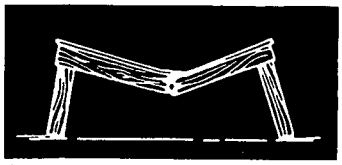
TBBBA



The Cram-Down

VOL. 3 NO. 1 | Tampa Bay Bankruptcy Bar Association Newsletter | Fall 1992

ELEVENTH CIRCUIT CRIMPS CROSS-COLLATERALIZATION FOR POST PETITION FINANCING

In a question of first impression, the Eleventh Circuit Court of Appeals ruled that the Bankruptcy Code prohibits cross-collateralization of pre-petition debt with pre- and post-petition collateral as a means of obtaining post-petition financing. Matter of Saybrook Manufacturing Co., Inc., 963 F.2d 1490 (11th Cir. 1992). The Eleventh Circuit Court concluded that such cross-collateralization was not authorized by §364 of the Bankruptcy Code and was directly inconsistent with the priority scheme of the Bankruptcy Code. The ruling gives unsecured creditors ammunition to oppose cross-collateralization under §364; however, it may hurt smaller debtors whose only hope for a successful reorganization may be financing from their previous lender.

The decision reversed bankruptcy and district court orders that approved a Manufacturers Hanover lien on assets to secure its pre-and post-petition loan to Saybrook Manufacturing Co. At the time the Debtors' chapter 11 petition was filed, the Debtors owed Manufacturers Hanover $34 million; however, the value of the collateral for the debt was less than $10 million. The bankruptcy court entered an emergency financing order the day after the Debtors' petition was filed which authorized the Debtors to borrow an additional $3 million from Manufacturers Hanover. In exchange, Manufacturers Hanover received a security interest in all of the Debtors' property, both pre- and post-petition. The post-petition security interest secured both the $34 million pre-petition debt and the $3 million post-petition loan. Thus, under the financing order, Manufacturers Hanover's unsecured pre-petition debt became secured by all the Debtors' assets.

Unsecured creditors objected to the bankruptcy court's authorization of the cross-collateralization of the pre-petition debt with unencumbered property of the bankruptcy estate. The bankruptcy court overruled the objection and denied the unsecured creditors' request for a stay pending appeal. The unsecured creditors then moved for a stay pending appeal in the district court. The district court denied the motion and dismissed the unsecured creditors' appeal as moot under §364(e) of the Bankruptcy Code because the unsecured creditors had failed to obtain a stay of the financing order pending appeal. Section 364(e) provides that unless the appellant obtains a stay pending appeal, the validity of credit extended in "good faith," including any related lien or priority, is not affected by appeal or by reversal of the authorizing order.

The Eleventh Circuit Court rejected the district court's reasoning and stated that §364(e) was only applicable if the challenged lien or priority was authorized under §364. Because the Circuit Court concluded that cross-collateralization was not authorized as a method of post-petition financing under §364, it held §364(e) was not applicable and the appeal was not moot. Saybrook, 963 F.2d at 1496.

The Court stated that cross-collateralization contradicts the Bankruptcy Code's fundamental goals:

> Creditors within a given class are to be treated equally, and bankruptcy courts may not create their own rules of superpriority within a single class. Cross-collateralization, however, does exactly that. As a result of this practice, post-petition lenders' unsecured pre-petition claims . . . Cross-collateralization is directly inconsistent with the priority scheme of the Bankruptcy Code. Id. (citations omitted).

It should be noted that the Eleventh Circuit panel specifically failed to address securing post-petition debt with pre-petition collateral, another method of cross-collateralization commonly used by leaders providing post-petition financing to Chapter 11 debtors. The form of cross-collateralization was not at issue in the appeal as the unsecured creditors challenged only the cross-collateralization of the pre-petition debt, not the collateralization of the post-petition debt.

Lynn Dunn

MEDIATION PROJECT UPDATE

On June 1, 1992, the procedures for the Court-annexed Mediation Pilot Program became part of the new Local Rules for the United States Bankruptcy Court for the Middle District of Florida (See Local Rule 2.33). In addition, the Judicial Conference of the United States, with approval of the Congressional Committees, authorized $18,000 for the mediation pilot project for the Middle District of Florida during the fiscal year which ended on September 30, 1992, and an additional $18,000 for the mediation program from October 1, 1992, through September 30, 1993, or until the new bankruptcy judges arrive. Therefore, all mediators who participated in the pilot project were authorized to be paid the sum of $200 per mediation. In addition, in several Chapter 11 cases, Judge Baynes recently directed the parties to mediation and the Court required that the mediators' compensation be paid by the parties.

