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FINANCING ALTERNATIVES IN BUSINESS BANKRUPTCIES

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We are all aware of the statistics which indicate the vast majority of Chapter 11 business cases that never reach the confirmation stage of the case. To the ill-fated ones, there may have been no hope, but many cases would have a fighting chance if new money was available on an equity, lending, or combination hybrid basis.

The focus of this article is to identify alternative sources of funding to assist Debtors in their reorganization efforts. By alternative sources, we make the assumption that the traditional conventional commercial banks either are already a creditor in the case (and probably objecting to classification and plan treatment) or will not approve a financing request at the loan committee level for new moneys.

Financing may become necessary at different times in the case. For example:

(a) Purchase money security interest for the purchase of a specific piece of equipment during the case.

(b) Inventory and receivable financing to complete a specific purchase order or job number.

(c) Funding the requirements of the Plan of Reorganization itself.

Section 364 of the Bankruptcy Code (11 U.S.C. Section 364) regulates the priority of a Debtor granting security interest to creditors, and the potential for competing rights of other secured creditors. Certainly Debtor's counsel and counsel for the secured creditor, or proposed secured creditor, should examine the Code and the case law to be sure their client's rights and the competing priorities of other secured creditors are considered. Section 364 does require that any secured credit transaction the Debtor wishes to enter into requires notice and hearing to all parties in interest.

Many Debtors never have to research Section 364 and the case law because they are unable to locate a financing source in any event. With the expansion of Chapter 11 as a tool for many large corporate Debtors to reorganize their affairs, the financ-

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ing community has responded and credit is available to fund Chapter 11 Debtors' Plans. This is clearly true in the major metropolitan and financial communities of our country, but what can Chapter 11 and Chapter 13 Debtors in West Michigan anticipate as funding sources?

I suggest (not in any particular priority) Debtors and their counsel consider the following sources and resources to finance their reorganization efforts:

(1) The existing bank or lender (See 11 U.S.C. Section 1129(b)(2)(A)).

(2) Key Vendors/Suppliers for open credit terms and movement away from cash in advance or cash on delivery terms.

(3) Asset based lenders.

(4) Use of financing brokers.

(5) Business industrial development corporation (Bidco's).

(6) Family members and friends.

While the Debtor's existing bank is not likely to advance new credit, remember that Section 1129(b)(2)(A) provides the Debtor with several tools to continue the existing lender's credit position. The pre-petition bank loan documents are not executory contracts which can be assumed (See 11 U.S.C. Section 365(c)(2)). The Bankruptcy Code, however, provides standards under which the Debtor can "cram down" the existing secured creditor. We must look to Section 1129(b)(2)(A) for direction. A complete discussion of this Section and the cram down case law of secured creditors is beyond the scope of this article. Briefly, however, 1129(b)(2)(A) provides three alternatives for the cram down of a secured class:

(a) The stretch out approach.

(b) The sale of the property free and clear of liens.

(c) The provision for the "indubitable equivalent".

First, the Stretch Out. Yo[u] of Reorganization can provide the secured class retains its [lien] and providing for "deferred [cash] payments" pursuant to Secti[on] 1129(b)(2)(A)(i)(II). Remember th[e] payment stream must have a present value of at least the value of the secured creditor's interest in the collateral (also the 1111(b) election available to the secured creditor may make the stretch out alternative difficult).

While the Bankruptcy Code sets no limit on the length of time over which payments may be deferred in a Chapter 11, the two limiting principles are adequate protection of the secured parties' interest and the feasibility of the Plan.

The second cram down alternative is the sale of the collateral free and clear of liens with the secured creditor receiving the proceeds and thereafter either deferred cash payments or the "indubitable equivalent". The advantage of selling collateral in a Plan is the lack of the requirement of Section 363(f)(3) which requires that the sale price exceed the amount of the lien unless the secured creditor consents.

The third alternative is to provide the secured creditor with the "indubitable equivalent" of its security. The two most simple forms of the "indubitable equivalent" are the return of the collateral to the secured creditor or the shift of collateral from one grouping of assets to a second grouping of assets for the benefit of the secured creditor. For a more complete discussion of the "indubitable equivalent", see In re: Murel Holding Corporation, 75 F2d 941, In re: Monnier Brothers, 755 F2d 1336, In re: Timbers of Inwood Forest Associates Ltd, 793 F2d 1380, opinion reinstated in 808 F2d 363, and In re: Metz, 67 BR 462.

The Debtor's vendors may be a source of credit as well. Try to convert the cash on delivery and cash in advance position to credit terms to allow the Debtor some lines of credit to assist cash flow. Cash flow projections showing feasibility of the Plan of Reorganization will be

...al in order to convince the ...s to take a second risk with ...ebtor. This will require your ... negotiating skills. Emphasize ... Debtor's high points -- for example, the quality of his products or ...ne timely delivery schedule. Perhaps this vendor may be a candidate for equity participation on a merger, acquisition or equity infusion basis. Be sure you consider all these options. If the vendor needs the goods or the services of the Debtor and cannot find timely alternative sources, the vendor may be a captive participant. Use that fact in your negotiations.

