporation's assets, and buyer could not have purchased corporation without funds from lender. 39 P.S. § 354.

19. Corporations ⟹542(1)

Adequate consideration did not support corporation's undertaking to repay $11.7 million loan at 3¼% interest above prime rate, and granting security interest to lender to insure repayment of that loan, for purpose of determining whether leveraged

buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, where none of the initial $11.7 million advance was used for operation of corporation's business. 39 P.S. §§ 353, 354.

20. Corporations ⚩542(1)

Access to working capital did not constitute fair consideration for corporation's undertaking to pay $11.7 million loan at 3¼% interest above prime rate, for purpose of determining whether leveraged buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, where loan proceeds actually went to a parent corporation. 39 P.S. §§ 353, 354.

21. Corporations ⚩542(1)

New management could not constitute fair consideration for corporation's undertaking to pay $11.7 million loan at 3¼% interest above prime rate, for purpose of determining whether leveraged buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, where loan proceeds actually went to a parent corporation. 39 P.S. §§ 353, 354.

22. Corporations ⚩547(4)

Under Pennsylvania Uniform Fraudulent Conveyance Act, burden shifts to proponent of transfer to show that corporation was solvent at time of transfer if opponent proves that transfer was for less than fair consideration and that corporation was "in debt" at time of conveyances. 39 P.S. §§ 353, 354.

23. Corporations ⚩547(4)

Rule that transferee has burden of proof under Pennsylvania Uniform Fraudulent Conveyance Act to establish solvency of corporation at time of transfer when transfer is not supported by fair consideration to corporation is not limited to interfamilial transfers. 39 P.S. §§ 353, 354.

24. Corporations ⚩542(1)

Corporation was not rendered insolvent by leveraged buyout transaction, for purpose of determining whether leveraged buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act; selling price did not show insolvency since buyer purchased stock at bargain price. 39 P.S. §§ 352(1), 353, 354.

25. Corporations ⚩542(1)

Corporation's property, plant and equipment did not necessarily lack value, for purpose of determining whether leveraged buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, merely because property, plant and equipment constituted specialized property related to manufacture of housewares and presumably could not be sold on moment's notice. 39 P.S. §§ 352(1), 353, 354.

26. Fraudulent Conveyances ⚩61

Economic realities of transfer cannot be ignored when determining whether transfer constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act. 39 P.S. § 354.

27. Corporations ⚩547(4)

Evidence supported conclusion that parties to leveraged buyout of corporation did not expect corporation to repay loan in short term, even though it was classified as demand note, for purpose of determining whether leveraged buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act. 39 P.S. § 354.

28. Corporations ⚩547(4)

To determine "present fair salable value" of corporation's property, plant and equipment, for further purpose of determining whether leveraged buyout of corporation constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, immediately available market did not have to be presumed in order to assign value to such assets. 39 P.S. § 354.

See publication Words and Phrases for other judicial constructions and definitions.

29. Corporations ⇐542(1)

Corporation's assets, including its property, plant and equipment, would have to be valued on going concern basis, rather than on liquidation basis, for purpose of determining whether leveraged buyout of corporation constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, where corporation's failure was not clearly imminent on date of leveraged buyout transaction, but instead corporation's assets had substantial value. 39 P.S. § 354.

30. Corporations ⇐542(1)

In addressing whether corporation was insolvent or had unreasonably small capital at time of leveraged buyout, for purpose of determining whether leveraged buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, bankruptcy court would have to consider whether corporation would be able to meet its obligations as it carried on its business following leveraged buyout. 39 P.S. §§ 354, 355.

31. Corporations ⇐542(1)

Adequacy of corporation's capitalization following leveraged buyout would be viewed as of date of transaction, although adequacy of capitalization should also encompass reasonable period of time after transaction, for purpose of determining whether leveraged buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act. 39 P.S. §§ 354, 355.

32. Corporations ⇐542(1)

Parties to leveraged buyout transaction may rely upon reasonable cash flow projections made at time of transaction in arriving at proper capital structure for corporation, for purpose of determining whether leveraged buyout constitutes constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act. 39 P.S. §§ 354, 355.

33. Corporations ⇐542(1)

Corporation did not have to be found insolvent or left with unreasonably small capital merely because lender provided it with its working capital, for purpose of determining whether leveraged buyout of corporation constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, where participants in leveraged buyout relied on their reasonable projections, and projections of corporation's management, that corporation's sales would stay relatively constant or improve following buyout. 39 P.S. §§ 354, 355.

34. Corporations ⇐542(1)

Corporation was not left with unreasonably small capital in its hands following leveraged buyout, nor was it insolvent in the "equity sense," for purpose of determining whether leveraged buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, even though corporation was ultimately placed into bankruptcy 15 months later, where bankruptcy was caused by number of complex factors including continued recession, intense competition from foreign manufacturers, mismanagement of corporation, and buyer's principal's illness and inability to attend to business. 39 P.S. §§ 354, 355.

35. Corporations ⇐542(1)

Corporation's delay in payments to creditors not long after leveraged buyout transaction did not prove that corporation was insolvent in the "equity sense" or was left with unreasonably small capital, for purpose of determining whether leveraged buyout constituted constructive fraudulent conveyance under Pennsylvania Uniform Fraudulent Conveyance Act, where corporation was not forced to delay payments to creditors because of leveraged buyout transaction, but rather was attempting to equalize its payments and receipts. 39 P.S. §§ 354, 355.

36. Bankruptcy ⇐2643, 2649

Leveraged buyout of corporate debtor did not constitute fraudulent transfer under Bankruptcy Code, even though corporation filed for bankruptcy relief 15 months after leveraged buyout, where corporation was not insolvent at time of leveraged buyout, and parties to leveraged buyout did

not intend to hinder or defraud creditors. Bankr.Code, 11 U.S.C.A. § 548.

37. Bankruptcy ⚩2643

If corporation was solvent at time of leveraged buyout, for purposes of Pennsylvania Uniform Fraudulent Conveyance Act, then corporation clearly was solvent for purposes of fraudulent conveyance provisions of Bankruptcy Code, since concept of insolvency under Pennsylvania statute is broader than that in Code. Bankr.Code, 11 U.S.C.A. §§ 548, 549; 39 P.S. §§ 354, 356, 357.

38. Bankruptcy ⚩2588

Chapter 7 trustee failed to establish that corporate debtor's repayments of loan, which arose in context of leveraged buyout transaction, should be set aside under provision permitting trustee to avoid postpetition transfer of property of estate that is not authorized under Bankruptcy Code or by bankruptcy court, where conveyances involved in leveraged buyout transaction were not fraudulent, and thus trustee could not prove that repayments of secured loan were "not authorized." Bankr.Code, 11 U.S.C.A. § 549(a)(1)(B).

See publication Words and Phrases for other judicial constructions and definitions.

39. Corporations ⚩542(1)

Even if corporation's $11.7 million initial advance as part of leveraged buyout transaction constituted distribution or dividend, trustee in corporation's Chapter 11 proceeding could not recover advance under Pennsylvania statute, where corporation was not rendered insolvent as result of leveraged buyout transaction. 15 P.S. §§ 1701, 1702 (Repealed).

Robert J. Cindrich, David B. Mulvihill, Manning J. O'Connor II, Mansmann Cindrich & Titus, Douglas A. Campbell, Stanley E. Levine, Campbell & Levine, Pittsburgh, Pa., for plaintiffs.

James D. Morton, George L. Cass, Buchanan Ingersoll, P.C., Pittsburgh, Pa., William F. Lloyd, Michael J. Sweeney, Sidley & Austin, Chicago, Ill., for defendant, Security Pacific Business.

David J. Armstrong, George E. McGrann, Dickie, McCamey & Chilcote, Pittsburgh, Pa., Philip M. Halpern, Collier, Cohen, Shields & Bock, New York City, for defendants, Coca Cola of New York and KNY Development.

W. Woodruff Turner, Robert B. Sommer, Terry Budd, Kirkpatrick & Lockhart, Pittsburgh, Pa., for defendants, John P. Brogan, John J. Brogan, Hanley Dawson, Jr., Hanley Dawson III, James McLean, James R. Winoker, J. Corp., Inc. and Muench–Kreuzer Candle Co.

Robert L. Potter, Frank R. Arcuri, Strassburger, McKenna, Gutnick & Potter, Pittsburgh, Pa., for third-party defendant, Frank W. Storey.

Grace S. Harris, Pittsburgh, Pa., for third-party defendant, Calvin D. McCracken.

OPINION

DIAMOND, District Judge.

