

P00-3(6)

11 U.S.C. § 101
11 U.S.C. § 502(f)
11 U.S.C. § 507(a)(2)

In re Atlas Telecom, Inc., Civil No. 00-309-HA; Case No. 398-33265-elp7

12/15/00

Haggerty (aff'g ELP)

Unpublished

District court affirmed Judge Perris's order holding that creditor Global Telecom Services, Inc.'s claim was a general unsecured claim. The issue was whether Global's claim qualified for a gap priority under § 502(f) and § 507(a)(2), which require that the claim arise after the commencement of the case but before the earlier of the appointment of a trustee and the order for relief, and that it arise in the ordinary course of the debtor's business or financial affairs.

The court concluded that Global's claim arose before, not after, the order for relief. The parties had entered into a contract prepetition. Global paid Atlas \$800,000 as a deposit. When Global failed to perform, the parties entered into another agreement under which Global agreed to post a letter of credit, Atlas agreed to credit Global with \$700,000, and Atlas agreed it would send Global the \$700,000 when Atlas drew on the letter of credit. Global posted the letter of credit, and Atlas's accountants moved the \$700,000 from income to a deposit account. However, Atlas did not pay Global the \$700,000, and an

involuntary bankruptcy petition was filed against Atlas. The contract was terminated postpetition.

The court concluded that the \$700,000 was a deposit on the contract and that Global was entitled to the money because it performed its obligations precedent to its right to the deposit. The court also concluded that the \$700,000 claim was a contingent claim that arose prepetition. Only the breach of the contract occurred postpetition.

The court also discussed the tests for determining whether a claim is in the ordinary course of business, the horizontal dimension test and the vertical dimension test. There was no evidence that the postpetition breach of the prepetition contract was an expenditure incurred in the ordinary course of business.

P00-3(6)

FILED

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CLERK, U.S. DISTRICT COURT
DISTRICT OF OREGON

BY: *[Signature]*

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF OREGON

In Re:

ATLAS TELECOM, INC.,

Debtor,

GLOBAL TELECOM SERVICES, INC.,
and GLOBAL TELE-SYSTEMS, INC.,

Appellants,

v.

JOHN H. MITCHELL,

Trustee-Appellee.

Bank. No. 398-33265-elp7

CIVIL NO. 00-309-HA *W*

OPINION AND ORDER

00 DEC 15 12:15 PM '00

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Certified to be a true and correct
copy of original filed in my office.
Dated 12-15-00
Donald M. Cinnamond, Clerk
By *[Signature]* Deputy

ECF

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1 HAGGERTY, Judge:

2 The matter before the court is an appeal from the decision of the United States
3 Bankruptcy Court for the District of Oregon entered on September 22, 1999. The district
4 court acts as an appeals court from decisions of the bankruptcy court.

5 **BACKGROUND**

6 Appellants Global Telecom Services, Inc., and Global Tele-Systems ("Global") filed
7 a proof of claim in the Chapter 7 bankruptcy case of Atlas Telecom, Inc. ("Atlas") in the
8 amount of \$7,300,000. The trustee, John Mitchell, objected to this claim. The bankruptcy
9 court heard argument on September 8, 1999, and entered a final order allowing Global a
10 general unsecured claim in the amount of \$700,000. This contested matter is a core
11 proceeding over which the bankruptcy court had jurisdiction because it involved the
12 allowance of a claim to which the trustee had objected. 28 U.S.C. § 157(b)(2)(B). This
13 court has jurisdiction to hear appeals from final orders entered in core proceedings. 28
14 U.S.C. § 158.

15 Global is seeking a "second position priority" by construing its claim as an
16 "unsecured claim allowed under section 502(f)" pursuant to 11 U.S.C. § 507(a)(2). A
17 second position priority under section 502(f) applies to claims arising (1) in the ordinary
18 course of the debtor's business or financial affairs; and (2) after the commencement of the
19 case but before the earlier of the appointment of a trustee and the order for relief. *See* 11
20 U.S.C. § 502(f). The bankruptcy court rejected Global's assertions on grounds that Global's
21 claim arose before, not after, the filing of Atlas's involuntary bankruptcy, and that Global
22 failed to establish that its claim arose in the ordinary course of the debtor's business or
23 financial affairs.

