The Bankruptcy Reform Act of 1994

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I. INTRODUCTION

On October 22, 1994, President Clinton signed into law H.R. 5116, an Act entitled "Bankruptcy Reform Act of 1994."1 This article discusses some of the more widely applicable and momentous changes contained in the Act. As used in this article, the term "Act" will mean the Bankruptcy Reform Act of 1994, and the terms "Bankruptcy Code" or "Code" will mean 11 U.S.C. § 101 et seq., either pre- or post-Act.

II. AUTOMATIC STAY

When a bankruptcy petition is filed, Section 362(a) of the Bankruptcy Code stays certain actions against a debtor and property of a debtor's estate.2 This automatic stay is a well known and essential feature of bankruptcy law. A creditor can obtain relief from the automatic stay by filing a motion with the bankruptcy court pursuant to Section 362(d).3

Section 362(e) of the Bankruptcy Code, as amended, provides:

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(e) Thirty days after a request under subsection (d) of this section for relief from the stay of any act against property of the estate under subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the court, after notice and a hearing, orders such stay continued in effect pending the conclusion of, or as a result of, a final hearing and determination under subsection (d) of this section. The court shall order such stay continued in effect pending the conclusion of the final hearing under subsection (d) of this section if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the conclusion of such final hearing. If the hearing under this subsection is a preliminary hearing, then such final hearing shall be [commenced] concluded not later than thirty days after the conclusion of such preliminary hearing [,] unless the 30-day period is extended with the consent of the parties in interest or for a specific time which the court finds is required by compelling circumstances.4

Before the amendment to Section 362(e), if the court failed to commence a preliminary hearing within 30 days from the date the motion for relief from stay was filed, or failed to commence a final hearing after 30 additional days, the stay automatically terminated.5 Section 362(e) did not compel the court to conclude the final hearing within a certain time frame, making it possible to continue resolution of the issue of relief from stay indefinitely.

When the strict time constraints of pre-amended Section 362(e) were not met, some courts looked to the facts and circumstances of cases in order to reimpose the automatic stay to protect the debtor.6 Because the protections of Section 362(e) are for the creditor,7 circumstances that indicate that a creditor has acted in a manner inconsistent with these time constraints have been used as an implied waiver of Section 362(e) protections.8

8. In re Bogosian, 114 B.R. 7 (Bankr. D.R.I. 1990) (involving an implied waiver where the creditor did not object to continuances of the final hearing). See also In re Wedgewood Realty Group, 878 F.2d 693, 698-99 (3d Cir. 1989), where the court cites the following examples of implied waiver cases: Borg-Warner Acceptance Corp. v. Hall, 685 F.2d 1306, 1308 (11th Cir. 1982) (involving an implied
Some courts have terminated the stay if a hearing was not scheduled within the time constraints of Section 362(e) even though the hearing was not scheduled due to the court's inadvertence or through no fault of the debtor. Even after the stay has terminated, a debtor may seek an injunction under Section 105(a) of the Bankruptcy Code to stay creditor action. Both parties must carefully

waiver where the creditor attended the final hearing outside of time constraints but did not object; In re McNeely, 51 B.R. 816, 821 (Bankr. D. Utah 1985) (regarding an implied waiver where the creditor did not schedule a final hearing within 30 days of the preliminary hearing); In re Small, 38 B.R. 143, 147 (Bankr. D. Md. 1984) (concerning an implied waiver where the creditor filed discovery that allowed debtor to file responses after 30 day period had run).

9. In re River Hills Apartments Fund, 813 F.2d 702 (5th Cir. 1987). It is the debtor's burden to monitor relief from stay proceedings and seek a stay continuance or hearing within the time frames through “aggressive litigation management.” Id. at 707. See In re Looney, 823 F.2d at 792 (stating that if no ruling has been made within 30 days from the initial motion filing date, then the stay is automatically terminated). The reason for the automatic termination rule was to prevent parties from having hearings continued and thus, in effect, continuing the stay. The hearing must be at least commenced within 30 days following the preliminary hearing, and the court must expressly continue the stay. Legislative history supports the proposition that simply requiring the hearings to be commenced within 30 days was not providing for speedy enough resolutions, so that the amendment now states that the final hearing must be concluded within this time frame except in exceptional cases. 140 CONG. REC. 10,764 (1994).

In In re Wedgewood Realty Group Ltd., 878 F.2d 693 (3d Cir. 1989), the court noted that technically violating the time constraints of Section 362(e) and Bankruptcy Rule 4001(a)(2) (subsequently amended) results in the automatic termination of the stay. Id. at 697 (citing Bankruptcy Reform Act of 1978, H. REP. No. 595, 95th Cong., 2d Sess. 344 (1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6300).

Old Bankruptcy Code § 362(e) required a preliminary or final hearing within 30 days. If the hearing was preliminary, then the stay had to be expressly continued, and a final hearing had to be commenced within 30 days of the preliminary hearing. Under Rule 4001(a)(2), the stay then expired unless the motion for relief was denied within an additional 30 day period. Because a continuance was authorized under the statute as long as the final hearing had been commenced, the rules were inconsistent with the Bankruptcy Code. The rule was deleted as unnecessary because of Bankruptcy Code § 362(e). In re SeSide Co., 155 B.R. 112, 115 n.2. (Bankr. E.D. Pa. 1993).

10. Section 105(a) of the Bankruptcy Code provides, “The court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a) (1988).

The court in the case of In re Orfa Corp., 170 B.R. 257 (Bankr. E.D. Pa. 1994), agreed that Section 105 is an appropriate means for continuing the stay when it is not the debtor's fault that the time constraints have been missed. Here, because of a local rule, the creditor was required to serve notice of the hearing, which it did not do until after the initial 30 day period. Under the River Hills analysis, however, the court may have deemed the debtor also responsible for not closely monitoring its situation to insure that a hearing was scheduled within 30
monitor litigation concerning motions for relief from stay and clearly understand whether the hearing is preliminary or final for purposes of appeal.\textsuperscript{11}

The amendments to Section 362(e) make it clear that the bankruptcy court may only authorize an extension that results in the final hearing being concluded more than 30 days after the preliminary hearing under exceptional circumstances.\textsuperscript{12} In other words, the entire motion for relief from stay process typically should be completed within 60 days from the time a creditor files a motion for relief from stay. The legislative history indicates that exceptional circumstances will be limited to illnesses or other meritorious circumstances, with the ultimate goal being to avoid delay and fairly balance the parties' interests.\textsuperscript{13}

\section*{III. Jury Trials}

May non-Article III appointed judges constitutionally conduct jury trials? This question was left unanswered by the Supreme Court in \textit{Granfinanciera v. Nordberg},\textsuperscript{14} where the Court addressed a party's right to a jury trial in a core bankruptcy proceeding.\textsuperscript{15} Subsequent to \textit{Granfinanciera}, seven circuit courts reviewed this question; six courts concluded that bankruptcy judges do not have authority to conduct jury trials, while one circuit court concluded that bankruptcy courts do have such authority.\textsuperscript{16} The Act resolves the jury trial issue by providing a limited right to a jury trial in bankruptcy court.
Section 112 of the Act adds a new subsection to 28 U.S.C. § 157, which provides as follows:

If the right to a jury trial applies in a proceeding that may be heard under this section by a bankruptcy judge, the bankruptcy judge may conduct the jury trial if especially designated to exercise such jurisdiction by the district court and with the express consent of all the parties.\(^\text{17}\)

