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LAND CONTRACTS IN BANKRUPTCY: *TERRELL* REVISITED

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By now, all bankruptcy practitioners in Western Michigan are doubtless aware of the Sixth Circuit's holding in Terrell v. Albaugh, 892 F.2d 469 (6th Cir. 1989). In Terrell, the Court of Appeals stated unequivocally that under Michigan law, land sale contracts are "executory contracts" within the meaning of Section 365 of the Bankruptcy Code.[1] This holding represented a significant departure from existing law.[2] As a result of Terrell, the treatment of a debtor's land contract interest, as well as the debtor's rights and obligations vis-a-vis the land contract vendor, will now be controlled by Section 365.[3] For debtors and trustees, Terrell means a significant reduction in the flexibility available in dealing with land contract vendors. For vendors, the decision provides opportunities but also poses many questions, most of which remain unresolved.

Terrell undoubtedly surprised many bankruptcy practitioners and has already

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[1] All references to the Bankruptcy Code shall mean Title 11 of the United States Code.

[2] Prior to Terrell, the Bankruptcy Courts in both the Eastern and Western Districts of Michigan had either held or stated as dicta that land contracts were not executory contracts, but were rather a species of secured real estate financing. See, In re Britton, 43 Bankr. 605 (Bankr. E.D. Mich. 1984); In re Frank Kunik Farms, 86 Bankr. 907 (Bankr. E.D. Mich. 1988); In re Cooper, 98 Bankr. 294 (Bankr. W.D. Mich. 1989).

[3] The most troublesome and intriguing of the questions posed by Terrell arises when land contract vendees are the debtors in bankruptcy; therefore, debtor/vendees and their non-debtor vendors will be the focus of this article.

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prompted the publication of articles discussing its philosophical underpinnings.[4] The decision is bound to generate numerous cases resolving the myriad of questions that were neither asked nor answered in the decision. Moreover, because of the unique combination of federal and state law involved in the analysis in the case, the results reached by different courts considering the Terrell issue vary widely. The three court of appeals decisions considering the issue illustrate this point. Compare Terrell, 892 F.2d at 473 (applying a federal law definition of executory contracts to Michigan law and concluding that land contracts are executory contracts) and Speck v. First National Bank of Sioux Falls (In re Speck), 798 F.2d 279 (8th Cir. 1986) (applying federal law and South Dakota law and reaching the same result as in Terrell); with Mitchell v. Streets (In re Streets & Beard Farm Partnership), 882 F.2d 233 (7th Cir. 1989) (applying federal law and Illinois law and deciding that land contracts are not executory).

Regardless of the merits of the decision, the fact remains that Terrell represents (at least for the present) the Sixth Circuit's definitive statement on the issue. The purpose of this article is not to debate the pro's and con's of Terrell but to discuss the more practical question: what does this decision mean to parties to land contracts in Michigan? In considering this question, the article will examine several areas in which, following Terrell, practice involving the treatment of land contracts of necessity will diverge markedly from previous practice.

Treatment of the Non-Debtor Vendor During the Bankruptcy.

Under pre-Terrell practice, a land contract vendor whose vendee had filed a bankruptcy proceeding could generally insist upon the same treatment as that given to a mortgagee in similar circumstances. In most instances, that meant that the vendor had the right to petition the bankruptcy court for "adequate protection" of his interest in the land contract property, and that he could insist upon relief from the automatic stay if he did not receive such adequate protection. See 11 U.S.C. §§361, 362(d)(1). Through the use of these statutes, the vendor therefore could generally ensure that he received periodic cash payments on the land contract from the very outset of the bankruptcy. See 11 U.S.C. §361(1) (providing that adequate protection may take the form of periodic cash payments).[5]

The post-Terrell vendor, however, has no such statutory right to obtain adequate protection. The statutory provision for "adequate protection" does not, by its terms, extend to obligations arising under Section 365. See 11 U.S.C. §361. Further, Section 365 by its terms does not make any provision for interim payments to non-debtors pending assumption or rejection of a contract or lease, except in the case of an "unexpired lease of non-residential real property." See 11 U.S.C. §365(d)(3). A land contract vendor is therefore

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[4] See, e.g., Teholiz, Some Notes on In re Terrell, Western District of Michigan Federal Bar Association Bankruptcy Newsletter (Vol. II, No. 7, March 1990).

[5] Of course, a pre-Terrell vendor's use of adequate protection as a means of obtaining periodic land contract payments would have been frustrated in the case where the value of the land contract property was exceeded by the unpaid balance on the land contract, because "adequate protection" is often unnecessary in such a situation. See United Savings Association of Texas v. Timbers of Inwood Forest Assoc., Ltd., 108 S. Ct. 626 (1988). This is one situation in which the position of land contract vendors may have been enhanced by Terrell. See infra.

ithout an express statutory right to receive interim payments toward the land contract debt.