24 The district court reviews the findings of fact of the bankruptcy court under a clearly
25 erroneous standard, and conclusions of law are reviewed *de novo*. *Daniels-Head & Assocs.*
26 *v. William M. Mercer, Inc. (In re Daniels-Head & Assocs.)*, 819 F.2d 914, 918 (9th Cir.

1 1987). Global does not challenge the bankruptcy court's findings of fact, but asserts that
2 the court erred in ruling that Global's claim arose "pre-petition" and was a contingent claim,
3 and that it should be construed as a general unsecured claim.

4 ANALYSIS

5 1. DID THE CLAIM ARISE BEFORE THE FILING OF ATLAS'S 6 INVOLUNTARY PETITION?

7 Under the Bankruptcy Code, a "claim" is a right to payment, whether or not that
8 right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured,
9 unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. 11 U.S.C. §
10 101(5)(a). Global argued unsuccessfully to the Bankruptcy Court that in accordance with
11 the parties' stipulated facts, Global did not enjoy a "right to payment" unless and until its
12 contract with Atlas was breached.

13 The parties agreed to the following facts: Global entered into a contract with Atlas
14 in October, 1994, in which Atlas agreed to sell Global a facsimile system. In February,
15 1996, the parties entered into a second, "Phase II" agreement, in which Global paid
16 \$800,000 to Atlas as a deposit for further sales of equipment and services. Global
17 subsequently failed to post required letters of credit, and Atlas disassembled what it had
18 built for Global and re-characterized Global's deposit as income. In March, 1998, the
19 parties entered into a third contract referred to as "Phase III," under which Atlas was to sell
20 equipment and provide services to Global. The parties agreed to cancel the Phase II
21 contract, and to credit Global with \$700,000. Global was to post a letter of credit for the
22 full purchase price of the agreement, and upon drawing on that letter, Atlas would send
23 \$700,000 to Global. Atlas moved \$700,000 from income to a "deposit" account, and
24 Global posted the letter of credit. All Phase III agreements were made before the
25 involuntary petition was filed against Atlas.
26

1 Under the terms of the Phase III contract, Atlas was to ship equipment within 90
2 days of receiving Global's letter of credit. The letter of credit was posted by Global's agent,
3 Redington Private Limited, on April 17, 1998. Atlas never built the Phase III system or
4 drew upon the letter of credit.

5 In its appeal of the Bankruptcy Court's decision, Global argues that its right of
6 payment from Atlas arose only after Atlas terminated the Phase III contract (which
7 occurred after the bankruptcy petition). Global argues that prior to Atlas's termination,
8 Global only had a right to enforce performance of the contract, and did not even hold a
9 contingent right to payment.

10 This court agrees with the Bankruptcy Court in concluding that the obligation for
11 Atlas to refund Global's deposit was an existing, contingent claim when the bankruptcy
12 petition was filed. When Atlas and Global entered into their Phase III contract, Global was
13 entitled to receive \$700,000, either because Atlas performed, which would trigger a rebate
14 of "a portion of the funds paid by the issuer of the letter of credit," or because Atlas failed
15 to perform, giving Global a "right to the return of the deposit." See Global's Opening Brief
16 at 7. Regardless of which "event" triggered Global's entitlement to the funds, Global must
17 be said to have possessed a claim to those funds upon entering into the Phase III contract.
18 This result is in harmony with the expansive definition of "claim" provided by the
19 Bankruptcy Code at 11 U.S.C. § 101, and with the reasoning found in *Pennsylvania*
20 *Welfare Dept. v. Davenport*, 495 U.S. 552, 558 (1990), in which the Supreme Court
21 recognized that the Code language that modifies the definition of claim "reflects Congress'
22 broad rather than restrictive view of the class of obligations that qualify as a 'claim'"
23 The Court also referred to the Congressional Record in noting that the Code intended to
24 provide the broadest possible definition of claim so that all legal obligations of a debtor can
25 be dealt with in bankruptcy. *Id.* (citations omitted).