Therefore, if a local district court rule authorizes a bankruptcy judge to conduct a jury trial, and if all the parties consent, the bankruptcy judge may conduct a jury trial. This legislation closely matches the Fifth Circuit Court of Appeal’s review of these issues in In re Clay.\(^\text{18}\) That court noted that if a party has a Seventh Amendment right to a trial by jury, the safeguards inherent in Article III of the Constitution cannot be abrogated without express congressional mandate or the parties’ consent.\(^\text{19}\) The Clay court also noted certain exceptions to Article III, including situations in which “Article I courts may hear cases involving ‘public rights,’ which are rights against the government or closely intertwined with a regulatory scheme.”\(^\text{20}\)

courts which have held that bankruptcy courts cannot hold jury trials include: In re Clay, 35 F.3d 190 (5th Cir. 1994); In re Stansbury Poplar Place, Inc., 13 F.3d 122 (4th Cir. 1993); In re Grabill Corp., 967 F.2d 1152 (7th Cir. 1992); In re Baker & Betty Fin. Servs., 954 F.2d 1169 (6th Cir. 1992); Kaiser Steel Corp. v. Frates, 911 F.2d 380 (10th Cir. 1990); and In re United Missouri Bank, 901 F.2d 1449 (8th Cir. 1990). The sole circuit to conclude that bankruptcy courts have the authority to conduct jury trials is the Second Circuit Court of Appeals in In re Ben Cooper, Inc., 896 F.2d 1394 (2d Cir. 1990), vacated, 498 U.S. 964 (1990).

18. 35 F.3d 190, 196 (5th Cir. 1994).
19. Id. at 196, 198. Article III of the Constitution provides:

The judicial Power of the United States, shall be vested in one Supreme Court, and in such inferior Courts as the congress may from time to time ordain and establish. The Judges, both of the Supreme and inferior Courts, shall hold their Offices during good behaviour, and shall, at stated times, receive for their services, compensation, which shall not be diminished during their continuance in office.

U.S. CONST. art. III, § 1.

The Seventh Amendment provides that “[i]n suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury, shall be preserved.” U.S. CONST. amend. VII. In In re Clay, the court stated, “[w]e are not persuaded that Congress would have challenged such formidable constitutional principles by innuendo.” 35 F.3d at 198.

20. In re Clay, 35 F.3d at 192 (citing Thomas v. Union Carbide Agric. Prods., 473 U.S. 568, 593-94 (1985); Northern Pipeline Constr. Co. v. Marathon Pipe Co., 458 U.S. 50, 67-70 (1982) (Brennan, J., plurality opinion)). The other two instances where jury trials may be conducted by non-Article III courts include courts for
Part of the confusion about whether bankruptcy core proceedings qualify under the public rights exception was created by the Supreme Court's statement in *Northern Pipeline Construction Co. v. Marathon Pipe Co.* that core proceedings "may well be" public rights cases. The *Clay* court concluded that regardless of whether the proceeding is core or non-core, if a party has a constitutional right to trial by jury under the Seventh Amendment, "Congress may not give jurisdiction to a non-Article III court." In reaching this conclusion, the Fifth Circuit rejected the argument that such proceedings are part of the public's interest in a controlled regulatory framework in bankruptcy and that a bifurcating opportunity for a jury trial in a district court would prove inefficient. In addition, the Fifth Circuit stated that a litigant has supreme power over its right to a jury trial. In other words, just because a party has a right to a jury trial before a constitutionally appointed Article III judge, the party is not required to receive such a jury trial. Therefore, as long as the parties consent, a non-Article III court can conduct the trial.

U.S. territories and the District of Columbia and courts-martial proceedings. *In re Clay*, 35 F.3d at 192 (citing *Marathon*, 458 U.S. at 64-65; *Palmore v. United States*, 411 U.S. 389 (1973); *Dynes v. Hoover*, 61 U.S. (20 How.) 65 (1857); *American Ins. Co. v. Canter*, 26 U.S. (1 Pet.) 511, 546 (1828)). These three exceptions are supported because Congress could have provided for less than a trial by jury under these limited circumstances such as by resolution in legislative courts or administrative agencies so that a non-Article III judge conducting a jury trial does not take away or diminish a constitutional right. *In re Clay*, 35 F.3d at 192.

21. *Marathon*, 458 U.S. at 71 (Brennan, J., plurality opinion). This statement from *Marathon* regarding core proceedings, however, was gratuitous as the issue in *Marathon*, an action brought by the debtor-in-possession for breach of contract, was found to be non-core. *Id.* The Court stated, "[T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be determined from the adjudication of state-created private rights, such as the right to recover contract damages... The former may well be a 'public right,' but the latter obviously is not." *Id.*

22. This question is answered by analyzing whether the litigant would have such a right as an action at law in Eighteenth century England. *Granfinanciera*, 492 U.S. at 42-44, 47.

23. *In re Clay*, 35 F.3d at 194-95.

24. *Id.* The court noted that:

The trustee [who was arguing that jury trials should be allowed in the bankruptcy court] would trumpet efficiency, but we hear a kazoo, at best. Reports of strategic manipulation of jury trials have been greatly exaggerated. In practice, litigants have not begun demanding more jury trials since 1989, when *Granfinanciera* established a right to jury trial in certain bankruptcy proceedings.

*Id.*

25. *Id.* at 196. The court noted that the party can settle and forego any jury if it chooses to do so. *Id.*

26. *Id.*
By enacting Section 112 of the Act, Congress clarified that parties may be deprived of their Seventh Amendment right to a jury trial before an Article III judge only by consenting to a trial before a bankruptcy court that has been authorized by the district court to conduct jury trials.

IV. SOVEREIGN IMMUNITY

The doctrine of sovereign immunity is identified with the phrase "the king can do no wrong," a phrase coined by Blackstone. This idea rests on two premises: (1) the theory of the divine right of monarchs and (2) the realities of the structure of the feudal system.

Ironically, the history of sovereign immunity in America was influenced greatly by the fear of states going bankrupt. In *Chisholm v. Georgia*, two South Carolinians filed suit against Georgia to collect on state bonds. The Court found that Article III of the Constitution did not grant a state immunity from suit in federal court. The states quickly realized that this ruling would give citizens of other states a forum to require them to pay bonds issued during the American Revolution. The Eleventh Amendment to the Constitution was ratified in order to prevent this result. *Chisholm v. Georgia* was also an opportunity for the Court to discuss the immunity of the United States. Chief Justice Jay pointed out that although the executive branch of the federal government could execute decisions adverse to the states and citizens, no authority could execute against the federal government.

Over the years, Congress has passed laws waiving immunity in many instances where appropriate; however, the Supreme Court has always found that such waiver must be "unequivocally expressed."

