The Cram-Down

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THE REPEAL OF THE "STOCK FOR DEBT" EXCEPTION: TAX FAIRNESS VS. DEBTOR'S FRESH START

Federal tax law generally provides that a taxpayer must include as ordinary taxable income any amount of debt forgiven or repurchased by a taxpayer at discount. This category of income is generally referred to as cancellation of debt, or "COD." However, a taxpayer that is insolvent or enjoys Title 11 protection (a "Debtor Taxpayer") need not include COD amounts as ordinary income. A Debtor Taxpayer must reduce certain tax attributes, including applicable net operating losses ("NOLS") by the COD amount.

Until now, if a Chapter 11 Debtor Taxpayer exchanged stock for debt, the so-called stock for debt exception usually applied and the Debtor Taxpayer was not required to reduce its tax attributes by the COD amount. Moreover, under the exception, the Debtor Taxpayer was not required to include the COD amount as income. The stock for debt exception originated as a judicially created exception and was eventually codified by the Internal Revenue Service ("IRS") in Revenue Ruling 59-222, 1959-1 C.B. 80. The stock for debt exception provided corporate Debtors with a significant tax planning device in reorganizing their financial obligations. But the exception has now been repealed.

The Tax Reform Act of 1993 repealed the stock for debt exception in bankruptcy cases filed after December 31, 1993. The repeal of the exception surprised many followers of Congress, and debate on the issue was not extensive. However, arguments were raised for and against the repeal of the stock for debt exception. A review of the arguments in favor and against the exception reveals that the dispute centered around the conflict between tax policy and bankruptcy policy.

Tax policy arguments favor repeal of the stock for debt exception

The tax policy arguments supporting repeal of the exception boiled down to a question of fairness. The stock for debt exception provided a Debtor Taxpayer with an advantage over a taxpayer that had not filed a Chapter 11. As such, many opponents of the exception argued that repeal of the exception would foster equal treatment for all taxpayers. This tax policy, otherwise known as the "horizontal equity principle," is one of the paramount goals of sound tax policy. Opponents of the stock for debt exception argued that the exception created an uneven playing field, providing the reorganized Debtor Taxpayer with an advantage over its competitors in the marketplace. By swapping stock for debt, the reorganized Debtor Taxpayer enhanced profitability prospectively because of its retention of tax attributes which could be used to eliminate or reduce future taxable income.

Opponents of the exception also argued that repeal of the exception simplified the tax laws. Moreover, repeal of the exception eliminated "trafficking" in tax losses. Finally, opponents urged that repeal eliminated the incentive for a corporation to file Chapter 11 in order to obtain the benefits of the stock for debt exception.

Bankruptcy policy favors retention of the stock for debt exception

In response to the tax policy arguments in favor of a repeal, proponents of the stock for debt exception based their arguments firmly upon bankruptcy policy. Proponents of the exception argued that retention of the exception encouraged reorganization rather than liquidation of financially distressed companies.

Proponents of the exception asserted that the tax fairness arguments are overstated. First, financially distressed Debtors should be afforded an opportunity to reorganize. Although striving for tax fairness is a laudable goal, seldom is the tax system "fair." Second, adherence to a policy which favors reorganization over liquidation should result in enhanced tax revenues over time.

Proponents of the exception pointed out that, without the exception, many debtors would have to be liquidated in order to satisfy their tax liabilities and, in all likelihood, no surplus funds would be available for distribution to other creditors. Moreover, the corporation's employees would lose their jobs, resources would lay idle, and all the other negative factors associated with liquidation would exist as opposed to a reorganization. The government would perhaps collect a portion of the tax liability but the overall impact on tax revenues would be detrimental. In short, proponents argued that the stock for debt exception should remain intact to help financially distressed businesses.

