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CERCLA AND THE SECURED CREDITOR - FLEET FACTORS LIABILITY

*By Michael W. Donovan**

It has become increasingly difficult to confidently represent secured creditors in loan workout and insolvency situations. The era of lender liability, the expanded scope of DePrizio preference liability, and the nuances of seemingly draconian environmental laws have added additional complexities and uncertainties to this area. Recently, the Eleventh Circuit Court of Appeals, as a result of its decision in United States v. Fleet Factors, 901 F2d 1550 (11th Cir. 1990) multiplied these concerns.

In 1976, Swansboro Print Works ("Debtor") entered into a factoring agreement with Fleet Factors Corporation ("Fleet"). As is typical in these situations, Fleet agreed to advance funds to the Debtor based on an assignment of accounts receivable. Additionally, Fleet also obtained a security interest in the Debtor's physical plant, including its equipment, inventory and fixtures. In 1979, the Debtor filed a Chapter 11 petition. The factoring agreement was continued during the Chapter 11 case with court approval. On February 27, 1981, the Debtor ceased operations and began to liquidate its inventory, while Fleet continued to collect the accounts receivable. In December 1981, the bankruptcy case was converted to Chapter 7 and a Trustee was appointed. In May 1982, Fleet foreclosed on its security interest in some of the Debtor's inventory and equipment. Fleet contracted with a liquidator to conduct an auction on an "as-is" basis on June 22, 1982. The removal of the items sold was to be the responsibility of the purchasers. On August 31, 1982, Fleet contracted to have the remaining unsold equipment removed. This was apparently completed in late December, 1983.

Unfortunately for Fleet, the Environmental Protection Agency ("EPA") inspected the facility on January 20, 1984. At that time, the EPA found 700 fifty-five gallon drums containing various toxic chemicals, and 44 truckloads of material containing asbestos. The clean-up cost incurred by the EPA was approximately $400,000. Subsequently, the physical facility

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was conveyed to the county at a foreclosure sale, due to the Debtor's failure to pay local taxes.

The United States brought an action against the principal officers and stockholders of the Debtor, and Fleet to recover the cost of cleaning up the hazardous wastes. Fleet brought a motion for summary judgment to dismiss the action against it. The motion was denied by the district court because it concluded that Fleet's activities might rise to the level of participation in management sufficient to impose liability under the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA"), 42 USC §9601, et al.

CERCLA imposes liability on the "owner" of a facility for the cost of cleaning up hazardous substances. 42 USC §9607(a)(1) and (2). "Owner" includes not only the present owners and operators of a facility, but also the owners and operators of a facility at the time the hazardous wastes are disposed. CERCLA excludes from the definition of owner, however, a person who, without participating in the management, holds an indicia of ownership primarily to protect a security interest. 42 USC §9601(20)(A). Thus, CERCLA, at least in theory, provides protection from liability for secured creditors who do not participate in management. In Fleet Factors, however, the government asserted that the actions of the secured creditor were sufficient to exclude it from the secured creditor exclusion in the statute. The government contended that Fleet's actions were sufficient to find it the owner or operator at the time the wastes were disposed. The district court, finding there were sufficient issues of fact as to whether Fleet was an owner or operator, denied Fleet's motion for summary judgment. An appeal was taken to the Eleventh Circuit Court.

In Fleet Factors, the Eleventh Circuit held that a secured creditor can incur liability for clean-up costs under CERCLA, if it "participates" in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes. 901 F2d at 1557. The Court noted that it was not necessary that the secured creditor actually be involved in the day-to-day operations, nor that it participated in management decisions relating to hazardous wastes. 901 F2d at 1557-58. The Court announced,

> . . . a secured creditor will be liable if its involvement with the management of a facility is sufficiently broad to support the inference that it could effect hazardous waste disposal decisions if it so chose.
>
> 901 F2d at 1558.

From lender liability cases, commercial attorneys are familiar with the types of control and involvement in management that can give rise to potential liability. However, in Fleet Factors these control elements were narrowly construed. The Court found significant fact questions arose because Fleet's involvement "increased substantially" after the business operations ceased and the Debtor began to wind down its affairs. It should not go unnoticed that this "increased involvement" allegedly occurred during the Debtor's liquidation in its Chapter 11 case. The Court further noted that during the liquidation,

> "Fleet required [the Debtor] to seek its approval before shipping its goods to customers, establish the price for excess inventory, dictated when and to whom the finished goods should be shipped, determine when employees should be laid off, supervise the activity of the office administrator at the site, receive and process employment and tax forms, controlled access to the facility, and contracted with Baldwin to dispose of the fixtures and

...uipment . . . ."
901 F2d at 1559.

The Court found that these facts, if proved, would remove Fleet from the CERCLA secured creditor exemption. Clearly, in hindsight, Fleet erred by obtaining too comprehensive of a cash collateral order, and by being too involved in monitoring the Debtor's liquidation of its collateral. Apparently, obtaining Bankruptcy Court approval was no protection for the creditor.

