UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	
	)	**Chapter 7**
GERARDO LEASING, INC.,	)	**Case No. 91 B 08499**
	)	
Debtor.	)	
_____	)	
	)	
In re:	)	
	)	**Chapter 7**
GERARDO & SONS MOTOR SERVICE, INC.,	)	**Case No. 91 B 10562**
	)	
Debtor.	)	
_____	)	
	)	
In re:	)	
	)	**Chapter 7**
GETCO, INC.,	)	**Case No. 91 B 15217**
	)	
Debtor.	)	
	)	**(Substantively consolidated)**

MEMORANDUM OF OPINION

These consolidated bankruptcy cases were originally filed under Chapter 11 of the Bankruptcy Code (Title 11, U.S.C., the "Code") but were later converted to cases under Chapter 7 of the Code. The cases are now before the court on the objection of the Chapter 7 trustee to a request by the Illinois Department of Revenue (the "IDOR") for payment of certain administrative claims—withholding taxes—that were incurred while the cases were proceeding under Chapter 11. The trustee and the IDOR disagree about the proper procedure for allowance of such claims. As discussed below, the procedure followed by the IDOR in this

case—the filing of a proof of claim without seeking a court order—is sufficient to require allowance of an administrative claim in the absence of an objection on the merits of the claim. Because the trustee's objection in the present case raises only the propriety of the procedure employed by the IDOR, the objection is overruled.

Jurisdiction

Jurisdiction over bankruptcy cases is placed exclusively in the district courts pursuant to 28 U.S.C. §1334(a). District courts may refer bankruptcy cases to bankruptcy judges, pursuant to 28 U.S.C. §157(a), and, by General Rule 2.33(a), the District Court for the Northern District of Illinois has made such reference. Bankruptcy judges are given the authority to enter appropriate orders and judgments in core proceedings arising in referred bankruptcy cases pursuant to 28 U.S.C. §157(b)(1). The allowance or disallowance of claims against the estate is a core proceeding under 28 U.S.C. §157(b)(2)(B).

Findings of Fact

In 1991, Gerardo Leasing, Inc., Gerardo & Sons Motor Service, Inc., and Getco, Inc. filed for bankruptcy relief under Chapter 11. In the same year, all three cases were converted to Chapter 7, and, in 1993, they were substantively consolidated. In August, 1991, after the conversion, the IDOR filed requests

for payment of unpaid withholding taxes that accrued during the operation in Chapter 11 of Gerardo & Sons Motor Service, Inc. and Gerardo Leasing, Inc. On November 16, 1998, the Chapter 7 trustee filed an objection to the IDOR's requests. The objection does not challenge the IDOR's requests on their merits, and it raises no factual dispute. Rather, the objection contends that the mere filing of requests for payment by the IDOR was insufficient to comply with the "notice and hearing" requirement of §503(b) of the Bankruptcy Code. The court received briefs from the parties—including the United States trustee, who supported the IDOR's position—and took the matter under advisement.

Conclusions of Law

Background. This case presents a recurring issue in converted Chapter 11 cases, resulting from an absence of guidance from the Federal Rules of Bankruptcy Procedure.

The Bankruptcy Code contains two sets of procedures for allowing payment to a creditor. The first of these procedures is defined by §§501 and 502. Section 501 provides for the filing of proofs of claim; §502(a) provides that a claim for which proof is so filed "is deemed allowed" unless a party in interest objects; and §502(b) both specifies the possible grounds for objection, and provides that if an objection is made, "the court, after notice and hearing, shall determine the amount of such claim as

of the date of the filing of the petition." This 501/502 procedure thus has three statutorily defined procedural features: (1) the creditor holding a claim is merely required to file a proof of its claim; (2) the claim is "deemed allowed," without action by the court, in the absence of an objection; and (3) if an objection is made, the court, after notice and hearing, determines the amount of the claim. Because the court is required to determine the amount of the claim as of the date of filing, the 501/502 procedure can only be meaningfully applied to claims that arose before the filing of the case or to claims that are treated as though they arose before the filing.[1]