Introduction

More than eighty years after the founding of its predecessor company, the Jeannette Corporation (sometimes hereafter "Jeannette") suffered an economic decline and bankruptcy in late 1982 from which it never recovered. Plaintiff, James Moody, Trustee of the bankruptcy estate, instituted this action to recover in excess of $12 million from the participants of a leveraged buyout of Jeannette that took place on July 31, 1981.

Plaintiff contends in this suit that the July 31, 1981, transaction was a fraudulent conveyance under the Pennsylvania Uniform Fraudulent Conveyance Act ("Pennsylvania Act") and the fraudulent conveyance provisions of the United States Bankruptcy Code. He also claims, *inter alia*, that certain of the defendants engaged in an unlawful dividend and/or distribution of Jeannette's assets, in violation of 15 Pa. Stat. §§ 1701, 1702.

On August 16, 1990, we concluded a five-week bench trial on Counts Two, Three, Five and Eight, the counts of the ten-count

amended complaint raising these issues.[1] In our findings of fact, conclusions of law and discussion below, we will set forth in detail our reasons for concluding that plaintiff has failed to establish that the July 31, 1981, transaction involved fraudulent conveyances or that any defendant authorized an unlawful dividend or distribution of Jeannette's assets. First, we summarize briefly the facts of the case and our conclusions of law.

Jeannette Corporation had its origin as Jeannette Glass Company, which was founded in 1898. Although glassmaking always remained one of Jeannette's principal businesses, it also manufactured and sold candles, ceramics, china and plastic housewares through several divisions and subsidiaries.

Maurice L. Stonehill controlled Jeannette from 1960 until it was purchased in 1978 by defendants Coca-Cola Bottling Company of New York, Inc. (sometimes hereafter "Coke of New York" or "Coke") and KNY Development Corporation (sometimes hereafter "KNY Development" or "KNY").

Coke and its subsidiary KNY purchased all of the stock of Jeannette in 1978 for nearly $40 million. After operating the company for two years with disappointing results, Coke put it on the market. Coke reached an agreement in principle to sell the company to one buyer for $19 million, but that sale was never consummated. Subsequently, on July 31, 1981, Coke and KNY sold Jeannette Corporation for $12.1 million to J. Corp., a holding company controlled by an investor group headed by defendant John P. Brogan. The Brogan group borrowed $11.7 million of the purchase price from defendant Security Pacific Business Credit, Inc. (sometimes hereafter "Security Pacific") through a transaction structured so that the loan ultimately was secured by a lien on all of Jeannette's assets. After some fifteen months under the Brogan group, a creditor of Jeannette filed an involuntary petition in bankruptcy against it under Chapter 7 of the Bankruptcy Code.[2]

We conclude, first, that the conveyances involved in the July 31, 1981, leveraged buyout of Jeannette Corporation were not intentionally fraudulent.

In arguing that the July 31, 1981, transaction involved intentionally fraudulent conveyances, plaintiff relies on the structure of the loan transaction between the Brogan group and Security Pacific and on the subsequent conduct of some of the defendants. Plaintiff argues that the defendants should be held liable under 39 Pa.Stat. § 357 and 11 U.S.C. § 548, because the evidence demonstrates that their actual intent was to hinder, delay, or defraud Jeannette's creditors. Plaintiff also argues that defendants should be liable under 39 Pa.Stat. § 356 because Jeannette intended or believed that it would incur obligations beyond its ability to pay. We explain below why we do not agree, and we set forth our reasons for finding that the transaction did not involve intentionally fraudulent conveyances.

Plaintiff also attacks the July 31, 1981, transaction under the constructive fraud sections of the applicable fraudulent conveyance acts, 39 Pa.Stat. §§ 354 and 355, and 11 U.S.C. § 548. While we find that the transaction was without fair consideration to Jeannette, we conclude that Jeannette was not rendered insolvent by it. Similarly, we conclude that Jeannette was not engaged in a business for which the capital remaining in its hands after the July 31, 1981, transaction was an unreasonably small capital. Because the fraudulent conveyance provisions of the Bankruptcy Code substantially mirror those of the Uniform Fraudulent Conveyance Act, we also

1. Plaintiff's claims for violation of the Racketeer Influenced and Corrupt Organizations Act (Count One), for breach of fiduciary duty (Counts Six and Seven), and for common law fraud (Count Nine) were severed and will be tried to a jury. Counts Four and Ten are no longer before us.

2. The bankruptcy case was converted to a voluntary one under Chapter 11 on December 10, 1982, with Jeannette Corporation operating as a debtor-in-possession. Subsequently, plaintiff was appointed trustee. This court converted the case to one under Chapter 7 by order dated May 1, 1990.

conclude that plaintiff has failed to establish that the transaction should be set aside under those provisions.

Finally, we conclude that plaintiff has failed to prove that an unlawful dividend and/or distribution of Jeannette's assets took place as a result of the July 31, 1981, transaction.

Findings of Fact [3]

Parties

1. Plaintiff James Moody is the duly appointed trustee of the bankruptcy estate of Jeannette Corporation. (Jt. Stip., ¶ 1).

2. Defendant Security Pacific Business Credit Inc. is a corporation organized and existing under the laws of the State of Delaware, engaged in the business of commercial finance, having a principal place of business at 228 East 45th Street in the City of New York, State of New York. A.J. Armstrong Co., Inc., which was engaged in the same business, was acquired by Security Pacific during the last week of July 1981. (For the sake of convenience, A.J. Armstrong Co., Inc. will be referred to hereinafter as "Security Pacific" unless otherwise noted). (Jt. Stip., ¶ 2).

3. Defendant The Coca-Cola Bottling Company of New York, Inc. is a corporation organized and existing under the laws of the State of Delaware, having a principal place of business in the Town of Greenwich, State of Connecticut. (Jt. Stip., ¶ 3).

4. Defendant KNY Development Corporation, which was also a Delaware corporation, was merged into Coke of New York and no longer exists as a corporate entity; it was a wholly-owned subsidiary of Coke of New York. (For convenience, Coke of New York and KNY Development will be referred to at times collectively as "Coke" or "Coke of New York"). (Jt. Stip., ¶ 4).

5. Defendant J. Corp. is a corporation incorporated under the laws of the State of Delaware on July 24, 1981. Defendant John P. Brogan ("Mr. Brogan" or "Brogan") has been the Chairman and a director of J. Corp., as well as of Jeannette Corporation, since July 1981. (Jt. Stip., ¶ 5).

6. Defendants Brogan, John J. Brogan, Brogan's father ("J.J. Brogan"), Hanley Dawson, Jr., Hanley Dawson III and James A. McLean became directors of Jeannette Corporation on or after July 31, 1981. Defendant James Winoker was a director of J. Corp. (D-259).[4]

7. Defendant Muench-Kreuzer Candle Company ("M-K Candle") is a corporation organized and existing under the laws of the State of Delaware. Brogan is also Chairman of the Board of M-K Candle. (Jt. Stip., ¶ 6).

Jeannette Corporation: 1898-1978

8. Jeannette Corporation is a Pennsylvania corporation headquartered in Jeannette, Pennsylvania which manufactured and sold, by itself or through subsidiaries, glass, ceramic, china, plastic and candle houseware products, principally in the United States and Canada. Jeannette's predecessor, the Jeannette Glass Company, was founded in 1898. (Jt. Stip., ¶ 7).

9. As of July 1981, there were four major components of Jeannette Corporation, which conducted different manufacturing operations at different locations. The Jeannette Glass division of Jeannette Corporation, located in Jeannette, Pennsylvania, manufactured glass products. The Brookpark division of Jeannette Corporation, located in Lake City, Pennsylvania, manufactured melamine dinnerware. The Royal China subsidiary of Jeannette Corporation, located in Ohio, manufactured earthenware, chinaware and ceramic products. The Old Harbor Candle subsidiary of Jeannette Corporation, located in Massachusetts, manufactured candles. (Joint Stip., ¶ 8).

3. The parties stipulated to many of the facts in this case and nearly all paragraphs of the Joint Stipulation were offered and received into evidence. When the court's finding is based upon the Joint Stipulation, we will cite the applicable paragraph, rather than the portion of the transcript showing the receipt of the stipulated fact in evidence.

4. We will reference exhibits by an abbreviation and a number. Stipulated exhibits will be identified by the letter "S," plaintiff's exhibits by "P," and defendants' by "D."

10. Jeannette's customers included chain, department, specialty and discount stores, market outlets, premium users, restaurant suppliers, and original equipment manufacturers such as lamp and appliance manufacturers. (Jt. Stip., ¶ 9).

