UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re: BKY 4-92-6279

CRAIG A. OBERLANDER, MEMORANDUM ORDER

Debtor.

At Minneapolis, Minnesota, January 21, 1994.

The above-entitled matter came on for hearing before the undersigned on the 5th day of January, 1993, on the motion of Americana Bank, Fidelity State Bank of Hector, Valley National Bank of North Mankato, Sargent County Bank, First State Bank of Miller, First State Bank of Murdock, St. Anthony Park State Bank, and Peoples State Bank ("Participant Banks") for payment of an unsecured claim. Appearances were as follows: David Van House for the Participant Banks; James Ramette as and for the trustee ("trustee"); Christopher Elliott for the debtor Craig Oberlander ("Debtor"); Gary Pihlstrom for Central Bank; and Jim Michels for Park National Bank.

FACTS

1. In 1989, Miller & Schroeder Investments Corp. ("Miller & Schroeder") made a loan to Uptown Village II in the amount of $1,900,000 ("the loan"). Debtor was a guarantor of the loan. Miller & Schroeder later sold the loan to the Participant Banks, but retained the servicing rights.

2. In 1991, the loan went into default and Miller & Schroeder, as the servicing agent, foreclosed on the mortgage securing the loan.

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3. Subsequently, Miller & Schroeder, on behalf of the Participant Banks, obtained a deficiency judgment ("Judgment") against Debtor. The Judgment was docketed on March 2, 1992 in the amount of $390,298.28.

4. On September 16, 1992, Debtor filed a petition for relief under chapter 7 of the Bankruptcy Code. In his schedules, Debtor listed Miller & Schroeder as a judgment creditor. Debtor did not list the Participant Banks as creditors.

5. The Notice of Filing originally sent out by the Clerk of Court stated that the case was a no-asset case. Miller & Schroeder got the original notice. The Participant Banks did not.

6. The First Meeting of Creditors was on October 19, 1992. Both Miller & Schroeder and counsel for the Participant Banks attended the meeting. Counsel for the Participant Banks had, at that point, confirmed the bankruptcy by reviewing the bankruptcy file at the Clerk of Court's office.

7. In January, 1993, the trustee determined that funds were available for distribution to unsecured creditors and thereby requested the Clerk of Court to notify the creditors, which it did by Notice dated January 21, 1993 ("Notice"). The Notice stated that the last day to timely file a proof of claim was April 21, 1993.

8. Miller & Schroeder was served with the Notice, but did not file a proof of claim. The Participant Banks were not on the service list and did not have notice of the last day to timely file a proof of claim.

9. On approximately June 30, 1993, Miller & Schroeder assigned its right and interest in the Judgment to the Participant Banks. By letter dated November 15, 1993, the Participant Banks notified the trustee of the unsecured claim they had against Debtor. Shortly thereafter, the trustee informed counsel for the Participant Banks that the date for timely filing a proof of claim had already expired.

10. On December 21, 1993, the Participant Banks filed a proof of claim ("Claim") setting forth the respective claims of each bank as a result of the assignment.

11. The trustee's Final Report Before Distribution ("Final Report") was certified by the United States Trustee, and the Clerk of Court mailed notice of the Final Report to all creditors on December 27, 1993. The Final Report does not allocate any of the estate's funds to any of the Participant Banks or to Miller & Schroeder. As of this hearing, the trustee had not made the final disbursements.

12. The Participant Banks now bring this motion seeking payment of the unsecured claim. According to the Participant Banks, they are entitled to distribution under § 726(a)(2)(C), which allows for second priority distribution if they did not have notice or actual knowledge of the case in order to timely file a proof of claim, and if they are able to receive payments from the final distribution.

13. The trustee objects, contending that the Participant Banks are precluded from distribution under § 726(a)(2)(C) since

they had notice of Debtor's bankruptcy before April 21, 1993. Essentially, the trustee maintains that § 726(a)(2)(C) only requires notice or knowledge of the case, as opposed to notice of the actual date to timely file a proof of claim. The trustee also asserts that the Participant Banks were not creditors of Debtor until Miller & Schroeder assigned the Judgment. Since the assignment was after April 21, 1993, the trustee contends that the Participant Banks did not have the right to receive notice of the date to timely file a proof of claim, and as such, they may not take advantage of § 726(a)(2)(C).