The Court attempted to provide creditors with some comfort in these situations. The Court remarked that "nothing in our discussions should preclude a secured creditor from monitoring any aspect of the Debtor's business . . . a secured creditor can become involved in occasional and discreet financial decisions relating to the protection of its security interest without incurring liability." 901 F2d at 1558. In a Chapter 11 setting, however, with a cash collateral order in place, or a liquidation occurring with the supervision of the Court, it is unclear what actions might, in the Eleventh Circuit's opinion, constitute "occasional and discreet financial decisions".

The Court acknowledged that its decision may be challenged as creating disincentives for lenders to extend financing to businesses with potential hazardous waste problems and encouraging secured creditors to distance themselves from management actions. The Court stated, however, that these concerns are unfounded. 901 F2d at 1558. Unfortunately, no discussion or reason was proffered by the Court as to why these concerns were untenable. Perhaps, because none exist. This conclusion is certainly contrary, however, to advice commercial attorneys would offer in this situation, or contrary to advice commercial lenders would be inclined to follow.

Perhaps more perplexing is that after holding that actively monitoring collateral in a Chapter 11 setting can give rise to potential environmental liability, the Court naively declares that this potential liability should encourage creditors to "monitor the hazardous waste systems and policies" of its debtors. Further, the Court reflected that "once a secured creditor's involvement becomes sufficiently broad that it can anticipate losing its exemption from CERCLA liability, it will have a strong incentive to address hazardous waste problems at the facility rather than studiously avoiding them. 901 F2d at 1558-59. This, in light of the Fleet Factors' decision, is a noble but unrealistic goal. In light of Fleet Factors, it would seem that lenders will want to avoid these situations and avoid any conduct which may jeopardize the CERCLA exemption. While the rationale of Fleet Factors may present polite policy arguments, they are unrealistic in a commercial and business setting.

Many creditors' attorneys have found some comfort in a recent Ninth Circuit decision, decided after Fleet Factors. In In re Bergsoe Metal Corporation, 910 F2d 668 (9th Cir. 1990), Bergsoe Metals, Debtor, engaged in lead recycling operations. Bergsoe and the Port of St. Helens, a municipal corporation ("Port"), entered into a "Memorandum of Agreement" whereby the Port would assist Bergsoe in constructing a lead recycling plant. The Port issued industrial development revenue bonds and pollution control bonds to provide funds for the acquisition of the land and construction of the plant. The Port issued the bonds. A secured creditor ("Bank") held the bonds in trust for the bond holders. The revenue from the bond sales went to the Debtor which was obligated to pay the Bank the money owed on the bonds.

The Debtor thereafter began to experience financial difficulty, and in September 1983 the Bank declared the Debtor in default. Subsequently, the Bank and the Debtor agreed upon a work-out arrangement whereby a management company was put in place to manage the recycling facility. In exchange, the Bank and Port agreed not to foreclose. The

plant did no better under this arrangement, and was shut down in 1986.

The Bank commenced an involuntary bankruptcy proceeding against the Debtor. The Bank and Trustee in bankruptcy filed suit against the shareholders to collect on the Debtor's obligations. After hazardous substances were found on the plant site, the plaintiffs amended their complaint to request a determination that shareholders were also liable for the cost of cleaning up the environmental contamination. Defendant shareholders thereafter filed a counterclaim including a third party complaint against the Port, alleging that the Bank and Port were liable under CERCLA for the cost of cleanup. The Port moved for summary judgment alleging that its ownership interest in the recycling plant was not sufficient to support CERCLA liability.

The Ninth Circuit reviewed the CERCLA provisions and considered the Fleet Factors' ruling. The Ninth Circuit did not adopt the Fleet Factors rule and left for "another day" the establishment of a Ninth Circuit rule. The Ninth Circuit noted, however, that "whatever the precise parameters of participation", there must be some actual management of the facility before a secured creditor will fall outside the exception. The Court in reviewing the factual background found that there was no participation on behalf of the Port. The Court found that there was no evidence that the Port had exercised any control of the Debtor after the leases and bond transactions were signed. Since the Port had not exercised actual management, there was no liability under CERCLA.

While at first blush secured creditors have taken some comfort from the fact that no liability was found, it should be noted that the Court did not rule on whether the Bank had liability as an "owner or operator" because of its involvement either with the pre-bankruptcy workout, or actions it may have taken in the bankruptcy proceeding itself. While the Port apparently had an absolutely passive role, the same could not be said for the Bank. Arguably, when the rest of the matter is heard, the Court may find the Bank liable based on its actions.

These two cases, and the potential enormous penalties and costs involved in environmental cleanup, should caution secured creditors to be careful in loan work-out in Chapter 11 situations. Clearly, involvement in a debtor's business, even in a Chapter 11 setting, with Court orders, presents potential liability. Cash collateral and adequate protection orders should be carefully drafted to avoid, to the extent possible, control issues or provisions which seem to give creditor a role in day-to-day business operations.

For liquidations in a bankruptcy setting, secured creditors should be careful to avoid any and all direct involvement. Secured creditors must be certain that the liquidation proposals and plans are clearly the debtor's, and secured creditors should have little or no say in the specifics of the liquidation. Further, the concerted use of Trustees or the Debtor should be considered rather than direct involvement by the secured lender. In summary, the less the secured creditor is perceived as being preeminently involved in any liquidation or bankruptcy, the better.

