

Not intended for publication

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

IN RE

THE GREAT AMERICAN PYRAMID
JOINT VENTURE, ET AL,

CASE NO. 91-27955
CASE NO. 91-27956
CASE NO. 91-27957
CASE NO. 91-27958
CASE NO. 91-27959
CASE NO. 91-27960

Debtor.

CHAPTER 7

MEMORANDUM OPINION AND ORDER RE
TRUSTEE'S OBJECTION TO LATE CLAIMS

Three former employees of Island Management Authority, Inc., filed proofs of claims for unpaid wages after the bar date for filing proofs of claims had passed. As a result of their tardiness, the chapter 7 trustee objected to these claims and proposed to allow them as late-filed under 11 U.S.C. § 726(a)(3). Alleging that their late-filing was due to a lack of notice of the chapter 7 conversion, the creditors asserted that their claims should not only be allowed, but also be given priority in the distribution of the estate under 11 U.S.C. § 726(a)(2)(C).

The Court conducted a hearing on this matter on August 26, 1997, pursuant to FED. R. BANKR. P. 9014. This is a core proceeding. 28 U.S.C. § 157(b)(2). In accordance with FED. R. BANKR. P. 7052, the following shall serve as this Court's findings of facts and conclusions of law.

I. FINDINGS OF FACT

Danny Mansberg, Chuck Mattka, and Cheryl D. Mattka are all former employees of the debtor, Island Management Authority, Inc. ("Island").¹ Mansberg worked for Island from September 1989 through July 1991. The Mattkas worked from July 1989 through July 1991. None of these individuals received a payroll check from Island for the last three months of their employment.

¹ The present case is a consolidation of six separate cases: The Great American Pyramid Joint Venture, case no. 91-27955; Island Management Authority, Inc., case no. 91-27956; H.R.C. (Memphis), Inc. a.k.a. Hard Rock Cafe International (Memphis), Inc., case no. 91-27957; Pyramid Sponsorship Joint Venture, case no. 91-27958; Pyramid Operating Authority, Inc., a.k.a. Pyramid Arena Design Authority, Inc., case no. 91-27959; Pyramid Management Authority, Inc., case no. 91-27960.

On July 23, 1991, Island filed a chapter 11 bankruptcy petition in the Western District of Tennessee. Mansberg and the Mattkas were listed on the matrix for this case as creditors of the estate. On August 19, 1992, Island's case was converted to a chapter 7 liquidation. Although Mansberg and the Mattkas had been listed as creditors in the chapter 11 case, their names were omitted from the chapter 7 matrix. As a result, they did not receive notice of the conversion, nor did they receive notice of the December 29, 1992, bar date for filing proofs of claims in the chapter 7 case.

Upon reading an article concerning Island's bankruptcy in The Commercial Appeal in the spring of 1993, Mansberg and the Mattkas eventually learned of the conversion. Mansberg filed his proof of claim on March 16, 1993, for \$1679.58. Chuck Mattkka filed a proof of claim on April 13, 1993, for \$7269.24. Cheryl Mattkka filed her proof of claim on April 13, 1993, in the amount of \$3862.12. Based on their post-bar date filing, the chapter 7 trustee objected to these claims.

II. CONCLUSIONS OF LAW

Because the claims at issue in this case arose in 1991, the Court must look to the Bankruptcy Code as it stood prior to the 1994 amendments in analyzing these objections. As in many situations in which amendments to the Code are made, the outcome of this case is decidedly different than it would be if the same claims arose today.

In the chapter 7 setting, there are several bankruptcy rules and code provisions which work together to determine a creditor's position in the line of distribution of the bankruptcy estate. First and foremost, FED. R. BANKR. P. 3002 mandates that an unsecured creditor holding a claim against the debtor must file a proof of such claim with the court in order for it to be deemed allowed. Such proof must be filed in a chapter 7 case within ninety days of the first date set for the § 341 meeting of creditors. FED. R. BANKR. P. 3002(c).² Should a creditor fail to file his proof of claim within the ninety day proscription of rule 3002, his claim is treated as tardily filed.

Once a claim is filed, either on-time or tardily, the next relevant section which determines a creditor's place in the line of distribution is 11 U.S.C. § 726. This provision sets forth the order in which claims are to be paid in the chapter 7 arena. According to this section, there are three possible positions a creditor's claim may take. Section 726(a)(3) generally designates a creditor who tardily files a general nonpriority unsecured claim as low man on the totem pole. Such claims are paid after all others have been satisfied, with the exception of claims for fines, penalties or forfeitures incurred pre-petition or

² Section 501 of title 11 gives creditors the right and power to file proofs of claims in all bankruptcy cases. 11 U.S.C. § 501.

claims for post-petition interest. 11 U.S.C. § 726(a)(3), (4), (5). Section 726(a)(2)(C) allows a nonpriority general unsecured creditor who tardily files his proof of claim to be given a higher priority, however, if the creditor failed to timely file because he did not have “notice or actual knowledge of the case in time for timely filing a proof of such claim . . .” 11 U.S.C. § 726(a)(2)(C)(I). If such notice or actual knowledge is found to be lacking, a claim which is tardily filed is elevated to second-in-line for payment along with all other general nonpriority unsecured claims. 11 U.S.C. § 726(a)(2)(C). The highest position a creditor’s unsecured claim may take is found in § 726(a)(1). This section directs that unsecured claims which qualify for priority under 11 U.S.C. § 507 are to be paid before all others. 11 U.S.C. § 726(a)(1).