Asset based lenders are also a valuable financing tool. This is especially true in the manufacturing industry where the Debtor owns machinery and equipment and builds a product. Hence, inventory and receivables financing is the common lending collateral basis. Asset based lenders do not provide much help, however, to retail or service Debtors. Asset based lenders many times have minimum loan requirements (several millions) which will preclude their use in smaller business cases. To access the asset based lenders, there are "loan brokers" who for a fee will assist in developing a prospectus book to present to the asset based financier. Several such brokers operate in West Michigan.

Remember that all these alternative financing sources will cost more in the form of interest rate, commitment fees and broker fees, than the conventional lenders charge. Further, the reporting requirements are much more aggressive. Debtors should expect to file daily compliance reports on inventory and account receivable levels. It is simply a risk/reward ratio. Businesses coming out of Chapter 11 are not viewed as blue chip borrowers.

Business Industrial Development Corporations ("Bidco's") are a new financial vehicle created by enabling legislation of the State of Michigan. In fact, the Michigan Strategic Fund is an investor in The Bidco on a percentage matching basis to assist in the initial capitalization of The Bidco. There are 7 Bidco's operating in Michigan providing funding to businesses from $50,000.00 to $600,000.00 and more on participation with other lenders. (See the attachment or summary of the policies of the seven Bidco's.)

One of the Bidco's operates in Grand Rapids, Michigan. It is Discovery Bidco located at 7 Ionia, S.W., Suite 300. I must disclose my affiliation with Discovery Bidco since I am a Shareholder and serve on its Board of Directors. I am excited, however, that Bidco's can and do provide an alternative financing source to many businesses including turn arounds, workouts, and Chapter 11 or Chapter 13 financing. While Discovery Bidco is only in its second year of operation, it committed to loan $150,000.00 to a retail Chapter 11 Debtor to finance the purchase of Christmas inventory. Unfortunately, our Bankruptcy Court would not approve the lending since my disclosure of being a Shareholder in the Discovery Bidco to the court, and the fact that our office was counsel to the Debtor-in-Possession was viewed as a potential conflict of interest. The point is, however, Discovery Bidco, in the proper case, is willing to provide financing to troubled businesses. I encourage you to call them if you have a client who could make use of their financing service.

Finally, family and friends many times can be sources of financing. I urge Debtor's counsel to advise the Debtor to make full and complete disclosure of all risks, and provide competent financial projections so those sources of financing are fully informed. It is bad enough that the Debtor's business may fail, but let's try to avoid the destruction of family and friendship relationships.

In closing the final piece of the puzzle in any Plan of Reorganization is the financing. Hopefully these suggestions will provide you some insights and thoughts to make that task a bit easier.

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

Toibb v. Radloff, 1991 W.L. 98970 (U.S.). This opinion, authored by Supreme Court Justice Harry Blackmun, addresses the issue of whether an individual debtor not engage in business is eligible to reorganize under Chapter 11 of the Bankruptcy Code.

Toibb ("Debtor") filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code, disclosing assets that included stock in an electric power company. He was unable to file a Chapter 13 because he had over $100,000 in debt and was unemployed. When he discovered that the stock had substantial value, he decided to avoid its liquidation by moving to convert his Chapter 7 case to one under Chapter 11's reorganization provision. After the Bankruptcy Court granted his motion, and he filed his reorganization plan, that Court sua sponte ordered the Debtor to show cause why his petition should not be dismissed because he was not engaged in business and therefore did not qualify as a Chapter 11 debtor. Debtor unsuccessfully attempted to demonstrate that he had a business to reorganize. He also argued that Chapter 11 should be available to an individual debtor not engaged in an ongoing business. Relying on Wamsganz v. Boatmen's Bank of De Soto, 804 F.2d 503 (8th Cir. 1986), the Bankruptcy Court found that petitioner failed to qualify for relief under Chapter 11. The District Court and the Court of Appeals affirmed.

The Supreme Court held that the Bankruptcy Code, under Section 109(d) and (b) permitted individual debtors not engaged in business to file for relief under Chapter 11. Toibb was a debtor within the meaning of 109(d). He was also a person who may have been a Chapter 7 debtor, since only railroads and various financial insurance institutions were excluded from Chapter 7's coverage. Section 109(d) makes Chapter 11 available to all entities eligible for Chapter 7 protection other than stock brokers and commodities brokers.

The Court went on to say that although Chapter 11's structure and legislative history indicated that it was intended primarily for the use of business debtors, the Code contained no ongoing business requirement for Chapter 11 reorganization, and there was no basis for imposing one.

Johnson v. Home State Bank, 111 S. Ct. 2150 (1991). This opinion, delivered by Supreme Court Justice Thurgood Marshall for a unanimous court, examines the issue of whether a debtor can include a mortgage lien in a Chapter 13 bankruptcy reorganization plan once the personal obligation secured by the mortgaged property has been discharged in a Chapter 7 proceeding.