AMENDMENTS

One of the most confused and confusing areas of bankruptcy practice is the procedure for amending the matrix, schedules and lists of creditors. It is very common for attorneys to file amended lists of creditors several weeks or months after a case is filed to add creditors. Here are the rules which apply in this area:

1. **Fee** - There is a $20.00 fee for amending a debtor's schedules or list of creditors after the 341 meeting notice has been sent out. Since first meeting notices are generated within 2-4 days of the filing or conversion date, it is almost certain that you will have to pay the fee if you are adding creditors. There are two exceptions. If you have provided us with a complete matrix before the 341 notice is sent and you simply wish to correct the address of a creditor (or creditors) who is already in the system, we will not consider this to be an amendment requiring a fee. (Please use the attached form for address changes.) In addition, if you send us an amended list of creditors as required by the court rules when a case is converted, there will be no fee if the list of creditors reaches us before the 341 meeting notice is mailed.

2. **New Matrix** -- When you amend schedules to add creditors, you must give us a new matrix. In all cases, we want a matrix on the BANCAP format (see instructions in the Local Bankruptcy Rules) listing only the creditors being added to the case.

3. **Number of Copies** -- If you are amending only the matrix, all we need is the original matrix. If you are amending schedules or lists of creditors, then we need the same number of copies as if the schedules, matrix or other pleading were being originally filed.

4. **Verification** -- Bankruptcy Rule 1008 requires that amendments to lists of creditors, schedules, or the matrix be verified. The best practice would be to use a generic verification form which can be used for a variety of purposes.

5. **Notification of Creditors** -- The debtor's attorney is responsible to notify affected creditors of an amendment (BR 1009). This Court generally sends out a copy of the first meeting notice to creditors who are added during the course of a case. However, this practice does not in any way negate the duty imposed by the court rule. Please send a notice and file a proof of service.

The Bankruptcy Court would greatly appreciate it if you would use the following coversheet whenever filing an amendment or changing the address of parties in interest. This will also act as a checklist of documents which must be filed with the Court.

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

COVERSHEET FOR AMENDMENTS

CASE NAME: _____

CASE NUMBER: _____

The enclosed documents amend the matrix, schedules and/or list of creditors previously filed in this case. Please check the appropriate boxes:

The purpose of this amendment is to:

☐ Add creditors. How many? _____

☐ Correct the addresses of creditors already listed on the schedules and matrix previously filed. (Use back of this form.)

☐ File new schedules because the case has been converted to another chapter and amendments are required by the court rules.

☐ Other (Please explain.) _____

_____

_____

The following documents are attached:

☐ $20.00 amendment fee. This is required whenever you add creditors after the notice of the first meeting of creditors has been mailed. It is not required when correcting addresses of previously listed creditors. It is not required when new schedules are filed in a converted case, unless the first meeting notice (for the converted case) has already been mailed.

☐ Amended schedules and list of creditors. Send the original and as many copies as are required by Local Bankruptcy Rule 5. Schedules must be verified by the debtor(s).

☐ Matrix. Send a matrix in the new format, listing only the creditors added to the previous matrix. Do not use the three column grid matrix for any reason. This is a change from previous policy. Please do not send a matrix adding creditors to a case unless you also send the amended schedules. Do not send a new matrix to correct an address -- use the back of this form. A matrix must be signed by the attorney preparing the matrix.

NOTE -- BR 1009 requires the attorney amending such pleadings to notify parties affected by the amendments. The Court tries to send a copy of the first meeting notice to all creditors added during the course of the case, but this in no way removes the duty imposed by BR 1009.

Corrections to Mailing Matrix

Use this form to make corrections to the Names and Addresses of any creditors or parties in interest who are listed on the current matrix of the case. You may also delete names from the matrix by using this form.

Do not use this form to add new creditors to this case.

Name of Creditor (As it now appears) _____

Please change to the following: _____

_____

_____

Name of Creditor (As it now appears) _____

Please change to the following: _____

_____

_____

Name of Creditor (As it now appears) _____

Please change to the following: _____

_____

_____

Name of Creditor (As it now appears) _____

Please change to the following: _____

_____

_____

SIGNED: _____

IF YOU HAVE MORE CHANGES JUST COPY THIS SHEET AND KEEP TYPING.

NOTICE OF CHANGE TO BANKRUPTCY FEE SCHEDULE

THE JUDICIAL CONFERENCE OF THE UNITED STATES HAS JUST MADE TWO CHANGES TO THE BANKRUPTCY FEE SCHEDULE WHICH WILL BE EFFECTIVE ON OCTOBER 1. FIRST (AND MOST IMPORTANTLY), THE FEES FOR MOTIONS FOR RELIEF FROM STAY WILL NO LONGER BE APPLIED TO STIPULATIONS OR MOTIONS TO APPROVE STIPULATIONS FOR RELIEF FROM STAY. IN SHORT, IF A RELIEF FROM STAY MATTER IS HANDLED PURELY BY STIPULATION AND ORDER, **NO FEE WILL BE IMPOSED** WHEN THE STIPULATION AND ORDER ARE FILED. SECOND, DEBTORS IN POSSESSION WILL NOT HAVE TO PAY THE ADVERSARY FILING FEE IF THERE ARE NO ESTATE FUNDS WITH WHICH TO PAY THE FEE. THEY WILL BE TREATED EXACTLY AS A TRUSTEE IN SUCH MATTERS. THE OFFICE OF THE CLERK WILL EXPECT AN ADVERSARY FILED BY A DEBTOR IN POSSESSION TO CONTAIN EITHER A CHECK FOR THE FILING FEE OR A STATEMENT SIGNED BY THE DEBTOR THAT THERE ARE NO FUNDS IN THE ESTATE FROM WHICH TO PAY THE FEE. THE ADVERSARY WILL NOT BE ACCEPTED WITHOUT A FILING FEE UNLESS SUCH AN AFFIRMATIVE STATEMENT IS ENCLOSED WITH THE PETITION.

