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WHEN DOES THE "ORDINARY COURSE" EXCEPTION OF 547(c)(2) APPLY?

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In the Sixth Circuit, the "ordinary course of business" exception to preference liability, 11 U.S.C. §547(c)(2), does much more than protect short-term credit transactions. Rather, it protects all usual actions between the debtor and its creditors, provided such actions are consistent with the concept of "undisturbed, normal financial relations", between those particular parties during the debtor's "slide into bankruptcy". This article summarizes the Sixth Circuit's analysis of §547(c)(2) as reflected in its most-recent decisions.

A Historical Perspective. Prior to the Bankruptcy Reform Act of 1984, the "ordinary course" defense to preference actions was limited to payments which were received within 45 days of the extension of credit. When Congress eliminated the 45 day limitation with scant explanation of its intentions, commentators and the courts were left to speculate as to the transactions that could qualify for the "ordinary course" defense. The uncertainty as to the scope of the "ordinary course" defense both promoted and frustrated the settlement of Trustees' preference actions.

These recent Sixth Circuit cases do not resolve all uncertainty surrounding §547(c)(2), but do reiterate a common theme: The policy of §547(c)(2) is to discourage unusual action by either the debtor or creditors, to leave undisturbed normal financial relations, even if those relations may be somewhat irregular.

Fulghum - A Look at Subsection (c)(2)(A) and (B). In In re Fulghum Construction Corp., 872 F.2d 739 (6th Cir., 1989), the Court focused on the meaning of ordinary course as it relates to §547(c)(2)(A) (debt incurred in ordinary course) and (B) (transfer made in ordinary course). Approximately one year before the filing of the bankruptcy petition, the sole shareholder of the soon-to-be-debtor corporation began making

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short-term cash advances to the debtor on the condition that the debtor repay these advances as it collected money from its construction contracts. Numerous advances and repayments were made, some of which fell within the preference period.

Thereafter, the trustee filed an adversary proceeding to recover the repayments as preferences. One of the issues on appeal was whether the creditor qualified for the 547(c)(2) defense.

As stated above, the Fulghum Court noted that, "Congress enacted §547(c)(2) 'to leave undisturbed normal financial relations, because they do not detract from the general policy of the preference section to discourage unusual action by either the debtor or the creditors during the debtor's slide into bankruptcy.'" Id. 743 [Emphasis added.]

The Court found that the (c)(2)(A) requirement was met because it was ordinary business for a shareholder to advance short-term funds to a struggling corporation to alleviate cash flow difficulties. Id. 743-44. This constituted a "recurring, customary, credit transaction", Id. 744, entitled to fall within the "ordinary course of business" requirement of (c)(2)(A) and (B). The Court stated that it "declines to discourage transactions of the type here at issue, which were a paradigmatic example of the type of transactions promoted by §547(c)." Id. 744. The Fulghum Court further noted that 547(c)(2) is "designed to encourage creditors to conduct business with a struggling enterprise so that debtors can rehabilitate themselves." Id. 744.

In short, as would be later illustrated by In re Finn, 909 F.2d 903 (6th Cir., 1990), the (c)(2)(A) "incurring of debt" element should not be a formidable hurdle if business with a struggling enterprise is to be encouraged.

Significantly, the Court stated that, "Even if the debtor's business transactions were irregular, they may be considered 'ordinary' for purposes of §547(c)(2) if those transactions were consistent with the course of dealings between the particular parties." Id. 743. The Court asserted that the focus of its 547(c)(2) analysis was on the "business practices which were unique to the particular parties under consideration and not to the practices which generally prevailed in the industry of the parties." Id. 743.

Fulghum did state that industry practice "might be relevant" to the (c)(2)(C) element of "ordinary business terms", Id. 743 n.5, but found no evidence on the record to indicate that the short-term advances made by the sole shareholder to enable the troubled corporation to meet its cash flow needs failed this requirement. Id. 743 n.5.

Yurika - Late Payment is O.K., if the Debtor is "Usually" Late. The Sixth Circuit issued three additional opinions on §547(c)(2) in relatively quick succession, commencing with the December 1989 opinion, In re Yurika Foods Corp., 888 F.2d 42 (6th Cir., 1989). Unlike Fulghum, which focused on (c)(2)(A) and (B), the Yurika opinion zeroes in on (c)(2)(B) and (C).