Lynne England

INSIDE

PRESIDENT'S COLUMN

The Tampa Bay Bankruptcy Bar Association is off to a good start. We already have 230 members. The membership continues to increase. We have approximately 75 to 80 subscriptions to the Computer Access Program at the Bankruptcy Court Clerk's Office. Because this represents a substantial increase from last year, we have decided to increase the number of telephone access lines from four to six. If the number of subscribers continues to increase, the number of telephone lines can readily be expanded to a total of eight.

I have appointed Roberta Colton and Sharyn Zuch to chair the Meetings, Programs, and Continuing Legal Education Committee; Harley Riedel to chair the Membership and Elections Committee; Michael Horan to chair the Publications and Newsletter Committee; and Stephen Meininger to chair the Court, United States Trustee and Clerk Liaison Committee. I have appointed Lynne England to chair the special committee concerning the Computer Access Program to the Bankurptcy Court Clerk's Office, I have appointed Robvert Glenn to chair a special committee on long-range planning.

We have scheduled meetings for almost every month w programs designed to sharpen our skills as bankruptcy lawyers. We expect to provide one hour of CLE credit at each luncheon meeting. In addition, we plan to provide CLE seminars including the Chapter 13 seminar, the seminar for paralegals and legal secretaries, and the annual seminar with David Epstein providing an update on bakruptcy cases. We are also planning some social functions including the annual dinner in June.

I hope that you will find your membership in the Tampa Bay Bankruptcy Bar Association provides you with an opportunity to make new friends, to socialize with your colleagues at the Bankruptcy Bar, to keep informed of new developments in bankruptcy law, and to improve your competency as a bankruptcy lawyer.

Tom Mimms

ELEVENTH CIRCUIT SETS OFF HOT CONTROVERSY REGARDING APPLICATION OF BANKRUPTCY CODE SECTION 362 (a) (7) TO LENDERS' "ADMINISTRATIVE FREEZES"

The Bankruptcy Code seeks to preserve setoff rights in bankruptcy. Bankruptcy Code §553 specifically provides that bankruptcy does not generally affect creditors' rights to set off mutual pre-petition debts. Of course, Bankruptcy Code §362(a)(7) provides that the automatic stay prohibits the exercise of setoff rights; however, Bankruptcy Code §362(d) enables a creditor possessing setoff rights to seek relief from the automatic stay. Additionally, the cash collateral provisions Bankruptcy Code §§363(c)(2) and 363(e) prohibit a debtor from using funds affected by setoff rights unless the creditor consents or bankruptcy court authorization is obtained. Bankruptcy Code §§506(a) and 542(b) also supplement the statutory framework structured to preserve setoff rights in bankruptcy.

Notwithstanding the foregoing, lenders can experience urgent logistical problems when their deposit holders seek bankruptcy protection. After the bankruptcy petition is filed, a debtor may continue to draw checks from a deposit account maintained with the lender, or may simply withdraw all available funds. In either event, setoff rights can be completely undermined before the lender can even consult with counsel. For this reason, many lenders have traditionally imposed an administrative "freeze" or "hold" on a debtor's deposit account immediately upon learning of the bankruptcy. A motion for relief from stay is then filed, and the lender prevails to the degree that it actually possesses setoff rights. Aware of lenders' administrative "freeze" procedures, debtors' counsel have traditionally admonished their clients to withdraw funds from their lenders' deposit account before the bankruptcy petition is filed. If their clients failed to heed this advice, their lenders generally obtained the funds soon thereafter. these well-established procedures for disposition of lenders' setoff rights in bankruptcy were very sound in practice; however, legal issues regarding the administrative "freeze" have remained.