Notwithstanding the lack of express statutory authorization, however, a land contract vendor has various means available for receiving compensation during the pendency of the bankruptcy.[6] To the extent that the debtor's use or occupation of land contract premises post-petition produces a benefit to the estate, the vendor will be entitled to administrative expense priority in an amount equal to that benefit. See Memphis-Shelby County Airport Auth. v. Braniff Airways, Inc. (Matter of Braniff Airways, Inc.), 783 F.2d 1283, 1285 (5th Cir. 1986); Zagata Fabricators, Inc. v. Superior Air Prods., 893 F.2d 624, 627 (3d Cir. 1990). Ordinarily, this amount will not be payable to the vendor until the land contract is either assumed (when it must be made up as part of the cure of arrearages) or rejected. See Braniff Airways, 783 F.2d at 1286. However, some courts have at least tacitly recognized the application of "adequate protection" principles as a means of ensuring the non-debtor a stream of interim payments, prior to assumption or rejection. See id.; In re DeSantis, 66 Bankr. 998, 1002 (Bankr. E.D. Pa. 1986).

Other cases, however, have expressly held that §§362 and 361 have no application to obligations falling under §365. See, e.g., In re Sweetwater, 40 Bankr. 733 (Bankr. D. Utah 1984). Even in these cases, however, the courts have in appropriate circumstances ordered that a debtor pay the non-debtor/lessor a "reasonable use" payment during the interim period. See, Harris International Telecommunications, Inc. v. Three Star Telecast, Inc. (In Re Three Star Telecast, Inc.), 73 Bankr. 270 (Bankr. D.P.R. 1987).

A significant practical difference between the "adequate protection" payments to a mortgagee and the "reasonable use" compensation under §365 lies in what these payments are intended to compensate for. "Adequate protection" should be paid in an amount sufficient to compensate the secured party for the loss suffered in the value of an interest in property. The amount of "reasonable use" payments, on the other hand, will be determined with reference to the benefit that the debtor obtains from the property during the bankruptcy proceeding. For practical purposes, it may be argued that this amount should be presumed to be the amount due periodically on the land contract. See, Braniff Airways, 783 F.2d at 1285 (holding with respect to a lease that reasonable use payments should be presumed to be in the amount of the rental payments). For this reason, the practical and factual considerations relevant to fixing the amount of payments in these two situations may differ significantly.

Treatment of Land Contract Debt Under Plan of Reorganization.

Before Terrell, the vendee/debtor (whose interest in the land contract was regarded and treated similarly to a buyer's interest under a secured sale) was often entitled to change the land contract terms through the bankruptcy. In a case arising under either Chapter 11 or 12 of the Code, the debtor had the right under appropriate circumstances to modify the contract to lower the payment amounts, change the applicable interest rate and/or extend the payment term. See, 11 U.S.C. §§1129(b)(2)(A)(i), 1225(a)(5)(B) & 1222(b)(9).[7] Moreover, if

[6] The case law in this area deals for the most part with unexpired leases. Therefore, procedures applicable to land contracts must be gleaned by analogy.

[7] The debtor's right to modify a secured claim in a Chapter 13 case is more limited. The terms of a debt secured only by a security interest in the debtor's principal residence cannot be modified. 11 USC §1322(b)(2). However, the rights of a holder of a claim secured by other property can be modified as

the value of the property had fallen below the unpaid land contract balance, the debtor could in essence rewrite the contract to reduce the contract balance to the amount of remaining value, and could pay off the remainder as a general unsecured claim.

Terrell effectively eliminates the debtor's right to modify the terms of a land contract. By virtue of that decision, the provisions of Section 365 now govern. Therefore, the debtor may "assume" the land contract or "reject" it; assumption, however, means that the contract is preserved (and will be performed under) according to its original terms, with the original payment amount, interest rate and amortization schedule intact.[8]

Before Terrell, if a land contract was in default at the time of the bankruptcy filing, the debtor could often modify the contract without ever having to cure the default.[9] Section 365, on the other hand, sharply curtails a debtor's ability to stretch out the payment of pre-petition arrearages on the land contract in the manner afforded to land contract vendees prior to Terrell. If the debtor chooses to assume the land contract, Section 365(b)(1)(A) explicitly requires that the debtor either immediately cure or provide adequate assurance of a prompt cure of all defaults under the land contract. The requirement of "prompt" cure will in most cases require that at the time of assumption of the contract, the debtor make a lump sum payment adequate to compensate for any and all missed payments, whether pre- or post-petition.

