The Cramdown

The Newsletter of the Tampa Bay Bankruptcy Bar Association SPRING, 2003

Editor, Donald R. Kirk

President's Message

By Catherine Peek McEwen

Association's members pay it forward

How are things on the home front? You've probably read or seen a lot about what's happening in this part of the world from the news. Things are getting busy around here as you can imagine. We've literally had 100's of people arriving everyday here [at a military base in Saudi Arabia]. They've had 1,000's arriving everyday in Kuwait. I hope Sadam gets the hint. I know the Iraqi people will be very glad to see him go. As an intelligence officer, all I can tell you is Colin Powell only scratched the surface in his address to the U.N. -Email to his mother by a major in military intelligence, 1st Battlefield Coordination Detachment

Pro bon publico. For the public good. What more satisfying way is there to meet this professional responsibility of ours than to do so for someone serving the public by risking his or her own life?

Some of our association's bankruptcy lawyers found this out recently by volunteering to assist families with members being shipped out of the U.S. Marine Corp Reserve Unit facility on Gandy to places undisclosed and far away in anticipation of being deployed in military action in the Middle East. Quite independent of that effort, other of our association's members recognized a need to provide *pro bono* services to family members left behind and suffering financial difficulties. As a result of these colleagues' leadership, the association will organize a *pro bono* program designed to assist our area's populous military and their families here during the period of time when we face escalated military buildup and, perhaps, war in the Middle East.

(Cont. on Page 5)

An announcement by Chief District Court Judge Patricia Fawsett:

With pleasure I announce that the Board of Judges has selected the Honorable Paul M. Glenn to serve as Chief Judge of the Bankruptcy Court. Judge Glenn will serve a four year term as Chief Judge commencing on March 20, 2003, the effective date of the resignation of Chief Judge Thomas E. Baynes, Jr. from this position. We are very grateful to Chief Judge Baynes for his considerable contributions to the honor and reputation of our Bankruptcy Court and thank him for his service in this leadership position. We are honored that Judge Glenn has consented to serve as the next Chief Judge and appreciate both his vision for this Court and his dedication to the development of collegiality. Please join me in thanking Chief Judge Baynes and congratulating our new Chief Judge Glenn.

* * *

Judge Glenn has agreed to give us a brief address at the beginning of our next luncheon/seminar on April 8th. Don't miss the opportunity to hear his vision for our court.

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VIEW FROM THE BENCH

DISCLOSURE AND DISCOVERY REQUIRES COUNSEL'S ACTIVE CARE AND ATTENTION

Sanctions Are Available for Negligently Failing to Produce

By Honorable C. Timothy Corcoran, III

Hardly a week goes by without receiving a new decision that suggests the practice of law is hazardous to the health of lawyers. One of the most recent decisions fitting this category teaches that sanctions are available for *mere negligence* in counsel's timely producing discoverable information, even when hiring and heeding the advice of experts to handle the production. With decisions like this coming out regularly nowadays, litigators need to increase the priority they place on the disclosure and discovery phases of their cases.

RFC v. DeGeorge

Residential Funding Corp. v. DeGeorge Financial Corp., 306 F.3d 99 (2d Cir. 2002), began as a simple action involving cross claims for breach of contract. (Although the defendant DeGeorge was in bankruptcy, the district court denied the plaintiff RFC's motion to refer the case to the bankruptcy court.) When DeGeorge requested RFC's e-mails, RFC decided it did not have the technical capability to retrieve the e-mails from backup tapes. It therefore employed a vendor to do so on its behalf. When the vendor was unable to retrieve the archived e-mails over time, RFC resisted producing the backup tapes themselves. Ultimately, RFC produced the tapes. Within four days of receiving the tapes, DeGeorge's vendor had located the e-mails, some of which were responsive to the discovery request, although none appeared damaging to RFC. By this time, however, trial had begun and the presentation of evidence was almost completed.

The Trial Court's Decision

DeGeorge moved for sanctions in the form of a jury instruction that the jury should presume the unproduced e-mails would have disproved RFC's theory of the case. The district court denied sanctions. It held that, to impose sanctions on the basis that evidence was not produced in time for use at trial, three elements were required: (1) that the producing party had an obligation to produce the evidence in a timely fashion; (2) that the producing party failed to produce the evidence timely with "a sufficient culpable state of mind"; and (3) " 'some evidence suggest[ing] that a document or documents relevant to substantiating [the claim of the party seeking sanctions] would have been included among the destroyed files.' " The parties agreed that RFC had the obligation to preserve and produce the e-mails. The district court, therefore, focused on the second and third prongs.

As to the second prong, the district court held that DeGeorge had failed to establish that RFC acted with "bad faith" or "gross negligence" for two reasons. First, RFC's decision to use an outside vendor to retrieve the e-mails rather than turn over the backup tapes was "neither implausible nor unreasonable," and it was this decision that led to much of the delay. Second, although recognizing "a somewhat purposeful[ ] sluggishness on RFC's part," the district court found these acts would not have resulted in the unavailability of the e-mails but for the "compressed timeline" under which both parties were operating.

As to the third prong, the trial court held that, apart from the non-production itself, DeGeorge had failed to show the e-mails would have been helpful to it.

The Court of Appeals' Decision

On appeal, the Second Circuit reversed the denial of the sanctions order and remanded for an evidentiary hearing after discovery on the sanctions issue. The court of appeals held that the district court had applied the wrong legal standard and had abused its discretion.

First, the court of appeals held that mere negligence in destroying or in failing to produce is sufficient to justify sanctions. It wrote that sanctions may be appropriate in some cases involving negligence "because each party should bear the risk of its own negligence."

Second, as to the relevance of the missing evidence, the court of appeals held that a party seeking sanctions need only adduce sufficient evidence to permit the trier of fact to infer that "the destroyed [or unavailable] evidence would have been of the nature alleged by the party affected by its destruction" or unavailability, being careful not to hold that party to too strict a standard lest the party be permitted to profit from its own wrongdoing. Where bad faith or gross negligence is involved, that alone permits the inference that the missing evidence is unfavorable to that party. In the case of negligence, something more is required to show that the missing evidence is relevant to the party's claim or defense. On the facts of the case, the court found that something to be RFC's "somewhat purposeful[ ] sluggishness." The court seemed to hold against RFC its passive acceptance of its vendor's inability to produce over an extended period of time, especially when DeGeorge's vendor accomplished the job in only four days.