In the absence of Bankruptcy Code provisions directly on point, the weight of scholarship and case law has tradition supported the proposition that an administrative freeze is not tantamount to a setoff, and does not therefore violate theautomatic stay. See Bank of Am. Nat'l Trust & Sav. Ass'n v. Edgins (In re Edgins), 36 B.R. 480 (9th Cir. B.A.P. 1984); 4 Collier on Bankruptcy, §553.15[6]; Weintroff and Resnick, Freezing the Debtor's Bank Account: A Banker's Dilemma Under the Bankruptcy Code, 100 Banking L.J. 316 (1983); Groschdahl, Freezing the Debtor's Bank Account: A Violation

see ADMINISTRATIVE FREEZES page 3

ADMINISTRATIVE FREEZES

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of the Automatic Stay?, 57 Am. Bankr. L.J. 75 (1983); Freeman, Setoff Under the New Bankruptcy Code: The Effects on Bankers, 97 Banking L.J. 484, 506 (1980). However, substantial case law holds that an administrative freeze is either the equivalent of a setoff or is otherwise violative of the automatic stay. See, e.g., United States v. Reynolds, 764 F.2d 1004 (4th Cir. 1985); United States ex rel. IRS v. Norton, 717 F.2d 767 (3d Cir. 1983). In the Middle District of Florida, many attorneys have assumed that administrative freezes do not violate the automatic stay. On July 29, 1992, the Eleventh Circuit invalidated this assumption by issuing its opinion in B.F. Goodrich Employees Federal Credit Union v. Patterson (In re Patterson), 967 F.2d 505 (11th Cir. 1992).

Patterson involved a dispute between a Chapter 13 debtor and his employer's credit union. In connection with his employment status, the debtor maintained two share accounts at the credit union. The credit union made a separate loan to the debtor, and periodically deducted from his paychecks installment payments due on the loan. Upon learning that the debtor and his wife had filed their Chapter 13 petition, the credit union immediately imposed what it described as "an administrative freeze" on both accounts. Notwithstanding the debtor's continued employee status, the credit union then essentially closed the accounts. Perhaps most significantly, the credit union filed a proof of claim reflecting that it had applied the account funds to reduce the outstanding balance of the loan. The debtor sought turnover of funds formerly in the accounts, and injunctive relief to restrain the closing of the accounts. Although the debtor withdrew his request for turnover and consented to the relief from the automatic stay, the bankruptcy court granted injunctive relief and imposed sanctions pursuant to Bankruptcy Code §362(h). Upon appeal to district court, the rulings of the bankruptcy court were affirmed.

The Eleventh Circuit opinion in Patterson concluded that the credit union's administrative freeze violated several subsection of Bankruptcy Code §362(a). Significantly, the Patterson court held that the freeze constituted an act to "exercise control over the property of the estate" in violation of Bankruptcy Code §362(a)(3). The Patterson court also held that the administrative freeze violated Bankruptcy Code §§362(a)(4) and 362(a)(6). Most importantly, the Patterson court found that the administrative freeze was actually a setoff, and therefore violated Bankruptcy Code §362(a)(7). Applying the classical three-part test to determine whether a setoff had occurred, the Patterson court found that the credit union (1) decided to affect a setoff, (2) overtly acted to affect a setoff, and (3) created a record indicating that a setoff had occurred. Because the debtor's rights to belong to the credit union were closely associated with his employment status, the Patterson court additionally held that the credit union's actions violated the anti-discrimination provisions of Bankruptcy Code §525(b).

The facts underlying the Patterson opinion are substantially distinguishable from those of the traditional deposit account setoff scenario. Patterson involved the actions of a unduly aggressive credit union, rather than a conventional lender. The credit union's effort to obtain a reaffirmation agreement was sanctionable in itself. Because the debtor's loan in Patterson was not in default when the administrative freeze was imposed, no mutuality existed. Accordingly, the credit union did not have enforceable setoff rights when it placed its administrative freeze on the accounts. The credit union in Patterson filed a proof of claim that clearly revealed the presence of all three elements of an actual setoff. As a matter of substance, Patterson involved a setoff masquerading as a freeze. Because the Patterson debtor's rights to maintain share accounts at the credit union were linked to his employment, anti-discrimination principles complicated the setoff dispute. Notwithstanding all of these special facts, the Patterson opinion's holding is fairly broad.

