

11 U.S.C. § 348(d)
11 U.S.C. § 1141(a)
11 U.S.C. § 1141(d)
Administrative expense claim

In re Melridge, Inc., Case No. 387-36589-elp7

07/05/95

ELP

The trustee proposed to treat Chapter 11 administrative expenses claims incurred prior to confirmation as a priority claim in a case converted to Chapter 7. The U.S. Trustee objected.

The court held that § 348(d) does not preserve the priority status of preconfirmation administrative expense claims in a case converted to a Chapter 7 after a plan had been confirmed. The court reached this conclusion based on the analysis described in In re Benjamin Coal Co., 978 F.2d 823 (3d Cir. 1992). Section 1141(d) discharged the administrative claims. Section 348(d) could not preserve and did not resurrect the discharged administrative claims.

Creditors had claims based on the terms of the plan. The plan substituted the obligations created by the plan for the discharged debts. Treatment of each former administrative claim depended on the classification of each claim under the terms of the plan. A claim acquired the right to contractual priority to the extent that the plan preserves the priority or to the extent the plan subordinates other claims. In this case, the plan preserved the right of non-ordinary administrative claims--or at least subordinated other creditors to the payment of these claims.

The court also rejected the creditor's argument that the plan did not discharge their administrative claims. A confirmation order specifically discharged "any and all debts that arose prior to" its entry. This language was binding on the creditors and barred them from asserting that the order did not discharge their debts.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:) Case No. 387-36489-elp7
)
MELRIDGE, INC.,) MEMORANDUM OPINION
)
Debtor.)

Trustee John Mitchell ("Trustee") proposed to treat Chapter 11 administrative expense claims incurred prior to confirmation as priority claims in a case converted to Chapter 7. The Trustee estimates that \$5,300,000 Chapter 11 administrative expense claims have been filed. The United States Trustee ("U.S. Trustee") objected to the proposal.

FACTS

On December 14, 1987, Melridge, Inc. filed a Chapter 11 petition. On February 14, 1989, nunc pro tunc January 30, 1989, the court entered an order ("Order") that confirmed Melridge's Chapter 11 plan ("Plan") of reorganization. The Order expressly stated that "any and all debts that arose prior to" its entry were

discharged. (U.S. Trustee's Mem., Ex. A, at 4.)

The Plan divided the creditors with Chapter 11 administrative expense claims ("Creditors") into three general categories. First, ¶ 1.1 defined an "Administrative Claim" as a claim entitled to priority under § 364 or §§ 503 and 507(a)(1). Paragraph 6.12.3 preserved the priority granted under the Code to the non-ordinary course administrative expense claims (hereinafter "non-ordinary course administrative claims"). (U.S. Trustee's Mem., at Ex. B, ¶ 6.12.3, at 38.) Second, ¶ 1.2 defined an "Administrative Claim Incurred in the Ordinary Course of Business" as any claim the Debtor incurred in the ordinary course of operating its business (hereinafter "ordinary course administrative claims"). Paragraph 1.2 specifically excluded any professional fee awarded under § 330. Paragraph 4.1 stated that "Administrative Claims Incurred in the Ordinary Course of Business shall be assumed by GFHC [Global Floral Holding Company]" Paragraph 6.3 released Melridge from liability on these debts. Third, ¶ 1.2 excluded the claims of GFHC and A.B.M. Verkoopbureau B.V. from the definition of "Administrative Claims Incurred in the Ordinary Course of Business." (hereinafter "GFHC/A.B.M. administrative claims") Paragraph 4.2 forgave the administrative claims of GFHC and A.B.M. Verkoopbureau B.V. "in their entirety." (U.S. Trustee's Mem., Ex. B, at ¶ 4.2.)

Melridge could not fulfill the terms of the Plan. On May

23, 1990, the court entered an order converting the case to Chapter 7.

ISSUES

1. Did § 348(d)¹ preserve the priority of the Creditors' preconfirmation administrative expense claims after conversion to Chapter 7?

