BANKRUPTCY LAW NEWSLETTER

Published by Federal Bar Association
Western District of Michigan Chapter

Vol. 2, No. 6 February, 1990

BANKRUPTCY SALES - SELECTED ISSUES
RE: NON-ORDINARY COURSE SALES

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Introduction

Section 363 of the Bankruptcy Code[1] and Bankruptcy Rules govern sales of property. They are the successors to Sections 70f and 70g of the Bankruptcy Act of 1898 (the "Act") and former Bankruptcy Rule 606 with respect to sales out of the ordinary course of business.

The Bankruptcy Code made two fundamental changes in the law of non-ordinary course sales. These changes reflect one of the primary objections of Code -- the removal of Bankruptcy Judges from administrative case matters. Under the Act, the Bankruptcy Judge had to confirm all proposed sales. After a sale was confirmed, the Bankruptcy Court was viewed as occupying the position of a vendor. See In re Burr Mfg. and Supply Co., 217 F 16 (2d Cir. 1914). Under the Code, if there are no objections to a proposed sale, there need be no Bankruptcy Court involvement -- no Bankruptcy Court confirmation is required and the sale may be consummated by the trustee and the purchaser.

This article will discuss selected procedural and substantive issues affecting sales out of the ordinary course under the Code.

Methods of Sale

Section 363(b)(1) authorizes the trustee[2] to sell property of the estate other than in the ordinary course of business. Bankruptcy Rule 6004(f) provides that sales not in the ordinary course may be by either private sale or public

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[1] 11 U.S.C. §363. All references to the Code or to the Bankruptcy Code are to Title 11 of the United States Code.

[2] Trustee includes the debtor-in-possession pursuant to Section 1107(a).

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auction. This is a radical departure from pre-Code procedure where sales wer heavily supervised by the Bankruptcy Court. The trustee may now enter into a agreement for sale with a party, provide proper notice and opportunity for objection, and, if no objection is filed, proceed to close the sale without even setting foot inside the Bankruptcy Court.

While this private sale method is clearly authorized, and presumably encouraged to reduce Bankruptcy Judge involvement in case administration matters, it is rarely used. The cautious purchaser and his title insurance company still like the comfort and security of a court order confirming sale; and the trustee usually prefers the public auction method to try to flush out a better price. Also, the trustee often utilizes a hybrid method -- a private agreement subject to higher bid at an auction to be held in the Bankruptcy Court. This gives the trustee an opportunity to maximize the return to the estate in the event his private sale was too good a deal for the purchaser.

Notice and Hearing

Section 363(b) provides that the trustee may sell property of the estate outside the ordinary course after "notice and a hearing". What does "notice and a hearing" mean? In Bankruptcy Court this term is given a special meaning by Section 102(1) -- such notice as is appropriate and such opportunity for hearing as is appropriate in the particular circumstances; and if a party in interest does not timely request a hearing or there is insufficient time for a hearing, no actual hearing may take place. Section 102(1) and Bankruptcy Rules 2002 and 6004 provide the framework for notice and hearing of sales pursuant to Section 363(b).

1. Notice Requirements.

a. Time Period. At least 20 days prior notice of the sale must be given, unless the Bankruptcy Court for cause shown shortens the time or directs another method of giving notice. Bankruptcy Rule 2002(a)(2); Bankruptcy Rule 6004(a). Shortened time is clearly contemplated by Section 102(1)(B)(ii) and less time has often been ordered when the property will perish or suffer some other severe immediate diminution in value.

b. Contents. The notice must contain the time and place of any public sale, the terms and condition of any private sale, the time fixed for filing objections and, if real estate is included, a general description of the property. Bankruptcy Rule 2002(c)(1). Extreme care should be taken to include all information that an appellate court might determine that a prospective higher bidder or objector should know about the property and the sale. Reference to an agreement containing terms and conditions of a private sale and an invitation to review it can be made, however, unusual terms should be mentioned. In a close decision in In re: Table Talk, Inc., 53 B.R. 937 (Bankr. Mass, 1985), reference in the sale notice to a written sales agreement without mention of a right of first refusal in favor of the sales agreement purchaser did not cause invalidation of the sales notice. However, a purchaser who knows of a material error in the contents of a notice may not be in good faith and thus may not be entitled to the protection of Section 363(m) from reversal or modification of the sale on appeal.

c. Parties Entitled to Notice. Bankruptcy Rule 2002(a) provides that notice must be given to the debtor, the trustee and all creditors and indenture trustees. In addition, case law requires that all "parties in interest" be given notice. This includes original bidders who have previously bid on the subject property. See In re Time Sales Finance Corp., 445 F.2d 385 (3rd Cir. 1971). Also, notice to all persons or entities claiming any ownership interest n the property is necessary (although sales free of liens are subject to additional requirements and safeguards not discussed here).

d. Time for Objections. Objections must be filed and served not less than five (5) days before the date set for the proposed action or within some other time as the Bankruptcy Court fixes. Bankruptcy Rule 6004(b). The time and manner for filing objections must be clearly set forth in the notice. An objecting party must be diligent in complying with the time period specified in the notice. Failure to do so may bar later relief, especially if the sale is private and no actual hearing is held.

