UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In Re:

JAMES J. FARNSWORTH, f/k/a Farnsworth Realtors, Inc., as sole shareholder of J. Farnsworth Realtors, Inc. d/b/a ERA Farnsworth Realtors and Farnsworth Construction Corp. and DIANE R. FARNSWORTH,

BK. NO. 89-20338

Debtors.

JAMES J. FARNSWORTH, and DIANE FARNSWORTH, as Debtors-In-Possession,

Plaintiffs, **AP. NO. 93-2056**

vs.

LOZIER, INC.,

Defendant.

BACKGROUND

On February 28, 1989, the Debtors, James J. Farnsworth and Diane R. Farnsworth, (the "Debtors") filed a petition initiating a Chapter 11 case. On their schedules, the Debtors listed Lozier Inc. ("Lozier") as an unsecured creditor with a claim in the amount of $17,000 against James J. Farnsworth only, for engineering services performed in 1987 and 1988. The schedules also indicated that Lozier held a collateral mortgage and that the claim was disputed.

On May 8, 1989 Lozier, by its attorney, filed a secured proof of claim in the amount of $21,986.30 (the "Lozier Claim"). The Lozier Claim stated that the consideration for the claim was a collateral security mortgage and that a judgment in connection with the mortgage had been obtained and filed in the Monroe County Clerk's Office on February 8, 1989 for the sum of

$21,986.30. No copies of a mortgage or judgment were attached to the Lozier claim.[1] The Court's file does not indicate that any preconfirmation objection to the Lozier Claim was ever filed with the Court pursuant to Rule 3007.

On April 12, 1990, the Debtors filed a motion for an order authorizing the Debtors to sell Lots 5, 6 and 8 of the McGowan Subdivision, which is located in the Town of Ogden, Monroe County. The proposed sale was on notice to all creditors including Lozier. On June 7, 1990, an order authorizing the proposed sale was entered which did not provide for a sale free and clear of liens. Although the pleadings in connection with the proposed sale do not discuss the claimed judgment lien of Lozier (in New York State a judgment filed in a County Clerk's Office results in a lien on all real property of the judgment debtor located in that county) and the Court's records do not indicate that Lozier appeared in connection with the motion, an agreement was apparently made between the Debtors and Lozier in connection with the completion of the sale since a submission made by Lozier in the pending adversary proceeding indicated that it released its judgment lien on the lots.

On May 14, 1990, the Debtors filed a Disclosure Statement and a Plan of Reorganization, each dated May 11, 1990. On June 4, 1990, the Debtors filed a Modified Plan of Reorganization (the "Modified Plan").

On June 29, 1990, the Debtors filed a Second Amended Disclosure Statement, dated June 27, 1990, which was mailed by the Court to all creditors, including Lozier, on July 12, 1990 along with the Modified Plan. The Second Amended Disclosure Statement referred to the Debtors' plan and advised the creditors that in the Modified Plan they were divided into only five classes. The first

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[1] Submissions made in the pending adversary proceeding indicated that the property covered by the collateral security mortgage was sold as part of a foreclosure proceeding brought by a prior mortgage holder.

four classes were described as consisting of Citibank (New York State), N.A., Dime Savings Bank, Fleet Mortgage Corp. and Willet Justice, Robert Peter and Gerald Teal, all secured creditors with mortgages on various remaining parcels of real property owned by the Debtors. The fifth class and only other class was described as consisting of general unsecured creditors. Article VII of the Second Amended Disclosure Statement, labelled Prospective Litigation, indicated that Lots 5, 6 and 8 of the McGowan Subdivision which were to be sold pursuant to the Plan for $75,000,

> are encumbered with a collateral security mortgage to Caledonia Lumber Co. in the amount of $14,086.00, and a judgment lien in favor of Lozier, Inc. in the amount of $21,986.00, which liens the Debtors consider voidable. Debtors shall proceed to void these liens to preserve the dividend to unsecured creditors. Debtors reserve their rights to dispute certain claims, including the claim of Lozier, Inc., in order to increase the dividend in an Allowed Claim.