Lenders have options for responding to the Patterson opinion. First, lenders can follow the Eleventh Circuit's advice for preserving setoff rights. The Patterson opinion encourages lenders possessing setoff rights to file ex parte motions for relief from stay pursuant to Bankruptcy Code §362(f), and to simultaneously tender deposit account proceeds into the bankruptcy court registry. However, Congress's failure to adequately fund the nation's bankruptcy court system makes it especially difficult to expect overnight processing of ex parte stay motions. Moreover, the bankruptcy court registry lacks the procedures, personnel, and statutory authority required to fulfil the Eleventh Circuit's expectations as expressed in Patterson. Perhaps most significantly, state and federal banking regulations do not permit financial institutions to indefinitely refrain from honoring or dishonoring drafts pending bankruptcy court determinations of setoff rights. Quite simply, the Patterson advice is impossible to heed.

Lenders may possess a second option for preserving setoff rights at the outset of a bankruptcy case: They may be able to safely impose administrative freezes in a manner that is not patently inconsistent with Bankruptcy Code §362(a)(7). A brief administrative freeze, rapidly followed by a motion for relief pursuant to bankruptcy Code §362(d), can be easily distinguished by the facts that produced the Patterson result. Unfortunately, the issue of whether such a distinction can ever make a difference is likely to be determined at a hearing on the debtor's motion for sanctions pursuant to Bankruptcy Code Section 362(h).

As news of the Patterson opinion spreads, a third option might prove most popular for lenders. Lenders may wish to abandon their valid setoff rights rather than run afoul of the laws that regulate their conduct. Although this option may be inconsistent with the Bankruptcy Code's framework for preserving setoff rights, it will probably be the least harmful to the lender in most circumstances.

The Patterson opinion raises far more questions than it answers. Because this opinion is so significant, the local bankruptcy bar could certainly benefit from additional guidance from the bench regarding the questions it has raised.

John Anthony

NEXT TBBBA PROGRAM

November 13, 1992 "Bankruptcy Appeals,"
The Honorable Elizabeth A. Kovachevich

NEW BANKRUPTCY JUDGES AUTHORIZED

The long awaited Judgeship Bill, initially passed by both the Senate and the House — but in different versions, was enacted into law by the signature of the President, on August 26, 1992 (P. 4. 102-361). The legislation authorizes the establishment of 35 additional bankruptcy judgeship positions, 7 of which are temporary positions. Fortunately, the legislation contains four full time positions for the Middle District of Florida, thus the temporary provision has no impact on the Bankruptcy Courts in this District.

Unfortunately, the Judicial Appropriation Bill currently under consideration by Congress has no provisions for any funds to implement the legislation, this there is no money to meaningfully embark on the selection and appointment process. However, the Circuit Council and Chief Judge Tjoflat agreed, notwithstanding the lack of funding, that the Circuit will solicit applications and start the selection process immediately. When the Circuit Council meets in February, 1993, it is hoped that the Circuit will be in a position to select the nominees and that funding will be available so the FBI and IRS screening process may commence. This timetable hopefully indicates that, provided everything falls into place, the positions will be filled by late May or June, 1993.

Of course, there is the additional problem with space, since there is no authorized space available in Tampa for the two additional judges or in Jacksonville for the additional Judge. It is hoped that by the time the new judges are sworn in and ready to go to work there will be additional facilities for them to conduct the business of the Court. Space is not a problem for the Orlando Division, as there is an almost full scale chambers already set up for the additional judge who will be sitting there.

Chief Bankruptcy Judge Alexander L. Paskay

COMPUTER ACCESS PROGRAM UPDATE

The Tampa Bay Bankruptcy Bar Association Board of Directors authorized law firms to obtain more than one password for use in the Computer Access Program, provided that the firm pay the applicable yearly charge for each additional password that it receives. (The yearly charge is $250 for law firms with four (4) or more attorneys and $100 for law firms with three (3) or fewer attorneys.) In addition, the Computer Access Program is now available to financial institutions who have attorneys in-house who are members of the Tampa Bay Bankruptcy Bar Association. It is also anticipated that two additional telephone lines will be added to the present computer system to facilitate improved access to the computer system.

Lynne England

CLE CREDITS

Florida Bar CLE approval will be sought for future program. Last year, one-hour credit was approved for each of the following four programs: Exemption Update, New Developments by David Epstein, Creditors' Committees, and Chapter 13 Procedures.

EDITOR'S NOTE

The Cram-Down begins this year with some new staffers and some holdovers. For the first time, however, Ed Waller will not be at the helm. Ed deserves the credit for initially getting the Cram-Down off the presses. Wish us luck as we attempt to survive without Ed in the lead. We have prevailed on Ed to continue to create his clever (and sometimes cursed) crossword puzzles. We hope to continue to provide information in an easy to read, not too stodgy format.