No Objection

If no objections to the sale are timely filed, the sale can be closed consistent with the provisions of the notice and the contract or agreement for the sale without obtaining an order of the Bankruptcy Court. As previously noted, this represents a substantial change from practice under the Bankruptcy Act, which required an order of the Bankruptcy Court confirming the sale.

In practice, sales are usually noticed out for an actual hearing in Bankruptcy Court. Often the notice provides that higher bids will be entertained at the hearing. At the hearing, after a bidding process, the trustee then routinely submits an order to the Bankruptcy Court purporting to confirm the sale. These orders are referred to as "comfort orders". They are a vestige of prior practice under the Act.

Most Bankruptcy Judges routinely sign these orders. Often these orders are submitted for recording and/or to title insurance companies to facilitate the issuance of a title insurance policy for the purchaser. However, Judges Abramson and Gabriel in their opinions In re HCC Properties, Inc., 55 B.R. 685 (Bankr. N.D. Tex. 1985) and In re Robert L. Hallamore Corporation, 40 B.R. 181 (Bankr. Mass. 1984) chastised counsel for requesting the entry of "comfort orders". These Judges stated that it was clear that, absent objection, no court involvement was necessary; and that repeated requests for comfort orders had no place on their burdened dockets. They added that the bar and title companies should obtain a clerk's certificate for recording purposes reflecting that no objections or requests for hearing were received.

A difficulty with the comfort order is that it often contains recitals regarding the requirements for a valid sale which are matters that are not actually passed upon or even mentioned at the hearing. These crucial requirements are that all proper parties in interest have been identified and given notice, that the notice was proper and complete, and that no objections were filed. In many, if not most, sales, the failure of any party to object will provide significant comfort that no problems will develop. However, if a proper party does not receive notice, or the notice contains a material defect, the sale may be later set aside. See Zalevsky v. Steele, 78 B.R. 100 (W.D. Pa. 1987) where failure to notify a prospective buyer whose prior bid led to the auction sale resulted in an order setting aside the sale.

Objections to the Sale

1. Standing. Objections to a sale may be filed by any person or entity with standing. Obvious parties with standing include those entitled to notice as outlined above. The creditors' committee generally does not have standing to object, although it has standing under Section 1109(a) to be heard and its opinion often bears on the evaluation of a sale by the Bankruptcy Judge if he or she is ruling on an objection. Potential purchasers who have not submitted

bids or who have submitted untimely bids do not have standing, even if they hav a higher bid. In re: Karpe, 18 CBC2d 1313 (M.D. Pa. 1988).

The standing requirements create some difficult and delicate issues. How does one interested in purchasing property from the estate and willing to pay the highest price object to a private sale? The potential purchaser probably does not have standing unless he submits a timely bid. How does he submit a timely bid if the trustee has chosen not to seek higher bids? He should file a timely objection containing his bid. How does a private sale purchaser protect his deal against a higher bidder? He should structure the sale in a unique manner so that his offer cannot easily be matched or bettered.

2. Hearing. A timely filed objection to a proposed sale is treated as a request for hearing on the objection. There will be an actual hearing in Bankruptcy Court. Any objection to standing will also be raised at this hearing. The reasons for objections can include suspected "sweet" terms to an insider or related party, attempts by a party willing to pay a higher price with different terms asking the Court to determine which purchaser will provide the greatest benefit to the estate, or simply attempts to frustrate a sale. Another common objection relates to sales of substantially all assets of a Chapter 11 debtor prior to confirmation of a Plan of Reorganization as discussed later.

At the conclusion of the hearing, the Bankruptcy Court will enter an order either granting or denying relief to the objector. When denying objections, the Bankruptcy Court generally will also confirm the sale in its order. When the Court is asked to confirm the sale, some courts have held that the court must also make a finding with respect to the "good faith" of the purchaser, principally to promote finality of its confirmation order. In re: Abbotts Dairies of Pennsylvania, Inc., 788 F.2d 143 (3rd Cir. 1986). This finding notifies prospective appellants of the need to obtain a stay pending appeal or face a dismissal for mootness under Section 363(m) if the district court affirms the good faith determination of the Bankruptcy Court. At least one court has said that the Abbotts' good faith determination requirement should only apply when a timely objection has been made. In re: Snyder, 74 B.R. 872 (Bankr. E.D. Pa. 1987).

