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"CONSECUTIVE" CHAPTER 11 FILINGS: USE OR ABUSE?

I. Introduction

A "consecutive" Chapter 11¹ petition means that a debtor's business has failed a second time. Twice a victim of cash short-falls or some other unforeseen contingency, the debtor returns to the sanctuary of the bankruptcy court unable to comply with the obligations established in a first reorganization plan.² For example, a debtor files for relief under Chapter 11 of the Bankruptcy Code ("Code").³ The bankruptcy court subsequently confirms the debtor's reorganization plan. After "substantial consummation,"⁴ the debtor defaults on the plan's financial obligations and the creditors take action to liquidate the debtor's assets. Rather than undergo liquidation under Chapter 7,⁵ the debtor halts creditors' efforts to foreclose on collateral a sec-

1. 11 U.S.C. §§ 1100-74 (1979). The Bankruptcy Code was enacted as the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978), on November 6, 1978, and most provisions became effective on October 1, 1979.

The Supreme Court held the Bankruptcy Reform Act to be unconstitutional in *Northern Pipeline Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). That case held that the Bankruptcy Reform Act conferred the judicial power of the United States upon judges who were appointed for only 14 years and who had no protection against a diminution in salary, in contravention of the constitutional requirement that judges exercising such power be appointed for life and that their salaries not be reduced. U.S. Const. art. III.

In response, many district courts adopted emergency rules under which Bankruptcy matters were referred by the district courts to bankruptcy judges for determination, subject to review by the district court. *See, e.g.*, Bankruptcy Rules for the Southern District of New York (McKinney's New York Rules of Court 1983).

The Code and related provisions were amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984). That Act amends 28 U.S.C. § 1334 (1988) to provide that the district courts have original and exclusive jurisdiction under title 11, the Bankruptcy Code. A new chapter 6 of title 28 of the United States Code is also created, providing for the appointment of bankruptcy judges, who are given authority to hear and determine certain proceedings under Chapter 11 upon reference by the district court, and subject to review by the district court. 28 U.S.C. §§ 157, 158. By vesting jurisdiction in the district courts and limiting the role of bankruptcy judge, the constitutional objection is obviated.

2. *See* Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKRUPTCY DEVELOPMENTS JOURNAL 1, 2-5 (1989).

3. Corporations in economic straits often seek refuge in Chapter 11 pursuant to 11 U.S.C. § 1101-74. *See* DOUGLAS G. BAIRD & THOMAS H. JACKSON, *CASES, PROBLEMS AND MATERIALS ON BANKRUPTCY* 947-56 (1990). The filing of a bankruptcy petition stops creditors from pursuing their claims. The debtor is given a breathing period to file a plan of reorganization which changes the capital structure of the firm. *Id.*

4. *See infra* note 97.

5. 11 U.S.C. § 701-66. *See* LAWRENCE KING, 4 COLLIER ON BANKRUPTCY, § 700.1 (1987). "Chapter 7 is the 'operative' chapter of the Bankruptcy Code which governs liqui-

ond time by filing a consecutive Chapter 11 petition. The filing of the second petition reimposes the automatic stay.⁶

The national average of confirmed plans over a five year period in the late 1980s remained relatively constant at 10 percent of Chapter 11 petitions filed.⁷ This low success rate creates a suspicion that a percentage of these petitions might have been found, on closer examination, to be candidates for dismissal as "bad faith" filings.⁸ Alternatively, conversion to Chapter 7 would have enabled creditors to avoid the costs of a second bankruptcy petition and to receive a higher fractional percentage on their claims.⁹ While further consuming an estate's assets, a consecutive petition can allow a debtor to change the creditor priorities established in a first case.

The problem for creditors is that a second bankruptcy results in a second petition date creating a second set of priorities.¹⁰ Generally, administrative priority claims arise from postpetition services, necessary to maintain a bankruptcy estate. To create an incentive for third parties to provide services and to participate in a bankruptcy reorganization, the Code provides that claims necessary to maintain an estate will be entitled to an administrative priority.¹¹ With a second petition, a first petition's administrative priority claims become unsecured

dation of a debtor. Liquidation is a form of relief afforded by the bankruptcy laws which involves the collection, liquidation, and distribution of the property of the debtor and culminates in the discharge of the liquidation debtor." *Id.* at 700-01.

6. *See In re Jones*, 105 B.R. 1007, 1012 (N.D. Ala. 1989) ("The main effect of a consecutive filing is to achieve a continuing reimposition of the automatic stay, thereby delaying the exercise of creditors' rights against their collateral. On occasion, serial filings attempt to circumvent the appeal process.").

7. Hon. Edith H. Jones, *The Good Faith Requirement in Bankruptcy*, 1988 ANN. SURVEY OF BANKR. LAW 45, 46.

8. *Id.* *See also* H. Miles Cohn, *Good Faith and the Single-Asset Debtor*, 62 AMERICAN BANKRUPTCY LAW JOURNAL 131 (1988). "Though seldom defined, 'good faith' was a prominent feature of all reorganization provisions of the Bankruptcy Act of 1898, which either by statute or by judicial interpretation required the debtor to act in good faith as a predicate for the filing of a petition and for the confirmation of a plan." *Id.*

9. *See* 11 U.S.C. §§ 507 & 503(b). Unsecured creditors are most likely to bear the cost of any bankruptcy proceeding. The cost of a debtor's attorney, committees, accountants, and all other entities that benefit a bankruptcy estate receive a first priority. Pursuant to § 507, all of their claims will be satisfied before prepetition unsecured claims. In addition to delay, a consecutive Chapter 11 brings a second round of priority expenses, further diminishing the assets available to satisfy unsecured claims.

10. 11 U.S.C. § 1141(d)(3)(b). A debtor's estate, consisting of all legal and equitable interests, is measured on the filing date. This filing date serves as the cleavage point in determining which creditors will be entitled to a priority claim.

Generally, unsecured claims arising before a petition receive no priority, while claims arising after the petition that are "actual and necessary expenses" of a bankruptcy estate, receive an administrative priority.

11. *See* 11 U.S.C. § 503(b)(1)(A).

because these claims arose prior to the second filing date and are not necessary to maintain the second estate.

In contrast to a consecutive Chapter 11, this problem does not arise where a reorganization fails and the court converts the case to Chapter 7. By providing for the "effect of conversion," the Bankruptcy Code protects a first petition's administrative priority claims by stating that the first petition date will serve as the only petition date and that conversion "[d]oes not effect a change in the date of the filing of the petition. . . ."¹² The absence of similar provisions governing creditor's rights in consecutive Chapter 11 petitions leaves a first petition's administrative priority creditors unprotected and may suggest that Congress never intended debtors to use a consecutive Chapter 11 as a liquidation mechanism. At least one commentator has criticized consecutive Chapter 11 filings and stated: "[d]espite the Seventh Circuit's holding, it is not clear that the Code by its terms permits serial filings."¹³

To date, a paucity of cases have dealt with consecutive Chapter 11 filings. In these cases, the courts have split as to whether consecutive filings constitute grounds for dismissal and have applied inconsistent filing standards.¹⁴ A recent surge in consecutive Chapter 11 cases suggests that the problem is growing. The threat of a geometric growth in the use of consecutive Chapter 11 petitions is apparent from the blossoming in the use of consecutive Chapter 13¹⁵ filings.¹⁶ In considering whether a debtor has filed a consecutive Chapter 13 petition in good faith, a number of courts have perceived consecutive Chapter 13 petitions to be an abuse of the bankruptcy system, upset-

12. See 11 U.S.C. § 348(a).

13. Benjamin Weintraub & Michael J. Cramos, *Defining Consummation, Effective Date Of Plan Of Reorganization And Retention Of Postconfirmation Jurisdiction: Suggested Amendments to Bankruptcy Code and Bankruptcy Rules* 64 AM. BANK. L.J. 245, 274 (1990).

14. *In re Casa Loma Assocs.*, 122 B.R. 814, 815 (Bankr. N.D. Ga. 1991). See, e.g., *In re Jartran*, 886 F.2d 859 (7th Cir. 1989); Official Committee of the Unsecured Creditors of White Farm Equipment Company v. United States, 20 B.C.D. 190 (N.D. Ill. 1990) (The cases permitted debtors to file consecutive Chapter 11 petitions.). But see *In re AT of Maine, Inc.*, 56 B.R. 55 (Bankr. D. Me. 1985); *In re Northampton Corp.*, 39 B.R. 955 (Bankr. E.D. Pa. 1984) (dismissing the debtors' consecutive "Chapter 11" petitions citing the good faith requirement in bankruptcy).

15. 11 U.S.C. §§ 1300-1330. LAWRENCE KING, 5 COLLIER ON BANKRUPTCY 1300-18, § 1300.02 (15th ed 1987). "Chapter 13 is designed to facilitate adjustments of the debts of individuals with regular income through extension and composition plans funded out of future income, under the protection of the court." *Id.*

16. A Lexis 1991 search produced over fifty cases that discuss consecutive filings in Chapter 13 bankruptcies.

ting the balance between debtors' and creditors' rights.¹⁷

The only circuit to address consecutive Chapter 11 filings was the Seventh Circuit in *Jartran, Inc.*¹⁸ This 1989 case took a liberal view towards consecutive filings that may have encouraged Chapter 11 debtors to utilize this novel tactic.¹⁹ This view departs from earlier precedent which may be interpreted as a per se holding that serial Chapter 11 petitions are not permitted.²⁰ While recognizing an inherent unfairness associated with consecutive filings, a third line of cases imposes a more restrictive good faith standard that permits consecutive Chapter 11 filings under limited circumstances.²¹

Courts recognize that consecutive filings necessitate repeated court appearances, involve lost time in foreclosing on collateral, result in lost interest, and threaten creditor priority positions. In light of these problems, this Note argues that bankruptcy courts should apply a good faith standard that imposes a higher level of scrutiny before permitting a debtor to proceed with a second filing and plan.²² Part II of this Note analyzes the good faith standards for consecutive Chapter 11 petitions established in different jurisdictions. Part III focuses on the threat consecutive petitions pose to the Bankruptcy Code's lease and executory contract provisions. Part IV analyzes how consecutive filings can undermine the Code's basic creditor protections. The Note concludes that courts should apply a rigorous good faith standard

17. See *In re Jones*, 105 B.R. 1007, 1012. (N.D. Ala. 1989) (The court contrasts Chapter 20's (7+13) with Chapter 26's (13+13), commenting that lawyers in some jurisdictions may now be guilty of malpractice if they do not employ the Chapter 20 device because the practice has become so common.)

18. *In re Jartran*, 886 F.2d 859 (7th Cir. 1989).

19. *Id.* at 860 (The Seventh Circuit perceived this tactic to be a novel approach for a corporate debtor. "In this case we are asked to determine the novel question of the propriety of serial Chapter 11 bankruptcy filings."). See also Official Comm. of the Unsecured Creditors of White Farm Equipment Co. v. United States, 20 B.C.D. 190 (N.D. Ill. 1990) (following the Seventh Circuit and becoming the second court to permit a consecutive filing).

20. See *In re Casa Loma Assocs.*, 122 B.R. 814, 818 (Bankr. N.D. Ga. 1991) (discussing *In re AT of Maine, Inc.*, 56 B.R. 55 (Bankr. D. Me. 1985); *In re Northampton Corp.*, 39 B.R. 955. (Bankr. E.D. Pa. 1984)).

