

BANKRUPTCY BAR ASSOCIATION

For The District of Maryland

Newsletter

Summer 1999

President's Message

Welcome to the start of the new Bar Association year. My predecessor, Howard Rubenstein, will be a tough act to follow. Howard deserves our thanks for his fine service throughout the past very success-

ful year. The Spring Break Weekend, the Judges boat cruise and the Annual Spring Dinner were immensely worthwhile and enjoyable. We have begun work on the other annual events, including the Spring Break Weekend and the Annual Spring Dinner.

decisions, timely information and links to other significant websites, including the Clerk's office. Webmaster Mark Neal has done an outstanding job and will continue to upgrade the site.



President Jim Vidmar congratulating Immediate Past President Howard Rubenstein at the Annual Spring Dinner in Columbia

ful year. The Spring Break Weekend, the Judges boat cruise and the Annual Spring Dinner were immensely worthwhile and enjoyable.

The upcoming year guarantees to be an exciting one. Already, we have a party on the docket. To commemorate the fifth anniversary of the opening of the Greenbelt Courthouse, there will be a celebration from 3:00 p.m. to 5:00 p.m. at the Courthouse on October 1, 1999. The Bar Association is one of several co-spon-

sors of the event. There will be a program for one-half hour followed by a reception. We have begun work on the other annual events, including the Spring Break Weekend and the Annual Spring Dinner.

I welcome Sari-Karson Kurland and Karen Moore as the new Chapter Chairs for the Greenbelt and Baltimore Divisions, respectively. The monthly events held by the local chapters continue to be a source of excellent continuing education and professional networking. I would like to encourage each of you to visit the Bankruptcy Bar Association's outstanding website at www.bankruptcybar.org. The website now contains late-breaking

decisions, timely information and links to other significant websites, including the Clerk's office. Webmaster Mark Neal has done an outstanding job and will continue to upgrade the site.

I would also encourage each of you who are currently using e-mail to submit your e-mail address to the Association's website. The use of e-mail will allow us to communicate more effectively within the Association.

Lastly, I encourage each of you to contact me with any suggestions you may have for the upcoming year. Regards.

James A. Vidmar, Jr.

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SUPREME COURT DECISIONS

The Supreme Court Passes On Validity Of New Value Exception

In Bank of America Nat'l Trust & Savings Ass'n v. N. LaSalle St. Partnership, a Chapter 11 debtor filed a plan of reorganization under which certain former partners of the debtor would contribute new capital in exchange for the entire ownership of the reorganized partnership. The debtor's undersecured lender, which would not be paid in full under the plan, objected to confirmation of the plan, arguing that under the absolute priority rule, the plan could not be confirmed via cramdown because the secured lender's unsecured deficiency claim would not be paid in full while the debtor's old equity holders would receive property. The bankruptcy court confirmed the plan pursuant to Section 1129(b), and both the district court and the Court of Appeals for the Seventh Circuit affirmed. The Seventh Circuit held that the phrase "on account

of" in Section 1129(b)(2)(B)(ii) permitted recognition of a "new value corollary" that allowed old equity holders to retain property if they contributed new capital that was reasonably equivalent to the property's value and necessary for a successful reorganization. Such old equity holders did not, according to the Seventh Circuit, retain property on account of prior equitable ownership in the debtor.

The Supreme Court reversed, and held that a debtor's prebankruptcy equity holders may not contribute new capital and receive equity in the reorganized debtor over the objection of a senior class of impaired creditors when the opportunity to contribute is given exclusively to old equity holders. The Court declined to rule on the validity of a new value corollary, but held that "on account of" implicates a causal relationship between the prior claim

or interest and receiving or retaining property of the debtor; sufficient causation between old equity's holdings and subsequent property of the debtor sufficient to disqualify a plan occurs whenever old equity holders obtained ownership interests for less than a third party would have paid. The Court further held that the debtor's plan was "doomed" because it did not extend an opportunity to anyone else to compete for the debtor's equity or to propose a competing plan, and held generally that plans that provide "junior interest holders with exclusive opportunities free from competition and without benefit of a market valuation will fall within the prohibition of Section 1129(b)(2)(B)(ii)."

Bank of America Nat'l Trust & Savings Ass'n v. N. LaSalle St. Partnership, 119 S. Ct. 1411 (May 3, 1999).

U.S. Court of Appeals for the District of Columbia

Section 304 Applies Even Where Foreign Debtor Does Not Own Property in the United States

The U.S. Court of Appeals for the D.C. Circuit has held that jurisdiction exists over a petition under 11 U.S.C. § 304 even though the foreign debtor does not own property in the United States. In this case, the appellants, nine professional tennis players, argued that the bankruptcy court could not exercise jurisdiction under 11 U.S.C. § 304 to enjoin a breach of contract claim against a foreign debtor in the United States District Court for the Dis-

trict of Columbia because the foreign debtor does not own property in the United States. The D.C. Circuit rejected appellants' argument and held that the absence of U.S. assets did not preclude the bankruptcy court from asserting jurisdiction over the § 304 petition.