Conclusion

It seems to this writer that the repeal of the stock for debt exception points to an unintentional trend to increase the pressure on Chapter 11 Debtors. It cannot be doubted that federal, state and local governments are becoming increasingly active in Chapter 11 cases. For instance, many state departments of revenue, including the Florida Department of Revenue ("DOR"), are adopting the IRS trust fund arguments in connection with the collection of state sales taxes. Adopting DOR's position would effectively remove collected sales taxes which have not been remitted to the state from the Debtor's estate. In addition, new Federal Statutes, workers compensation premiums, environmental regulations and increased compliance demands from the myriad of other government agencies and taxing authorities have only increased the prospects of liquidation over reorganization. In my opinion, retention of the stock for debt exception would have been a small price to pay to ensure the potential viability of a Chapter 11 Debtor.

Al Gomez

INSIDE

PRESIDENT'S MESSAGE

According to a public opinion poll in December, 1988, more than 65 percent of Florida citizens felt "lawyers are greedy and are more concerned about money than the best interests of their clients." More recently, a comprehensive, nationwide telephone survey, commissioned by the ABA, revealed that 63 percent of the respondents believe lawyers make too much money, and 59 percent said lawyers are greedy. Only 34 percent believed that lawyers provide leadership in the community and, overall, only 40 percent expressed favorable feelings toward lawyers. At the same time, a large percentage of those surveyed said that information about lawyers' pro bono activities would significantly improve their perception of the profession.

Beyond the issue of image, we, as lawyers, are in a position to educate the public about their rights and about the justice system in general, to serve our communities by exercising leadership in civic and cultural affairs, and to help the less fortunate by donating legal services. Historically, lawyers have enjoyed positions of political influence and have, of course, made major contributions to society. We have thus created high expectations. To the extent that the public believes we are not living up to these expectations, we are losing the confidence of the public.

Under these circumstances, we have a decision to make. We can continue to brace ourselves psychologically before answering, when someone asks what we do. We can continue to show good humor and even bravado, although we may cringe inwardly, when we are confronted with the latest lawyer joke. Or, we can take the offensive.

We can seize the opportunity provided by the Florida Supreme Court's pro bono rules. As bankruptcy lawyers, we have special experience in dealing with the consequences of unwise use of credit, shortsighted financial decisions, fiscal irresponsibility, and unexpected financial reverses. We can draw upon our experience and marshal our talents as bankruptcy lawyers to provide leadership, education, and counseling for those with the need for our ideas and suggestions but without the means or chance to obtain them.

This year our new Community Service Committee, chaired by Jay Passer and Harley Riedel, is developing projects with Bay Area Legal Services, with Consumer Credit Counseling Services, and with various school systems; the indigent, the working poor, and even students will have access to volunteers from our bar association for purposes of counseling, advice, and education. In addition, our association is already represented on the Hillsborough County Circuit Court pro bono committee and we will be working with our members from other counties in seeking similar representation in their communities.

Please contact Jay (281-1103) or Harley (229-0144) or me (222-1137) with your ideas and suggestions for other community service projects. If we are to be considered greedy, let it be for more and better opportunities to serve our communities and those who need, but cannot afford, the benefit of our expertise.

Edward M. Waller, Jr.

NEW JUDGES ARRIVE

Bankruptcy Judges C. Timothy Corcoran and Paul Glenn officially join the Tampa Division of the U.S. Bankruptcy Court on December 1. Judge Corcoran will commence holding hearings during the week of December 6. Judge Glenn's courtroom activities may be delayed a couple of weeks until a temporary courtroom is available. Both new judges probably will not be assigned new cases through the random draw until January.

Until recently, providing courtrooms for Judges Corcoran and Glenn posed a major problem. Only one extra courtroom exists, and it will be dismantled as part of the construction of two new courtrooms on the third floor. However, two temporary courtrooms with chambers will quickly be constructed on the first floor to accommodate the two new judges. Permanent courtrooms and chambers are probably at least six months away.

Judges Corcoran and Glenn will hold hearings in December on proceedings assigned to them by Judges Paskay and Baynes. Judge Corcoran will also hold some hearings in Orlando in existing cases. The new Judges will not participate in the random case draw until the temporary courtrooms are in use. The current target date for participation in the random draw is January 3, 1994.