Yurika was in the business of distributing, marketing and selling food products and shipped its products by UPS. In the latter part of 1984, Yurika began experiencing cash flow problems, and fell behind in its payments to UPS. UPS tariffs filed with the ICC required payment within seven days. In early 1985, UPS demanded that Yurika post several deposits to insure payment on its account and, at one point, suspended any credit to Yurika. Credit was later restored. The Bankruptcy Court opinion below noted that Yurika paid more than one-third of UPS' bills between 9 and 15 days after receipt of the bill, and a "significant number" between 15 and 30 days after receipt.

Yurika later filed for bankruptcy and the trustee filed an adversary proceeding against UPS alleging that

UPS had received preferential payments within three months of bankruptcy. The trustee argued that the payments could not be ordinary, as a matter of law, because they violated federal regulations which required payment within seven days. UPS argued that the payments were not preferential because they were made in the ordinary course of Yurika's and UPS' business.

The Bankruptcy Court and the District Court rejected UPS' defense. The lower courts concluded that since acceptance of late payments by UPS violated federal regulations, the payments were illegal and, therefore, could not qualify for the ordinary course defense. The court reached this conclusion despite the fact that it found that Yurika ordinarily did make late payments to UPS, and that such late payments were the ordinary practice between the parties.

The Sixth Circuit reversed the lower courts and concluded that the late payments were not illegal and, therefore, not per se out of the ordinary course. Citing to Fulghum, the Court noted that 547(c)(2) is intended to protect "recurring customary credit transactions which are incurred and paid in the ordinary course of business of the debtor and transferee", Id. 45, including late payments if such late payments were the standard course of dealings between the parties. Id. 44. "Irregular" payments also qualify under (c)(2)(B) if the transactions are consistent with the course of dealings between the particular parties. Id. 45.

The Court was apparently not inclined or persuaded to find that these payments were not consistent with the Fulghum-stated policy of §547(c)(2) to discourage unusual action by creditors on the eve of bankruptcy, even though UPS actually demanded several deposits and suspended credit, prior to the preference period.

Although the Court does not explicitly state that it is engaging in a §547(c)(2)(C) analysis, it reiterates Fulghum's acknowledgment that courts "might" be required to examine industry standards in addition to the parties' prior dealings. Id. 45. The Court states that, "In the instant case, industry practices are directly implicated," notes that "82% of carriers in the industry had not followed the credit limitations set out in the regulations and invoice terms", and concludes that the payments were made in the "ordinary course of business". Id. 45. Interestingly, the Court did not remand the case for proofs as to the average number of days past due in the industry, perhaps because of the relatively short period past due in that case.

Industrial Metal - "Unusual" Action Disqualifies MichCon. Five months later, in In re Industrial Metal Fabricators, No. 89-1814 (6th Cir., May 2, 1990), 1990 U.S. App LEXIS 7132, in an unpublished opinion, the Court focused on §547(c)(2)(B). In early 1986, the debtor in that case began falling behind in payments to Michigan Consolidated Gas Company ("MichCon"). MichCon supplied the heating fuel for the debtor's factory. MichCon continued to provide fuel to the debtor and accepted the late payments until April of 1986, when MichCon advised the debtor that its gas supply would be terminated if the debtor did not arrange to pay the arrearage. The parties then negotiated a payment agreement, which the debtor later refused to sign. The debtor did not make any payments under the April agreement.

In June, MichCon then sent the debtor a shut-off notice, which resulted in a second round of negotiations and agreement on a repayment plan which was to extend over several months. All of these events occurred prior to the 90-day preference period.

Thereafter, the debtor made several payments under the June agreement, two of which occurred within 90 days of the date that the debtor filed bankruptcy. The trustee filed a preference action against MichCon to

recover the two payments made within 90 days of bankruptcy.

The issue on appeal was whether the payments on the debt were made in the ordinary course of business. Again, the Court cited its Fulghum policy of protecting recurring, customary credit transactions and the general policy of discouraging any "unusual action" by either the debtor or creditors during the slide into bankruptcy. Id. LEXIS 4-5.