DISCUSSION

A. Timeliness

In a chapter 7 proceeding, a proof of claim "shall be filed within 90 days after the first date set for the meeting of creditors." Bankruptcy Rule 3002(c). Rule 3002(c) sets forth six exceptions to this rule. If a creditor cannot satisfy one of these exceptions, the court is precluded from enlarging the time period in which a creditor may timely file a proof of claim. See Bankruptcy Rule 9006(b)(1). Even if an exception exists, the court may enlarge the time "only to the extent and under the conditions stated." Bankruptcy Rule 9006(b)(3). Therefore, the court has no discretion to deem a late filed claim as timely filed. In re Rago, 149 B.R. 882, 884 (Bankr. N.D. Ill. 1992).

In the present case, an exception existed under Rule 3002(c)(5) since the trustee discovered that payment of dividends was possible. As a result, the date for timely filing a proof of

claim was April 21, 1993. Miller & Schroeder did not file a proof of claim. Further, the Participant Banks did not file the Claim until December 21, 1993. Clearly, the Claim was not timely filed.[1]

B. Allowance

Nonetheless, the fact that the claim is untimely does not mandate disallowance of the claim. Allowance of a claim is governed by § 502 which provides that a claim is deemed allowed unless an objection is made, and even if an objection is made, the claim is allowed unless it falls into one of eight categories. Tardily filed claims is not one of the categories. See In re Hausladen, 146 B.R. 557, 559-60 (Bankr. D. Minn. 1992); Lastra v. Blood Services Program of American Red Cross (In re Corporacion de Servicios Medico-Hospitalarios de Fajardo, Inc.), 149 B.R. 746, 749-50 (Bankr. D. Puerto Rico 1993); Rago, 149 B.R. at 885. Here, the Claim is allowed under § 502 since an objection has not been made.

C. Priority

The next issue is what priority of distribution the Claim is entitled to under § 727(a). As a general rule, in a chapter 7 case

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[1] Park National Bank argues that the Participant Banks should have first brought a motion to treat the Claim as timely filed under Bankruptcy Rule 9006(b)(1). In a chapter 7 case, this Court may not extend this deadline under the "excusable neglect" standard set forth in Rule 9006(b)(1) and Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. Partnership, 113 S. Ct. 1489 (1993). This standard only applies to chapter 11 cases. See In re De Vries Grain & Fertilizer, Inc., __ F.3d __, No. 93-1372, 1993 WL 530817 (7th Cir. Dec. 22, 1993); In re Carlin Inv. Co., 158 B.R. 690, 694 (Bankr. N.D. Ohio 1993); In re Jones, 154 B.R. 816, 818 (Bankr. M.D. Ga. 1993); National Bank of Canada v. Chadderdon (In re Smartt Constr. Co.), 138 B.R. 269, 271 (Bankr. D. Colo. 1992).

a tardily filed but allowed general unsecured claim is entitled to distribution of property of the estate under either § 726(a)(2)(C) or (a)(3). In re Carlin Inv. Co., 158 B.R. 690, 693 (Bankr. N.D. Ohio 1993); Bucyrus Constr. Products, Inc. v. McGregor (In re Ray Brooks Machinery Co., Inc.), 113 B.R. 56, 60 (Bankr. M.D. Ala. 1989), aff'd, 898 F.2d 15, 15 (11th Cir. 1990).

1. Section 726(a)(2)(C)

The Code accords second priority status to a tardily filed proof of claim if "the creditor that holds such claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim . . . and proof of such claim is filed in time to permit payment of such claim." 11 U.S.C § 726(a)(2)(C).

In order for the Participant Banks' Claim to be entitled to this priority, the Participant Banks must establish three elements: (1) the Participant Banks are creditors that hold a tardily filed claim; (2) the Participant Banks did not have notice or actual knowledge of the case by April 21, 1993--the last day to timely file a proof of claim; and (3) the Claim was filed in time to permit payment of such claim. Because the trustee has not made distribution, the Participant Banks have satisfied the third element. They fail, however, to satisfy the other two. I will address each of these two elements separately.

a. "Creditors" holding a tardily filed claim

The Code defines a "creditor" as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor. 11 U.S.C. § 101(10)(A). A

"claim" is defined as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. 11 U.S.C. § 101(5)(A).

The Participant Banks were not creditors when Debtor filed his petition for relief. At that date, Miller & Schroeder was the only creditor holding a claim on the Judgment, for it was the only entity entitled to payment. Whatever rights the Participant Banks had to the claims against Debtor were wholly derivative of the claim of Miller & Schroeder. Therefore, only Miller & Schroeder was entitled to the notice of filing and to the notice that assets were available and only Miller & Schroeder could file a proof of claim.[2] See In re Ellington, 151 B.R. 90, 95 (Bankr. W.D. Tex. 1993) ("If one does not own a claim against the debtor, one may not file a claim against the debtor.").

b. Notice

For the Claim to have second priority distribution under § 726(a)(2)(C), the Participant Banks must have been a creditor without "notice or actual knowledge of the case in time for timely filing." This section assures due process to the creditor whose

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[2] This is of course subject to Bankruptcy Rules 3004 and 3005 which provide that the trustee or a guarantor, surety, indorser or other codebtor may, in certain circumstances, file a claim in the name of the creditor. For present purposes, however, only Miller & Schroeder could file a proof of claim vis-a-vis the Participant Banks.