Mike Horan

The Application of § 552(b) to an Undersecured Creditor's Interest in Rents

Recently, there have been a number of reported decisions addressing the issue of whether an undersecured creditor's allowed secured claim, secured by a lien on rents, may increase by the amount of rents generated postpetition. One line of cases holds that the allowed amount of an undersecured creditor's secured claim is determined as of the petition date and may not increase during the pendency of the bankruptcy case. Confederation Life Ins., Co. v. Beau Rivage Ltd., (In re Beau Rivage Ltd.) , 126 B.R. 632 (N.D. Ga. 1991). On the other hand, several courts have held that an undersecured creditor holding an assignment of rents is entitled to an allowed secured claim for rents generated from the petition date through confirmation (although it is unclear from these cases whether the secured claim includes gross or net rents). In re Birdneck Apartment Assoc., II L.P., 156 B.R. 499 (Bankr. E.D. Va. 1993).

The controversy between these two lines of cases focuses on the tension between § 552(b) and the U.S. Supreme Court's Holding in United States Savings Assoc. of Texas v. Timbers of Inwood Forest Assoc., Ltd., 484 U.S. 365, 108 S. Ct. 626 98 L.Ed.2d 740 (1988). Primarily, the courts have addressed this issue in ruling on whether or not postpetition adequate protection payments should be applied to reduce an undersecured creditor's allowed secured claim. In re IPC Atlanta Ltd. Partnership, 142 B.R. 547 (Bankr. N.D. Ga. 1992). In IPC, the court held that an undersecured creditor was not entitled to include postpetition rents as part of its allowed secured claim due to Timber's mandate that the proportions of an undersecured creditor's claim should not alter during the pendency of the case. Id. at 559. Accordingly, as the undersecured creditor's collateral had not depreciated postpetition, the IPC court held that adequate protection must be applied to reduce its allowed secured claim as it would otherwise constitute "interest" in violation of Timbers and § 506(b).

Similarly, other courts have focused on Timbers' holding that § 552(b) requires a lien on rents as a condition of having them applied to "satisfying" a claim of a secured creditor ahead of the claims of unsecured creditors. In re Oaks Partners, Ltd., 135 B.R. 440, 450 (Bankr. N.D. Ga. 1991). By focusing on the Court's use of the word "satisfying" rather than "increasing", these courts have held that postpetition adequate protection payments must be applied to reduce an undersecured creditor's allowed secured claim. Id.; In re Reddington/SunArrow, Ltd. Partnership, 119 B.R. 809 (Bankr. D.N.M. 1990). Thus, the foregoing cases apply an implicit limitation on the applicability of § 552(b) to an undersecured creditor's allowed secured claim.

However, other courts have reflected any limitation on § 552(b) based on Timbers in favor of a more textual, "plain meaning" application of the statute. In re Flagler-At-First Associates, Ltd., 114 B.R. 297, 301 (Bankr. S.D. Fla. 1990) (Cristol, J.). The Flagler court held that an undersecured creditor's allowed secured claim included the excess rents generated and paid to the creditor as adequate protection during the Chapter 11 case. The Court held that the postpetition payments were not "interest." Rather, they were essentially a "wash" as the additional collateral value represented by the excess rents was set-off by the adequate protection payments paid to the creditor. In short, Flagler held that the debtor's adequate protection payments simply compensated the undersecured creditor for the corresponding postpetition increase in the amount of its secured claim. Id. at 303. This view has been adopted by other bankruptcy courts. In re Landing Assoc., Ltd., 122 B.R. 288 (Bankr. W.D. Tx. 1990); In re Vermont Investment, Ltd. Partnership, 142 B.R. 571 (Bankr. D. Col. 1992); In re Birdneck Apartment Assoc., II, L.P., 156 B.R. 499 (Bankr. E.D. Va. 1993) (where the bankruptcy court rejected the debtor's Timbers argument in favor of the Court's recent decision in Dewsnup v. Timm, _____ U.S. _____,112 S. Ct. 773, 116 L. Ed. 26 903 (1992), which held that any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors).