If objections to sale are denied, how may the various parties proceed? May the trustee and purchaser immediately proceed to close the sale? May the losing objector appeal?

Closing the Sale

Bankruptcy Rule 7062 incorporates the automatic 10-day stay rule of Rule 62 of the Federal Rules of Civil Procedure. It is not clear whether a sale transaction is subject to this stay. Bankruptcy Rule 7062 excludes certain orders from the stay, however, sales are not expressly included in this section, and, thus, it can be well argued that sales are subject to the automatic 10-day stay. Thus, a sale closed within 10 days of the order denying objections may not be entitled to the protection of Section 363(m) which insulates purchasers in the event of reversal or modification on appeal. If the 10-day period expires, then the parties may close the sale even though they have knowledge of the filing of a notice of appeal, unless a stay pending the appeal is obtained.

What happens when the sale does not timely close? Or if the purchaser wants to renegotiate a material term of the purchase contract? Or if a substantially higher bidder appears before the sale is closed? These questions raise issues relating to the standing of parties to object regarding post-sale confirmation matters and the finality of Bankruptcy Court sales.

The failure to close timely must be brought before the Bankruptcy Court by a party in interest. An unsuccessful bidder desirous of a second chance to purchase does not have standing, unless he has been designated as an alternate purchaser in the Court's order confirming the sale. Often, even though a closing has not timely occurred (constituting a breach of the agreement or contract between the trustee and the purchaser), in practice, the Court will usually grant an extension before vacating or reversing its confirmation order. The Court will often grant relief regarding changes in other terms, unless a significant change in the benefit to the estate will occur.

The submission of a higher bid by a party after sale confirmation presents an invitation to the Bankruptcy Judge to overturn a confirmed sale. This will occur only in extreme cases where fraud, mistake or a like infirmity exists. In re: Chung King, Inc., 753 F.2d 547 (7th Cir. 1985). While the objective is to obtain the highest price for the estate, once the sale is confirmed, to protect the integrity of the sale process, the proceeding should be ended. In re: Webcor, 392 F.2d 893 (7th Cir. 1968).

Appeals

An objector or bidder who loses in the Bankruptcy Court may appeal, if the order of the Bankruptcy Court is a final order. Generally this will be the case when material objections are denied. However, a Bankruptcy Court order authorizing a special master to negotiate the sale of two television stations to the high bidder was held not to be a final order. In re American Colonial Broadcasting Corp., 758 F.2d 794 (1st Cir. 1985). The American Colonial court held that the high bidder might not successfully negotiate the sale and a second hearing would be necessary if he did to approve the negotiated agreement. An objection could be brought at the second hearing, from which an appeal could then be taken. The Court therefore ruled the Bankruptcy Court's order was interlocutory, and the failure of a showing of irreparable injury precluded the appeal attempt.

If an appeal is taken from a final order confirming a sale, the appellant will generally have a difficult time. Unless a stay is obtained, the closing of the sale during the pendency of the appeal almost always renders the appeal moot. Exceptions to this involve appeals where damages or rights to sales proceeds are at issue; or when a bad faith purchaser is involved, negating the Section 363(m) provisions.

Bankruptcy Rule 8005 governs stay procedure in appeals. A prudent party should first request a stay orally in the Bankruptcy Court immediately following denial of his objection. If this is unsuccessful, he should then proceed immediately to the District Court. The appellant must be prepared to post a bond and establish the irreparable harm type standards which are a prerequisite to injunctive relief. Note that mootness of the appeal if the sale closes does not constitute irreparable harm.

SALE OF SUBSTANTIALLY ALL ASSETS PRIOR TO FILING PLAN OF REORGANIZATION

1. The Issue: To what extent may a Bankruptcy Judge authorize the sale of substantially all of the assets of a bankrupt's estate out of the ordinary course of business and outside the plan of reorganization.

Section 363(b) of the Bankruptcy Code provides that:

"[t]he trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate." 11 USC §363(b).

The plain meaning of the language of 363(b) appears to permit the trustee to dispose of property of a corporate debtor's estate, independent of a plan of reorganization under 11 USC 1101 et seq. Section 363(b)(1) and the Bankruptcy Rules require only that the trustee provide notice and opportunity for hearing. As discussed above, no court order is required and, in the absence of objection, there is no judicial involvement in the sale.