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27. ERLICH, ERLICH'S BLACKSTONE 67 (1959).
29. 2 U.S. (2 Dall.) 419 (1793).
30. Id.
31. 1 WARREN, THE SUPREME COURT IN UNITED STATES HISTORY (rev. ed. 1926).
32. The Eleventh Amendment provides:
The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another state, or by citizens or subjects of any foreign state.
U.S. CONST. amend. XI.
33. *Chisholm*, 2 U.S. (2 Dall.) 419 (1793).
34. Irwin v. Department of Veterans Affairs, 498 U.S. 89, 95 (1990). For example, the Chandler Act of 1938 and the Bankruptcy Act of 1898 contained no
When the Bankruptcy Code was initially drafted, the issue of sovereign immunity was a foreign concept. The original commission report\(^{35}\) proposed a section of a new bankruptcy law to deal with sovereign immunity. The proposed provision stated:

Section 1-104. Applicability of Act to United States, states and subdivisions. All provisions of the Act shall apply to the United States and to every department, agency, and instrumentality thereof, and to every state and every subdivision thereof except where otherwise specifically provided. This section does not render any branch or unit of the government eligible for relief as a petitioner except as provided in Chapter VIII [public agencies and subdivisions], or subject to relief as a debtor upon an involuntary petition.\(^{36}\)

Adoption of this straightforward provision undoubtedly would have been seen as a clear and "unequivocal expression" of the intent of the United States to waive sovereign immunity for itself and to waive any state and local government immunity that may have existed. The note added to this section provided quite simply:

This section, with the exceptions indicated, answers the question whether all of the provisions of this act are intended to apply to federal and state governments and to all subdivisions and instrumentalities thereof.\(^{37}\)

For whatever reason, Congress decided not to adopt this simple provision. Instead, Congress adopted what ultimately became Section 106 of the Bankruptcy Code, which is, as the Supreme Court ultimately told us, less than an unequivocal expression of the waiver of sovereign immunity.\(^{38}\) The Court was first faced with the question of whether the Code authorized a monetary recovery against a state agency in *Hoffman v. Connecticut Department of Income Main-

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37. *Id.*
38. *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242 (1985). The Court stated that, "Congress may abrogate the states' constitutionally secured immunity from suit in federal court only by making its intention unmistakably clear in the language of the statute. The fundamental nature of the interests implicated by the Eleventh Amendment dictates this conclusion." *Id.*
In a plurality opinion, the Court declared that although Sections 106(a) and 106(b) were clear, Section 106(c) was not. Because Section 106(c) was the only section under which a trustee could recover in the case, the trustee lost. Justice White wrote: "[T]he narrow scope of the waivers of sovereign immunity in Sections 106(a) and (b) makes it unlikely that Congress adopted in Section 106(c) [a] broad abrogation of Eleventh Amendment immunity." Justice Scalia found that Congress could not override a state's Eleventh Amendment right not to be sued for a money judgment using the Constitution's bankruptcy clause. In a dissent, Justice Marshall wrote: "[T]he language of [the Code] satisfies even the requirement that Congress' intent to abrogate the States' Eleventh Amendment immunity be 'unmistakably clear.'" Several years later, the Court revisited this issue, this time in a suit against a federal agency. In *In re Nordic Village, Inc.*, the trustee in a Chapter 11 proceeding sued the IRS to recover funds a corporate executive embezzled in order to pay his personal taxes. The Bankruptcy Court allowed recovery, and the United States Court of Appeals for the Sixth Circuit affirmed. Justice Scalia, speaking for a seven member majority of the Supreme Court, pointed out that Sections 106(a) and (b) were "unequivocal expressions" of the intent to waive sovereign immunity in two settings: (1) where the governmental unit had filed a claim, and the trustee filed a compulsory counterclaim, and (2) where the trustee claimed a set-off using a permissive counterclaim. The Court called Sections 106(a) and 106(b) "models of clarity." Justice Scalia agreed that while Section 106(c) waived sovereign immunity in some instances, it failed to establish unambiguously that the waiver extended to monetary claims against the entity, when no governmental claim was involved.

Section 106 as amended by the Bankruptcy Reform Act of 1994 provides a convoluted recitation of sections to which the purported

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40. *Id.* at 101 (White, J., plurality opinion) (emphasis added).
41. *Id.*
42. *Id.* at 105 (Scalia, J., concurring).
43. *Id.* at 106 (Marshall, J., dissenting) (emphasis added).
46. *Id.*
48. *Id.*
49. *Id.*
50. Amended section 106(a)(1) provides:
waiver would apply and a restatement of the previous language. Previous Section 106(a) became Section 106(b) with a slight change. The earlier 106(a) provided that sovereign immunity was waived as to any claim against the governmental unit under certain conditions. The amended 106(b) provides that the governmental unit "that has filed a proof of claim in the case" is deemed to have waived immunity under the same conditions. The new Section 106(b) is even less of a waiver than the old Section 106(b). In the old subsection, the governmental unit waived immunity if there was a claim against the unit which was property of the estate and which arose out of the same transaction or occurrence as the unit's claim. The immunity was waived even in the absence of a proof of claim being filed. In the new subsection, if the governmental unit must file a proof of claim, immunity is not waived, at least not by that subsection. Congress added a few introductory words to new Section 106(c), but the new subsection continues to require the governmental unit's claim be allowed before allowing an offset of a claim against the estate.

The real change in Section 106 occurred in old subsection 106(c) which was deleted, and new subsection 106(a) which was completely re-written. The drafters of new subsection 106(a) apparently incorporated the language of *Hoffman v. Connecticut Department of Income Maintenance* because the subsection now provides for the "abrogation" of sovereign immunity. However, the new subsection lists by section numbers the extent to which the immunity is abrogated. It would seem to have been more appropriate for Congress to adopt the proposal of the National Bankruptcy Conference which simply provided that "all provisions of this title apply to governmental units."
V. INSIDER PREFERENCES

Section 202 of the Bankruptcy Reform Act of 1994 addressed problems created in interpreting the Bankruptcy Code originally adopted in 1979 concerning insider preferences. Shortly after the adoption of the Bankruptcy Code of 1979, a theory was advanced that the Code had dramatically changed the law of insider preferences. Clearly, there were radical changes, but the changes turned out to be even more radical than intended by the drafters of the Code.

Under pre-Bankruptcy Code Law, a “preference” was a transfer to a creditor made under certain conditions and within four months before the petition.\(^4\) No different time limits were in place for transfers to insiders. The Commission draft of the new Bankruptcy Code proposed in 1973 reduced the time limit to three months, but it eliminated the requirement that the preferred creditor have any reasonable cause to believe that the debtor was insolvent, as was previously required.\(^5\) In addition to the three month time limit, the Commission proposed a one year time limit if the transfers were to “insiders” under the Code; however, it still required that the insider have reasonable cause to believe that the debtor was insolvent at the time of the transfer.\(^6\) The Commission placed the burden of proof of insolvency and reasonable cause on the trustee. This was the first time a proposal was made suggesting that insider creditors be treated differently than non-insider creditors.

The Bankruptcy Code, when ultimately adopted in 1979, extended the insider concept beyond what the Commission had proposed.\(^7\) Although the Code retained the three month (actually 90 days) rule for transfers to non-insider creditors and the one year rule for transfers to insider creditors, it deleted any requirement that either creditor have reasonable cause to believe the debtor was insolvent at the time of the transfer.

Even though many changes were made to the concept of preferences with the enactment of the Bankruptcy Code in 1979, it was argued that Congress did not intend to allow recovery from non-insiders beyond the 90 day time limit. In Arkansas, this issue was first considered in the case of Mixon v. Mid-Continent Systems,

money recovery. \(\text{Id.}\) No recovery, however, is available for punitive damages. \(\text{Id.}\) This subsection provides that judgments may include costs and attorneys' fees consistent with 28 U.S.C. § 2412(d)(2)(a).

54. 3 COLLIER ON BANKRUPTCY ¶¶ 60.02-60.35 (James W. Moore et al. eds., 14th ed. 1977).
56. \(\text{Id.}\)
and became known as a "Big Three Preference Action." The issue later became more widely known as a "Deprezio Preference."

An insider preference occurs when an insolvent debtor transfers property to a non-insider creditor, such as a money-lender, between 90 days and one year before filing bankruptcy, and the transfer benefits an insider who guaranteed the debtor’s obligation. At first blush, it would appear that the transfer to a non-insider outside the 90 day time limit cannot be recovered by the trustee because Section 547(b)(4)(B) allows the recovery of a transfer within the one year period only "if such creditor at the time of such transfer was an insider." According to Section 547, a trustee may recover a transfer made for the benefit of a creditor between 90 days and one year prior to the petition if such creditor was an insider at the time of the transfer. Notice that the transfer need not have been made to the creditor, but only for the benefit of the creditor. A guarantor of a debtor is also a creditor holding a contingent claim. If the primary debt is not paid, then the insider/guarantor must pay and is subrogated to the claim of the creditor. The Section 101(5) definition of claim is so broad that it undoubtedly includes the rights of the insider/guarantor in this situation. The transaction described above meets the requirement of the Code that the transfer be to or for the benefit of a creditor, because it reduced the insider’s contingent liability to the non-insider money-lender.

