

**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
TO RESTRICT AND LIMIT LOAN TRANSACTIONS**

Commercial Mortgage & Finance Co. (the “Debtor”) respectfully opposes the relief sought by the Official Committee of Unsecured Creditors (the “Committee”) in its Motion to Restrict and Limit Loan Transactions. The Committee seeks to prevent the Debtor from transacting its primary business, which involves making loans including loans to subsidiaries. The Committee perceives its members to be necessary participants on the Debtor’s loan committee who would hold veto power over the Debtor’s operation of its business. That constriction is not contemplated under either Section 363 or 1103¹. As detailed herein, the additional costs that the Debtor would incur raises the specter that the Committee’s involvement might raise the cost of doing business to a level that it will be improbable that the Debtor could make a profitable loan. As such, the Debtor must oppose the relief sought in the motion.

OVERVIEW OF THE COMMITTEE’S PROPOSAL

The Debtor has been in the loan business since its inception and continues to make loans on a limited basis. The limitation on loan production is self-imposed and relates to current macroeconomic financial conditions. Should a profitable loan opportunity arise including a transaction involving a subsidiary, the Debtor, as debtor in possession, should have the ability to

¹ Unless otherwise indicated, all statutory references will be to the United States Bankruptcy Code, 11 U.S.C. §101 et.seq.

take advantage of such an opportunity. Under the Debtor's current strategy, it only considers (a) loans to third parties that would be readily saleable either in the secondary mortgage market or through the eventual sale of its loan portfolio or (b) loans to CMF Mortgage, Inc., its consumer loan subsidiary, which themselves would be saleable in the same fashion. To the extent the Debtor needs to make a loan to one of its other operating subsidiaries in the same fashion as it has done in the past, it would do so based on the determination that the loan would benefit the estate.

The Committee did not consult with the Debtor regarding this proposal (or any of the other relief sought in its motions) in advance of filing. Further, the Committee has not indicated to the Debtor or in its motions why the restrictions requested in this or the related motions are necessary. Instead, the Committee filed this motion and related motions by which the Committee seeks to provide unsecured creditors with comfort. While the Debtor does not question the Committee's best intentions, the proposed relief is not allowed under the Bankruptcy Code.

Specifically, the Committee requests:

Until a Plan of Reorganization is confirmed by this Court, it would be in the best interest of creditors and would preserve the assets of the Debtor's bankruptcy estate to restrict and limit the ability and authority of the Debtor to make any loans to CMF, City Plaza, Greater Grandview, Security Safe or any third party as well as the ability and authority of CMF, City Plaza, Security Safe or Greater Grandview to make any loans without first obtaining the prior written consent and agreement of the Committee or, if the Committee does not consent or agree to the making of such loan, the prior approval and authorization of this Court though the entry of an Order authorizing and approving such loan or loans, after notice and a hearing.

Motion at ¶13.

The Committee's proposed constrictions on the Debtor's business activities have practical as well as legal problems. The margins on loans on an individual basis are small. This

is true for even the most profitable lenders. Competition, which is the hallmark of the capitalist system, forces participants to compete to offer their products at a price that is attractive to the end user. If the cost of credit is too great, a potential borrower will have a number of other sources with whom that borrower could take his, her or its business. If the Debtor were required to add the cost of drafting pleadings by which it would seek court approval, it is unlikely that the Debtor could show that any loan would be profitable. Similarly, the costs incurred by Debtor's and committee counsel in participating in the loan making process would potentially eliminate the likelihood of offering a loan on a profitable basis.

The Debtor objects to the Motion as an improper expansion of the Committee's powers not authorized under the Bankruptcy Code.

THE DEBTOR, RATHER THAN THE COMMITTEE, IS
RESPONSIBLE FOR THE USE OF ESTATE PROPERTY

Under the constructs of the Bankruptcy Code, the parties must start by acknowledging that a debtor in possession has the right to operate its business in the ordinary course. "Indeed, 'if a debtor had to seek court approval to pay for every expense incurred during the normal course of its affairs, the debtor would be in court more than in business.'" *In re Husting Land & Development, Inc.*, 255 B.R. 772, 778 (Bankr. D.Utah 2000) (quoting *Bagus v. Clark (In re Buyer's Club Markets, Inc.)*, 5 F.3d 455, 458 (10th Cir.1993).