Haarhuis v. Kunnan Enterprises, Ltd., 1999 U.S. App. Lexis 10889 (May 28, 1999).

U.S. District Court for the District of Maryland

Court Grants § 365(d)(4) Extension Beyond Initial Period

Judge Smalkin has held that § 365(d)(4) does not prohibit additional extensions beyond the initial 60 day lease extension period.

In granting the extension, the Court distinguished a similar case previously decided by the same court, DeBartolo v. Devan. Unlike DeBartolo, which strictly construed the statute's language concerning the initial extension, the issue here was not as clear because the statute could plausibly be read to allow ad-

ditional extensions. Consequently, the court did not adhere to the same degree of literal construction it took in DeBartolo.

The Court also pointed out that this holding does not affect the strict interpretation of the statute's requirement of court action within the initial 60 day period.

Belair Food Market, Inc. v. Valu Food, Inc. and So-Lo Foods, Inc., Case Nos. 98-6627 and 98-66268 (June 14, 1999).

Members on the Move

Sanford A. Harris is pleased to announce the opening of his law firm, Law Offices of Sanford A. Harris, P.A., 106 Old Court Road, Suite 200, Baltimore, MD 21208. Mr. Harris can be reached at (410) 602-2550 or by fax at (410) 602-3770.

Andrew J. Love has joined the law firm of Shaw Pittman as an associate in their bankruptcy/creditors' rights group.

John E. Lucian, an associate at Linowes & Blocher LLP, has recently published an article in the May/June 1999 edition of West's Journal of Bankruptcy Law and Practice. The article, entitled *Damn Those Damages: An Analysis and Overview of 11 U.S.C. Sec. 502(b)(6)*, analyzes a landlord's claim for damages stemming from a breach of lease by the debtor. The article may be found at 8 J. Bankr. L. & Prac. 365.

Fourth Circuit Update

Landlord Whose Post-Petition Lease Was Rejected by Trustee after Conversion to Chapter 7 Entitled to Chapter 11 Administrative Expense Claim

The Fourth Circuit affirmed bankruptcy and district court rulings which held that a landlord who entered into a Chapter 11 post-petition commercial lease that was subsequently rejected by the Chapter 7 trustee after conversion of the case was entitled to a Chapter 11 rather than Chapter 7 administrative expense claim. While still operating in Chapter 11, the debtor entered into a ten year shopping mall lease. The debtor's case later converted and the Chapter 7 trustee rejected the lease. The landlord then sought allowance of: (1) a Chapter 11 administrative expense claim for unpaid rent during the Chapter 11 case; and (2) a Chapter 7 administrative expense claim for future rent due under the lease. The trustee objected to allowance of the claim as a Chapter 7 administrative expense claim.

The trustee argued that once the lease was delivered to the landlord, it ceased being an "actual" and "necessary" expense entitled to administrative priority. The court rejected this argument, holding that the lease was an actual post-petition expense and was beneficial to the debtor prior to conversion. The court also found that if landlords were not guaranteed to receive administrative priority on future rent, they would have little incentive to enter into long-term post-petition leases.

The court also rejected the trustee's argument that the lease had been rejected by an earlier court order and by operation of § 365(d)(4). In order to

have accepted rejection of the lease and waived its right to an administrative expense claim, the landlord had to have clearly and affirmatively relinquished this right. Since there was no such explicit language in the earlier order, the court rejected the trustee's argument. The court also found that § 365(d)(4) only applied to pre-petition leases and therefore did not apply to the present post-petition lease. This finding was consistent with the policy of giving creditors financial incentives for dealing with Chapter 11 debtors.

The court also rejected the trustee's argument that the future rent owed under a post-petition lease is subject to the rent cap of § 502(b)(6). Such a cap would be a disincentive for landlords to enter into post-petition leases. Furthermore, the landlord's duty to mitigate its administrative claim for future rent (under Florida law) would prevent the landlord from receiving a windfall. Finally, the court found that granting the landlord a Chapter 11 claim only rather than Chapter 7 administrative expense claim balanced the need to encourage landlords to continue to lease to Chapter 11 tenants with the trustee's necessary discretion to administer efficiently the liquidation of the bankruptcy estate.

Devan v. Simon Debartolo Group, L.P. (In re Merry-Go-Round Enterprises, Inc.), 1999 U.S. App. Lexis 11753 (June 8, 1999).

Section 523(a) Covers Secondary Debt Transactions

The Fourth Circuit has held that § 523(a) is broad enough to reach secondary debt transactions including extensions, renewals, and refinancings of debt such as settlement agreements.

In this case, a secured creditor brought an action against a discharged debtor seeking a determination that its claim for legal fees and costs resulting from a settlement agreement was not dischargeable. The creditor alleged that its claim was excepted from discharge

under § 523(a)(2) because of the debtor's fraudulent activity. The court determined that the settlement transaction was within the purview of § 523(a)(2) and, pursuant to § 525 of Restatements (Second) of Torts, that the creditor proved by a preponderance of the evidence that the debtor engaged in false representations that led to the settlement agreement.