As for the Middle District of Florida, Judge Corcoran has recently made an oral ruling wherein he adopted Judge Leif Clark's opinion in Landing Associates and held that an undersecured creditor was entitled to an allowed secured claim which included all postpetition rents generated through the date of the confirmation hearing. However, Chief Judge Paskay has recently issued a memorandum opinion wherein he held that postpetition adequate protection payments received by an undersecured creditor must first be applied to reduce postpetition accrued interest, thereby decreasing the undersecured creditor's allowed unsecured claim, with any residual postpetition payments applied against the creditor's allowed secured claim. Thus, as this controversy concerning the scope of § 552(b) has yet to be resolved by the federal courts of appeal, it remains a significant issue for both bankruptcy litigators as well as transactional attorneys who attempt to draft security documents within the friendly confines of § 552(b).

Edmund S. Whitson, III

Changes in the Bankruptcy Computer Access System

During the month of October, we were advised by the Bankruptcy Court that the Judicial Conference has determined that all courts should have public access systems and should charge for such access. It is our understanding that the charge will be one dollar per minute for computer access to the bankruptcy court system, although a proposed voice information system will be free. Once the Bankruptcy Court's new public access system is in place and all of the "bugs" have been worked out, it is our understanding that we will no longer be able to utilize the Tampa Bay Bankruptcy Bar's present computer access system. The new public access system will be implemented in the Bankruptcy Court for the Middle District of Florida sometime after the first of the year in 1994. As soon as we receive additional information concerning the new public access system, we will provide you with an update.

Lynne England

Motions for Reconsideration or Rehearing

After receiving a written opinion from the Court following a hearing, the losing party may believe that the Court must have missed something in ruling against him. The visceral reaction is to fire off a Motion for Rehearing or a Motion for Reconsideration. Before drafting such a Motion, however, the prudent practitioner should be aware of the Rules and the case law which discuss the requirements for such motions.

A party's ability to move for reconsideration or rehearing of a particular court order or judgment is grounded in Federal Rule of Civil Procedure 59. Rule 59 is made applicable to Bankruptcy matters pursuant to Bankruptcy Rule 9023. While Rule 59 specifically mentions moving for a new trial, Rule 59 enables a party to seek an alteration or an amendment to a judgment or an order. Such a Motion must be served no later than ten days after entry of the order or judgment. It should also be noted that Rule 40, Federal Rules of Appellate Procedure, governs a Petition for Rehearing in bankruptcy appeals (i.e. District Court or the 11th Circuit).

Judge Kovachevich recently stated in In re Ingersoll that there are three instances when a Court should grant a motion which seeks to alter or amend a judgment in an action tried without a jury:

1) when there has been a manifest error of law;
2) when there has been a manifest error of fact; or
3) when there has been newly discovered evidence.[1]

When seeking a reconsideration based on newly discovered evidence, two separate elements must be plead. First, the motion must allege that the newly discovered evidence could not have been discovered with reasonable diligence before the Court entered its ruling or judgment.[2] Second, the motion must allege that the newly discovered evidence would have produced a materially different result if it had been presented to the Court prior to the Court rendering its judgment.[3]

Although at one time, a Motion for Reconsideration had to be pursued as a prerequisite for an appeal, this is no longer the case. Practitioners should not consider a Motion for Reconsideration or rehearing to be a vehicle for raising issues or citing authorities that could or should have presented to the Court prior to the Court's ruling.[4] Clearly, where an attorney seeks to rehash legal arguments previously made to the Court, or desires to refute the Court's ruling, the attorney should appeal the decision rather than a motion for reconsideration or rehearing.[5]

Dennis LeVine

[1] In re Ingersoll, 124 B.R. 116 (M.D. Fla. 1991)
[2] In re Ingersoll, 124 B.R. at 123.
[3] In re Ritz Theatres, Inc., 69 B.R. 299 (Bankr. M.D. Fla. 1987) (J. Paskay); In re DeVault Manufacturing Company, 4 B.R. 382 (Bankr. D. Pa. 1980).
[4] In re Bank of New England Corporation, 142 B.R. 584, 587 (D. Mass. 1992).
[5] In re Grand Builders, Inc., 122 B.R. 673, 675 (Bankr. W.D. Pa. 1990).

Questions Anyone!