2. If not, how are the administrative expense claims treated?

DISCUSSION

Section 348(d) does not preserve the priority status of the preconfirmation administrative expense claims in a case converted to a Chapter 7 after a Chapter 11 plan has been confirmed. I reach this conclusion based on the interplay between §§ 348(d) and 1141(d) and based on the analysis described in In re Benjamin Coal Co., 978 F.2d 823 (3d Cir. 1992). Section 348(d) governs the effects of conversion on preconversion claims. It preserves the priority of administrative expense claims, but relegates all other claims to a prepetition status. Section 1141(d) governs the effect of confirmation on claims incurred in a Chapter 11 proceeding. It states that confirmation discharges all dischargeable claims, including administrative expense claims. Benjamin Coal, at 827; see In re Qintex Entertainment, Inc., 8 F.3d 1353, 1358 n.7 (9th Cir. 1993) (citing Benjamin Coal, 978 F.2d at 827); see also,

¹ Unless otherwise stated, all references to "sections" refer to the Bankruptcy Code, 11 U.S.C. §§ 101 et seq.

Hillis Motors v. Hawaii Auto Dealers' Ass'n, 997 F.2d 581, 589 (9th Cir. 1993). As a result of the discharge which occurred upon confirmation of the Plan, the Creditors' administrative expense claims were discharged to the extent not expressly preserved by the Plan. Section 348(d) could not preserve and did not resurrect discharged administrative claims. Benjamin Coal, 978 F.2d at 827. I reject the Creditors' argument to the contrary, because it ignores the effect of confirmation and the discharge under § 1141. See Benjamin Coal, 978 F.2d at 827.

The Creditors have claims based on the terms of the Plan. Id.; In re Erie Hilton Joint Venture, 157 B.R. 244, 246 (Bankr. W.D. Pa. 1993). While confirmation of the Plan discharged all dischargeable debts, the Plan substituted the obligations created by the Plan for the discharged debts. In re Grimes, 117 B.R. 531, 536 (9th Cir. BAP 1990). Section 1141(a) explicitly binds Melridge and each preconfirmation creditor to the new obligations.²

Recent case law supports this approach. In Benjamin Coal, for example, a Chapter 11 creditor lost a § 364(c)(1) super-priority administrative claim following postconfirmation conversion to Chapter 7. The creditor had agreed in the plan to terminate his

² The Ninth Circuit treats a Chapter 11 plan like a consent decree and construes its terms like a contract. Hillis Motors, 997 F.2d at 588; In re Affordable Hous. Dev. Corp., 175 B.R. 324, 329 (9th Cir. BAP 1994).

super-priority. With confirmation of the plan, the creditor no longer had a super-priority. Instead, he had new claim based on the plan. Benjamin Coal, 978 F.2d at 826-27. In re Sprouse-Reitz Stores also supports this treatment. 177 B.R. 679 (Bankr, D. Or. 1994). Judge Sullivan held that a priority tax claim retained its priority following the postconfirmation filing of a second Chapter 11. He reached this holding, in part, because the confirmed plan continued the priority treatment of the tax claim. Id. at 681. In In re Larsen, 169 B.R. 404, 408 (D. S.D. 1994), the district court accorded priority to a Chapter 7 claim of an attorney who represented a debtor in Chapter 11 proceedings, because the Chapter 11 plan maintained the administrative quality of the claim.

The U.S. Trustee reads Benjamin Coal and similar cases too broadly in arguing that a Chapter 11 administrative claim incurred prior to confirmation in a case converted to a Chapter 7 is treated equally with a prepetition non-priority unsecured claim, even though a plan directs payment of the administrative expense claim prior to the unsecured claim. In Benjamin Coal, the court did not examine the treatment of a former administrative claim vis-a-vis unsecured claims under a confirmed Chapter 11 plan in a case converted to Chapter 7. Rather, the court decided whether the claim retains its administrative status or whether it was converted to a contractual claim under the plan and, thus, required the creditor to file a proof of claim in the Chapter 7 case. The

court's conclusion that the claim is converted to a contractual claim under the plan supports the conclusion that the terms of the plan control the priority of the claim vis-a-vis unsecured claims. Benjamin Coal, 978 F.2d at 827.