According to Bankruptcy Code Section 550, after establishing that a transfer is avoided, a trustee may recover the transfer from the initial transferee — in our case, the money-lender. The pre-1994 Code did not contain a restriction on the trustee’s right to collect the transfer from the benefitted insider creditor, regardless of the fact that the trustee was able to set aside a transfer which occurred more than 90 days before the petition only because the benefitted creditor was an insider.

59. This phrase was derived from the name of the debtor, Big Three Transportation, Inc., in Mixon v. Mid-Continent Sys., Inc., 41 B.R. 16 (Bankr. W.D. Ark. 1983).
60. This phrase was derived from the name of the debtor in Levit v. Ingersoll Rand Fin. Corp., 847 F.2d 1186 (7th Cir. 1989).
62. Id.
63. Id.
64. 11 U.S.C. § 101(5)(A) (Supp. V 1993). Section 101(5) defines claim as including a "contingent" right to payment. Id.
Many bankruptcy courts considering facts similar to those above declined to allow recovery from the non-insider creditor. All of the circuit courts which have considered the issue agreed with De-prezio and allowed recovery from the non-insider creditor.

Nothing in the Bankruptcy Code prevented trustees from pursuing the insider creditor rather than the non-insider creditor. However, because an insider of a bankrupt company often has more shallow pockets than a bank or other money-lender, the money-lenders became the obvious target of these types of preference actions. Many courts and commentators felt that allowing recovery from the non-insider beyond the 90 day limit was unfair and inequitable. Allowing recovery from the non-insider creditor also led to results that lacked practical commercial sense. For example, a diligent, conscientious lender which had the foresight to secure a guarantor for a loan would be in worse shape than a lender which did not obtain a guarantor.

The National Bankruptcy Conference recommended changing the Code back to the pre-Code law which allowed a trustee to bring actions only against those as to whom a transfer was preferential. Congress made the change with Section 202 of the Act by amending Section 550 of the Code. The new Section 550(c) simply provides that transfers made between 90 days and one year before filing the petition, which are avoided under Section 547(b), may not be recovered from one class of creditors.

In order for a transferee to escape liability and take advantage of the amendment, the transferee must meet three requirements imposed by the Act. The first requirement is that the transfer must have been made between 90 days and one year before the filing of

67. See Ray v. City Bank & Trust Co., 899 F.2d 1490, 1495 (6th Cir. 1990); Manufacturers Hanover Leasing Corp. v. Lowrey, 892 F.2d 850 (10th Cir. 1989); Kellogg v. Blue Quail Energy, Inc., 831 F.2d 586 (5th Cir. 1987). See generally 4 COLLIER ON BANKRUPTCY ¶ 550.02 (Lawrence P. King et al., eds., 15th ed. 1994).
69. The NATIONAL BANKRUPTCY CONFERENCE, CODE REVIEW PROJECT FINAL REPORT 228 (1994).
71. Id.
72. Id.
The second requirement is that the transfer must have been avoided under Section 547(b).\textsuperscript{74} Even though Section 550 applies to recoveries using other avoiding powers under Sections 544, 548, and 549, this new narrow limitation applies only to recoveries under Section 547.\textsuperscript{75}

The third requirement is that the preference must be made "for the benefit of a creditor" who was an insider at the time of such transfer.\textsuperscript{76} One might ask why the phrase "for the benefit" was used. Section 547(b) allows for recoveries of transfers either to or for the benefit of a creditor; the amendment, by contrast, only mentions transfers "for the benefit of a creditor" and omits the language that would limit transfers directly to an insider.\textsuperscript{77} Read literally in conjunction with Section 547(b), the third requirement of the now amended Section 550(c) would limit recoveries only if the transfer were "for the benefit of a creditor."

One might also ask why it is significant that only non-insider creditors are being protected with this amendment when all such transfers would have been for the benefit of an insider creditor. The answer is found in the concluding clause of the amendment to Section 550 where there may be an unfortunate shift in tenses. We say "unfortunate" since it is impossible to tell from reading the amendment whether it was intended. If it was intended, it is not merely unfortunate; it is nonsensical. The language of Section 202 of the Act provides that "the trustee may not recover . . . from a transferee that is not an insider."\textsuperscript{78}

This concluding phrase can be interpreted to mean that if a former insider creditor benefitted from a preference at the time she was an insider, but is no longer an insider at the time the trustee files the preferential transfer action, then the trustee cannot recover from the former insider. Does this mean, for instance, that in a Chapter 7 proceeding, the previous officers of the debtor who are no longer insiders after the trustee is appointed are exempt from the provisions regarding insider preferences? There is nothing in the

\textsuperscript{73.} Id.

\textsuperscript{74.} Id. Section 547(b) provides the requirements necessary to avoid a preferential transfer. 11 U.S.C. § 547(b) (1988).


\textsuperscript{76.} Id.


legislative history regarding the drafters' intent; therefore, only judicial interpretation will answer these questions.

The implication of this amendment to insiders is important. While the money-lenders are now protected, insiders also receive benefits from the amendments. An insider may now cause a preferential transfer to be made to a creditor outside the 90 days before filing and know that the benefit derived from the transfer to the non-insider creditor cannot be set aside. The contingent creditor of the insider is now protected from the reach of Section 547 by Section 202 of the Act.

Trustees will always look for deep pockets, just as any plaintiff does. With the deep pockets of the money-lenders extinguished by Section 202 of the Act, the trustee may be less inclined to pursue the insider with the requisite expenditure of time, effort and attorneys' fees, especially where collection of any judgment is less likely. Presumably, preference actions should become less plentiful for trustees, and creditors of estates in bankruptcy will suffer.

For the insider, the ability to negotiate with the trustee is enhanced if the insider is able to convince the trustee of the difficulty of collection. With the right type of planning, an insider would be able to reduce the debt secured by a potentially exempt asset owned by the insider (such as a mortgage on the insider creditor's home) by paying with corporate funds the creditor of the corporation who holds a guarantee secured by that potentially exempt asset to the detriment of the other creditors. This type of situation could not have occurred to the detriment of the corporate debtor's creditors without the amendments found in Section 202 of the Act.

VI. LIEN STRIPPING IN CHAPTER 11

Section 206 of the Act amends Section 1123(b) to afford lenders with security interests only in a debtor's principal residence the same protection as lenders under Chapter 13 of the Bankruptcy Code. The new Section 1123(b) provides:

(b) Subject to subsection (a) of this section, a plan may—

(5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured

79. The legislative history indicates that this amendment was intended to conform Chapter 11 mortgagee treatment with that allowed under Chapter 13. 140 CONG. REC. 10,767 (daily ed. Oct. 4, 1994).
claims, or leave unaffected the rights of holders of any class of claims.\textsuperscript{80}

By making the language of Section 1123(b)(5) identical to Section 1322(b)(2),\textsuperscript{81} Congress has extended the principle of \textit{Nobleman v. American Savings Bank}\textsuperscript{82} to Chapter 11 cases.