Johnson gave a mortgage to Home State Bank ("Bank") to secure promissory notes totalling approximately $470,000. After he defaulted on those notes, Bank began foreclosure proceedings in State Court. While foreclosure proceedings were pending, Johnson filed under Chapter 7 of the Bankruptcy Code. Pursuant to Section 727, the Bankruptcy Court discharged Johnson from personal liability on his promissory notes to the Bank. Notwithstanding the discharge, the Bank's right to proceed against Johnson in rem survived the Chapter 7 liquidation. Therefore, the Bank re-initiated the foreclosure proceedings once the automatic stay protecting Johnson's estate had been lifted. Subsequently, the State Court

an in rem judgment of approximately $200,000 for the Bank. Before the closure sale was scheduled, Johnson filed under Chapter 13 of the Bankruptcy listing the mortgage as a claim against his estate. The Bankruptcy Court irmed his plan to pay the Bank in four annual installments and a final loon payment, which would equal the Bank's in rem judgment. The District urt reversed, ruling that the Code did not allow a debtor to include in a hapter 13 plan a mortgage used to secure an obligation for which personal liability had been discharged in a Chapter 7 proceeding. The Court of Appeals affirmed, saying that since Johnson's personal liability had been discharged, the Bank no longer had a claim against Johnson subject to rescheduling under Chapter 13.

The Supreme Court ruled that a mortgage lien securing an obligation for which the debtor's personal liability had been discharged in a Chapter 7 liquidation is a "claim" within the meaning of Section 101(5) and is subject to inclusion in an approved Chapter 13 reorganization plan. The Court stated that Congress intended in that section to incorporate the broadest available definition of "claim."

The Court went on to say that in Pennsylvania Department of Public Welfare v. Davenport, 110 S. Ct. 2126 (1990), it concluded that "right to payment" meant nothing more nor less than an enforceable obligation. A surviving mortgage interest corresponds to an enforceable obligation of the debtor. In other words, the court must allow the claim if it is enforceable against either the debtor or his property. Even after the debtor's personal obligations have been extinguished, the creditor still retains a "right to payment" in the form of its right to the proceeds from the sale of the debtor's property. The Court stated that alteratively, the creditor's surviving right to foreclose on the mortgage could be viewed as a "right to an equitable remedy" for the debtor's default on the underlying obligation. Therefore, bankruptcy discharge extinguishes only one mode of enforcing a claim, an in personam action, while leaving intact another mode of enforcing a claim, an in rem action.

When addressing the Bank's contention that serial filings under Chapter 7 and 13 evade the limits that Congress intended to place on the Chapters' remedies, the Court stated that Congress had expressly prohibited various forms of serial filings. An example of this would be Sections 109(g), 727(a)(8), and 727(a)(9). The absence of a like prohibition on serial filings of Chapter 7 and Chapter 13 petitions, combined with the care with which Congress fashioned these express prohibitions, convinced the Court that Congress did not intend categorically to foreclose the benefit of Chapter 13 reorganization to a debtor who previously had filed for Chapter 7 relief. In addition, the full range of code provisions designed to protect Chapter 13 creditors, such as Sections 1325(a)(3), 1325(a)(4), 1325(a)(5), and 325(a)(6), combined with Congress's intent that "claim" be construed broadly, made it unlikely that Congress intended to use the Code's definition of "claim" to police the Chapter 13 process for abuse.

Farrey v. Sanderfoot, 1991 W.L. 83070 (U.S.). This opinion, authored by Supreme Court Justice Byron White, considers whether Section 522(f) allows a debtor to avoid the fixing of a lien on a homestead, where the lien is granted to the debtor's former spouse under a divorce decree that extinguishes all previous interests the parties had in the property, and does not secure more than the value of the non-debtor spouse's former interest.

Farrey and Sanderfoot divorced in 1986. A Wisconsin court awarded each one half of their marital estate. Among other things, the decree awarded Farrey's interest in the family home and real estate to Sanderfoot and ordered him to make payments to Farrey to equalize their net marital assets. To secure the award, the court granted Farrey a lien against Sanderfoot's real property. Sanderfoot did not pay Farrey and subsequently filed for bankruptcy, listing the marital home and real estate as exempt homestead property. Sanderfoot moved to avoid Farrey's lien under 522(f)(1). The Bankruptcy Court denied his motion.

The Bankruptcy Court found that the lien could not be avoided because tected Farrey's pre-existing interest in the marital property. The Di Court reversed and the Court of Appeals affirmed.

The Supreme Court held that Section 522(f)(1) requires a debtor to h possessed an interest to which a lien attached before it attached, to avoid t fixing of a lien on that interest. The statute does not permit avoidance of an lien on a property, but instead expressly permits avoidance of "the fixing of a lien on an interest of the debtor." A fixing that takes place before the debtor acquires an interest, by definition, is not on the debtor's interest. The Court went on to say that this reading fully comports with 522(f)'s purpose, which is to protect the debtor's exempt property, and its legislative history, which suggests that Congress primarily intended Section 522(f)(1) as a device to thwart creditors who, sensing an impending bankruptcy, rush to court to obtain a judgment to defeat the debtor's exemptions. To permit lien avoidance where the debtor at no point possessed the interest without the judicial lien would allow judicial lienholders to be defrauded through the conveyance of an unencumbered interest to a prospective debtor.

The Court also found that Farrey's lien could not be avoided under Section 522(f)(1). The parties had agreed that under state law the divorce decree extinguished their joint tenancy in which each had an undivided one half interest, and created new interests in place of the old. Thus, her lien fixed not on Sanderfoot's pre-exiting interest, but rather on the fee simple interest that he was awarded in the decree that simultaneously granted Farrey her lien. The result would be the same, even if the decree merely recorded the couple's pre-existing interest, since the lien would have fastened only to what had been Farrey's pre-existing interest, an interest that Sanderfoot would never have possessed without the lien already having fixed. The Court concluded that to permit Sanderfoot to use the Bankruptcy Code to deprive Farrey of protection for her own pre-existing homestead interest would neither follow the statute's language nor serve its main goal.