Because the sale of a major part of the debtor's estate may have the practical effect of deciding issues that would ordinarily be treated in a plan of reorganization, courts have been reluctant to interpret Section 363(b) as a grant of unfettered power of a trustee to sell substantially all the assets of the debtor's estate. Courts have generally recognized that the literal reading of Section 363(b) would conflict with the purposes and policy of the reorganization statute. For this reason, courts have carved out implied conditions for the sale of substantially all of a debtor's assets under Section 363(b) such as perishable or deteriorating estate assets, "emergency" circumstances, "cause" or a "good business reason" for the sale.

2. The Perishable or Deteriorating Value Standard Under the Bankruptcy Act of 1867: Section 25 of the Bankruptcy Act of 1867, a predecessor of Section 363(b), provided for the sale of a debtor's property prior to liquidation of the estate:

"When it appears to the satisfaction of the Court that the estate of the debtor, or any part thereof, is of a perishable nature, or liable to deteriorate in value, the Court may order the same to be sold, in such manner as may be deemed most expedient, under the direction of the messenger or assignee, as the case may be, who shall hold the funds received in place of the estate disposed of . . ."

The Second Circuit applied this standard in approving the sale of the debtor's stock of handkerchiefs immediately before Christmas, recognizing that the value of the handkerchiefs would greatly decline after the holidays. In re Pedlow, 209 F 841, 842 (2d Cir. 1913).

3. The "Cause" Standard: Section 116(3) of the Chandler Act of 1938 eliminated the "perishable or deterioration in value" standard, replacing it with a "cause shown" standard for the sale of a debtor's assets. That Section provided, in part, that:

" . . . the Judge may authorize a receiver or a trustee or a debtor in possession, upon notice as the Judge may prescribe and upon cause shown, to lease or sell any property of the debtor, whether real or personal, upon such terms and conditions as the Judge may approve."

It is under this standard that the "emergency" rule was formulated. In In re Solar Manufacturing Corporation, 176 F2d 493, 494 (3rd Cir. 1949), the Third Circuit ruled that a pre-confirmation sale should be "confined to emergencies where there is imminent danger that the assets of the ailing business will be lost if prompt action is not taken". The "emergency" rule was embraced by other courts. See, e.g., In re Pier Penn Petroleum Company, 188 F2d 851 (2d Cir. 1951) and In re White Motor Credit Corp., 4 CBC2d 1562 (Bankr. ND OH 1981).

4. "Best Interest of the Estate" Standard: The "best interest of the estate" standard, applied before the Bankruptcy Code was adopted in the Bankruptcy Reform Act of 1978, seems to combine the "emergency" rule and the "perishability/deterioration in value standard". The Fifth Circuit, in In re Dania Corporation, 400 F2d 833, 835-37 (5th Cir. 1968), cert. denied, 393 US 1118 (1969), upheld the sale of the debtor's primary asset (stock) when it was found to be in the best interest of the debtor because the stock's value was deteriorating and causing the diminution of the debtor's estate prior to reorganization. See also, In re Equity Funding Corporation of America, 492 F2d 793, 794 (9th Cir. 1974), cert. denied 419 US 964 (1974).

5. Sale Under the Bankruptcy Code: Bankruptcy Code Section 363(b) has eliminated the requirements of its predecessor statutes that for the sale of a debtor's assets outside reorganization there exists an emergency situation, that the assets must be perishable or deteriorating rapidly, that there is "cause" for the sale, or even that the sale would be in the best interest of the estate. Section 363(b) does not have any such qualifying language whatsoever.

The courts have nevertheless been reluctant to allow the trustee unfettered discretion in allowing for sale of the assets of the debtor outside plan of reorganization. In In re Braniff Airways, Inc., 700 F2d 935, 940 (5th Cir. 1983), the court stated that:

> "The debtor and the bankruptcy court should not be able to short circuit the requirements of Chapter 11 for confirmation of the reorganization plan by establishing the terms of the plan sub rosa in connection with the sale of assets."

In In re Lionel Corporation, 722 F2d 1063 (2d Cir. 1983), the Lionel Corporation, a toy train manufacturer, sought court authorization to sell its majority interest in one of its subsidiary companies. A hearing was held on the proposed sale. While it was established that the proposed sale price of the stock was "fair", testimony established that the stock was not an asset that was deteriorating in value. There was no reason stated why the sale of the stock could not be accomplished through the reorganization plan. Apparently, the exclusive reason for Lionel's application to sell the stock was that the creditors' committee insisted upon it. The bankruptcy judge affirmed the sale. The district court affirmed the bankruptcy court order. The Second Circuit reversed, holding that:

> "A Judge determining a 363(b) application [must] expressly find from the evidence presented before him at the hearing a good business reason to grant such an application." [Emphasis added.]