The court of appeals made another point:

> In addition to our doubts whether the District Court fully considered all of the evidence, we are uncertain whether the District Court appreciated that as a discovery deadline or trial

A View From the Bench *(cont. from pg. 3)*

date draws near, discovery conduct that might have been considered "merely" discourteous at an earlier point in the litigation may well breach a party's duties to its opponent and to the court. In the circumstances presented here — *i.e.*, trial was imminent and RFC had repeatedly missed deadlines to produce the e-mails — RFC was under an obligation to be *as cooperative as possible*. Viewed in that light, RFC's "purposefully sluggish" acts — particularly its as-yet-unexplained refusal to answer basic technical questions about the tape until prompted to do so by the District Court — may well have constituted sanctionable misconduct in their own right.

Lessons

Most of us would have thought that the trial court got this case about right. Yet the court of appeals applied a much higher standard. So what are the lessons for today's litigators to be learned from *RFC v. DeGeorge*? I offer the following:

• Counsel must ensure evidence is preserved from the inception of the dispute, even before litigation begins. Take reasonable steps to protect potentially responsive documents and electronic data.

• Counsel needs to take charge of the disclosure and discovery process. It is perfectly acceptable to engage and rely on experts and vendors. It is not acceptable to do so without responsible supervision or oversight, especially if 20-20 hindsight will show the vendor was not performing competently.

• It is also perfectly acceptable to use and rely on the client's in-house personnel to assist counsel and to furnish necessary expertise in the disclosure and discovery process. Nevertheless, counsel must view any claim of inability to retrieve data with suspicion.

• Discovery as to irretrievability and relevance of unproduced data can be available in sanctions disputes. Sanctions litigation of this sort can mushroom into its own kind of "federal case."

• The relevance of missing data is not a complete defense to a sanctions motion, although it can be a complete defense to an adverse inference sanction. Many lesser sanctions — such as fees and costs — are available. Non-production alone is sanctionable under Rule 37(b) and (c)(1).

Conclusion

In our bankruptcy court, we fortunately do not see the high-powered sanctions litigation reflected in *RFC v. DeGeorge*. Nevertheless, there are many lessons in that case for us to learn. The most basic one is that placing disclosure and discovery on "autopilot" is a dangerous way for counsel to proceed.

Editor's Note by Luis Martinez-Monfort: On Tuesday, February 18, 2003, prior to the commencement of the monthly TBBBA luncheon, Judge C. Timothy Corcoran III publicly announced his intention to retire from the court upon the completion of his fourteen year term in August. Originally appointed to serve as the bankruptcy judge for the Orlando Division of the Middle District of Florida in 1989, Judge Corcoran shifted to the Tampa Division in 1993 when the local court expanded to four judges. During the course of his term, Judge Corcoran presided over such cases as Braniff Airlines, Jumbo Sports, and Toy King. Judge Corcoran is a graduate of the University of North Carolina and earned his Juris Doctor from the University of Virginia. He was admitted to the bar in 1973 and was a partner at Carlton Fields prior to his appointment to the bench. Most recently, Judge Corcoran was the recipient of the Young Lawyers Division for the Hillsborough County Bar Association's Robert W. Patton Outstanding Jurist Award for his achievements on the bench and his service to the local bar. A full retrospective on Judge Corcoran's career will appear in the Summer edition of the CramDown.

Press Release From Judge Corcoran

Friends, I want to inform you that I intend to retire from the court upon the completion of my 14 years of judicial service in August. Although I had notified the court of appeals that I was willing to accept reappointment, I understand that reappointment will not be forthcoming.

In August, I will be a few months short of my 58th birthday. I am blessed to have my health, vigor, enthusiasm, wonderful friends, and a myriad of interests and pursuits. I am excited about continuing an active and productive professional life. In the meantime, there remains much work to be done. I intend to ensure a smooth transition and to leave a clean deck for my successor.

Let me take this opportunity to thank my judicial colleagues, both from the district court and the bankruptcy court. We are fortunate to have such fine judges.

Let me also thank my personal staff and the members of the clerk's office whose tireless work often goes unseen and unrecognized. You were of immense help to me, and each of you is important and special.

I also want to thank the members of the Bar, especially the countless numbers who have provided support, good will, and friendship and who have recognized that my every act has been — and will continue to be — motivated by the desire to provide fair, efficient, and effective justice to all who come here. You have been a source of comfort and inspiration to me.

Thanks to all of you.

President's Message *(cont. from Pg. 1)*

The first group of association members heeded a last-minute call by a retired Marine Sergeant Major to "come help" at Family Day for the 4th Assault Amphibian Battalion at the end of January at the Marine facility. The Red Cross and other volunteer organizations were there to provide information helpful to those having to make a transition where moms, dads, sons, and daughters would be away for an unknown period of time. Lawyers were called upon to help with wills, powers of attorney, and advance planning documents. They also answered questions about how to handle car loans, leases, and the like while overseas. Herb Donica and Scott Stichter mobilized some of the association's Community Service Committee members on short notice and spent the afternoon out there with Don Stichter, Jan Donica, John Brook, Patty Halloran, and David McEwen. Jan, armed with her laptop — armed itself with special estate planning software, drafted the planning documents while the others did intake for the documents, helped with the execution of them, and answered questions about the Soldiers' and Sailors' Civil Relief Act of 1940 ("SSRA").

Other association members decided to make *pro bono* work for the military a special project of the newly formed Consumer Lawyers Committee. At a recent 341 meeting, co-chair Harvey Muslin observed a *pro se* Chapter 13 debtor who was struggling to meet the filing requirements. Her 341 meeting had been continued twice already. This debtor probably did not even belong in bankruptcy because her reason for being there was financial hardship caused by her service member husband's being overseas. She was evidently unaware of the protections of the SSRA. Harvey jumped in and volunteered to take her case. "That's the least I could do if her husband is out there risking getting killed for me," he said.