On August 27, 1990, the Debtors filed a Third Amended Disclosure Statement, dated August 25, 1990. On September 11, 1990, an order was entered approving the Second Amended Disclosure Statement and setting a hearing on confirmation for October 15, 1990. On September 18, 1990, the Third Amended Disclosure Statement was mailed by the Court to all creditors, again including Lozier, along with an additional copy of the Modified Plan. Except for different financial information attached as exhibits, the Third Amended Disclosure Statement was identical to the Second Amended Disclosure Statement.

Article II of the Modified Plan separated the creditors of the Debtors into classes, the same four classes of secured creditors and one class of unsecured creditors described in the Second and Third Amended Disclosure Statements. Article X of the Modified Plan, entitled General Provisions, provided that, "the Court shall retain jurisdiction to insure that the purpose and intent of the Plan is carried out. The Court shall retain jurisdiction to hear and determine all claims against the Debtors and to enforce all causes of action which may exist on behalf of the Debtors." The Modified Plan also provided in Article X that, "Nothing herein contained shall prevent the

reorganized Debtors from taking such action as may be appropriate to the enforcement of any cause of action which may exist on behalf of the Debtors, which may not have been enforced and prosecuted by the Debtors." The Modified Plan further appeared to contemplate that objections to claims may continue to be prosecuted, even after confirmation of the plan, since it provided for the setting aside of a portion of the creditors fund created by the Plan pending final resolution of claim objections.

On October 10, 1990 Lozier filed a ballot accepting the Modified Plan. After a November 19, 1990 adjourned confirmation hearing, a December 12, 1990 Order of Confirmation and Discharge was entered.

On August 7, 1992, the Court issued an order directing the Debtors to file a final accounting and application for final decree on or before September 8, 1992. An accounting was filed on September 2, 1992. However, in response to the Court order requiring an application for a final decree, the attorney for the Debtors indicated that a final decree should not be entered at this time since there remained open issues as to the validity of certain claims and the voidability of a potentially preferred judgment lien.

On March 17, 1993, an adversary proceeding was commenced by the Debtors pursuant to the provisions of Section 547 and the terms of the confirmed Modified Plan to avoid the judgment lien of Lozier as preferential.

A Memorandum of Law submitted on behalf of Lozier states that the single issue before this Court is whether an avoidance action may be brought more than four years after the filing of a Chapter 11 petition when no trustee has been appointed and where the debtor's litigation rights were not reserved in the Disclosure Statement or the Confirmed Plan of Reorganization. Lozier asserts that the adversary proceeding commenced by the Debtors is time-barred by the provisions of Section

546(a),[2] since it was commenced more than two years after the appointment of a trustee within the meaning of Section 546(a)(1). Lozier makes the argument that since, pursuant to Section 1107, a debtor in possession has all of the rights, powers and duties powers of a trustee, it should be considered to be a trustee for the purposes of Section 546(a)(1). In addition, Lozier asserts that the Third Amended Disclosure Statement and the Modified Plan do not clearly reserve to the Debtors the right to bring the pending postconfirmation lien avoidance action and that pursuant to Section 1141 the Debtors are bound by the terms and provisions of the Modified Plan which does not provide them with such avoidance rights.

The Debtors assert that Section 546(a)(1) does not apply to a Chapter 11 debtor in possession; the avoidance action was commenced as permitted by Section 546(a)(2) before the Chapter 11 case had been closed; the confirmed Modified Plan at Article X clearly provided that the Debtors could enforce any cause of action which existed at the time of confirmation but which had not previously been enforced and prosecuted by the Debtors; and Lozier accepted the Modified Plan when it clearly treated Lozier as an unsecured creditor.

DISCUSSION

Courts are split on the question of whether Section 546(a)(1) applies to a debtor in possession in a Chapter 11 case. Most courts which have addressed this issue hold that debtors in possession

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[2] Section 546(a) provides that:

> An action or proceeding under Section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of–
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> (1) two years after the appointment of a trustee under section 702, 1104, 1163, 1302, or 1202 of this title; or
>
> (2) the time the case is closed or dismissed.

are not subject to the two-year statute of limitations that applies to trustees. *In re Pullman Construction,* 132 B.R. 359, 360 (Bankr. N.D.Ill. 1991). This Court agrees with the majority and holds that Section 546(a)(1) does not apply to a debtor in possession in a Chapter 11 case. *See In re Century Brass Products, Inc.*, 127 B.R. 720, 721 (Bankr. D.Conn. 1991); *In re Korvettes, Inc.*, 67 B.R. 730, 733 (Bankr. S.D.N.Y. 1986).