21. See, e.g., *In re Casa Loma Assocs.*, 122 B.R. at 818; *In re Garsal Realty, Inc.*, 98 B.R. 140 (Bankr. N.D.N.Y. 1989).

22. The good faith issue will often be raised by the parties but the court may raise and act on the issue sua sponte. See *Little Creek Dev. Co. v. Commonwealth Mort. Corp.*, 779 F.2d 1068, 1071 n.1 (5th Cir. 1986) ("The parties agree that the bankruptcy court has the power to raise the issue of good faith sua sponte as an inquiry into its jurisdiction, and former Bankruptcy Act precedent in this circuit confirms their position."). See also *In re Metro. Realty Corp.*, 433 F.2d 676, 679 (5th Cir. 1970), cert. denied, 401 U.S. 1008 (1971); *S. Land Tile Corp. v. Mitchell*, 375 F.2d 874, 877 (5th Cir. 1967) ("As soon as the lack of good faith affirmatively appeared, the district court acted properly in dismissing the petition even though the plan stage had not been reached.").

consistent with recent decisions from the Northern Districts of Georgia²³ and New York.²⁴ As illustrated by these decisions, an extraordinary change of circumstance or a strong indication that a debtor has a realistic reorganization prospect represent the limited circumstances under which a second Chapter 11 should be permissible.

II. Background On Consecutive Chapter 11 Petitions

A. Bankruptcy's General Good Faith Requirement

Judge Edith H. Jones of the Fifth Circuit has described good faith as the "gatekeeper of the equity court."²⁵ As courts of equity, bankruptcy courts have the power to interfere with contracts, delay and reduce the payment of debts, prevent employees from receiving timely wages and benefits, defer compliance with environmental regulations, and have an adverse effect on consumer protection.²⁶ Because a bankruptcy court's door is open to anyone who satisfies the Code's definition of insolvency, "not generally paying his debts as they come due,"²⁷ the burden often falls on bankruptcy judges to uphold the integrity of the bankruptcy system by dismissing petitions filed in bad faith.

An unwarranted bankruptcy petition is not a victimless matter.²⁸ Bad faith cases crowd out good Title 11 cases by the often disproportionate amount of judicial attention that must be devoted to them.²⁹ One can speculate that a large number of bad faith cases will inevitably drive up the cost of credit transactions and disadvantage participants in the credit economy.³⁰

Since the Code's enactment in 1978, courts have employed various good faith requirements to prevent the maintenance of cases with no possibility of reorganization that were filed with the intent to delay and harass creditors.³¹ Although section 1129(a)(3) contains the only

23. *Casa Loma*, 122 B.R. at 818.

24. *Garsal*, 98 B.R. at 150.

25. Jones, *supra* note 7, at 45.

26. *Id.*

27. 11 U.S.C. § 101(31)(C)(i) defines insolvent as: "generally not paying debts as they come become due. . .".

28. Jones, *supra* note 7, at 45.

29. *Id.*

30. *Id.*

31. See, e.g., *In re Coastal Cable T.V., Inc.*, 709 F.2d 762, 764 (1st Cir. 1983); *In re Nite Lite Inns*, 17 B.R. 367, 370 (Bankr. S.D. Ca. 1982). Findings of lack of good faith in proceedings based on § 362(d) or 1112(b) have been predicated on certain recurring but non-exclusive patterns, and they are based on a conglomerate of factors rather than on any single datum.

explicit good faith requirement in Title 11, good faith issues surface throughout the Code including: challenges to a debtor's filing, the hurdle in creditors' motions for relief from stay, and good faith as prescribed by Rule 11 of the Federal Rules of Civil Procedure.³² In section 1129, good faith is a standard for plan confirmation. This standard is related, but not identical to, the "good faith" required in filing for bankruptcy relief.³³ Pursuant to this section, a court may not confirm a plan unless the debtor satisfies all elements of section 1129 including subsection (a)(3), that "the plan has been proposed in good faith."³⁴

In developing good faith standards, courts have emphasized different factors in determining whether a debtor has acted in bad faith. For example, the First and Seventh Circuits have articulated a test that questions whether a Chapter 11 plan is reasonably likely to achieve a result consistent with the objectives and purposes of the Code.³⁵

In *Madison Hotel Associates*,³⁶ the debtor, Madison Hotel Associates ("MHA"), asserted that the U.S. District Court for the Western District of Wisconsin (the "District Court") construed section 1129(a)(3)'s good faith requirement too narrowly. The Seventh Circuit agreed with the debtor and found that the District Court erred in its definition of good faith. The court held that under section 1129(a)(3), a court should look to the circumstances surrounding the debtor's plan and should review a proposed plan for accuracy and "a fundamental fairness in dealing with one's creditors."³⁷ The court noted that the bankruptcy judge is in the best position to assess the good faith of the parties' proposals and that, in this case, the judge had held three separate evidentiary hearings concerning the feasibility of MHA's plan. The Seventh Circuit found several additional facts relevant to its finding that the debtor proposed his plan in good faith.

32. Bankruptcy Rule 9011 makes Rule 11 applicable to bankruptcy proceedings. Pursuant to Rule 11, an attorney's signature represents that the pleading is well grounded in fact and warranted by law and that it is not motivated by an improper purpose; i.e. to harass or to cause unnecessary delay. See *In re French Gardens, Ltd.* 58 B.R. 959, 964 (Bankr. S.D. Tex. 1986) (Court found a filing to prevent foreclosure with no hope of reorganization to be abusive.).

33. See *In re Madison Hotel Assocs.*, 749 F.2d 410, 425 (7th Cir. 1984) (reversing the District Court for the Western District of Wisconsin for failing to make the legal distinction between the good faith that is required to confirm a plan under § 1129(a)(3) and the good faith that has been established as a prerequisite to filing a Chapter 11 petition for reorganization).

34. See 11 U.S.C. § 1129(a)(3).

35. See *In re Coastal Cable T.V., Inc.*, 709 F.2d 762, 765 (1st Cir.1983).

36. 749 F.2d 410, 425.

37. *Id.* (quoting *In re Rimgale*, 669 F.2d 426, 432-33 (7th Cir. 1982)).

These included findings that: the plan called for full payment of all creditors; all creditors, with one exception, affirmatively accepted the plan; and the plan would enable MHA to continue as a viable entity in accord with the purposes of Chapter 11.³⁸

While the Seventh Circuit's interpretation of section 1129(a)(3)'s good faith requirement focused on fairness to creditors, the First Circuit defined good faith as consistency with Chapter 11's objective of "resuscitating a financially troubled corporation."³⁹ Presumably, a debtor whose plan presents no reasonable likelihood of reorganization will not overcome this good faith hurdle. Decided under the old Bankruptcy Act, *Gonzalez Hernandez v. Borgos*⁴⁰ demonstrates a reorganization plan whose objective conflicted with sound reasons of public policy.⁴¹ Looking at all the circumstances, the First Circuit determined that Mr. Borgos' plan sought to place his assets beyond the reach of his dependent children. Citing the principles of good conscience, the court stated that a plan which disables a debtor from meeting obligations can hardly be regarded as having been proposed in good faith.⁴²

The Second Circuit formulated a different good faith standard by adding an "honesty and good intentions" prong to the requirement that a debtor have a "[b]asis for expecting that a reorganization can be effected."⁴³ As applied, this standard focuses on full disclosure and ulterior motives as basic issues to be considered under section 1129(a)(3).⁴⁴ In *Koelbl v. Glessing*,⁴⁵ the test included an inquiry into the debtor's conduct to ascertain any evidence of dishonesty and to determine whether the purpose in filing a Chapter 11 was to hinder or delay secured creditors.⁴⁶

38. *Id.*

39. *See, e.g.,* B.M. Brite v. Sun Country Dev., Inc., 764 F.2d 406, 408 (5th Cir. 1985); *In re Nite Lite Inns*, 17 B.R. 367, 370 (Bankr. S.D. Cal. 1982).

The Fifth Circuit has advocated a similar good faith standard. *See Jasik v. Conrad*, 727 F.2d 1379, 1383 (5th Cir. 1984) The Fifth Circuit stated that a reorganization plan must be "viewed in light of the totality of the circumstances" surrounding confirmation of the plan. The court's standard necessitates that a plan be "proposed with the legitimate and honest purpose to reorganize and present a reasonable hope of success," to satisfy § 1129(a)(3)'s good faith requirement. *Id.* at 1383. *See also* Public Finance Corp. v. Freeman, 712 F.2d 219, 221 (5th Cir. 1983).

40. 343 F.2d 802 (1st Cir. 1965).

41. *Id.* at 805.

42. *Id.* at 806.

43. *See* *Koelbl v. Glessing*, 751 F.2d 137, 139 (2nd Cir. 1984).

44. *Id.* *See also In re Weathersfeld Farms, Inc.*, 14 B.R. 572, 574 (Bankr. D. Vt. 1981) (Bankruptcy cannot be used to thwart foreclosure).

45. 751 F.2d at 137.

46. *Id.* at 139.

The policies behind the good faith requirement promote a balance of interests between debtor and creditor.⁴⁷ These policies are particularly important with consecutive bankruptcy filings, where the injury to creditors is likely to be more acute by virtue of having to live through the bankruptcy process twice. The Fifth Circuit has stated that non-debtor parties bear the burden of repeated court appearances, lost interest on capital, and the need to absorb a second round of administrative expenses—including the cost of debtor's counsel.⁴⁸ With consecutive Chapter 11 petitions, courts have proposed different levels of scrutiny in formulating their good faith definitions.

B. The Seventh Circuit's Liberal Good Faith Standard as Applied to Consecutive Filings

When a debtor proposes a consecutive Chapter 11 petition, two principal issues arise: (i) whether the debtor filed the consecutive plan in good faith and (ii) whether the consecutive plan can change the priority structure established in the first plan.⁴⁹ The Bankruptcy Courts for the Eastern District of Pennsylvania in *Northampton* and for the District of Maine in *AT of Maine* answered both questions negatively and dismissed consecutive Chapter 11 petitions.⁵⁰ In contrast, the Seventh Circuit answered both questions affirmatively.⁵¹

In becoming the first jurisdiction to permit a debtor to file a consecutive Chapter 11 petition, the Seventh Circuit in *Jartran* advocated a permissive good faith standard that appeared to fall short of the stricter general good faith analysis applied by other United States Courts of Appeal.⁵² As discussed in the previous section, good faith

47. In *Little Creek Dev. Co. v. Commonwealth Mortgage Corp.* 779 F.2d 1068, 1072 (5th Cir. 1986), the Fifth Circuit summarized these policies:

[g]ood faith prevents abuse of the bankruptcy process by debtors whose overriding motive is to delay creditors without benefitting them in any way or to achieve reprehensible purposes. Moreover, a good faith standard protects the jurisdictional integrity of the bankruptcy courts by rendering their powerful equitable weapons (i.e. avoidance of liens, discharge of debts, marshalling and turnover of assets) available only to those debtors and creditors with 'clean hands.'

Id.