Mark Van Allsburg

STEERING COMMITTEE MEETING MINUTES

A meeting was held on September 27, 1990 at noon at the Peninsular Club.

1. A financial report on the Shanty Creek Seminar was submitted by Brett Rodgers which indicated that the Bankruptcy Section earned a net "profit" from the Seminar of $3,047.44.

2. Tentative dates were established for the 1991 Seminar to be held, again, at Shanty Creek. The preferred dates are August 22 and 23, with July 18 and 19 as a backup.

3. Discussion was had regarding a keynote speaker for the 1991 Seminar, and Robert E. L. Wright will be looking into the same.

4. A sub-committee was formed composed of Mark Van Allsburg, James A. Engbers, and Thomas W. Schouten for the purpose of looking into furnishing the attorneys' lounge on the 7th floor of the Federal Building, between the courtrooms, with furniture and telephones.

5. The next Steering Committee meeting was scheduled for noon at the Peninsular Club on Friday, October 19, 1990.

Larry A. Ver Merris

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.

In re The George Worthington Co., Case Nos. 89-3279/3286 (6th Cir. Sept. 12, 1990). In this Chapter 11 case pending in the Bankruptcy Court for the Northern District of Ohio, the bankruptcy and district courts had denied a request by the official creditors' committee for reimbursement of the out-of-pocket expenses of its members as administrative expenses. These decisions were affirmed on appeal to the Sixth Circuit in a 2-1 decision authored by Judge Contie. The Sixth Circuit noted that, even though these expenses were reimbursed as administrative expenses under Chapter XI of the Bankruptcy Act of 1898, there was no similar authorization contained in the Bankruptcy Code. According to Judge Contie, "the legislative history of Section 503(b) indicates that, for whatever reason, Congress has not explicitly granted the Bankruptcy Court the authority to allow for the reimbursement of such expenses." In the penultimate paragraph of his decision, Judge Contie summarized the Court's holding and its basis:

There is no explicit statutory basis for the payment of administrative expenses of an official creditors' committee in the Code. The decision as to what participants in the bankruptcy process may receive compensation is in the hands of Congress, and, for whatever reason, Congress acted or failed to act, we believe that the court must faithfully adhere to the balance between the creditors' interests and the preservation of the debtor's estate established by Congress in the Code. If active participation by official creditors' committees in the reorganization process needs greater encouragement by the reimbursement of administrative expenses, the remedy should be supplied by Congress, not the court.

SEOR, Inc. v. Textron Oil Corp. (In re Frederick Petroleum Corp.), Case No. 89-3450 (6th Cir. Aug. 23, 1990). This decision rendered by the Sixth Circuit Court of Appeals sets forth a test to determine the finality of an order for purposes of appellate jurisdiction. 28 U.S.C. § 158(d). The order in question was entered by the district court holding that certain alleged unexpired leases of realty had not been rejected under 11 U.S.C. § 365(d)(4). The district court reversed the bankruptcy court below and remanded the matter "for further proceedings consistent with this opinion." This order was thereafter appealed to the Sixth Circuit. On appeal, it was argued that the Sixth Circuit lacked subject matter jurisdiction since the district court's order was not "final" under 28 U.S.C. § 158(d).

In its decision dismissing the appeal and remanding the matter to the district court, the Sixth Circuit declared that any partial disposition of a proceeding contained in an order or judgment below will be deemed "non-final for the purposes of the exercise of appellate jurisdiction" unless the district court certifies that the partial disposition is final under Rule 54(b) of the Federal Rules of Civil Procedure. In doing so, the Sixth Circuit distinguished its earlier decision of In re Gardner, 810 F.2d 87 (6th Cir. 1987), which articulated a different standard of finality. Under the Gardner standard, a partial disposition of a dispute will be deemed non-final if the district

court's order "remands the case for a factual determination on an issue ce to the case."

Bavely v. United States of America (In re Terwilliger's Catering Plus, Inc.), Case No. 89-3561 (6th Cir. August 13, 1990). This appeal arises from a Chapter 7 case pending in the United States District Court for the Southern District of Ohio. In this proceeding, both the bankruptcy court and district court held that the Chapter 7 debtor's liquor license constituted property of the estate to which a federal tax lien attached. These decisions were affirmed by the Sixth Circuit on appeal. The State of Ohio argued that the liquor license issued by it to the debtor did not constitute property to which a tax lien could attach. The state also argued that the license could not become a part of the bankruptcy estate since that license was a privilege granted by the state that did not give rise to property or contract rights. The Sixth Circuit rejected these arguments on the ground that federal bankruptcy law, and not state law, determines what is property of the estate under 11 U.S.C. § 541(a), citing its earlier decision rendered in In re Tittabawassee Investment Co., 831 F.2d 104 (6th Cir. 1987).

