IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Case No. 02-10109 (JJF)
	)	
FANSTEEL INC., *et al.*,	)	Chapter 11
	)	(Jointly Administered)
Reorganized Debtors.	)	**Related Docket No.: 2110, 2137**
		Hearing Date: April 29, 2004 at 3:30 p.m.

REPLY TO RESPONSE OF MICHAEL J. MOCNIAK IN OPPOSITION TO DEBTORS' SIXTH OMNIBUS SUBSTANTIVE OBJECTION TO CLAIMS

Fansteel, Inc. ("Fansteel") for its reply to the Response of Michael J. Mocniak ("Mocniak") To Debtors' Sixth Omnibus Substantive Objection To Claims (the "Sixth Objection"), dated March 29, 2004 (the "Mocniak Response"), respectfully states as follows:

The Mocniak Claim and the Objection

1. As set forth in the Sixth Objection and the Mocniak Response, Mocniak has filed proofs of claim in Fansteel's chapter 11 case, denominated as Claim Nos. 778 through 781, seeking "remuneration for amounts owed by the Debtors under a pre-petition severance agreement between Mocniak and the Debtors." Three of the proofs of claim filed by Mocniak are unliquidated and this Court, after notice to Mocniak and no objection having been filed, entered an order dated February 13, 2004 (Docket # 2041), determining that no Disputed Claim Reserve[1] need be established on account of such Disputed Unliquidated Claims.[2] The fourth

[1] Unless otherwise defined herein, all capitalized terms shall have the meanings ascribed to them in the Second Amended Joint Reorganization Plan for the Debtors confirmed by Order dated December 23, 2003.

[2] Because the Court has estimated the maximum limitation on the allowed amount of Mocniak's unliquidated claims at $0, the February 13, 2004 order effectively disallows those claims.

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proof of claim filed by Mocniak was filed in the Face Amount of $188,641.10, of which amount $4,650.00 was asserted as a priority claim under section 507(a)(3)[3] of the Bankruptcy Code (the "Code") and $183,991.00 as a general unsecured claim.

2. In the Sixth Objection, Fansteel seeks disallowance of the proofs of claim filed by Mocniak, by invoking section 502(d) of the Bankruptcy Code, 11 U.S.C. § 502(d). Pursuant to the plain language of that statute, the claim of a creditor who has received an avoidable transfer must be disallowed unless such transfer has been relinquished for the benefit of the estate. The Sixth Objection asserts that Mocniak is a transferee of a transfer avoidable under Code section 549, 11 U.S.C. § 549, and despite written demand has failed to repay the avoidable transfer.

3. The Sixth Objection is supported by the Affidavit of R. Michael McEntee, the Chief Financial Officer of Fansteel, which is attached thereto as Exhibit C (the "McEntee Affidavit"). The McEntee Affidavit demonstrates that (a) Fansteel's books and records reflect that transfers were made to Mocniak subsequent to the Petition Date in the amount of $11,653.82, (b) the post-petition payments to Mocniak were made inadvertently on account of a pre-petition severance agreement in anticipation of court approval of a then-filed motion (the "Severance Motion") to assume the pre-petition agreement, (c) the Severance Motion to assume the pre-petition severance agreement with Mocniak was objected to by the United States Trustee and the Creditor's Committee and, as a result, was withdrawn by the Debtors; (d) by letter dated September 6, 2002, Fansteel made written demand of Mocniak to repay the post-petition

[3] Mocniak resigned his position with Fansteel on June 24, 2001 and was not employed by the Debtors during the section 507(a)(3) priority period. Moreover, at the time he was employed, Mocniak was Vice President, General Counsel and Secretary of Fansteel and, therefore, not entitled to the priority afforded non-management employees under section 507(a)(3). Accordingly, in the event the Debtors' objection pursuant to section 502(d) is not sustained, the Debtors reserve the right to challenge the priority status claimed by Mocniak.

transfer; and (e) Mocniak failed and refused to repay the post-petition transfer despite the written demand. None of the facts set forth in the McEntee Affidavit are contradicted by Mocniak's Response.

Section 502(d) May Be Used Defensively

4. Mocniak's opposition to the Sixth Objection is premised solely on the argument that "there has been no judicial determination respecting the Debtors' allegation that Mocniak received an avoidable transfer. . . ." Mocniak contends that the Sixth Obligation amounts only to a "mere allegation" and points out that the Debtors have not commenced an adversary proceeding on the Code section 549 avoidance claim; he then suggests in a footnote that section 549 liability cannot be judicially determined because an action to avoid and recover the transfers is now time-barred by the applicable statute of limitations.

5. In substance, Mocniak would like the Court to believe that, in order to invoke Code section 502(d), the Debtors must not only be able to meet all of the elements necessary to avoid a section 549 transfer but also must be able to commence a timely action to recover the transfer. This argument is not, however, supported by the plain language of the statute. Code section 502(d) states that "the court shall disallow any claim of any entity . . . that is a transferee of a transfer avoidable under section . . . 549 . . . ." 11 U.S.C. § 502(d). Pursuant to section 549(a) of the Code, the "trustee may avoid the transfer of property of the estate (1) that occurs after the commencement of the case; and (2) . . . (B) that is not authorized under this title or by the court." 11 U.S.C. § 549(a). The facts set forth in the McEntee Affidavit establish that the post-petition transfers to Mocniak clearly meet the requirements of an avoidable post-petition transfer. Therefore, disallowance of Mocniak's claims is mandated under section 502(d).