48. *Id.*

49. Priorities in bankruptcy enable special types of unsecured creditors to receive payment before other classes of unsecured creditors. 11 U.S.C. § 507 specifies the kinds of claims that are entitled to administrative priority in distribution.

50. *AT of Maine*, 56 B.R. 55; *Northampton*, 39 B.R. 955. See *infra* notes 90-108 and accompanying text.

51. *In re Jartran*, 886 F.2d 859 (7th Cir. 1989); Official Comm. of the Unsecured Creditors of White Farm Equip. Co. v. United States, 20 B.C.D. 190 (N.D. Ill. 1990).

52. See *supra* notes 25-48 and accompanying text.

requires that a court scrutinize a debtor's honesty and motives, while considering whether the result is consistent with the Bankruptcy Code's policies and statutory scheme.

The *Jartran* case began with the 1981 bankruptcy of Jartran, Inc. ("Jartran"), a company that rented and leased trucks on a nationwide basis.⁵³ The court confirmed Jartran's fifth amended plan of reorganization on September 29, 1984 (*Jartran I*).⁵⁴ Approximately one and a half years later, the reorganized Jartran filed a second Chapter 11 petition, this time with the aim of liquidating rather than reorganizing the company (*Jartran II*).⁵⁵ Fruehauf Corporation ("Fruehauf"), a creditor under the original Chapter 11 plan, argued that this second Chapter 11 filing was improper and should be dismissed.⁵⁶ In the alternative, Fruehauf argued that if a second filing were permissible Fruehauf should retain its administrative priority⁵⁷ recognized by the debtor's original plan.⁵⁸

The bankruptcy court rejected Fruehauf's assertions⁵⁹ and the Seventh Circuit affirmed, emphasizing that the Bankruptcy Code contains no explicit limitation on consecutive Chapter 11 filings.⁶⁰ The court reasoned that "serial Chapter 11 filings are permissible under the Code if filed in good faith, as are liquidating Chapter 11 plans."⁶¹

53. *Jartran*, 886 F.2d at 861.

54. *See In re Jartran*, 71 B.R. 938, 939 (Bankr. N.D. Ill. 1987). Fruehauf's claim against Jartran totaled \$54,700,000 and was to be discharged through monthly payments from Jartran to Fruehauf of \$200,000 per month for 72 months plus a lump sum to be paid at confirmation. *Id.* at 939-40.

55. *Jartran*, 886 F.2d at 860-61.

56. *Id.* at 861.

57. *See* 11 U.S.C. § 503. *See also* *United Trucking Service v. Trailer Rental Co. (In re United Trucking Serv.)*, 851 F.2d 159, 19 C.B.C.2d 542 (6th Cir. 1988) The claim arose from the debtor's postpetition use of leased equipment allegedly in violation of the terms of the prepetition agreement. To qualify a claim as an administrative expense under § 503, the claim must arise after the bankruptcy filing from a service that benefits the bankruptcy estate. In contrast to a postpetition expense, claims that arise prepetition are treated as general unsecured claims rather than as an administrative expense. The claims' amount reflected the actual value conferred on the bankruptcy estate by reason of wrongful acts or breach of agreement.

See H.R. REP. NO. 95-595, 95th Cong., 1st Sess. at 355 (1977). The provision specifies the kinds of administrative expenses that are allowable in a case under the Bankruptcy Code. The section provides: "The actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case, and any taxes on, measured by, or withheld from such wages, salaries, or commissions, are allowable as administrative expenses." The subsection is derived mainly from § 64a(1) of the Bankruptcy Act. *Id.*

58. *Jartran*, 886 F.2d at 861.

59. *Jartran*, 71 B.R. 938 (Bankr. N.D. Ill. 1987).

60. *Jartran*, 886 F.2d at 867 (discussing the good faith requirement on all Chapter 11 filings).

61. *Id.*

Unlike section 109(g),⁶² which imposes a 180 day limit on the filing of consecutive Chapter 13 petitions, the Bankruptcy Code imposes no parallel temporal limitation on Chapter 11 filings.⁶³ In the absence of explicit limitations, the circuit court reasoned that Congress, had they wished, could have easily included a limitation on a Chapter 11 debtor's right to file a consecutive petition.⁶⁴

The *Jartran* court's conclusion that "it is equally clear that the provisions of the Code permit the arrangement at issue here" is not self-evident.⁶⁵ In fact, the court's general reference to the Bankruptcy Code and to the *Sinclair*⁶⁶ decision do not support its holding that consecutive petitions are permissible. Disagreeing with the Seventh Circuit's broad language advocating consecutive filings, one commentator has observed that: "The statement that serial Chapter 11 filings are permissible under the Code is not supported by any section of the Code. . ."⁶⁷ Similarly, the *Sinclair* decision appears to be erroneously cited by the Seventh Circuit. That decision did not involve consecutive Chapter 11 petitions and instead focused on how a court should proceed when the Code conflicts with its legislative history.⁶⁸

The fundamental concern to be addressed in a good faith analysis is that creditors be treated equitably and that the bankruptcy system's integrity be upheld.⁶⁹ Concluding that Congress did not intend to bar debtors from filing consecutive Chapter 11 petitions, the court in *Jartran* went on to discuss the good faith issue.⁷⁰ The Seventh Circuit defined "good faith" broadly to include filings even where they "circumvent protections generally afforded creditors under the Code's provisions for failed reorganizations."⁷¹ This enigmatic standard seems to contradict itself. In *Jartran*, the court permitted a consecutive filing to reduce the largest creditor's administrative claim and to circumvent a well established creditor protection. In spite of this result, the Seventh Circuit pronounced *Jartran*'s second plan to be "equitable," justifying it as a "good faith" admission that *Jartran* was unable to continue operating as a going concern.⁷² However, conver-

62. 11 U.S.C. § 109(g).

63. *Jartran*, 886 F.2d at 869-70.

64. *Id.* at 870.

65. *Id.* at 866.

66. 870 F.2d 1340 (7th Cir. 1989).

67. Weintraub & Cramers, *supra* note 13, at 273.

68. *In re Sinclair*, 870 F.2d at 1341.

69. *See supra* notes 25-48 and accompanying text.

70. *See* 11 U.S.C. § 1129(a)(3) (imposing a good faith requirement for confirmation of a Chapter 11 plan).

71. *Jartran*, 886 F.2d at 870.

72. *Jartran*, 886 F.2d at 868.

sion to Chapter 7 would have provided an equally viable means to liquidate Jartran that would not have circumvented this creditor protection.⁷³ A belief that conversion would raise a myriad of complex issues that would be "mind-boggling" motivated the court to opt for a new Chapter 11 rather than to convert the case.⁷⁴ However, the complexity relates to jurisdictional issues that could be cured by including a plan provision providing that the first court retain jurisdiction should the debtor default.⁷⁵

In 1989, a second case from the same jurisdiction followed *Jartran*.⁷⁶ The circumstances in this case of a failed reorganization and a consecutive filing that impaired a priority claim were strikingly similar to those in *Jartran*.⁷⁷ At stake in *White Farm Equipment Company v. United States*,⁷⁸ was an Internal Revenue Service ("IRS") priority tax claim that had been established in the first Chapter 11 filing.

In *White Farm*, the bankruptcy court confirmed the debtor's first amended reorganization plan in 1981.⁷⁹ A provision in the initial plan provided that all claims made by governmental units, including the IRS, would be completely satisfied in six years by equal annual installments.⁸⁰ After five years of sporadic plan payments, a creditor forced the debtor into bankruptcy by filing an involuntary Chapter 7. The bankruptcy court noted that "very little, if any, of the claim of the IRS for withholding taxes was paid subsequent to the reorganization."⁸¹ Protecting the IRS tax lien, the bankruptcy court found that its priority status survived a consecutive filing.⁸²

On appeal to the district court, the issue was whether the debtor's second Chapter 11 could alter the IRS's priority claim.⁸³ Relying on *Jartran*, the district court reversed the bankruptcy court and permitted the debtor to file a consecutive petition, diminishing the IRS's claim to general unsecured status.⁸⁴ Citing the *Jartran* decision, the court stated:

73. *Id.*

74. Weintraub & Cramers, *supra* note 13, at 275.

75. *Id.* (discussing the jurisdictional problems that arise when a debtor defaults on a substantially consummated plan).

76. *In re White Farm Equip. Co.*, 103 B.R. 177 (Bankr. N.D. Ill. 1989).

77. *Id.* at 178.

78. 111 B.R. 158 (N.D. Ill. 1990).

79. *Id.* at 159.

80. *Id.*

81. *Id.* at 160.

82. 103 B.R. 177, 180 (Bankr. N.D. Ill. 1989).

83. *White Farm*, 111 B.R. at 159.

84. *Id.* at 162.

The provisions of a confirmed plan bind all parties whose rights are affected by the plan. . . when, as here, substantial operations under a confirmed plan are followed by a second case, *the entity's unpaid liabilities under the first plan become general unsecured claims in the second case.*⁸⁵

The *White Farm* opinion broadened the definition of when a consecutive Chapter 11 petition is proper, as articulated in the *Jartran* case. While *Jartran* permitted a consecutive Chapter 11 petition for the limited purpose of liquidating a failed debtor,⁸⁶ the district court in *White Farm* placed no similar limitation on the use of consecutive Chapter 11 petitions.⁸⁷ In allowing a consecutive Chapter 11 petition to impair a priority claim,⁸⁸ the court's liberal good faith standard permits a consecutive Chapter 11 even where the result is unlikely to further the Congressional policy of creditor cooperation in bankruptcy reorganizations.⁸⁹

C. Jurisdictions Suggesting that Consecutive Petitions are Bad Faith Per Se

Two bankruptcy courts have advocated an opposing view that suggests that consecutive Chapter 11 petitions are bad faith per se.⁹⁰ While these courts do not purport to establish a per se rule, a subsequent opinion has stated these decisions could be interpreted as supporting the view that a consecutive Chapter 11 petition is bad faith per se.⁹¹

Applying a strict standard, the District of Maine's Bankruptcy Court rejected a debtor's attempt to file a consecutive Chapter 11 peti-

85. *Id.* (quoting *In re Jartran*, 76 B.R. 123, 125 (Bankr. N.D. Ill. 1987)).

86. *Jartran*, 886 F.2d 859, 870 (7th Cir. 1989).

87. *White Farm*, 111 B.R. 158 (N.D. Ill 1990) (permitting a consecutive chapter 11 petition with a goal of reorganizing rather than liquidating, suggesting that consecutive Chapter 11 filings are appropriate in a broader set of circumstances).

88. *Id.* at 160-61 (The court acknowledged that § 507(a)(7) entitled the I.R.S. to priority status in the first plan of reorganization. However, the court argued that the Bankruptcy Code intended to treat the individual debtor differently from the corporate debtor. Because § 523 states that tax obligations are excepted from discharge for individuals, the court reasoned that tax obligations must be dischargeable for non-individual debtors or § 523 becomes a nullity; "if the drafters thought that the I.R.S. would never lose its priority over an unpaid tax claim because of the provisions of § 507, then it would not be necessary, to prohibit discharge to individual debtors.").

89. *See infra* note 187.