Owen v. Owen, 1991 W.L. 83023 (U.S.). This opinion, authored by Supreme Court Justice Antonin Scalia, explores the issue of whether the elimination of judicial liens encumbrancing exempt property can operate when a state has defined the exempt property in such a way as specifically to exclude property encumbered by judicial liens.

Helen and Dwight Owen were divorced in 1975. Helen obtained a judgment against Dwight for approximately $160,000. At that time, Dwight did not own any property in Sarasota County, Florida, but under Florida law, the judgment would attach to any after-acquired property recorded in the county. In 1984, he purchased a condominium in Sarasota County, and upon acquisition of title, the property became subject to Helen's judgment lien.

One year later, Florida amended its homestead law so that Dwight's condominium, which had not previously qualified as a homestead, thereafter did. Under the Florida Constitution, homestead property is exempt from forced sale and no judgment decree or execution can be a lien thereon. Thus, pre-existing liens are in effect an exception to the Florida homestead exemption.

Dwight later filed for bankruptcy under Chapter 7 and claimed a homestead exemption in the condominium. At that time, the condominium was valued at approximately $135,000 and was his primary asset. His liabilities included approximately $350,000 owed to Helen. The Bankruptcy Court discharged Dwight's personal liability for these debts and sustained his claimed exemption.

The condominium remained subject to Helen's pre-existing lien and after discharge Dwight moved to re-open his case to avoid the lien under Section 522(f)(1). The Bankruptcy Court refused to decree the avoidance; the District Court affirmed as did the Court of Appeals.

st, the Court noted that the Bankruptcy Court allows states to define what rty is exempt from a bankruptcy estate. The Florida Constitution provides mestead exemption which the state courts have held inapplicable to liens attach before the property in question acquires its homestead status.

The Court held that judicial liens could be eliminated under Section 522(f), even though the state has defined the exempt property in such a way as to specifically exclude property encumbered by such liens. Section 522(f) provides that the debtor may avoid the fixing of a judicial lien on an interest of the debtor in property, to the extent that such lien impairs an exemption to which the debtor would have been entitled under Section 522(d).

The Court went on to say that in order to determine the application of 522(f), the Federal Bankruptcy Courts with respect to federal exemptions under Section 522(d) asked not whether the lien impairs an exemption to which the debtor is in fact entitled, but whether it impairs an exemption to which he would have been entitled but for the lien itself. This approach, which gives meaning to the phrase "would have been entitled" in the applicable text is correct. A different approach could not be adopted for state exemptions in light of the equivalency of treatment accorded to federal and state exemptions by Section 522(f).

The Court made clear that it expressed no opinion on the questions of whether respondent's lien could be said to have impaired an exemption to which the petitioner would have been entitled at the time the lien was fixed, in light of the fact that petitioner did not yet have a homestead interest; whether the lien in fact fixed "on an interest of the debtor" if, under state law, it attached simultaneously with petitioner's acquisition of his property interest; and whether the Florida statute extending the homestead exemption was retroactive.

In re Middleton Arms, Limited Partnership; Haystack, Ltd.; Maple Canyon; L.P.; Cinnamon Ridge, L.P., Case No. 90-6292 (6th Cir. June 6, 1991). This case, authored by Circuit Judge Cornelia Kennedy, addresses the issue of whether a Bankruptcy Court improperly used its equity powers when allowing an insider to be employed as a real estate agent for the sale of certain apartments.

Each of the Debtors owned apartment projects at different locations. Each Debtor was a limited partnership in which Freeman Properties, Inc. was the corporate general partner and all of the Debtors had entered into management contracts with Jacques-Miller Properties, Inc. to manage the apartment projects and the partnership affairs.

Jacques Properties is a subsidiary of Jacques-Miller, Inc., which has a department that arranges for the sale of apartment projects. Two of the Debtors owed pre-petition debts to Jacques-Miller, Inc. Each Debtor filed under Chapter 11 and filed separate applications with the Bankruptcy Court for authority to employ Jacques-Miller, Inc. as real estate agent for the sale of the apartment projects. The United States Trustee objected to the employment.

The parties stipulated that Jacques-Miller, Inc. was not a disinterested party and that because of the relationships between Jacques Properties, Debtors and Jacques-Miller, Inc., Jacques-Miller, Inc. was an insider.

The Bankruptcy Court found that although Section 327 did not permit the Debtors to employee Jacques-Miller, Inc., the equity powers granted to the Bankruptcy Court under Section 105(a) allowed the Court to permit the employment. The U.S. Trustee appealed to the District Court, which reversed the Bankruptcy Court's decision and the Debtors appealed the District Court's order.

The Court stated that although Section 105(a) grants the Bankruptcy Court equitable power, whatever equitable powers remain in the Bankruptcy Courts must

and can only be exercised within the confines of the Bankruptcy Code. T
went on to say that Section 327(a) clearly states that the Court cannot
the employment of a person who is not disinterested, even if the person do
have an adverse interest. The Bankruptcy Court could not use equi
principals to disregard unambiguous statutory language.