This change in the treatment of land contracts may be the one that will create the harshest effect upon debtors who are accustomed to dealing with such debts as secured obligations. It will pose a special problem for individual debtors who are buying their primary residences on land contract. Before Terrell, such a debtor might have used bankruptcy as a means of saving the equity in his home when he fell behind on his land contract payments and was facing forfeiture or foreclosure; post-Terrell, bankruptcy no longer offers this option to debtors.

Interestingly, in at least one other circuit the bankruptcy courts have found that the perceived injustice resulting from this treatment of land contracts justifies holding (at least in the residential context), that a vendee/debtor has the option of treating a land contract either as a secured debt or as an executory contract. See, Fox v. Hill (In re Fox), 83 Bankr. 290 (Bankr. E.D. Pa. 1988) (holding that notwithstanding the federal and/or the state definitions of "executory contracts," Congress could not have intended the harsh results that treatment under section 365 would impose upon land contract vendees); compare with Terrell, 892 F.2d at 470 (categorically stating that land contracts are subject to section 365, despite the fact that this meant that a debtor/vendee could not subject a land contract debt to "cram-down" under 11 U.S.C. §1225(a)(5)).

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under Chapters 11 or 12.

[8] See, Cottman Transmissions, Inc. v. Holland Enterprises, Inc. (In re Holland Enterprises, Inc.), 25 Bankr. 301 (E.D. N.C. 1982) ("an assumed contract under Section 365 is accompanied by all its provisions and conditions"); Matter of Executive Technology Data Systems, 79 Bankr. 276 (Bankr. E.D. Mich. 1987) ("executory contract may not be assumed in part and rejected in part").

[9] In a case under Chapter 13, the debtor cannot postpone the cure of defaults on a debt with a term that extends longer than the term of the plan beyond a "reasonable time". See, 11 U.S.C. §1322(b)(5).

The Risk of Rejection in Liquidation Proceedings.

Section 365(d)(1) requires that a Chapter 7 trustee exercise his "assume or reject" option with respect to an executory contract within sixty days of the entry of the order for relief. If the trustee fails to act within that time, the executory contract will be "deemed rejected". If assumption is desired, the trustee must act by filing his formal motion for assumption within the applicable time limit. See, Matter of Cybernetic Servs., Inc., 94 Bankr. 951, 953 (Bankr. W.D. Mich. 1989).

The above-described provisions of Section 365 impose upon Chapter 7 trustees a duty to act affirmatively to preserve existing land contracts. This duty was not present when land contracts could be characterized as secured sales transactions. If the trustee fails to meet this new duty, there is a significant risk that the debtor (who may be current on his land contract payments and wish to maintain the land contract property) will be deemed to have rejected the land contract under Section 365, thereby creating a breach that jeopardizes the debtor's ability to maintain the land contract. See, 11 U.S.C. §365(g)(1) (stating that rejection of an executory contract constitutes a breach of the contract).[10] This risk is especially threatening in cases where the individual debtor is purchasing his principal residence on land contract.

Trustees may receive some guidance (and individual debtors some comfort) from a line of cases involving residential leases under Section 365. These cases hold that despite the language of Section 365(d), a trustee's deemed rejection of a residential lease will be treated not as a breach but as an abandonment of the lease. See, Rich Mar Apartments v. Knight (In re Knight), 8 Bankr. 925, 929 (Bankr. D. Md. 1981); In re Adams, 65 Bankr. 646 (Bankr. E.D. Pa. 1986); see also, Adams v. Philadelphia Housing Auth. (In re Adams), 94 Bankr. 838 (Bankr. E.D. Pa. 1989) (holding that although debtor's attempt to "assume" residential lease through Chapter 13 plan had been ineffectual, the effect of the failure to assume was abandonment, rather than rejection of the lease).[11] In Knight, for example, the trustee's failure to assume the lease was held merely to have removed the lease from the bankrupt's estate; this left the debtor free to perform under the lease without giving the landlord an independent basis upon which to declare that the lease had been breached. See, 8 Bankr. at 929.

The holdings in these cases certainly could be adopted in cases involving land contracts, at least to the extent that executory contracts and residential leases are treated similarly under Section 365(d). Further, trustees might find that affirmatively abandoning land contracts (under Section 554) is an attractive alternative to rejection in those cases where the debtor, although he is not building up equity by paying off his land contract, nonetheless cannot afford to lose the land contract property.