In Lionel, the reason cited in support of the sale was the creditors' committee's insistence on it. The Second Circuit found this reason insufficient as a matter of fact because it was not a sound business reason, and insufficient as a matter of law because it ignored the equity interests required to be considered under Chapter 11. 722 F2d at 1071.

Other courts have since adopted this "good business reason" rule for using, selling or leasing property out of the ordinary course of business under Section 363(b). See, e.g., Stephens Industries, Inc. v. McClung, 789 F2d 386, 390 (6th Cir. 1986), and In re Continental Airlines, Inc., 780 F2d 1223, 1226 (5th Cir. 1986).

6. Anticipated Future Developments: In fashioning its good busine reason rule, the Second Circuit in Lionel articulated certain policy considera tions for bankruptcy judges faced with a proposed sale of substantially all o a debtor's assets out of the ordinary course of business and outside the plan of reorganization. Factors for consideration include:

a. The proportionate value of the asset to the estate as a whole;

b. The amount of elapsed time since the filing;

c. The likelihood that a plan of reorganization will be proposed and confirmed in the near future;

d. The effect of the proposed disposition on future plans of reorganization;

e. The proceeds to be obtained from the disposition vis-a-vis any appraisals of the property;

f. Which of the alternatives of use, sale or lease the proposal envisions; and

g. Whether the assets are increasing or decreasing in value. Lionel, 722 F2d at 1071.

The Lionel court did not intend that this list be exclusive, but that it illustrate to bankruptcy judges the bases for determining the propriety of such a sale on a case-by-case basis.

RECENT BANKRUPTCY DECISIONS

The following are summaries of recent court decisions that address important issues of bankruptcy law and procedure. These summaries were prepared by Patrick E. Mears with the assistance of Larry A. Ver Merris.

Hardin v. Caldwell, Case Nos. 88-6404, 88-6405 (6th Cir. Feb. 9, 1990). The background of this second appeal to the Sixth Circuit Court of Appeals is set forth at In re Caldwell, 851 F.2d 852 (6th Cir. 1988). In this case, three creditors held judgments totalling approximately $50,000 against the debtor for false arrest, malicious prosecution and false imprisonment rendered by the Tennessee state court. After the debtor commenced a Chapter 7 case, these creditors initiated an adversary proceeding against debtor to determine the dischargeability of that debt under 11 U.S.C. § 523(a)(6). In this adversary proceeding, the bankruptcy court ruled that these debts were nondischargeable since they arose from a wilful and malicious injury caused by debtor. Thereafter, debtor moved to convert his case to Chapter 13 and proposed a 36-month plan that would pay these creditors only 36% of their claims.

At this time, debtor was 54 years old, in good health and occupied the position of assistant chief of the Knoxville, Tennessee police department. His yearly income was $26,000 after taxes and he also held a real estate broker's license. The bankruptcy court, over the objections of the judgment creditors, granted the debtor's motion to convert, finding that his plan was proposed in good faith. On the first appeal to the Sixth Circuit, that Court remanded the matter to the district court for a finding as to whether the plan was proposed in good faith. On remand, the district court found a lack of good faith and vacated the bankruptcy court's prior order permitting the conversion to Chapter 13. The debtor then appealed to the Sixth Circuit.

In its opinion affirming the district court, the Sixth Circuit, per Judge Bailey Brown, addressed the concept of "good faith" contained in 11 U.S.C. § 1325(a)(3).

> Discharge under Chapter 13, though a salvation for some debtors, is a loophole for others. The good faith, or lack of it, with which the plan is proposed, distinguishes a sincere effort at repayment from a false one. Courts should not approve Chapter 13 plans which are nothing more than "veiled" Chapter 7 plans. [citation omitted]. A Chapter 13 plan which proposes to repay only a small portion of a debt which could not be discharged under Chapter 7 deserves "particular scrutiny." [citation omitted].

The Court then stated that the debtor has the burden of establishing good faith; "best efforts under 11 U.S.C. § 1325(b), without more, are not enough." The Court then recited the twelve-factor test of good faith announced in an earlier decision, In re Okoree-Baah, 836 F.2d 1030 (6th Cir. 1988). Applying this test to the facts before it, the Sixth Circuit found that the debtor lacked good faith. He had not disclosed all of his assets in his bankruptcy schedules, had made transfers of property on the eve of bankruptcy and had proposed only a 36-month plan. According to the Court,

> [o]ur decision rests on much more than the fact that this debt is not dischargeable under Chapter 7; it rests on Caldwell's unrelenting efforts to reduce the assets available to his creditors, to make only minimal payments and over the shortest possible time, and to make even those only when threatened with garnishment. The plan before us was not tendered in good faith, but was one more effort to avoid paying the judgment creditors.