The focus was on subsection (c)(2)(B). With respect to the requirement that the payment be made in the "ordinary course", the Court examined the specific business practices of the two parties. The Court rejected MichCon's argument that the payments under the repayment agreement were made in the ordinary course of business. In the Court's view, payments made as a result of settlement agreements and shut-off notices were not "customary" between the debtor and MichCon, even though such practices may have been customary for MichCon and even though such actions and agreements occurred prior to the 90-day preference period. Apparently, the Court regarded these agreements as "unusual action", tainting any payments subsequently made in the preference period, because of the advantage that MichCon gained over the debtor because of its actions.

The Court did not address the interplay of industry standards, if any, under subsection (c)(2)(C), with its (c)(2)(B) analysis. Judge Keith, in dissent, attempts to resurrect MichCon's defense by arguing that MichCon's industry standards supersede the Fulghum (c)(2)(B) test of focusing on the business practices unique to Industrial and MichCon.

Finn - Payments on Long-Term Debt Incurred Long Before Payment Qualify Under §547(c)(2)(A). Finally, in In re Finn, 909 F.2d 903 (6th Cir., 1990), the Sixth Circuit's most recent pronouncement on §547(c)(2), the Court once again examined §547(c)(2)(A). In that case, the debtor, an individual, entered into a revolving consumer loan agreement with a credit union in October of 1985. In February of 1986, the debtor drew $3,500.00, on an unsecured basis, to pay off existing consumer debt. In March of 1986, the debtor began making monthly payments on the loan. In December of 1986, the debtor was laid off and in February of 1987, the debtor filed bankruptcy.

The trustee filed an adversary proceeding against the debtor's brother, who had guaranteed the loan to the bank, claiming that all payments on the loan within one year of filing bankruptcy were preferential transfers since they benefited the brother as a guarantor. The brother defended based on §547(c)(2).

The bankruptcy court and the district court held that the ordinary course exception did not apply because long-term consumer debt is never incurred in the ordinary course of a consumer's affairs pursuant to §547(c)(2)(A). Of course, prior to the repeal of the 45-day rule in 1984, §547(c)(2) would not have provided the brother with a defense since the debt was incurred more than 45 days before any of it was repaid. It was undisputed that the debt was incurred in the ordinary course of the bank's business, i.e., (c)(2)(A), and that the payments were made on ordinary business terms, i.e., (c)(2)(C). Id. 906 n.5.

The Court of Appeals rejected the lower courts' conclusion that long-term consumer debt can never be incurred in the ordinary course of a consumer's financial affairs. Id. 906. The Court concluded that "the incurring of a long term consumer debt that is a 'normal financial relation' and which is not an 'unusual action' undertaken during the 'slide into bankruptcy' will satisfy §547(c)(2)(A)'s requirement for an exception from the avoidance rules." Id. 907. Again, as was the case in Fulghum, Industrial Metal and Yurika, the Court emphasized that the purpose of §547(c)(2) is to "leave undisturbed normal financial relations" and "to discourage unusual action by either the debtor or his creditors during the debtor's slide into bank-

ruptcy." Id. 906-07. The Court remanded the case to the bankruptcy court to determine if the loan was incurred in the ordinary course of the debtor's financial affairs.

The Finn Court also stated that, while prior course of dealing is relevant, especially when there have been numerous prior transactions, the fact that this was the first transaction between the parties did not per se disqualify such transaction from satisfying (c)(2)(A). Id. 908. Moreover, and most significantly, the Finn Court noted that "the length of time between incurring the debt and making the challenged payment has no independent overriding significance." Id. 906. In other words, 547(c)(2) applies not only to short-term credit, but to long-term debt as well.

Finally, Finn mischaracterizes Fulghum twice, first in stating that a transaction can be "ordinary" if "consistent with the course of dealings between the parties", even where "as in Fulghum, the debtor's business transactions were irregular within its industry", Id. 907 [emphasis added]. Later, the Finn Court claimed that the emphasis in Fulghum was on "whether a practice that was definitely not ordinary in the borrower's industry could nevertheless be in the ordinary course of business between two particular businesses." Id. 908. To the contrary, Fulghum observed that the short-term financing provided by the sole shareholder in that case to meet cash flow needs "is a common practice." Fulghum at 743 n.5, 744 [emphasis added].

Should Industry Standards Have a Bearing? It remains to be seen whether, as a result of Finn, reference to industry standards as a component of (c)(2)(C) will fall by the wayside. As characterized by Judge Rhodes in In re Steel Improvement Co, 79 BR 681, 683 (Bkrtcy. Ct. E.D. Mich., 1987), a "majority" of decisions around the country look exclusively to the course of dealing between the creditor and debtor. A "minority" of decisions interpret (c)(2)(C) to require that the manner and timing of the late payments also be consistent with the ordinary course of business in the parties' industry.