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[10] The deemed rejection may simply result from the trustee's inadvertence or failure to follow the required procedure for assumption within the allowed time. In other cases, however, the diligent trustee may feel that he is unable properly to assume the debtor's land contract; for example, this could occur in a situation where the fair value of the land contract property had fallen below the unpaid land contract balance. In this case it may be difficult for the trustee to justify assumption of the land contract debt in the eyes of other creditors.

[11] The Court in Knight defined a residential lease as "the conventional consumer arrangement under which the Debtor takes possession of premises as the tenant for the purpose of residing in those premises on a continuous basis, rather than for the leasing of premises for an investment or business purpose." 8 Bankr. at 929.

The Effect of Rejection.

Section 365(i) specifically sets forth the consequences of a debtor/vendor' rejection of a land contract under which the vendee is in possession. Accordin to that subsection, rejection by the debtor/vendor does not deprive the non debtor of his right of possession, nor does it deprive the non-debtor of hi right to receive title to the property upon payment of the purchase pric according to the terms of the contract. Rejection merely relieves the debto of all obligations under the land contract other than the duty to deliver title See, 11 U.S.C. §365(i).

The Code is silent, however, concerning the effect of rejection by debtor/vendee, except for the general statement that rejection of an executor contract constitutes a "breach" of that contract. See, 11 U.S.C. §365(g)(1) The general statement poses rather than answers questions. For example, doe this "breach" constitute a termination of the debtor's rights under the lan contract, giving the non-debtor the right to retake possession of the premises or does it merely provide the non-debtor with the right to institute judicia or extra-judicial foreclosure or forfeiture proceedings?

The bankruptcy court in this district has recently provided some guidance a to the meaning of "breach" in this context. Ruling from the bench in the cas of In re Properties Corporation of America, Case No. SG 90-80907 (February 22 1991), Judge Stevenson stated that the rejection of a land contract does not i and of itself terminate the land contract or give the non-debtor vendor a righ to insist upon the immediate surrender of the premises; rather, the rejectio removes the land contract from the estate in bankruptcy and restores to th parties whatever rights and remedies they are entitled to under state la following a breach of the land contract. The effect of this ruling in some way narrows the bridge between pre- and post-Terrell practice involving lan contracts. In many cases, the situation of the land contract vendor followin rejection of the land contract will be akin to that of a non-debtor mortgage who obtains relief from the automatic stay in bankruptcy: both will be left t resort to the state law remedies that they would have followed earlier but fo the bankruptcy.

Pre-Petition Forfeiture or Foreclosure.

Another significant issue raised (but not answered) by Terrell concerns th right of a debtor/vendee to use Section 365 to revive rights under a lan contract that has been breached before the bankruptcy was commenced. Prior Terrell, it was clear that if the vendor's breach had resulted in th commencement of foreclosure proceedings, the vendee could reinstate the contra by curing any defaults if bankruptcy occurred at any time prior to th foreclosure sale. See, In re Carr, 52 Bankr. 250 (Bankr. E.D. Mich. 1985); re Glenn, 760 F.2d 1428 (6th Cir. 1985). If forfeiture proceedings had be commenced by the vendor, the crucial point was expiration of the applicab redemption period. See, Carr, 52 Bankr. at 256-57.

The rules set forth in Carr were derived in part from the application theories used in the context of mortgages, based upon the assumption that la contracts are essentially secured sales transactions. See, Carr, 52 Bankr. 253. Post-Terrell, however, the mortgage analogy no longer holds currency. deciding the post-petition rights of parties to a land contract that w breached pre-petition, the courts must fit the situation into the rubric Section 365. If foreclosure or forfeiture proceedings have been commenced, t post-petition question might well be: is there still an executory contract be assumed or rejected?

In the forfeiture context, Carr has characterized the situation thus: between the 16th day following the forfeiture notice and the expiration of the redemption period, the land contract has "terminated," but is subject to reinstatement upon the vendee's timely cure. Carr, 52 Bankr. at 253-54. It is therefore possible to imagine a bankruptcy court finding that if a filing occurs during that period, the contract will still be deemed "executory" and subject to cure under Section 365. Such a finding would put the debtor/vendee under a forfeiture proceeding in roughly the same position he would have been in pre-Terrell.

A different problem arises, however, in the foreclosure situation. In many land contracts, the vendor is entitled to accelerate the entire balance of the land contract, after a fairly short notice period, prior to institution of foreclosure proceedings. If a bankruptcy occurs after acceleration has occurred but before the foreclosure judgment or the sale, will the debtor/vendee still have the right to assume the contract under the terms provided in Section 365? An argument can be made that once acceleration has occurred, there is no more "executory contract" to assume. Strictly speaking, there would be no basis at this point (if one looks no further than Section 365) for allowing the debtor to cure the default. If this result is upheld by bankruptcy courts, it is possible to envision land contract vendors favoring the acceleration/foreclosure remedy over the forfeiture remedy in the future.