11. In approximately 1960, Maurice L. Stonehill acquired a controlling interest in the Jeannette Glass Company, which subsequently became "Jeannette Corporation" in 1971. (Jt. Stip., ¶ 11).

12. During the years Mr. Stonehill controlled the company, Jeannette Glass/Jeannette Corporation made a number of acquisitions, including McKee Glass Works in 1961; Royal China Co. and the Brookpark facility in 1970; Old Harbor Candle Co. in 1975; and Walker China Co. in 1976.

13. During the mid–1970s, the officers of Jeannette Corporation included: Maurice L. Stonehill, Chairman; Mark B. Silverberg, President; Thomas S. Smith, Vice President—Manufacturing; Frank W. Storey, Vice President—Finance, Treasurer and Controller; and Calvin D. McCracken, Secretary.

14. For many years prior to 1979, Jeannette Corporation was a successful company. It and its subsidiaries experienced substantial growth and consistent profitability over those years. On a consolidated basis, annual net sales grew from approximately $9.6 million in 1965 to $61.7 million in 1978. Jeannette Corporation and its subsidiaries earned a net profit in each of those years, and in all of those years, except one, sales on a consolidated basis increased. (Jt. Stip., ¶¶ 12, 15).

15. On a consolidated basis, Jeannette's annual gross profit margin (net sales minus cost of goods sold) during 1965 through 1978 ranged from 18% to 32.9% of net sales. In all but two of those years it exceeded 20%. (Jt. Stip., ¶ 16).

16. During the three years ending December 31, 1977, Jeannette's sales, on a consolidated basis, had an average compound growth rate of 16% per year. (Jt. Stip., ¶ 17).

17. In the fiscal year ended December 31, 1977, Jeannette's consolidated financial records reflected net after-tax income of $3.4 million on sales of approximately $59 million. (Jt. Stip., ¶ 18).

18. Capital expenditures at Jeannette Corporation during 1977 included $2 million to build an electric glass-melting furnace which increased glass production capacity by 25%. The funds used to build the new electric furnace were borrowed from Mellon Bank, N.A., through the Westmoreland County Industrial Development Authority, at an interest rate of 6.34%. (Jt. Stip., ¶¶ 19–20).

19. In November 1977, Jeannette Corporation entered into a $6 million revolving credit arrangement with Mellon Bank. The proceeds of this arrangement were used to refinance short-term debt and otherwise augment working capital. (Jt. Stip., ¶ 21).

20. The consolidated pre-tax profit of Jeannette Corporation and its subsidiaries in 1978 was approximately $6.1 million, the highest ever achieved. (Jt. Stip., ¶¶ 22–23).

21. The testimony of a number of witnesses established that the business of Jeannette Corporation and its subsidiaries on a consolidated basis tended to be cyclical, with the second half of the year generally having higher sales and being more profitable than the first half. Jeannette Corporation's production, however, involved high fixed costs throughout the year. Its cash needs, therefore, varied substantially month to month. It needed access to cash from sources other than sales during the first half of the year in order to meet its expenses.

Jeannette Corporation: 1978–1981

22. In June of 1978, Coke of New York made a tender offer to acquire any and all outstanding shares of Jeannette Corporation stock for $20 per share, which the Jeannette board of directors accepted. (Jt. Stip., ¶ 24).

23. Coke of New York accomplished its acquisition of Jeannette Corporation through its wholly-owned subsidiary, KNY Development, and completed the acquisition by the end of 1978. Thereafter, Jeannette Corporation was operated as a whol-

ly-owned subsidiary of Coke of New York. (Jt. Stip., ¶ 25).

24. Coke of New York paid a total of approximately $39.6 million for the stock of Jeannette Corporation. This price was negotiated in an arms-length transaction between a willing buyer and a willing seller. (Jt. Stip., ¶ 26).

25. Coke of New York's acquisition of Jeannette Corporation was part of a diversification program it established because of concerns regarding its core bottling business. Prior to 1978, Coke of New York had acquired several other businesses as part of this program. (Jt. Stip., ¶¶ 27–28).

26. Charles E.F. Millard ("Mr. Millard") was the Chairman and Chief Executive Officer of Coke of New York from 1978 through 1981. (Jt. Stip., ¶ 29).

27. When Coke of New York purchased Jeannette Corporation, Mark Silverberg became Jeannette's Chief Executive Officer. Mr. Silverberg reported to William J. Sullivan, Executive Vice President of Coke of New York. Mr. Sullivan reported directly to Mr. Millard. (Jt. Stip., ¶¶ 30–32).

28. The May 1978 consolidated balance sheet of Jeannette Corporation and its subsidiaries reflected a net stockholders' equity of $23.5 million. Therefore, the $39.6 million purchase price exceeded the net book value of Jeannette Corporation by approximately $16 million. (Jt. Stip., ¶ 33).

29. Following the acquisition, Coke of New York adjusted some of Jeannette's asset and liability accounts to reflect their fair market value at the date of purchase, in accordance with Generally Accepted Accounting Principles ("GAAP"). (Jt. Stip., ¶ 34).

30. Coke of New York had a financial incentive to write-up the value of Jeannette's property, plant and equipment ("PP & E") to the maximum extent permitted because it paid approximately $16 million over book value. Had it not done so, then the entire $16 million excess would have been reflected as "goodwill." The amount of goodwill could be reduced to the extent that Coke of New York could justify moving it to the PP & E column where it became subject to depreciation.

31. To achieve this end, Coke of New York obtained an appraisal of Jeannette's PP & E. The appraisal report concluded that the fair market value of the PP & E of Jeannette Corporation and its subsidiaries was over $29 million, as of September 15, 1978. Of that amount, over $26 million related to PP & E that remained in Jeannette's possession as of July 31, 1981. (Jt. Stip., ¶¶ 35–36; D–169).

32. Based in part on the appraisal, Coke of New York increased the values assigned to some of the PP & E by approximately $5.7 million dollars on Jeannette Corporation's financial records, to an amount somewhat lower than the full appraised value. The total net book value for PP & E was approximately $22.4 million as of the end of 1978. (Jt. Stip., ¶ 36).

33. Over $11 million was allocated to goodwill on the Jeannette Corporation consolidated balance sheet, reflecting the cost to Coke of New York of the acquisition in excess of the value attributed to the assets and liabilities acquired. (Jt. Stip., ¶ 37).

34. Jeannette was not as financially successful in 1979, its first full year under Coke of New York's ownership, as it had been in prior years, particularly after giving effect to certain noncash adjustments and to costs associated with the acquisition. (Jt. Stip., ¶ 42; S–36, p. 7).

35. The consolidated pre-tax loss of Jeannette Corporation and its subsidiaries in 1979 was approximately $5 million. Approximately $2 million of that amount, however, was attributable to a new procedure adopted in that year for the valuation of inventory at the Jeannette Glass facility in order to satisfy the GAAP requirement that inventory be valued at the lower of cost or market. This adjustment did not involve any actual cash outlay. (Jt. Stip., ¶¶ 40–41; D–282, p. 1; S–29, pp. 4–6).

36. The consolidated net sales in 1979 were almost $4 million lower than they had been in 1978. This was only the second time since 1966 that annual net sales had declined from a prior year. (Jt. Stip., ¶ 43).

37. In June 1979, a special management task force of Coke of New York prepared a report analyzing the causes of Jeannette Corporation's disappointing 1979 performance. The task force found that the reasons for the large profit decline were complex and went to all aspects of Jeannette's business, and that the root causes of the problem were neither self-correcting nor short-term. Nevertheless, the report concluded that the problems could be corrected and that Jeannette could perform well in the future. (D-716).

38. Jeannette Corporation's financial performance improved in 1980 compared to 1979. Its net sales increased by over $9 million, and its gross margin as a percentage of net sales increased from 7.7% to 14.5%. It achieved approximately a break-even year prior to the recognition of Coke of New York's acquisition costs. (Jt. Stip., ¶¶ 67-68).

39. Jeannette Corporation's profit from operations in 1980 (before interest, miscellaneous expenses, taxes, and acquisition costs) was approximately $1.3 million. This figure would have been even higher but for the substantial expense resulting from depreciation. Mr. Pfingstler, Coke of New York's expert witness, testified that Jeannette had a positive cash flow in that break even year of approximately $3 million.

40. Jeannette Corporation's improved performance in 1980, compared to 1979, was due in large part to substantial increases in net sales by the Jeannette Glass division and by the Royal China subsidiary. (S-29, p. 5; S-36, pp. 7, 11-12).