Judge Rhodes suggests that the majority approach either ignores subparagraph (C) of §547(c)(2) and thereby makes it a nullity, or interprets subparagraph (c) to require the same showing as subparagraph (B) and thereby makes it superfluous.

Is the Sixth Circuit in the majority or in the minority? The Fulghum and Finn courts, of course, focused on subparagraph (c)(2)(A) - not (c)(2)(C). The trustee in Fulghum and Finn did not dispute the "ordinary business terms" requirement of (c)(2)(C). The Yurika and Industrial Metal opinions zeroed in on (c)(2)(B). All ignore Judge Rhodes' characterization of the case law. Industrial Metal seemingly ignores (c)(2)(C) in shooting down MichCon under (c)(2)(B). Yurika only half-heartedly "directly implicates" industry standards in remanding the case back to the lower court for a determination of whether the late payments at issue constituted the ordinary practice between the parties. Yurika at 45. Fulghum says industry standards "might be relevant".

The only other hint of the Court's inclination on "industry standards" as a component of (c)(2)(C) is a veiled reference to them in a case having little to do with a transfer "in the ordinary course". In a June 1989 case in which the Court addressed the misappropriation of mortgagors' monies in the well-known Salem Mortgage scam, the Court summarily rejected a §547(c)(2) claim on the basis that the fraudulent diversion and misappropriation of monies did "not comport with ordinary course of business practices commonly pursued by properly conducted mortgage companies and/or service institutions", First Federal of Michigan v Barrow, 878 F.2d 912, 918-19 (6th Cir., 1989). The Court did cite Judge Rhodes' In re Steel Improvement Co decision as one requiring that the disputed payment must be "consistent

with the ordinary course of business in the parties' industry." Id. [Emphasis added.]

But, Barrow is a subsection (c)(2)(A) case - and then only summarily so. There, the mortgagees and taxing authorities became creditors of Salem's estate only upon Salem's conversion of funds intended to be segregated and escrowed for their benefit - certainly not a debt incurred by Salem in the ordinary course of business or financial affairs of either Salem or the bilked third parties. The Barrow decision offers little guidance as to the applicability of industry standards in a case where subparagraphs (c)(2)(A) and (c)(2)(B) have been met.

If the common theme of Fulghum, Yurika, Industrial Metal, and Finn, i.e., that the policy of §547(c)(2) is to leave undisturbed "normal" (including irregular or late payments consistent with a course of dealing) financial relations between two parties, and to discourage any unusual action between the debtor or creditor (including any adjustment perhaps to bring late payments into "industry compliance"), there appears little reason to resort to such "industry standards". Yet, if so, what does §547(c)(2)(C)'s "made according to ordinary business terms" mean?

Questions, Questions, Questions. Certainly, these cases raise just as many questions as those that they answer. It is by no means certain what "unusual action" may jeopardize the creditor's §547(c)(2) defense. For example, the conversion of a receivable to a promissory note, in circumstances in which the parties had never done so before, would suggest a "disturbed" course of dealing, even if the irregularity or lateness of payment thereon did not change pre- and post-execution of the note. Similarly, if a debtor has historically paid invoices when they were 60 days past due, a payment made only 10 days past due is arguably recoverable.

Would it be "unusual" for a debtor to refinance prior to the preference period where the reasons motivating the refinancing include creditor insecurity? If so, would payments made in the subsequent preference period be recoverable from the "innocent", new creditor, even though no "unusual" action took place in the 90-day period? Would the outcome in Finn have been different if the debtor had signed promissory notes with its consumer creditors, rather than taken out a loan at her credit union? Would an increase in a debtor's line of credit balance on the eve of bankruptcy reflect the requisite "inconsistency" with a prior course of dealing to jeopardize the 547(c)(2) defense with respect to payments made in the same time period?

Does Industrial Metal stand for the proposition the "unusual action" taken prior to the preference period render "abnormal" any payments made thereafter? If so, how can UPS's actions in Yurika be condoned, and MichCon's actions in Industrial Metal be condemned? Perhaps MichCon's initial acceptance of late payments is the distinction between Yurika and Industrial Metal. In either case, there may be circumstances in which the Industrial Metal approach will detract from the other aim of §547(c)(2) noted by Fulghum - encouraging short-term credit dealings with troubled debtors in order to forestall bankruptcy. Fulghum at 744.