After that event, Harvey collaborated with Consumer Lawyers Committee co-chair David Hicks and volunteer Kelly Petry, and together they began to enlist other volunteers from the committee to take on referrals by trustees who identify *pro se* debtors to be spouses or dependents of someone in active military service. The first organizational meeting for the project will be held sometime soon at the courthouse (hopefully during a noon break on a "cattle call" consumer day for one of the judges). Look for future announcements about the project via email.

In the meantime, if you happen to be counseling a debtor who might be protected by the SSRA – or a creditor who wants to take action against someone who is protected, be aware that the SSRA provides for reduced interest rates on mortgage loans and credit card debt, protection from eviction depending on the amount of monthly rent payable, and delay of all civil court actions, such as foreclosures. Additional protections are available to reservists who have been called up for active duty. To obtain more information, contact Bill Zewadski (813-223-7474), whose partner John Vento (a Colonel and Senior Reservist in the U.S. Air Force Reserve) has compiled useful resource materials on the SSRA, or Patty Halloran (813-877-9222), who also knows much about the SSRA, or surf the 'net for some helpful websites, including www.defenselink.mil/specials/Relief_Act_Revision/.

Finally, this thought on the subject:

> *This morning my son requested a rather elaborate breakfast before school, and I made it for him cheerfully. He is only seven or eight years younger than some of the boys I prepared documents for yesterday. Maybe someday he will go away to fight so that other little 11-year old boys can eat scrambled eggs in their mommies' kitchens and play Gamecube before school. Today I treasure the joy of having my family safe and all in one place, having seen all those people who are sacrificing that and so much more for the rest of us. –Email from Jan Donica, mother-lawyer-pro bono volunteer*

We can all "pay it forward" in a way that makes us truly appreciate *pro bono* service to those who have a special need for access to legal services during this critical time in our nation's history.

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Congress gets reform advice from bankruptcy judges

Congress is starting to look at bankruptcy reform again, but this time with some input from those who really know better than Congress about what reform is needed. Nationally known bankruptcy judges A. Thomas Small (E.D. N.C.) and Eugene R. Wedoff (N.D. Ill.) collaborated on a paper titled "A Proposal for More Effective Bankruptcy Reform" and sent it to all members of the House and Senate Judiciary Committees February 27th. Hopefully they will read it. The proposal offers "several modifications [to legislation debated in recent Congressional sessions] that will make the reforms more workable in practice," according to American Bankruptcy Institute Resident Scholar David G. Epstein. To read the 24-page report, go to the ABI's home page, www.abiworld.org. Notably for consumer debtors' counsel, the proposal urges elimination of the increased liability for counsel beyond what is already required by Rule 9011, Federal Rules of Bankruptcy Procedure. If you agree with the proposal, consider contacting your representative in the House and both of our state's Senators, *but do it quickly!*

REMOVAL OR REFERRAL:
THE PROBLEM OF "RELATED TO" ACTIONS PENDING IN DISTRICT COURT

By J. Ryan Chandler

The perception exists, rightly or wrongly, that the Bankruptcy Court is to the debtor what Raymond James Stadium is to the Buccaneers. Removal statutes, 28 U.S.C. §§ 1441 and 1452, give parties all the ammunition they need to remove "related to" state court actions to Bankruptcy Court in District's that have entered general orders of reference. However, opinions diverge on the procedural soundness of using § 1452 to remove "related to" actions pending before a United States District Court (the "District Court"), as there is support for the contention that removal of such actions must instead be accomplished through a specific order of reference. In the eyes of practitioners, this debate becomes important because it determines whether the District Court or Bankruptcy Court decides where the action will be tried, particularly because some non-debtor parties ostensibly view the District Court as a more favorable venue in which to have their disputes resolved.

In *Centrust Savings Bank v. Love*, 131 B.R. 64 (S.D. Tex. 1991), the court noted that Bankruptcy Courts "receive cases by referral [from the District Court], never by removal." *Id.* at 66. The court reasoned that any attempt to remove a case from the District Court to the Bankruptcy Court was an "attempt to remove a case from me to me for me to refer to my adjunct for bankruptcy." *Id.* at 67. In this court's view, the only proper procedure for sending a case to Bankruptcy Court from the District Court was to petition the District Court for a specific order of reference. *Id.* Interestingly, the court never addressed the impact of that District's general order of reference on "related to" claims.

In contrast, the court in *In re Engra, Inc.*, 86 B.R. 890, 896 (Bankr. S.D. Tex. 1988), found that a "related to" District Court action could properly be removed to the Bankruptcy Court via § 1452 and viewed the general order of reference as determinative. "Despite the appearance of a procedural boomerang, when a party files an application for removal [of an action pending before the District Court], although technically the proceeding is removed to district court, the reference of proceedings related to a bankruptcy case is invoked, and the proceeding is, at least in [Districts with standing orders of reference,] *automatically* referred to the bankruptcy court." *Id.* at 896 (emphasis in original).

Florida weighed in on the subject in *MATV-Cable Satellite, Inc. v. Phoenix Leasing, Inc.*, 159 B.R. 59, 60 (Bankr. S.D. Fla. 1993) in which Judge Cristol found existing case law to be "of limited guidance due to a combination of incomplete analyses and many recent revisions to §1452 and Fed.R.Bankr.P. 9027." *Id.* at 59. In its analysis, the court looked no further than the general order of reference in determining that the District Court had already answered the question by ruling "that any and all cases arising under Title 11 and any or all proceedings arising in or related to a case under Title 11 shall be referred to the Bankruptcy Judges for the District." *Id.* at 60 (citing the Southern District of Florida's general order of reference). However, after analogizing "related to" District Court actions to dairy cows unable to find their way to the appropriate barn at sundown, the court noted that, while the general order of reference established that "related to" District Court actions would be referred to the Bankruptcy Court, it did not prescribe the means. *Id.* In the absence of a specific provision, Judge Cristol determined that either a notice of removal or a motion to refer would suffice to bring a "related to" District Court action before the Bankruptcy Court. *Id.*

A recent decision by Judge Corcoran tapped a similar vein in addressing the question of whether a "related to" District Court action could be removed to the Bankruptcy Court for the same District and sheds further light on what may be the limits of § 1452. *In re the Academy*, 2002 Bankr. LEXIS 1494 (Bankr. M.D. Fla. Dec. 31, 2002). The court focused its analysis on the language of the Middle District of Florida's general order of reference and found that its "whole thrust… is aimed at newly filed matters rather than to existing and already pending matters." *Id.* at *5. As a result, the court drew a distinction between "related to" claims filed in District Court pre-petition and those filed post-petition. While acknowledging by negative implication that a party can use § 1452 to remove "related to" District Court actions filed post-petition, the court found that District Court actions that become "related to" proceedings only because of a subsequent bankruptcy filing cannot be "removed" to Bankruptcy Court but instead must arrive via a specific order of reference.

