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C-L CARTAGE AND THE CONVENTIONAL WISDOM: A WORD OF CAUTION

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The Sixth Circuit has now followed the Seventh Circuit's decision in Levit v. Ingersoll Rand Financial Corporation (In re V.N. Deprizio Construction Co.), 874 F.2d 1186 (7th Cir. 1989), and the Tenth Circuit's decision affirming the district court's decision in Manufacturers Hanover Leasing Corp. v. Lowrey (In re Robinson Brothers Drilling, Inc.), 892 F.2d 850 (10th Cir. 1989), by ruling in Ray v. City Bank and Trust Company (In re C-L Cartage Co., Inc.), ____ F.2d ____, 1990 U.S. App. Lexis 4710 (6th Cir. 1990), that a trustee in bankruptcy can recover avoidable payments made to non-insiders during the extended one-year preference period, instead of the 90-day preference period generally applicable to non-insiders, when those payments benefit insider creditors or guarantors. Bankruptcy practitioners reading the decisions in the C-L Cartage, Deprizio, and Robinson Brothers cases have some small inkling of how a senior economics major at Universitat Karl Marx in East Berlin must have felt when the walls came tumbling down this past winter. Most of the principles and assumptions upon which our behavior has long been based have disappeared overnight. While those senior economics majors scramble for new careers or new theories of economic reality, many bankruptcy lawyers, urged on by various commentators (see, e.g., Secured Lending Alert, Drafting Around the Insider Guarantee Problem, Vol. 5, No. 11, January, 1990; Michigan Business Formbook, M.A. Kleist, B.J. Newman, and D.D. Kopka, eds., ICLE 1989, 90 Supp., Form 3.3), are recommending that their clients revise their guaranty forms to include a waiver of claims by the guarantor against the principal debtor. Such a waiver, it is argued, will break the chain of extended preference liability. But attorneys should not race to implement this change without analyzing all of its implications, for this "solution" is itself beset with risks that may be worse than any extended preference liability exposure.

This article is not a critique of the result in Deprizio, which has now been adopted by the Sixth Circuit. Nor will it debate whether Deprizio should have come to its conclusion based on §550(a)(2) of the Bankruptcy Code as opposed to §550(a)(1). Although those issues are interesting, what concerns our clients most is how

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they should respond to C-L Cartage. This article will argue that the response should be a cautious one, focusing more on lending practices and pricing than on major changes in guaranty language.

First, including the new waiver language in a guaranty may not provide the circuit breaker to extended preference exposure that one seeks. Second, it may increase customer resistance to signing guarantees. Third, it may be thrown back at the lender as evidence of its control over the customer and its officers in lender liability or equitable subordination litigation. The fact may be that no completely acceptable quick fixes are available (absent Congressional amendments to §§5547 and 550 of the Bankruptcy Code to make them say expressly what most courts until Deprizio read them to say.) But there are certain actions lenders and other creditors that take guarantees can take to limit their exposure.

I. The C-L Cartage Case And The Conventional Wisdom

The facts and analysis of the C-L Cartage case were discussed in the April, 1990 (Vol. 2, No. 8) edition of this newsletter. In summary, the Sixth Circuit reviewed and rejected the equitable and two transfer theories under which creditors whose debt had been guaranteed by an insider had escaped extended preference liability in other cases, stating:

> " [w]e prefer a literal reading of the statute permitting recovery from non-insider transferees for payments made during the extended preference period which benefit insider creditors or guarantors. Insiders, using their knowledge and control over the debtor, have an incentive to cause the debtor to prefer particular outside creditors when the insiders themselves derive benefits from those payments. . . . Favoring certain creditors over others similarly situated is particularly what sections 547 and 550 seek to prevent. A straightforward application of the statutory language is consistent with the policies these sections were enacted to further. "

C-L Cartage lacks the extended analysis and verbal flights of fancy of the Deprizio decision[1] -- in fact, it refers to Deprizio only in passing. Deprizio discusses a number of defenses to which the guaranteed creditor might be entitled; C-L Cartage discusses none of them, and in fact ignores what would appear to be the principal defense to the preference action under the facts of that case -- payment in the ordinary course of business. However, C-L Cartage reaches the same result as Deprizio and Robinson Brothers Drilling, with the non-insider being made subject to the extended insider preference period.