UPDATE ON FLORIDA STATUTE §697.07 (ASSIGNMENT OF RENTS)

As bankruptcy practitioners, we are well aware of the dispute concerning Florida Statute §697.07 (assignment of rents). Since its introduction on October 1, 1987, two views of interpretation have emerged. The first line of cases adopts the absolute transfer argument. For instance, several bankruptcy judges in Florida have held that, where the mortgagee makes a written demand for rents prior to bankruptcy, an absolute transfer of the rents of the debtor's property to the mortgagee is effected. Accordingly, the rents are not "cash collateral" within the meaning of §363(a) of the Bankruptcy Code, and, therefore, the rents are not property of the estate. See In re 163rd Street Mini Storage, Inc., 113 B.R. 87 (Bankr. S.D. Fla. 1990) (Weaver, C.L.); In re Aloma Square, Inc., 85 B.R. 623 (Bankr. M.D. Fla. 1988) (Proctor, J.).

On the other hand, both Chief Judge Paskay and Judge Baynes have consistently refused to adopt the absolute transfer view of §697.07. Essentially, Judge Paskay and Judge Baynes have taken the position that §697.07 does not effect an absolute transfer and that the mortgagee simply retains a lien on the rents. See In re One Fourth Street North, Ltd., 103 B.R. 320 (Bankr. N.D. Fla. 1989) (Paskay, C.J.); In the Matter of Growers Properties No. 56, Ltd., 117 B.R. 1015 (Bankr. M.D. Fla. 1990) (Baynes, J.) (See footnote 1).

As a result of the dispute concerning §697.07, the Bankruptcy/UCC Committee of the Business Law Section of the Florida Bar proposed a revision to §697.07 which clarified the statute by providing that the mortgagee retains a lien interest in the rents. The Committee's revisions align with the Judge Paskay/Judge Baynes' line of cases. As a result of the Bankruptcy/UCC Committee's proposal, House Bill 23(e) was introduced on March 25, 1992 and Senate Bill 10(e) also was introduced on March 24, 1992. According to Mark Wolfson, a member of the Bankruptcy/UCC Committee who helped draft the revision to §697.07, the Senate did not consider the pending bill because of other legislative matters which took priority over the Committee's proposal. Mr. Wolfson expects both the House and the Senate to consider the bill in its entirety in the next session.

Al Gomez

MOVERS AND SHAKERS

The Summer of 1992 has been marked by substantial moving and shaking in the TBBA community. Among the movers and shakers are:

Movers:

Michael Barnett departed from the firm of Isaak & Barnett, P.A., to practice on his own. Meanwhile, Jeffrey S. Sandler joined Malka Isaak in practice.

Mrak J. Bernet left Carlton Fields Ward Emmanuel Smith & Cutler to join Stearns Weaver Miller Weissler Alhadeff & Sitterson, P.A.

Allen Dubow departed from Mark Jasperson's Debt Relief Legal Center of The Florida Legal Group, P.A., to practice on his own.

Gray Gibbs, formerly of Gibbs & Rudzick, P.A., joined the Tampa office of Foley & Lardner.

Joryn Jenkins left the firm of Annis, Mitchell, Cockey, Edwards & Roehn to teach at Stetson University Law School. Replacing Joryn Jenkins at Annis, Mitchell is Keith Fendrick, who recently departed Honigman, Miller, Schwartz and Cohn's Tampa office.

David S. Jennis left Holland & Knight to practice with the firm of Baynard, Harrell, Mascara, Ostow & Ulrich, P.A. in St. Petersburg.

Ginnie L. Van Kesteren left Johnson, Blakely, Pope, Bokor, Ruppel & Burns, P.A. to practice on her own.

Bethann Scharrer, formerly a law clerk for Chief Judge Paskay, has joined Johnson, Blakely.

