

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:) Chapter 11
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)
KMART CORPORATION,) Case No. 02 B 02474
) Honorable Susan Pierson Sonderby
)
Debtor.) Hearing Date: September 22, 2009
) Hearing Time: 11:00 a.m.
)
_____)

**KMART CORPORATION’S REPLY TO MOTION FOR SUMMARY JUDGMENT
(DAVID KERSH)**

David Kersh, a creditor, has filed a motion for summary judgment. Although the motion itself is simple, the history of the matter, which requires some retelling, is more involved.

Kersh filed a claim (claim no. 48076) that totaled \$96,119 for several different alleged wrongs, including \$65,369 for amounts allegedly owed in connection with a membership passbook that in 1990 Kmart sold for Kersh on a consignment basis. Kersh filed his claim as a secured claim. Kmart previously moved for partial summary judgment on the claim, arguing that *res judicata* barred Kersh from having a claim for most of what he sought. Specifically, as to a “secured” claim related to “Metro Passbook memberships” (the subject of the present motion) Kersh had previously lost a case brought against Kmart in the Michigan state courts. (See ¶¶s 5 and 6, Kmart’s Motion For (I) Order Granting Partial Summary Judgment On Claim Of David Kersh, Claim No. 48076 And (II) Order Partially Allowing Claim Of David Kersh As A Class 7 Claim, docket no. 29865, and related Statement of Material Facts, docket no. 29866). Kmart’s summary judgment motion has been continued because of health problems of Mr. Kersh.

Notwithstanding its firm belief that Kersh's claim is wholly without merit, because of the cost and nuisance of dealing with the claim, Kmart ultimately elected to allow the entire claim as a secured claim. However, because Kersh had no collateral that actually secured his claim, pursuant to Class 1 of Kmart's Plan, and in accordance with 11 U.S.C. §506(a), Kersh's secured claim was valued at \$0. Under the Plan he was therefore entitled to a general unsecured claim for the deficiency on his secured claim, which deficiency was the full amount of his claim (\$96,119). Because the claim did not relate to a rejected lease or goods supplied by a vendor, the claim fell into Class 6, the general class of unsecured creditors. Class 6 creditors receive about .105 cents on the dollar of claim.

On August 3, 2007 Kmart sent a \$10,595.18 check to Mr. Kersh with an explanation as to how it calculated its claim. The \$10,595.18 represents the full amount of a Class 6 distribution on the claim. A copy of Kmart's letter is Ex. 2 to Kersh's motion. Kersh never cashed the check.

In his new Motion, Kersh seeks a judgment to the effect that he is entitled to receive the full \$96,119. The Motion does not comply with the rules applicable to summary judgment motions, and the motion includes no evidence of any collateral that ever existed to support a purported secured claim. However, because the legal issue raised is so discrete, Kmart submits this response to the Motion should the Court take up the Motion notwithstanding its defects.

ARGUMENT

A “secured claim” is not a label, it is a factual reality. A claim is secured when the obligor on the claim has pledged its property to secure the payment of the claim.¹ See 4 Colliers on Bankruptcy, 15 ed. ¶506.03[1], p. 506-10 (“As a threshold matter, a claim cannot be a ‘secured claim’ for purposes of Section 506(a) unless it is secured by a ‘lien’ on some specific item of property ...”).

This fundamental reality is the basis of Section 506(a) of the Bankruptcy Code. A creditor’s claim is a secured claim if it is secured by a lien on property in which the estate has an interest, but only “to the extent of the value of such creditor’s interest in the estate’s interest in such property ...” Under the plain language of Section 506(a), a creditor must clear two hurdles to have a secured claim. First, the creditor must have an interest in property of the debtor as security for its claim. Second, such an interest in property must have value. If the property is worthless, or does not exist at all, then there is no secured claim.

Kmart’s Plan of Reorganization, in its treatment of secured claims, follows Section 506(a) of the Code. The Plan defines “Secured Claim” in Section 1.144 by referring to a determination the Court makes under Section 506(a). Class 1 of the Plan includes all Secured Claims not otherwise classified under the Plan. Under Section 5.1 of the Plan, a Class 1 holder of a Secured Claim receives “Cash in an amount equal to the value of the Secured Claimholder’s interest in property of the Estate which constitutes collateral for such Allowed Secured Claim ...”

¹ Some claims, such as those of mechanics, are secured by operation of law. There is no suggestion in the motion that Kersh had any sort of statutory or judicial lien on property of Kmart.

Under both Section 506(a) of the Code and the Plan, to the extent an allowed claim is not a secured claim, it is an unsecured claim. Under Kmart's Plan, unless a claim falls within one of the defined types of claim listed in Section 1.106 of the Plan, the claim is an "Other Unsecured Claim" that falls into Class 6 (See Section 5.6 of the Plan).

In the present motion, Kersh must show that, at the time Kmart filed for bankruptcy on January 22, 2002², Kmart had property in which Kersh had an interest as security for his claim. Kersh addresses this in Paragraph 5 of his motion, where he says: "In fact, collateral still exists because the collateral is cash collected by Kmart in December 1990 from the sale of the Metro Passbook memberships which they placed in segregated account and then lost the account number." There is no evidence to support this statement, however. Kersh does not refer to an account that was created, and attaches no document from Kmart that showed the existence of such an account. Moreover, Kersh does not allege and can certainly not prove that the account, if it ever existed, still existed on January 22, 2002, the day of Kmart's bankruptcy filing.

Even if one were to hypothetically assume that in 1990 Kmart deposited into a segregated account monies collected on the sale of Metro Passbook memberships, but then in the next 11 years used the money for some other purpose, Kersh would not be a secured creditor. The collateral must exist at the time the case is filed. Collateral lost or converted before the filing gives rise to only an unsecured claim.

In essence, Kersh argues that because Kmart never owned the Metro Passbook memberships, but only dealt with them on a consignment basis, the money Kmart collected on sales of the memberships belonged to Kersh. Even if all this is true, and even if Kersh had not

² Under Section 506(a), the lien must be against property in which the estate has an interest. The estate does not come into effect until the bankruptcy filing.

already lost on the claim in the Michigan courts, he would still only have an unsecured claim. Unless the cash from the 1990 sale of the memberships had remained in a segregated account as of 2002, Kersh can have no special claim to any money of Kmart. The money, to the extent that it was ever collected and segregated, was years ago commingled with other Kmart funds and paid out to someone else. There is no constructive trust theory recognized in bankruptcy that allows a creditor an interest in general funds of the estate. *See In re First Cent. Fin. Corp.* 377 F.3d 209, 217-18 (2d Cir. 2004) (“The constructive trust doctrine can wreak ... havoc with the priority system ordained by the Bankruptcy Code.”)

Although Kersh provides no evidence of the existence of a segregated account, there is in this case sworn evidence of the absence of such an account. In its Schedule B Kmart listed all of its bank accounts in existence as of the filing date. A copy of Schedule B is attached hereto as Exhibit A. There is no entry on Schedule B of an account that in any way relates to Kersh or the alleged sale of his membership books in 1990.

The remaining arguments of Kersh regarding Court jurisdiction and the nondischargeability of his claim are without merit.

Dated: September 8, 2009

KMART CORPORATION

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