



Entered on Docket
April 15, 2008

Hon. Mike K. Nakagawa
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

In re

ROBERT LYNN HORNE,

Debtor.

Case No. BK-S-07-15280-MKN

Chapter 11

Date: March 28, 2008

Time: 9:30 a.m.

**MEMORANDUM DECISION ON DEBTOR'S
OBJECTION TO PROOF OF CLAIM FILED BY
JEFF MORLEY AND WILLIAM TOPKIS**

A hearing on Debtor's objection to Proof of Claim filed by Jeff Morley and William Topkis was held on March 28, 2008. The appearances of counsel were noted on the record. After oral arguments were presented, the matter was taken under submission.

BACKGROUND¹

Robert Lynn Horne ("Debtor") commenced a voluntary proceeding under Chapter 11 on August 23, 2007. On December 21, 2007, Jeff Morley and William Topkis ("Topkis and Morley") filed an unsecured proof of claim in the amount of \$2,400,295.73 .

On January 20, 2008, Debtor commenced an adversary proceeding against Topkis and Morley, denominated Adversary No. 08-1029 ("Avoidance Action"), seeking, *inter alia*, the

¹ In the text and footnotes of this Memorandum, all references to "Section" shall be to provisions of the Bankruptcy Code appearing in Title 11 of the United States Code unless otherwise indicated. All references to "Rule" shall be to provisions of the Federal Rules of Bankruptcy Procedure unless otherwise indicated.

1 recovery of an alleged fraudulent transfer involving the Debtor's purchase of certain Boy ScoutS
2 memorabilia. An answer to the complaint was filed on March 3, 2008, and special counsel has
3 been appointed to represent the Debtor in the proceeding².

4 On February 8, 2008, Debtor filed an objection to the Topkis and Morley claim ("Claim
5 Objection") under Section 502(d). (Dkt# 148) Topkis and Morley filed opposition to the
6 Objection on March 5, 2008 (Dkt#182), as well as the declaration of Ogonna Atamoh ("Atamoh
7 Declaration")(Dkt# 183), one of their counsel of record. Debtor filed a reply on March 13, 2008
8 (Dkt# 188).

9 A hearing on the Claim Objection was conducted on March 28, 2008, along with
10 approval of Debtor's proposed Amended Disclosure Statement³. After oral argument was
11 presented, both matters were taken under submission. A separate Memorandum Decision and
12 Order thereon have been entered with respect to the Amended Disclosure Statement.

13 DISCUSSION

14 Section 502(d) provides that "a court shall disallow any claim of any entity from which
15 property is recoverable under section...550...of this title or that is a transferee of a transfer
16 avoidable under section ...548...of this title, unless such entity or transferee has paid the amount,
17 or turned over any such property, for which such entity or transferee is liable under
18 section...550...of this title." Under Section 502(d), a creditor essentially cannot receive a
19 distribution in a case until the creditor returns any property or the value of the property obtained
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21 ² A separate adversary proceeding, denominated Adversary No. 08-1019, was
22 commenced by the Debtor on January 22, 2008, naming Topkis and Morley as defendants, in
23 addition to several other individuals and entities. The Robert Lynn Horne Family Limited
24 Partnership also is a plaintiff in that proceeding. The complaint seeks damages, injunctive and
25 declaratory relief.

26 ³ A proposed plan of reorganization (Dkt# 99) and an accompanying disclosure
27 statement ("Initial Disclosure Statement") (Dkt# 98) were filed on December 21, 2007.
28 Objections to approval of the disclosure statement were filed by creditor David Odenath and by
creditors Topkis and Morley. On March 3, 2008, an amended plan (Dkt# 176) and an amended
disclosure statement ("Amended Disclosure Statement") (Dkt# 175) were filed by the Debtor.

1 through an avoidable transfer. In a Chapter 11 context, this provision has added significance
2 since only creditors having allowed claims are entitled to vote on a proposed Chapter 11 plan.
3 See 11 U.S.C. §1126(a).