In any event, as a result of C-L Cartage, commentators and lawyers are suggesting that lenders insert in their guarantees language such as that suggested in the Secured Lending Alert article referred to above:

> " Notwithstanding anything to the contrary in this guaranty, the guarantor hereby irrevocably waives all rights it may have at law or in equity (including, without limitation, any law subrogating the guarantor to the rights of the lender) to seek contribution, indemnification, or any other form of reimbursement from the debtor, any other guarantor, or any other person now or hereafter primarily or secondarily liable for any obligations of the debtor to the lender, for any disbursement made by the guarantor

under or in connection with this guaranty or otherwise. "

The Michigan Business Formbook suggests a slightly different tack (optional language in brackets):

" Guarantor waives any and all claims and rights (whether arising in equity, at common law, or under a statute or agreement) that arise from or relate to Guarantor's execution, delivery, or performance of this Guaranty [unless and until the indebtedness is paid in full]. This waiver includes, but is not limited to, any right of subrogation, contribution, indemnity, and exoneration, and recourse to security, and any right to participate in any claim or remedy that Creditor at any time has against Debtor or with respect to any security for the indebtedness. "

The rationale for including this waiver is found in the Deprizio case, in which the Seventh Circuit refused to allow recovery of substantial payments to the IRS for withholding taxes during the extended preference period, which payments directly benefited the responsible officers of the debtor. Concluding that a responsible officer who pays the 100 percent penalty assessed because of the corporation's failure to pay withholding taxes has no "claim" against the corporation under §101(4) of the Bankruptcy Code, even though the Deprizio court held that the responsible officer benefited from the payments, the officer was not a "creditor" of the debtor. 874 F.2d at 1192. As a result, one of the elements necessary to find a preferential transfer did not exist and the trustee could not recover the transfer. Therefore, the reasoning continues, by inserting the suggested waiver language in guarantees, the lender creates a circuit breaker that will prevent the guarantor from becoming a creditor of the debtor and thereby prevent extended preference liability from resting upon the lender.

II. Some Problems With The Conventional Wisdom.

A. The Effectiveness of the Waiver. If the waiver language is narrowly drafted to deal only with the waiver of any subrogation, contribution, or indemnification rights in connection with the guaranty itself (as in the Michigan Business Formbook), the waiver may not be effective. Section 547(b)(1) speaks of a transfer to or for the benefit of "a creditor", not "the creditor". "Creditor" is generally defined as a holder of one or more pre-petition claims against the debtor. 2 Collier on Bankruptcy, ¶101.09, p. 101-39 (15th Ed. 1990). In many instances, the guarantor may be a creditor of the principal debtor for some reason other than a subrogation claim in connection with the guaranty. As noted in a recent article:

" Even if the lender persuades its insider guarantor to waive these claims, the possibility remains that the guarantor may have or acquire other claims against the borrower. Insiders may make loans to the borrower, be owed monies, have claims pursuant to employment contracts or stock option agreements or own debt instruments issued by the borrower. In each such case, the guarantor could be construed to be an insider creditor of the borrower regardless of the waivers contained in the guarantee. If the trustee in the borrower's insolvency proceeding can demonstrate that the insider benefited from the transfer to the lender, the outside lender may still be subject to a one-year preference period. "

J. Hilson and R. Davidson, Guarantees To Lenders Set Aside, The National Law Journal, October 30, 1989, pages 30-32.

In addition to these kinds of debts, the borrower might owe debts to the insider for reimbursement of employee expenses or for retirement benefits. If an insider has a claim against the debtor corporation based on any of these (or any other) grounds, the narrowly drafted waiver may not be effective. Further, including the optional language suggested by the Michigan Business Formbook, which allows the subrogation claim to "bounce back" once the guaranty is paid in full (in an effort to prevent the guarantor from claiming unconscionability), may cause a court to find that the guarantor continues to have a contingent or unmatured or equitable claim under the definition of §101(4) and is therefore a "creditor" of the debtor.

In order to prevent the guarantor from being a creditor for any reason, one might include language in the waiver that expressly states that the guarantor waives any claims whatsoever, whether growing out of the guaranty or otherwise. (Whether the language suggested by the Secured Lending Alert achieves this goal is debateable.) However, as will be discussed in part 2(B) below, it is difficult to imagine potential guarantors signing guarantees containing such language.

It is also difficult to imagine that bankruptcy trustees will be unable to come up with arguments or theories which might allow courts to pierce the form of the guaranty waiver language to get at the substance of the transaction, which is a preferential transfer for the benefit of an insider. A bankruptcy court could rationalize the result by refusing to exalt form over substance. As the Supreme Court stated in Pepper v. Litton, 308 U.S. 295, 304-305 (1939):

> " The bankruptcy courts have exercised [their] equitable powers in passing on a wide range of problems arising out of the administration of bankrupt[cy] estates. They have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done . . . "