Although what little Florida case law exists on the subject of removal versus referral leaves us with some ambiguity as to the applicability of §1452 to pre-petition "related to" actions pending in the District Court, it is instructive in stressing the importance of the general order of reference. In implementing 28 U.S.C. § 157, Congress left the District Courts to decide how much, if any, of their jurisdiction under 28 U.S.C. §1334 to refer to the Bankruptcy Courts. While Judges Corcoran and Cristol reached slightly different interpretations of their respective District's general orders of reference, both Judges viewed the District Court's use of §157 as determinative in drawing their conclusions that §1452 could only be used to remove actions to which the general order of reference applied. As a result, parties weighing the use of §1452 to remove a "related to" District Court action to Bankruptcy Court should consider the breadth of the general order of reference entered in the District where that particular action is pending.

CM/ECF Updates

By Terry Miller, Chief Deputy

Dear Trustees and Members of the Bar,

I wanted to quickly advise you of our current CM/ECF status and request that you discontinue the practice of filing "combined motions and orders" as described below effective on February 18, 2003.

"Go-Live" Date - I am pleased to announce that the Middle District Bankruptcy Court is currently scheduled to go live and begin all internal case processing under CM/ECF on Tuesday, February 18, 2003 (unless some unanticipated event causes us to delay this date).

Access differences - All attorneys and trustees will continue to file pleadings in paper as is done now. All "pre-cm/ecf" cases, i.e. cases in our current NIBS system will remain in paper, and pleadings in existing cases will not be scanned. The existing paper file folders will remain and we will continue to place filed documents in these files. However, no new entries will be made in "pre-cm/ecf" cases in the NIBS system as of the 2/18/03 date. The existing docket and all other data will be converted over to CM/ECF, so that case managers will only docket in CM/ECF. As a result, trustees, attorneys and other PACER users will notice some minor but noteworthy changes when viewing case information from PACER. Also please review the new information page detailing differences under CM/ECF when you connect to PACER. You can access that page by selecting the following link, http://www.flmb.uscourts.gov/ecfvspacer.htm. Some differences to note here are:

NIBS Docket vs. CM/ECF Docket

-Docket and other case data will be converted into CM/ECF data

-In "pre-cm/ecf cases," the following message is inserted into all converted docket entries

"ORIGINAL NIBS DOCKET ENTRY."

-All orders and notices issued on and after 2/18 will be either generated by CM/ECF directly or will be scanned by the Clerk's staff, then put in CM/ECF and hyperlinked to the appropriate docket entry

-Therefore, PACER and file review computer access from our intake offices will allow users to view orders in all cases that are issued on and after 2/18 (pre-cm/ecf and post-cm/ecf).

-PACER users will be able to use their current ID's and passwords for query access to CM/ECF

Combined Motions/Applications & Order Pleadings

Due to filing processes dictated under CM/ECF, effective February 18, 2003, the filing of "combined motions (or applications)" which incorporate the proposed order within the same pleading should be discontinued - - regardless of case type, i.e. "pre-cm/ecf converted cases or cm/ecf cases. We are requesting that trustees and attorneys discontinue this practice on these type pleadings and file the motion/application as one document and the proposed order as a separate document accompanying the motion. Below is a list of trustee related pleadings we currently accept in this format that should be changed to meet the new requirement. Pleadings filed in the "combined" format with not be rejected for filing, but may cause substantial delay in processing; Clerk's office staff will line through the order section, then a separate proposed order will be requested.

APPLICATION and Affidavit to Employ Accountant for Trustee with Order Granting
APPLICATION and Affidavit to Employ Appraiser with Order Granting
APPLICATION and Affidavit to Employ Attorney with Order Granting
APPLICATION and Affidavit to Employ Attorney for Trustee with Order Granting
APPLICATION and Affidavit to Employ Auctioneer for Trustee with Order Granting
APPLICATION and Affidavit to Employ Professional Person With Order Granting
APPLICATION and Affidavit to Employ Real Estate Agent with Order Granting
MOTION and NOTICE and Report of Compromise
MOTION and ORDER Allowing Claim No.
MOTION and ORDER Disallowing Claim No.
MOTION and ORDER
MOTION and ORDER f/Authorization to Sell Estate Ppty w/o Notice to C'ors
MOTION and Order Allowing Secured Claim and Determining Right to Distribution
MOTION and Order Dismissing Case W/180 DAY INJUNCTION;order delayed 14 days to allow conversion, w/cert of mailing via BNC
MOTION and ORDER Granting Dismissal of Case with 180 day injunction enjoining debtor from refiling
MOTION and Order to Deduct and Remit Income filed by
MOTION of Trustee to Dismiss or Convert and Notice of Hearing
MOTION to Dismiss by Tee for Failure to Make Payments Under Confirmed Plan W/Notice of Hrg. Set for:
MOTION to Dismiss by Tee for Failure to Appear at 341 Mtg. w/Notice of Hrg. Set for:
OBJECTIONS to Claims by TEE & Notice of Hearing
SEALED Motion and Notice of Motion
TRUSTEE'S Motion to Dismiss with Prejudice for No Payments Made to Trustee and Notice of Hearing
TRUSTEE'S MOTION to Dismiss with Prejudice for No Payments and to Bar Filing Another Case (180 days) w/Notice of Hearing

(cont. on Page 16)

THE TAMPA BAY BANKRUPTCY BAR ASSOCIATION
2002-2003
Committee Chairs

The Association is looking for volunteers to assist us this coming 2002-2003 year. If you are interested in getting more involved with the Association or one of the Standing Committees, please contact any one of the Association officers or the Chairpersons listed below.