Within the statutory language itself, § 726(a)(1) makes no distinction between priority claims which are timely filed and those which are not. In the case of United States v. Cardinal Mine Supply, Inc., the Sixth Circuit held that claims which qualify for priority under § 507, but which are tardily filed will be allowed to be paid under § 726(a)(1) so long as the reason for the tardy filing was a lack of notice or actual knowledge of the bankruptcy case. Id., 916 F.2d 1087, 1092. The Sixth Circuit has continued to adhere to this position regarding priority claims. See Internal Revenue Service v. Century Boat Co. (In re Century Boat Co.), 986 F.2d 154 (6th Cir. 1993).

The phrase “notice or actual knowledge” is one which the bankruptcy courts around the nation have had the task of interpreting. In the majority of cases which have addressed the issue, the courts have held that the requirement of “notice or actual knowledge” is one which necessarily implicates due process considerations. United States v. Cardinal Mine Supply, Inc., 916 F.2d 1087 (6th Cir. 1990); Spring Valley Farms, Inc. v. Crow (In re Spring Valley Farms, Inc.), 863 F.2d 832 (11th Cir. 1989). Before a creditor is deprived of his property rights, i.e. a claim, he must receive notice of the need to file proof of his claim and an opportunity to be heard. Cardinal Mine Supply, Inc., 916 F.2d at 1091.

It is true that in the case at bar Mansberg and the Mattkas received notice of Island’s chapter 11 filing. At that stage in Island’s bankruptcy, however, there was no need for these creditors to file proofs of claims. See 11 U.S.C. § 1111(a). It was not until the case was converted to a chapter 7 liquidation that a need for such filing arose. Because Mansberg and the Mattkas were omitted from both the original and amended chapter 7 matrices, they never received notice of either the conversion or the bar date for claims. Having received notice of such things would surely have put them on notice of the need to file proofs of claim or the bar date for doing so.

To the best of this Court's knowledge, no Sixth Circuit case has addressed the issue of whether notice of the chapter 11 case is sufficient to give a creditor "notice or actual knowledge" under § 726 once a case is converted. In Cardinal Mine Supply, the Sixth Circuit granted priority status to a claim by the IRS which was not listed as a creditor on the debtor's chapter 7 matrix. In that instance, however, there was no conversion from chapter 11. Id. at 1087. Not surprisingly, this total lack of notice was found to satisfy the "no notice or actual knowledge" requirement of § 726. Id.

Despite this lack of binding Sixth Circuit caselaw, there exists very persuasive authority for finding that notice of the chapter 11 case does not qualify as "notice or actual knowledge" of the chapter 7. In the case of In re Corporacion de Servicios Medico-Hospitalarios de Fajardo, Inc., 149 B.R. 746 (Bankr. D.P.R. 1993), several creditors, who did not have notice of either the chapter 11 case or the chapter 7 conversion, filed late claims. The trustee objected and the court allowed the claims under 11 U.S.C. § 726(a)(2)(C). Id. at 751. In so holding, the court stated:

Even had these creditors been aware of the prior chapter 11 bankruptcy case, we do not believe this satisfies the "notice or actual knowledge of the case" language contained in § 726(a)(2)(C). The only logical interpretation of that sentence is to read the term "case" as referring to the chapter 7 bankruptcy case, and not to the prior chapter 11 case. We reject the Trustee's argument that once a creditor has any knowledge that a debtor is in bankruptcy, no matter how long, or under which chapter, that it thereupon assumes the continuing obligation to monitor the case throughout its lifetime, in the event a conversion results. In our view, this would place an unreasonable burden on creditors, who are not receiving notices, to constantly inquire of the court about possible bar dates.

Id. at 750-51. This reasoning appears to be the soundest available to address situations like the one in the case at bar. As a result, this Court finds that Mansberg and the Mattkas did not have "notice or actual knowledge" sufficient to alert them of the need to file a proof of claim. Their claims will be allowed under § 726(a)(1) and (2) as late-filed without "notice or actual knowledge." Accordingly, they will not be relegated to the parameters of § 726(a)(3).

Because a portion of the claims at issue in the case at bar qualify for priority status under § 507, parts of Mansberg's and the Mattkas' claims will be paid as priority unsecured claims pursuant to § 726(a)(1). *See* 11 U.S.C. § 507(a)(3). Section 507 limits the amount of unpaid wages which may be paid as a priority claim to \$2,000.00 per claimant. As a result, Mansberg's entire claim for \$1679.58 will be paid as a priority claim under § 726(a)(1). Because their claims are larger, only \$2,000 of Chuck Mattkas' and \$2,000 of Cheryl Mattkas' claims will be paid under § 726(a)(1). The remainder of both

claims will be classified and paid under § 726(a)(2)(C). Judgment consistent with this opinion will be entered accordingly.

III. ORDER

It is therefore **ORDERED** that:

1. Danny Mansberg shall have a priority claim of \$1679.58 for unpaid wages pursuant to 11 U.S.C. § 726(a)(2)(C)(i);
2. Chuck Mattka shall have a priority claim of \$2,000.00 for unpaid wages and a general unsecured claim for the remainder of his unpaid wages pursuant to 11 U.S.C. § 726(a)(2)(C)(i);
3. Cheryl D. Mattka shall have a priority claim of \$2,000.00 for unpaid wages and a general unsecured claim for the remainder of her unpaid wages pursuant to 11 U.S.C. § 726(a)(2)(C)(i).

IT IS SO ORDERED.

BY THE COURT,

**G. Harvey Boswell
United States Bankruptcy Judge**

Date: September 17, 1997