

PROOFS OF CLAIM - A PITFALL



Our clients who are trade creditors seldom run into a problem in filing Proofs of Claim. If a creditor sells on open account and his customer files a bankruptcy petition, then the creditor may subsequently file a Proof of its unsecured balance, including any allowable interest or service charges due as of the petition date.

The creditor who has some collateral, but not enough to secure its entire claim, however, has a more difficult time filing a Proof of Claim. It is common to speak in terms of "secured creditors," or even "partially secured creditors," but this is really erroneous terminology.

A creditor who has collateral, but not enough collateral to cover the debtor's balance with the creditor, actually has two claims - one secured claim equal to the value of its collateral, and one unsecured claim for its remaining balance. It is a common practice to file both claims with the Court on one Proof of Claim form as a "partially secured claim."

The problem with this approach is that the holder of such a claim must timely notify a Chapter 7 trustee of the unsecured portion of its claim in order to share in the distribution of the estate's assets as an unsecured creditor.

A Chapter 7 trustee only distributes dividends from the estate to holders of unsecured claims. In a typical Chapter 7 scenario, a creditor with collateral files a secured proof of claim, or, more properly, a proof of a secured claim, and then moves to have the automated stay terminated so it can repossess its collateral and sell it. Upon sale of the collateral, however, this creditor is usually left with a deficiency claim. At that point, if there are assets available for distribution in the estate, the creditor should then file an Amended Proof of Claim reflecting the unsecured balance remaining. As an added precaution, the creditor should mail a copy of this Amended Proof of Claim to the Chapter 7 trustee.

In the recent case of *In Re: William A. and Teri Padgett*, a creditor used a standard Proof of Claim form and listed several items as security for its debtor's obligation. The standard form stated that the claim in question was a "general unsecured claim, except to the extent that the security, if any, described in paragraph 9 is sufficient to satisfy the claim." The trustee reviewed the claim, treated it as a secured claim, and the creditor therefore received no dividend.

The creditor in question moved for reconsideration of the trustee's final report excluding it from the distribution on the basis that the collateral for its loan was worthless and that it wanted its claim treated as an unsecured claim entitled to a dividend. The Bankruptcy Court held that the creditor must timely file an amended or supple-

mental Proof of Claim reflecting that the claim is unsecured in order to be treated an unsecured creditor by the trustee, and the creditor's motion was thus overruled.

The Court further stated that the proper time for the creditor to disagree with the trustee's position was prior to the entry of the order approving the final report. Since the creditor's Proof of Claim did not list values for its collateral, the Court ruled the trustee was justified in treating the claim as fully secured. Nothing in the standard form language of the Proof of Claim form overcame this fact. □

This publication is not a legal opinion of Greene & Cooper nor any partner thereof. You should consult with legal counsel prior to relying on any information contained herein.