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When Is The Doctrine Of Necessity Truly Necessary

By Carrie Beth Lesser Baris

The filing of a Chapter 11 bankruptcy petition certainly could result in the disruption of a company's business operations for a number of reasons including the concerns of critical vendors and service providers upon which the company relies. Concerns that the debtor would be unable to pay current amounts due and owing, and concerns over the ability of the Chapter 11 debtor to continue as a going concern in the future, may cause a critical entity to pull the plug on its business relationship with the debtor.

To minimize or prevent expected disruption, a debtor may seek authority from the bankruptcy court to pay pre-petition claims of critical vendors and service providers prior to confirmation of a plan in the bankruptcy case, essentially elevating the priority of such claims. The justification for such treatment is known as the doctrine of necessity or the necessity of payment doctrine.

Decisions on this issue reflect careful consideration by courts as to whether a pre-petition claim warrants payment prior to confirmation, however the analysis employed by courts can differ. This article will summarize two cases employing different approaches with regard to the necessity of payment doctrine including the *In re Just For Feet*, 242 B.R. 821 (D. Del. 1999) decision and the *In re Corserv, L.L.C.*, 273 B.R. 487 (Bankr. N.D. Tex. 2002) opinion.

1. The Subjective Approach: *In re Just For Feet, Inc.*, 242 B.R. 821 (D. Del. 1999)

Just For Feet, Inc. and its subsidiaries filed for Chapter 11 relief in November 1999 immediately prior to the holiday shopping season. A few days after the bankruptcy filing, the debtors filed a motion for authorization to pay the pre-petition claims of trade vendors which drew a number of objections from secured creditors and the United States Trustee.

Just For Feet operated a number of retail stores specializing in brand name footwear and related apparel. At the time of the filing, Just For Feet had not yet received the merchandise it ordered for the upcoming holiday season. Typically, its trade vendors shipped merchandise on credit, but since the filing, Just For Feet's creditors were demanding cash-in-advance payments and refused to ship merchandise until their pre-petition claims were paid. *Id.*

In an effort to receive its $50 million in new inventory and keep the vendors happy, Just For Feet proposed to pay pre-petition and post-petition claims of "critical" trade vendors as they became due, in exchange for the vendors' written agreement to extend credit to Just For Feet on similar or better terms than the company had enjoyed in the past. *Id.* at 823-24.

Although the filing of a petition for relief under Chapter 11 typically stays "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case," certain pre-petition claims by employees and trade creditors may need to be paid to facilitate a successful reorganization. *Id.* (quoting 11 U.S.C. §362(a)(6)). Section 105(a) of the Bankruptcy Code provides a statutory basis for the payment of pre-petition claims prior to confirmation. *Id.*; *see* 11 U.S.C. §105(a). The United States Supreme Court articulated this theory over one hundred years ago in a railroad

(cont. on page 19)

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Replacement Cost or Liquidation Value — What is the appropriate standard for Redemption in a Chapter 7 Case?

by Dennis LeVine

An increasing number of debtors are obtaining loans to "redeem" collateral in Chapter 7 cases. Under Section 722 of the Bankruptcy Code, a debtor may redeem collateral from a lien on consumer goods (and thereby extinguish the lien) by paying the secured creditor, in a lump sum, the value of the collateral. This article examines whether courts use "replacement value" or "liquidation value" to determine the value of the asset which the debtor seeks to redeem.

Section 722 of the Bankruptcy Code provides:

> "An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the **allowed secured claim** of such holder that is secured by such lien."

While the statute contains several prerequisites to entitle a debtor to redeem, the primary issue is whether or not the a secured claim in a Chapter 7 redemption is valued at "replacement value" (i.e. what the debtor would pay to obtain like property for the same proposed use) or "liquidation value" (i.e. what the creditor would receive by selling the collateral).

In 1997, the U.S. Supreme Court held that "the appropriate valuation standard in a Chapter 13 case, in which a debtor wishes to retain and use collateral pursuant to his plan over the objection of a secure creditor, is replacement value." Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S.Ct. 1879, 138 LE.2d 148 (1997). After Rash, creditors argued that Rash (which interpreted Section 506 of the Bankruptcy Code dealing with the value of a secured claim) supported "replacement value" as the standard for redemption in Chapter 7 cases. Unfortunately, the Bankruptcy Courts interpreting Section 722 have not agreed, and have concluded that the standard for valuation for redemption is the "liquidation value" of the collateral.

The leading case holding liquidation value as the appropriate standard is In Re Donley, 217 B.R. 1004 (Bankr. S.D. Ohio 1998). In Donley, the Court found support for the debtor's argument in the Legislative history of *§722 (*redemption under *§722* "amounts to a right of first refusal on a foreclosure sale of the property involved. It allows the debtor to retain his necessary property and avoid high replacement costs, and does not prevent the creditor from obtaining what he is entitled to under the terms of his contract."*H.R.Rep. No 95-595, at 127 (1977), 1978 U.S. Code Cong. & Admin. News at 6088 (cited by Rash, at 217 B.R., at 1007).* The 6th Circuit in Donley found that a creditor's allowed secured claim "should be valued by a standard which measures what the [creditor] would receive if the redemption did not occur and it were forced to repossess and to sell the [collateral] in the most beneficial manner it could". 217 B.R. at 1007. In other words, the value of collateral should be determined by assessing what the creditor could receive at a foreclosure sale, and not by what the debtor would pay to replace the collateral.