41. In July 1981, immediately prior to the sale of Jeannette Corporation by Coke of New York to J. Corp., Jeannette Corporation was projecting that in 1981 it would have net sales of approximately $70 million and an operating income (before interest, taxes, and acquisition costs, but after depreciation) of $1,376,000. (S-2; S-33; D-891).

42. During the period 1978 through 1981, Coke of New York invested approximately $6 million in Jeannette for capital expenditures and approximately $5 million for maintenance and repairs to its physical plant.

Coke of New York's Search for a Buyer

43. In April 1979, corporate management at Coke of New York began evaluating all of its operations to determine which businesses it wished to continue to operate and which businesses it wished to divest. (Jt. Stip., ¶ 44).

44. Coke of New York ultimately decided to sell Jeannette Corporation as part of an overall corporate strategy designed to reverse the earlier diversification program and focus the company's attention and resources on its core bottling businesses. The decision occurred in the context of another strategic decision made in 1980, whereby Coke of New York ultimately was taken private in late 1981 in a leveraged buyout, valued at over $200 million. (Jt. Stip., ¶ 64).

45. In November 1979 Coke of New York retained Fulham & Co., Inc. ("Fulham & Co."), a private investment banking firm, to find prospective purchasers for Jeannette Corporation's Brookpark Division and its Old Harbor and Walker China subsidiaries. By December 1979, Fulham & Co. was asked to locate purchasers for all of Jeannette Corporation. (Jt. Stip., ¶¶ 46-47).

46. Fulham & Co. was authorized to develop qualified buyers and to conduct the preliminary steps in the acquisition of Jeannette Corporation by these buyers. By mid-April 1980, Fulham & Co. had contacted approximately 44 companies in connection with its effort to sell Jeannette Corporation. (Jt. Stip., ¶¶ 47-48; S-115).

47. In June 1980, Jeannette Corporation sold its Walker China subsidiary to Mayer China Company, pursuant to an agreement in principle reached during February 1980. (Jt. Stip., ¶¶ 49-50).

48. At its July 23, 1980, meeting, Coke of New York's board of directors ratified a recommendation to sell the stock of Jeannette Corporation, and determined that the value of Coke's investment in Jeannette should be written down, as of June 30, 1980, to approximately $17 million, a reduction of some $22.6 million from its previ-

ously carried book value. The write-down was made on the basis of negotiations in progress which indicated that Coke of New York would derive approximately $17 million from the sale of Jeannette, net of the costs associated with the sale. This write-down was in accordance with GAAP for reporting discontinued operations. (Jt. Stip., ¶¶ 54–57).

49. Also during the summer of 1980, the Coca-Cola Company based in Atlanta (hereafter "Coca-Cola") advised Mr. Millard of reports that a third party might be planning an unfriendly takeover of Coke of New York. (Jt. Stip., ¶ 62).

50. Throughout 1980, Fulham & Co. continued its efforts to locate a purchaser for Jeannette Corporation and/or its subsidiaries. (Jt. Stip., ¶ 66).

51. As part of these ongoing efforts, Fulham & Co. contacted a representative of Lancaster Colony Corporation ("Lancaster Colony"), on August 17, 1980, to discuss the interest Lancaster Colony might have in purchasing Jeannette Corporation. Lancaster Colony was a company engaged in the manufacture and sales of housewares. (Jt. Stip., ¶ 70).

52. Shortly thereafter, from late September through early November 1980, there were several discussions between management representatives of Coca-Cola and Coke of New York. Those discussions culminated in a tentative agreement on or about November 23, 1980, in which Coca-Cola agreed to purchase the stock of Coke of New York for $215.8 million, and then resell most of it to members of current management (including Mr. Millard) and other investors by means of a leveraged buyout. This leveraged buyout was consummated in August 1981, a month after the transaction at issue here. (Jt. Stip., ¶¶ 63–64).

53. Generally speaking, a leveraged buyout is a transaction in which a substantial part of the purchase price paid for the stock of a corporation is borrowed, and that borrowing is secured by the corporation's assets. A fundamental feature of leveraged buyouts generally is the substitution of debt for equity. The cash from the debt goes to the selling shareholders and the purchasers obtain the benefits of ownership.

54. On December 4, 1980, Coke of New York and Lancaster Colony jointly announced an agreement in principle for Lancaster Colony to acquire Jeannette Corporation from Coke of New York for cash and securities valued at approximately $19 million. (Jt. Stip., ¶ 71).

55. In late May 1981, Lancaster Colony informed Coke of New York that it was withdrawing its agreement to purchase the stock of Jeannette Corporation. While Coke of New York proposed a reduction in the sales price, the transaction never took place. (Jt. Stip., ¶ 72).

56. After Lancaster Colony withdrew its offer to purchase Jeannette Corporation, Fulham & Co. was recommissioned to search for prospective purchasers for Jeannette. (Jt. Stip., ¶ 73).

Coke of New York's Negotiations with Brogan

57. In June 1981, Mr. Brogan, who had known Mr. Fulham for many years, learned from Fulham & Co. that Coke of New York was attempting to sell Jeannette Corporation. Brogan previously had expressed an interest in purchasing Jeannette's Old Harbor subsidiary. (Jt. Stip., ¶¶ 73–75).

58. According to Brogan, his business involved acquiring companies through leveraged buyout transactions. M–K Candle, for example, was a company that he and his small group of regular investors had acquired through a leveraged buyout.

59. Fulham & Co. knew that Brogan's business centered on leveraged buyout transactions. It also knew that he was a successful businessman who had acquired and had profitably run companies through leveraged buyouts, although two of Brogan's companies had been involved in bankruptcy proceedings.

60. Through Fulham & Co., Coke of New York supplied financial data concerning Jeannette Corporation to Brogan and began to negotiate with him about a possible purchase of Jeannette. (Jt. Stip., ¶¶ 77, 78, 80, 81).

61. By mid-July 1981, Brogan had offered to acquire all of the stock of Jeannette Corporation for $11 million, along with a letter of credit in the amount of $1.5 million to assure payment of contingent pension liabilities. (Jt. Stip., ¶ 82).

62. According to Mr. Millard and Fred H. Marcusa, Coke of New York's Vice President and General Counsel, the price that would be paid to shareholders in the leveraged buyout of Coke of New York had been established by mid–1981. Therefore, the purchase price for Jeannette would have no impact on Coke of New York shareholders. Having lost half a year or more on the unsuccessful Lancaster Colony transaction, and with most of company management's attention being devoted to Coke of New York's own "going private" leveraged buyout transaction, Coke of New York was willing to reduce the selling price of Jeannette Corporation below the Lancaster Colony price. Coke of New York wanted a buyer who would be able to close the transaction expeditiously and allow it to move forward with its plans to be a privately held company focused on the bottling business.

63. During a meeting at the offices of his attorney, Brogan suggested that the transaction include a stock redemption. Brogan and Mr. Heberling, an in-house attorney for Coke of New York, testified that Brogan's proposal called for Coke of New York to cause Jeannette to encumber its assets to raise funds which would be paid to Coke to redeem (i.e., buy back from Coke) a portion of Jeannette's stock. Brogan would then buy the remaining Jeannette stock for the difference between the purchase price and the amount of the new encumbrance placed on Jeannette's assets.

64. Mr. Marcusa rejected Brogan's redemption proposal for several reasons, including Mr. Marcusa's judgment that the proposal was inappropriate and would involve complicated legal issues. Mr. Marcusa also believed that the deal should be relatively straightforward in light of the low purchase price.

65. On or about July 22, 1981, Brogan agreed to increase his offer for the stock of Jeannette Corporation from $11 million to $12 million, and Coke of New York dropped the requirement that Brogan provide it with a letter of credit as security for the potential unfunded pension liability. (Jt. Stip., ¶ 84).

66. As a condition for the elimination of the letter of credit, the Purchase Agreement between Coke of New York and J. Corp. provided that the Jeannette Union Pension Plan would not be terminated within sixty calendar months of the closing, and that the purchaser, J. Corp., would undertake to indemnify Coke of New York for any liability which would result from termination and/or derogation of the provisions of the Purchase Agreement. (Jt. Stip., ¶ 85).

67. As a further condition to the elimination of the letter of credit, Brogan agreed to provide to Coke of New York a security agreement and security interests in the assets of Jeannette Corporation to the extent that Coke of New York should be called upon to pay any unfunded vested pension liability. (Jt. Stip., ¶ 86).