The 501/502 procedure has been implemented, in detail, by the Federal Rules of Bankruptcy Procedure. Rule 3001 defines a proof of claim as "a written statement setting forth a creditor's claim" and provides that it "shall conform substantially to the appropriate Official Form." (At present, there is only one official form, Form 10, for proofs of claim.) Rules 3002 to 3005

[1]Several types of postpetition claims, specified in §502, are treated as though they arose prepetition. *See* §502(e)(2) (claims for reimbursement or contribution which become fixed after a case commences), §502(f) (claims arising in the ordinary course of the debtor's business after the commencement of an involuntary case but before the order for relief), §502(g) (claims arising during the involuntary gap period), §502(h) (claims arising from avoidance recoveries), and §502(i) (concerning certain taxes entitled to priority). In addition, when a Chapter 11 case is converted to Chapter 7, nonadministrative claims against the estate that arose postpetition are treated as prepetition claims pursuant to §348(d) of the Code.

set time limits for the filing of proofs of claim by various parties. Rule 3006 governs withdrawal of claims. Rule 3007 governs objections (requiring notice to the claimant, the debtor and the trustee). Rule 3008 deals with reconsideration.

The other procedure for payment of creditor claims is defined by §503 of the Code. This section applies only to claims for payment of an expense involving the administration of a bankruptcy estate—necessarily arising after the bankruptcy filing. However, in contrast to the well-defined 501/502 procedure, §503 provides simply (a) that "[a]n entity may timely file a request for payment of an administrative expense or may tardily file such request if permitted by the court for cause," and (b) that "[a]fter notice and a hearing, there shall be allowed administrative expenses," several types of which are specified, including taxes incurred by the estate; there is no stated requirement for judicial determination of the amount of the claim; no objection procedure; and no definition of the parties either required to give notice or entitled to receive it.

Only with respect to one category of administrative claims—compensation for services rendered to the estate by a trustee, examiner, professional person, or attorney, and reimbursement of the expenses of such bankruptcy professionals—does the Code provide a more detailed set of procedural requirements. Section 330(a)(1) provides that claims for professional compensation and expense reimbursement are to be

allowed by an award of the court "[a]fter notice to the parties in interest and the United States Trustee and a hearing," and §330(a)(2) provides that the court may, on its own motion or on the motion of any party in interest, award compensation in an amount less than that requested by a professional.

The drafters of the Bankruptcy Code expected that the procedure for payment of administrative claims not involving professional services would be defined by the Federal Rules of Bankruptcy Procedure. *See* H.R. Rep. No. 95-595, at 355 (1977), *reprinted in Collier on Bankruptcy* App. Part 4(d)(i) (15th ed. rev. 1996); S. Rep No. 95-989, at 66 (1978), *reprinted in Collier, supra*, App. Part 4(e)(i) (both stating that the rules would "specify the time, the form, and the method" of filing requests for payment); and 124 Cong. Rec H11094 (daily ed. Sept. 28, 1978), S17411(daily ed. Oct. 6, 1978) (remarks of Rep. Edwards and Sen. DeConcini) (stating that, as a result of a legislative compromise, even the place for filing such requests would be determined by rule). This expectation has not been met. The Federal Rules of Bankruptcy Procedure track the Code in providing procedures for professional compensation and reimbursement,[2] but they include no provisions governing

[2]Fed. R. Bankr. P. 2016(a) requires the filing of an application setting forth a detailed statement of "services rendered, time expended, and expenses incurred" by a professional seeking an award, and, for all applications for compensation or reimbursement in excess of $500, Fed. R. Bankr. P. 2002(a)(6)

administrative claims generally. Thus, an administrative claim not arising from the provision of professional services—like the claim of the IDOR in this case—falls into a procedural void.

