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July 15, 1998

Professor Lawrence P. King
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Professor Walter Taggart
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Re: Bankruptcy Rule 2003--Temporary Allowance of Claims

Dear Professors King and Taggart:

I am writing this letter to the Advisory Committee on Bankruptcy Rules. Ken Klee suggested that I send this letter to you as the Reporters to the Advisory Committee on Bankruptcy Rules. This letter deals with the temporary allowance of claims in contested trustee elections and recommends that a revision be made to Bankruptcy Rule 2003.

There have been two recent bankruptcy court decisions, In re San Diego Symphony Orchestra Ass'n., 201 B.R. 978 (Bankr. S.D. Cal. 1996), and In re Centenial Textiles, Inc., 209 B.R. 31 (Bankr. S.D.N.Y. 1997), which have held that bankruptcy courts lack the power to temporarily allowed disputed claims in trustee elections.[1] As Judge Bowie stated in the San Diego Symphony decision:

> [Section 702 of the Code] does not authorize temporary allowance of otherwise disputed claims. . . . [T]o the extent that the prior version of Rule 2003(d) actually granted authority to temporarily allow claims (as distinct from appearing to do so in

[1] I represented the voting Musicians in the San Diego Symphony bankruptcy case. My clients initially appealed this decision, but due to the conversion of the case to Chapter 11, the appeal became moot and was dismissed.

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> derogation of the controlling statute), that authority was withdrawn by amendment. Accordingly, and in light of the express language of section 702(a), the Court has no authority to temporarily allow otherwise disputed claims for voting purposes.

As explained in this letter, the reasoning underlying these decisions is flawed and is contrary to the legislative history of Bankruptcy Code § 702 (which Judge Bowie never even mentioned in his decision) and nearly 100 years of well-developed case law on this exact issue.

Provisional Allowance Of Claims Under the Bankruptcy Act of 1898.

The Bankruptcy Act of 1898 provided for creditors to elect trustees at the creditors' meeting. Almost immediately after the enactment of the Bankruptcy Act of 1898, courts recognized that the need to promptly resolve trustee elections may require "provisional" allowance or disallowance of claims. See In re Malino, 118 F. 368 (S.D.N.Y. 1902) ("in proper cases provisional allowances or disallowances may be made in order that a trustee may be expeditiously selected . . ."); In re Pan American Match Co., 242 F. 995 (D. Mass. 1917) (same); In re Milne, Turnbull & Co., 159 F. 280, 282 (S.D.N.Y. 1908) (referee was correct when he provisionally allowed claim and disallowed objection where objecting party had failed to establish by a preponderance of the evidence that preference had been received).

This "provisional" or "temporary" allowance of claims continued through and including the enactment of the Code. See In re Flexible Conveyor Co., 156 F.Supp 164, 172 (N.D. Ohio 1957) ("claims of secured or priority creditors may be temporarily allowed for such sums as the court may seem to be owing above the value of their security or priorities to enable such creditors to participate in the proceedings"); In re Ira Haupt & Co., 379 F.2d 884 (2nd Cir. 1967)(referee correctly allowed creditors' claims for purposes of voting on trustee election).

Temporary Allowance of Claims Under the Bankruptcy Code.

In 1978, the Bankruptcy Code was enacted. Included in the Code is section 702 which allows creditors to elect their own trustees in chapter 7 bankruptcy cases. Section 702(a) uses the terms "allowable," "liquidated," "fixed" and "undisputed" to determine eligibility of a claim. In using these terms, it appears that Congress intended that bankruptcy courts would make the determinations whether claims were, in fact, "allowable," "liquidated," "fixed" and "undisputed" because these are all undefined descriptive legal conclusions. One of the

procedures for making such determinations is the temporary or "provisional" allowance of claims. As set forth in the legislative history to § 702:

> "The Rules of Bankruptcy Procedure also currently provide for temporary allowance of claims, and will continue to do so for the purposes of determining who will be eligible to vote."

Senate Report No. 95-989, 95th Cong., 2d Sess. 92-93 (1978); See also House Report No. 95-595, 95th Cong., 1st Sess. 378 (1977). This is the only procedure for resolving eligibility questions mentioned anywhere in § 702.

The legislative history to § 702 illustrates that temporary allowance is the procedure Congress contemplated courts would use to resolve eligibility questions. It also shows that temporary allowance of claims for trustee elections is not inconsistent with the Code.

Following enactment of the Code, bankruptcy courts routinely temporarily allowed claims in connection with a Chapter 7 election. See In re Metro Shippers, Inc., 63 B.R. 593, 598 (Bankr. E.D. Pa. 1986) (When there is an objection to the amount or allowability of a claim in connection with a Chapter 7 election, "the court may temporarily allow it for that purpose in an amount that seems proper to the court.") As another bankruptcy court noted: "[T]he provisional allowance of disputed claims for the purpose of expeditiously selecting a trustee has long been recognized." In re Cohoes Ind. Terminal, Inc., 90 B.R. 67, 69 (S.D.N.Y. 1988). Prior to the San Diego Symphony decision there was no reported decision in which a court held that the power to temporarily allow claims was inconsistent with § 702 of the Code probably because the legislative history quoted above said otherwise.