All of the reported Bankruptcy Court decisions have followed Donley. In re Ard, 280 B.R. 910 (Bankr. S.D. Ala. 2002); In re Tripplett, 256 B.R. 594 (Bankr N.D. Ill. 2000); In re Williams, 224 B.R. 873 (Bankr. S.D. Ohio 1998); In re Dunbar, 234 B.R. 895 (Bankr. E.D. Tenn. 1999); In re Henderson, 235 B.R. 425 (Bankr. C.D. Ill. 1999). In In re Tripplett, the Court analyzed the holding in Rash and pointed out the distinctions between a Chapter 13 cramdown (the action being taken in Rash) and a Chapter 7 redemption. In a Chapter 13 cramdown under *§1325(a)(5)(B)*, a Chapter 13 debtor "keeps the collateral over the creditor's objection and provides the creditor, over the life of the plan, with the equivalent of the present value of the collateral." 256 B.R. at 597. In a Chapter 7 redemption, however, the creditor receives an immediate lump sum payment for the collateral, and does not suffer any damage from potential depreciation of the collateral or a default by debtor. The court reasoned that the Supreme Court in Rash merely intended to benefit a creditor with added protection in a cramdown under Chapter 13, but did not intend the same standard to apply in a Chapter 7 redemption, where such added protection is not needed due to the requirement of a lump sum payment.

The proposed bankruptcy reform legislation would amend *Section 722* to explicitly provide for "retail replacement value." Nonetheless, under the current law, liquidation value and not replacement value is the standard for determining value in a Chapter 7 redemption.

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A joint effort by the Hillsborough County Bar Association and Chief Judge Manuel Menendez of the Thirteenth Judicial Circuit of the State of Florida has produced the Speaker's Bureau. The Speakers Bureau provides speakers to schools and civic organizations on law-related topics. If you would like to volunteer to speak on bankruptcy law issues, please call the HCBA's Melissa Fincher at 221-7777.

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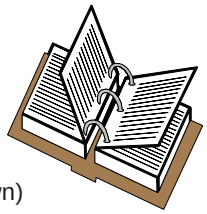

EVENT	DATE	LOCATION
National Conference of Bankruptcy Judges Mid-Year Meeting	March 9, 2003	San Francisco
Clerk's Half Day Seminar and Lunch	April 8, 2003	Hyatt Hotel (downtown)
TBBBA Fifth Annual Golf Tournament	April 18, 2003	Bay Palms Golf Club MacDill AFB
TBBBA Half Day Seminar	May 2003 (date to follow)	TBA
Stetson University College of Law's Fourth International Bankruptcy Symposium	May 18-21, 2003	York, England
Florida Bar Annual Meeting	June 25-28, 2003	Orlando World Center Marriott
ABI Southeastern Bankruptcy Workshop	July 30-August 2, 2003	Amelia Island, Florida

NINETEENTH ANNUAL RETREAT
BANKRUPTCY BAR ASSOCIATION
SOUTHERN DISTRICT OF FLORIDA

Plans are well under way for the 19th Annual Weekend Retreat of the Bankruptcy Bar Association for the Southern District of Florida. This years event will be at The Breakers in Palm Beach on May 9th through May 11th. For those who have not attended our retreat in the past, we present current bankruptcy issues through a series of case studies in break out sessions consisting of approximately twenty participants. Each case study includes a brief factual scenario followed by relevant materials designed to promote discussions. The discussion groups are facilitated by our guest group leaders. Joining us this year as group leaders are Bankruptcy Judges Judith Fitzgerald (Western District of Pennsylvania), George Paine and Keith Lundin (Middle District of Tennessee) Mary Walrath (District of Delaware), Thomas Waldron (Southern District of Ohio) and C. Ray Mullins (Northern District of Georgia). Professor Jeff Davis of the University of Florida will also be a group leader this year.

Our topics this year include :

- Creditor committee standing to pursue avoidance actions
- Non-debtor releases in plans of reorganization
- Enforceability of arbitration clauses in bankruptcy
- Director and officer liability and insurance coverage issues
- Floating homestead
- Ethical issues under Pillowtex
- Surcharge issues
- Ethical issues in representing both a corporation and its shareholder
- International jurisdiction and venue issues
- Issues concerning shortening claims bar dates
- Sections 366 as applied in telecom cases
- Preference and ordinary course issues

In addition to the seminar, the Retreat includes a cocktail reception Friday evening, a cocktail party and dinner (with entertainment) on Saturday evening and a Sunday breakfast and Bankruptcy Trivial contest.

The seminar sessions are Friday afternoon and Saturday and Sunday morning leaving Saturday afternoon free for our golf tournament, tennis tournament, fishing or just lounging by the pool. It is always a great time, and a great way to meet your colleagues and exchange information and ideas in a beautiful setting. We look forward to seeing you in Palm Beach in May.

For more information, or a copy of our brochure contact Laura Silverman, Executive Director of the Bankruptcy Bar Association at 305-891-5080 or check our website at www.bbasdfl.org

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TAMPA BAY BANKRUPTCY BAR ASSOCIATION FIFTH ANNUAL GOLF TOURNAMENT

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When: Friday, April 18, 2003*
11:30 p.m. check-in/lunch
12:30 p.m. shot gun start

Where: Bay Palms Golf Club
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Tampa (813) 840-6904

Format: Four person scramble

Fee: $60.00 per person
(Includes golf, box lunch, drink tickets, prizes, dinner and more)

*Please note that April 18 is Good Friday. Check box below if you would like a vegetarian meal.

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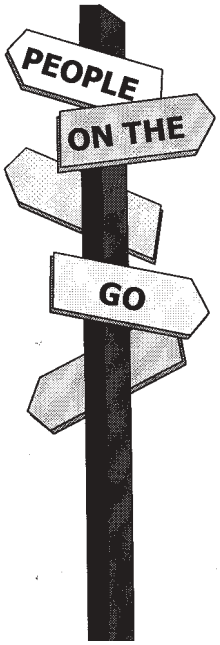
Please include all team members (if you have a team) on the same application. Individuals or groups of less than four will be randomly teamed into four person teams. Anyone and everyone is invited – friends, clients, family, non-bankruptcy attorneys – even judges!

****Enter MacDill AFB through Bayshore gate. Must have photo ID. Unlike prior years, NO last minute substitutions will be permitted. Please advise if non-golfers wish to attend so that they are included on the name list at the entry gate.**



Amanda Bennett has become associated with **Bush Ross Gardner Warren & Rudy, P.A.** Ms. Bennett received her B.A. in economics from Bellarmine University in 1999. In 2002, she received her Master of Business Administration as well as her Juris Doctor degree from Stetson University College of Law.