Hundreds of bankruptcy cases reaffirm this maxim, including In re A.H. Robins Company, Inc., 880 F.2d 694, 702 (4th Cir. 1989), and MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 94 (2d. Cir. 1988). A bankruptcy court could perhaps read the definition of "claim" to find that a person who may have been compelled to sign such a waiver of claims has an equitable claim or that the waiver is simply unconscionable. Or perhaps the court could simply reject the waiver as being violative of public policy. Most devastating might be a finding upholding the waiver. This is because, if the debtor owed no debt to the guarantor as a result of the waiver, any payment by the debtor to the lender may be a "gift" to the guarantor and hence a fraudulent conveyance to the guarantor. This finding would leave the lender exposed to a far greater reach back under the statute of limitations of Michigan's version of the Uniform Fraudulent Conveyance Act than the maximum one-year reach back under §547![2] Whatever the arguments, courts will likely be receptive to arguments in favor of avoiding a result that would allow a company president to sign a guaranty containing waiver language and then intentionally prefer himself by making a substantial payment on the unsecured or undersecured debt shortly before 90 days before the filing, thereby escaping preference liability both for the creditor and for himself.

B. Customer Resistance. If a lender decides to include the proposed waiver language in its guaranty despite the risk that it might not work, how might a customer respond?

most lenders know, obtaining a personal guaranty of corporate indebtedness is generally an important and oftentimes difficult part of the negotiations for extending financing. Borrowers do not like signing personal guarantees, and no one should think they will overlook the suggested waiver language. And conversely, because the waiver could have a draconian effect, the lender will probably wish to have the language printed in a conspicuous typeface to make sure it catches the guarantor's attention. Once the borrower's prospective guarantor focuses on the language, the more arduous the negotiations will be, particularly if the language waives all claims.

A lender may be able to convince a "pure" guarantor who has no other claims against the debtor that it is in his best interest to sign a guaranty containing a waiver of claims so that payments to the lender and the benefit to the guarantor can be insulated from avoidance by a bankruptcy trustee. However, what happens if the bankruptcy court eventually disregards the waiver language and imposes a preference recovery against the lender during the extended preference period? Now suppose that you have the rare guarantor who has voluntarily paid off the balance of the guaranteed debt and, but for the waiver, would have recovered something from the debtor under a subrogation claim. However, to preserve the waiver fiction, no proof of claim was filed and the bar date for filing a claim has passed. Does that guarantor now have a claim for misrepresentation or breach of contract against the bank for the lost dividend because of the failure of the waiver language?

Where the guarantor has other claims against the debtor, in particular for benefits under an employment contract, pension, or otherwise, it is difficult to imagine the guarantor willingly signing a guaranty with broad waiver language. He might well choose to go down the street to another bank that might not ask for that language. Although doing without an insider guaranty might be considered, lenders who have attempted to liquidate a borrower's business where the principal has nothing on the line by way of a guaranty will know that that alternative is generally not an acceptable one.

C. Waiver Language As Possible Evidence Of Control. The waiver idea might be carried to its logical conclusion. What about obtaining covenants to prevent exposure where junior creditors have their debt guaranteed? Hilson and Davidson suggest that strategy in their article "Guarantees to Lenders Set Aside", supra:

> " Lenders can insert waivers of the guarantor's right to reimbursement, indemnification, and contribution into guarantees from 'insider' creditors. To the extent that junior creditors are also guaranteed, a senior lender should consider requiring that such 'junior' guarantees contain similar waivers. Lenders also might insist that their borrowers covenant not to enter into transactions with insider guarantors that would create rights of contribution or indemnification against the borrowers. The benefits to lenders of such demands must be carefully weighed against the risk of appearing to 'control' their borrowers. "

Id. at p. 32.

One must remember that the setting where waiver language will most likely become an issue is in a bankruptcy or insolvency proceeding involving the principal debtor. The optimism and general good feelings that prevailed at the time the loan documents were initially executed will have given way to bitterness, desperation, and a casting about for parties to blame for the bad fortune of the debtor and its guarantors/principals. The lender will usually be the easiest target with the deepest pocket for both the

guarantors/principals and the disappointed creditors of the debtor. Particularly where the broad form waiver language was included in the guaranty and the guarantor in fact gave up claims against the debtor other than for subrogation under the guaranty, the complaining party, whether it be a bankruptcy trustee, shareholders of the debtor, or creditors of the debtor, may argue that the ability to extract such language in the guaranty is evidence of control of the corporation by the lender. The plaintiff will argue that the lender should be responsible for the company's debts or that its claims should be equitably subordinated to the claims of other creditors. Although it is difficult to imagine a court imposing lender liability or equitable subordination simply because the lender obtained a guaranty with broad waiver language in it, it might find control in this area that suggests control on other issues that were detrimental to the principals or to creditors. This is particularly so where there is a jury that might be incensed that the lender would require such a waiver in its guaranty.

