
IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
CENTRAL DIVISION

In re:

CF&I FABRICATORS OF
OF UTAH, INC., et al,

Debtors.

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: Bankruptcy Number 90B-06721

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:
: [Chapter 11]

THE COLORADO & WYOMING
RAILWAY COMPANY,

Debtor.

:
:
: Bankruptcy Number 90B-06730

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:
: [Chapter 11]

**ORDER DENYING MOTION FOR PAYMENT OF PREPETITION CLAIMS
AND MOTION FOR LIMITED NOTICE**

William J. Westmark (Trustee), the Trustee for The Colorado & Wyoming Railway Company (Railroad), the chapter 11 debtor in this case, filed an unopposed motion for an order allowing payment of prepetition claims and for an order limiting notice in this case. The Trustee sought to pay five service creditors holding unsecured claims totalling \$1,686.45, four creditors holding property or use tax claims totalling

\$51,952.27, and the Internal Revenue Service holding a claim of \$2,788.19 for railroad retirement supplemental annuity tax.¹

The Trustee's motion set forth 11 U.S.C. § 1122(b)² as statutory authority for allowing early payment. That section permits the classification in a chapter 11 plan of certain unsecured claims less than or reduced to an amount the court approves as reasonable and necessary for administrative convenience. The Trustee argued that he should be allowed to pay those claims now in order to avoid the necessity of classifying such claims in a forthcoming plan. He also argued that payment now, as opposed to payment through a plan, would eliminate creditors with a nominal interest in the property of the estate and, as a consequence, reduce the matrix in the case. Further, immediate payment would enable the Railroad to maintain the good will of these small creditors, who continue to do business with the Railroad postpetition. The Trustee argued the Railroad was operating at a profit and always intended to pay these claims, absent this bankruptcy filing.

The Trustee asserted different grounds for the payment of the property and use tax claims. By way of an uncontested proffer, the attorney for the Trustee represented that certain of the creditors needed the funds in order to support their school systems and for that reason, he argued that he should be able to pay claims that have priority status.

¹ This listing represents the majority of claims in the case at the time the motion was filed, with the exception of unliquidated claims for personal injury tort claims and certain anticipated claims for substantial pension underpayment. Not all claims filed against the Railroad had been docketed and some were not included in the motion.

² Future references are to Title 11 of the United States Code.

The Trustee proposed that if the motion for payment of prepetition claims were granted, then notice should no longer go to the creditors that were paid.

No case law was cited for the argument that because section 1122(b) permits an administrative convenience class of claims, it also permits payment of such claims prior to confirmation of a plan. That argument is unavailing and not supported by the statute. Section 1122(b) specifically contemplates that a plan be in existence in order to designate an administrative class. The other grounds asserted, that of reducing the matrix and eliminating creditors with nominal interest, were likewise not supported by any case law or statutory authority, and constitute insufficient grounds in light of the clear intent of the statute that creditors be paid according to a confirmed plan. A general principle of bankruptcy law is that unsecured creditors be treated equally.

At the hearing, the Trustee argued that the small service creditors' claims should be paid according to the Necessity of Payment Rule as stated in *In re Penn Central Transp. Co.*, 458 F. Supp. 1234, 1326 (E.D. Pa. 1978). The Necessity of Payment Rule allows a trustee to pay prepetition claims necessary to enable the railroad to continue operating. The creditor whose claim is paid must have refused to deal with the railroad unless the prepetition claims were paid, and the threats of noncooperation must have endangered the railroad's continued operation. *Penn Central*, 458 F. Supp. at 1326. No evidence was presented, and apparently none exists, that the creditors included in the motion would discontinue service to the Railroad if their prepetition claims were not paid. Considering that the bankruptcy petition was filed over five months ago, it seems likely

that these prepetition creditors are at least content, though perhaps not pleased, to await the normal course of distribution. The theory is inapplicable for want of any evidence that payment prior to distribution through a plan is necessary to the Railroad's rehabilitation.

The argument that priority claims should be paid now instead of through a plan has somewhat more merit and precedent. Courts have granted authority to pay priority wage claims, as an expansion of the Necessity of Payment Rule. *In re Adams Apple, Inc.*, 829 F.2d 1484, 1490 (9th Cir. 1987).³ No cases have been cited, however, regarding the use of the Necessity of Payment Rule to pay prepetition tax claims. This lack of case law is consistent with the premise that payment of certain prepetition claims must be essential to the rehabilitation efforts of the debtor. There is no evidence that payment of these tax claims fall within this category.⁴ The representations supporting the payment of the tax claims under this theory are that the creditors involved need the payments. This is insufficient cause, under the circumstances of this case, to grant the motion.