68. The $12.1 million price at which the stock of Jeannette Corporation was ultimately sold on July 31, 1981, was not derived by evaluating individual or specific assets of Jeannette; rather, it was determined as a result of overall arm's length negotiations.

69. Both Brogan and Mr. Millard understood that Coke of New York's agreement to sell Jeannette Corporation for $12.1 million was conditioned on Brogan's completing the transaction by the end of July. If he did not do so, Coke of New York could change the price or "shop" the company to other prospective buyers. Coke of New York and Brogan reasonably viewed this price as a significant bargain for Brogan, made possible by Coke of New York's desire to return to its core businesses and Brogan's contemplated ability to close the transaction quickly.

70. In July 1981, Coke of New York wrote down its investment in Jeannette Corporation to approximately $9.1 million. This figure represented what Coke of New York had determined to be the anticipated

net realizable value to Coke of Jeannette at that time, including estimated costs of disposition and a reserve for losses through the expected date of sale, in accordance with GAAP. (Jt. Stip., ¶ 76).

Brogan's Efforts to Obtain Financing

71. Brogan approached New England Merchants Bank about the possibility of providing acquisition and working capital financing for Jeannette Corporation. New England Merchants Bank prepared a 55-page report that analyzed the accounts receivable and inventory of Jeannette Corporation and its subsidiaries. (Jt. Stip., ¶ 87).

72. By mid-July, Brogan realized that New England Merchants Bank would not be able to make a decision regarding the financing quickly enough. He contacted Joseph Realmuto, a Vice President of A.J. Armstrong Co., Inc. (which shortly thereafter became Security Pacific), about financing a transaction by the end of the month. (Jt. Stip., ¶ 88).

73. A.J. Armstrong had been in the business of providing secured financing, including leveraged acquisition financing, for many years. Its personnel had substantial experience in determining whether a business was a good candidate for a leveraged acquisition. (Jt. Stip., ¶ 89).

74. Because A.J. Armstrong was a small, informally run organization with substantial asset-based lending experience it could analyze and make a decision regarding a proposed transaction more rapidly than many other lending institutions.

75. Security Pacific (we will hereinafter refer to A.J. Armstrong and/or Security Pacific as "Security Pacific") was familiar with Mr. Brogan, having previously supplied the acquisition and ongoing working capital financing of M-K Candle. Its personnel had a high opinion of Brogan's business abilities, particularly his ability to run a business that had been acquired through a leveraged buyout. (Jt. Stip., ¶ 90).

76. Mr. Realmuto, during his prior employment with another commercial finance organization, had been the account executive involved in the financing of two companies which Brogan and his father had acquired Ingram Richardson Company and Road Machinery, Inc. (Jt. Stip., ¶ 91).

77. Ingram Richardson Company and Road Machinery, Inc., both of which had been acquired by means of leveraged transactions, were subsequently forced into Chapter 7 bankruptcies. Mr. Seiden, the Senior Vice-President at Security Pacific in charge of new business, was aware from discussions with Mr. Realmuto prior to July 31, 1981, that both companies had some difficulties. Nevertheless, Security Pacific had a high opinion of Brogan's ability to run a leveraged company in light of the M-K Candle relationship.

78. A day or two after the initial telephone call between Brogan and Mr. Realmuto, Brogan met with Security Pacific personnel in their New York offices to discuss possible financing. Brogan and Security Pacific understood that any such financing would be secured by a pledge of Jeannette Corporation's assets. This meeting took place on or after July 15, 1981. (Jt. Stip., ¶ 92).

79. In analyzing Jeannette, Brogan prepared one year of monthly projections of (a) Jeannette's balance sheet, (b) its income statement, and (c) the resulting anticipated revolving credit availability. These projections showed that availability remained positive by a comfortable margin throughout the entire year. Brogan provided these projections to Security Pacific, which reviewed them and concluded that they were reasonable. In fact, Security Pacific personnel considered the proposed Jeannette financing to be in the top ten percent of the deals they had done in this area. (Tr. 11, 93:8–94:24 (Brogan); Tr. 14, 127:20–130:25, 163:9–163:21 (Seiden)).[5]

Security Pacific's Decision to Finance the Transaction

80. Stephen Ngan performed part of Security Pacific's review of the proposed Jeannette Corporation financing. Mr. Ngan was a credit analyst who held an MBA

5. Our citations to the transcript of the trial will be in the form "Tr. [volume], [page]:[line]." When applicable, we will identify the witness following the transcript citation.

from New York University and who had years of prior experience at several lending institutions, including Chemical Bank and Chase Manhattan Bank. Mr. Ngan later left Security Pacific to acquire the Walkin Shoe Company through a leveraged buyout.

81. When Brogan originally spoke to Security Pacific about the transaction, he proposed that he and his investment group would invest a total of $400,000: $200,000 in stock, and $200,000 in subordinated debt. Security Pacific advised Brogan that it wanted to see more commitment on the investors' part, and suggested an equity investment of ten percent of the total purchase price, approximately $1.2 million. In lieu of this additional equity, Brogan offered to give Security Pacific a guaranty from M–K Candle, a profitable company owned by the J. Corp. investors.

82. Security Pacific accepted Mr. Brogan's proposal as it considered the M–K Candle guaranty to be very valuable because M–K Candle was a successful company. (Tr. Vol. 14, 138:20—140:14 (Seiden)).

83. During the last week of July 1981, Security Pacific sent Mr. Ngan and Metro Jones, a field examiner, to Jeannette Corporation's headquarters to review the company's financial records and to speak with company personnel. They had with them a copy of the New England Merchants report, which Brogan had given to Security Pacific, and were able to rely in part upon that prior work. Mr. Ngan spoke with Jeannette Corporation President Mark Silverberg and company financial personnel and relied upon information they provided to him. Mr. Ngan's analysis included a discussion with Frank Storey and other accounting personnel concerning Jeannette's working capital needs, going back through the company's prior performance on a month-by-month basis for an 18 month period. (Jt. Stip., ¶¶ 93–94; Tr. 5, 143:11–143:17 (McCracken); Tr. 17, 127:6, 140:18–141:22, 159:2–159:14, 170:2–170:11, 173:7–173:21, 185:19–186:3, 195:11–195:13 (Ngan); Tr. 20, 10:16–11:10).

84. While Mr. Ngan advised Jeannette Corporation personnel that his analysis was for the possible financing of Brogan's transaction, he did not advise them of the structure of the proposed transaction.

85. Mr. Ngan worked with a sense of urgency because Security Pacific had little time to decide whether to finance Brogan's purchase of Jeannette.

86. Based upon the financial information and projections Mr. Ngan obtained from Jeannette Corporation, he prepared a memorandum dated July 28, 1981, in which he discussed Jeannette Corporation's financial condition and analyzed the possible effects of the proposed acquisition financing on the company. (Jt. Stip., ¶ 95; S–29).

87. The parties disputed the impact of Mr. Ngan's memo, as well as the soundness of its assumptions and conclusions. Mr. Ngan concluded that after the proposed acquisition, Jeannette Corporation would have a "very respectable" tangible net worth of at least $9 million and would earn a pre-tax profit of $800,000 in its first year of operation after the acquisition, even after the payment of interest on the acquisition debt. That pre-tax profit figure also took into account depreciation expense calculated on the basis of Coke of New York's upwardly revised valuation of fixed assets. (S–29, pp. 1, 8, 12).

88. Mr. Ngan's profit figure was based partly on a projected sales figure of $75 million. Jeannette President Mark Silverberg, who described expected price increases and new product lines, supplied Mr. Ngan with that figure. Mr. Ngan concluded that Mr. Silverberg's sales projection was reasonable based on the company's prior experience and other available information. While plaintiff attacks the $75 million dollar figure as overly optimistic, it was Jeannette's own president who gave this figure to Mr. Ngan. Furthermore, while somewhat less probative than the judgment of the company's president, Jeannette Corporation's 1980 business plan projected 1982 sales of over $90 million at a gross margin of 18.7%. (S–32, p. 6325).

89. Based on discussions with and information from Jeannette Corporation management personnel, Mr. Ngan's memo used a 17% gross profit margin assump-

tion. Jeannette Corporation's gross profit margin had exceeded that figure in every year between 1965 and 1978. In 1979 it had dipped to 7.7%, and in 1980 it was 14.5%. Because several of Jeannette Corporation's operations were high fixed cost operations, an increase in the gross margin percentage would have been consistent with an increase in sales.