One thing is certain. The Fulghum, Yurika, Industrial Metal, and Finn decisions undoubtedly resolve any question that the "ordinary course" exception of §547(c)(2) has taken on a scope far more reaching than the defense offered under the "45-day" rule prior to 1984. In this circuit, it protects all usual actions consistent with undisturbed, normal financial relations - including late and irregular payments - between the debtor and that particular creditor.

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.

Internal Revenue Service v. Nordic Village, Inc. (In re Nordic Village, Inc.), Case No. 89-3656 (6th Cir. October 4, 1990). Nordic Village, Inc. ("Debtor") commenced a Chapter 11 case on March 27, 1984. Debtor conducted business under the assumed name of "Swiss Haus, Inc." On July 18, 1984, an officer and shareholder of the Debtor, Josef Lah, drew a $26,000 counter check on the Debtor's account and made that check payable to the drawee bank. In exchange for the check, the bank issued several cashier's checks to Lah, including one for $20,000 made payable to the Internal Revenue Service. This check bore the notation "Remitter: Swiss Haus, Inc." Lah thereafter delivered this check to the IRS with instructions that it be credited against his personal outstanding tax liabilities, which was done by the IRS.

In August of 1984, a trustee was appointed in the Debtor's bankruptcy case. The trustee thereafter commenced an adversary proceeding against the IRS to recover the $20,000 paid to it by Lah as an unauthorized post-petition transfer under 11 U.S.C. § 549. After trial, the Bankruptcy Court for the Northern District of Ohio held that this payment would be avoided as an unauthorized post-petition transfer of estate property. The Bankruptcy Court characterized the IRS as the initial transferee under 11 U.S.C. § 550(a)(1) on the ground that Lah was acting as the Debtor's agent when he withdrew the funds from the Debtor's account. On appeal, the District Court affirmed and held, in the alternative, that the IRS was an "immediate transferee" under 11 U.S.C. § 550(a)(2). According to the District Court, the IRS knew or should have known that the payment was voidable because of the notation on the cashier's check as to the remitter's identity.

On appeal, the Sixth Circuit Court of Appeals affirmed the decisions below in a 2-1 opinion authored by Senior District Judge Charles Joiner sitting by designation. A dissenting opinion was issued by Judge Cornelia Kennedy. The first issue addressed by Judge Joiner was whether the IRS could claim the defense of sovereign immunity. Judge Joiner concluded that, under the plain language of the controlling statutes, viz., 11 U.S.C. §§ 106 and 550, this defense has been waived by Congress.

The second issue--whether the IRS, as an immediate transferee, took the cashier's check without knowledge of the voidability of the transfer--was also decided adversely to the IRS. According to Judge Joiner,

> . . . because of the words 'REMITTER: SWISS HAUS, INC.,' it cannot be said that the IRS acted without knowledge of the voidability of the transfer. It is not an ordinary business practice for corporate entities to pay one another's taxes. This notation is sufficient to place a reasonable person on notice that the transfer was illegitimate, and by extension, that it was voidable.

Bustop Shelters of Louisville, Inc. v. Classic Homes, Inc., Case No. 89-5928 (6th Cir. September 20, 1990). In this case, Bustop Shelters of Louisville, Inc. ("Bustop") was engaged in the business of constructing and maintaining bus shelters for passengers in the Louisville, Kentucky, area. Bustop entered into several contracts with Classic Homes,

Inc. ("Classic"), pursuant to which Classic agreed to install 400 shelters for Bustop and would clean and maintain those shelters. In 1982, Bustop notified Classic that is was cancelling the contracts and sued Classic in state court for the return of unused materials Bustop had previously delivered to Classic. Thereupon, Classic counterclaimed for breach of contract damages. Later, Classic commenced a bankruptcy case and removed this litigation to the bankruptcy court. After trial, the bankruptcy court entered a judgment for $438,226.86 against Bustop. On appeal to the Sixth Circuit, that court affirmed the bankruptcy court's finding that Bustop had breached the contracts but remanded the matter for a new trial on damages.