90. *See In re AT of Maine, Inc.*, 56 B.R. 55, 58 (Bankr. D. Me. 1985); *In re Northampton Corp.*, 39 B.R. 955, 956 (Bankr. D.N.H. 1984) (These courts viewed a second Chapter 11 petition as fundamentally unfair to the unsecured and secured creditors. The inequity stemmed from the fact that the second plan altered creditors' rights established by a previously consummated plan of reorganization.).

91. *In re Casa Loma Assocs.*, 122 B.R. 814, 818 (Bankr. N.D. Ga. 1991).

tion.⁹² In *AT of Maine*, the debtor, AT of Maine, Inc., together with its affiliate, American Trawler Corporation, filed a voluntary Chapter 11 petition in 1981.⁹³ The court confirmed the debtor's consolidated reorganization plan in 1982.⁹⁴ The requirements of the confirmed plan included: the transfer of property between the consolidated corporations, the allowance of monthly claims, plus the payment of a sum of money to be distributed pro rata.⁹⁵ Subsequently, the debtor was unable to make payments on the first confirmed plan and attempted to file a consecutive petition in 1985.⁹⁶

The court's "good faith" definition focused on a perceived conflict between the consecutive petition and the language of the Bankruptcy Code. The court found that the debtor's first reorganization plan was "substantially consummated."⁹⁷ Citing the Bankruptcy Code's bar against modifying a substantially consummated plan, the court perceived AT of Maine's second plan to be a vehicle to modify and to avoid the obligations established by the first Chapter 11 plan.⁹⁸ Because a consecutive petition will inevitably modify a first petition's obligations, the court's ruling that AT of Maine's second Chapter 11 petition was not filed in good faith would appear to bar consecutive Chapter 11 petitions.⁹⁹

In *Northampton*,¹⁰⁰ the Bankruptcy Court for the Eastern District of Pennsylvania reached a similar result. The court found that the filing of the second petition was tantamount to modifying the previous plan after substantial consummation and reasoned that to hold otherwise would be to "allow (a) debtor to continuously circumvent the provisions of a confirmed plan by filing Chapter 11 petitions *ad infinitum*."¹⁰¹ In this case, the debtor filed a first Chapter 11 reorganization petition in 1981.¹⁰² The confirmed plan required the payment of

92. *AT of Maine*, 56 B.R. at 58.

93. *Id.* at 56.

94. *Id.*

95. *Id.*

96. *Id.*

97. 11 U.S.C. § 1101(2) defines "substantial consummation" as:

(A) transfer of all or substantially all of the property proposed by the plan to be transferred;

(B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and

(C) commencement of distribution under the plan.

98. *AT of Maine*, 56 B.R. at 58.

99. *Id.*

100. *In re Northampton*, 39 B.R. 955 (E.D. Pa. 1984).

101. *In re Northampton*, 37 B.R. 110, 112-13 (Bankr. E.D. Pa. 1984).

102. *Northampton*, 39 B.R. at 956.

a \$2,000,000 claim to Manufacturers Hanover ("Hanover") by April 28, 1983.¹⁰³ Hanover's claim arose from mortgage loans.¹⁰⁴ When the debtor failed to meet repayment deadlines, Hanover initiated foreclosure proceedings.¹⁰⁵ To stop the foreclosure, the debtor sought to reimpose the automatic stay by filing a second Chapter 11 petition.¹⁰⁶ The court concluded that the debtor was not acting in good faith¹⁰⁷ since he was "attempting to use the Chapter 11 proceeding predominantly for the purpose of affecting the claims of Hanover and other creditors which were unsuccessfully addressed in the confirmed plan in the prior Chapter 11 proceeding. . . ."¹⁰⁸

D. Jurisdictions Advocating a Middle Position by Applying a More Rigorous Good Faith Standard

While agreeing with *Jartran's* holding that consecutive petitions are permissible, a number of courts require additional justification for a debtor's second filing.¹⁰⁹ These courts have opted to limit consecutive filings to circumstances where a debtor has both acted in good faith and where the second petition results from "unforeseen or changed circumstances."¹¹⁰

For example, in *Garsal Realty, Inc.*,¹¹¹ the court discussed the standards under which a consecutive Chapter 11 filing would be permissible. The court advocated a rigorous facts and circumstances analysis "to ascertain a valid reorganization purpose consistent with a debtor's realit[ies]."¹¹² The case involved a sixty unit apartment complex encumbered by a \$1,382,388 mortgage.¹¹³ After filing for Chapter 11 relief and substantially consummating the first plan, the debtor defaulted and filed a second plan.¹¹⁴ The mortgagee sought relief from stay or alternatively to dismiss the second filing on the grounds that

103. *Id.*

104. *Id.*

105. *Id.*

106. See 11 U.S.C. § 362(a) (automatic stay enjoins creditors from removing property from a bankruptcy estate).

107. See *Northampton*, 39 B.R. at 956 (recognizing the two cases to be substantially similar. In both cases, the debtors sought to modify a previously confirmed Chapter 11 plan after confirmation).

108. *Id.* ("since we stated that these claims may not now be affected or modified by the current Chapter 11 case, we conclude that "cause" under § 1112(b) is present.").

109. See, e.g., *In re Casa Loma Assocs.*, 122 B.R. 814, 818 (Bankr. N.D. Ga. 1991); *In re Garsal Realty, Inc.*, 98 B.R. 140, 150 (Bankr. N.D.N.Y. 1989).

110. *Casa Loma*, 122 B.R. at 818.

111. *Garsal*, 98 B.R. 140.

112. *Id.* at 151.

113. *Id.* at 143.

114. *Id.* at 144.

the debtor had acted in bad faith.¹¹⁵

As a preliminary matter, the *Garsal* court noted that the debtor incurred most of the debts listed in the second petition after the first plan's substantial consummation date.¹¹⁶ While agreeing with the *Jartran* decision that a consecutive filing alone is not grounds for dismissal, the court required an additional test by mandating that a debtor undergo a "bona fide change in circumstances" to justify "multiple filings."¹¹⁷ In this case, the changed circumstances included an increased debt load, unforeseen levels of tenant vacancy sparked by a drop in interest rates which encouraged home buyers, and the closing of a nearby company that had provided a tenant source.¹¹⁸ Consistent with general good faith principles, the court stated that a good faith inquiry should focus on: "whether or not there was a pattern or strategy behind the filings to frustrate statutory requirements and abuse the bankruptcy process."¹¹⁹

This more rigorous good faith requirement was subsequently upheld by a second jurisdiction in a bankruptcy also involving an apartment complex owned by a partnership. In *Casa Loma Associates*,¹²⁰ a default in the first Chapter 11 plan precipitated a second filing. Following the *Garsal* opinion, the court elaborated on the changed circumstances that could "warrant a second filing."¹²¹ As a principle, the court stated: "relying merely on changed market conditions" is not enough to support a consecutive filing.¹²² However, in *Casa Loma*, an unanticipated change in federal law and the discovery of fire damage and structural defects, unknown at the time of consummation of the debtor's first plan, substantially affected the debtor's ability to perform under the plan.¹²³ Turning to the good faith issue, the court commented that the creditor had failed to demonstrate the factors necessary to support dismissal as a bad faith filing. In addition, the "[d]ebtor appear[ed] to have a reasonable prospect of successful reorganization."¹²⁴

The more rigorous good faith standard requires both that a debtor act in good faith and undergo an unanticipated change in circum-

115. *Id.* at 143.

116. *Id.* at 150.

117. *Id.*

118. *Id.*

119. *Id.*

120. *In re Casa Loma*, 122 B.R. 814 (Bankr. N.D. Ga. 1991).

121. *Id.* at 818.

122. *Id.*

123. *Id.* at 818-19.

124. *Id.* at 819.

stances. This stricter definition prevents a debtor from circumventing creditor protections and requires a compelling justification for subjecting creditors to the delay inherent in a consecutive bankruptcy.

III. Consecutive Chapter 11 Petitions Interfere With Bankruptcy Code Protections And Policies And Should Be Limited By A Narrow Good Faith Standard

A. The Impact of Consecutive Chapter 11 Petitions on Leases and Executory Contracts

A widely accepted definition of a corporation suggests that a corporation is little more than a nexus of contracts.¹²⁵ Naturally, contractual rights play a significant role in corporate reorganizations, particularly where a debtor's assets include long-term leases and supply contracts. A debtor's right to assume or reject executory contracts is a well-established debtor privilege. While debtors have a broad right to assume contracts, the burden of assumption is that a party to an assumed contract will be entitled to a priority should a debtor subsequently breach an assumed contract.

Consecutive Chapter 11 petitions threaten the Code's well-established treatment of leases and executory contracts by permitting a debtor to assume a lease while avoiding the burden of assumption. Unlike the *Garsal* court's standard, which questions whether a debtor has a "pattern" or "strategy" to frustrate statutory requirements, the *Jartran* decision fails to scrutinize whether the result is consistent with the Bankruptcy Code and whether the second petition is merely an attempt to avoid the burden that arose from the debtor's assumption of a contract in a first bankruptcy.

In *Jartran*, Fruehauf Corporation, a principal creditor, continued to lease equipment to Jartran in the period following Jartran's first Chapter 11 petition.¹²⁶ Fruehauf's original claim against Jartran arose from Jartran's breach of an assumed lease.¹²⁷ While Fruehauf's original claim would have been satisfied as a priority claim if the case had been converted to Chapter 7, the second Chapter 11 petition made the status of their claim an issue. The Seventh Circuit estab-

125. See, e.g., McChesney, *Contractarianism Without Contracts? Yet Another Critique of Eisenberg*, 90 COLUM. L. REV. 1332 (1990); Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989).

126. *In re Jartran*, 886 F.2d 859, 871 (7th Cir. 1989).

127. *Id.* See also 11 U.S.C. § 365 which permits a debtor to assume or to reject executory contracts and leases.

lished that an administrative priority in a first Chapter 11 petition did not guarantee similar priority treatment in a consecutive case.

To reach this result, the court treated the first and second Chapter 11 petitions as separate and independent cases¹²⁸ advocating a narrow reading of section 365(g)¹²⁹ and section 503.¹³⁰ "Proceeding" in section 365(g)(2) was read to exclude *Jartran II* and "estate" in section

128. *Jartran*, 886 F.2d at 871.

129. 11 U.S.C. § 365(g) states:

Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—

(2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, 12 or 13 of this title—

(A) if before such rejection the case has not yet been converted under §§ 1112, 1307, or 1208 of this title, at the time of such rejection; or

(B) if before such rejection the case has been converted under §§ 1112, 1307, or 1208 of this title—

(i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or

(ii) at the time of such rejection, if such contract or lease was assumed after such conversion.

§ 365(g) defines the time at which a rejection of an assumed contract or lease constitutes a breach. *See In re Multech*, 47 B.R. 747, 750 (section indicates that the act of assumption creates an administrative expense obligation of the particular proceeding in which the contract or lease was assumed). *See also Jartran*, 886 F.2d at 871. The Seventh Circuit defined "proceeding" narrowly to include a debtor's first petition but not a debtor's second petition. The court stated: "[w]e are now dealing with *Jartran II*, and the leases have not been assumed in this proceeding. Thus § 365(g)(2) is inapplicable on its face." 886 F.2d at 871. Because *Jartran* assumed Fruehauf's master lease in *Jartran I* rather than *Jartran II*, the Seventh Circuit concluded that the administrative priority relates to the first case and not to the second. *Id.*

130. 11 U.S.C. § 503 dictates that certain costs will be given a special priority as an administrative expense. Subsection (b) specifies the kinds of administrative expenses that are allowable in a case under the Bankruptcy Code. The subsection, with some changes, is derived mainly from § 64a(1) of the Bankruptcy Act. The actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered are allowable as administrative expenses. 11 U.S.C. § 503 (Historical and Revision Notes).