Olle v. The Henry & Wright Corp., Case Nos. 89-3532/3615 (6th Cir. August 9, 1990). This decision addresses the scope of a bankruptcy court's power to alter or amend a final judgment or order under Rule 60(b) of the Federal Rules of Civil Procedure ("FRCP"), made applicable in bankruptcy cases and proceedings by Bankruptcy Rule 9024. This appeal arose from a dispute over an order entered by the Bankruptcy Court for the Northern District of Ohio in December, 1982 confirming an auction sale of a debtor's assets and abandoning the debtor's trade name and good will. Approximately 2 1/2 years later, a party to the proceedings filed a motion to correct this order, arguing that the debtor's good will and trade name had been sold at the auction sale. In September 1985, the trustee filed an amended report of sale, which stated that the trade name and good will had indeed been sold at auction, thereby correcting his earlier report. This amended report was approved by a nunc pro tunc order of the bankruptcy court, which was appealed to the district court.

On appeal, the district court held that the bankruptcy court lacked jurisdiction to enter its nunc pro tunc order approving the trustee's amended report of sale since the mistake was a substantive one that could only be corrected under FRCP 60(b)(1) within one year of the date the original order was entered. This decision was appealed to the Sixth Circuit, which thereafter remanded the case to the bankruptcy court for detailed findings of fact and conclusions of law. On remand, the bankruptcy court issued these findings of fact and conclusions of law and authorized the trustee to amend his report of sale. On appeal from this order, the district court vacated the bankruptcy court's order and reinstated the original order authorizing the sale and abandoning the trade name and good will. The district court again concluded that, under FRCP 60(b)(1), the motion to amend the order had been tardily filed.

On a second appeal to the Sixth Circuit, it held that the 1982 order could be amended or altered under FRCP 60(b)(6), which permits this action "for any other reason justifying relief from the operation of the judgment." The one-year limitation period does not apply to a motion under FRCP 60(b)(6) but such a motion must be made within "a reasonable time." The Sixth Circuit therefore remanded this matter to the bankruptcy court for a determination of whether the motion to correct the 1982 sale order fit within the rubric of FRCP 60(b)(6) and whether that motion was filed within a reasonable time as required by that rule.

Official Unsecured Creditors' Committee v. The Shaler Corp. (In re Belknap, Inc.), Case No. 89-6235 (6th Cir. July 25, 1990). In this important decision, the Sixth Circuit held in accordance with all other circuits that, for purposes

etermining the date of transfer under 11 U.S.C. § 547(b), the date on which e debtor's check is delivered to the preference defendant controls, unless che check is thereafter dishonored. According to the Sixth Circuit,

> . . . the commercial expectation behind the transfer of a check is treated like the commercial expectations behind the transfer of a cashier's check or a certified check. When the debtor gives the check to the creditor it constitutes a 'transfer of an interest in the debtor's property' because the debtor then has no right to delay payment of the check and the payor does not make a new extension of credit to the drawer by accepting a check rather than cash. Rather, it is more like transferring money than making a loan for the period of time it takes for the check to clear. . . .

In determining when a check is delivered for the purposes of this analysis, the Sixth Circuit declared that delivery occurs when the creditor actually receives the check. In addition, the check "must be presented for payment within 'the 30-day period deemed reasonable under the U.C.C.' and honored upon presentment in order for the delivery date to be considered the time of transfer."

MCA Insurance Co. v. Peninsula Asphalt Corporation (In re Peninsula Asphalt Corp.), Case No. 1:90-CV-81 (W.D. Mich. Sept. 6, 1990). In the fall of 1988, MCA Insurance Company ("MCA") issued performance and lien bonds to Peninsula Asphalt Corporation ("Debtor") in connection with a public construction project on which Debtor acted as general contractor. On April 14, 1989, Debtor commenced a Chapter 11 case in the Bankruptcy Court for the Western District of Michigan. Prior to that date, Debtor defaulted under the lien bond by failing to make a timely payment to a subcontractor.

After April 14, 1989, MCA retained the services of bankruptcy counsel and a bond consultant to assist MCA in the Debtor's Chapter 11 case. On May 17, 1989, MCA paid the unpaid subcontractor as required by the lien bond. In settlement of litigation between Debtor and MCA, Debtor assumed the public construction project contract, all subcontracts, the bonds and a general indemnity agreement executed by Debtor and others for MCA's benefit.

In July, 1989, MCA filed a motion for allowance of professional fees and expenses as administrative expenses with the bankruptcy court. The fees and expenses sought to be recovered were generally those charged to MCA by its attorneys and bond consultant. MCA also asserted in its motion that it held a lien on the proceeds payable to Debtor from the public construction contract by virtue of its equitable subrogation rights arising from the general indemnity agreement. The bankruptcy court, per Judge Lawrence Howard, held after a hearing that only those fees and costs incurred by MCA between May 17, 1989, and June 20, 1989, were recoverable as administrative expenses and rejected MCA's argument that it held a lien on the contract proceeds to secure this claim. On appeal, District Judge Enslen affirmed Judge Howard's decision.

