

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
WESTERN DIVISION**

IN RE:)	Chapter 11 Proceeding
)	
COMMERCIAL MORTGAGE AND FINANCE, CO.)	Case No. 08-73242
)	
Debtor.)	Judge Manuel Barbosa
)	

**DEBTOR’S RESPONSE TO MOTION FOR
IMPOSITION OF LIENS AND ENCUMBRANCES**

Commercial Mortgage & Finance Co. (the “Debtor”) respectfully opposes the relief sought by the Official Committee of Unsecured Creditors (the "Committee") in its Motion for Imposition of Liens and Encumbrances (the “Motion”).

**THE COURT LACKS JURISDICTION TO ENTER THE ORDER
EVEN IF THE DEBTOR SUPPORTED THE MOTION**

The Committee seeks to impose liens on the assets of four subsidiary corporations owned by the Debtor. The Committee does not indicate how this Court is empowered to exercise its jurisdiction over those entities to compel them to grant liens in favor of third parties, i.e., the unsecured creditors. Precedent indicates that bankruptcy courts are courts of limited jurisdiction.

“The jurisdiction of bankruptcy courts, like that of other federal courts, is grounded in, and limited by, statute.” *Celotex Corp. v. Edwards*, 514 U.S. 300, 307, 115 S.Ct. 1493, 1498, 131 L.Ed.2d 403 (1995). Section 1334(b) of title 28 of the United States Code is the statutory source of bankruptcy jurisdiction and is thus the starting point for the bankruptcy judge to ascertain whether jurisdiction exists. *In re Cary Metal Products, Inc.*, 152 B.R. 927, 930 (Bankr.N.D.Ill.1993), *aff’d*, *Zerand-Bernal Group, Inc. v. Cox*, 23 F.3d 159, 161 (7th Cir.1994) (citing *In re Spaulding & Co.*, 131 B.R. 84 (N.D.Ill.1990)).

In re Kmart Corp., 359 B.R. 189, 194 (Bankr. N.D.Ill. 2005).

The Committee admits that “... Grandview Real Estate, CMF Real Estate, CMF Mortgage Notes and CMF Mortgages constitute significant assets of the Debtor's wholly owned

subsidiary corporations but are not a part of the Debtor's bankruptcy estate. ¹” (Motion at ¶12). Since the entities who would grant the liens are not debtors and their assets are not estate assets, this Court does not have the power to compel CMF Mortgage Co., City Plaza Realty, Inc., Greater Grandview, Inc. or Security Safe Deposit, Inc. to grant liens on their assets for the benefit of parties to whom they are not in privity, i.e., the Debtor’s unsecured creditors. While as a part of a plan of reorganization or through the filing of one or more separate cases, these entities may in the future fall within the parameters of this Court’s jurisdiction; at this time, they operate independently. Since they are not debtors themselves, this Court cannot direct them to act in the fashion requested by the Committee.

THE COMMITTEE IMPROPERLY SEEKS TO OPERATE THE DEBTOR’S BUSINESS

If jurisdiction existed, the Debtor still should not be compelled to take direction from the Committee. As a threshold matter, the decision whether the Debtor requires security for its loans is a decision left to the Debtor’s management. The Debtor, as a debtor in possession, serves as a trustee for the benefit of all estate creditors. See, §1107². The Debtor has historically not required security for its loans to its subsidiaries.

As debtor in possession, the Debtor, through its management, is the party responsible for the operation of its business in the ordinary course including decisions such as requiring security for loans under §363.

§363(c)(1) provides: “If the business of the debtor is authorized to be operated under §§721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary

¹ The Committee incorrectly asserts that the “City Plaza Real Estate” and the “City Plaza leases” are owned by City Plaza Realty, Inc. As disclosed in the Debtor’s Schedule A and Schedule G, these are estate property.

² Unless otherwise indicated, all statutory references will be to the United States Bankruptcy Code, 11 U.S.C. §101 et.seq.

course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.” *Id.*

The Northern District of Illinois has adopted the Reasonable Expectations Test to determine whether a transaction or a type of transaction falls or would fall within the ordinary course of business. *Martino v. First National Bank of Harvey* (In the Matter of Garofalo's Finer Foods, Inc.), 186 B.R. 414 (N.D.Ill. 1995). Under that test, “a post-petition transaction undertaken by the debtor that is similar in size and nature to pre-petition transactions undertaken by the debtor would be within the ordinary course of business.” *Garofalo's Finer Foods*, 186 B.R. at 426. Using this test provides the necessary standards to determine whether a specific transaction is within the ordinary course of business.

The core of the reasonable expectations test is its analysis of the debtor's pre-petition conduct as a means to inform and develop expectations of its post-petition conduct. *See, In re Johns-Manville*, 60 B.R. at 617. The debtor's pre-petition conduct is not, however, the sole reference for defining these expectations. *Id.* In applying this test, the court must also consider the changing circumstances that are inherent in a debtor's efforts to operate its business under chapter 11. *Id.*; *accord, In re Roth Am., Inc.*, 975 F.2d 949, 953 (3d Cir.1992). The test seeks to discern “any significant alterations” in a debtor's pre- and post-petition activities. *Medical Malpractice Ins. Assoc. v. Hirsch* (In re Lavigne), 183 B.R. 65, 70 (Bankr.S.D.N.Y.1995).