Soult v. Maddox, Case No. 89-3303 (6th Cir. Jan. 23, 1990). The Chapter 7 debtor, Michael Soult, ("Debtor"), purchased a dental practice from William Maddox ("Maddox") on an installment basis. Prior to full payment being made to Maddox, Debtor commenced a Chapter 7 case in the Bankruptcy Court for the Southern District of Ohio. The amount due Maddox by Debtor at that time amounted to approximately $14,000. Debtor's Chapter 7 case was a "no asset" case.

Debtor failed to list Maddox as a creditor in his schedules and statements filed in his bankruptcy case. Approximately one year after the claims bar date expired, Maddox learned that the Debtor filed a bankruptcy petition. In 1988, after Debtor received his discharge and his bankruptcy case was closed, Maddox commenced litigation against Debtor in Ohio state court to recover the prepetition debt due him from the sale of Maddox's dental practice. Thereafter, Debtor moved to reopen his bankruptcy case and to list Maddox as a creditor nunc pro tunc. This motion was granted and Maddox's claim was held to be discharged. This decision was affirmed by the federal district court on appeal, whereupon Maddox appealed to the Sixth Circuit.

The Sixth Circuit, citing its prior decision of In re Rosinski, 759 F.2d 539 (6th Cir. 1985), affirmed the decision of the courts below. The Sixth Circuit, per Judge David Nelson, concurred with the lower courts' finding that the Debtor's failure to list Maddox as a creditor in his schedules was an inadvertent mistake and was not the product of a "wilful, reckless or frau ulent" act by the Debtor.

United States Trustee v. PHM Credit Corporation, Case No. 89-72607 (E.D. Mich. Jan. 25, 1990). This decision arises from the United States Trustee's appeal from a final order of the bankruptcy court authorizing the law firm of Honigman, Miller, Schwarz & Cohn ("Honigman, Miller") to act as counsel to the Chapter 11 debtor, PHM Credit Corporation ("Debtor"). District Judge John Feikens had previously refused to hear an earlier appeal by the U.S. Trustee on this same issue since it was taken from an interlocutory order. See the analysis of Judge Feikens' earlier decision in the June, 1989 issue of the Newsletter. This decision is also reported at 99 Bankr. 762.

Judge Feikens first held that the U.S. Trustee had standing to appeal under section 307 of the Bankruptcy Code. Judge Feikens disagreed with the decision of In re Revco, D.S., Inc., 99 Bankr. 778 (N.D. Ohio 1989) which applied the "person aggrieved" standard to the U.S. Trustee. Second, Judge Feikens declared that the U.S. Trustee had not waived its appeal rights nor did the confirmation order bar the appeal. On the latter point, the Court stated that the appeal would not "affect or collaterally attack" the Debtor's confirmed plan. Finally, Judge Feikens held that the "curative" provisions of the bankruptcy judge's order restricting certain of Honigman, Miller's actions were not an abuse of the court's discretion and were authorized under 11 U.S.C. § 105(a). In affirming the decision below, Judge Feikens characterized the U.S. Trustee's position as "hypertechnical . . . ignoring the fundamental economic realities of the case."

In re Ryan, Case No. 88-CV-74948 (E.D. Mich. Jan. 12, 1990). The debtors, husband and wife, commenced a Chapter 7 case in the Detroit Bankruptcy Court in June, 1984, and their case was assigned to former Bankruptcy Judge George Brody. In their schedules and statements filed with the bankruptcy court, debtors listed as an asset on Schedule B-2 a "counterclaim for damages against Comprehensive Accounting Corporation; Anti-Trust and Sexual Discrimination Claims against Comprehensive Accounting Corporation." At the time they filed their Chapter 7 petition, these claims had been asserted against this corporation in an action pending in Wayne County Circuit Court. The debtors listed the value of these claims as "undetermined." Five days prior to the meeting of creditors in the Chapter 7 case, the Wayne County Circuit Court dismissed the debtors' counterclaims for lack of progress. In July, 1984, the Chapter 7 trustee filed a "no asset" report with the bankruptcy court and, three months later, the debtors received their discharge. Thereafter, the bankruptcy court closed this case.

After the debtors received their discharge, they commenced another action against Comprehensive Accounting Corporation on the same claims listed in their bankruptcy schedules. Thereafter, the debtors received a mediation award of $12,500 on these claims. The debtors' Chapter 7 trustee learned of this award and instructed the debtors to accept it. When the debtors refused to follow this directive and rejected the award, the trustee filed a motion to reopen the closed Chapter 7 case, which motion was granted by Bankruptcy Judge Brody on March 7, 1988. Two months later, Judge Brody granted the trustee's motion for turnover of the mediation award and determined that it was property of the estate. This order permitted the trustee to accept the mediation award and to receive and distribute its proceeds. The debtors thereupon appealed to the federal district court from the orders reopening the Chapter 7 case and directing the debtors to turn over the award to the trustee.