In a second statutory argument, Fruehauf claimed that the balance due on the *Jartran I* leases, the costs of repossessing equipment, and the balance due on defaulted payments for lost or stolen vehicles should be treated as administrative expenses. *Jartran*, 886 F.2d at 871. 11 U.S.C. § 503(b)(1)(A) "permits administrative expense claims for 'the actual, necessary costs and expenses of preserving the estate.'" *Id.* (quoting 11 U.S.C. § 503(b)(1)(A)). In rejecting this argument, the court drew the same distinction that it used to reject Fruehauf's § 365(g) argument. *Id.* Without looking at the factual claim of whether the costs were necessary or actual, the Seventh Circuit disposed of the argument stating: "None of these expenses were actual or necessary for preserving the estate in *Jartran II*, which was not yet extant." *Id.*

Fruehauf's final statutory argument again turned to 11 U.S.C. § 503. Fruehauf invoked this section to establish its entitlement to an administrative priority for its expenses incurred in marshalling and repossessing equipment since the filing of *Jartran II*. The Court rejected this claim asserting that expenditures "must benefit the estate as a whole

503(b)(1)(A) was read to exclude *Jartran II*. Therefore, Fruehauf could not claim an automatic administrative priority in the second case simply by pointing to the provisions of the original reorganization plan.¹³¹ Even the court appeared to acknowledge that its holding would produce the unfortunate consequence of denying creditors an important bankruptcy protection and stated that: "the Code clearly by its terms permits serial good faith Chapter 11 filings, even where the effect is to circumvent protections generally afforded creditors under the Code's provisions for failed reorganizations."¹³² The Seventh Circuit's result illustrates the conflict between consecutive Chapter 11 petitions and the Code's traditional treatment of executory contracts and leases that will be discussed in the following section.

B. The Historical Treatment of Assumed Leases

The Bankruptcy Code's treatment of unexpired leases and executory contracts¹³³ reflects a long history that can be traced back to provisions in the 1898 Bankruptcy Act.¹³⁴ History demonstrates a legislative and judicial tendency to extend broad protections to parties that contract with a debtor in the period following a debtor's peti-

rather than just the creditor claimant." *Id.* at 871. A lessor's act in repossessing vehicles is generally one of desperation to salvage collateral when a lessor defaults.

The Seventh Circuit characterized Fruehauf's repossession of its leased trailers from Jartran as a self-serving act. *Id.*

131. *Id.*

132. *Id.* at 870.

133. See 11 U.S.C. § 365 which governs unexpired leases and executory contracts in bankruptcy. This section gives a debtor the broad power to assume or to reject an executory contract or unexpired lease within 60 days of filing a bankruptcy petition and establishes a principal right for the debtor that is at the heart of bankruptcy reorganizations. The provision protects a debtor's vital business interests and enables a debtor to reap the benefits of prepetition contracts that are necessary for it to continue operating its business.

While affording the debtor the important right to assume executory contracts and leases, important creditor's rights flow directly from the debtor's decision to assume a contract. The Bankruptcy Code attaches great importance to a debtor's decision to assume an executory contract. The decision entitles the creditor to an administrative priority should the reorganization fail. As a result, the debtor must carefully decide which contracts will be assumed and which will be rejected. When an executory contract is not assumed by the time of confirmation of a plan or conversion of a case, the non-debtor party is treated as if it had a prepetition claim. A prepetition claim receives no administrative priority should the debtor's reorganization fail and the debtor liquidate.

134. 11 U.S.C. § 64(a) of the 1898 Bankruptcy Act provides:

The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of the bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration, including the actual and necessary costs and expense of preserving the estate subsequent to filing the petition.

tion.¹³⁵ Through administrative priorities designated in section 507, the Bankruptcy Code gives preferential treatment to specifically defined classes of creditors as a means of furthering important policies and creating desirable incentives. Priorities in bankruptcy enable one type of creditor to receive payment before other classes of creditors.

In *Jartran*, a creditor received a priority designation that was subsequently revoked within a year's time by the confirmation of the second plan.¹³⁶ *Jartran*'s second plan provided for the debtor's liquidation pursuant to a new Chapter 11 rather than conversion of the same case to Chapter 7. While a Chapter 11 plan may seek to liquidate a debtor's estate, a liquidating plan does not preserve jobs and economic resources, as a justification for reshuffling creditor priorities. *Jartran II*'s revocation of earlier priorities significantly diminished the value of a claim without reference to the "purposes" and "objectives" of the Code.

Section 64 of the Bankruptcy Act recognized a priority for the necessary costs and expenses of preserving the estate subsequent to filing the petition.¹³⁷ Courts interpreting the administrative expense provisions of the Bankruptcy Act of 1898 held that these provisions, which were very similar to those contained in the present Code, authorized the courts to treat as administrative expenses executory contracts entered into during a reorganization but before conversion to straight bankruptcy.¹³⁸ Under the old Bankruptcy Act, courts extended broad protections to entities that contracted with a debtor-in-possession.¹³⁹ The similarity this language bears to the present Bankruptcy Code demonstrates a Congressional interest in protecting parties to assumed executory contracts or leases, subsequently breached by a debtor.¹⁴⁰

This interest is evident from the Bankruptcy Code's evolution. Congress amended the Bankruptcy Act in 1967 to mandate that the

135. *In re Chugiak Boat Works*, 18 B.R. 292, 295 (Bankr. D. Alaska 1982).

136. *Jartran*, 886 F.2d 859.

137. *Id.*

138. *Chugiak*, 18 B.R. at 294.

139. *See In re Avorn Dress Co.*, 78 F.2d 681, 683 (2nd Cir. 1935) (The obligations arising from purchases and sales made by the debtor in possession in the ordinary course of business before conversion to straight bankruptcy constitute administrative expenses, with no need for prior court approvals of the transactions. Where a debtor is reorganizing, a commitment made that a service is necessary for a debtor's reorganization gives the provider of that service a priority claim under Sections 62 and 64 of the Bankruptcy Act.). *See also In re California Eastern Airways*, 95 F. Supp. 348, 351 (D. Del. 1951).

140. *Chugiak*, 18 B.R. at 295.

courts give assumed executory contracts an administrative priority.¹⁴¹ The 1967 amendment explicitly provided that any executory contract entered into or assumed during the reorganization proceeding but rejected after conversion to straight bankruptcy, constituted an administrative expense of the reorganization proceeding.¹⁴² The amendment and its legislative history reflect a Congressional intent to recognize the rights of parties "who have dealt with an officer of the court in the debtor relief proceeding."¹⁴³ By including an identical amendment in Chapters 10, 11, and 12 of the Act, Congress expanded this protection to creditors in all reorganizations.

In the present Bankruptcy Code, the first priority is for "administrative expense claims" allowed under section 503(b).¹⁴⁴ This provision is an integral part of the Code's solution to the problem of getting suppliers, customers, and others to continue to do business with a debtor in bankruptcy. An "administrative priority" creates a right for those whose claims arise during a bankruptcy proceeding to be paid before the general, unsecured creditors holding prepetition claims.¹⁴⁵

The Seventh Circuit's interpretation of section 365(g) is at odds with this historical evolution. The legislative history does not suggest that Congress sought to change the Code's view of administrative priorities for executory contracts from the view espoused by courts under the Act and the Act's 1967 amendment.¹⁴⁶ Section 365(g) of the Bankruptcy Code together with section 503(b) cover cases where prepetition and postpetition executory contracts are either assumed or rejected by a debtor.¹⁴⁷ Section 365(g) continues the practice under the Act of granting an automatic administrative expense priority to

141. *Id.* See also S. REPORT NO. 749, 90th Cong. 1st Sess., reprinted in 1967 S. Rep. U.S. Code Cong. & Admin. News, 2002, 2005.

142. Subsection (b) of the 1967 Amendment states:

Any contract which is entered into or assumed by a debtor in possession, receiver, or trustee in a proceeding under this chapter and which is executory in whole or in part at the time of the entry of an order directing that bankruptcy be proceeded with shall be deemed to be rejected unless expressly assumed within sixty days after the entry of such order or the qualification of the trustee in bankruptcy, whichever is the later, but the court may for cause shown extend or reduce the time. When a contract entered into or assumed in a superseded proceeding is rejected, the resulting liability shall constitute a cost of administration of the superseded proceeding.

Bankruptcy Act of 1964, Pub. L. No. 90-157, § 2(b), 81 Stat. 511, 513 (1967).

143. *Chugiak*, 18 B.R. at 295 quoting S. Report No. 749, 90th Cong. 1st Sess., reprinted in 1967 U.S.C.C.A.N. 2002, 2005.

144. 11 U.S.C. § 507(a)(1).

145. See BAIRD & JACKSON, *supra* note 3.

146. *Chugiak*, 18 B.R. at 295.

147. *Id.*

executory contracts assumed during a reorganization which are later rejected after conversion.¹⁴⁸ In addition to prepetition, "assumed" executory contracts, the provision applies to new contracts initially conceived during the debtor's reorganization that are approved by the bankruptcy court.¹⁴⁹ By placing a debtor's new contracts in the same category as a debtor's postpetition assumed contracts, the present Bankruptcy Code's protection to creditors extends even further than the 1898 Bankruptcy Act.

Commenting on the language of section 365(g), courts have concluded that an administrative priority arises automatically as a creditor protection.¹⁵⁰ By focusing on the debtor's act of assumption, the statute indicates that this protection is not permissive, but is obligatory. In permitting a debtor to file a second Chapter 11 petition, the Seventh Circuit introduces a new priority structure that usurps the priorities established in the first case. The Seventh Circuit's reading of the statute gives debtors an opportunity to revoke this administrative priority, making the protection permissive rather than automatic.¹⁵¹

The approach conflicts with important bankruptcy policies, evident from other courts' interpretations of section 365(g). The Bankruptcy Court for the Northern District of Alaska in *Chugiak Boat Works*¹⁵² faced a situation similar to *Jartran*. *Chugiak* involved an unsuccessful reorganization that led to the debtor's breaching of obligations that the court characterized as executory.¹⁵³

Chugiak Boat Works filed for Chapter 11 relief in 1980.¹⁵⁴ In the reorganization period prior to the case's conversion, a customer made a \$4,150 down-payment on a boat to be manufactured by the debtor in the ordinary course of its business.¹⁵⁵ The debtor later terminated its business operations and breached its contract with its customer.¹⁵⁶ After an unsuccessful attempt to reorganize, the case was converted to Chapter 7. The issue before the court was whether the obligation to return the deposit accepted by a debtor in the course of his reorganization constitutes an administrative expense in the Chapter 7

148. *Id.*

149. *Id.* at 296-97.

150. *Id.* at 295.

151. *In re Jartran*, 886 F.2d 859, 870 (7th Cir. 1989).

152. *Chugiak*, 18 B.R. at 292.