III. Some Possible Responses For The Lender.

Because of its possible ineffectiveness, the likely resistance of guarantors to it, and the possible additional risk that might follow the lender that uses it, waiver language should be inserted in guarantees only after very careful consideration and disclosure to the client of the possible risks. Doing without insider guarantees is not a solution either, because, as discussed above, guarantees are often the most effective way for a lender to maintain the interest and assistance of the corporate principals in the liquidation of the corporate assets and to make sure they actively participate in the litigation. But a lender can do some other things that might limit its exposure.

One possible strategy is to return the focus to the adequacy of the security held by the lender for the indebtedness. The lender might be better served by carefully understanding the customer's business, what assets might bring in liquidation and what the expenses of liquidation might be than by relying on guaranty waiver language that might give only the illusion of protection. (If the lender is fully secured, there is no preference, because the lender is not the recipient of more than it would receive in liquidation.) Second, the lender can do whatever it can to make sure the guaranty is itself fully collateralized. Third, the lender could insert provisions in the guaranty that expressly provide that the guaranty continues to the extent any payments are recovered from the lender in a preference action or otherwise. The Michigan Business Formbook suggests the following language:

> " If any payment applied by Creditor to the indebtedness is set aside, recovered, rescinded, or required to be returned for any reason (including without limitation the bankruptcy, insolvency, or reorganization of Debtor or any other obligor), the indebtedness to which the payment was applied shall for the purposes of this guaranty be deemed to have continued in existence, notwithstanding the application, and this guaranty shall be enforceable as to that indebtedness as fully as if Creditor had not made the application. "

Fourth, the lender could consider including a provision that would provide that the collateral securing the guaranty is not released until one year after payment of the indebtedness. (Admittedly, guarantors will resist such provisions.) Fifth, the lender may have to more carefully police the loan to ensure ordinary course payments and good collateral to loan value. Finally, the lender can price the loan appropriately, considering the additional risk of extended preference liability.

There is no magic solution to this problem; but, lenders can protect themselves against extended preference liability by doing their homework more carefully at the outset, pricing their product accordingly, and carefully monitoring payments and collateral value during the term of the loan. None of these recommendations is entirely satisfactory. However, they may give the lender more protection than the insertion of waiver language, which may only give a false illusion of comfort to the lender.

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1. E.g., "As the investigation continued and Deprizio's indictment was imminent, it was circulated that he might 'sing'. So in January, 1986, Deprizio was lured to a vacant parking lot where an assassin's gun and the obligations of a lifetime were discharged together. Corporations are not so easily liquidated."

2. I am indebted for this last argument to Peter L. Borowitz of Debevoise & Plimpton in New York who will be making this argument, among others, in an article on this topic to appear in the August, 1990 issue of the Business Law Journal.

FROM THE BANKRUPTCY COURT:

BANKRUPTCY COURT IMPLEMENTS VOICE CASE INFORMATION SYSTEM (VCIS)

The US Bankruptcy Court for the Western District of Michigan has just installed a VCIS (Voice Case Information System) as a new service to the bankruptcy bar and to the general public. VCIS uses a computer-generated synthesized voice device which reads back case information directly from the court's BANCAP data base without the assistance of the clerk's office staff in response to telephone inquiries. This system is now in use in several other districts, which report as many as 400 inquiries a day being handled directly by computer.

VCIS is now operational for the Western District of Michigan. Although information is limited to those cases which have been entered into the BANCAP automated docketing system (i.e., cases after January 1, 1988), it is expected that the majority of calls will be from persons interested in newly filed cases. Calls may be made almost any time during the day, only excepting those rare occasions when the computer is down for service.

VCIS is designed to be user-friendly. Using a touch-tone telephone, the caller dials (616) 456-2075. A computer-generated voice answers and gives the caller a series of instructions for obtaining case information. Within seconds, callers are given such information as the case number; type of case, debtor's name and the name and telephone number of the debtor's attorney, the name of the trustee, the judge, the status of the case, the date and location of the 341 creditor meeting and, if appropriate, the date of the discharge and closing date of the case. VCIS may be just the first of several innovations. Tests are already being done of a system which will allow attorneys, credit agencies and the like to access information in the BANCAP database directly via personal computer and modem. There is even discussion of electronic filing of documents.

Court staff will be happy to demonstrate the VCIS system to members of the bar, financial institutions, credit search companies and other interested organizations. For further information about the system call Ken Bross, BANCAP Systems Administrator, at 456-2056.

Mark Van Allsburg

SEMINAR
FOR PARALEGALS
AND FOR LEGAL SECRETARIES

JUNE 20, 1990

The U.S. Bankruptcy Court for the Western District of Michigan will be conducting a seminar for bankruptcy paralegals and for legal secretaries. This will be a very basic, very practical course intended for the paraprofessional legal employee who has primary responsibility for preparing and filing bankruptcy forms.