Judge Enslen first declared that, since the various contracts, bonds and indemnity agreement had been assumed by Debtor under 11 U.S.C. § 365, the fees incurred between the date on which MCA paid the subcontractor, viz., May 17, 1990, and June 20, 1989, were properly classified as administrative expenses. Judge Enslen nevertheless rejected MCA's argument that it was a secured creditor with enforceable liens in the construction contract accounts receivable since MCA had not filed an appropriate UCC-1 financing statement perfecting that lien.

Auto Specialties Manufacturing Co. v. Sachs (In re Auto Specialties Co.), Case No. 1:90-CV-428 (W.D. Mich. Aug. 27, 1990). This litigation arises from

the Chapter 7 case of Auto Specialties Manufacturing Company ("Debtor") p... in the Bankruptcy Court for the Western District of Michigan. Debtor comme... an adversary proceeding against two defendants asserting, inter alia, clai... under the Racketeer Influenced and Corrupt Organizations Act ("RICO"). Nine months after filing its complaint, Debtor moved to withdraw the reference of this action from the bankruptcy court to the federal district court under 28 U.S.C. § 157(d).

The district court, per Judge Robert Holmes Bell, first addressed the Debtor's argument that because provisions of the Bankruptcy Code and RICO determined the resolution of the adversary proceeding, its reference should be withdrawn on mandatory grounds. Judge Bell disagreed with this argument since Debtor failed to establish that "its RICO claim will present questions of first impression or that simultaneous construction of Bankruptcy Code and RICO provisions will be necessitated."

Judge Bell then addressed and rejected Debtor's argument that sufficient cause existed to permit discretionary withdrawal of reference. Debtor argued that, since it demanded a jury trial of non-core claims and since the bankruptcy court lacked jurisdiction to preside over a jury trial of these claims, the entire adversary proceeding should be removed to the district court. Judge Bell declared that, since the matter was not ready for trial, the action should continue to be prosecuted in the bankruptcy court. If and when the action later becomes "trial-ready," then the district court would entertain a renewed motion to withdraw the reference.

Andrews University v. Merchant (In re Merchant), Case No. 1:89-CV-1123 (W.D. Mich. July 24, 1990). This decision interprets the scope of 11 U.S.C. § 523(a)(8), which excepts from an individual debtor's discharge certain educational loans. In 1988, Weiner Merchant, an individual ("Debtor"), commenced a Chapter 7 case. Debtor had previously been enrolled as a student at Andrews University. Rather than pay cash for her tuition, Debtor was allowed by Andrews University to take classes on credit. Debtor also borrowed approximately $6,000 from Michigan National Bank ("MNB"). Before she graduated, Debtor signed an agreement promising that her parents would pay her tuition charges by October, 1987. The agreement also provided that if this indebtedness was not paid, the balance due would be added to the MNB loan balance.

One day after filing her Chapter 7 petition, Debtor requested a copy of her transcript from Andrews University. Andrews refused this request on the grounds that her debts were nondischargeable under 11 U.S.C. § 523(a)(8). Debtor then commenced an adversary proceeding against Andrews, which was tried by Bankruptcy Judge David Nims.

Judge Nims held that, by refusing to release Debtor's transcript, Andrews violated Sections 362 and 524 of the Bankruptcy Code. Andrews appealed from this decision to the district court, which affirmed the decision below. District Judge Bell first held that the extensions of credit made by Andrews to the Debtor were not properly classified as educational loans excepted from discharge under 11 U.S.C. § 523(a)(8) since "the credit extended by Andrews was not a 'program' and it was not 'funded' by Andrews." Judge Bell then affirmed Judge Nims' decision that Andrews' withholding of the college transcript from Debtor violated the automatic stay since it constituted an attempt to collect a pre-petition debt.

Auto-Owners Ins. Co. v. Benker, Case No. G89-158 (W.D. Mich. July 17, 1990). In this case, Auto-Owners Insurance Company ("Auto-Owners") became obligated to pay $86,200 to Lyle and Dolores Benker ("Debtors") after Debtors' home was destroyed by fire. Before this sum was paid to Debtors, the Internal Revenue

...ce served a Notice of Levy upon Auto-Owners, asserting that they owed sums ...excess of $75,000 arising from their failure, as responsible persons of a corporate taxpayer, to collect and pay trust fund taxes. Thereafter, in September, 1989, Debtors commenced a Chapter 13 case in the Bankruptcy Court for the Western District of Michigan.

One issue involved in this litigation was whether the cash proceeds of the Auto-Owners insurance policy on the Debtors' home constituted "property of the estate" under 11 U.S.C. § 541(a), notwithstanding that the IRS had levied on these monies prior to the commencement of Debtors' Chapter 13 case. Relying on an earlier decision of the Sixth Circuit, NLT Computer Services v. Capital Computer Services, 755 F.2d 1253 (6th Cir. 1985), Judge Bell held that these monies did constitute estate property subject to the automatic stay and, therefore, "should be distributed by the bankruptcy court."