Your Association is planning a luncheon program for next year involving a panel discussion on practice and procedure in the Tampa Division. We hope the panelists will be all four Tampa Division judges (assuming the GSA has agreed to provide courtrooms for the two new ones by then). We intend that one of the program's features will be a "Q & A Firing Line," during which the program moderator will ask the judges what our inquiring minds want to know. Accordingly, we are soliciting your questions now. Here's your chance to have your questions asked without attribution, so don't hold back. Simply send in the form below and we'll do the asking for you.

To: TBBBA CLE Committee, P.O. Box 2405, Tampa, FL 33601
Re: Q & A Firing Line

(1) Here is/are my question(s):

_____
_____
_____
_____
_____
_____

(2) Please direct the question(s) to:

Judge _____/ all the judges (circle one).

Stetson Law School
Alexander L. Paskay Scholarship

Stetson University College of Law has created an endowed scholarship named for Chief Judge Alexander L. Paskay in honor of his 30 years as a bankruptcy judge. Judge Paskay, a member of the adjunct faculty at Stetson since 1973, serves on its Board of Overseers and is chair of Stetson's nationally recognized annual bankruptcy seminar. Dean Bruce R. Jacob of Stetson announced the creation of the scholarship at The Tampa Bay Bankruptcy Bar Association's Annual Dinner on June 11, 1993. The scholarship was created by donations from The Tampa Bay Bankruptcy Bar Association and The Florida Bar Business Law Section. As of September 30, 1993, 44 law firms and attorneys had pledged $53,975.00 to endow the scholarship.

Stetson's policies for endowed scholarships permit five percent of the endowment to be expended annually. Any return greater than five percent is added to the corpus of the endowment to insure its growth. As the endowment grows, the amount awarded each year as a scholarship will also grow.

Thomas B. Mimms, Jr.

Pro Bono: Ask not what your Community can do for you, but . . .

Rules 4.61 and 4.65 of the Rules regulating The Florida Bar have been amended and their amended versions took effect on October 1, 1993. When read in conjunction, these sections require all members of The Florida Bar to annually report whether or not they either performed 20 hours of pro bono legal service or donated $350 to a legal aid organization. The definitions of "pro bono legal service" and "legal aid organization" will be interpreted over the months to come; however, one thing remains clear: Attorneys who perform pro bono legal services in conjunction with already established pro bono legal aid centers, such as Bay Area Legal Services or Gulfcoast Legal Services, will receive credit towards the newly implemented aspirational goals.

In cooperation with Bay Area Legal Services, the Tampa Bay Bankruptcy Bar Association has begun developing a plan whereby TBBBA members can serve their communities' pro bono legal needs in one of two ways. The first way is for a bankruptcy attorney to volunteer time at Bay Area Legal Services in performing client intake functions. Those functions generally include client interviewing and initial issue analysis. The second way is for a bankruptcy attorney to either volunteer to accept pro bono Chapter 7 and 13 cases or to serve on a panel to research certain case issues for other attorneys who have accepted pro bono representations. Attorneys who are interested in satisfying their pro bono obligation through the pilot program developed by the TBBBA and Bay Area Legal Services can sign up to perform intake functions on pro bono cases, to accept pro bono Chapter 7 and Chapter 13 representations, or to assist on a research panel. To do so, contact Steven Berman, Pro Bono Coordinator for the TBBBA at 224-9000. Ask Not What Your Community Can Do For You But What You Can Do For Your Community!

Steven Berman

MOVERS & SHAKERS

Movers:

John A. Anthony left the firm of Glenn, Rasmussen & Fogarty to join Shackleford, Farrior, Stallings & Evans, P.A.

William S. Porter, II left the firm of Stearns, Weaver, Miller, Alhadeff & Sitterson, P.A., to join Stichter, Reidel, Blain & Prosser, P.A.

Joel S. Treuhaft left the firm of Anderson & Orcutt, P.A. to join the firm of Tayburn, Lerner & Treuhaft, P.A.

Robin S. Trupp left the firm of McWirter, Grandoff & Reeves, P.A. to join the firm of Anderson & Orcutt, P.A.

Shakers:

Ronald J. Harris was disbarred by the Florida Supreme Court.