1 Global acknowledges that it enjoyed a contractual claim once it entered into the
2 Phase III contract, but asserts that the bankruptcy claim it has filed arises not from the
3 Phase III contract, but from its entitlement to a "return of its deposit," which did not arise
4 until after the involuntary bankruptcy petition was filed. *See* Global's Reply Brief at 5. This
5 argument is rejected. In reality, under the broad perspectives established by the Code and
6 counseled by the Supreme Court, Global possessed this "right to a return of a deposit" as a
7 contingent claim after entering into the Phase III contract. The contingent right to a
8 "deposit return" matured into a claim after Atlas failed to perform, but the timing of that
9 maturity fails to alter the existence of Global's pre-petition claim as defined by the Code.

10 **2. DID GLOBAL FAIL TO ESTABLISH THAT ITS CLAIM AROSE IN**
11 **THE ORDINARY COURSE OF THE DEBTOR'S BUSINESS?**

12 Next, Global asserts that not only did its claim arise after the bankruptcy petition,
13 satisfying one of the prerequisites for a section 502(f) secured claim, but that its claim also
14 arose in the ordinary course of the debtor's business, which would satisfy the other
15 prerequisite. Global appeals the Bankruptcy Court's ruling that Global's claim, as now
16 construed by Global, would not have arisen in the ordinary course of the debtor's business.

17 The Bankruptcy Court set out the proper tests for determining whether a claim is in
18 the ordinary course of business, and then doubted that "repudiation of contracts [or] wilful
19 breach is ordinary in the industry," and observed that Global failed to provide evidence of
20 "industry standard[s]." E.R. Section 5, at 52. The court concluded that the burden to
21 produce such evidence rests with the creditor, and that none was presented. *Id.* at 53.

22 Global argues on appeal that testimony was introduced establishing that its Phase III
23 agreement with Atlas involved the sale and installation of telecommunications equipment,
24 which clearly was a normal business transaction for the debtor. In light of that, Global
25 argues that it should have been the Trustee's burden to show that the contract was *not* in the
26 debtor's ordinary course of business.

1 This court concludes that the Bankruptcy Court properly rejected Global's argument
2 that its claim arose post-petition. The court then – after assuming for arguments' sake that
3 Global's construction of its claim as one for "refund of deposit" was valid – correctly
4 determined that there was no evidence to support that a claim for a deposit refund arose
5 from the debtor's ordinary course of business.

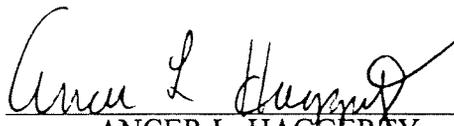
6 Global complains, without supporting authority, that the court should have assigned
7 the burden of proof to the Trustee, and asserts that the Phase III agreement "giving rise to
8 the claim" was within the ordinary course of the debtor's business. Opening Brief at 11. If
9 Global acknowledges that its claim in fact arose as part of the Phase III contractual
10 obligations, then its claim is clearly a pre-petition claim. If Global insists that its claim was
11 created by the conduct of the debtor at some point after the petition for involuntary
12 bankruptcy was filed, then there is no basis presented for finding that such a claim arose in
13 the ordinary course of the debtor's business.

14 **RULING OF THE COURT**

15 For the reasons provided, Global's appeal is denied. This court ADOPTS the
16 decision of the Honorable Elizabeth L. Perris, United States Bankruptcy Judge, which was
17 filed on September 22, 1999.

18 IT IS SO ORDERED.

19 DATED this 14 day of December, 2000.

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22 _____
23 ANCER L. HAGGERTY
24 United States District Judge
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