90. In his memo, Mr. Ngan compared Mr. Brogan's projection for the first year of operation with Jeannette Corporation's actual 1980 performance and Jeannette's projection for 1981. He found the Jeannette 1981 projection to be realistic when viewed in reference to the actual results achieved in 1980 and in the first six months of 1981. Mr. Ngan concluded, however, that the Brogan projection was not realistic because it had an overly optimistic gross profit margin of 16.9% forecast on a sales volume of $70 million. Plaintiff faults Mr. Ngan for then using sales and gross profit figures higher than those used by Mr. Brogan. As we found above, however, the sales figure was reasonable under the circumstances. At any rate, Brogan's figures are not as overly optimistic as Mr. Ngan first believed. As Brogan explained to Mr. Seiden, the Brogan projection figures took into account the substantial reduction in annual depreciation expense which would result from Brogan's anticipated write down of the book value of Jeannette's fixed assets. Using the anticipated lower depreciation levels, Brogan's projection of a $930,000 operating profit based upon $70 million in sales was consistent with Jeannette's actual and projected sales and operating experience in 1981. On the other hand, Mr. Ngan's calculation had been based on depreciation levels as recorded under Coke of New York's ownership.

91. The earnings projection reflected in Mr. Ngan's memo included depreciation that was calculated on the basis of the PP & E values carried on Jeannette's books under Coke of New York. Using that accounting basis, the company could have sustained apparent paper losses amounting to millions of dollars annually and still have been able to continue paying its debts and to operate normally because of its cash flow. (Tr. 14, 144:15–145:7 (Seiden); D-891; D-892; Tr. 18, 168:22–170:13 (Pfingstler)).

92. Based upon his analysis, Mr. Ngan recommended that Security Pacific agree to provide financing for the acquisition of Jeannette Corporation and for subsequent working capital. Mr. Ngan thought that Jeannette would be very successful after the proposed transaction. (Jt. Stip., ¶ 96; S-29, p. 12).

93. Security Pacific also sent one of its employees, E.J. Donegan, to the Jeannette Glass facility to conduct an inventory inspection. Mr. Donegan prepared a July 24 memorandum in which he described the nature and condition of the Jeannette Glass inventory and made recommendations regarding how much Security Pacific might consider lending against that inventory as collateral. (S-124).

94. After senior Security Pacific personnel had reviewed various materials including Jeannette's financial records, Mr. Ngan's July 28, 1981, memorandum, Mr. Donegan's July 24, 1981, memorandum, the Manufacturers' Appraisal report, the New England Merchants report, and Mr. Brogan's projections, they concluded that the proposed transaction would leave Jeannette Corporation with a substantial margin of solvency and more than adequate capital to continue operating its businesses, including millions of dollars of working capital financing from Security Pacific. (Tr. 14, 150:6–153:8, 155:6–155:18, 159:4–164:16 (Seiden)).

95. As was its practice in all proposed leveraged buyout transactions, before entering into the Jeannette revolving credit transaction, Security Pacific furnished its entire file on Jeannette to its counsel. Based upon this information, counsel agreed with Security Pacific's conclusion that the transaction would not violate the fraudulent conveyance laws, in light of Jeannette's substantial net worth and capitalization after the proposed transaction. Security Pacific, however, did not ask for an opinion letter from counsel to this effect.

(P–166; Tr. 14, 169:25–172:11; Tr. 15, 71:5–71:8, 72:10–72:15 (Seiden)).

96. Security Pacific decided to proceed with the proposed financing of the acquisition of Jeannette Corporation in the last few days of July 1981, after Mr. Ngan's July 28, 1981, report had been submitted and reviewed by other Security Pacific personnel. (Jt. Stip., ¶ 97).

97. Security Pacific officials testified, and we accept their testimony as true, that Security Pacific had no incentive to make this loan if it believed that Jeannette would fail. Security Pacific made its money by earning interest in continuing, long-term lending relationships, and it received no up-front fees relating to this transaction. It also knew from prior experience that failure of a leveraged company could result in a fraudulent conveyance claim and that even the successful defense of such a case would be costly and time consuming. (Tr. 14, 123:19–124:14, 164:20–166:13 (Seiden); Tr. 16, 82:23–83:20 (Faraone)).

98. Security Pacific would not have entered into this lending arrangement if it did not believe that Jeannette would be successful. (Tr. 14, 165:11–166:9 (Seiden)).

[1] 99. In agreeing to provide the financing of J. Corp.'s acquisition of Jeannette Corporation, Security Pacific acted without fraudulent intent. Security Pacific had no ulterior motive in agreeing to provide the financing. Its only motive was its intention to profit from an ongoing lending relationship with the company. Based upon its investigation of the proposed transaction and its substantial experience with similar kinds of transactions, Security Pacific expected that Jeannette Corporation would operate profitably after such an acquisition. We find that its expectation was reasonable. (Tr. 14, 154:23–155:18, 159:4–161:2, 163:9–21, 174:11–179:14 (Seiden); Tr. 8, 133:2–133:23 (Faraone)).

The July 31, 1981, Transaction

Pre-closing activities

100. On July 24, 1981, J. Corp. was incorporated under the laws of the State of Delaware. J. Corp.'s originally-contemplated capitalization was $200,000 of subordinated debt, to be borrowed from M–K Candle, and $200,000 of equity. (Jt. Stip., ¶ 5).

101. As of July 31, 1981, J. Corp.'s $200,000 equity capitalization consisted of funds borrowed by J. Corp./John P. Brogan one day earlier from Lincoln Trust Bank in Hingham, Massachusetts. The Brogan group made their equity contributions shortly afterwards.

102. On July 29, 1981, Coke of New York's Board of Directors met in Hackensack, New Jersey to approve the sale of Jeannette Corporation to J. Corp. for the purchase price of $12 million, subject to adjustments at closing. (Jt. Stip., ¶ 98).

The closing

103. The closing of the sale of the stock of Jeannette Corporation to J. Corp. took place at the offices of Coke of New York in Hackensack, New Jersey on July 31, 1981. A pre-closing took place the day before in New York City. (Jt. Stip., ¶¶ 102–104).

104. Representatives of all the parties to the transaction attended the closing: the buyer, J. Corp., was represented by Mr. Brogan, James A. McLean and three attorneys from Thompson, Hine & Flory; the seller, Coke of New York, was represented by Mr. Sullivan (its Executive Vice President, and the management employee at Coke primarily responsible for overseeing the sale of Jeannette), Mr. Heberling, and at least two outside attorneys from the firm of Jones, Day, Reavis & Pogue; and the lender, Security Pacific, was represented by Mr. Seiden and other Security Pacific personnel, as well as by attorneys from the law firm of Kaye Scholer Fierman Hays & Handler. (Jt. Stip., ¶ 105).

105. At the July 31, 1981, closing, a series of transactions—which were deemed by agreement of the parties to have taken place simultaneously—were consummated, including the following:

(a) J. Corp. entered into an agreement with Coke of New York and KNY Development to purchase all of the outstanding stock of Jeannette Corporation from KNY Development.

(b) J. Corp. obtained an unsecured loan from Security Pacific in the amount of $12,110,800, executing a demand note in that amount to evidence the indebtedness.

(c) J. Corp. utilized the proceeds of the $12,110,800 loan to purchase the Jeannette Corporation stock from KNY Development, by authorizing and directing Security Pacific to disburse those proceeds to the order of Coke of New York.

(d) After J. Corp. acquired the stock of the Jeannette Corporation, it appointed a new board of directors for Jeannette Corporation, the Chairman and Vice-Chairman of which were Mr. Brogan and his father (John J. Brogan) respectively. The directors elected under Coke of New York's ownership previously had resigned.

(e) Jeannette Corporation, through Mr. Brogan, entered into an Accounts Receivable Security Agreement and related documents with Security Pacific under which it could obtain revolving credit.

(f) As security for this revolving credit facility, Jeannette Corporation executed security agreements granting Security Pacific first lien security interests in all of Jeannette's accounts receivable, inventory, equipment, and other personal property, as well as a mortgage on its real property. The security interests were perfected by Security Pacific's filing financing statements in various jurisdictions.

(g) Mr. Brogan, on behalf of Jeannette Corporation, executed a letter authorizing and directing Security Pacific to remit the proceeds of the first advance under the revolving credit facility, $11,710,800, to or for the account of J. Corp. These funds were used by J. Corp. to repay all but $400,000 of J. Corp.'s demand promissory note to Security Pacific.

(h) J. Corp. repaid the $400,000 balance of its indebtedness to Security Pacific.

(i) J. Corp. and M-K Candle executed guarantees to Security Pacific covering payment of certain obligations of Jeannette Corporation and its subsidiaries to Security Pacific.