TBBBA DOCKET

Future Programs
CLE Credit Being Sought

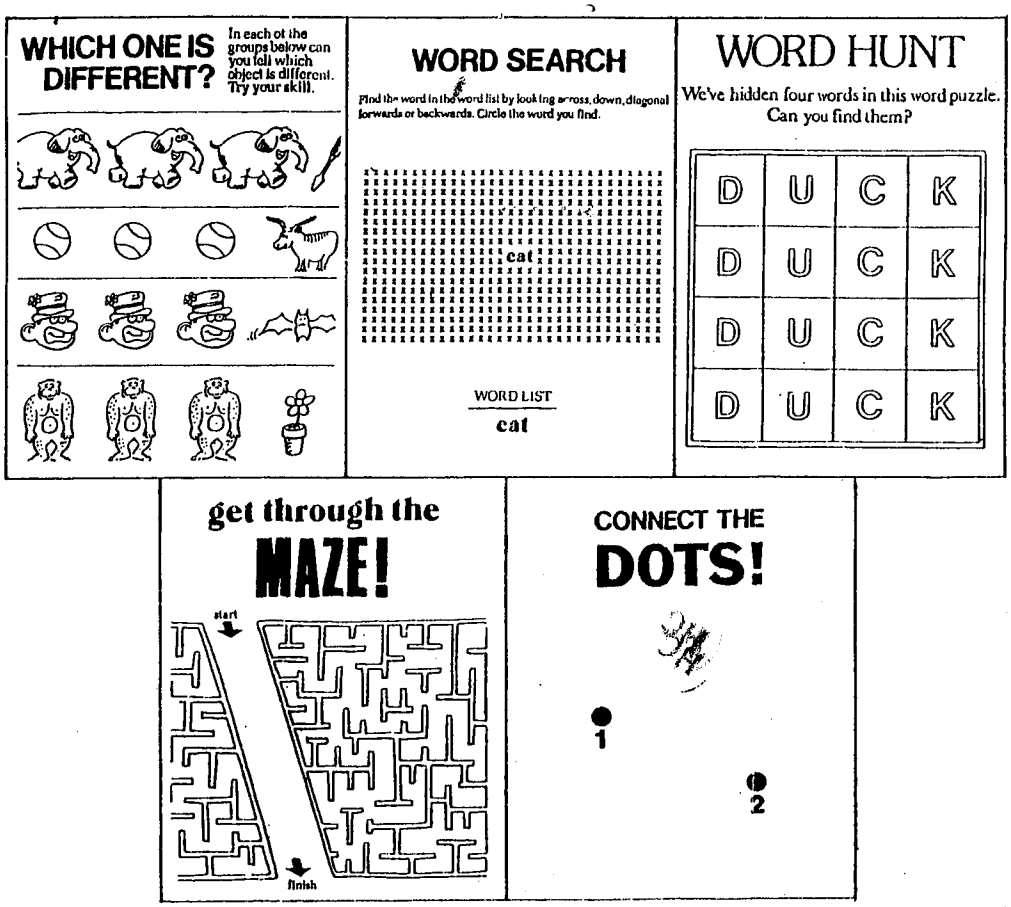
"Ethics" - Panel Discussion by Judges Roney, Kovachevich, Paskay and Baynes
Friday, December 10, 1993
Downtown Tampa, Hyatt Regency

"Mock Trial of Objection to Confirmation and Cram Down"
Friday, January 14, 1994
Tampa Westshore, Omni Hotel

THE BACK PAGE

The creator of the Cram-Down's famed crossword puzzle moved on to a new position with our association. Despite repeated pleas from the editor to submit the President's message in the form of a crossword puzzle, that unnamed association officer declined to do so. To fill this void, we provide a challenging brain teaser culled from a collection of legal humor maintained by Judge Thomas Baynes.

Florida Bar Exam



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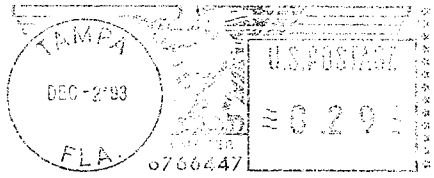

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