In \textit{Nobleman}, the Court considered whether Section 1322(b)(2) of the Bankruptcy Code should be read in conjunction with and limited by Section 506(a) which defines a creditor’s secured claim rights.\textsuperscript{83} The Court rejected the argument that Section 506(a) must first be applied to determine the value of the secured claim for purposes of non-disturbance under Section 1322(b)(2). The Supreme Court noted that the express language of Section 1322(b)(2) provides that the “rights” of primary residence lenders cannot be affected.\textsuperscript{84} Noting that the term “rights” is not defined by the Bankruptcy Code, the Supreme Court utilized the state law definition of creditor’s rights.\textsuperscript{85} The Court stated that a secured creditor should not be limited to its allowed secured claim under Section 506(a) for purposes of non-disturbance under Section 1322(b)(2).\textsuperscript{86} Therefore, the Court concluded that a creditor may retain all its rights as to this type of security under Section 1322(b)(2), including the right to receive payment for the entire debt.\textsuperscript{87}

\begin{footnotesize}

\textsuperscript{81} 11 U.S.C. § 1322(b)(2) provides that:
\begin{itemize}
  \item (b) Subject to subsections (a) and (c) of this section, the plan may—
  \begin{itemize}
    \item (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor’s principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;
  \end{itemize}
\end{itemize}
\textsuperscript{83} 11 U.S.C. § 506(a) provides:
\begin{itemize}
  \item An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor’s interest in the estate’s interest in such property . . . and is an unsecured claim to the extent that the value of such creditor’s interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor’s interest.
\end{itemize}
\textsuperscript{84} Nobleman, 113 S. Ct. at 2110 (quoting Butner v. United States, 440 U.S. 48, 54-55 (1979)).
\textsuperscript{85} Id.
\textsuperscript{86} Id.
\textsuperscript{87} Id. Interestingly, even outside the context of a mortgagee with a security
\end{footnotesize}
The Court next noted that a mortgagee whose security is only in the debtor’s principal residence can point to the use of the word “claim” in the governing statute as encompassing both secured and unsecured debts.\textsuperscript{88} The section protects the debtor’s enforceable mortgage provisions as a claim without qualifying it as solely a secured claim. Consequently, it is inappropriate to reduce a mortgagee’s rights by pointing to Section 506(a).\textsuperscript{89} Ironically, the debtor is not allowed to alter a secured creditor’s right to payment on perhaps her most important asset, her residence.\textsuperscript{90}

interest only in a debtor’s primary residence, the Supreme Court has not allowed the lien avoidance language of Section 506(d) to be read in conjunction with Section 506(a) to allow an undersecured creditor’s lien rights to be stripped to the allowed secured claim value as determined by Section 506(a). As one commentator said:

Even though the term “allowed secured claim” might arguably have the same meaning for purposes of section 506(d) that it does for section 506(a), the Court held that Congress did not intend to depart from the pre-Bankruptcy Code rule that liens pass through the case unaffected. Thus, section 506(d) can be used to avoid a lien only if the underlying claim is disallowed, not if a portion of the claim is deemed unsecured by operation of section 506(a).

3 \textsc{Collier on Bankruptcy} \textsuperscript{\textit{§} 506.07} (Lawrence P. King et al., eds., 15th ed. 1994) (citing Dewsnup v. Timm, 502 U.S. 410 (1992)). The Court stated that it has long been the rule that the lien rights of a creditor are unaffected solely because of a bankruptcy. Of course, the lien can be disallowed if the claim is avoided, which is the remaining right under Section 506(d). The secured creditor retains its lien rights and benefits from any subsequent appreciation in the asset to the date of foreclosure of its lien interests. Dewsnup v. Timm, 502 U.S. 410, 417 (1992). While this creditor for purposes of Section 506(a) will have its claim bifurcated and, therefore, will receive an unsecured claim for the undersecured portion of its claim; presumably, if the undersecured claim portion results in an additional return to the creditor, then this creditor will not be allowed to obtain more than its allowed indebtedness under its governing documents.

The Court has noted that it is impossible to reduce a mortgagee’s claim and not affect its rights because contractual rights are contained in one document in which the payment terms are not bifurcated by secured versus unsecured. \textit{Nobleman}, 113 S. Ct. at 2111. One court noted that at oral argument in \textit{Nobleman}, “counsel was unable to give the questioning Justice ‘an example of how one can modify the rights pertaining to this unitary instrument only as to the unsecured portion, but not as to the secured portion.’” Citicorp Mortgage, Inc. v. Hirsch (\textit{In re Hirsch}), 166 B.R. 248, 252 (E.D. Pa. 1994).

88. \textit{Nobelman}, 113 S. Ct. at 2111.
89. \textit{Id.} The Court explained:

It is also plausible, therefore, to read “a claim secured only by a [homestead lien]” as referring to the lienholder’s entire claim, including both the secured claim and the unsecured components of the claim. Indeed, § 506(a) itself uses the phrase “claim . . . secured by a lien” to encompass both portions of an undersecured claim.

\textit{Id.}

90. \textit{Id.} at 2112 (Stevens, J., concurring). Justice Stevens suggested that “[t]he
Under Section 1123(b), the question of what constitutes "a claim secured only by a security interest in real property that is the debtor's principal residence" opens the door for courts to review individual mortgages on a case-by-case basis. In Nobleman, the deed of trust granted rights in addition to a lien on the primary residential interest. 91

VII. POST PETITION RENTS

The Constitution of the United States empowered Congress "[t]o establish ... uniform Laws on the subject of Bankruptcies through-

anomaly is, however, explained by the legislative history indicating that favorable treatment of residential mortgagees was intended to encourage the flow of capital into the home lending market." Id.

91. Included in the grant under the Nobleman deed of trust was a percentage interest in the common areas of the primary residence condominium unit as well as a pledge of:

[A]ll the improvements now or hereafter erected on the property, and all easements, rights, appurtenances, rents, ... royalties, mineral, oil and gas rights and profits, water, water rights, and water stock, and all fixtures now or hereafter attached to the property, all of which, including replacements and additions thereto, shall be deemed to be and remain a part of the property covered by this Deed of Trust.

In re Hirsch, 166 B.R. at 252. The Hirsch court notes that where a creditor's interest goes beyond the standard real estate pledge, such as set out in the Nobleman Deed of Trust, that such additional security would result in the creditor not receiving the protections of Section 1322(b)(2). The Hirsch court gives a colorful example assuming that the debtor was Citizen Kane and that the mortgage covers not only all of Xanadu's real estate and fixtures but also significant furniture and equipment, including:

[G]riffins, gargoyles and goblets. ... The legislative history of § 1322(b)(2) records that Congress wished to give extra protection to home mortgage lenders in order to encourage such common financings, Grubbs v. Houston First American Sav. Assoc., 730 F.2d 236, 246 (5th Cir. 1984), and adding Citizen Kane's horde to Xanadu would give his lender more than Congress believed necessary.

In re Hirsch, 166 B.R. at 254.

The Hirsch court indicates that the debtor's ability to scale back its creditor's rights will in some measure depend on the ability of the creditor to show that the lender's interests were secured by property other than the real estate and boiler plate real estate interests. Id. Such was the case in In re Ramirez where the real property provided almost half of the debtor's income from two rental units located on it. In re Ramirez, 62 B.R. 668 (Bankr. S.D. Cal. 1986). Noting that the lender would only qualify the debtor for the loan based on this rental income, the Ramirez court found that the secured party's security interest extended to more than the debtor's principal residence, and also included its commercial rental features, and thus allowed the debtor to alter the creditor's rights pursuant to its Chapter 13 plan. Id. at 670.