As correctly pointed out by Lozier, Section 1141 makes the provisions of a confirmed plan binding on all creditors and, except as otherwise provided in the plan or in the order confirming the plan, the property dealt with by the plan is free and clear of all claims and interests of creditors after confirmation of a plan. In this case, the Modified Plan provided for only four classes of secured creditors and a class of unsecured creditors. Lozier was not one of the enumerated secured creditors and therefore was clearly treated by the Plan as an unsecured creditor. Notwithstanding its prepetition judgment lien and filed secured proof of claim, where Lozier twice received copies of the confirmed Modified Plan and related Disclosure Statements which clearly treated it as an unsecured creditor, did not object to the treatment at the hearing to approve the Disclosure Statement or the hearings on confirmation and specifically accepted the Modified Plan in writing, it is bound by the terms of the confirmed Modified Plan and, in addition, must be deemed to have waived its lien and claim to a secured status.

Furthermore, the Court believes that the language contained in the Second and Third Amended Disclosure Statements and the Modified Plan, copies of which were forwarded to all creditors including Lozier on more than one occasion, notified Lozier that the Debtors considered its judgment lien to be avoidable and that the Debtors were reserving their right to litigate that issue should the parties not otherwise agree to the avoidability of the lien. Since January 3, 1992, the Court has heard a number of postconfirmation motions in Chapter 11 cases from which it has become clear that prior to that date many confirmed Chapter 11 plans, especially in cases where there

was not an active creditors committee, often contained: (1) exceptionally broad and often ambiguous and confusing provisions for the retention of jurisdiction by the Court; (2) confusing provisions with respect to available rights and remedies of creditors when a debtor defaults under the plan; and (3) open-ended provisions for the bringing of claim objections, avoidance actions or the completion of other matters which could have been completed, or at least commenced, before confirmation.

Such provisions have often resulted in considerable confusion. For example, although since January, 1992 this Court has consistently held that the automatic stay provided by Section 362 terminates upon confirmation of a Chapter 11 plan, creditors continue to file motions to lift the stay because of confusion with respect to their rights and remedies under such confirmed plans with broad and confusing retention of jurisdiction and default provisions. They have candidly advised the Court that they have elected to "be safe rather than sorry." As a result, in connection with the confirmation of Chapter 11 plans, this Court has and will continue to focus on retention of jurisdiction and default provisions to attempt to ensure that they are not overly broad, ambiguous and confusing. Also, this Court has and will continue to require that claim objections, avoidance actions and other litigation either be completed by the time of confirmation or that specific time frames for their commencement are set forth in the confirmed plan or in the confirmation order.

In addition, prior to January, 1992, final decrees were not entered in this Court in confirmed Chapter 11 cases until the plan was fully completed. It was the Court's change of policy, which is now to administratively close Chapter 11 cases within 90 days of confirmation if there has been substantial consummation, unless at the time of confirmation an extended period of time is requested and the detailed reasons for the extension are approved by the Court, which resulted in the notice to the Debtors to file their final accounting and decree in this case and the need to conclude the Lozier matter.

The Answer interposed by Lozier in the adversary proceeding raises the defense that the Debtors were solvent at the time its judgment lien attached. However, since the judgment lien attached within 90 days of the filing of the Chapter 11 petition, Section 547(f) provides for a presumption of insolvency. From the oral arguments, a pretrial before the Court, and the submissions made on behalf of Lozier, the Court believes that Lozier has withdrawn its insolvency defense, and the Court finds that the Debtors have met their burden of proof with respect to the remaining elements of Section 547. Therefore, the judgment lien of Lozier should be avoided as a preference.

CONCLUSION

The judgment lien of Lozier is avoided as preferential and the claim of Lozier otherwise found to be unsecured, since it was provided for as an unsecured claim in the confirmed Modified Plan which was accepted by Lozier in writing and is binding on Lozier pursuant to the provisions of Section 1141. Lozier is hereby directed to provide the Debtors with a release of its judgment lien on all real property owned by the Debtors in Monroe County and any other county where its February, 1989 judgment was docketed.

IT IS SO ORDERED.

/s/
HON. JOHN C. NINFO, II
U.S. BANKRUPTCY COURT JUDGE

Dated: August 16, 1993