Conclusion.

The foregoing presents only a sampling of the many issues that lurk among the shadows for land contract vendees or vendors who become enmeshed in bankruptcy proceedings. Unfortunately, most of these issues are likely to remain open issues for some time, as the courts take the time to apply the various provisions of Section 365 to the myriad of practical considerations created by these types of land sale transactions. In the meantime, perhaps the best rule of thumb for the practitioner to follow (and the only reliable one) is not to assume that the courts will treat land contract problems the same way they would have prior to Terrell.

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.

Moses v. Allard (In re Moses), Case No. 90-CV-73567-DT (E.D. Mich. Dec. 14, 1990). In this Chapter 7 case, the individual debtor refused to answer all questions posed to her at her Section 341 meeting, citing her Fifth Amendment privilege against self-incrimination. At the time of this meeting, there was pending against the debtor a criminal proceeding in Switzerland instigated by one of her creditors alleging misrepresentations concerning certain accounts receivable. The Section 341 meeting was adjourned to permit the Detroit Bankruptcy Court to resolve the issues concerning the scope of debtor's Fifth Amendment privilege.

On December 4, 1990, the Bankruptcy Court, per Judge Ray Reynolds Graves, issued an order compelling debtor to testify at the adjourned Section 341 meeting. Judge Graves found that debtor failed to establish a reasonable fear that she would be subjected to Swiss criminal prosecution since she failed to prove the existence of an extradition treaty between the United States and Switzerland. Judge Graves also found that debtor failed to establish that her response to certain questions at the Section 341 meeting would tend to incriminate her.

Debtor appealed to the federal district court from this order and petitioned for a stay pending appeal. The district court, per Judge Gerald Rosen, granted this stay. Judge Rosen first found that debtor would suffer irreparable injury if the order was not stayed pending a decision on appeal. Judge Rosen stated that if this order remained in effect without a stay, the debtor would "be compelled to disclose publicly information which may well be disseminated to the Swiss authorities and used by them in prosecuting the criminal case against her."

Judge Rosen also found that the Chapter 7 trustee would suffer very little harm if the stay is entered--the stay would only delay the administration of debtor's estate. Addressing the test of whether debtor was likely to succeed on the merits of her appeal, the district court held that she "need not make an extremely strong showing of likelihood of success on the merits in order to prevail in the instant motion." Judge Rosen stated that there was a possibility, although not a strong one, that debtor would be prosecuted in Switzerland on the basis of her testimony at the Section 341 meeting. Finally, the district court found that the public interest weighed in favor of granting the stay pending appeal. Judge Rosen noted that there was a split of authority, not yet addressed by the United States Supreme Court or the Sixth Circuit, on the issue of whether the Fifth Amendment's privilege against self-incrimination extended to fear of foreign prosecution.

<u>In re Cliff's Ridge Skiing Corporation</u>, Case No. GM 87-00206 (Bankr. W.D. Mich. February 5, 1991). This case involves complicated issues of lien priorities in fixtures under Michigan real estate law and the Uniform Commercial Code. The facts of this case are lengthy and complex and, for that reason, will not be restated in detail here. In October 1987, Cliff's Ridge Skiing Corporation ("Debtor") commenced a Chapter 11 case in the Marquette Bankruptcy Court. Three months later, this case was converted to Chapter 7. The trustee thereafter sold all of Debtor's assets pursuant to Section 363 of the Bankruptcy Code. One of these assets, a chairlift installed on a ski slope, was sold for $22,500 and the proceeds were deposited in an escrow account pending a determination of their proper distribution among three competing secured creditors.

One of these secured creditors, First of America Bank-Marquette, N.A. ("FOA"), held a mortgage on the realty to which the chairlift was annexed. This mortgage, which was recorded in the Marquette County land records in August 1980, specifically mentioned that fixtures were subject to the mortgage. However, since Debtor did not purchase and install the chairlift until the latter part of 1982, the mortgage did not specifically mention the chairlift.

The second secured creditor, Cliff's Ridge Development Co. ("Development"), held a mortgage on this realty which was properly recorded in the Marquette County real estate records in November 1982. This mortgage did not mention fixtures in general or the chairlift in particular as collateral for the debt owed by Debtor to Development.

The third secured creditor, First National Bank & Trust Company of Marquette ("First National"), had made a fixture filing under the Uniform Commercial Code with the Marquette County Register of Deeds. First National's UCC-1A, which specifically mentioned the chairlift, was recorded in December 1982. In addition, FOA, but not Development, had executed a written agreement subordinating FOA's lien in the chairlift to the security interest held by First National in that same property.