How the courts deal with this situation depends on whether the nonprofessional administrative claim is required to be determined while a case is pending in Chapter 11 or after it has been converted. While a bankruptcy case is pending in Chapter 11, the trustee or debtor in possession is generally empowered to incur and pay unsecured debt in the ordinary course of business. 11 U.S.C. §§363(c), 364(a), 1107(a). When the trustee or debtor in possession does not pay such debt, thus giving rise to an administrative claim, the procedure usually employed by the creditor to obtain payment is the filing of a motion under Fed. R. Bankr. P. 9013-14, which govern requests for relief not otherwise specified by the rule, and which provides for notice to the trustee or debtor in possession, and to such other entities as the court directs. *See, e.g., Von Der Ahe v. Flint Hills Foods, Inc. (In re Isis Foods, Inc.)*, 27 B.R. 156 (W.D. Mo. 1982); *In re Florida West Gateway, Inc.*, 166 B.R. 981 (Bankr. S.D. Fla. 1994).

However, if such a motion has not been determined by the court prior to conversion, it is not clear that the 9013 motion

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requires 20 days' notice of the hearing on the application.

practice is the appropriate procedure for allowing a nonprofessional administrative claim. That is because another of the rules, Fed. R. Bank. P. 1019, establishes special procedures for Chapter 11 cases converted to Chapter 7. Rule 1019(5) provides that the debtor in possession or the trustee at the time of such a conversion must file "a schedule of unpaid debts incurred after the filing of the petition and before conversion of the case," and Rule 1019(6) provides for notice to the creditors listed on this schedule "that their claims may be filed pursuant to Rules 3001(a)-(d) and 3002." As noted above, these rules effectuate the 501/502 proof-of-claim procedure, including time limits. Thus, in the context of a converted Chapter 7 case, it appears that entities holding nonprofessional administrative claims, unpaid during the pendency of the case in Chapter 11, must file a proof of claim within the deadlines established by Rule 3002.

At least one court has held that a proof of claim need not be filed in this situation, noting that the language of the rule is permissive. *In re Pro Set, Inc.*, 193 B.R. 812, 816-17 (Bankr. N.D. Tex. 1996). However, the majority of courts—including the Seventh Circuit, whose decisions are binding here—have held that Rule 1019 requires the filing of a proof of claim as a prerequisite for payment of an administrative claim after conversion of a Chapter 11 case to Chapter 7. *See, e.g., In re*

De Vries Grain & Fertilizer, Inc., 12 F.3d 101, 104 (7th Cir. 1993); *United States v. Ginley (In re Johnson)*, 901 F.2d 513, 518 (6th Cir. 1990); *United States v. Brandt (In re Lissner)*, 119 B.R. 143, 145 (N.D. Ill. 1990). These decisions note that there is a compelling reason to require timely filing of administrative claims after conversion to Chapter 7—the Chapter 7 trustee needs to know promptly the extent of the claims against the estate in order to administer it efficiently—and that Rule 1019 offers unpaid administrative claimants no alternative to filing a proof of claim.

In the present case, the IDOR filed its requests for payment within the time specified by Rule 3002, and the trustee acknowledges that these requests are sufficient to serve as proofs of claim.[3] The trustee's argument is that simply filing a proof of claim is not enough—that, in order to comply with the notice and hearing requirement of §503, an administrative claimant in the position of the IDOR must not only file a timely

[3]The trustee thus does not contend that the IDOR's requests failed to include the substance of the information required by Official Form 10, as required by Rule 3001. However, even if the requests were in some way deficient as proofs of claim, the IDOR would have been allowed to amend the requests to cure the deficiency, as long as the essential elements of the claims were apparent from the filing. *See In re Stoecker*, 5 F.3d 1022, 1028 (7th Cir. 1993) ("A creditor should . . . be allowed to amend his incomplete proof of claim (what is often called an 'informal proof of claim') to comply with the requirements of Rule 3001, provided that other creditors are not harmed by the belated completion of the filing.")

proof of claim, but must also file a motion for payment of the claim under Rules 9013 and 9014. This argument appears to raise a question of first impression.

The appropriate procedure. The position of the IDOR and the United States trustee in this case is simple: they argue that Fed. R. Bankr. P 1019(6)—in requiring the filing of proofs of claim under Rules 3001 and 3002 for administrative claims of the sort involved in the present case—incorporates the procedure applicable to proofs of claim under §§501 and 502 of the Bankruptcy Code. Part of the 501/502 procedure is allowance of claims for which proof is filed—without court order—in the absence of objection. Here, because there is no substantive objection to the IDOR's claims, the IDOR and the United States trustee assert that no further proceeding is necessary for allowance of the claims.