On appeal, District Judge Paul Gadola affirmed the two orders entered by Judge Brody below. In his opinion, Judge Gadola declared that Judge Brody "did not abuse his discretion in deciding to reopen the case." The record contained no suggestion that the trustee's motion to reopen was motivated by "fraud or intentional design." Judge Gadola also held that the Chapter 7 trustee had proper standing to move to reopen the case. Finally, Judge Gadola found that Bankruptcy Judge Brody's finding that these claims had not been abandoned by the trustee was not "clearly erroneous."

In re Watervliet Paper Co., Inc., Case No. SK 88-03257 (Bankr. W.D. Mich. Dec. 22, 1989). The background of this decision is contained in In re Watervliet Paper Co., 96 Bankr. 768 (Bankr. W.D. Mich.), aff'd, Case No. G 89-30236 (W.D. Mich. Aug. 28, 1989), both of which have been discussed in prior issues of the Newsletter. In this decision, Bankruptcy Judge JoAnn Stevenson was asked to decide whether the law firm of Clary, Nantz, Wood, Hoffius, Rankin & Cooper ("Clary, Nantz"), counsel for the Chapter 11 debtor, could recover from the estate attorneys' fees of $10,000.00 incurred in prosecuting an appeal from Judge Stevenson's earlier ruling that Clary, Nantz was not "disinterested" within the meaning of 11 U.S.C. § 327(a). Judge Stevenson sustained the objection of the U.S. Trustee, finding that these fees were not chargeable to the estate since they resulted in no benefit to the estate.

In re American Sunlake Limited Partnership, Case No. GG 89-01196 (Bankr. W.D. Mich. Dec. 19, 1989). Prior to filing its Chapter 11 petition, the debtor, American Sunlake Limited Partnership ("Debtor"), entered into an agreement with Wilder Corporation ("Wilder") wherein Debtor purchased from Wilder certain realty subject to a mortgage in favor of Florida Federal Savings Bank ("Bank"). This agreement also permitted Debtor to reconvey certain portions of that realty upon the nonoccurrence of certain conditions required to be performed by Wilder after the sale. If this reconveyance was made, the Debtor's obligation to Wilder would be reduced by $800,000 and any interest paid on that debt that was allocated to the reconveyed property would be credited to reduce the principal amount of this debt. Wilder was granted a second mortgage on this realty to secure Debtor's obligations to it and Wilder reaffirmed its indebtedness due Bank under the first mortgage note.

Debtor took possession of the realty after the sale closed and began operating it as a mobile home park. In February, 1987, Debtor attempted to reconvey certain portions of the realty to Wilder in accordance with their prior agreement but Wilder refused to accept the deed of reconveyance. Thereafter, Debtor commenced an action in Florida state court against Wilder to determine its legal rights and remedies. In this action, Debtor established an escrow account into which it deposited the disputed portions of the sums due Wilder and continued to make payments to Bank and to the real estate taxing authorities for taxes assessed against the realty subject to reconveyance.

On March 31, 1989, Debtor commenced its Chapter 11 case in the Grand Rapids Bankruptcy Court. As of that date, Debtor was not in default on its obligations to Bank or Wilder. In May and June, 1989, trial was held in the Florida state court action after the automatic stay was modified. At the trial's conclusion, the state court entered judgment in favor of Debtor. Specifically, the state court held that (i) the Debtor properly reconveyed the realty to Wilder; (ii) the monies in the escrow account must be returned to Debtor; (iii) Wilder must reimburse Debtor for the disputed portions of four monthly payments previously received by Wilder; (iv) Wilder must reimburse Debtor for real estate taxes paid by Debtor on the reconveyed property; and (v) Wilder must pay Debtor's costs and attorneys' fees. After this judgment was rendered, Wilder filed a motion in the Debtor's Chapter 11 case seeking to recoup or offset the sums payable to Debtor under the state court judgment.

In his decision denying Wilder's motion, Bankruptcy Judge James Gregg first discussed the elements of recoupment. According to Judge Gregg, recoupment is an equitable remedy that must involve a single transaction, rather than a series of transactions, between debtor and the creditor seeking recoupmen. Second, there must be some form of overpayment to the debtor by the credito whether accidentally or contractually made. In reviewing the case law applyin this doctrine, Judge Gregg stated that the cases "involve some variation of the theme that a creditor has paid or advanced to the Debtor more funds prepetition than have been earned by the Debtor as of the date of filing." Judge Gregg then declared that Wilder could not avail itself of this doctrine for two reasons. First, there was no overpayment made by Wilder to the Debtor. Wilder's payments to Bank on the mortgage debt were based on his independent obligation to Bank. Second, since Wilder breached his agreement with Debtor, Wilder had "unclean hands." Thus, Wilder forfeited any claim to an equitable remedy such as recoupment.