§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 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 Debtor holds the rights of a trustee under the terms of Section 1107. The debtor's right to use, sell or lease estate property under

subsections (c)(1) of §363 is constrained by the protection afforded under subsection (e) to entities holding security interests in the debtor's property. There is no similar restriction placed on the use of property based on the objections of unsecured creditors.

WHAT CONSTITUTES THE ORDINARY COURSE OF BUSINESS

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 acknowledges that the business activities that it hopes to curtail are at the core of the Debtor's business. “In the operation of their respective businesses, the Debtor and CMF will make loans to third parties secured by mortgages against real property granted by the third parties to the Debtor or CMF.” Motion at ¶9. Since the business activities that the Committee seeks to curtail involves the Debtor's core business, the Committee should not

prevail. 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 business judgment rule is a “policy of judicial restraint born of the recognition that directors are, in most cases, more qualified to make business decisions than are judges.” *International Insurance Co. v. Johns*, 874 F.2d 1447, 1458 n. 20 (11th Cir.1989). The rule is intended to protect directors and officers from liability when they make good faith decisions in an informed, deliberate manner. *In re Munford, Inc.*, 98 F.3d 604, 611 (11th Cir.1996). Courts should approve an exercise of a debtor's business judgment unless it is “so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice.” *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1047 (4th Cir.1985).

In re Friedman's, Inc., 336 B.R. 891, 895 (Bankr. S.D.Ga. 2005).

Under §1107(a), the Debtor in bankruptcy has a fiduciary duty to his creditors not to squander property of the estate. *Home Insurance Company of Illinois v. Adco Oil Company*, 154 F.3d 739, 743 (7th Cir. 1998). A debtor in possession must act in the best interests of all of its creditors. *Id.* The Committee is not empowered under §363 or any other provision in the Bankruptcy Code to operate the Debtor's business.

Similarly, if the Debtor seeks to enter into a new or different line of business including lending of a nature that creditors would not be expected to contemplate, the Debtor would need to seek the approval of this Court. *See generally, Garofalo's Finer Foods, Infra*

THE COMMITTEE IMPROPERLY SEEKS TO OPERATE THE DEBTOR'S BUSINESS

In addition to attempting to prevent the Debtor from operating its business in the ordinary course, the Committee seeks to expand its powers beyond which the Bankruptcy Code allows. §1103(c) set forth the scope of the Committee's powers:

(c) A committee appointed under section 1102 of this title may--

- (1) consult with the trustee or debtor in possession concerning the administration of the case;
 - (2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;
 - (3) participate in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan;
 - (4) request the appointment of a trustee or examiner under section 1104 of this title; and
 - (5) perform such other services as are in the interest of those represented.
- 11 U.S.C. §1103(c).

The Second Circuit noted in *Official Committee of Unsecured Creditors of WorldCom, Inc. v. S.E.C.*, 467 F.3d 73 (2d Cir. 2006) the limitations on a committee powers:

A creditors' committee is a creature of statute, deriving its powers and duties from bankruptcy law. *Manville Corp. v. Equity Security Holders Committee* (In re Johns-Manville Corp.), 52 B.R. 879, 883-84 (Bankr.S.D.N.Y.1985) (“In re Johns-Manville”), aff’d 60 B.R. 842 (S.D.N.Y.1986), rev’d on other grounds, 801 F.2d 60, 65, 69 (2d Cir.1986); see also 11 U.S.C. § 1102. The principal source of a creditors' committee's powers and duties is 11 U.S.C. § 1103(c), which grants, inter alia, the authority to consult regarding the administration of the bankruptcy case, perform certain investigations of the debtor's business, participate in the formulation of a bankruptcy plan, request the appointment of a trustee, and “perform such other services as are in the interest of those represented.” 8 U.S.C. § 1103(c)(5).

WorldCom, 467 F.3d at 79

The Committee seeks to do more than consult regarding administration or conducting an investigation, it seeks to control the Debtor’s operations by requiring that its member or members serve as gatekeepers with regard to any loan request. If the Committee does not approve a loan request, the Debtor must file a motion to resolve any dispute before this Court. The powers granted to committees under §1103(c)(1)-(4) are very specific. Since none of the rights granted thereunder give rise to the requested relief, the Debtor presumes, the Committee

relies on the catch-all provision contained in subsection (c)(5). An examination of precedent indicates that such reliance is misplaced.