When turning to the issue of whether the Bankruptcy Court could permit th
Debtors to employee Jacques-Miller, Inc. under Section 1107(b), the Circui
Court stated that that section provides for an exception to the ban o
employment of interested persons where the employee is a Debtor-in-Possessio
and where the person fails to qualify as a disinterested person solely due t
former employment by the debtor. In this case, the Debtors admitted tha
Jacques-Miller, Inc. was an insider. Therefore it was an interested person fo
reasons other than prior employment. The Court concluded that the Sectio
1107(b) exception that would allow the Bankruptcy Court to approve the Debtors'
request to employ Jacques-Miller, Inc. did not apply.

In re Huhn, Case No. 1:90-CV-688 and Case No. 1:90-CV-734 (April 24, 1991). In this case, authored by District Judge Robert Holmes Bell, Sundance Chevrolet ("Sundance") appealed two rulings from the Bankruptcy Court; one denying Sundance's request for a credit of $3,971.52 on the purchase price for taxes paid, and another from an order denying Sundance's motion for a refund of $25,000 from the proceeds of a sale.

On March 30, 1981, Sundance and Debtors entered into a nine year lease with an option to purchase. The lease payment was $4,500 per month plus an amount corresponding with the Debtors' tax escrow payment. The option price was $500,000 less the cost of roof repairs if the property was purchased before the end of the nine year option term. The option price was to be $450,000 if the property was purchased within a 30 day extension period at the end of the lease term. In order to be entitled to the $450,000 purchase price, the tenant had to give written notice before the expiration of the nine year lease, of its intention to purchase during the extension period.

In March of 1989, the Debtors filed bankruptcy and Sundance began making its lease payments to the trustee. On May 17, 1989, before the end of the ninth year of the lease, Sundance advised both the Debtors and the trustee of its intent to exercise the option to purchase for $500,000. On July 26, 1989, Sundance wrote to the trustee to reiterate its intention to purchase the property, but this time Sundance stated the purchase price of $450,000.

The Bankruptcy Court entered an order authorizing and directing the trustee to sell the property to Sundance for $500,000, less the cost of roof repairs. Sundance did not appeal the order. Instead, on December 4, 1989, Sundance gave written notice of its intent to extend the term of the option for 30 days, and to purchase during the window period for $450,000. In January and February, the Bankruptcy Court entered two orders directing the trustee and Sundance to close on the sale of the property before March 1, 1990, and confirmed the sale price of $500,000, less roof repairs. Again, no appeal was taken.

Sundance purchased the property on March 30, 1990, for a price of $475,000, which reflected the purchase price of $500,000, less $25,000 for roof repairs. After the closing, Sundance filed a motion with the Bankruptcy Court requesting a refund of $25,000 on the purchase price, and for $3,971.52 in a credit for the January, February and March 1990 real estate taxes it had paid into escrow at closing. Sundance's motion to set the sales price was denied. The Bankruptcy Court originally ruled that Sundance was entitled to a credit for taxes paid but later reversed its position and disallowed the credit.

Sundance appealed the order denying the purchase price refund and the order denying the tax credit.

District Court stated that an appeal from a final order must be take
n 10 days from the date of the entry of the order. Sundance contends that
orders entered were correct at the time, but that a new issue was raised
e the parties entered the window period when Sundance was entitled to
rchase at the lower price of $450,000. Once Sundance gave written notice in
ecember 1989 of its intent to extend the option for 30 days, the sale of the
property during the window period at the lower price was placed in issue. In
response to this argument, the Court stated that the time for appeal was when
the Bankruptcy Court entered its January and February orders setting the price
and scheduling the sale. Those orders were not appealed, became final and are
now barred by principals of finality and res judicata.

The Court went on to say that even if the claims were not barred by the Bankruptcy Court's previous rulings, the Court would affirm the denial of the refund anyway. In view of Sundance's May 17, 1989, letter indicating its intent to exercise the option to purchase, the Bankruptcy Court's determination that the option sale price should be $500,000, less repairs, was not erroneous. It was also not error for the Bankruptcy Judge to require that once the option was exercised, the closing be held within a reasonable time frame.

The Court stated that the Bankruptcy Court's conclusion that the lease agreement did not entitle Sundance to a credit for the tax portion of the rental payments made in January through March, in the amount of $3,971.52, was correct. The Court was unwilling to rewrite the lease agreement and accordingly denied the request for a credit because the parties to the lease and the option could have provided for a tax credit upon exercise of the option, but chose not to. The question before the Court was one of contract interpretation, not whether taxes were paid in advance or in arrears. The Court went on to say that Sundance's tenant had no tax obligation, even though the rental payments were designed to facilitate the landlord's payment of taxes. The tax portion of the rental payment was the property of the landlord and remained so after it was paid into the escrow account.

In the Matter of Dalby, Case No. 90-71433-DT (E.D. Mich. April 23, 1991). This appeal, authored by District Judge Lawrence Zatkoff involves a fraudulent conveyance by a debtor. In June of 1988, Eugene Dalby ("Debtor") filed under Chapter 7 of the Bankruptcy Code. After investigating the Debtor's financial affairs, the trustee discovered various fraudulent conveyances of the Debtor's property to various relatives and associates, one of which was real property transferred by the Debtor to the WED Family Preservation Trust ("WED") for insufficient consideration. WED consisted of three Dalby family members, Patricia Marshall, Owner's Trust and Donald Nilssin. As a result, the trustee initiated an adversary proceeding against WED to set aside the fraudulent conveyances and to recover those properties for the bankruptcy estate.