In a 35-page opinion authored by Bankruptcy Judge James Gregg, he first concluded that the chairlift was a fixture under Michigan law. The stipulated facts submitted to him by the three competing lien creditors were analyzed in light of the three-pronged test to determine whether and when personal property becomes a fixture:

(1) is the property annexed or attached to the realty,
(2) is the attached realty adapted or applied to the use of the realty, and
(3) is it intended that the property will be permanently attached to the realty?

Judge Gregg then addressed the issue of how liens and security interests in fixtures are created and perfected under Michigan law. He concluded that there are two methods by which this can be accomplished. First, a creditor may obtain and perfect a lien in fixtures under Michigan real estate law by obtaining a mortgage on the subject realty and recording that mortgage in the proper land records. The mortgage need not contain a particular description of the fixtures involved. In fact, it is not even necessary for the mortgage to state that the mortgage lien extends to fixtures in order for that lien to attach to that property.

The second method for obtaining and perfecting a security interest in fixtures is under Article 9 of the Uniform Commercial Code. The creditor must obtain a security agreement signed by the debtor covering this fixture and must file his UCC-1A with the Register of Deeds in the county in which the subject realty is located. Applying these principles to the facts before him, Judge Gregg concluded that all three secured creditors held valid and perfected liens in the chairlift. The next, and final issue, before him was to determine the relative priorities of these competing liens.

Judge Gregg found that First National did not hold a purchase-money security interest in the chairlift under UCC § 9-107 and, therefore, First National was not entitled to the special priority afforded such a lienor under UCC § 9-313(4)(a). Since the chairlift was purchased and delivered prior to the closing of First National's loan to Debtor, that subsequent loan did not "enable" Debtor to purchase the chairlift as required by UCC § 9-107.

Without considering the subordination agreement between First National and FOA and applying a "first in time, first in right" rule, Judge Gregg concluded that FOA held first priority in the proceeds of the chairlift's sale, Development was second, and First National was third. However, the subordination agreement skewered these priorities and created a circular priority issue. FOA had subordinated its lien position to First National's, which was junior to Development's. In resolving this problem, Judge Gregg declared that

> . . . the effect of the Subordination Agreement should be construed as FOA and First National having "traded places" to the extent of the money advanced by First National to the Debtor for the chairlift loan which remains unpaid or the remaining mortgage balance owed to FOA by the Debtor, whichever is less. By so doing, [Development's] interest and its original priority position will not be adversely or beneficially affected by the other parties' subordination agreement.

since the amount of First National's unpaid claim exceeded the total sale proceeds, First National received all of those proceeds, including the interest earned on those monies while in escrow.

First of America Bank v. Gaylor (In re Gaylor), Adversary Proceeding No. 90-9069 (Bankr. E.D. Mich. Jan. 25, 1991). In this decision, Bankruptcy Judge Arthur Spector addresses the issue of whether an individual Chapter 7 debtor can "strip down" a lien on real property sold by the debtor after the bankruptcy case is closed. On March 23, 1990, the individual debtors, husband and wife, commenced a joint case in the Flint Bankruptcy Court. A creditor, First of America Bank ("Bank"), thereafter commenced an adversary proceeding for a determination that a debt owed to it by debtors was nondischargeable. Debtors then filed a counterclaim seeking to avoid the unsecured portion of the Bank's lien on their principal residence under 11 U.S.C. § 506(d). Debtors alleged that their home's value was $163,000 and was subject to liens senior to Bank's in the total sum of $170,000. Bank held a third mortgage on the parcel in the sum of $45,200. Bank filed a motion to dismiss debtors' counterclaim for failure to state a claim upon which relief may be granted. This motion to dismiss was granted by Judge Spector.

In his opinion, Judge Spector first addressed the issue of whether the estate had any interest in debtors' home. Bank argued in its motion that a debtor could not seek relief under 11 U.S.C. § 506(d) with respect to property in which the estate holds no interest. In his discussion, Judge Spector cited and disagreed with an earlier decision of the federal district court, Seifert v. Selby, Case No. 88-CV-10247 (E.D. Mich. Feb. 10, 1989), which held that if no party has timely filed an objection to a claimed exemption, the subject property is exempt in its entirety and not just for the value of the interest claimed as exempt. In the case before Judge Spector, the debtors claimed an exemption of $1 in their home. If Judge Spector followed Seifert, the entire parcel of realty would be exempt and not just the value of the debtors' interest in that property.