153. *Id.* at 293.

154. *Id.*

155. *Id.*

156. *Id.*

liquidation.¹⁵⁷

The court proceeded by tracing the history of section 365(g) back to the 1898 Bankruptcy Act and concluded that the overwhelming purpose of section 365(g) is to provide protection to creditors that have chosen to continue business relations with a reorganizing debtor.¹⁵⁸ "The history of the bankruptcy law's treatment of executory contracts, together with the provisions of the Code,¹⁵⁹ . . . compel the conclusion that the Court is authorized to treat such obligations as administrative expenses."¹⁶⁰ Many courts acknowledge the purpose of Chapter 11 as a means of preventing those liquidations that are avoidable, thus rehabilitating the debtor and ensuring more substantial satisfaction of creditors.¹⁶¹

In contrast to *Jartran*, the *Chugiak* court construed section 365(g) broadly to recognize the risks inherent in doing business with a reorganizing debtor.¹⁶² Protecting these entities with administrative priorities makes it palatable for a customer to make a deposit to a company coming out of bankruptcy.¹⁶³ As *Jartran* demonstrates, consecutive Chapter 11 petitions permit a debtor to treat a customer's deposit as a general unsecured claim against the estate. Such treatment would deter suppliers, landlords, and customers from committing resources to a debtor in a reorganization.

The bankruptcy court's policy arguments in *Chugiak* resemble those of Fruehauf's in *Jartran*: "[t]here would be little chance of attracting potential customers or creditors to deal with a financially troubled debtor if the performance of the debtor's obligations to those entities was not somehow assured."¹⁶⁴ After *Jartran*'s bankruptcy filing, Fruehauf placed large amounts of equipment essential to the carrying on of *Jartran*'s business at risk. Fruehauf asserted that the

157. *Id.* at 294.

158. *Id.*

159. See 11 U.S.C. §§ 365(g) and 363(c)(1).

160. *Chugiak*, 18 B.R. at 293.

161. *Id.* at 298. See also *In re Heatron, Inc.*, 6 B.R. 493, 496 (Bankr. W.D. Mo. 1980).

162. *Chugiak*, 18 B.R. at 298.

163. *Id.* "The policy of Congress of encouraging alternatives to liquidation bolsters this conclusion, since the protection of potential customers of a debtor in possession is necessary to foster a successful reorganization." *Id.* at 293.

164. *Id.* at 298. See also *In re Jartran*, 886 F.2d 859, 870. Fruehauf argued strenuously before the Seventh Circuit and the Bankruptcy Court that a successive Chapter 11 filing for the purpose of liquidation is unfair. *Id.* at 870. Fruehauf's policy argument asserted that successive filing for purposes of liquidation may discourage creditors from agreeing to Chapter 11 arrangements in the future since this outcome in many cases deprives creditors of protection in the event the arrangements failed. *Id.* The Seventh Circuit acknowledged these arguments but concluded that the framers of the Code had other policy concerns. *Id.*

assurance of an administrative priority, if Jartran's business reorganization failed, was the primary reason they continued to conduct business with Jartran.¹⁶⁵

In addition to protecting parties that contract with a reorganizing debtor, the Bankruptcy Court for the Northern District of Iowa provided an additional rationale for a broad reading of section 365(g).¹⁶⁶ In *Multech*,¹⁶⁷ the debtor, Multech Corporation ("Multech"), entered into a lease in October of 1975 involving industrial property.¹⁶⁸ The lease provided for a ten-year term running until November 30, 1985.¹⁶⁹ On January 11, 1982, Multech initiated Chapter 11 proceedings under the Bankruptcy Code.¹⁷⁰ Although Multech had fallen into arrears on its lease payments, the bankruptcy court permitted the debtor to assume the unexpired lease.¹⁷¹ Multech's reorganization ultimately failed and performance under the assumed lease was short-lived.¹⁷² Consequently, the bankruptcy court converted Multech's Chapter 11 proceedings to a Chapter 7 liquidation.¹⁷³

In analyzing the question of whether costs arising from the breached lease are entitled to an administrative priority, the *Multech* court's rationale and approach is diametrically opposed to *Jartran*'s use of a consecutive Chapter 11. In both cases, the reorganization failed and the remaining task for the debtor was to liquidate the estate's assets.¹⁷⁴ While *Jartran* allowed an administrative expense to be demoted by a second Chapter 11 petition, the court's language in *Multech* suggests that claims arising from leases and executory contracts may never be demoted. "[I]f a lease is assumed in Chapter 11

165. *Jartran*, 886 F.2d at 870.

166. See *In re Multech*, 47 B.R. 747 (Bankr. N.D. Iowa 1985). The court interpreted 11 U.S.C. § 365(g): "By defining the time at which a rejection of an assumed contract or lease constitutes a breach, section 365(g) clearly indicates that the act of assumption creates an administrative expense obligation of the particular proceedings in which the contract or lease was assumed." *Id.* at 750.

167. *Id.* at 749.

168. *Id.* at 748.

169. *Id.* at 749.

170. *Id.*

171. *Id.* 11 U.S.C. §§ 365(a) and (b)(1)(A) permit a debtor to assume a lease so long as the debtor can cure defaults and provide adequate protection of future lease payments. *Multech*'s granting the lessor a security interest and the inclusion of a "drop dead" provision, granting lessor immediate relief from the automatic stay, should the debtor default, were found to be adequate protection. *Id.*

172. *Id.*

173. *Id.*

174. *Id.* ("On August 17, 1982, Multech's Chapter 11 proceedings were converted to a Chapter 7 liquidation."). Compare *In re Jartran*, 886 F.2d 859, 861 ("On March 4, 1986, the reorganized Jartran filed a second Chapter 11 petition, this time with the aim of liquidating rather than reorganizing the company.").

proceedings, the liabilities flowing from the rejection of that lease will ever after be regarded as a Chapter 11 administrative expense."¹⁷⁵

The court defended this statement by analyzing how courts supervise the assumption of executory contracts and the significance of this supervision. The court recognized that the filing of a bankruptcy petition creates a new juridical entity that is separate and apart from the business entity that existed prior to bankruptcy proceedings.¹⁷⁶ Control is transferred to a distinct legal entity, usually the debtor-in-possession, that runs the business under the supervision of the court.¹⁷⁷ The *Multech* court looked at the mechanism by which an estate assumes an executory contract and argued that the act of assumption is a transaction with the debtor-in-possession. Therefore, the debtor-in-possession causes legally cognizable injuries and any claim arising from those actions is entitled to priority as an administrative expense.¹⁷⁸

The rationale behind this conclusion stems in part from the broad powers that exist as part of a debtor's business judgment.¹⁷⁹ These broad powers give the debtor-in-possession the discretion to reallocate assets, to borrow money and to enter obligations that will benefit the reorganization.¹⁸⁰ The *Multech* court stated that the assumption of an executory contract reflects the debtor's business judgment that some benefit will inure to the estate and thus to unsecured creditors from assuming this particular prepetition obligation.¹⁸¹

The basic conflict between the Seventh Circuit and *Multech* concerns who should bear the cost when a debtor's business judgment proves to be wrong. *Multech* provides a compelling rationale for preserving the administrative priority of a claim arising from the debtor's breach of an assumed executory contract.¹⁸² The court observed that permitting the expenses that flow from a breached lease to maintain a priority status harms unsecured creditors by the amount of the land-

175. *Id.* at 750.

176. *Id.*

177. *See In re Mammoth Mart, Inc.*, 536 F.2d 950, 954 (1st Cir. 1976).

178. *Multech*, 47 B.R. at 751.

179. *See* Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKR. DEV. J. 1, 11 (1989).

180. *Id.* " 'Business discretion' involves choices about the use of the existing assets and business operations of the Chapter 11 debtor, both during and after reorganization." *Id.* at 8. "Acting in the ordinary course, the debtor in possession can operate the business, sell, use or lease assets, and obtain additional financing. There is no judicial review unless a party in interest requests it." *Id.* at 12.

181. *Multech*, 47 B.R. at 751.

182. *Id.*

lord's claim.¹⁸³ However, the court concluded that the unsecured creditors rather than the lessor should bear the cost because the exercise of the debtor's business judgment is initially intended to benefit all creditors.¹⁸⁴

In *Jartran*, an analogous situation existed. Jartran's assumption of the lease was an exercise of the debtor's business judgement.¹⁸⁵ Persuaded by the debtor that this act would benefit the Jartran reorganization, the Bankruptcy Court for the Northern District of Illinois approved the assumption of the lease.¹⁸⁶ Fruehauf, the lessor, bore the risks of continuing to lease expensive equipment to a bankrupt entity presumably under the assumption that their claim would be satisfied before all other unsecured claims in the event Jartran's reorganization failed. The *Jartran* decision demonstrates how consecutive Chapter 11 petitions can allow a debtor to dispose of an administrative priority claim as a general unsecured claim in contravention of the policy of encouraging reorganizations.

The goal of Chapter 11 provides an important backdrop in determining whether a debtor has filed a Chapter 11 petition in good faith. In an often quoted section of its legislative history, Congress defined Chapter 11's goals as follows:

The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.¹⁸⁷

Because consecutive Chapter 11 petitions can compromise creditor interests¹⁸⁸ and can discourage creditors, like Fruehauf, from continu-

183. *Id.*

184. *Id.* at 752 (because an executory contract has been scrutinized by the court prior to assumption, the liabilities and expenses resulting from a subsequent rejection are automatically granted administrative expense priority that will not be subject to further limitation by 11 U.S.C. § 503).

185. See *Jartran*, 886 F.2d 859 (Where debtor in possession assumed lease after filing first bankruptcy petition).

186. *Jartran*, 71 B.R. 938, 940 (Bankr. N.D. Ill. 1987).

187. H.R. REP. NO. 95-595, 95th Cong., 2d Sess at 220-21 (1978), reprinted in 1978 U.S.C.A.N. 5963, 6179.

188. See *Jartran*, 886 F.2d at 870. "[A]lthough the framers of the code were concerned about protecting creditors, they had other policy concerns, including rationaliz[ing] the various forms of relief available to a failing business, making business reorganization a quicker, more efficient procedure, and providing greater protection, for debtors, creditors, and the public interest." *Id.*

ing to do business with a bankrupt entity, their use should be limited by a strict good faith standard. Permitting consecutive Chapter 11 petitions, especially where they circumvent Bankruptcy Code protections, cuts against the paramount Chapter 11 goal of encouraging creditor cooperation with debtor reorganizations.

IV. The Detrimental Effect Of Consecutive Filings On Creditor Protections

To protect creditors, the Bankruptcy Code establishes creditor remedies that should apply when a debtor defaults. It is expected that when reorganizations fail, liquidation will proceed either through conversion to Chapter 7¹⁸⁹ or through liquidation in the first Chapter 11.¹⁹⁰ By allowing a consecutive Chapter 11 petition, the Seventh Circuit in *Jartran* invented a different remedy.¹⁹¹ The heart of this new remedy involves allowing a debtor to file a second Chapter 11 petition and to confirm a second reorganization plan.