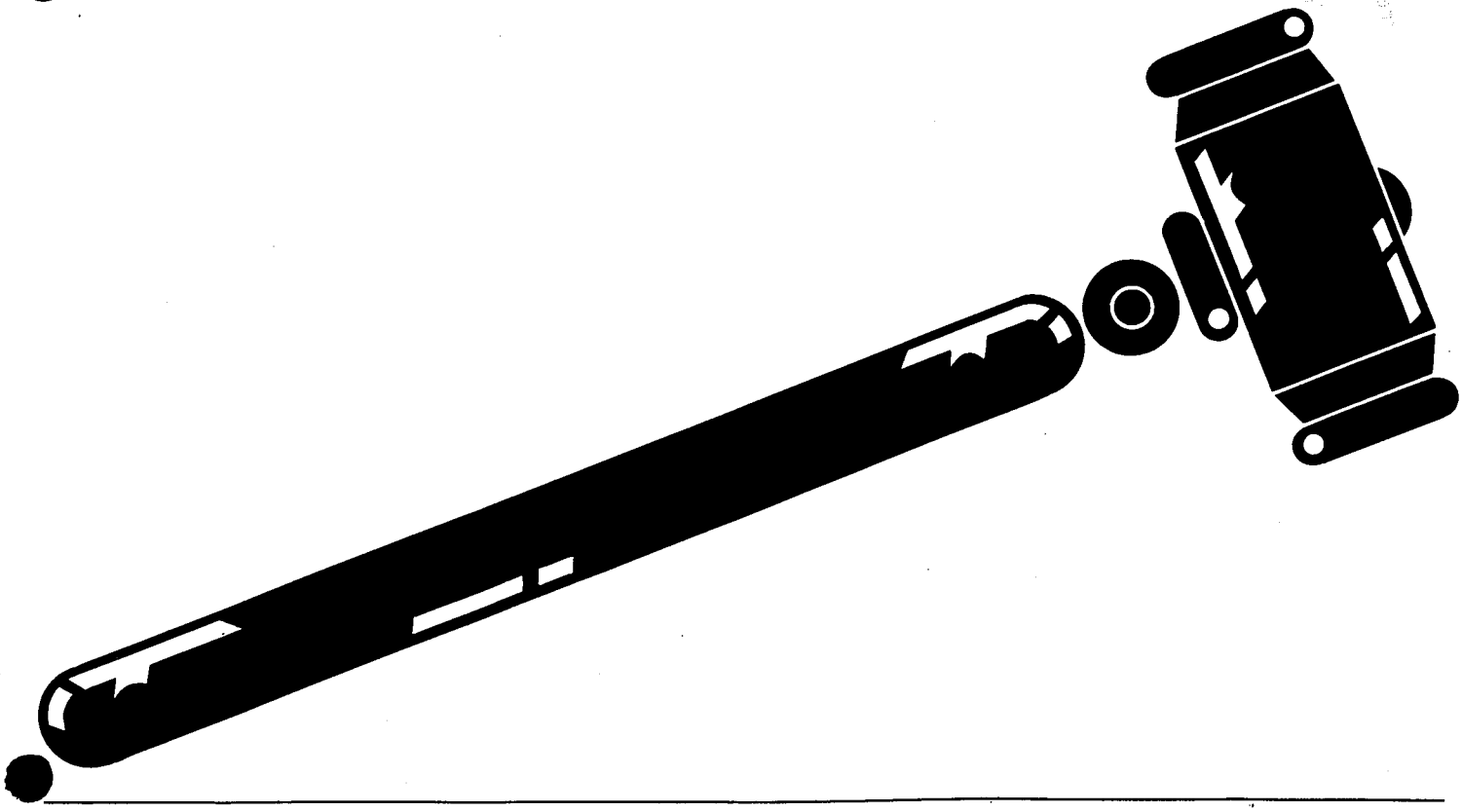
Cindy L. Turner is about to leave Stichter Reidel Blain & Prosser, P.A. to join Watkins & Principe, P.A.

Shakers:

Throughout Tampa, non-professional or paraprofessional businesses have been springing up that prepare bankruptcy papers for filing by pro se debtors. Many lawyers consider these businesses to be engaged in the unauthorized practice of law. In the Ft. Myers Division, Chief Judge Paskay has apparently put three such operations out of business by depriving them of the fees charged to debtors in connection with the rendition of bankruptcy typing services. New "services" of this nature are popping up all over Tampa. For more information, call 1-800-547-9900 or 854-1314.

Rumor has it that final distributions in the confirmed bankruptcy case of Murray Industries, Inc., will probably be made by year's end.

On September 14, 1992, Bicoastal Corporation's amended and restated plan of reorganization was confirmed.