The trustee mailed a copy of the Second Amended Complaint and Summons to each efendant, return receipt requested. Return of Service for each defendant was iled with the Court. They failed to file answers. They maintained that they ere never served with the Second Amended Complaint and Summons.

On October 3, the Bankruptcy Court granted the trustee's motion for default d ordered the defendants to file answers to the Second Amended Complaint. On nuary 16, 1990, the Bankruptcy Court granted the trustee's motion for entry a default judgment against all the defendants. The defendants appealed.

When addressing the issue of proper service of the complaint and summons, the urt stated that the appellants provided the Bankruptcy Court with addresses which they could be contacted regarding official court business. When the ustee served the appellants, service was returned with unconventional mark- gs, including messages such as "return to sender" and "refused" inscribed with l point pen rather than with standard U.S. Postal Service markings. In the kruptcy Court at depositions and during court proceedings, the trustee

attempted to illicit appellants' residences and was provided with iden different addresses. The Court went on to say that, oddly, the i recipient appeared for court appearances announced in the returned se suggesting that appellants did in fact reside at the listed addresses. O the appellants, Donald Nilssin, provided the Court with a resident addres Cedarville, Illinois, but later claimed to reside outside the United Stat The Court stated that Mr. Nilssin's post hoc relocation could not invalida proper service under Rule 7004. The Court concluded that appellants were legally served but chose to ignore service of the Second Amended Complaint.

The next issue addressed by the Court was appellant's contention that the trustee's action was barred by the Statute of Limitations. The Court found that the appellants' argument lacked merit for three reasons. First, they never argued the matter in the Bankruptcy Court, thus, it was not preserved and could not be argued on appeal. Second, even if it could have been argued on appeal, appellants waived their right to assert such an affirmative defense because they failed to timely plead it in an answer or other responsive pleading. Lastly, the statutory site in which appellant relied had no application in the case. MCLA Section 600.5855 sets a limitation on actions alleging fraudulent concealment, which was not at issue in this case.

The last issue addressed by the Court involved the defendant's claim that the Bankruptcy Court's grant of the trustee's motion for entry of default judgment was erroneous. The Court found that the appellants' claim that they filed an answer to the Second Amended Complaint lacked merit because they filed the answer after the Bankruptcy Court had heard oral argument on the issue of entering default judgment and after appellants had chosen to ignore the Bankruptcy Court's generous allowance of additional time to file their answer.

Because of the appellants' lack of a meritorious defense and their culpable conduct, the Court was precluded from vacating the default judgment. It found that the appellants' tactics of delay and obfuscation in the Bankruptcy Court caused the default to be entered.

In the Matter of Book Building Associates Limited Partnership, Case No. 89-CV-73599 (E.D. Mich. February 6, 1991). This opinion authored by District Judge John Feikens involves an appeal from the Bankruptcy Court which granted partial summary judgment and attorney fees to Bacalis and Associates ("Bacalis"), a legal professional corporation.

On March 19, 1986, a communications antenna on top of the Book Building was damaged in a wind storm causing damage to the Book Building itself. Michigan Mutual Insurance Company ("Michigan Mutual") offered to pay $88,000 for repairs to the building. This offer was rejected.

Subsequently, Book Building Associates Limited Partnership ("BBALP") retained Bacalis in an attempt to recover greater insurance proceeds. Bacalis filed his First Amended Complaint on March 19, 1988, against Michigan Mutual, Detroit Cellular Telephone Company, the owner of the communications antenna, and Travelers Insurance Company, the former first mortgagee of the Book Building.

Due to Bacalis' efforts, Michigan Mutual paid $351,150.62 into an interpleader fund pursuant to court order, which was entered on October 11, 1988.

During the course of these proceedings, BBALP defaulted on the mortgage debt and in August on 1988, Travelers initiated foreclosure proceedings. Travelers' bid of $3,600,000 at the foreclosure sale was the successful bid. The debt secured by the first mortgage was $4,035,330.59.

During the course of the state court action brought by BBALP, BBALP sought to enjoin Travelers from prosecuting foreclosure proceedings. Allowing the foreclosure proceedings to continue, the consent order of October 11, 1988

ed that in the event BBALP failed to redeem the property from the closure sale, Travelers would be entitled to so much of the insurance eeds as were sufficient to pay any deficiency between the amount bid at the eclosure sale and the amount due.

BBALP did not redeem the Book Building within the statutory redemption period. Prior to the expiration of the redemption, Travelers assigned to BTP all of its rights in the Book Building, including all right, title and interest in the first mortgage and any insurance proceeds related to the Book Building.

After the state court action was removed to the Bankruptcy Court for the Eastern District of Michigan, BBALP was ultimately denied the relief it requested and was deemed entitled to recover nothing. BTP and Bacalis, in his individual capacity, filed cross-motions for summary judgment. The Bankruptcy Court granted Bacalis partial summary judgment and authorized fees and reimbursement of expenses. BTP appealed.

The Court determined that the Bankruptcy Court did not err in awarding fees to Bacalis but was clearly erroneous in its calculation of those fees.