AGENDA

10:00 -INTRODUCTION OF THE STAFF AND ORGANIZATION OF THE BANKRUPTCY COURT

11:00 -ERRORS TO AVOID IN NEW CASE FILINGS, AMENDMENTS AND ROUTINE ORDERS

NOON -LUNCH (PROVIDED ON SITE)

1:00 -THE NEW COURT RULES (WITH EMPHASIS ON FEE APPLICATIONS, RELIEF OF STAY MOTIONS, ETC.)

2:00 -PRACTICAL PROBLEMS (FOCUS TO BE ON PROBLEMS EXPERIENCED BY PARTICIPANTS IN DEALING WITH THE BANKRUPTCY COURT)

This program will cost $15.00 per person, which will cover the cost of materials provided as well as lunch. This seminar will be limited to 10 persons and will be repeated as often as necessary to meet demand.

PERSONS INTERESTED IN ATTENDING THE JUNE 20 SEMINAR SHOULD MAKE A RESERVATION BY CALLING JULIE ARCHER, JEAN GUINN OR SUE BART at 456-2901. A CHECK FOR $15.00 SHOULD BE SENT AND MADE PAYABLE TO THE U.S. BANKRUPTCY COURT AFTER THE RESERVATION IS MADE.

Mark Van Allsburg

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.

New York Life Ins. Co. v. Revco D.S., Inc. (In re Revco D.S., Inc.), Case Nos. 89-3488/3489 (6th Cir. April 27, 1990). This decision involved an appeal from a financing and adequate protection order entered by the Bankruptcy Court for the Northern District of Ohio in the Revco Chapter 11 cases. In late July, 1988, Revco commenced its Chapter 11 case and approximately one month later, the Bankruptcy Court entered an order authorizing the debtor in possession to obtain post-petition financing from a group of banks, which financing would be secured by superpriority liens in essentially all of Revco's assets. That same order, hereinafter referred to as the "Financing Order, required Revco to make periodic adequate protection payments on its prepetition secured claims held by essentially the same lenders who extended post-petition financing to Revco. Two holders of Revco's preferred stock, New York Life Insurance Company and New York Life Insurance and Annuity Corporation (referred to jointly as "NYLIC"), objected to Revco's adequate protection payments to these creditors. After a hearing, the Bankruptcy Court overruled NYLIC's objection and entered the Financing Order. Thereafter, the federal district court dismissed NYLIC's appeal from the Financing Order because NYLIC failed to obtain a stay pending appeal under 11 U.S.C. §364(e). On appeal to the Sixth Circuit, NYLIC argued that this dismissal was erroneous.

In its opinion, the Sixth Circuit first held that NYLIC, as holders of Revco preferred stock, had standing to appeal as a "person aggrieved" and

the Financing Order was a final order subject to appeal. The Sixth Circuit then reviewed the statutory language and legislative history of 11 U.S.C. §364(e) which states that a post-petition lender acting in good faith cannot have its debt or lien affected on a subsequent appeal unless a stay pending appeal was first obtained. Even though NYLIC failed to obtain such a stay, the bankruptcy court failed to make "an explicit finding" as to the post-petition lenders' good faith in making these loans. This failure permitted NYLIC to prosecute and maintain its appeal. According to the Sixth Circuit, "an implicit finding of 'good faith' in a §364(e) context is insufficient and . . . good faith under that section should not be presumed." The Sixth Circuit thereupon remanded the matter to the Bankruptcy Court for an explicit finding on the good faith issue.

United States of America v. Ginley (In re Walter Johnson), Case No. 88-4079 (6th Cir. April 24, 1990). In this case, the Sixth Circuit held that a claims bar date established by the bankruptcy court in a Chapter 7 case after conversion from Chapter 11 applied to a late filed proof of claim (or request for payment) of Chapter 11 administrative expenses of the Internal Revenue Service. The Sixth Circuit relied upon the language of Bankruptcy Rule 1019(7) in support of its decision.

Urbanco, Inc. v. Urban Systems Streetscape, Inc., 111 Bankr. 134 (W.D. Mich. 1990). On March 10, 1986, Urban Systems Streetscape, Inc. ("Debtor") commenced a Chapter 7 case in the United States Bankruptcy Court for the Western District of Michigan. At that time, Debtor was a defendant in a breach of contract suit brought in California state court by Pacific Lighting Sales, Inc. ("Pacific"). That action was automatically stayed by Debtor's bankruptcy filing. Thereupon, Pacific filed a proof of claim in Debtor's Chapter 7 case and amended its complaint in the California action to assert "alter ego" claims against non-bankrupt entities related to Debtor. On June 12, 1989, Bankruptcy Judge David E. Nims, Jr. entered an order closing Debtor's Chapter 7 case. Some time thereafter, the alter ego defendants in the California action moved to reopen the Debtor's Chapter 7 case, asserting that Pacific's claims against them were property of the Debtor's estate and should be administered by the Trustee. Judge Nims denied this motion pursuant to an order issued on or about October 30, 1989, on the basis that the equitable doctrine of laches barred defendants from obtaining the relief they requested. Trial of the California action was scheduled to begin on February 20, 1990.