Cassandra Norton Culley has become associated with **Hill, Ward & Henderson, P.A.**, with offices at 101 E. Kennedy Blvd., Suite 3700, Tampa, Florida, 33601. Ms. Culley graduated from Wellesley College in 1999 with a B.A. in Economics and Political Science. She graduated cum laude from Florida State University College of Law in 2002. Ms. Culley joins **Michael P. Brundage, Gregory P. Brown, and Luis Martinez-Monfort** in the Creditor's Rights and Bankruptcy department at Hill, Ward.

Christine M. Hoke has become associated with **Gray Harris.** Ms. Hoke attended Florida State University where she earned a Bachelor of Science degree in Economics. Ms. Hoke then attended Thomas M. Cooley Law School, earning a Juris Doctor degree, cum laude, in 1996.

Joseph A. Probasco has become associated with **Bush Ross Gardner Warren & Rudy, P.A.** Mr. Probasco received his B.A. in accounting from Michigan State University in 1999. He then received his Juris Doctor degree in 2002 from Florida State University College of Law.

Charles "Chip" Radeline has become associated with **Gray Harris**. Mr. Radeline attended the University of Florida where he earned a Bachelor of Arts degree in Political Science in 1997. He then graduated from the University of Florida College of Law in 2001.

Dennis J. LeVine of Dennis LeVine & Associates, P.A. in Tampa participated on a panel at the ABI's Rocky Mountain Bankruptcy Conference in Denver, Colorado in January, 2003. The panel's topic was "Consumer Bankruptcy Issues-What Business Lawyers Need to Know".

Seth Nelson has joined the Tampa office of the Buchanan Ingersoll law firm. He concentrates in commercial, creditors' rights, health care, and intellectual property litigation.

Gregory M. McCoskey has received the "AV" rating by Martindale Hubbell, an organization that rates legal ability and ethical standards of lawyers in the country. He is a lawyer with the Glenn Rasmussen Fogarty & Hooker law firm in Tampa.

Adam C. King has joined the Jennis & Bowen law firm in Tampa. He concentrates in the areas of commercial litigation and commercial bankruptcies.

Edward M. Waller, Jr. of Fowler White Boggs Banker, P.A. has been named in the 2003-2004 edition of The Best Lawyers in America.

Darren D. Farfante has joined Fowler White Boggs Banker, P.A.. Mr. Farfante was a Trial Attorney with the United States Department of Justice, Tax Division in Washington, D.C. where he investigated and litigated cases involving sophisticated offshore tax shelters, challenges to federal tax statutes and regulations, taxpayer fraud, constitutional challenges to government action, corporate control issues, partnership issues, and tax issues arising in bankruptcy. In 2001, Mr. Farfante was recognized for his achievements with the U.S. Department of Justice, Tax Division Outstanding Attorney Award.

Catherine Peek McEwen received an award for Outstanding Pro Bono Service for Client Intake from Bay Area Legal Services at the Hillsborough County Bar Association's Pro Bono Awards Luncheon in March.

ORDER Directing Substitution of Parties and/or ORDER Dismissing Adversary Proceeding
MOTION and ORDER Allowing Secured Claims
MOTION and ORDER to Dismiss for Failure to Attend Section 341 Meeting by Ch. 13 Trustee
MOTION and ORDER to Dismiss with Prejudice for Failure to Attend Section 341 Mtg. by Ch. 13 Trustee
MOTION and ORDER to Dismiss for Delinquency in Payments by Chapter 13 Trustee
ORDER and Notice of Reassignment of Case, w/ certificate of mailing to all creditors and interested parties via BNC
ORDER and NOTICE on Conversion to Chapter 7:
ORDER and NOTICE on Conversion to Chapter 11:
ORDER and NOTICE on Conversion to Chapter 13:

New VCIS Toll-Free Number - Effective on 2/18, our new VCIS number is 1-866-879-1286. Case related queries regardless of the venue of original filing, should be made to this toll-free number. To remind everyone, VCIS is the system accessible from touch-tone telephones, which provides basic case information. Since all databases will be converted into one database under CM/ECF, one number that can be called throughout the district (and state and country) has been established.

Go-Live Schedule Impact

Converting data from NIBS to CM/ECF necessitates that we temporarily shut down our NIBS servers prior to starting the data conversion process. The conversion has been timed to start Friday afternoon (2/14/03) and run through the weekend so that we can take advantage of the Federal holiday (Washington's Birthday). The following schedule highlights when the conversion process starts in each office. Case lookup access from PACER (through the Internet) will not be disrupted. Case Lookup access from our public access computers will be unavailable for approximately one hour after the respective conversion start times.

We ask for everyone's cooperation by making arrangements to file petitions and other pleadings before the designated conversion times, then limit filing to emergency matters or to those pleadings with a 2/14 filing deadline. If no urgency exists, then delay filing until the following Tuesday. With that said, we will still continue to accept all petitions and other pleadings at our intake counters, record them as filed and issue receipts as always. However, any item received during conversion status, will not be entered into our new CM/ECF system until the following Tuesday.

Orlando - NIBS Conversion Starts at 12 noon
Tampa - NIBS Conversion Starts at 1:00 p.m.
Jacksonville - NIBS Conversion Starts at 2:00 p.m.

Conversion will be completed by TUESDAY, FEBRUARY 18, 2003. Access into our system will still be available through PACER and through our public access computers located in the file review rooms of each office. Please be aware that docket information for pleadings (not New Cases) filed after the conversion start times will not be available for viewing through electronic access until Tuesday afternoon. On cases filed after the start of the respective conversion times only new case information limited to case number, judge, debtor, trustee, and 341 meeting time/location on cases filed will be accessible from our public access computers.

On-going CM/ECF related activities

The next phase of our implementation, which we hope to kick-off in about six weeks, will concentrate on organizing training for "external users" and other related activities such as testing of electronic filing of petitions and other designated pleadings.