While innovative, the approach diminishes creditor protections provided in the Bankruptcy Code. The next section analyzes how consecutive Chapter 11 petitions circumvent section 1127's limitation on a debtor's ability to modify a plan and interfere with the expectation that, should a debtor default on plan obligations, liquidation will ensue through conversion to Chapter 7.¹⁹²

A. Consecutive Filings Upset the Limitations on a Debtor's Right to Modify a Confirmed Plan

While the Bankruptcy Code contains no explicit limitation on consecutive Chapter 11 petitions, the Code contains a rigid set of conditions that specify when a debtor can modify or revoke a plan.¹⁹³ The

189. 11 U.S.C. § 1112(b) permits conversion of Chapter 11 plans that cannot be effectuated to Chapter 7. 11 U.S.C. § 1141 governs the "Effect of Confirmation" of a plan of reorganization in a Chapter 11 bankruptcy. The provision binds all parties in a business reorganization to the obligations established by the plan.

In addition to binding the parties of a bankruptcy reorganization to the plan, 11 U.S.C. § 1141(d) discharges the reorganized debtor's prepetition liabilities. The effect of a confirmation is to discharge the entire pre-confirmation debt, replacing it with a new indebtedness as provided for in the confirmed plan. Upon confirmation, the debtor holds the property of the estate free and clear of the liens of creditors.

190. See, e.g., H.R. REP. NO. 95-595, 95th Cong., 1st Sess. at 349 (1977).

191. *Jartran*, 886 F.2d at 870. (asserting that the consolidation of Chapters X and XI (of the old Act) into Chapter 11 of the new Code, without any limitation as to consecutive filings, had as its aim a more rational, flexible method for permitting commercial debtors to continue in business while ensuring that similarly situated creditors were treated equitably).

192. See *In re Mushroom Transp. Co.*, 78 B.R. 754 (Bankr. E.D. Pa. 1987).

193. 11 U.S.C. § 1127.

Bankruptcy Code governs the modification of a confirmed plan through section 1127.¹⁹⁴ The most important limitation prescribed by this section establishes a threshold beyond which a "proponent"¹⁹⁵ will be barred from modifying a plan.¹⁹⁶ The right to modify a confirmed plan terminates when the plan is substantially consummated.¹⁹⁷ While defined in the Bankruptcy Code, substantial consummation is a bankruptcy term of art that courts define on a case-by-case basis.¹⁹⁸ To meet this requirement, some courts require that more than half rather than a mere preponderance of the plan must have been completed.¹⁹⁹ Other courts have defined substantial consummation as requiring completion of or near completion of transfers of property to or from the debtor at or near the time the plan is confirmed.²⁰⁰ To protect creditors, the possibility for altering a plan diminishes as the debtor moves closer to fulfilling the plan.

In addition to modification, the Bankruptcy Code provides another limited circumstance where a debtor may be able to revoke a confirmed plan.²⁰¹ Pursuant to section 1144, a debtor may revoke an order for relief in the event of fraud. The request must be made

194. 11 U.S.C. § 1127. The provision's subsections contain the following limitations: Subsection (a) allows only the proponent of a plan to modify its terms. Subsection (b) adds an important time restriction, barring proposals for modification after substantial consummation. Subsection (c) requires that the modification comply with the disclosure provisions of 11 U.S.C. § 1125.

The legislative history adds the caveat that if the modification is sufficiently minor, the court might determine that additional disclosure was not required under the circumstances.

The three subsections share the common requirement that modifications be consistent with 11 U.S.C. §§ 1122 and 1123 which govern the classification of claims and a plan's contents. Before this modification becomes part of the already confirmed plan, the Court must confirm the plan as modified and the circumstances must warrant the modification.

195. A plan's "proponent" may be either a debtor or a creditor. Creditors are free to propose reorganization plans after the debtor's 180 day exclusivity period, from the time of filing, expires. 11 U.S.C. § 1121(C)(3).

196. 11 U.S.C. § 1127(b).

197. *Id.*

198. *See, e.g., In re Hayball Trucking, Inc.*, 15 C.B.C.2d 1201 (Bankr. E.D. Mich. 1986).

199. *See In re Jorgensen*, 16 C.B.C.2d 157 (9th Cir., B.A.P., 1986).

200. *See United States v. Novak*, 20 C.B.C. 2d 131 (D.S.D. 1988).

201. The Bankruptcy Code provides that an order of confirmation may be revoked under certain circumstances:

On request of a party in interest at any time before 180 days after the date of the entry of the order of confirmation, and after notice and a hearing, the court may revoke such order if and only if such order was procured by fraud. An order under this section revoking an order of confirmation shall

(1) contain such provisions as are necessary to protect an entity acquiring rights in good faith reliance on the order of confirmation; and

(2) revoke the discharge of the debtor. 11 U.S.C. § 1144.

within 180 days after the date of entry.²⁰² The 1984 amendment to section 1144 changed the language to permit revocation "only" on the basis of fraud.²⁰³ The amendment and the case law interpreting this provision illustrate the narrow circumstances where bankruptcy courts permit revocation.²⁰⁴ These specific limitations in the Bankruptcy Code suggest that Congress was generally adverse to a debtor's efforts to alter a confirmed reorganization plan. Case law has construed the rights arising from a court's confirmation of a debtor's plan as binding, enabling creditors and parties to rely upon a plan's obligations.²⁰⁵

Consecutive Chapter 11 petitions should not provide a means to circumvent these rigid limitations on a debtor's right to modify a consummated plan. In *Jartran*, the debtor's consecutive filing diminished the value of Fruehauf's *Jartran I* claim by lowering it to that of a general unsecured creditor.²⁰⁶ This modification cannot be reconciled with the Code's definition of a permissible modification or revocation. Because the circuit court accepted the bankruptcy court's factual finding that the first plan had been substantially consummated,²⁰⁷ the Bankruptcy Code's limitation on modification would appear to apply. To escape this requirement, the Seventh Circuit drew a distinction that appeared to ignore the Code's explicit language, asserting that "*Jartran II* is not an attempt to modify the terms of the plan, but rather is a good faith admission that *Jartran* was unable to continue operating as a going concern."²⁰⁸ No provision in the Bankruptcy Code creates an exception for "good faith admissions" that modify a confirmed plan.²⁰⁹ Whether *Jartran II* was an "attempt to modify" Fruehauf's claim is irrelevant. Rather than focusing on the objective effect that flows from a debtor's action, the Seventh Circuit's standard for modification reads an analysis of a debtor's subjective intent into the Bankruptcy Code.

In seeking to distinguish *Northampton*²¹⁰ and *AT of Maine*,²¹¹ the

202. *Id.*

203. *Id.*

204. See *In re D.F.D. Inc.*, 43 B.R. 393 (Bankr. E.D. Pa. 1984). A creditor alleged that the debtor obtained an order of confirmation through fraud because of the debtor's knowing failure to list the creditor on its schedules. The court held that principles of equity precluded the creditor from having the confirmation revoked.

205. See *In re AT of Maine*, 56 B.R. 55, 57; *In re Northampton*, 39 B.R. 955, 956.

206. *Jartran*, 886 F.2d at 870.

207. *Id.* at 868.

208. *Id.*

209. 11 U.S.C. § 1127(b).

210. 39 B.R. 955 (Bankr. E.D. Pa. 1984).

211. 56 B.R. 55 (Bankr. D. Me. 1985).

Seventh Circuit asserted that Jartran did not have a conscious intent to alter the first plan's terms.²¹² This subjective reading suggests that the rights flowing from a confirmed plan are inferior to contractual rights. To enable parties to rely on a plan's provisions, the *AT of Maine* and *Northampton* courts invoked the Code's limitations on modification to reject the debtors' consecutive Chapter 11 petitions.²¹³

The *AT of Maine* court cited section 1127(b) for the proposition that: "[t]he proponent of a plan or the reorganized debtor may modify such plan at any time after confirmation of such plan and *before* substantial consummation of such plan."²¹⁴ Unlike the Seventh Circuit, the bankruptcy courts in the aforementioned cases perceived the debtor's attempt to file a consecutive plan as a *sub rosa* means to modify obligations established in a substantially consummated plan.²¹⁵ Consistent with the Bankruptcy Code's intent, these courts refused to allow debtors to alter creditors' rights established in a confirmed plan.²¹⁶ *AT of Maine* recognized that the debtor's only motive was to use the consecutive filing as a vehicle to protect the trust's sole beneficiary from the estates of two secured creditors: MNB and SBA.²¹⁷ Similarly, the *Northampton* court characterized the debtor's filing of a second Chapter 11 petition with an eye toward curing defaults arising under a previously confirmed Chapter 11 plan as akin to modifying the previous plan.²¹⁸

Emphasizing a creditor's right to take action when a debtor breaches a plan, *AT of Maine* and *Northampton* maintained that creditors may take whatever action they are entitled to against the property held by the trust as a result of nonpayment.²¹⁹ Because the consecutive Chapter 11 petition interfered with a creditor's remedy, the courts labelled the debtors' consecutive filings as bad faith.²²⁰ The Bankruptcy Code's limitations on modification and on revocation of a confirmed plan recognize the inconvenience or prejudice that creditors would suffer if a debtor had an unbridled right to modify plan obligations. By expanding the debtor's right to alter a confirmed plan,

212. *Jartran*, 886 F.2d at 867-68.

213. See *AT of Maine*, 56 B.R. at 57; *Northampton*, 39 B.R. at 956.

214. *AT of Maine*, 56 B.R. at 56.

215. *Id.* at 57. ("[C]ourt found that the filing of the second petition was tantamount to modifying the previous plan after substantial consummation in violation of 11 U.S.C. § 1127(b). . .").

216. See *AT of Maine*, 56 B.R. at 57; *Northampton*, 39 B.R. at 956.

217. *AT of Maine*, 56 B.R. at 58.

218. *Northampton*, 39 B.R. at 956.

219. See *AT of Maine*, 56 B.R. at 57.

220. *Id.* at 58.

the Seventh Circuit permitted a consecutive Chapter 11 to emasculate the Bankruptcy Code's explicit limitations on modification.

B. When Allowed, Consecutive Filings Prevent a Creditor's Remedy: Conversion to Chapter 7

Where a debtor defaults on plan obligations, the Bankruptcy Code gives the court authority to convert the reorganization to a liquidation under Chapter 7.²²¹ The threshold for converting a case is relatively low in terms of the degree of injury a creditor must sustain from a debtor's default. Case law suggests that a bankruptcy court need not give exhaustive reasons for its decision to convert, against a debtor's wishes.²²² In contrast to modification, conversion remains an alternative even after substantial consummation.²²³

Against this statutory scheme delineating specific rules for conversion in the wake of failed reorganizations, the Seventh Circuit denied Fruehauf the opportunity to convert *Jartran I* to Chapter 7.²²⁴ The distinction between the Seventh Circuit's liquidating Chapter 11 and conversion to Chapter 7 may seem insignificant because both accomplish the end of liquidation. However, section 726(a)(1) provides an essential protection for creditors with priority claims in a Chapter 7 liquidation.