The 1991 Amendment to Rule 2003.

In 1986, the "Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986" (the "1986 Bankruptcy Act") was enacted to make the U.S. trustee permanent and nationwide. The 1986 Bankruptcy Act did not amend § 702 at all.

By virtue of making the U.S. Trustees' program nationwide, substantial revisions of the Bankruptcy Rules were required. During 1988 and 1989, the Advisory Committee on Bankruptcy Rules worked on those amendments. That process included amending Rule 2003.

During the course of the election dispute in the San Diego Symphony bankruptcy case, I obtained a detailed declaration from Peter McCabe, Secretary to the Committee on Rules of Practice and Procedure to the Judicial Conference of the United States. Attached to Mr.

McCabe's declaration are copies of minutes from the Advisory Committee meetings (during 1988 and 1989) at which the revisions to Rule 2003 were discussed and preliminary drafts of the revisions to Rule 2003. I have enclosed for your reference a copy of Mr. McCabe's declaration.

As stated in the Preface to Preliminary Draft of Proposed Amendments to the Bankruptcy Rules (attachment 8 to Mr. McCabe's Declaration) regarding the changes: "Rule 2003, governing meetings of creditors or equity security holders, is amended . . . to conform to the 1986 Act which gives the United States trustee the duty to call and preside at the meetings."

The minutes from the Committee meetings at which the revisions to Rule 2003 were discussed reveal that proposed changes centered around the role of the U.S. Trustee in elections. They also reveal that removing the ability of bankruptcy courts to temporarily allow claims was never discussed or even contemplated. There is only one mention of allowance of claims in any of the Rule Committee meetings. That reference is found in the minutes from the May 13-14, 1988 meeting. Those minutes state:

> "Members King, Shapiro, Mabey and Leavy expressed concern about the United States trustee exercising the judicial function of allowing a claim, especially since a motion to resolve the dispute also is required."

McCabe Declaration, Att. #2. Thus, the only mention to allowance of claims for an election in the minutes is an objection to the U.S. trustee allowing claims--which the Rules Committee viewed a judicial function, not a function of the U.S. trustee's office.

The amendment process was completed in June 1990 and the amendment to Rule 2003 was adopted without change by the Supreme Court on April 30, 1991. McCabe Declaration, ¶¶ 8-9. Based upon my review of the attachments to Mr. McCabe Declaration, there does not appear to have been any intent by the Advisory Committee to delete the temporary allowance powers from Rule 2003(b).

Recommendations.

The temporary allowance of claims provision should be restored to Bankruptcy Rule 2003. This will make Bankruptcy Rule 2003 consistent with the § 702 of the Code and its legislative history. Without this correction, interim trustees or other parties who wishing to deprive creditors of their electoral rights need only assert an objection to the claims of the

voting creditors (which is exactly what happened in the San Diego Symphony case when the interim trustee objected to the claims of 76 creditors on the eve of the election).[2/]

I would be pleased to supply whatever additional information the Committee needs. Or, if the Committee so desires, propose corrective language to Rule 2003.

Very truly yours,

BROBECK, PHLEGER & HARRISON LLP

By
Jeffrey K. Garfinkle

Enclosure

cc: Professor Kenneth Klee (w/enc.)
Professor Alan N. Resnick (w/enc.)

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[2] At a hearing on the claim objections held several months after the San Diego Symphony decision was issued, the bankruptcy judge overruled virtually all of the claim objections.

COMMITTEE ON RULES OF PRACTICE AND PROCEDURE
OF THE
JUDICIAL CONFERENCE OF THE UNITED STATES
WASHINGTON, D.C. 20544

August 6, 1998

Jeffrey L. Garfinkle, Esquire
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550 West C Street
Suite 1300
San Diego, California 92101-3532

Dear Mr. Garfinkle:

Thank you for the July 15, 1998 letter you sent to Professors King and Taggart, which was forwarded to me by Professor Alan Resnick, regarding your suggestion to amend Bankruptcy Rule 2003. A copy of your letter will be sent to the chair and reporter of the Advisory Committee on Bankruptcy Rules for their consideration.

We welcome your suggestion and appreciate your interest in the rulemaking process.

Sincerely,

Peter G. McCabe
Secretary

cc: Honorable Alicemarie H. Stotler
Honorable Adrian G. Duplantier
Professor Kenneth N. Klee
Professor Alan N. Resnick
Professor Daniel R. Coquillette