The alter ego defendants thereupon appealed to the federal district court, arguing that Judge Nims had abused his discretion in refusing to reopen the Debtor's Chapter 7 case. The alter ego defendants asserted that their potential liability to Pacific constituted an asset of the Debtor's estate that should be administered by the Trustee for the benefit of Debtor's creditors. The district court, per Judge Robert Holmes Bell, rejected this argument and affirmed the decision below. According to Judge Bell, the decision of whether to reopen a bankruptcy case under 11 U.S.C. §350(b) "is a matter committed to the sound discretion of the bankruptcy judge and will not be set aside absent abuse of discretion." In affirming the decision below, Judge Bell noted that the defendants took no action in the bankruptcy court until the eve of trial in the California action. Pacific's rights in that action would be prejudiced if the Debtor's case were to be reopened at that late date.

Grogan v. A & A Energy Properties, Ltd. (In re Corango Resources, Ltd.), Case No. 89-70527 (E.D. Mich. May 2, 1990). In this Chapter 7 case, the trustee commenced an adversary proceeding against A & A Energy Properties, Ltd. ("Defendant") seeking the return of a preference. This action was commenced in the United States Bankruptcy Court for the Eastern District of Michigan. Defendant thereafter moved in the district court to withdraw the preference action from

the bankruptcy court since Defendant had made a jury demand, which demand deprived the Bankruptcy Court of jurisdiction. Although the trustee did not oppose the Defendant's motion, the federal district court, per Judge Avern Cohn, denied the motion to withdraw sua sponte. In his decision, Judge Cohn declared that bankruptcy courts have power to conduct jury trials in core proceedings, thereby deciding the issue left open by the United States Supreme Court in Granfinanciera, S.A. v. Nordberg, 109 S.Ct. 2782 (1989).

Aetna Life and Casualty Co. v. Howath (In re Howath), Case No. 90-CV-70003-DT (E.D. Mich. April 13, 1990). This appeal arose from the dismissal of an adversary proceeding by the Bankruptcy Court for the Eastern District of Michigan on account of the failure of plaintiff's counsel to attend a pretrial conference before the bankruptcy judge. After the bankruptcy court entered the dismissal order, plaintiff's counsel filed a motion for rehearing under Fed.R.Civ.P. 60(b) claiming that his failure to attend was caused by mistake, inadvertence or excusable neglect. In support of this motion, Plaintiff's counsel asserted that his secretary neglected to record the date of the pretrial conference in her diary and in counsel's calendar. The bankruptcy judge denied this motion.

On appeal, Federal District Judge John Feikens reversed the dismissal order and the order denying plaintiff's motion for rehearing and remanded the matter for a hearing on the issue of whether counsel's failure to attend the pretrial conference was done in bad faith. In his opinion, Judge Feikens declared that a "presumption exists against dismissal for a single failure to appear that has not been shown to constitute a bad-faith failure to prosecute." However, Judge Feikens noted that lesser sanctions can be imposed short of dismissal in the absence of bad faith. In the case on appeal, there were no facts in the record to support the bankruptcy court's dismissal of the adversary proceeding.

Durant Enterprises, Inc. v. Cr[illegible] tors Committee of Hamady Brothers F[illegible] Markets, Inc. (In re Hamady Brothe[illegible] Food Markets), 110 Bankr. 815 (E.D. Mich. 1990). In this Chapter 11 case commenced in the Bay City Bankruptcy Court, the creditors committee proposed a plan providing for the transfer of ownership of the debtor, Hamady Brothers Food Markets, Inc. ("Debtor"), away from its parent corporation, Durant Enterprises, Inc. ("Durant"), to a third party, McColgan Investment Company ("McColgan"). This plan was confirmed by Bankruptcy Judge Arthur Spector. Durant thereafter filed an appeal from that confirmation order to the district court although Durant did not then seek a stay of that order. Approximately two weeks later, Durant filed with the district court a motion seeking a stay and enlargement of the time to designate the record and issues on appeal. The district court thereafter granted the enlargement of time but directed Durant to seek a stay of the confirmation order pending appeal in the bankruptcy court, which Durant did. On June 20, 1989, Judge Spector entered a consent order which

> . . . [prohibited] Durant from seeking a stay, and [insulated] from further review, even if [the district court] were to reverse or modify the Confirmation Order, the validity or priority of any loan, or any financial accommodation made at any time by an entity. The Consent Order [did] not waive or otherwise withdraw Durant's appeal.