However, other cases that have held that the use of the debtor is primarily residential even though there are other actual or potential uses. See, e.g., In re Glenn, 760 F.2d 1428 (6th Cir. 1985), cert. denied, 474 U.S. 849 (1985); In re Ballard, 4 B.R. 271 (Bankr. E.D. Va. 1980).
out the United States."  Although bankruptcy law was uniformly established under "the Bankruptcy Code," the application has been inconsistent due to differences in judicial interpretation of the Bankruptcy Code and variances in state laws defining property rights.

94. Except in the areas of fraudulent conveyances and preferences, property rights are largely defined by state law. Butner v. United States, 440 U.S. 48, 54 (1979). In addition, the uniform interpretation of property rights in state and federal courts within the same state has been cited as a proper goal. Such uniformity "reduce[s] uncertainty, ... discourage[s] forum shopping, and ... prevent[s] a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'" Butner, 440 U.S. at 55 (quoting Lewis v. Manufacturers Nat'l Bank, 364 U.S. 603, 609 (1961)). Especially with national companies or companies with subsidiaries operating in several states, a focus solely on uniform interpretations within a state neglects the federal forum shopping that can otherwise result.

Code areas that are subject to state law variances include, but are not limited to, 11 U.S.C. § 544(a) (allowing a trustee to avoid a transfer of property of the debtor as if a hypothetical lien creditor or hypothetical bona fide transferee under state law); and 11 U.S.C. § 546(b) (allowing a creditor to perfect an interest in property notwithstanding a bankruptcy stay, where the filing is deemed to relate back to a time period before the bankruptcy filing).

Another example is found under Bankruptcy Code § 546(a). Here, the exercise of the trustee's avoiding powers are limited in time to the earlier of "two years after the appointment of a trustee under section 702, 1104, 1163, 1302 or 1202 [of Title XI]; or the time the case is closed or dismissed." 11 U.S.C. § 546(a)(1988).

Before the Act, § 546(a)(1) was subject to varying interpretations. Some courts applied the two year limit to a debtor in possession who exercised the powers of a trustee. Zilkha Energy Co. v. Leighton, 920 F.2d 1520, 1524 (10th Cir. 1990). Accord Construction Management Serv. v. Manufacturers Hanover Trust Co., 13 F.3d 81 (3d Cir. 1994); In re Software Center Int'l, Inc., 994 F.2d 682 (9th Cir. 1993).

A recent bankruptcy court decision held to the contrary, stating that the two year limitation period only expressly applies to a bankruptcy trustee. In re Electrical Materials, 160 B.R. 1018, 1022 (Bankr. W.D. Mo. 1993). This case held that § 546(a) does not require an action to be brought within two (2) years after the debtor in possession comes into existence, but only before the case is closed or dismissed. Id. This difference in interpretations was resolved by § 216 of the Act, which amended § 546(a) to read as follows:

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of —

(1) the later of —

(A) 2 years after the entry of the order for relief; or

(B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the periods specified in subparagraph (A); or

(2) the time the case is closed or dismissed.

In passing the Act, Congress addressed state law differences regarding creditors' rights in a debtor's post-petition rents. Section 214 of the Bankruptcy Reform Act amends Bankruptcy Code Section 552(b) as follows:

(b)(1) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, or profits of such property, then such security interest extends to such proceeds, product, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

(2) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, and notwithstanding section 546(b) of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to amounts paid as rents of such property or the fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties, then such security interest extends to such rents and such fees, charges, accounts, or other payments acquired by the estate after the commencement of the case to the extent provided in such security agreement, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

Even pre-amendment Section 552(b) did not specifically address perfection issues. The pre-amendment provision regarding the requirement that "applicable non-bankruptcy law" be consulted before concluding that the security interest continues in rents often resulted in courts reviewing state law to determine when a security interest in rents became perfected.

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95. Butner, 440 U.S. at 54. The Court acknowledged that such a Congressional rule regarding rents would be within Congress' express power. Id.


Case law interpreting Section 552(b) created a patchwork of state law-specific results. Some courts allowed an admittedly unperfected post-petition interest to become perfected and relate back based on post-petition actions under Section 546(b). Many courts criticized the use of Section 546(b) as a vehicle for allowing post-petition perfection in rents.

98. See, e.g., In re Wheaton Oaks Office Partners Ltd. Partnership, 27 F.3d 1234, 1243 (7th Cir. 1994) (finding that an executed and recorded assignment of rents created a perfected lien on future rents and that no steps for collection were necessary to protect the interest); In re Multi-Group III Ltd. Partnership, 99 B.R. 5 (Bankr. D. Ariz. 1989) (holding that under Arizona's lien theory of mortgages and statutory framework, mortgagee was not entitled to rents until specific, affirmative actions were taken).


Section 362(b)(3) provides a limited exception to the stay "to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title." 11 U.S.C. § 362(b)(3)(1988).

Under § 546(b), the trustee's rights to set aside an unperfected lien interest under its strong arm provisions (11 U.S.C. § 544) are subject to any generally applicable law that:

- permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of such perfection. If such law requires seizure of such property or commencement of an action to accomplish such perfection, and such property has not been seized or such action has not been commenced before the date of the filing of the petition, such interest in such property shall be perfected by notice within the time fixed by such law for such seizure or commencement.


A Texas case provides a good example of the variances in analysis used by courts in reviewing the post-petition perfection issue. Under Texas law, affirmative steps must be taken to effectuate an assignment of rents. In re Casbeer, 793 F.2d 1436, 1442 (5th Cir. 1986). Although certain actions are admittedly sufficient, such as obtaining a receiver or obtaining possession of the property, Texas courts could review on a case by case basis the sufficiency of the particular steps taken. In re Village Properties, Ltd., 723 F.2d 441, 446 (5th Cir. 1984), cert. denied, 466 U.S. 974 (1984). The mortgagee in Casbeer filed a motion for relief from stay, a motion to prevent use of rents, and a complaint for injunctive relief. Casbeer, 793 F.2d at 1438. Noting that the subject mortgage provisions prevented additional encumbrances, and that such contract provisions are important in reviewing lien priorities, the Casbeer court found that the creditor's post-petition actions were sufficient to cause its perfection to relate back. Id. at 1443.

100. See, e.g., In re Multi-Group III Ltd. Partnership, 99 B.R. 5, 9 (Bankr. D. Ariz. 1989). Legislative history shows that the intent of Bankruptcy Code § 546(b) was to protect the creditor who is otherwise allowed to create an interest that relates back, such as under Section 9-301(2) of the Uniform Commercial Code. Just as a creditor does not get credit for the "use value" of its pledged property, other than post-petition interest if the creditor is over secured, the unperfected, unsecured creditor should not receive overly favorable treatment. Multi-Group III Ltd., 99 B.R. at 11.
Under Arkansas law, the question of whether an interest in rents is perfected depends on whether the rents are pledged and whether the assignment is absolute or conditional. Other courts specifically reject the distinction between absolute or conditional assignments.

According to legislative history, the amendment purportedly removes the pre-condition of a perfected security interest under state law in order to claim an interest in post-petition rents. By amending Section 552(b), however, Congress either sidestepped or confused the question of whether a creditor must have a perfected interest in post-petition rents under non-bankruptcy state law, thus preventing strong arm challenges under Section 544 solely because a properly perfected post-petition security interest is alleged not to exist.

To fully understand the effect of this amendment, consider the following hypothetical. A lender ("Lender") takes a mortgage on an Arkansas office building ("Building") which does not include any mention of rents. The owner of the Building then gives Lender a letter granting an interest in the rents, which Lender does not file of record. The mortgage is duly recorded as required by state law. The owner of the Building then files a Chapter 11 proceeding. The Debtor then proceeds to use post-petition rents as he sees fit. Lender files a motion to prevent use of post-petition rents claiming a security interest in the rents. Under the pre-Act Code, the Debtor would have prevailed because Lender failed to file a record of his interest in the rents.