The Chapter 7 trustee disagrees with this view of the appropriate procedure, based principally on the language of §503(b). In contrast to §§501 and 502, §503 permits payment of administrative claims only "after notice and hearing." If Chapter 11 administrative claims that are unpaid at the time of a conversion to Chapter 7 can be paid merely on the basis of an uncontested proof of claim, then, the trustee argues, the notice and hearing requirement would be violated.

The trustee's argument reflects a mistaken understanding of "after notice and hearing." This phrase is a term of art in the

Bankruptcy Code, specially defined by §102(1):

> '[A]fter notice and a hearing', or a similar phrase—(A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but (B) authorizes an act without an actual hearing if such notice is given properly and if—(1) such a hearing is not requested timely by a party in interest . . . .

Accordingly, in the circumstances of a nonprofessional Chapter 11 administrative claim that is unpaid at the time of conversion to Chapter 7, "after notice and a hearing" would require only "appropriate" notice and an "appropriate opportunity" for a hearing, and the claim could be allowed without an actual hearing if the appropriate notice was given and no request for hearing was made.

In fact, the 501/502 procedure does provide appropriate notice and opportunity for hearing, under this standard, in the context of the type of administrative claim at issue here. The only party who would reasonably be required to receive notice of such a claim is the Chapter 7 trustee, who, pursuant to §704(5) of the Code, has the obligation of assuring that only proper claims are allowed. But precisely because the Chapter 7 trustee must review all proofs of claim in administering the case, the trustee is necessarily given appropriate notice of an unpaid Chapter 11 administrative claim if a proof of that claim is timely filed after conversion.

Other parties do not require individualized notice. The

interests of individual creditors of the estate are unlikely to be sufficiently effected by the allowance or disallowance of a particular claim to require that they receive individualized notice of the claim.[4] Nor is it necessary that the debtor receive notice. After conversion from Chapter 11, the debtor has no obligation for the administration of the estate, and would only be entitled to share in its distribution after all creditors were paid with interest. 11 U.S.C. §726(a)(6). Moreover, Fed. R. Bankr. P. 1019(5)(A) requires the debtor to list all unpaid debts incurred after the filing of the case and before conversion, and so the debtor's position as to the correct amount of any unpaid Chapter 11 administrative expenses should be of record. Finally, any party with a particular interest in any asserted unpaid administrative claims may obtain notice by reviewing the court records.

Just as the provisions of the 501/502 procedure satisfy the "notice" requirement of §503, so they satisfy the "hearing" requirement. The Chapter 7 trustee (and any other party in interest) may employ Fed. R. Bankr. P. 3007 to bring an objection to any proof of claim for an unpaid nonprofessional administrative expense incurred during the Chapter 11 case. Such

[4]Thus, creditors are not required to receive notice of objections to claims in the 501/502 procedure (as effectuated by Fed. R. Bankr. P. 3007), even though the hearing of such objections, pursuant to §502(b), is "after notice and hearing."

an objection is a request for hearing; if no such objection is made, the relief sought by the administrative claimant may be awarded without hearing, consistent with the requirements of §503(b).[5]

The remaining arguments of the Chapter 7 trustee can be dealt with briefly. The trustee asserts that the "notice and hearing" requirement of §503(b) implies that the court must specifically allow each administrative claim. There is no basis for this reading. Section 503(b) actually states that after notice and hearing, "there shall be allowed administrative expenses," without stating by what mechanism the allowance should take place. This lack of specification, as noted above, was deliberate, providing maximum discretion to the rule making process. That process may, in accord with the statutory language, provide for allowance of certain administrative claims by operation of law, without a court order.[6]

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[5]*In re Transouth Truck Equipment, Inc.*, 87 B.R. 937, 939-40 (Bankr. E.D. Tenn. 1988), in holding that an unpaid Chapter 11 administrative claimant must file a proof of claim after conversion of the case to Chapter 7, considered in dicta the question of whether a hearing would be necessary on all such claims, and concluded that it was not, for reasons similar to those discussed here. The *Transouth* dicta was approved in *United States v. Brandt (In re Lissner Corp.)*, 119 B.R. 143, 147 (N.D. Ill. 1990).