4 Where a final adjudication of an avoidance action has not been completed, the assertion
5 of the avoidance claim as a defense to a proof of claim “is sufficient to place the claim in a status
6 in which it is neither allowed or disallowed.” In re Sierra-Cal, 210 B.R. 168, 173 (Bkrtcy.E.D.
7 Cal.1997). An objection under Section 502(d) provides no affirmative relief, see Committee of
8 Unsecured Creditors v. Commodity Credit Corp. (In re KF Dairies), 143 B.R. 734, 737 (9th
9 Cir.B.A.P. 1992), and the underlying avoidance action ultimately must be adjudicated on the
10 merits before there is a recovery of the transferred assets by the estate. See In re Sierra-Cal,
11 supra, 210 B.R. at 173.

12 Before addressing the parties’ arguments, the Court must express its puzzlement as to
13 what the Claim Objection is intended to achieve. Since it will not result in a final adjudication of
14 Topkis and Morley’s liability in the Avoidance Action or the Debtor’s liability on the Topkis and
15 Morley claim, it presumably is intended to have some strategic purpose for plan confirmation. In
16 this case, however, that purpose is not readily apparent.

17 Under the Debtor’s initial proposed plan, the Topkis and Morley claim was included in
18 impaired, general unsecured creditor Class 3. See Initial Disclosure Statement at Section
19 V(B)(1) and Exhibit “E”⁴. On the same day the Initial Disclosure Statement was filed, Topkis
20 and Morley filed their combined proof of claim in the amount of \$2,400,295.73. There was only
21 one other impaired Class 2, that being Citibank on a secured claim. Had it remained in the
22 general unsecured class, the Topkis and Morley claim would have been the dominant claim and
23 likely would have controlled class acceptance. If the general unsecured class had rejected plan
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25 ⁴ The original Class 3 included “the amount of all general unsecured claims listed on the
26 Debtor’s schedules, including those listed as disputed.” The Debtor’s schedules included as
27 Exhibit “E” to the Initial Disclosure Statement lists Topkis and Morley as having a combined but
28 disputed claim in the total amount of \$2,300,000.

1 treatment, the Debtor would not be in compliance with Section 1129(a)(8), which requires all
2 impaired classes to accept plan treatment. The Debtor could then have proceeded to cramdown
3 under Section 1129(b) only if Section 1129(a)(10) were met through Citibank's acceptance of
4 the plan as an impaired class.

5 Debtor's amended plan places the Topkis and Morley claim into a separate, impaired
6 unsecured Class 4. See Amended Disclosure Statement at Section V(B)(1). There are two other
7 impaired Classes 2 and 3, the latter of which involves general unsecured creditors. Citibank
8 remains in Class 2 as an impaired secured claim. The placement of the Topkis and Morley claim
9 into a separate impaired unsecured class presumably makes it easier to obtain class acceptance
10 by the general unsecured creditors in Class 3⁵. The chance of obtaining acceptance from
11 Citibank in Class 2 appears to be the same since its treatment is not significantly different than
12 that proposed in the original plan. If either Class 2 or Class 3 accepts plan treatment under the
13 amended plan, Section 1129(a)(10) would be met and the Debtor could proceed to cramdown
14 under Section 1129(b).

15 Once the Topkis and Morley claim is placed into a separate class, however, it is difficult
16 to determine what difference it will make for confirmation purposes if it is disallowed under
17 Section 502(d). Given that Topkis and Morley are likely to reject plan treatment, pursuit of a
18 cramdown under Section 1129(b) would require the presence of at least one impaired class that
19 accepts the plan. If the Topkis and Morley claim is neither allowed or disallowed, it cannot vote
20 under Section 1126(a). If no acceptances are received from members of an impaired class, it is
21 well-established that the class is deemed to have rejected the plan. See In re M. Long Arabians,
22 103 B.R. 211, 215-16 (9th Cir. B.A.P. 1989). See also In re Pardee, 218 B.R. 916, 940 (9th Cir.
23 B.A.P. 1998). Thus, sustaining the claim objection under Section 502(d) will have little or no
24 effect on plan confirmation in this case since it disenfranchises the entirety of impaired Class 4,
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26 ⁵ The Court makes no determination whether placement of the Topkis and Morley claim
27 into a class separate from other unsecured creditors is appropriate under Section 1122(a).