The Court reasoned that on equitable grounds Bacalis was entitled to a fee for services rendered. The reason for this was that the fund which, through Bacalis' efforts, was paid into the Wayne County Circuit Court was not available until the proceedings instituted by Bacalis made it so. It was also clear to the court that BTP did little or nothing to secure this fund from Michigan Mutual.

While the Bankruptcy Court correctly held that Bacalis should receive one third of the total recovery plus costs, it incorrectly determined what constituted the total recovery in the case. The Court found that the total recovery was $351,150.62 minus $23,092.06, which were Bacalis' costs. This left $328,058.56 of which Bacalis was entitled to one third, which equalled $109,352.85 plus $23,092.06 in costs for a total of $132,444.91.

STEERING COMMITTEE MEETING MINUTES:

A meeting was held on June 21, 1991 at noon at the Peninsular Club.

1. Robert E. L. Wright gave a report concerning the Sixth Circuit Conference Reception for Bankruptcy Judges held at the Bowers Harbor Inn earlier this month. From all accounts it was a good reception and very much appreciated by all in attendance.

2. At the Sixth Circuit Conference, the Bankruptcy Appellate Panel (BAP) was put to a vote, and the Sixth Circuit declined to adopt BAP in this Circuit.

3. Mark Van Allsburg reported that the balance of the furniture should be arriving on June 25, 1991 for the Attorney Conference Lounge. It is expected that the monies collected to date should cover the cost thereof.

4. Pat Mears and Brett Rodgers gave a brief update concerning the Shan Seminar. The new Bankruptcy Rules and forms, which go into eff August 1, 1991, will be discussed as part of the open forum which conclude this Seminar.

5. Mark Van Allsburg circulated a copy of a summary of the changes to Bankruptcy Rules, which go into effect August 1, 1991. A summary of t anticipated changes to such Rules is included as part of this Newsletter. Keep in mind that these Rules are apparently subject to change by Congress until August 1, 1991, and we would suggest that you obtain a copy of the new Rules rather than rely on the enclosed summary. You should also make a note to obtain new bankruptcy forms for filing of debtor proceedings commencing on August 1, 1991. While the old forms may be accepted for a short period of time, use of the new forms will be mandatory in the near future. In any event, please do not mix the old forms with the new, as this could cause you, your client and the Court considerable problems.

6. It was also brought out that the United States District Court for the Western District of Michigan was adopting new local rules which will also become effective on August 1, 1991. It is uncertain the impact these Rules may have on local procedure in the U.S. Bankruptcy Court and, as a consequence, Robert E. L. Wright agreed to obtain a copy of the same and advise the Steering Committee as to what impact, if any, such new local district rules will have on bankruptcy practice. It is hoped that a summary of such rules or an "impact statement" will be available either in the next Newsletter or otherwise at the Shanty Creek Seminar.

7. The subject of the election of new Steering Committee Members was also brought up. At the present time, the terms of three members, Thomas W. Schouten, James A. Engbers, and Brett N. Rodgers, will expire in August, 1991. To date, two other applications have been received for consideration as Steering Committee members. If any of our readers are interested in serving on the Bankruptcy Steering Committee, which service will be for a three-year term, please send a letter to that effect to my attention. Keep in mind that the Steering Committee has always taken the position that any member of the Bankruptcy Section of the Federal Bar Association who desires to attend a Steering Committee Meeting may do so and may also express his/her opinion on any issues which are brought up at these meetings.

8. The next Steering Committee Meeting will be held on July 19, 1991 at noon in the Gold Room 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 May 31, 1991. These filings are compared to those made during the same period one year ago, and two years ago.

	1/1/91 - 5/31/91	1/1/90-5/31/90	1/1/89-5/31/89
Chapter 7	2,222	1,694	1,390
Chapter 11	74	61	45
Chapter 12	7	6	4
Chapter 13	747	676	581
Totals	3,050	2,437	2,020

Changes in Bankruptcy Rules

Rule	Change
	General Changes
1001	New name: Federal Rules of Bankruptcy Procedure
Throughout	Part X rules abrogated, provisions dealing with the U.S. trustee incorporated in the main body of the rules in line with nationwide expansion of U.S. Trustee Program
Throughout	Chapter 12 incorporated into rules
Throughout	References to Official Bankruptcy Forms are to "appropriate" forms, not by form numbers
Throughout	The phrase "file with the court" shortened to "file," other words are unnecessary
Throughout	Retiree committees under § 1114 incorporated into rules
9003(a)	Examiners added to prohibition on ex parte meetings and communications with the court
9009	Official Bankruptcy Forms construed to be consistent with Bankruptcy Rules and Code
9029	Local rules may not prohibit or limit use of Official Bankruptcy Forms (Official Forms must be accepted in every bankruptcy court)
9032	Bankruptcy Rules may provide that subsequent amendments to a Civil Rule made applicable by a Bankruptcy Rule are not effective with regard to bankruptcy cases and proceedings (See Rule 7004[g] in Miscellaneous section)
9034	Papers relating to listed matters shall be transmitted to U.S. trustee by filing entity unless U.S. trustee requests otherwise
9035	Bankruptcy Rules apply in Alabama and North Carolina to the extent that they are not inconsistent with provisions of titles 11 and 28 in effect in those states, which are served by bankruptcy administrators, not U.S. trustees (Committee Note includes guidelines for determining which rules apply)
	Abstention
5011	Bankruptcy judge issues final order on abstention motions under 28 U.S.C. § 1334(c), not report and recommendation which the clerk transmits to the district court
	Appeals
8002(a)	Notices of appeal filed after the announcement of a decision by the court but before the entry of the judgment or order treated as filed after the entry
8004	Clerk transmits copies of notices of appeal to U.S. trustee
8006	Periods for designating items as part of the record on appeal are changed to 10 days
8006	Party designating items as part of record on appeal provides copies of the items to clerk; if party fails to provide copies, clerk shall prepare copies at party's expense
8007(b)	Clerk transmits a copy of record on appeal, not original papers; bankruptcy court retains original papers
8016(b)	District clerk or BAP clerk notifies U.S. trustee of entry of judgment or order on appeal
	Calendaring
2002(a)(5)	20-day notice of hearing on dismissal of a chapter 12 case
2002(a)(9)	20-day notice of chapter 12 confirmation hearings
	Claims
1019(6)	Postpetition claims in case converted from chapter 12 to chapter 7 filed pursuant to Rules 3001 and 3002