This is not to say, however, that the Participant Banks could never become creditors and file proofs of claims. Rule 3001 contemplates the assignment of claims and sets forth a series of rules on how to effectively assign a claim.

late filing was not the result of a failure to act by the creditor. See Zidell, Inc. v. Forsch (In re Coastal Alaska Lines, Inc.), 920 F.2d 1428, 1431 (9th Cir. 1990); In re Columbia Ribbon & Carbon Mfg., Inc., 54 B.R. 714, 717 (Bankr. S.D. N.Y. 1985).

The Participant Banks focus on the term "notice" and insist that, under § 726(a)(2)(C), they must have been deprived of actual notice from the Clerk of Court indicating the last date to timely file a proof of claim. The trustee focuses on the term "knowledge" and asserts that, if a creditor has notice of or actual knowledge of the bankruptcy case before the date to timely file a proof of claim, the creditor is precluded from distribution under § 726(a)(2)(C).

Contrary to the Participant Banks' contention, § 726(a)(2)(C) requires only that the creditor have notice or actual knowledge of the case. Proof of either notice of the case or knowledge of the case precludes a creditor from receiving second priority distribution. Coastal Alaska Lines, 920 F.2d at 1433; Ray Brooks Machinery, 113 B.R. at 63.

Legislative history supports this conclusion. "Though it is in the interest of the estate to encourage timely filing, when tardy filing is not the result of a failure to act by the creditor, the normal subordination penalty should not apply." H.Rep. 95-595, 95th Cong. 1st Sess. at 383; see also Columbia Ribbon, 54 B.R. at 717.

In the present case, the tardy filing was due to the Participant Banks' failure to act. The Participant Banks had

actual knowledge of the case in time to arrange for the timely filing of a proof of claim by Miller & Schroeder since its counsel attended the First Meeting of Creditors. Admittedly, the trustee indicated that the case was a no-asset case, but this does not negate the fact that the Participant Banks had notice of the case, which is all that is required. The Participant Banks were interested parties. As such, they could have protected their rights by requesting notice pursuant to Bankruptcy Rule 2002(i), Rule 9010(b) and Local Rule 403. The Participant Banks did not do so. It is not the estate's duty to bear the burden of the Participant Banks' mistakes.

Finally, it would be wholly illogical to allow the Claim second priority status. Had Miller & Schroeder not assigned the claim, it would still be the holder of a tardily filed but allowed claim.[3] Miller & Schroeder would not, however, be entitled to priority under § 726(a)(2)(C) since it received the Notice indicating the last date to timely file a proof of claim. Yet, Miller & Schroeder did assign the claim and by virtue of this assignment, the Participant Banks argue that they should receive second priority distribution status. To allow this would be to accord greater rights to the assignee than to the assignor and encourage the assignments of claims for the purpose of curing defects in the claim.

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[3] This is assuming that Miller & Schroeder would have eventually filed a proof of claim.

2. Section 726(a)(3)

The Code grants a third priority distribution from the estate "in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title, other than a claim of the kind specified in paragraph (2)(C) of this subsection." 11 U.S.C. § 726(a)(3). The effect of this subsection is to accord a lower level of priority to late claims filed by creditors who did have timely notice of the case, as well as creditors who lacked timely notice or knowledge, but did not file their claims in time to permit payment. See Rago, 149 B.R. at 886. Since the Participant Banks are not entitled to distribution under § 726(a)(2)(C), they are entitled to distribution under § 726(a)(3).

CONCLUSION

The Participant Banks were not creditors of Debtor and they had actual knowledge of the bankruptcy case and could have protected their rights by arranging for the timely filing of a proof of claim.

ACCORDINGLY, IT IS HEREBY ORDERED THAT:

1. The Participant Banks' motion for payment of the unsecured claim pursuant to § 726(a)(2)(C) is DENIED;

2. The Participant Banks are entitled to payment of the unsecured claim under § 726(a)(3); and

3. The trustee's request for fees is DENIED

Nancy C. Dreher
United States Bankruptcy Judge