(j) Jeannette Corporation, through Mr. Brogan, entered into an Agreement Re: Pensions under which it agreed to indemnify Coke of New York and KNY Development against potential liabilities (for employee pension benefits) which could arise upon the termination of certain Jeannette pension plans.

(k) As security for this indemnification, Jeannette Corporation (through Mr. Brogan) entered into an agreement granting Coke of New York and KNY Development a security interest in all of Jeannette's accounts receivable, inventory, equipment, and other personal property, which was subordinate to the security interest held by Security Pacific.

(*l*) Coke of New York, KNY Development and Security Pacific entered into an Intercreditor Agreement in which they agreed among themselves that Security Pacific's secured claim had priority over any claim of Coke of New York with respect to Jeannette Corporation's assets.

(m) Jeannette Corporation and Security Pacific executed a Lock Box Agreement under which Jeannette Corporation undertook to instruct all customers to mail their payments to a post office box maintained by Mellon Bank, from which those payments would be transferred directly to Security Pacific and credited against the outstanding balance of Jeannette's revolving credit facility.

(Jt. Stip., ¶ 106).

106. At no time on or after July 31, 1981, did J. Corp. execute or deliver to Jeannette Corporation a promissory note or other document evidencing any indebtedness arising out of the initial $11,710,800 advance. J. Corp. has never repaid to Jeannette any portion of that advance.

107. The July 31, 1981, transaction was, and will be viewed by the court as, one integrated transaction. All parties were aware of the leveraged nature of the transaction, that Security Pacific would be providing the bulk of the funds for the transaction, that those funds would pass to J. Corp. and immediately to Coke of New York, and that Jeannette Corporation would repay the loan. Each portion of the July 31, 1981, transaction was dependent upon the occurrence of the other. The parties would not have completed any step of the transaction unless they all were completed.

108. We also find that Jeannette's grant of the security interest in its assets to secure the repayment of the initial $11.7 million advance was without fair consideration to Jeannette Corporation. The funds were actually for the benefit of J. Corp., which thereby acquired ownership of Jeannette. Jeannette's only benefit from the transaction was new management and access to the balance of the availability under the revolving credit facility discussed below. These were not fair consideration for the requirement to repay $11.7 million.

109. At the time of the July 31, 1981, transaction, Jeannette Corporation had outstanding an unsecured obligation to Mellon Bank, N.A., a portion of which remains unpaid, as well as outstanding trade debt. (Jt. Stip., ¶ 108).

110. Security Pacific was aware, in advance, of the structure and details of the July 31, 1981, transaction. In fact, Security Pacific's counsel either prepared or were intimately involved in the preparation of the loan documents signed at the closing.

[2] 111. Coke of New York has maintained that it did not know, and was not particularly concerned with, the structure of Mr. Brogan's financing agreement with Security Pacific. However, it is clear from the facts adduced at trial that at the time of the July 31, 1981, closing, Coke of New York knew that J. Corp.'s acquisition of Jeannette Corporation was a leveraged buyout which would result in Jeannette Corporation's having a secured debt to Security Pacific in an amount somewhat below the $12.1 million purchase price. Coke of New York had rejected Brogan's stock redemption proposal, which clearly demonstrated Brogan's intent to leverage the transaction. Furthermore, Mr. Brogan told Coke of New York officials that he intended to encumber Jeannette's assets and ultimately Coke and Security Pacific entered into an Intercreditor Agreement regarding their security interests in Jeannette's assets. Finally, Coke of New York officials were present at the closing and pre-closing. In light of all this evidence, we find that Coke of New York knew that the transaction would be leveraged for a substantial part of the purchase price at the time of the closing.

The Parties' Intent

112. While we find that all of the parties were aware of the leveraged nature of the transaction, there is no evidence that before or after the July 31, 1981, transaction, Jeannette or any of the defendants ever intended to hinder, delay or defraud creditors, or believed that Jeannette would incur debts beyond its ability to pay as they matured. Projections prepared both before and after July 31, 1981, showed that the company could pay its debts and run its business in an ordinary manner. Those projections were reasonable and prudent at the time they were made. Based on these projections, those made by Mr. Brogan relating to availability, and the due diligence performed by Security Pacific, the parties involved all intended and believed Jeannette could pay its debts as they matured. We also find that no party to the July 31, 1981, transaction had an incentive to enter into that transaction if it had expected Jeannette to be unsuccessful. (S-29; S-33; S-34; S-44; S-45).

Operation of the Revolving Credit Facility

113. After the July 31, 1981, transaction Jeannette Corporation's asset base, on which it previously had been able to borrow, was fully liened. As a result of these liens, Jeannette Corporation could not dispose of any of its assets (except in the ordinary course of business) without the

prior consent of Security Pacific and Coke of New York; and if any such assets were sold, the proceeds were not available to Jeannette to spend as it saw fit. Rather, the proceeds of the sale of any of Jeannette's assets were applied to reduce the Security Pacific indebtedness.

114. In addition, Jeannette was prohibited under the terms of the loan documents from granting additional security interests to anyone else. This effectively eliminated Jeannette's access to required capital from any sources other than Security Pacific.

115. Under the loan documents, the proceeds of substantially all of Jeannette Corporation's accounts receivable after July 31, 1981, were paid directly into a lock-box account at Mellon Bank and applied to reduce Jeannette's $11.7 million secured obligation to Security Pacific. (Jt. Stip., ¶ 115).

116. As a result of the revolving credit facility, Jeannette Corporation's sole source of operating capital—i.e., funds required to run the business and to meet its seasonal working capital needs—was the remaining borrowing "availability" from Security Pacific. Jeannette had to borrow from Security Pacific on a daily basis the money it needed to carry on its business.

117. In general terms under the revolving credit facility, by applying preset lending formulas (i.e., 80% of accounts receivable, 50% of certain kinds of inventory, etc.) to the current balances of eligible collateral in these categories, and subtracting the outstanding loan balances, Jeannette and Security Pacific would determine Jeannette Corporation's net unused "availability"—the additional amount that it could, under normal circumstances, expect to borrow from Security Pacific under the revolving credit facility at any particular time. The formulas were designed to ensure that Jeannette did not borrow more money than it could repay under any circumstance, including a liquidation.

118. As payments from Jeannette Corporation customers came to Security Pacific through the lock-box, they were applied to reduce the outstanding loan balance, leading to an increase in availability. Jeannette would then draw upon this availability for funds to finance its further operations, which would eventually result in further customer payments into the lock-box. This cycle explains the characterization of this arrangement as a "revolving" credit facility.

119. The use of such a revolving credit facility, with customer payments directly to the lender through a lock-box and availability calculations based on collateral values, is a standard practice in the commercial finance industry.

120. The use of a lock-box speeds up the crediting of payments to a borrower's account (thus reducing interest expense and increasing availability) and protects a lender against misuse of its cash collateral.

121. Although the total outstanding Security Pacific loan balance on Jeannette Corporation's financial records never exceeded the initial $11,710,800 advance, because of the revolving nature of the credit facility, the total amount of cash advanced to Jeannette Corporation was many times that amount. (S-25; D-349; D-373).

122. The interest rate on the Security Pacific revolving credit was set at 3¼ percent over the prime rate. This was a standard, competitive rate at that time. The advances under the revolving credit facility were payable on demand, although the parties contemplated a long-term lending relationship. (Tr. 14, 166:14–167:18 (Seiden)).

123. Mr. Brogan had planned to spend approximately two weeks every month at Jeannette at the outset to ensure its successful operation under his ownership. Very shortly after the July 31, 1981, transaction, however, Brogan learned that his kidneys were failing. From August through November of that year his weakened physical condition limited his ability to devote attention to his businesses. In late 1981 he began dialysis treatments, which required him to be in the hospital three days a week and which seriously restricted out of town travel. In June 1982 he received a transplanted kidney from his sister, and under doctor's orders was able to devote virtually no attention to business matters from late May until September 1982.

124. Security Pacific had considered Brogan's active involvement in the transaction an important factor in its financing decision, because it respected his demonstrated ability to acquire and run businesses in leveraged transactions. Security Pacific may not have made the loan if it had known that Brogan had an illness that would seriously impede such involvement.