This section dictates the order in which general distribution will occur in liquidation cases. After the trustee has reduced the estate's property to money, the property is first distributed among priority claimants as determined by section 507.²²⁵ Because Fruehauf's claim arose from an assumed lease (i.e. the agreement with Jartran), Fruehauf's claim would have been satisfied before those of the unsecured creditors had the Seventh Circuit followed the conventional route of

221. 11 U.S.C. §§ 1112(b)(6)(9) provides that a court may dismiss a bankruptcy case or convert a Chapter 11 case to a case under Chapter 7 after confirmation by reason of the following:

- (6) revocation of an order of confirmation under 11 U.S.C. § 1144 of this title, and denial of confirmation of another plan or a modified plan under § 1129 of this title;
- (7) inability to effectuate substantial consummation of a confirmed plan;
- (8) material default by the debtor with respect to a confirmed plan;
- (9) termination of a plan by reason of the occurrence of a condition specified in the plan.

222. See *Koerner v. Colonial Bank*, 800 F.2d 1358, 1368 (5th Cir. 1986) (Court found cause to convert simply in the debtor's inability to effectuate a plan and in unreasonable delay, deemed prejudicial to the creditors.).

223. See 11 U.S.C. § 1127.

224. *Jartran*, 886 F.2d at 867-68.

225. H.R. REP. NO. 95-595, 95th Cong., 1st Sess., 383 (1977).

converting to Chapter 7.²²⁶ The Seventh Circuit held this protection to be inapplicable in a Chapter 11 liquidation.²²⁷

In denying Fruehauf its administrative priority, the Seventh Circuit defended its position by asserting that Fruehauf should have bargained for greater protections.²²⁸ However, experts in the field have described the universe of possible alternatives as encompassed by conversion to Chapter 7 or liquidation within the same Chapter 11 proceeding.²²⁹ It is unreasonable to make a creditor negotiate for protections explicitly provided in the Code. The Seventh Circuit recognized that Fruehauf acted under the assumption that it was guaranteed an administrative priority should the plan fail, whatever form the liquidation would take.²³⁰ In addition, the court cited the greater costs of administering a Chapter 7 as a second justification for a liquidating, consecutive Chapter 11 petition.²³¹ Aside from the obvious cost of appointing a Chapter 7 trustee, the court does not specify what these costs would include and why they would exceed the cost of liquidating in Chapter 11.

Allowing a debtor to file a consecutive Chapter 11 petition sidesteps priority provisions explicitly provided in the Bankruptcy Code. It is not logical to conclude that Congress desired that the courts have specific guidelines in a Chapter 7 conversion and complete discretion to reestablish priorities in a consecutive Chapter 11 liquidation.²³² Congress' failure to include provisions to govern priorities in a Chapter 11 liquidation suggests that Congress never intended a debtor to use a consecutive Chapter 11 petition as a means to liquidate.²³³

226. *See, e.g., Chugiak*, 18 B.R. at 298 n.10 ("And in the case of businesses liquidating under Chapter 11, the policy basis is to provide for a controlled liquidation that will more likely maximize the amount to be paid on creditors' claims than would a liquidation under Chapter 7."). While courts advocate a liquidating Chapter 11 as a means to maximize the liquidation value of an estate through a protracted sale, the Seventh Circuit cites no authority for placing the burden on creditors with administrative claims.

227. The Code provides for the "[d]istribution of property of the estate" as follows:

(a) Except as provided in § 510 of this title, property of the estate shall be distributed—

(1) first, in payment of claims of the kind specified in, and in the order specified in, § 507 or this title. 11 U.S.C. § 726.

228. *Jartran*, 886 F.2d at 869.

229. *Id.* at 870 n.12.

230. *Id.*

231. *Id.* at 870.

232. *See* 11 U.S.C. § 726 (providing that in a case which has been converted to Chapter 7 proceedings, the Chapter 7 administrative expense claims have priority over any administrative expenses incurred prior to the conversion).

233. *See In re Northampton Corp.*, 39 B.R. 955, 956 (Bankr. E.D. Pa. 1984) (filing of second petition gives rise to an automatic stay under 11 U.S.C. § 362(a) which barred Hanover, the creditor, from further continuing with the foreclosure. A reimposition of

C. A More Rigorous Good Faith Standard Should Encompass Both a Good Faith and a Changed Circumstance Component

The good faith analysis has been criticized as one of the "most nebulous concepts in bankruptcy law. . ."²³⁴ Responding to this criticism, courts have delineated factors to analyze a debtor's use of two Chapter 11 petitions. While one standard cannot enumerate the countless circumstances that may constitute bad faith, one bankruptcy court has stated that the "real test" for good faith should mandate that a court consider "[t]he presence of honest intention of the debtor and some real need and real ability to effectuate the aim of the reorganization even if this involves the total liquidation of the assets."²³⁵

In addition to finding good faith, courts should predicate the propriety of a consecutive Chapter 11 upon a finding of significant and unanticipated changed circumstances. A number of equitable rationales support including a changed circumstance requirement. These rationales include: frustration that creditors experience in dealing with multiple filings,²³⁶ the nature of the automatic stay, a desire to prevent the relitigation of cases involving identical debtor and creditor issues, and the prevention of "end-run modifications" around substantially consummated plans.²³⁷

The inclusion of a changed circumstance requirement as a necessary condition for maintaining a consecutive Chapter 11 avoids the redundancy that can occur when identical parties return to the bankruptcy court after a debtor's default on a substantially consummated plan. Recognizing the repetitive nature of consecutive filings, the Bankruptcy Court for the Central District of California invoked a *res judicata* rationale to permit a creditor's foreclosure remedy on collateral whose ownership rights had been litigated in a prior Chapter 13 case.²³⁸ The debtor's first plan contained a prospective order giving the creditor an immediate right to foreclose should the debtor de-

the automatic would have inconvenienced creditors by requiring their reappearance in court).

234. *In re Garsal*, 98 B.R.140, 151 (Bankr. N.D.N.Y. 1989).

235. *In re North Redington Beach Associates, Ltd.*, 91 B.R. 166, 169 (Bankr. M.D. Fla. 1988).

236. *See In re Kinney*, 51 B.R. 840, 844 (Bankr. C.D. Cal. 1985); *In re Jones*, 105 B.R. 1007, 1014 (N.D. Ala. 1984) ("Jones did not wait 180 days. He waited only long enough for his lawyer to fill out a new petition. . .The patience of the creditor was exhausted, if not the patience of the trustee and of the judge.").

237. *Garsal*, 98 B.R. at 149.

238. *In re Abadul-Hasan*, 104 B.R. 263, 267 (Bankr. C.D. Cal. 1989).

fault.²³⁹ The bankruptcy court held the prospective order to be enforceable to protect a creditor in a second filing. The holding permitted Fireman's Fund to proceed with its foreclosure sale in spite of the second automatic stay. Commenting on the Bankruptcy Code's lack of explicit guidance regarding consecutive filings, the court stated:

[T]here is no way available to prevent multiple filings and their detrimental effect on creditors who have previously fully and fairly litigated the automatic stay issues. The "prospective order" does not interfere with the right of the debtor to file a bankruptcy, but does protect the creditor from multiple delays and removes the incentive of the debtor to act in an abusive manner.²⁴⁰ (footnote omitted).

Applying this *res judicata* rationale, the court justified extending the scope of the prospective order to protect a creditor in a consecutive case.²⁴¹

A second rationale for requiring a significant change in circumstances focuses on the nature of the automatic stay. The automatic stay comes into being without the debtor taking any action to prove that he is entitled to it.²⁴² Attaining bankruptcy relief involves only a few ministerial tasks, including the paying of a \$90 fee and filling out a petition.²⁴³ Once the debtor attains bankruptcy protection, courts are generally reluctant to give a creditor relief from the stay until it becomes clear that the creditor has suffered detriment and that the debtor has not been able to provide adequate protection.²⁴⁴ Consequently, the Bankruptcy Court for the Central District of California concluded that when a bankruptcy petition is filed, all of the presumptions weigh in favor of the debtor.²⁴⁵ Arguing that a debtor should be entitled to only one presumption, not a series of new ones at the cost of \$90 each,²⁴⁶ courts have justified the dismissal of a debtor's consecutive Chapter 13 petition.²⁴⁷

Finally, the nature of the "bona fide" change in circumstances required by two recent consecutive Chapter 11 decisions illustrates an

239. *Id.*

240. *Id.*

241. *Id.* ("There is nothing so sacrosanct about the automatic stay that it should not be subject to the *res judicata* effect given to other types of litigation.")

242. *In re Jones*, 105 B.R. 1007, 1013 (N.D. Ala. 1989).

243. *Abadul-Hasan*, 104 B.R. at 267.

244. *Jones*, 105 B.R. at 1013.

245. 104 B.R. at 268.

246. *Id.*

247. *Id.*

intent to strengthen the good faith standard. In permitting a consecutive Chapter 11, both the *Garsal*²⁴⁸ and *Casa Loma*²⁴⁹ courts required that the change be unforeseen and involve factors beyond the debtor's control.²⁵⁰ A disadvantageous shift in federal law and loss precipitated by the closing of a nearby company satisfied these requirements.²⁵¹ In addition, these changes could not have been anticipated at the time of the debtor's petition and are distinguishable from a failure caused by mere "changed market conditions."²⁵² Rather than include changed circumstances as an element of the court's general good faith standard, the courts considered changed circumstances as a distinct prong in assessing the propriety of consecutive Chapter 11 filings.

V. Conclusion

The Bankruptcy Code contains no explicit limitation on a debtor's right to file consecutive Chapter 11 petitions. Interpretations of the Code's good faith standard have varied between the Seventh Circuit's liberal interpretation and the more rigorous analysis adopted in recent decisions. Recognizing the inconsistencies between the good faith interpretations, recent decisions support a consecutive Chapter 11 standard that includes a changed circumstances component as a separate test from the more general good faith considerations.

In support of a more stringent standard, this Note has argued that using consecutive Chapter 11 petitions in lieu of converting to Chapter 7 can deprive creditors of critical protections. By analyzing the evolution of the Bankruptcy Code's provisions for leases and assumed contracts, this Note demonstrates that consecutive Chapter 11 petitions produce results that appear inconsistent with the Code's objective of promoting reorganizations. As is clear from the recent growth in consecutive Chapter 11 filings, debtors will continue to be attracted to the maneuver as a means to alter plan obligations and delay creditors. In *Jartran*, the court's decision conflicted with the expectation that creditors who assist a debtor in its reorganization will receive protection should the reorganization fail. Under the first reorganization, Fruehauf's claim against Jartran, which exceeded \$54 million,²⁵³ had to be satisfied as an administrative priority claim before all other

248. *Garsal*, 98 B.R. at 150.

249. *Casa Loma*, 122 B.R. at 818.

250. *Garsal*, 98 B.R. at 150.

251. *Id.*

252. *Casa Loma*, 122 B.R. at 818.

253. *In re Jartran*, 71 B.R. 938, 940 (Bankr. N.D. Ill. 1987).

unsecured debt. The consecutive filing transformed the priority claim into general unsecured debt.

The *Jartran* decision was one of the major bankruptcy cases of the 1980's. In its wake, the decision has left significant ambiguity over whether courts should apply a liberal or rigorous good faith standard to consecutive filings. The result complicates the practitioner's dilemma regarding whether a third party should be advised to continue business relations and commit resources to a debtor in Chapter 11. Thus, the inclusion of a changed circumstance component will help to clarify the nebulous good faith standard and uphold the integrity of the Bankruptcy Code's priority system.

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