After Section 214 of the Act, the Lender will argue that the amended Section 552(b)(2) provides that it has a security interest in the rents because it entered into a security agreement before the commencement of the case and the agreement extends to rents. There is nothing in amended Section 552(b)(2) that requires perfection of that interest. The Lender will point to the legislative history which provides that the intent of the amendment is to avoid the requirements of "non-bankruptcy" law. The Debtor will point out that

101. First Fed. Sav. v. City Nat'l Bank, 87 B.R. 565, 567 (Bankr. W.D. Ark. 1988). Under Arkansas law, rents are a separate interest in realty and may be conveyed or pledged in addition to a pledge solely of the realty. Id. (citing Ark. CODE ANN. § 18-12-102 (Michie 1987)).

102. See Northwestern Nat'l Life Ins. Co. v. Metro Square (In re Metro Square), 93 B.R. 990 (Bankr. Minn. 1988). The court found that conflicting language in the documents supported an absolute as well as unconditional assignment arguments. Id. In addition, the court held that rents were collaterally assigned as additional security. Id. at 996.

Section 552(b)(1) begins by saying "Except as provided in section[...
Therefore, the court must look only to Section 544 to
determine if it should cut off the Lender's rights. The Debtor will
assert that any further reference to the amended Section 552(b)(1)
is unnecessary.

Unfortunately, the correct decision for the court is difficult to
determine because both the Lender and the Debtor are correct in
their arguments. Although the legislative history and comments clearly
support the Lender's argument, the Debtor appears to have the
better argument when looking at the plain language of the amend-
ments contained in Section 214 of the Act and Section 544 of the
Code. 104

Under the pre-Act Section 552(b) of the Bankruptcy Code, if
a creditor's interest in post-petition rents was deemed unperfected
on the date the petition was filed, the creditor's interest was subject
to defeat by a trustee or debtor in possession pursuant to Section
544. 105 As noted, it is puzzling that Section 552(b), as amended, is
still subject to the avoiding powers of Section 544. Does this mean
that a trustee as a bona fide purchaser or hypothetical lien creditor
can avoid a pre-petition, unperfected interest in rents? If post-petition
rents are subject to Section 544, then Congress's clearly articulated
goals as outlined in the legislative history protecting creditors' in-
terests in unperfected post-petition rents may have been for naught. 106

The amended Code Section 552(b) now clearly includes hotel
revenues or room rents in the context of property 'proceeds. This
change addresses the question of whether hotel revenues are accounts

that "[t]here is...no more persuasive evidence of the purpose of a statute than
the words by which the legislature undertook to give expression to its wishes").

105. This section gives the trustee the power to assert the status of a lien creditor
or bona fide creditor for value, which status may allow the trustee to defeat the

106. Under Section 544 of the Bankruptcy Code, the analysis arguably returns
to an inquiry of whether under a particular state's law a hypothetical lien creditor
or hypothetical bona fide purchaser may defeat an unperfected security interest in
rents. Perhaps in this specific context, the courts will note that Section 544(a),
because of its specific reference to a debtor's property, cannot affect the proceeds,
which are estate property under Section 541(a)(6). This argument, which is made
in a bankruptcy treatise, is quickly shot down by this treatise because the interest
in proceeds "will fail upon the avoidance for any reason of the security interest
in the collateral that produced the proceeds." 2 DAVID EPSTEIN, ET AL., BANKRUPTCY
§ 6-78, n.3 (1992). In addition, under Section 547(e)(2), if rights to proceeds are
not perfected, then the transfer of the proceeds (if considered real property under
governing state law) will be deemed to occur immediately before the date of the
filing of the petition for preference purposes or ten days after the effective date
receivable and, therefore, property of the debtor’s estate or are “proceeds, . . . rents, or profits” under old Section 552(b). If a third-party creditor proves that it has an interest in rents, the provisions of Section 363 require that the rents, as cash collateral, be protected. The protection afforded is typically that rents be used to maintain the collateral. Even when such an order of adequate protection is not made under Section 363(a), courts have reached similar results.

VIII. SMALL BUSINESS CASES

Section 217 of the Act begins with the creation of a sub-category of Chapter 11 for “small businesses.” The amendment defines a “small business” as a person engaged in commercial or business activities, with aggregate, noncontingent liquidated secured and unsecured debts not exceeding $2,000,000. The amendment excludes a person whose primary activity is the business of owning or operating real property from “small business.”

Neither “commercial” nor “business” activity is defined in the Code or the Act. However, Section 1304 implies that if one incurs trade credit in the production of income, then one is engaged in business. Therefore, an individual engaged in commercial or business activity will be able to choose between Chapter 13 and Chapter 11, depending on the level of debt. However, a partnership or


113. Id.

corporation can never use Chapter 13 and would be relegated to Chapter 11 depending upon its debt amounts and activities in the real estate business. Given the increase in the Chapter 13 limits on debt, an individual engaged in business will certainly want to look closely at Chapter 13 before deciding which chapter to proceed under. Individuals, under the new Act, may now file Chapter 13 if their noncontingent, liquidated unsecured debts are less than $250,000, and their noncontingent, liquidated secured debts are less than $750,000.115

After defining who may take advantage of the small business amendments, Section 217 makes other changes to Chapter 11. The first provision (217(b) of the Act) deals with the appointment of creditors and equity security holders committees. The pre-Act law compelled the United States Trustee to appoint a committee of holders of unsecured claims.116 Now, a "party in interest" may request the court to direct that the United States Trustee not appoint a committee of unsecured creditors.117 No guidance is given to the court as to when it should or should not allow the United States Trustee to avoid appointing a committee.118

The committee of unsecured creditors might become more popular and thus more active as a result of the amendments in Section 110 of the Act.119 This provision amends Section 503(b)(3) to allow for the actual and necessary expenses incurred by appointed committee members in the performance of their duties.120 The allowance could encourage committee members to take a more active part in committee activities.

Another change made by the small business amendments concerns the exclusivity period. Under the pre-Act Section 1121, the debtor, absent court modification, had an exclusive period of 120 days in which to file a plan of reorganization, and that exclusivity continued for 180 days from the petition while the debtor sought approval of the plan.121 If the debtor elects to be treated as a small business, Section 217 of the Act provides several changes in the

118. Presumably, existing case law on the necessity of committees will continue to control. One such case is In re Shaffer-Gordon Assoc., Inc., 40 B.R. 956 (Bankr. E.D. Pa. 1984).
120. Id.
length of time for the confirmation process. First, the election by the debtor shortens the exclusivity period from 120 days to 100 days from the petition date.\textsuperscript{122} Section 217 also establishes a deadline of 160 days in which any plan may be filed by any party in interest.\textsuperscript{123} Therefore, by giving up 20 days of the otherwise applicable exclusivity period, the debtor can impose on all parties an absolute 160 day period for filing any competing plans. Section 217 also permits the debtor and parties in interest to petition the court to \textit{reduce} the 100-day period and the 160-day period when appropriate.\textsuperscript{124} The 100-day period may be increased, but only if the debtor shows that the need for an increase is caused by circumstances for which the debtor should not be held accountable.\textsuperscript{125}

Once the election is made under Section 217(e), the court may conditionally approve a disclosure statement subject to final approval after notice and hearing.\textsuperscript{126} Section 217 also allows the court to shorten the time, to not less than 10 days, between mailing a conditionally approved disclosure statement and the hearing on confirmation of the plan.\textsuperscript{127} Creditors may find themselves with a very short period of time in which to react to a conditionally approved disclosure statement and proposed plan of reorganization. After the conditional approval of the disclosure statement by the court, the debtor may mail the plan and disclosure statement to the creditors and solicit approval of the plan based on the conditional approval of the disclosure statement.\textsuperscript{128}

At least one other interesting question remains concerning Section 217. Must a small business election be made for all purposes? Based on the language of Section 217, arguably, an election could be made for one purpose but not the other. Section 217(e) modifies the section of the Code dealing with filing plans, and Section 217(f) deals with disclosure statements, and neither mentions the other. These issues will be determined by judicial interpretation.