6. The great majority of the courts that have addressed this issue have concluded that "defensive" use of Code section 502(d) is permitted and the Mocniak Response ignores pervasive precedent that the limitations periods set forth in Code sections 546(a) and 549(d) are inapplicable to claim objections under section 502(d). See, e.g., El Paso v. America West Airlines, Inc., 217 F.3d 1161, 1165-66 (9th Cir. 2000); Committee of Unsecured Creditors v. Commodity Credit Corp. (In re KF Dairies, Inc.), 143 B.R. 734 (9th Cir. BAP 1992) (holding that section 549's limitation period was inapplicable to a section 502(d) claim objection); United States Lines, Inc. v. United States (In re McLean Indus., Inc.), 196 B.R. 670, 675 (S.D.N.Y. 1996); In re Badger Lines, 199 B.R. 934, 939-40 (Bankr. E.D. Wis. 1996), rev'd on other grounds, 202 F.3d 945 (7th Cir. 2000); In re Stoecker, 143 B.R. 118 (N.D. Ill.), aff'd in part and rev'd in part and remanded on other grounds, 143 B.R. 879 (N.D. Ill. 1992), aff'd in part and vacated in part and remanded, 5 F.3d 1022 (7th Cir. 1993); In re Eye Contact, Inc., 97 B.R. 990, 992 (Bankr. W.D. Wis. 1989); In re Larsen, 80 B.R. 784, 790-91 (Bankr. E.D. Vir. 1987) (claimant failed to return unauthorized post-petition transfers avoidable under § 549); In re Mid Atlantic Fund, Inc., 60 B.R. 604 (S.D.N.Y. 1986).

7. The majority of courts permitting defensive use of section 502(d) have looked not only to the purpose and clear language of the statute but also have examined its legislative history. Noting that Code section 502(d) was derived from then existing law, the courts have concluded that the statute's pre-Code predecessor, Section 57g of the Bankruptcy Act, also permitted a trustee to raise an otherwise time-barred voidable transfer so as to cause the disallowance of a claim. See, e.g., In re Meredosia Harbor & Fleeting Service, Inc., 545 F.2d 583 (7th Cir. 1976), cert. denied, 430 U.S. 967 (1977); In re Cushman Bakery, 526 F.2d 23 (1st

Cir. 1975), cert. denied, 425 U.S. 937 (1976) (two year statute of limitations contain in Section 11c did not apply to a trustee's objection under Section 57g).

8. No reported decisions in the Third Circuit, including the opinions of Bankruptcy Judges Walsh and Walrath cited by Mocniak, have addressed the issue of the applicability of the avoidance action statutes of limitation to claims objections under section 502(d) or are inapposite to the holdings in the cases cited above. Both in Cohen v. TIC Financial Systems (In re Ampace Corporation), 279 B.R. 145 (Bankr. D. Del. 2002), decided by Judge Walsh, and in In re Lids Corp., 260 B.R. 680 (Bankr. D. Del. 2001), decided by Chief Judge Walrath, adversary proceedings seeking to avoid and recover the preferences were pending and defensive use of section 502(d) was not in issue. Similarly, In re La Roche Industries, Inc., 284 B.R. 406 (Bankr. D. Del. 2002) does not consider defensive use of Code section 502(d), but instead stands for the proposition that a failure to object to a claim under section 502(d) precludes a later assertion of a preference action against the creditor following claim resolution (a holding criticized by several other courts, including Judge Walsh in TWA Inc. Post Confirmation Estate v. City and County of San Francisco Airports Commission (In re TWA Inc. Post Confirmation Estate), 305 B.R. 221 (Bankr. D. Del. 2004)).

9. The purpose of section 502(d) of the Code is to preclude entities which have received voidable transfers from sharing in the distribution of the assets of the estate unless the voidable transfer has been returned. Based on the prevailing law, the judicial determination of avoidability sought by Mocniak can clearly be made in the context of an objection to his proofs of claim. See 4 Collier on Bankruptcy ¶ 502.05 [2][a]. Thus, in a case cited by Mocniak, In re Chase & Sanborn Corp, 124 B.R. 368, 370 (Bankr. S.D. Fla. 1991), the court stated:

> Nothing on the face of the statute or any case requires the entry of a judgment as a prerequisite to the disallowance under § 502(d) of a

> preferred creditor's claims. Indeed pursuant to § 502(d) courts have disallowed the claim of a creditor that received and failed to return a preference where the trustee not only lacked a judgment imposing liability for the preference, but could not obtain a judgment because the preference claim was time-barred. That is, the trustee was allowed to use § 502(d) defensively to disallow the preferred creditor's claim even though he could not obtain an affirmative judgment for the amount of the preference .....

10. The Sixth Objection and the supporting McEntee Affidavit make an uncontroverted prima facie showing that Mocniak received a transfer avoidable under Code section 549. The McEntee Affidavit establishes that post-petition transfers were made by Fansteel to Mocniak in the amount of $11,653.82. The transfers were made on account of Mocniak's pre-petition claim arising out of a pre-petition severance agreement and, accordingly, were not authorized by the Bankruptcy Code. Moreover, because the motion filed by the Debtors to assume the pre-petition severance agreement was withdrawn and the pre-petition severance agreement was not assumed by the debtor-in-possession, Mocniak's pre-petition claim was not transformed into an administrative expense or other post-petition obligation by order of this Court. Nothing contained in Mocniak's Response refutes or contradicts the established facts or prevents this Court from making a judicial determination of avoidability requiring disallowance of Mocniak's claims.

WHEREFORE, the Debtors respectfully request that the relief requested by the Sixth Objection in respect of the claims of Mocniak be granted in all respects and that the proofs of claim filed by Mocniak be disallowed in their entirety pursuant to section 502(d) of the Bankruptcy Code.

Dated: April 21, 2004

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