In Re Biondo, Case No. 98-2548 (June 8, 1999).

The Bankruptcy Bar Association Newsletter is published quarterly by the Bankruptcy Bar Association for the District of Maryland, Inc.

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The Court of Appeals of Maryland

Res Judicata Did Not Preclude Circuit Court Litigation on Issue of Fraud Not Raised in Prior Bankruptcy Proceeding

The Court of Appeals of Maryland has held that res judicata did not bar debtors from litigating claims of fraud in the circuit court even though those claims were not raised in a turnover proceeding in bankruptcy court. The case arose out of litigation that began in the circuit court between a bank and debtors in which the bank attached a securities account of the debtors. Subsequently, the debtors filed a Chapter 11 petition, both parties accused the other of fraudulent acts, and the bankruptcy court abstained from hearing the debtors' allegations of fraud.

The debtors filed a separate turnover proceeding in bankruptcy court to recover the securities account, but did not seek to prevent enforcement of the agreements on fraud grounds. The bankruptcy court found the agreement to be valid. The bankruptcy case was then converted to Chapter 7, the debtors ceased being parties to the turnover action, and the debtors purchased their state court claim from the trustee.

In the circuit court, the bank moved for judgment and relied on res judicata, claiming that the bankruptcy court had conclusively determined the debtors'

fraud claims. The circuit court granted the motion, and the Court of Special Appeals reversed. In affirming the Court of Special Appeals, the Court of Appeals found that (a) the debtors had no standing to raise fraud in the turnover proceeding and were left with the right to seek damages in state court, and (b) the trustee and the debtors were not in privity because once the claim for damages was sold, no identity of interest existed.

FWB Bank v. Richman, 1999 Md. Lexis 331 (June 15, 1999).

Maryland Court of Special Appeals

State Courts Have Authority to Appoint Receiver Independent of Statute

The Maryland Court of Special Appeals has held that the circuit court can appoint a receiver independent of the receivership statute. In this case, the Carousel Hotel in Ocean City, Maryland was suffering from severe financial problems resulting from substantial conflicts between the hotel owner and the owners of

condominium units located within the hotel. As a result, the circuit court appointed a receiver to assume complete control of the financial affairs and operations of the hotel. In affirming the circuit court's decision, the Court of Special Appeals held that a circuit court has the equitable power to appoint a re-

ceiver outside of the receivership statute if the property at hand will suffer imminent loss unless the court takes immediate possession.

Hamzavi v. Bowen, 1999 Md. Lexis 98 (May 27, 1999).

U.S. Bankruptcy Court for the District of Columbia

Room and Board Debt Dischargeable if School Does Not Require Prepayment

Judge Teel has held that a creditor must prove funds came from a school "program" or that there was an obligation to "repay funds received" in order to prevent discharge of a student loan.

A student sought to discharge a student loan consisting of four semesters of room and board. In making its determination, the court held that a student loan is not dischargeable if it is either (1) for

an educational loan made under any program funded in whole or part by the university or (2) for an obligation to repay funds received as an educational benefit, scholarship, or stipend.

The court determined that the university failed to show that the extension of credit for room and board after the first semester was made under a "program" funded by the university because the loan

was not part of a structured school program. The court also found that the room and board debt did not create an obligation "to repay funds received" because the student was provided room and board without requiring prepayment.

In re Pelzman, 233 B.R. 575 (May 14, 1999).

U.S. Bankruptcy Court for the District of Maryland

Discharge Injunction Not Violated by In Rem Action

Judge Mannes has held that a debtor's pre-petition property remains subject to valid governmental tax liens. In this case, a discharged debtor filed suit against the IRS contending that the IRS' attempts to contact him through letters and to revive or renew pre-filing tax liens violated the discharge injunction of § 524(a). In reviewing the complaint,

the court noted a bankruptcy discharge extinguishes only in personam actions but not in rem actions. Consequently, the court concluded that the numerous notices and attempts by the IRS to revive two pre-petition tax liens on the debtor's accounts did not violate the discharge injunction.

The court also pointed out that tax liens do not attach to property acquired post-petition, including wages which constitute property of the debtor.

In Re Dinatale, Case No. 98-1444 (July 1, 1999.)

Trustee May Use the 26 U.S.C. § 121 Exemption from Capital Gains Upon the Sale of Debtor's Residence

Judge Keir has held that a trustee may use the 26 U.S.C. § 121 exclusion from capital gains upon the sale of the Debtor's residence. The IRS argued that only an individual taxpayer may use the exclusion, not a trustee. However, according to Judge

Keir, "the result urged by the IRS. . . would be to deprive the individual debtor of the benefit of an exclusion which clearly is available to that individual under the Internal Revenue Code."

Gregory P. Johnson, Trustee v. Internal Revenue Service (In re Williams), Adversary Case No. 94-1-A470 (July 13, 1999).