\textbf{IX. SINGLE ASSET CASES}

Section 218 of the Act deals with single asset real estate cases in bankruptcy.\textsuperscript{129} A "single asset" real estate case is where the

\textsuperscript{122} Id.
\textsuperscript{123} Id.
\textsuperscript{124} Id. § 217(d).
\textsuperscript{125} Id. § 217(e)(3)(B).
\textsuperscript{126} Id. § 217(f)(1).
\textsuperscript{127} Id. § 217(f)(2).
\textsuperscript{128} Id.
debtor’s only business is the ownership of nonresidential real estate.\textsuperscript{130} In the 1970s and 1980s, debtors in single asset real estate cases were typically limited partnerships formed to take advantage of liberal tax laws.

Although there is nothing in the pre-1994 bankruptcy law that entitles single asset debtors to any less protection, courts have found bad faith in these filings based, in part, on the fact that only a single asset was owned by the debtor.\textsuperscript{131} The concept that owners of a single real estate asset are entitled to less protection than other debtors under the Bankruptcy Code has now progressed to the point that Congress has carved out certain real estate developers as an exception in Chapter 11 reorganizations.\textsuperscript{132}

Treating single asset owners differently is not new to Congress. In 1978, the Senate’s proposed version of Section 362 would have almost insured that single asset cases would never survive.\textsuperscript{133} The Senate proposal provided that property was not necessary for reorganization. If no business was conducted on the property by the debtor, courts should grant relief from the automatic stay within thirty days of the hearing. The only way the debtor could avoid relaxation of the stay was to show equity in the property. The proposed amendment simply took away from the debtor any argument that the property was necessary for reorganization. Thus, without proof of equity, the creditor would be entitled to relief from the automatic stay immediately. That Senate proposal died in the House; however, bankruptcy courts proceeded to dismiss single asset real estate cases, which courts considered abusive of the reorganization process.\textsuperscript{134}

\textsuperscript{130} Id. § 218(a).
\textsuperscript{131} Little Creek Develop. Co. v. Commonwealth Mortgage Corp., 779 F.2d 1068 (5th Cir. 1986). Here, the court summarizes the issue of good faith, or lack thereof, as a basis for finding: (i) cause for relief from the automatic stay under Section 362(d)(1), or (ii) regarding dismissal or conversion of cases under Section 1112(b). Mentioning that a totality of circumstances must be reviewed, the court notes that many appropriate candidates for “bad faith” filings include where:

The debtor has one asset, such as a tract of undeveloped or developed real property. The secured creditors’ liens encumber this tract. There are generally no employees except for the principals, little or no cash flow, and no available sources of income to sustain a plan of reorganization or to make adequate protection payments.

\textsuperscript{133} S. 2266, 95th Cong., 2d Sess. (1978).
\textsuperscript{134} See Phoenix Piccadilly, Ltd. v. Life Ins. Co., 849 F.2d 1393 (11th Cir.
The Supreme Court stepped into the fray in 1988 when it found that the portion of Section 362(d)(2)(B) which mentioned effective reorganization required that the effective reorganization be "in prospect." The recommendation of the National Bankruptcy Conference on the amendment of Section 362 actually moved away from the "necessary for effective reorganization" concept and placed emphasis on the effect of lifting the stay on the estate and the other creditors.

The concept that single real estate asset debtor cases should move along more quickly than other types of cases has finally found its way into the Bankruptcy Code in Section 218 of the Act. The concept is handled mechanically by adding a definition of single asset real estate as (1) real property constituting a single property or project, (2) which is not residential real property with fewer than 4 residential units, (3) which generates substantially all of the gross income of a debtor, (4) on which no substantial business is being conducted by the owner other than the business of operating the real property, and (5) the owner has noncontingent, liquidated secured debts in an amount of $4,000,000 or less. This definition is the same as in the 1978 Senate proposal, with the exception of the $4,000,000 limit.

The use of the $4,000,000 limit is puzzling. Apparently this limit is a corollary to the "too big to fail" rule in banking and should be known as the "too small to reorganize" rule.

Under the new Section 362(d), as amended by the Act, the automatic stay shall be lifted as to property which constitutes single asset real estate, unless within 90 days of filing the debtor has filed a plan of reorganization or commenced monthly payments to each creditor with a claim secured by the real estate. If filed, the plan

135. United Sav. Ass'n v. Timbers of Inwood Forest, 484 U.S. 365 (1988). The court explained, "[T]his means there must be 'a reasonable possibility of a successful reorganization within a reasonable time.'" Id. at 376.
138. Id. § 218(a) (codified at 11 U.S.C. § 101(51B)).
140. Ironically, the Timbers of Inwood Forest Associates project would not have qualified under the definition, since its debt was greater than $4,000,000.
must have a reasonable possibility of being confirmed within a reasonable time. The monthly payments must equal interest computed at the current market rate multiplied by the value of the “creditor’s interest in the real estate.” Note that even if the debtor can prove equity, the equity cannot be saved unless the plan is filed or payments begin.

Thus, to obtain relief from the automatic stay under this amendment, the secured creditor must prove all of the following:

(a) Substantially all of the debtor’s gross income comes from real property which is not residential property with fewer than 4 units; and
(b) The debtor conducts no substantial business on the property, other than the business of operating the property; and
(c) The total noncontingent, liquidated secured debts of the debtor are $4,000,000 or less; and
(d) The debtor has not filed within 90 days after the order for relief (or any extension granted by the court within the 90 days):
   (i) a plan which has reasonable possibility of being confirmed within a reasonable time; and
   (ii) the debtor has not commenced monthly payments to each creditor whose claims are secured by the real estate, in amounts equal to interest at a current fair market rate on the value of each creditor’s interest in the real estate.

The failure to prove any one of these elements would relegate the creditor to the same rules applicable to creditors of non-single asset debtors.

From a creditor’s point of view, this amendment may actually slow down the creditor’s rush to file motions for relief from stay. Creditors that would normally file such motions immediately may now want to wait until after the 90th day, knowing that the amendment will provide the needed pressure to keep the debtor moving.

142. Id.
143. Id. § 218(b)(3). A creditor with a $1,000,000 debt with collateral worth $500,000 must be paid on a monthly basis the amount that is calculated by the following formula: market interest rate x 500,000 divided by 12. In Timbers, the Supreme Court found the phrase “value of such creditor’s interest” in Section 506(a) means “the value of the collateral.” Timbers, 484 U.S. at 631. Presumably, Congress did not intend to require interest payments on a secured creditor’s entire claim (including the unsecured portion) under new Section 362(d)(3). Such a result would directly conflict with Section 506(b) and cases interpreting it such as Timbers.
toward a plan or payment to the secured creditors.\textsuperscript{146} For those purposes, the amendments may be worthwhile.

X. CONCLUSION

The Bankruptcy Reform Act of 1994 represents, once again, a hurried and piecemeal effort to address issues raised by interpretation of the existing Code and issues which concern special interest groups. It remains to be seen if the amendments will accomplish any meaningful, positive reform of bankruptcy law.