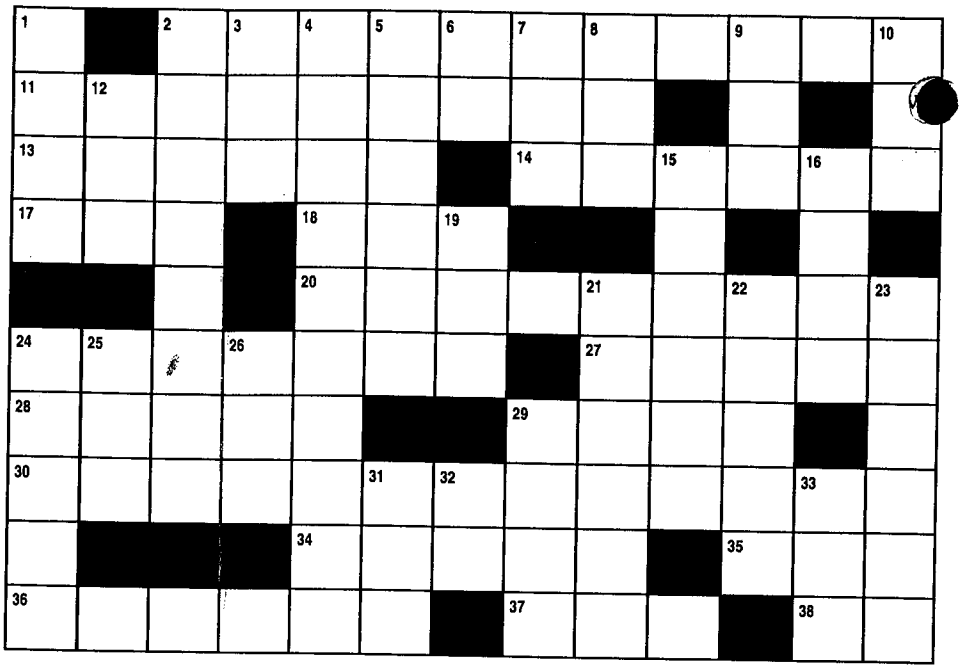


If you have suggestions or comments regarding **The Cram-Down**, please pass them on to a member of the Editorial Staff.

OFFICIAL TAMPA BAY BANKRUPTCY BAR ASSOCIATION CROSSWORD PUZZLE

ACROSS

2. The Bankruptcy Code is designed for these debts generally to be discharged.
11. It starts pumping as trial starts.
13. Big proponent of mediation
14. Wrong which occurs at McDonald's
17. What many lawyers have ample supply of.
18. Initials associated with movie industry.
20. What many lawyers enjoy too few of.
24. What office workers thank God for.
27. What professionalism can improve.
28. Four female and four male lawyers singing together.
29. What fraudulent debtor may do with assets when filling out schedules.
30. Yesterday.
34. What we do when we have a conflict.
35. Condition which may exist at hearings in cases involving large number of consumer creditors.
36. What Judge must do when not impartial
37. Fastest way to visit English courts.
38. First and last letter of what debtor can claim; or printer's measure.



DOWN

1. What a female lawyer should not be called (at least not in court).
2. What a tax claim has in common with a post-petition rent claim.
3. What you add to child to make more.
4. Some experiences are energizers; others are _____ .
5. He produces, directs and stars in a bankruptcy seminar every year.
6. Chicago subway.
7. What we called Orlando judge before he became a judge.
8. Descriptive of corporate entity.
9. What I do when nature calls (two words).
10. "Tampa has too many Bankruptcy Judges"_____ .
12. Title of number 2 person in attorney general's office. (initials)
15. What the Judge suggested the lawyer should do with his shaggy beard. (two words)
16. If one is too valuable, exemption will not protect it.
19. Training ground for military officers. (initials)
21. What Appellate Courts use to limit arguments.
22. What we take when we become lawyers.
23. Many restaurants in Florida fare better or worse depending upon the_____ .
24. He tells us where to go, how to get there, and where to stay when we get there.
25. Initials associated with broadcast industry.
26. A female lawyer who comes out.
29. Sources of gold and iron.
31. Type of arrangement with client which must poass muster with the Bankruptcy Judge.
32. Middle District _____ Florida.
33. It's O.K. to be a zealous advocate, but not to the point that you incur the _____ of the Judge.

The Cram-Down
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