Auto Specialties Manufacturing Co. v. Manufacturers National Bank of Detroit (In re Auto Specialties Mfg. Co.), Case No. G89-50766 (W.D. Mich. July 7, 1990). This is another decision arising from the Chapter 7 case of Auto Specialties Manufacturing Company ("Debtor"). In 1988, after Debtor commenced its bankruptcy case under Chapter 11, Debtor entered into an adequate protection agreement with its pre-petition lender, Manufacturers National Bank of Detroit ("Bank"). This agreement provided that Bank would be paid interest on its secured claim in accordance with a formula set forth in that agreement. In March, 1989, Debtor commenced an adversary proceeding against Bank alleging fraud, breach of contract, and breach of fiduciary duty. In its complaint, Debtor sought money damages and equitable subordination of Bank's claims. Debtor thereafter filed a motion with the bankruptcy court seeking to change the interest rate formula in the adequate protection agreement on equitable grounds. Bankruptcy Judge JoAnn Stevenson denied this motion, holding that Bank, an oversecured creditor, was entitled to be paid interest at the contract rate under 11 U.S.C. § 506(b).

On appeal to the District Court, Judge Bell affirmed the decision below. Judge Bell agreed with Judge Stevenson that Bank was entitled to be paid interest at the contract rate and that Debtor had failed to demonstrate a "substantial change in the circumstances" in order to alter the adequate protection agreement.

Williams v. Independent Bank (In re Williams Brothers Asphalt Paving Co.), Case No. G89-50565 (W.D. Mich. July 7, 1990). This decision arises from the Chapter 7 case of Williams Brothers Asphalt Paving Co. ("Debtor"), a Michigan business corporation that had previously been a general partnership. In September, 1970, one of the partners, Richard Williams, elected to withdraw from the partnership. Richard Williams then entered into an agreement with the remaining partners surrendering to them certain insurance policies on his life. Under this agreement, these policies were to be returned to Richard Williams upon full payment of certain indebtedness due by him to the partnership. In 1976, this debt was repaid but the policies were not surrendered to Richard Williams.

In 1982, Debtor commenced a Chapter 11 case in the Bankruptcy Court for the Western District of Michigan. This case was thereafter converted to Chapter 7. In October, 1983, Independent Bank ("Bank") purchased all of Debtor's assets, including these life insurance policies, at a sale conducted under 11 U.S.C. § 363(b). In October, 1988, Richard Williams commenced an adversary proceeding in bankruptcy court against Bank demanding that these policies be cancelled. Bank continued to pay the premiums on these policies.

After a trial, Bankruptcy Judge Nims held that these policies had been properly sold to Bank and dismissed the adversary proceeding. On appeal,

District Judge Bell affirmed the decision below. Judge Bell first held although Richard Williams had an enforceable claim for the return of t policies in 1976, that right had expired prior to the sale of these policies Second, Judge Bell declared that public policy did not prohibit Bank from acquiring these policies--this ownership did not constitute an "incentive to murder" as argued by Richard Williams.

In re Studio Camera Supply, Inc., 116 Bankr. 70 (E.D. Mich. 1990). Prior to the commencement of its Chapter 11 case, Studio Camera Supply, Inc. ("Debtor") had instituted a breach of contract suit in state court against Compuware Corporation (the "State Court Litigation"). Also prior to its Chapter 11 case, Debtor received a mediation award of $40,000 in the State Court Litigation, which award Debtor rejected. This Litigation was described in Debtor's disclosure statement but the Debtor's Chapter 11 plan, later confirmed, did not specifically provide for the disposition of any proceeds received from this Litigation.

After Debtor's plan was confirmed, the State Court action was tried and resulted in a judgment for $357,413.46 in favor of Debtor. This judgment was later affirmed on appeal. As an appeal bond, Compuware obtained a letter of credit from Comerica Bank, payable upon termination of all appeals.

Thereafter, Compuware filed with the Detroit Bankruptcy Court a petition to reopen the Debtor's Chapter 11 case and to enjoin payment on the letter of credit. Compuware alleged in its petition that these funds should be paid into the bankruptcy estate since Debtor had "concealed" the existence and true value of this Litigation. After a hearing, Bankruptcy Judge Ray Reynolds Graves dissolved an earlier injunction against payment of the letter of credit and refused to reopen the case. Judge Graves stated in his opinion that Compuware's counsel "failed to make even a minimum inquiry into the facts and circumstances of this case" before filing its motion to reopen. On a later motion for sanctions under Bankruptcy Rule 9011, Judge Graves ordered Compuware's counsel to pay the Debtor's attorney fees and for the time, effort and expense incurred by Debtor's president.

On appeal, District Judge Lawrence Zatkoff affirmed the order imposing the sanctions. After reviewing the record on appeal, Judge Zatkoff concluded as follows:

> In sum, [Debtor] had clearly revealed throughout the pendency of the bankruptcy matter the true state of affairs with respect to its pending lawsuit with Compuware. Appellants clearly made certain representations to Judge Graves which proved to be false, misleading and totally inaccurate. Therefore, Judge Graves' imposition of sanctions was not an abuse of discretion.