[6]The Chapter 7 trustee notes that under a former version of Fed. R. Bankr. P. 3009, the court was required to approve all distributions made by a Chapter 7 trustee. In the trustee's view, this judicial approval may have complied with the requirement of judicial allowance of administrative claims under

Similarly, the trustee argues that there is "no linguistic justification" for imposing notice and hearing requirements on professionals seeking fees and expenses different from the requirements imposed on nonprofessional administrative claimants. However, the Bankruptcy Code itself creates special procedures for professionals in §§330 and 331, and there is ample ground in bankruptcy policy for the distinction. The fees of bankruptcy professionals are necessarily outside the ordinary course of the debtor's business—but within the expertise of the court. In contrast, the nonprofessional costs of administration are likely to be incurred in the ordinary course of the debtor's business in Chapter 11. These nonprofessional expenses of administration could be paid by a debtor in possession or trustee, in Chapter 11, without court order, pursuant to §§363, 1106-08. *See In re Telesphere Communications, Inc.*, 148 B.R. 525, 530-31 (Bankr. N.D. Ill. 1992). Thus, after conversion to Chapter 7, it may well be that these administrative expenses should be able to be allowed with less judicial scrutiny than required for allowance of professional fees.

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§503(b). However, when Rule 3009 was amended in 1993 to remove the requirement of court approval for distribution—s*ee* Fed. R. Bank. P. 3009 advisory committee's note (1993), noting the deletion of judicial approval—the trustee asserts that another mechanism for judicial approval of administrative claims became necessary. This argument plainly depends on the notion that judicial approval of all administrative claims is required by §503(b). As pointed out above, there is no such requirement.

Finally, the Chapter 7 trustee makes an argument that the bankruptcy rules themselves acknowledge the need for judicial approval of Chapter 11 administrative claims unpaid at the time of a conversion to Chapter 7. Rule 1019(6), in directing the filing of proofs of claim by unpaid administrative creditors, makes reference only to Rules 3001(a) through (d), omitting Rule 3001(f). Rule 3001(f) provides that a proof of claim is prima facie evidence of the claim's validity. Omitting this subsection, the trustee asserts, indicates an intent that administrative claims enjoy no presumption of validity, and hence must be proved at a hearing. However, the presumption of validity set out in Rule 3001(f) only has the effect of requiring the party objecting to a claim to bear the burden of going forward with evidence at a hearing. *Collier on Bankruptcy* ¶ 3001.09[2] (15th ed. rev. 1996). It does not determine whether a hearing is necessary. By omitting this provision in the context of administrative claims in converted cases, Rule 1019(6) has the effect of requiring the claimant, rather than the objecting party, to bear the burden of going forward. In other respects, the 501/502 procedure remains entirely applicable, with no hearing required in the absence of an objection.

Conclusion

It would certainly be possible to effectuate §503 by requiring all administrative claims to be brought before the

court for approval prior to allowance. Indeed, an amendment to Fed. R. Bankr. P. 1019, currently proposed by the Supreme Court, may have that effect. *See* 67 U.S.L.W. 4259-60 (1999). However, the current language of Rule 1019, as interpreted by the Seventh Circuit, adopts a proof of claim procedure, in which judicial determination is required only after the filing of an objection. Nothing in the Bankruptcy Code prohibits this procedure. To the contrary, §503(b) indicates that the widest discretion was given to the rule makers to develop an appropriate procedure for the allowance and payment of administrative claims not involving professional services. Under the current rules, then, the filing of a proof of claim by the IDOR, without further action on its part, was sufficient to result in allowance of the claim. The Chapter 7 trustee's objection is therefore overruled. A separate order will be entered to that effect.

Dated: May 13, 1999

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Eugene R. Wedoff
United States Bankruptcy Judge