110 Bankr. at 816.

Thereafter the creditors' committee filed a motion in the district court for dismissal of Durant's appeal as moot, arguing that by withdrawing the stay and permitting the confirmation order to be implemented, "Durant [had] allowed to go forward such substantial and irreversible actions in reliance on the Committee's plan and that any appeal from that plan [was] essentially moot." 110 Bankr. at 817. In support of this argument, the

mittee stated that McColgan had ready acquired all of Hamady's quity securities, that new financing arrangements had been entered into and millions of dollars of new credit had been extended. The committee also sought to supplement the record on appeal with evidence supporting its dismissal motion.

In his opinion addressing this motion, District Judge George Woods first permitted the committee to supplement the record on appeal as requested. Judge Woods found that there was "ample case law authorizing the court to take judicial notice of the bankruptcy court's orders and to allow a supplementation of the record on appeal." 110 Bankr. at 817.

In addressing the mootness issue, Judge Woods first noted the "substantial body of case law" holding that a district court "may dismiss as moot an appeal from a confirmation order, when the underlying plan has been so substantially consummated that effective relief is no longer available to the appellant." Id. One of the factors a court must consider in this regard is the appellant's failure to obtain a stay of the confirmation order pending the appeal's outcome. The consent order entered by Judge Spector permitted Durant to pursue its appeal but also "allowed to go forward substantial action in confirmation of the plan, and insulated much of that action from the effects of the outcome of Durant's appeal." 110 Bankr. at 818. Reviewing the facts before him, Judge Woods remanded the mootness issue to Bankruptcy Judge Spector for decision since he, as the overseer of the plan and its confirmation, could "bring a broader perspective and familiarity to the matter, and save all those involved from the waste of time involved in re-briefing the district court." 110 Bankr. at 819.

In re Estate of Eleanor L. Blood, Deceased, Case No. GG 90-81458 (Bankr. W.D. Mich. May 25, 1990). In this decision marked "Not for Publication," Bankruptcy Judge James D. Gregg dismissed an involuntary petition filed against a probate estate. Judge Gregg followed other decisions on the issue finding that a probate estate is not a "person" within the meaning of 11 U.S.C. §§109(b) and 303(a) that is eligible for relief under Chapter 7 of the Bankruptcy Code.

Lasich v. Wickstrom (In re Wickstrom), Adversary Proceedings Nos. 88-0015/0016 (Bankr. W.D. Mich. April 20, 1990). This decision rendered by Bankruptcy Judge Gregg addresses important issues involving fraudulent conveyances and exempt property. In the two adversary proceedings involved here, the Chapter 7 trustee ("Trustee") of the individual debtor, George Wickstrom ("Debtor"), sought to recover from defendants a $20,000 payment and two transfers of real property made by Debtor prior to the date on which he commenced his Chapter 7 case. Trustee alleged in his complaint that these transfers constituted either preferences or fraudulent conveyance. The two parcels of realty that were transferred are referred to in Bankruptcy Judge Gregg's decision are referred to as the "marital home" (transferred to Debtor's parents) and the "recreational camp" (transferred to Debtor's son), both of which were held by Debtor and his wife as entireties property. The $20,000 payment was made to Debtor's parents. These monies were proceeds of a workers compensation claim belonging to Debtor. The parties submitted to the Bankruptcy Court certain stipulated facts and the defendants filed a joint motion for summary judgment in the consolidated adversary proceedings. Judge Gregg denied this motion, finding that the Trustee had stated in his complaint valid causes of action under 11 U.S.C. §§547(b) and 548(a).

In support of their motion, defendants argued that the properties transferred by Debtor to them were exempt property under Michigan law. Consequently, they argued that, the Trustee could not unwind these transfers and preserve them for the benefit of creditors. Once back in the estate, these properties would be subject to the Debtor's exemption claims. Judge Gregg characterized this argument as a "no harm-no foul" position.

Judge Gregg rejected this position, declaring that a debtor will waive his right to claim property as exempt if he voluntarily transfers that property to a third person prior to commencing a bankruptcy case. This rule applied to both the entireties real estate and the proceeds of the workmen's compensation claim.