In re Harmon, Case No. 89-08980 (Bankr. E.D. Mich. August 22, 1990). this Chapter 13 case, the employed debtor was married to and lived with spouse who also held a job. His wife did not commence a Chapter 13 ca Their living expenses were split equally between them. In the debtor's budg he proposed to calculate his net disposable income by deducting one-half of total family expenses from his after-tax income. The trustee objected confirmation of the debtor's plan on the ground that it failed to pay over him all of the debtor's net disposable income under 11 U.S.C. § 1325(b)(1) The trustee argued that debtor's net disposable income should be calculate subtracting the total family expenses from the total family income. Under debtor's plan, unsecured creditors would receive a 50 percent distribution 3 years. The trustee's calculations, if adopted, would generate a 97 per dividend to these creditors.

The Detroit Bankruptcy Court, per Judge Steven Rhodes, overruled the Trustee's objection and confirmed the debtor's plan. Judge Rhodes first noted that since the court lacked jurisdiction over debtor's spouse, she could not be compelled to make any payments toward the plan. Second, Judge Rhodes concluded that the pre-bankruptcy agreement between debtor and his spouse concerning the equal sharing of family expenses was reasonable and supported by the evidence. Finally, Judge Rhodes found that debtor's plan was proposed in good faith.

In re Tomlinson, 116 Bankr. 80 (Bankr. E.D. Mich. 1990). This decision, authored by Bankruptcy Judge Arthur Spector, addresses the eligibility requirements for filing Chapter 13 petitions contained in 11 U.S.C. § 109(e). In this case, Judge Spector found that the debtor's unsecured debts exceeded the $100,000 ceiling contained in 11 U.S.C. § 109(e). Included in the unsecured debts was a claim secured by a mortgage lien in certain realty that debtor had quitclaimed to her husband prior to her Chapter 13 filing. Since this claim was not secured by estate property, it was properly classified as unsecured in determining debtor's eligibility for Chapter 13.

In re Moon, 116 Bankr. 75 (Bankr. E.D. Mich. 1990). In this decision, Bankruptcy Judge Spector discusses the circumstances under which a Chapter 7 case may be reopened in order to add an omitted creditor to debtor's schedules. Due to the length of the opinion and the complexity of the facts involved, this decision will not be discussed here.

EDITOR'S NOTEBOOK

The U.S. Supreme Court granted cert on June 28, 1990 in the case of In re Ben Cooper, Inc (CA 2, NY, 1990), 896 F2d 1394, 20 BCD 139, in which the Second Circuit held that bankruptcy courts may conduct jury trials in core proceedings without violating either the Seventh Amendment or Article III. The Supreme Court's decision will resolve a conflict between the Second Circuit and the Eighth Circuit's decision that bankruptcy courts lack statutory authority to conduct a jury trial stated in In re United Missouri Bank, NA (CA 8, Mo, 1990), 901 F2d 1449, 20 BCD 644, reh den, en banc. This issue was avoided by the Supreme Court in the Granfinanciera case discussed in the July, 1989 Newsletter. Also before the Court will be an issue as to whether or not a dispute concerning a post-petition contract is a core proceeding. In dictum, the Eleventh Circuit has recently stated that the Supreme Court's Granfinanciera decision cast doubt upon the constitutionality of the bankruptcy court's authority to adjudicate certain core proceedings without the parties' consent. See In re Davis (CA 11, Ga, 1990), 899 F2d 1136.

The U.S. Supreme Court has also granted cert in Grogan v Garner (US 1990), 109 L Ed 2d 308, 110 S Ct 1945. In re Garner (CA 8, Mo, 1989), 881 F2d 579, reh den. In this case, the Eighth Circuit held that the "clear and convincing" evidence standard applied to a non-dischargeability action based on fraud. The Supreme Court will decide whether or not this or the lesser "preponderance" of the evidence standard is the correct standard to be used in Section 523 actions.

On June 25, 1990 Public Law 101-311, dealing with the bankruptcy treatment of swap agreements and forward contracts was signed into law. This new statute makes various additions and changes to the Bankruptcy Code, the scope of which is beyond this article.

Lorman Business Center, Inc. will be offering a seminar at the Eberhard Center in Grand Rapids on November 29, 1990 titled "The In's and Out's of Bankruptcy Practice for Non-Bankruptcy Practitioners". For more information contact Lorman Business Center, Inc. at (715) 833-3940.

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 August 31, 1990. These filings are compared to those made during the same period one year ago, and two years ago.

	1/1/90 - 8/31/90	1/1/89 - 8/31/89	1/1/88 - 8/31/88
Chapter 7	2,642	2,210	1,871
Chapter 11	100	63	61
Chapter 12	14	9	25
Chapter 13	1,119	809	790
Totals	3,875	3,091	2,747

Due to a computer error, the figures stated in the August Newsletter for the filings from January 1, 1990 - July 31, 1990 were slightly in error. The correct figures are as follows:

	1/1/90 - 7/31/90
Chapter 7	2,299
Chapter 11	87
Chapter 12	12
Chapter 13	979

Our apologies for any inconvenience this may have caused.