In reviewing the language of 11 U.S.C. § 522(d), which permits a debtor to exempt his "interest" in property and that section's legislative history, Judge Spector disagreed with Seifert and concluded that a debtor's property remains property of the estate to the extent that its value exceeds the statutory amount which the debtor may exempt:

> . . . we believe that the language of the statute, its legislative history, case law and the leading treatises support the conclusion that a debtor's maximum allowable exemption under §522(d) is his equity in the property or the applicable statutory ceiling, whichever is less, and that the property in which a debtor claims an exemption remains property of the estate to the extent its value exceeds the maximum allowable exemption.

Judge Spector then addressed the issue of whether the doctrine of stare decisis required him to follow the Seifert decision since it was issued by a federal district judge sitting in the Eastern District of Michigan. Judge Spector concluded that he was not bound to follow this decision since it represented the views of only one district judge among many in his district. According to Judge Spector, "a decision rendered by an individual judge in a multi-judge district simply does not constitute a decision of the district court itself." Consequently, Judge Spector concluded that the debtors' bankruptcy estate continued to have an interest in the principal residence despite debtors' claimed exemption and the Seifert decision.

Judge Spector then cited decisions from other jurisdictions supporting his conclusion that debtors in Chapter 7 cases could not utilize 11 U.S.C. § 506(d) to avoid valueless liens in estate property. To permit a debtor to do otherwise would conflict with the statutory scheme of Chapter 7 which permits debtors to retain less property than they otherwise may be entitled to retain in reorganization cases. Judge Spector, however, noted that there is a split of authority among the federal courts on this issue.

In re Winkler, Case No. 90-04409-G (Bankr. E.D. Mich. Jan. 16, 1991). In this decision, Bankruptcy Judge Graves held that the United States Trustee's office, and not the bankruptcy court clerk, must serve a notice of hearing on a motion made by the United States Trustee to convert a Chapter 11 case to one under Chapter 7. The United States Trustee had refused to serve the notice and had filed a motion to compel the bankruptcy court clerk to so act. Judge Graves wrote that the United States Trustee is bound by the requirements of motion practice set forth in L.B.R. 2.08 (E.D.M.) which requires the person filing a motion that is objected to by another party to serve the notice of hearing. Judge Graves also found that the United States Trustee is a "person" bound by the notice requirements of Bankruptcy Rule 2002(a). Nevertheless, Judge Graves, in his amended order dated January 24, 1991, stayed the effect of his ruling until October 1, 1991, to permit the drafters of the Bankruptcy Rules of Procedure to address this problem in their revisions to those rules.

CORRECTIONS

Two of the case summaries which appeared in the January, 1991 Newsletter were somewhat misleading in the facts or holdings, and are corrected below. Our thanks to our readers who found these errors and alerted us to the same.

In Leitch v. The Lievense Insurance Agency (In re Kent Holland Die Casting & Plating, Inc.), we stated that the Sixth Circuit reversed the decision of the United States District Court for the Western District of Michigan, which had affirmed the Bankruptcy Court's dismissal of Aetna Casualty & Surety Company from this adversary proceeding. In reality, the Sixth Circuit held that, "The bankruptcy and district courts were correct in ruling that the trustee's complaint did not relate back under FRCP 15 (c)." However, the question of equitable estoppel was never addressed in the lower courts. The Sixth Circuit remanded the case to the bankruptcy court for further factual findings with regard to Aetna's conduct on the estoppel issue as well as to develop the record in regard to the real party in interest, deliberate misrepresentation and tolling of the statute of limitations.

In In re Urbanco, we indicated that the Chapter 11 debtor filed a motion to assume an unexpired lease of non-residential real property within the 60-day period in 11 USC §365(d)(4), and never filed a motion for additional time to assume or reject the lease. In fact, no motion to assume the unexpired lease of non-residential real property, or for additional time to assume or reject, was made within 60 days after the debtor filed for Chapter 11 relief, as is required by 11 USC §365(a) and (d)(4) and Bankruptcy Rules 6006 and 9014.

Our apologies to any readers who may have relied on the previous summaries of these cases.

Larry A. Ver Merris

EDITOR'S NOTEBOOK:

In the Wall Street Journal of Friday, February 8, 1991, at page B-6, it was reported that a Wisconsin Appeals Court ruled that a bankruptcy trustee can not be held personally liable for the cost of cleaning up a contaminated waste site unless he intentionally violated the law. This opinion reversed a lower court decision finding the trustee liable for the cleanup of wastes from a plating plant because the facility was generating and storing hazardous waste without a license while under his supervision. The court of appeals panel ordered the trial court to determine whether the trustee deliberately failed to obtain the necessary license under Wisconsin law to operate the facility.