In the meantime, Bustop filed its own Chapter 11 petition, thereupon staying Classic's enforcement of its judgment. Thereafter, the stay was lifted which permitted Classic to attach monies in Bustop's debtor in possession account. In 1988, Bustop filed a Chapter 11 plan that created the following classes of creditors:

> (i) Class B--secured claim of a bank holding a lien on a vehicle owned by Bustop. This claim was described in the plan as impaired. The plan provided that Bustop's obligations to the bank would be assumed by Creative Displays, Inc., a separate corporation owned by essentially the same shareholders as Bustop.
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> (ii) Class C-2--all unsecured claims, six in number, between $201 and $20,000. Under the plan, these impaired claims would be paid on a pro rata basis.
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> (iii) Class C-3--the unsecured claim held by Classic. This claim was listed as impaired and would be paid on a pro rata basis with claims in Class C-2. However, subject to the outcome of Bustop's appeal, payments to Classic under the plan would be deposited in an interest-bearing account.

Bustop's plan was accepted by all impaired creditors except for Classic. At the confirmation hearing, the Bankruptcy Court held that this plan was unconfirmable under 11 U.S.C. §§ 1129(a)(1) and 1129(a)(10). First, this court found that the bank's claim was not impaired since Bustop's obligation to pay this claim was not extinguished upon the assumption by Creative Displays, Inc. Second, the Bankruptcy Court found that Bustop had improperly classified Classic's claim in a separate class. Since this claim properly belonged in Class C-2, that class could not accept the plan and, therefore, no impaired class of claims accepted the plan as required by 11 U.S.C. § 1129(a)(10). The District Court affirmed this decision on appeal and Bustop thereafter appealed to the Sixth Circuit.

In its opinion affirming the decisions below, the Sixth Circuit, per Judge Kennedy, found that the bankruptcy court had not abused its discretion in rejecting Bustop's classification scheme. Judge Kennedy also concluded that the bank's claim was not impaired since Bustop's obligation to repay this claim was not extinguished upon Creative Displays' assumption of the debt.

Sharon Wilson v. The United States Trustee (In re Sharon Wilson), Case No. 1:89:CV-1110 (W.D. Mich. October 11, 1990). The Chapter 7 debtor herein, Sharon Wilson ("Debtor"), filed her voluntary petition on April 12, 1989. The United States Trustee thereupon moved to dismiss this case on "substantial abuse" grounds under 11 U.S.C. § 707(b), which motion was granted by Bankruptcy Judge JoAnn Stevenson. At the hearing on this motion, Judge Stevenson found that Debtor had been dishonest and was able to repay a por-

tion of her debt. Debtor thereupon appealed to the District Court from the dismissal order. In an opinion authored by Judge Douglas Hillman, that dismissal order was affirmed.

Applying the legal standards crafted by the Sixth Circuit in In re Krohn, 886 F.2d 123 (6th Cir. 1988), Judge Hillman found that the Debtor had misstated her income on her schedules and had engaged in a number of "eve of bankruptcy" purchases. He concluded that "[g]iven the totality of the circumstances, the bankruptcy court was correct when it found that debtor had lacked honesty."

In examining her monthly budget submitted to the bankruptcy court, Judge Hillman found that Debtor's expenses were excessive and unjustifiable. If these excessive amounts were deleted from her budget, Debtor could repay 32 percent of her unsecured debt over 3 years and 53 percent of that debt over 5 years. Consequently, Judge Hillman concluded that Debtor failed to demonstrate a need of Chapter 7 relief.

In re Centennial Insurance Associates, Inc., Case No. HG 90-80700 (Bankr. W.D. Mich. October 12, 1990). Centennial Insurance Associates, Inc. ("Centennial") is an insurance agency. On February 16, 1990, three entities--Commercial Union Insurance Company, Stanley Dickinson, and Elizabeth Dickinson--filed an involuntary Chapter 7 petition against Centennial. Approximately one month later, The Hartford Insurance Companies joined in that involuntary petition under 11 U.S.C. § 303(c). Centennial thereafter moved to dismiss the petition on bad faith grounds. Bankruptcy Judge Lawrence E. Howard conducted a hearing on this motion on August 8, 1990.