In its motion, Wilder also requested the bankruptcy court to offset Wilder's payments made to Bank against the sums due Debtor under the state court judgment. Judge Gregg first outlined the elements of the setoff doctrine: "The debt owed to the debtor and the claim asserted against the debtor (1) must be mutual obligations; (2) that arose from separate transactions; and (3) both must have accrued prepetition." Judge Gregg added that a bankruptcy judge has discretion to permit the application of this doctrine. Reviewing the facts before him, Judge Gregg refused to lift the automatic stay to permit Wilder to exercise any setoff rights it may have. According to Judge Gregg, a substantial equity cushion (viz. $800,000) existed in the real estate to protect Wilder's interests therein. Judge Gregg also refused to allow the setoff because of Wilder's unclean hands.

Webster v. Barbara, Adversary Proceeding No. 83-1310 (Bankr. E.D. Mich. Jan. 2, 1990). In this 52-page opinion, Bankruptcy Judge Ray Reynolds Graves entered judgment in favor of a Chapter 7 trustee avoiding the obligation of the debtor, a law firm, to repurchase its founder's stock and the security interests in the firm's assets granted to secure that obligation. Judge Graves also equitably subordinated the founder's claims to the claims of all other creditors under 11 U.S.C. § 510(c). Due to the length and complexity of this opinion, it will not be summarized in detail here.

In re Wolverine Knitting Mills, Inc., 107 Bankr. 546 (Bankr. E.D. Mich. 1989). In this decision, Bankruptcy Judge Arthur Spector held that an accounting firm retained by a Chapter 11 debtor could recover from the estate compensation for clerical and typing services at $25.00 per hour. The firm demonstrated that it had billed its regular clients for these services and that it was a common practice in the Bay City area for accounting firms to bill for these services.

EDITOR'S NOTEBOOK

Please take note that the "sunset" provisions of Public Law 99-509, §5005(a) have made Bankruptcy Code §362(b)(12), (13) inapplicable to petitions filed after December 31, 1989.

On January 9, 1990 the U.S. Supreme Court granted cert in Begier v. IRS, Docket No. 89-393, 1990 US LEXIS 17. In Begier v. United States IRS, 878 F2d 762 (CA 3, 1989), the Third Circuit held that the debtor's pre-petition payments of non-segregated funds to the IRS in satisfaction of tax withholding obligations were not a preference. This is contrary to the 9th Circuit's ruling in In re R & T Roofing Structures, (CA 9, Nev), which adopted the view of the District of Columbia Circuit in Drabkin v. District of Columbia, 824 F2d 1102 (1987), that such transfers were voidable preferences.

The local Bankruptcy Rules were adopted and became effective as of February 1, 1990. Copies of these Rules may be obtained from the Bankruptcy Court at a cost of $15.00 per copy. It is highly recommended that you obtain one "original" copy from the Court and make photocopies of it for intra-office use.

In a letter to the Editor of Michigan Lawyers Weekly which appeared in the edition of February 12, 1990, Michael A. Lockman, Assistant in Charge - Occupational Regulation Division, Department of Attorney General, wrote concerning making claims against the Homeowner Construction Lien Recovery Fund. This letter indicated, inter alia, that the position of the Fund is that the statutory requirement imposed on plaintiffs to make reasonable collection efforts to collect payment will include the obligation to pursue a claim in bankruptcy. Specifically, the letter indicates that where a general contractor files bankruptcy and certain subcontractors and materialmen remain unpaid on a specific project for which payment was received, such may be a breach of trust imposed by the Builders Trust Fund Act and, in such a situation, "the Fund's position is that a reasonable effort to obtain payment includes advocating before the bankruptcy court the non-dischargeability of such a debt."

Last month I was able to use a coupon at American Speedy Printing Centers, the printer for the Newsletter, which reduced our printing costs by 50%. If any readers have or receive similar coupons that will otherwise go unused, please send them to me.

Larry A. Ver Merris

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the United States Bankruptcy Court for the Western District of Michigan during the period from January 1, 1990 through January 31, 1990. These filings are compared to those made during the same period one year ago.

	Jan. '90	Jan. '89
Chapter 7	285	233
Chapter 11	12	14
Chapter 12	0	1
Chapter 13	149	115