As a followup to the discussion of "Fleet Factors" liability for secured creditors, which appeared in the September, 1990 Newsletter, we note that the EPA has proposed a new rule interpreting the CERCLA "secured lender exemption" [§101(20)(A)]. This recent proposal from the EPA consists of a draft interpretive regulation together with an explanatory preamble which was sent to the Office of Management and Budget for review on September 14, 1990. The draft will be eventually revised and may be published for public comment at a later date. The draft attempts to overrule the most damaging language in Fleet Factors and specifies activities a lender may engage in without incurring CERCLA liability. There are other features of the proposed draft, however, which threaten to impose new obligations on lenders.

The U.S. Supreme Court recently granted cert. in two bankruptcy cases of interest. In Toibb, Sheldon v. Radloff (1991, U.S.), 1991 U.S. LEXIS 485, Docket No. 90-368, cert. granted January 18, 1991, In re Toibb (1990, CA 8 Mo), 902 F.2d 14, reh. denied en banc 1990 U.S. App. LEXIS 9501, the Supreme Court agreed to address the availability of Chapter 11 for individual non-business debtors. In Johnson v. Home State Bank (1991, U.S.), 1991 U.S. LEXIS 578, Docket No. 90-693, cert. granted January 22, 1991, In re Johnson (1990, CA 10 Kan), 904 F.2d 563, the Supreme Court will address whether mortgage arrearages can be repaid through a Chapter 13 plan by a debtor who has been discharged in Chapter 7 from personal liability on such debt (the so-called "Chapter 20" filing).

Larry A. Ver Merris

STEERING COMMITTEE MEETING MINUTES:

A meeting was held on February 15, 1991 at noon at the Peninsular Club.

1. James A. Engbers gave a brief update regarding the status of donations for the attorney lounge on the 7th floor of the Federal Building. To date, a total of $2,350.00 has been pledged, and Jim expected to receive further responses once his new batch of "dunning" letters is sent out.

2. Scott H. Hogan, on behalf of Pat Mears, made a brief report from the Educational Committee for the Shanty Creek Seminar. At this time, most of the speakers have been lined up for the Seminar and we would expect to be able to send out a brochure shortly. It is anticipated that the costs this year will be $105.00 for FBA members and $125.00 for non-FBA members, which will apply to all in attendance.

3. Brett Rodgers briefly updated all in attendance on the Sixth Circuit Conference to be held in the Traverse City area in June. Needless to say, the bankruptcy sections' participation in this conference is somewhat up in the air at this time.

4. Under new business, your editor noted that hand-in-hand with the recent postal increases to first-class mail was an increase in the bulk mailing rate from 16.7¢ per item to 19.8¢ per item for envelopes up to 3.3 oz. Also, your editor is investigating the possibility of a new printer and re-formatting the layout of the Newsletter. Changes, if any, will be noted in future editions.

5. Discussion was also had concerinng the possibility of making the Newsletter a bi-monthly (every two months) publication in light of the difficulty in getting parties to write lead articles. Selling advertising in the Newsletter was also brought up. Both of these topics were adjourned for further discussion at a later date.

6. The next Steering Committee meeting, per the January, 1991 Newsletter, will be held on the third Friday in March, that being March 15, 1991, in the Gold Room at noon at the Peninsular Club.

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, 1991 through January 31, 1991. These filings are compared to those made during the same period one year ago, and two years ago.

	Jan. '91	Jan. '90	Jan. '89
Chapter 7	385	285	233
Chapter 11	17	12	14
Chapter 12	0	0	1
Chapter 13	151	149	115
Totals	553	446	363

BANKRUPTCY ISSUES

Presented by

The Grand Rapids Bar Association CLE Committee

March 20, 1991

L.V. Eberhard Center

1:30 p.m. - 5:00 p.m.

Presenters:

Robert A. Hendricks:

The New Treatment of Land Contracts in Bankruptcy. . . The Effect of *Terrell* on the Attractiveness of Land Contracts.

Harold E. Nelson:

Strategic Considerations for Potential Debtors and Creditors . . .

What Assets Would be Exempt?
What Claims Would be Dischargeable?
How Would a Bankruptcy Affect My Case?
Should I Threaten to File?
Should I Take the Threat Seriously?

James W. Zerrenner:

Divorce and Bankruptcy: The Fatal Subtraction

☆ The Seminar will also feature a panel of Bankruptcy Judges in the Western District ☆

Hon. Laurence E. Howard
Hon. David E. Nims, Jr.
Hon. JoAnn C. Stevenson
Hon. James D. Gregg

✎ Please register me for the **BANKRUPTCY SEMINAR** on March 20, 1991.

lame:____Phone:______________

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