At the conclusion of this hearing, Judge Howard held that the debt owed by Centennial to Commercial Union was the subject of a bona fide dispute and, therefore, the petition had been filed in bad faith. However, Judge Howard reserved decision on the issue of whether the petition should be dismissed. The issue to be decided by Judge Howard was: did the intervention of The Hartford "cure" the original defect in the petition. In a written opinion, Judge Howard reviewed the relevant case law and concluded that the petition must be dismissed. According to Judge Howard,

> [t]hese cases clearly demonstrate that bad faith filings of involuntary petitions are not to be permitted. The impact on a debtor of the filing of an involuntary petition is severe, and should be permitted only when the statutory requirements of 11 U.S.C. § 303 are met. To allow an involuntary petition to proceed otherwise would be judicially irresponsible, and would set a dangerous precedent.

Joseph E. Scrima v. Insurance Company of North America (In re Joseph E. Scrima), Adversary Proceeding No. 86-0198 (Bankr. W.D. Mich. September 21, 1990). This is a Supplement to Bankruptcy Judge Howard's previous Report and Recommendation discussed in the August 1990 issue of the Newsletter. In this Supplemental Report, Judge Howard computes under Michigan law the amount of interest due by Transamerica Insurance Company to Insurance Company of North America ("INA") on INA's contribution claim. INA was found entitled to statutory interest under M.C.L.A. § 600.6013(b) from October 23, 1987, to the date on which the judgment is entered by the District Court. Thereafter, INA is entitled to post-judgment interest under 28 U.S.C. § 1961.

Performance Papers, Inc. v. Georgia Pacific Corp. (In re Performance Papers, Inc.), Adversary Proceeding Nos. 90-8074/8070/ 8054 and 89-0391 (Bankr. W.D. Mich. September 26, 1990). In the Performance Papers Chapter 11 case, a number of adversary proceedings were commenced involving creditors holding valid reclamation claims under 11 U.S.C.

§ 546(c). The goods subject to these reclamation demands were sold by the debtor during the course of the Chapter 11 case and the creditors were granted replacement liens on other assets of the debtor. In these adversary proceedings, a joint motion for partial summary judgment was filed to resolve the issue of the proper method of valuing these liens. The reclamation creditors argued that this value is to be determined by the invoice price of the goods originally subject to the reclamation demand. The debtor asserted that this value should be determined by the amount realized from the subsequent resale of these goods, whichever was less than the original invoice price.

Bankruptcy Judge James Gregg agreed with the reclamation creditors and held that the value of each reclamation creditor's lien "is presumed to be equal to the invoice of those goods received in the previous ten days and still in the debtor's possession at the time of the written reclamation demand."

In re Fuhrman, 118 Bankr. 73 (Bankr. E.D. Mich. 1990). In November 1987, the individual debtors, husband and wife, filed their first Chapter 12 case. After submitting two Chapter 12 plans that were not confirmed, this first case was dismissed in May 1988 for failure to confirm a plan. In June 1989, debtors filed a second Chapter 12 petition and again submitted two plans which were also denied confirmation. In May 1990, this second case was dismissed by the Bankruptcy Court. In June 1990, debtors filed their third Chapter 12 petition. In response, the Farm Credit Bank of St. Paul moved to dismiss this third case with prejudice under 11 U.S.C. § 1208. AFter a hearing, Bankruptcy Judge Arthur Spector granted this motion and dismissed the debtors' third Chapter 12 case.

In his opinion, Judge Spector declared that, in order to successfully defend against the dismissal motion, debtors were required to establish that there has been a material change in their circumstances since the dismissal of their prior case. Judge Spector held that debtors failed to produce any such evidence at the hearing.

In re Chris-Kay Foods East, Inc., 118 Bankr. 70 (Bankr. E.D. Mich. 1990). During the course of this Chapter 11 case, the debtor's lease of nonresidential realty, a retail store in a shopping mall, was rejected by operation of law under 11 U.S.C. § 365(d)(4) since the debtor failed to assume the lease within the 60-day statutory period and failed to obtain an extension of that period. Thereupon, the debtor's lessor filed a motion to compel the debtor to surrender the premises. The issue for decision on this motion according to Bankruptcy Judge Spector was

> . . . whether a lessor is entitled to immediate possession of nonresidential real estate from a debtor in possession after the 60 day time period under [11 U.S.C.] § 365(d)(4) has expired without an effective assumption of the lease by the debtor in possession.