The Bankruptcy Code supports this conclusion for two reasons. First, enforcing the Plan in this case is like enforcing a subordination agreement where creditors agree to subordinate a claim to rehabilitate a financially distressed debtor. The Plan binds the parties to its terms. (U.S. Trustee Mem., Ex. B., at Art. XIV, 48.) Section 510(a) recognizes the enforcement of a subordination agreement if permitted by nonbankruptcy law.³ Subordination agreements are enforceable under Oregon law. ORS 79.3160; see In re Kors, Inc. 819 F.2d 19, 24 (9th Cir. 1987). Second, § 1129(a)(9) protects the priority of administrative expense claimants by requiring payment of such claims on the effective date of the plan, unless the holder of the claim agrees to less favorable treatment. If a holder accepts less favorable treatment, the holder should receive the bargained-for treatment.

In this case, treatment of each former administrative claim will depend on the classification of the claim under the terms of the Plan. Paragraph 6.12.3 of the plan expressly preserves the right of non-ordinary course administrative claims to be treated as

³ Moreover, § 726 specifically authorizes distribution of assets to enforce a subordination agreement.

Chapter 11 administrative claims. Even if my legal analysis regarding the ability to preserve such priority is incorrect, or that Plan language is not sufficient to preserve such priority, the Plan language effectively subordinated the payment of other creditors to the payment of non-ordinary course administrative claims. An administrative expense claim acquires the right to contractual priority to the extent that the Plan subordinates the payment of all other unsecured claims. Cf. In re Larsen, 169 B.R. at 408. Both the ordinary course administrative claims and the GFHC/A.B.M. administrative claims have been discharged because the Plan relieved the debtor from any further obligation to pay such claims.

There is one final argument raised by the Creditors which I want to address. Creditors argue that the plan did not discharge their administrative claims because a discharge is not available under §1141(d)(3). That section provides that confirmation of a plan does not discharge a debtor if the debtor does not engage in business after consummation of a liquidating plan and if the debtor would be denied a discharge under § 727(a). If the Order was silent about discharge, this section might allow a creditor to assert that the confirmation order did not have the effect of granting a discharge to a corporate debtor who does not engage in business after the consummation of a liquidating plan. In this case, however, the Order specifically discharged "any and all debts

that arose prior to" its entry. (U.S. Trustee's Mem., Ex. A, at 4.) This discharge language is binding upon the creditors and bars the creditors from asserting that the Order did not discharge their debts. See In re Laing, 31 F.3d 1050, 1051 (10th Cir. 1994); In re Pavlovich, 952 F.2d 114, 118 (5th Cir. 1992); Stoll v. Gottlieb, 305 U.S. 165, 169 (1938); see also, Paul v. Monts, 906 F.2d 1468, 1471 n.3 (10th Cir. 1990); In re Pierce Packing Co., 169 B.R. 421, 430-31 (Bankr. D. Mont. 1994).

CONCLUSION

For the forgoing reasons, § 348(d) does not preserve the priority of the Creditors' preconfirmation administrative expense claims. Subject to special provisions for Chapter 7 administrative expense claims, the Chapter 11 administrative expense claimants are entitled to the treatment described in the Plan.⁴ As explained, the Plan divides administrative claims into three distinct categories. The treatment of a particular administrative claim depends on the category in which the particular claim falls. At this point, the record is insufficient to determine the category for a particular claim.

Negotiation is the aspiration of the Chapter 11 reorganization process. Successful negotiations should not be discouraged by eliminating the bargained for treatment of creditors

⁴ I do not address the treatment of postconfirmation claims relative to the non-ordinary course administrative claims because there is no evidence of such claims.

if a case converts to Chapter 7.

This Memorandum Opinion shall constitute Findings of Fact and Conclusions of Law as required by Fed. R. Bankr. P. 7052 and they shall not be separately stated. Mr. Vidas shall submit an appropriate order within fourteen (14) days.

ELIZABETH L. PERRIS
Bankruptcy Judge

cc: Pamela J. Griffith John H. Mitchell
Albert Kennedy Wendell G. Kusnerus
Daniel F. Vidas