Garofalo's Finer Foods, 186 B.R. at 425.

The Committee cannot dispute that the Debtor, if it were to make a new loan to one of its subsidiaries, which frankly is not contemplated, would fall in line with the expectations of creditors. The fact that the Debtor did not advise its unsecured creditors of the existence of any such loans does not alter their reasonable expectation of the Debtor's operation of its business. *Garofalo's Finer Foods*, 186 B.R. at 427. The Committee seeks to overturn the Debtor authority to use its property in the ordinary course in direct contravention of §363(c)(1). The relief

requested is unnecessary. The Committee has recourse in the event the Debtor acts in violation of its obligations, which are governed by the business judgment rule.

The Committee seeks to usurp the Debtor's obligation to operate the estate by seeking an order compelling the Debtor to act. Other than the fact that the Debtor's subsidiaries owe "substantial obligations and indebtedness" (Motion at ¶13) and that the imposition of liens would at least in the Committee's view be in "the best interest of creditors and the Debtor's bankruptcy estate" (Motion at ¶13), the Committee does not indicate why the relief is necessary.

The Committee seeks control over the Debtor and its assets. This is contrary to the parties' rights and obligations. "A bankruptcy trustee in a reorganization case has the discretionary authority to exercise his business judgment in operating the debtor's business similar to the discretionary authority to exercise business judgment given to an officer or director of a corporation." *State of Illinois, Department of Revenue v. Schechter*, 195 B.R. 380, 384 (N.D.Ill. 1996); citing *In re Holiday Isles, Ltd.*, 29 B.R. 827, 829 (S.S.Fla.1983).

Unlike the Debtor, who has an obligation to all creditors, the Committee's fiduciary obligations are limited:

We do not accept this contention, as it seems based on the erroneous assumption that the Official Unsecured Creditors' Committee is a fiduciary for the estate as a whole. While a creditors' committee and its members must act in accordance with the provisions of the Bankruptcy Code and with proper regard for the bankruptcy court, the committee is a fiduciary for those whom it represents, not for the debtor or the estate generally. *In re Microboard Processing, Inc.*, 95 B.R. 283, 285 (Bankr.D.Conn.1989); *In re Johns-Manville Corp.*, 60 B.R. 842, 853 (S.D.N.Y.), rev'd on other grounds, 801 F.2d 60 (2d Cir.1986). Thus the committee's fiduciary duty, as such, runs to the parties or class it represents. *Markey v. Orr, No. G89-40886*, 1990 WL 483808 at *4, 1990 U.S. Dist. LEXIS 3005 at *9-*10 (W.D.Mich.1990); *Pension Benefit Guar. Corp. v. Pincus, Verlin, Hahn, Reich & Goldstein P.C.*, 42 B.R. 960, 963 (E.D.Pa.1984); *Microboard*, 95 B.R. at 285; *Johns-Mansville*, 60 B.R. at 853. It is charged with pursuing whatever lawful course best serves the interests of the class of creditors

represented. *In re Seascope Cruises, Ltd.*, 131 B.R. 241, 243 (Bankr.S.D.Fla.1991).

In re SPM Mfg. Corp., 984 F.2d 1305, 1315-16 (1st Cir. 1993).

The Committee's concern with protecting unsecured creditors is proper. The Debtor, however, can limit its decision-making to protecting only certain constituents in this case.

THERE IS NO STATUTORY BASIS FOR THE MOTION UNDER THE
BANKRUPTCY CODE NOR A BASIS UNDER ILLINOIS LAW

The Debtor can discern no statutory basis for the motion. The Committee has no authority to compel the Debtor to grant a lien on its assets let alone force the Debtor's subsidiaries to do so. That power is held exclusively in the first instance by the Debtor, as to its assets, pursuant to §363 and in the latter instance by the subsidiaries under general corporate law.

The Committee appears to ask the Court to utilize §105 to compel a result. Such an action is not appropriate under the Bankruptcy Code. The Seventh Circuit has stated that the grant of equitable power in § 105 is limited in that it "allows [bankruptcy] courts to use their equitable powers only as necessary to enforce the provisions of the Code, not to add on to the Code as they see fit." *In re Fesco Plastics Corp.*, 996 F.2d 152, 156 (7th Cir.1993); "The Supreme Court has taught that any grant of authority given to the bankruptcy courts under § 105 must be exercised within the confines of the bankruptcy code." *Gouveia v. Tazbir*, 37 F.3d 295, 300 (7th Cir.1994) (citing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988)). The rights granted under §105 do not extend to directing the Debtor's subsidiary corporations to grant liens for the benefit of its parent's unsecured creditors.