In answering this question in the affirmative, Judge Spector followed the majority of cases holding that 11 U.S.C. § 365(d)(4) "prevails over contrary state law and that a lessor of nonresidential real estate is entitled to immediate possession" upon the lease's deemed rejection. There is, however, authority to the contrary, which includes In re Cybernetic Services Corp., 94 Bankr. 951 (Bankr. W.D. Mich. 1989) (Gregg, B. J.). Judge Spector also declared that the rejection of a lease terminates the lease.

STEERING COMMITTEE MEETING MINUTES

A meeting was held on October 19, 1990 at noon at the Peninsular Club.

1. Discussion was had regarding the plans for the 7th floor attorneys lounge and reports were made by Mark Van Allsburg, Thomas Schouten and James Engbers. The Committee also reviewed and approved the proposed plans for this space. Mark Van Allsburg volunteered to follow up on quotes for obtaining necessary furniture, as well as investigating further into telephones and telephone service to this area. He will also, hopefully, obtain governmental authority to install walls so as to partition this area off into three rooms. Depending upon costs, the Committee may be soliciting for used furniture, phones or monetary contributions to furnish this area.

2. The Committee voted to approve holding the 1991 bankruptcy seminar at Shanty Creek on August 15 - 17. The Committee is still working on obtaining a guest speaker for next year's seminar.

3. Pat Mears was nominated and agreed to chair the Education Committee for the 1991 seminar. As he will be looking for topics and speakers for next year's program, we would suggest that you contact Pat should you desire to lecture or have any topics that might be of interest.

4. A report was made regarding the Newsletter editor for 1991. Feelers have been sent out but, as of this date, no affirmative response has been received.

5. It was also announced that we should expect to hear an announcement as to the new Assistant U.S. Trustee for the Western District of Michigan within the next month.

6. A brief report was made on the recently held Sixth Circuit Judicial Conference. As part of such report it was indicated that Judge Gilbert S. Merritt, Chief Judge of the Sixth Circuit Court of Appeals, was asked to develop a proposal for implementation of a bankruptcy appellate panel (BAP) in the Sixth Circuit. The Committee voted to have its chairman, Brett N. Rodgers, author a letter to Judge Merritt indicating that the Bankruptcy Steering Committee favored the development of a proposal for implementation of BAP in this District. Should any of our readers desire to write Judge Merritt concerning this topic, we would suggest that you write him in care of the United States Court of Appeals - Sixth Circuit, 524 U.S. Post Office & Courthouse, Cincinnati, Ohio 45202.

7. The next Steering Committee meeting was scheduled for noon at the Peninsular Club on Friday, November 16, 1990.

Larry A. Ver Merris

EDITOR'S NOTEBOOK:

In the March, 1990 edition of this Newsletter, I indicated that the Michigan Court of Appeals had taken under advisement the question of whether or not making "reasonable collection efforts" under the Homeowners Construction Lien Recovery Fund makes it obligatory that a party must advocate the non-dischargeability of a debt before the bankruptcy court where the debtor may be in breach of the trust imposed by the Builders Trust Fund act. Recently the Michigan Court of Appeals in a case titled Abode v Webster, No. 117664, decided this issue in the negative, holding that, under the facts in that case, a non-dischargeability suit was not mandatory in order for a materialman to recover under §203 of the Construction Lien Act. The debtor in that case, Gary Webster, was a residential builder and general contractor, and Wickes Companies, Inc. had furnished materials to Webster. Thereafter Wickes, among other things, filed suit against Webster and also filed a motion in the instant action for summary disposition pursuant to MCR 2.116(C)(10) claiming that, as a matter of law, it was entitled to payment from the Homeowner Construction Lien Recovery Fund. The trial court granted Wickes' motion for summary disposition which was affirmed by the Court of Appeals in an unanimous opinion. We do not have a case citation for this opinion, although we believe the same will be published shortly. My thanks to Gregory G. St. Arnauld for supplying me with a copy of this case.

To the consternation of the lending community, the Eleventh Circuit Court of Appeals has declined to rehear, en banc, United States v Fleet Factors Corp, discussed in the September, 1990 Newsletter, in which the Eleventh Circuit greatly expanded the exposure of secured lenders to liability for environmental clean-up costs. Rehearing was denied on July 17, 1990.

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

	1/1/90 - 9/30/90	1/1/89 - 9/30/89	1/1/88 - 9/30/88
Chapter 7	2,965	2,475	2,043
Chapter 11	107	71	68
Chapter 12	14	13	27
Chapter 13	1,249	934	870