External Group 1 - Chapter 7 & 13 Trustees and staff
Anticipated Start Date: To be determined, but most likely dates will be in mid-April

External Group 2 - Bar Association Advisory Committee Members & Volunteer Attorneys
Anticipated Start Date: Would follow immediately after group 1

External Group 3 - High Volume Filers

External Group 4 - All other attorneys

Also, due to limits on staff and space resources, attorney training (starting with group 3) may not commence in each of the divisions at the same time.

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(b) (1) possess, and have a reputation for, integrity and good character; (2) possess, and have demonstrated, a commitment to equal justice under the law; (3) possess, and have demonstrated, outstanding legal ability and competence; (4) indicate by demeanor, character, and personality that the applicant would exhibit judicial temperament if appointed; and (5) be of sound physical and mental health sufficient to perform the essential duties of the office.

(c) Not be related by blood or marriage to (1) a judge of the United States Court of Appeals for the Eleventh Circuit; (2) a members of the Judicial Council of the Eleventh Circuit; or (3) a judge of the district court to be served, within the degrees specified in section 458 of title 28, United States Code, at the time of the initial appointment.

(d) Have been engaged in the active practice of law for a period of at least five years. The judicial council may consider other suitable legal experience as a substitute for the active practice of law.

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Highlights from the March Membership Luncheon

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bankruptcy when it stated that "many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property, for the receiver to pay pre-existing debts . . . " *Id.* (quoting *Miltenberger v. Logansport*, 106 U.S. 286, 1 S.Ct. 140, 27 L.Ed. 117 (1882)). Bankruptcy courts have since used their equitable powers under Section 105 to fashion similar relief.

For example, the Third Circuit adopted the necessity of payment doctrine in *In re Lehigh & New England Railway Co.*, 657 F.2d 570, (3d Cir. 1981). In *Lehigh*, the Third Circuit held that a court could authorize the payment of pre-petition claims if such payment "was essential to the continued operation of the debtor." *Id.* at 581.

The objectors in *Just For Feet* cited several cases in opposition to the necessity of payment doctrine under Section 105 on the ground that such payment would upset the priority scheme contemplated by the Bankruptcy Code. *Just For Feet*, 242 B.R. at 825 (citing *In re Oxford Management, Inc.*, 4 F.3d 1329, 1333-34 (5th Cir. 1993)).

At the time of the motion, it was clear that Just For Feet could not survive unless it had name brand sneakers and athletic apparel to sell in its stores. Just For Feet needed a continuous supply of inventory from athletic footwear and apparel vendors such as Nike, New Balance, Fila, Reebok, Adidas, Asics, K-Swiss and Converse. Accordingly, the bankruptcy court found that payment of the pre-petition claims of certain trade vendors – the athletic footwear and apparel vendors – was essential to the survival of the debtor during the Chapter 11. *Id.* at 826. With regard to other vendors, the bankruptcy court held that Just For Feet had not shown that the payment of such vendors was critical to the survival of the company during its Chapter 11 proceedings.

2. The Objective Test: *In re Corserv, L.L.C.*, 273 B.R. 487 (Bankr. N.D. Tex. 2002)

The *Corserv* decision subjects the necessity of payment doctrine to more scrutiny than prior decisions. According to the *Corserv* court, the necessity of payment doctrine is a rule of payment not of priority. *In re Corserv, L.L.C.*, 273 B.R. 487 (Bankr. N.D. Tex. 2002). "Except where an unsecured claim, non-payment of which could impair a debtor's ability to operate, has been accorded priority treatment by Congress and existing senior creditors consent or are clearly provided for, a bankruptcy court may order payment of unsecured pre-petition claims only under the *most extraordinary circumstances*." *Id.* (emphasis added).

The Corserv bankruptcy involved six related debtors who each filed a petition for relief under Chapter 11 of the Bankruptcy Code which were administratively consolidated. The principal business of the debtors consisted of providing telecommunications services, cable television, website development and hosting in parts of North Texas. In some areas, the debtors were the only providers of these services. *Id.* at 489. As part of their "first day" motions, the debtors sought relief to pay the pre-petition unsecured claims of critical vendors. Although the motion to pay critical vendors (which had been narrowed by the time of the hearing) was not opposed, the bankruptcy court was not prepared to grant it solely on that basis.

After determining that a court could allow a debtor to pay pre-petition debt other than pursuant to a plan, the bankruptcy court believed that the necessity of payment doctrine is a "device to be used only in rare cases." *Id.* at 492. To satisfy its concerns regarding the application of the doctrine, the *Corserv* court formulated its own test to be applied in resolving whether a pre-petition claim should be paid prior to confirmation. *Id.* at 498. According to the *Corserv* court, previous decisions addressing the necessity of payment doctrine were limited to general standards like "essential to the continued operation of the debtor." *Id.* (citing, *In re Just For Feet*, 242 B.R. at 825. "None of these formulations provides meaningful guidance to practitioners, leading to the filing of pleadings like the motion requesting relief far beyond any reasonable concept of necessity." *Id.*

Under the *Corserv* test, the debtor must show three elements to invoke the doctrine of necessity: 1) it must be critical that the debtor deal with the claimant; 2) unless it deals with the claimant, the debtor risks the probability of harm, or, alternatively, loss of economic advantage to the estate or the debtor's going concern value which is disproportionate to the amount of the claimant's pre-petition claim; 3) there is no practical or legal alternative by which the debtor can deal with the claimant other than by payment of the claim. *Id.* "If these three conditions are proven by a preponderance of the evidence, necessity of payment has been shown and this Court will authorize payment of the pre-petition claim." *Id.*

Based upon the evidence presented by the debtors in the *Corserv* case, the court commended the debtor for the effort to pare down the critical vendor list. The court accepted that the debtors' motions as filed represented the debtors' best efforts to deal with angry creditors anxious for payment. "But with the law well-established that, absent the most extraordinary circumstances, pre-petition general unsecured claims should – must – not be paid other than through a plan; . . . this Court concludes that it can go no further than it has to accommodate Debtors' request." *Id.* at 501-02. Ultimately, the court denied the motion to pay critical vendors. The court did authorize payment to a contract employee included in the motion to pay critical vendors, but only because the employee's claim was based on a legal theory other than the necessity of payment doctrine.

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