1 thereby resulting in the Debtor's noncompliance with Section 1129(a)(8).

2 Topkis and Morley, however, primarily argue that the Claim Objection is premature since
3 the Avoidance Action has not been adjudicated. See Opposition at 5:11 to 8:19, citing Holloway
4 v. Internal Revenue Service (In re Odom Antennas, Inc.), 340 F.3d 705 (8th Cir. 2003) and In re
5 Parker North American Corp., 24 F.3d 1145 (9th Cir. 1994). Neither authority cited, however, is
6 persuasive.

7 Odom Antennas involved a Chapter 7 case where the bankruptcy trustee commenced an
8 adversary proceeding to determine the nature, validity, extent and priority of liens held by the
9 Internal Revenue Service ("IRS") and other lienholders. One of the other creditors (Holloway)
10 crossclaimed, asserting that the IRS's claim and Stevens' claim should be disallowed under
11 Section 502(d). 340 F.3d at 707. The bankruptcy court entered a judgment determining that the
12 IRS's tax lien and a separate creditor's (Stevens) judgment lien had priority over the liens of
13 other creditors, and also denied Holloway's crossclaim under Section 502(d). On appeal, the
14 district court and the circuit court concluded that the IRS and Stevens did not receive avoidable
15 transfers on which a disallowance under Section 502(d) would be appropriate. 340 F.3d at 708.
16 Moreover, the circuit court rejected Holloway's assertion that Section 502(d) is itself a vehicle to
17 avoid liens. Id. The timing of Holloway's crossclaim under Section 502(d) simply was not an
18 issue at all since it was raised in connection with an existing adversary proceeding to determine
19 lien priorities.

20 The result reached in Odom Antennas is unremarkable in the context of a Chapter 7
21 proceeding: there is no ongoing process of reorganization and no final distributions are made by
22 the assigned trustee until the end of the case. The typical Chapter 11 process is quite different
23 and a debtor-in-possession is required to operate under statutorily imposed deadlines that cannot
24 await the outcome of highly contested and prolonged litigation. Moreover, the greater the delay
25 in a Chapter 11 proceeding, the greater the administrative expense that is incurred. In light of
26 these dynamics, courts in this circuit have recognized that a claim objection under Section

1 502(d) does not require a final adjudication of the avoidance action in advance. Rather, as
2 indicated in Sierra-Cal, supra, the claim is held in suspense - neither allowed nor disallowed -
3 until an ultimate determination on the merits. 210 B.R. at 173. In this situation, the holder of
4 the suspended claim is not without a remedy, however, if it wants to participate in the balloting
5 process.

6 In In re Dynamic Brokers, Inc., 293 B.R. 489, 496 (9th Cir. B.A.P. 2003), the appellate
7 panel observed as follows:

8 “The rules do, however, accommodate the possibility that claims objections and
9 plan confirmation proceedings may be on parallel tracks and different timetables.
10 They coordinate the two with a provision that makes clear that claim objections
11 need not be resolved before a chapter 11 plan is confirmed. Specifically, the
12 holder of a claim that is subject to an unresolved objection is still permitted to
13 vote to accept or reject a chapter 11 plan by way of a temporary allowance in an
14 amount that the court, after notice and hearing, "deems proper." Fed.R.Bankr.P.
15 3018(a)..."

16 293 B.R. at 496. The leading bankruptcy treatise discusses claim objections in connection with
17 plan confirmation in more detail as follows:

18 A creditor may vote if its claim is deemed allowed or if its claim has been
19 allowed by the court. A claim is deemed allowed unless an objection is filed to it.
20 Thus, any creditor with a claim to which an objection has been filed may not vote
21 on a plan.