The court is inclined to be cautious regarding permission to pay prepetition debt not absolutely necessary for the Railroad's rehabilitation in light of the substantial claims asserted against it by the Pension Benefit Guarantee Corporation (PBGC) Trust.

³ Certain other employee claims that arose prepetition may likewise be paid. *In re Gulf Air, Inc.*, 112 B.R. 152 (Bankr. W.D. La. 1989). *In re Chateaugay Corp.*, 80 B.R. 279, 285-86 (S.D.N.Y. 1987), *appeal dismissed*, 838 F.2d 59 (2d Cir. 1988). Courts have also allowed payment to suppliers and consumers or to foreign creditors. See R. Eisenberg & F. Gecker, *The Doctrine of Necessity and its Parameters*, 73 Marq. L. Rev. 1, 11-17 (1989).

⁴ It is conceivable that payment of a prepetition tax claim may be required to cure a default on an executory contract relating to real or personal property. Those circumstances have not been argued here.

Pending legislation that seeks to change the priority of the payment of such claims in bankruptcy cases may affect this case in the future.⁵ The most compelling argument advanced by the Trustee at the hearing was the applicability of section 1171(b),⁶ pertinent only to railroad reorganization cases. See *B & W Enters. Inc. v. Goodman Oil Co. (In re B & W Enters., Inc.)*, 713 F.2d 534, 535 (9th Cir. 1983). That section incorporates the Six Months Rule⁷ that allows payment of certain prepetition debts for labor, equipment, supplies or improvements from postpetition operating receipts. *In re Boston & Maine Corp.*, 634 F.2d 1359, 1366 (1st Cir. 1980), *cert. denied*, 450 U.S. 982 (1981). To qualify for payment under this rule, three criteria must be met. The claim must consist of a necessarily incurred current operating expense for material or services used in the operation of the railroad.⁸ The claim must have accrued within the six months preceding the filing of the petition. The creditor must have furnished the labor, equipment, supplies

⁵ See "Bush Proposes Help for PBGC," *Bankruptcy Court Decisions*, Vol. 21, Issue 10, p. A3 ("the PBGC may receive some additional guidance through remedial legislation that would define the priority of its claims for underfunded pension plans of bankruptcy companies").

⁶ 11 U.S.C. § 1171(b)

Any unsecured claim against the debtor that would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the date of the order for relief under this title shall be entitled to the same priority in the case under this chapter.

⁷ The Six Months Rule found its genesis in the practice of receivers in railroad equity receivership cases of paying necessary expenses incurred in the period immediately prior to the receivership. *In re McLean Indus.*, 103 B.R. 424, 425 (Bankr. S.D.N.Y. 1989).

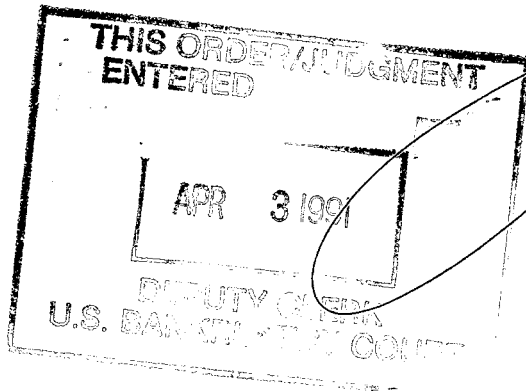
⁸ Payment for per diem charges for use of other carriers' railcars, repairs to railcars, and fuel supplied for operation of locomotives fall into this category. Freight charges on interline shipments collected and accounted for by the destination carrier were held in trust for other participating lines. *In re Penn Central Transp. Co.*, 486 F.2d 519, 523-24 (3d Cir. 1973), *cert. denied*, 415 U.S. 990 (1974). One court has allowed payment for legal fees. *In re Michigan Interstate Ry. Co.*, 87 B.R. 921 (Bankr. E.D. Mich. 1988).

or improvements in expectation of payment from current railway operating revenues and not in reliance on the debtor's general credit. *Boston & Maine*, 634 F.2d at 1365.

In this case, no evidence was presented that the service creditors relied upon anything other than the general credit of the Railroad, as opposed to the operating revenues currently generated. No evidence exists that the tax claimants relied upon anything other than the general credit of the Railroad. In addition, tax claims are not debts for labor, equipment, supplies or improvements. Therefore, they do not qualify under the Six Months Rule. Based upon the foregoing determination, it is hereby

ORDERED, that the Railroad's motion for an order allowing payment of prepetition claims and for an order limiting notice in this case is denied.

DATED this 2nd day of April, 1991.




JUDITH A. BOULDEN
United States Bankruptcy Judge