In a case involving a debtor's request for the extension of the automatic stay to a subsidiary, the Fourth Circuit declined to extend bankruptcy jurisdiction to a subsidiary corporation despite the debtor's urging. "It is a fundamental precept of corporate law that each corporation is a separate legal entity with its own debts and assets, even when such corporation is

wholly owned by another corporate entity.” *Kreisler v. Goldberg*, 478 F.3d 20, 2139 (4th Cir. 2007). This Court should arrive at the same result in this case. By granting the motion, the Court would have to ignore the separate legal existences apparent in this situation.

Illinois law is similarly clear that a corporation and its subsidiaries are distinct entities. “Under Illinois law, a corporation is presumed to be ‘separate and distinct from its officers, shareholders, and directors, and those parties will not be held personally liable for the corporation's debts and obligations.’” *Judson Atkinson Candies, Inc. v. Latini-Hohberger Dhimantec*, 529 F.3d 371, 378 (7th Cir. 2008) (quoting *Tower Investors, LLC v. 111 E. Chestnut Consultants, Inc.*, 371 Ill.App.3d 1019, 864 N.E.2d 927, 941 (1st Dist. 2007). As distinct entities, this Court should not require that they take actions that would give strangers, in this case the Debtor’s unsecured creditors, rights that would be to their detriment and to the detriment of their own creditors.

THE DEBTOR MUST MEET ITS FIDUCIARY OBLIGATION TO ALL CREDITORS

The Debtor respects the Committee’s role. It embraces the idea set forth in *In re Together Development Corp.*, 262 B.R. 586, 593 (Bankr. D.Mass. 2001) that “[t]he creditors’ committee is not merely a conduit through whom the debtor speaks to and negotiates with creditors generally.” However, unlike the Committee, the Debtor is a fiduciary for all constituents. Sometimes the Debtor cannot agree with the Committee’s position. Here, the Debtor disagrees with the Committee regarding the need or propriety for the imposition of a lien on third parties’ assets. The Committee has not articulated why the liens are needed. Even if circumstances indicated otherwise, the Debtor would be wary with regard to agreeing, since the relief will effect other creditors’ rights. To agree with the Committee could give rise to a claim from administrative creditors that the Debtor failed in its fiduciary obligations to those parties. The Debtor would be a participant in granting one class of creditors’ lien rights that they did not

seek in extending credit. In essence, the Committee wants the unsecured creditors to receive an unbargained for benefit to the detriment of other creditors.

The Committee implies that the unsecured creditors are the sole constituents in this case. They are not. The Debtor is operating its business on a going concern basis. As such, it incurs real estate tax, utility, payroll and other administrative expenses. To grant a lien in favor of the unsecured creditors would serve the purpose of defining how substantial assets of the estate are distributed. The imposition of the liens amounts to a sub rosa plan of reorganization. The proposal is similar to the transaction rejected in *In re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983). The Fifth Circuit determined that a sale of assets by Braniff was a plan sub rosa because it dictated some of the terms of any future reorganization plan, restructured the rights of creditors, and required all parties to release all claims against the debtor, its officers, directors, and secured creditors. In this instance, the same result occurs, other than the release of claims. The approval of the Committee's motion would give unsecured creditors priority rights in millions of dollars of assets to the detriment of administrative claimants. Once this Court entered an order granting the relief sought in the motion, the priorities would be altered.

An official committee of unsecured creditors is a paradigm example of a party that is accountable to a limited constituency. This Committee owes a fiduciary duty to the class of unsecured creditors as a whole. 7 *Collier on Bankruptcy* ¶ 1103.05 [2] (15th ed. rev'd 2002). The Committee acts as the representative of the unsecured creditors for those claims owned exclusively by the Committee. The Debtor's mandate is broader. It is a fiduciary for all creditors. To serve that mandate, the Debtor cannot agree with the relief the Committee seeks in this instance.

CONCLUSION

The Committee while having a laudable goal of seeking to protect unsecured creditors seeks relief that the Court lacks the jurisdiction to grant. That relief is not available under the provisions of the Bankruptcy Code, nor contemplated under Illinois law. An order granting the motion would alter the priorities set forth in the Bankruptcy Code to the detriment of other creditors holding claims of a higher priority. Clearly, the Committee asks the Court to rewrite a lending relationship and thereby ignore the terms to which the parties entered. Finally, the Committee seeks to impose liens on nonparties to whom the unsecured creditors are not in privity and on whose assets they did not rely in extending credit. For these reasons, the Court should deny the motion.

COMMERCIAL MORTGAGE & FINANCE CO.

By: /s/ Gregory J. Jordan
One of Its Attorneys

Gregory J. Jordan (ARDC# 6205510)
Louis Apostol (ARDC# 3125952)
Vernon Kowal (ARDC #6194791)
Apostol, Kowal & Jordan, Ltd.
200 South Wacker Drive, 32nd Floor
Chicago, IL 60606-
(312) 854-7180 (Telephone)
(312) 276-9285 (Facsimile)