22 The obvious potential for abuse by a plan proponent makes it necessary to
23 provide for temporary allowance of a claim for voting purposes. Rule 3018(a)
24 allows temporary allowance of a claim in such amount as the court deems proper
25 after notice and hearing on any pending objections. Temporary allowance will be
26 appropriate when the objection was filed too late to be heard prior to the
27 confirmation hearing, when fully hearing the objection would delay
28 administration of the case, or when the objection is frivolous or of questionable
merit. If the claim objection has been pending for a long enough time to have
permitted its resolution, the court may decline to allow the claim or any part of it
for voting purposes if the delay in hearing the objection is attributable to the
claimant. The court, however, regardless of the circumstances, has the discretion
to allow or disallow all or part of the claim for voting purposes. Temporary
allowance of a claim for voting purposes may be sought by the claimant or any
party in interest. It should be done by motion. Notice should be given at least to
the claimant, the party objecting to the claim, the plan proponent, the debtor, the
trustee and any committee or other party who may be soliciting votes on the plan.

1 9 Collier on Bankruptcy, ¶ 3018.01[5] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev.
2 2008).

3 Parker North American did involve a Chapter 11 proceeding where the Resolution Trust
4 Corporation (“RTC”) filed a proof of claim as receiver of an insolvent savings and loan. The
5 debtor-in-possession did not object to the RTC’s claim under Section 502(d), but instead brought
6 a preference action under Section 547 and 550. The bankruptcy court determined that the
7 debtor had failed to exhausted its administrative remedies before proceeding against the RTC
8 and the court therefore lacked subject matter jurisdiction. It granted summary judgment in favor
9 of the RTC, but the district court reversed.
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11 When the RTC appealed, the Ninth Circuit agreed with the district court and
12 characterized the debtor’s preference action as an affirmative defense to the RTC’s proof of
13 claim. 24 F.3d at 1155. In dicta, the circuit court panel observed that “If successful in
14 establishing preference liability, [Debtor] will invoke § 502(d) of the Code, which requires the
15 bankruptcy court to disallow claims asserted by a creditor who has received a preferential
16 transfer unless the creditor disgorges the preference payments.” Id. The court then noted that
17 Section 502(d) does not compel surrender of a preferential transfer nor does it provide for
18 affirmative relief. Id., citing In re KF Dairies, supra. Because Parker North American did not
19 involve a claim objection at all, however, the bankruptcy, district and circuit courts were not
20 required to determine whether the preference action had to be adjudicated before Section 502(d)
21 could be applied.
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25 Based on the foregoing, the Court is not persuaded by the Odom Antennas or Parker
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1 North American decisions⁶ that final adjudication of the Avoidance Action is required before
2 Section 502(d) is applied to the Topkis and Morley claim. Rather, the Court agrees that Section
3 502(d) is mandatory at this juncture and requires that the claim be disallowed. See In re Sierra-
4 Cal, supra, 210 B.R. at 173. The disallowance, however, is without prejudice to any efforts by
5 Topkis and Morley to seek a temporary allowance under Bankruptcy Rule 3018(a)⁷.
6

7 CONCLUSION

8 Debtor's objection to the Topkis and Morley claim will be sustained as stated above. A
9 separate order has been entered concurrently herewith.
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18 ⁶ Similarly, the decision in In re America West Airlines, Inc., 208 B.R. 476
19 (Bkrtcy.D.Ariz. 1997), aff'd, 217 F.3d 1161 (9th Cir. 2000), is not persuasive. In that case, the
20 debtor-in-possession objected to the City of El Paso's tax claims after the statute of limitations
21 under Section 546 had expired for commencing an action to avoid a statutory lien under Section
22 545. 208 B.R. at 479-80. The bankruptcy court converted the claim objection into an adversary
23 proceeding in order to resolve all disputes between the parties. 208 B.R. at 477-78. The claim
24 objection was filed on August 13, 1994, and the bankruptcy court's order granting summary
judgment in favor of the debtor was issued on March 31, 1997, i.e., approximately 2 years and 7
months later. All of this occurred after the debtor's plan of reorganization already had been
confirmed and final adjudication of the avoidance action therefore had no effect on the
confirmation process.

25 ⁷ In view of the disallowance, it is not necessary to address the clarification of the Topkis
26 and Morley claim that was requested by the Debtor. See Objection at 5:3-12. It appears,
27 however, that a clarification has been provided by counsel. See Atomah Declaration at ¶ 15 and
Exhibit "A" attached thereto.

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