Solvency of Jeannette Corporation

125. It is undisputed that Jeannette Corporation was solvent before the July 31, 1981, transaction.

126. Immediately prior to the closing of the July 31, 1981, transaction, the consolidated financial records of Jeannette Corporation and its subsidiaries (which, with the exception of the Alternate Standard Reserve on inventory, were maintained in accordance with GAAP) reflected the following amounts for the company's balance sheet accounts (all figures, including totals, are rounded to the nearest thousand):

Assets	
Cash	$ 265,000
Net accounts receivable	7,929,000
Inventory	14,370,000
Intercompany accounts	519,000
Other current assets	46,000
Total current assets	$23,129,000
Property, plant & equipment	17,731,000
Goodwill	11,377,000
Other assets	119,000
Total assets	$52,356,000
Liabilities	
Accounts payable	$ 2,964,000
Current portion, long-term debt	500,000
Accrued liabilities	4,168,000
Current liabilities	$ 7,632,000
Long-term debt	1,856,000
Accrued pensions	2,441,000
Total liabilities	$11,929,000
NET WORTH	$40,427,000

(Jt. Stip., ¶ 107).

127. In the period following the July 31, 1981, transaction, each of Jeannette's four major operating segments continued to function as a going concern. The company continued collecting accounts receivable, producing and selling inventory, and paying its debts. Therefore, in valuing the company's assets, we use going concern values. (Tr. 18, 3:6–3:13 (Pfingstler)).

128. The $265,000 of cash remained with the company after closing and was used by it. Its present fair salable value as of July 31, 1981, was $265,000.

129. Under GAAP, a company must carry accounts receivable on its financial records at their net realizable value. Jeannette personnel calculated the $7.929 million of net accounts receivable by deducting over $1 million of reserves from total receivables. The reserves were designed to estimate the extent to which customers would fail to pay their accounts or would return goods or claim credits for breakage and similar problems.

130. Jeannette actually collected at least $8.3 million on the accounts receivable

that were outstanding at July 31, 1981. Over $7 million of this amount was collected by October 31, 1981.

[3] 131. Based on the foregoing, we conclude that the present fair salable value of the receivables after the July 31, 1981, transaction was approximately $8.3 million.

132. In the July 31, 1981, transaction, Coke of New York had agreed to reimburse Jeannette Corporation for a portion of its pension obligation. The present fair salable value of that receivable as of July 31, 1981, was $248,000, which was the amount Coke of New York later paid to Jeannette.

133. GAAP required that Jeannette's inventory be valued at its cost or market value, whichever was lower. In 1979 Jeannette had established a reserve, known as the Alternate Standard Reserve, to effectuate this requirement for the Jeannette Glass inventory. In July 1981, the Alternate Standard Reserve was carried on the financial records of Coke of New York rather than those of Jeannette Corporation, and amounted to approximately $2.2 million. (Jt. Stip., ¶ 107).

134. Jeannette regularly monitored its inventory and either wrote off or wrote down inventory that was obsolete or slow moving. As of July 31, 1981, Jeannette's financial records did not reflect significant amounts of obsolete, slow moving, or overvalued inventory. (Tr. 5, 128:2–128:8 (McCracken)).

135. In the months following the July 31, 1981, transaction, the inventories of Jeannette Corporation and its subsidiaries turned over rapidly. Within a few months, most of the finished goods inventory (approximately $6 million of a total of $8 million) was sold, and most of the raw material and work in process was converted into finished product that was thereafter sold, generally at prices well above cost.

[4] 136. The present fair salable value of Jeannette's inventory following the July 31, 1981, transaction was approximately $12.2 million using either the Alternate Standard Reserve carried on Coke of New York's financial records or an analysis of the extent to which inventory may not have been sold or used profitably in the period following July 31, 1981.

137. The intercompany account between Jeannette Corporation and Coke of New York was canceled in the course of the July 31, 1981, transaction. Consequently, after the closing it had no value.

138. The prepaid amounts and other items represented by "other current assets" on the July 31, 1981, balance sheet of the company represented assets, such as prepaid rent, that were actually used thereafter by Jeannette Corporation or its subsidiaries in their subsequent operations. The present fair salable value of those other assets following the July 31, 1981, transactions was $46,000.

139. Based on the foregoing, the total present fair salable value of Jeannette Corporation's current assets (which excludes, among other things, PP & E) following the July 31, 1981, transaction was over $21 million. There was relatively little dispute at trial regarding the values of these assets.

[5] 140. The parties sharply disagreed, however, on the value of Jeannette's PP & E. Coke of New York's expert witness, Mr. Pfingstler, opined that Jeannette's PP & E had a value of some $12.2 million. Plaintiff's expert did not give an opinion on the value of the PP & E. Rather, plaintiff argued that we should assign the PP & E no value in our solvency analysis. We discuss below our reasons for rejecting plaintiff's argument that these assets had no value. For the reasons which immediately follow, we find that Jeannette's PP & E was worth at least $5–6 million, and was possibly worth as much as Mr. Pfingstler's $12 million figure.

141. As of July 31, 1981, Jeannette carried its PP & E on its books and records at book value of $17,731,000, which was net of depreciation already taken.

142. In late 1978 and early 1979, the Manufacturers' Appraisal Company performed a fair market valuation of Jeannette's PP & E. For assets that remained

with Jeannette as of July 31, 1981, (Walker China had been sold in 1980), the fair market value appraisal indicated a value of $26,865,000 for PP & E. (D-169; D-864).

143. During the three years that Coke of New York owned Jeannette Corporation, over $11 million was spent on capital improvements and on maintenance and repair of fixed assets. The only major disposition of fixed assets during that period was in connection with the sale of the Walker China subsidiary. (D-866).

144. Mr. Pfingstler opined that the PP & E should be valued at approximately $12.7 million, rather than at the net book value of over $17 million. In doing so, he relied, in part, on work papers prepared in connection with the audit of the financial statements of Jeannette Corporation and its subsidiaries by the accounting firm Price Waterhouse in 1982. Those work papers led Mr. Pfingstler to conclude that some fixed assets were identified by Jeannette personnel as possibly having no continuing use as of July 31, 1981.

145. The work papers revealed that Price Waterhouse personnel concluded that $700,000 worth of the fixed assets identified by company personnel as worthless should be written off and that the value of the remaining PP & E on the financial statements as of July 31, 1981, should be reduced by the amount of the unamortized appraisal increment. The Price Waterhouse personnel therefore proposed that the PP & E be valued at $12,736,000 in accordance with GAAP as of July 31, 1981. Mr. Pfingstler relied upon these conclusions in assigning the PP & E a value of $12.7 million.

146. In July 1982, the inventory and fixed assets of the Old Harbor subsidiary were sold as a going concern by Jeannette Corporation to Towle Manufacturing Company for approximately $2 million. An audited financial statement prepared by Price Waterhouse in conjunction with that sale assigned a GAAP value of $2.5 million to those assets at the time, with approximately $1.3 million of that amount representing PP & E, less accumulated depreciation. (Jt. Stip., ¶ 118; D-141; P-367, pp. 1-10).

147. In November 1982, Jeannette Corporation sold the assets of its Brookpark division (other than cash and receivables) as a going concern for $1.1 million cash and notes and the assumption of $62,000 of accrued liabilities. (Jt. Stip., ¶ 120).

148. In the Brookpark sale, $550,000 of the purchase price was attributed by the parties to the division's real property (land and buildings), according to the realty transfer tax affidavit of value. (D-353A).

149. In 1983, Jeannette Corporation's Royal China subsidiary was placed in a bankruptcy proceeding. In 1984 the operating assets of the company were sold as a going concern out of bankruptcy for a net amount of approximately $4.2 million plus the assumption of certain pension liabilities. (Jt. Stip., ¶ 122; D-369).

150. A bankruptcy auction sale of most of the then remaining assets of Jeannette Corporation conducted in September 1983 yielded a net amount of approximately $2.15 million. The principal assets sold were the fixed assets and the unsold inventory of Jeannette Glass, as well as the outstanding notes that had been part of the consideration in the sale of the Brookpark division. Some of the assets were promptly resold for an immediate profit. Furthermore, glass tanks were among Jeannette's assets. These tanks, however, had been shut down "cold" before the auction of Jeannette's assets. Once shut down cold, they had essentially scrap value. Therefore, there were valuable assets in the Jeannette Glass Division on July 31, 1981, which were worth only scrap value during the liquidation. (Jt. Stip., ¶ 123; D-89; D-90; D-92; Tr. 19, 93:4-7 (Fontana)).

151. The Schedule B-1, listing real property, filed in Jeannette's bankruptcy case asserted that the market value of the land and buildings of the Jeannette Glass Division was $300,000. Schedule B-2 of Personal Property indicated that the market value of the machinery, fixtures and equipment of the Division was $1.5 million. (P-128; P-128A).

152. Less than a month before trial, plaintiff submitted revised proposed find-