The Sixth Circuit in *Official Committee of Tort Claimants, v. Dow Corning Corporation*, (In re Dow Corning Corporation), 142 F.3d 433 (6th Cir. 1998) (Table) declined to approve a request by a committee to conduct lobbying activities.

Legislative and administrative lobbying does not fall within any of the activities enumerated in § 1103(c)(1) through (4). Thus, to be an authorized activity for a creditors' committee, lobbying must come within the meaning of “other services” that are “in the interest of those represented.” § 1103(c)(5).

The district court held that the plain meaning of subsection (c)(5) was unambiguous and that the correct inquiry should be whether the lobbying activities in question are in the interest of those represented. In doing so, the district court rejected the bankruptcy court's reliance on the principle of ejusdem generis and concluded that rule could be invoked only when there is uncertainty in the correct meaning of words.

Ejusdem generis, or “of the same kind, class, or nature,” Black's Law Dictionary (Sixth Edition, 1990), is a shorthand for the notion that a general term should be understood in light of the specific terms surrounding it. Thus, this court has applied the principle to amplify the meaning of otherwise unambiguous language such as “other income.” *Woods v. Simpson*, 46 F.3d 21, 23 (6th Cir.1995). Stated another way, ejusdem generis provides that “where general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.” *Nationwide Mutual Ins. Co. v. Cisneros*, 52 F.3d 1351, 1357 (6th Cir.1995), cert. denied, 516 U.S. 1140, 116 S.Ct. 973, 133 L.Ed.2d 893 (1996). It is entirely appropriate to refer to the principle of ejusdem generis, as the bankruptcy court did, in considering whether legislative and administrative lobbying may be considered an “other service” within the meaning of § 1103(c)(5).

Dow Corning, 142 F.3d at 3

The *Dow Corning* court agreed that pursuant to the doctrine of ejusdem generis, that the expansion of the Committee's powers to include lobbying would render the first four subparts meaningless. Similarly, active participation in the Debtor's operation by reviewing each

expenditures falls well outside the purview of consultation or investigation. It would make the Committee the driving force in the decision making process in this bankruptcy case.

Certainly, §1103(c)(5) cannot be read to mean that it permits an official committee of unsecured creditors to do anything that is in the best interest of its constituency then subsections (c)(1)-(4) of § 1103 would become unnecessary and meaningless. Courts have expressed “a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment.” *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552, 562, 110 S.Ct. 2126, 2133, 109 L.Ed.2d 588 (1990)). Given this statutory construction rule, it seems clear that the Committee lacks the power to petition the Court for the relief sought and the Court does not have the statutory authority to grant it.

If the power to control the Debtor business through the control of its expenditures does not derive from §1103, the Committee cannot rely upon §105 for authority. 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.

THE DEBTOR MUST MEET ITS FIDUCIARY OBLIGATION TO ALL CREDITORS

Unlike the Committee, the Debtor is specifically empowered to administer its assets. "Indeed, the Code not only authorizes the chapter 11 debtor to manage the estate's legal claims, but in fact requires the debtor to do so in a way that maximizes the estate's value. Under the Code, the debtor-in-possession is held "accountable for all property [of the estate] received." *In re Smart World Technologies, LLC*, 423 F.3d 166, 175 (2d Cir. 2005) (citing § 1106(a)(1) incorporating § 704(a)(2)). The Committee does not bear this burden. "In contrast, a committee owes a fiduciary duty to the class it represents, but not to the debtor, other classes, or the estate. *In re Adelphia Communications Corp.*, 544 F.3d 420 n. 1 (2d Cir. 2008) (citing *Smart World*, 423 F.3d at 175 n. 12). Since the Committee does not owe a fiduciary duty to the Debtor or other creditors, it should not be granted rights as a signatory or signatories or the power to control disbursements. Those roles will alter the Committee's role far beyond what the Courts or Congress contemplated. As a fiduciary for all constituents, the Debtor cannot agree with the Committee's position.

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.

Even if the Court had the statutory authority to grant the relief the Committee seeks, the Committee has not articulated any reason why it requires the power it seeks. 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 agreed with the Committee to avoid a fight and thereby failed in its fiduciary obligations to those parties.

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.

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