Taunt v. Wojtala (In re Wojtala), Adversary Proceeding No. 89-0539 (E.D. Mich. 1990). In this adversary proceeding, the trustee sought to bar the individual Chapter 7 debtor, George Wojtala ("Debtor"), from receiving a general discharge under 11 U.S.C. §727(a)(2). In his complaint, the trustee claimed that the Debtor intended to hinder, delay or defraud his creditors by making a series of property transfers to family members on the eve of bankruptcy. The Debtor defended this action on the ground that the transfers were made for fair consideration and without fraudulent intent. Debtor also claimed that, since the transfers were designed by his counsel, he was therefore immune from the trustee's attack. After trial, the Bankruptcy Court for the Eastern District of Michigan, per Bankruptcy Judge Ray Reynolds Graves, entered judgment against the Debtor denying him a general discharge. Reviewing the facts in the record, Judge Graves held that the trustee had satisfied his burden of proving that Debtor had "engaged in a transaction with the intent to hinder, delay or defraud his creditors" under 11 U.S.C. §727(a)(2).

STEERING COMMITTEE MEETING MINUTE

A meeting was held on May 18, 1990 at noon at the Peninsular Club.

1. A discussion was had regarding the program timetable and other aspects of the Shanty Creek Seminar. All Steering Committee members should note that there will be a breakfast commencing at 7:45 on the morning of Friday, August 24, 1990 for the purpose of nominating/appointing new Committee members for the coming year(s), as well as staggering the terms of the Committee members. The breakfast will be held at Shanty Creek just prior to the first workshop session.

2. Approval was given for the final form of the Shanty Creek program announcement and reservation form. It was also decided to send such form with this Newsletter so as to save on mailing costs.

3. Robert W. Sawdey reported that a meeting is tentatively scheduled for next month with some of the Judges of the U.S. District Court to discuss the possible implementation of BAP in this District.

4. Discussion was had regarding storage of records for the Bankruptcy Section of the Federal Bar Association and having a central depository for such storage as well as information on standing and ad hoc committees. For the time being, Brett N. Rodgers will retain all Steering Committee records.

5. The next Steering Committee meeting was scheduled for noon at the Peninsular Club on Friday, June 15, 1990.

Larry A. Ver Merris

EDITOR'S NOTEBOOK

Enclosed with this Newsletter you should find a reservation form for the August 23 - 25 Bankruptcy Seminar at Shanty Creek Resort, together with an accommodations form/envelope. We would strongly suggest that, if you are planning to attend this Seminar, you make your reservations as soon as possible as there is a limited number of hotel rooms set aside for those attending the Seminar.

In the May 30, 1990 edition of the Wall Street Journal, p. B-2, it was reported that the U.S. Supreme Court ruled, 8-1, in the case of U.S. v. Energy Resources Co., that Federal bankruptcy judges may order the Internal Revenue Service to treat tax payments made by a company in a Chapter 11 reorganization as contributions to employee income taxes and Social Security withholding, rather than paying off the company's own income tax bill. As unpaid contributions to employee tax withholding accounts become the liability of the company's officers, the decision effectively allows corporate officers to reduce their "responsible person" liability through allowing the company in a Chapter 11 to pay withholding taxes ahead of its own income taxes. Although I have not read the text of such opinion, it would appear to overrule the Sixth Circuit's opinion in In re Du Charmes & Co., 852 F2d 194 (6th Cir 1988) in which that court held that payments made under a Chapter 11 plan are "involuntary" and hence the debtor could not designate which taxes those payments could be applied against.

On May 29, 1990, the Wall Street Journal reported, at p. B-5, that the Federal Court of Appeals in Atlanta ruled that a commercial financing company (Fleet Factors Corp.) may be liable for the cleanup of hazardous waste at a site owned by a company to which it lent money which company (Swainsboro Print Works) later filed bankruptcy. Apparently after the bankruptcy petition was filed Fleet arranged to auction off the company's inventory and equipment in which it maintained a security interest. During the winding-down process asbestos was apparently released and drums containing hazardous waste were spilled on the property. Fleet contended that it was not liable for the cleanup because it did not own or operate the site and that Fleet's actions were covered by an exemption in the Federal Superfund Law that shields lenders from liability when they have a security interest in a company's assets but do not participate in its management. While, again, I have not read the text of the opinion, the article indicates that the Court of Appeals in this decision held that lenders who are able to affect hazardous waste disposal decisions at a site are liable under the Federal Superfund Act. The appeals panel also found that the lower court had erred when it ruled that lenders must be involved in the day-to-day operations of a facility to incur liability. Fleet has not yet decided whether or not it will appeal such decision.

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 April 30, 1990. These filings are compared to those made during the same period one year ago, and two years ago.

	1/1/90 - 4/30/90	1/1/89 - 4/30/89	1/1/88 - 4/30/88
Chapter 7	1,337	1,110	985
Chapter 11	41	42	37
Chapter 12	6	4	11
Chapter 13	536	469	412