Rule	Change
1019(6)	Court fixes time for filing claims arising from rejection of executory contracts and unexpired leases in case converted from chapter 12 to chapter 7
3001(e)	Court's role in transfer of claims is limited; statement of consideration not required for certain transfers; clerk substitutes transferee for transferor in certain circumstances in absence of timely objection
3002(c)	Chapter 12 claims filed within 90 days after date first set for meeting of creditors
3003(c)(3)	Chapter 11 claim may be filed late to the extent that a chapter 7, 12, or 13 claim may be under Rule 3002(c)(2), (3), or (4)
	Closing
2002(f)(8)	Notice of chapter 7 trustee's final account required only if net proceeds exceed $1,500
2003(g)	Clerk notices final meetings called by U.S. trustee in cases with net proceeds exceeding $1,500
2015(a)(6)	Reports on progress toward consummation of chapter 11 plan: abrogated, see § 1106(a)(7)
2015(a)(7)	Application for final decree in chapter 11 case: abrogated, see Rule 3022
3022	The court shall enter a final decree after a chapter 11 case is fully administered; the court may act on its own motion
5009	If chapter 7, 12, or 13 trustee files a final account and certifies that the case has been fully administered, there is a presumption that the case is fully administered unless U.S. trustee or party in interest files an objection within 30 days; the court may discharge the trustee and close the case without reviewing the final account

Rule	Change
	Conversion
1019	Conversion of chapter 12 case to chapter 7
2002(a)(5)	Clerk or other person gives 20-day notice of hearing on conversion or dismissal of chapter 12 case
	Discharge and Dischargeability
4004(a)	U.S. trustee is given 25 days' notice of time to object to chapter 11 debtor's discharge (From Rule X-1008[a])
4004(c)	Discharge is issued after bar dates for objecting to discharge and filing a § 707(b) motion to dismiss
4004(c)	Discharge is not issued if there is a pending § 707(b) motion to dismiss
4007(c)	Dischargeability complaint in a chapter 12 case must be filed within 60 days of the first date set for the meeting of creditors
4008	Court may hold a discharge hearing but is not required to do so (see § 524[d])
	Docketing
2013(a)	Clerk is not required to maintain a record of fees awarded to professionals employed by debtors in possession
5005(b)(2)	An entity, other than the clerk, transmitting a paper to the U.S. trustee shall promptly file a verified certificate of service
5005(c)	A paper intended to be filed with the clerk but erroneously delivered to the U.S. trustee, shall be transmitted to the clerk; the court may deem the paper to have been filed on the date originally delivered

Rule	Change
5011	Bankruptcy judge issues a final order on abstention motions under 28 U.S.C. § 1334(c), not a report and recommendation which the clerk transmits to the district court
9027(a)	Notice of removal is filed, not application for removal (see 28 U.S.C. § 1446)
9027(a)	Notice of removal shall contain statement whether proceeding is core or non-core; if non-core, whether filing party consents to entry of judgment by bankruptcy judge
9027(b)	Removal bond: abrogated, see 28 U.S.C. § 1446
9027(d)	Bankruptcy judge issues final order on remand motions under 28 U.S.C. § 1452(b), not report and recommendation which the clerk transmits to the district court
	Financial
2013(a)	Clerk is not required to maintain a record of fees awarded to professionals employed by debtors in possession
3011	Chapter 12 trustee files list of creditors entitled to be paid from unclaimed funds paid into court
5008	Funds of the estate: abrogated in light of § 345(b) and the role of the U.S. trustee in approving bonds and supervising trustees
6003	Disbursement of money of the estate: abrogated in view of the role of the U.S. trustee in supervising trustees
9027(b)	Removal bond: abrogated, see 28 U.S.C. § 1446
	Forms
Throughout	References to Official Bankruptcy Forms are to "appropriate" forms, not by form numbers

Rule	Change
1007	Chapter 13 Statement abolished, debtor files schedules in all chapters
9009	Official Bankruptcy Forms shall be construed to be consistent with Bankruptcy Rules and Code
9029	Local rules may not prohibit or limit use of Official Bankruptcy Forms (Official Forms must be accepted in every bankruptcy court)
	Intake
Throughout	The phrase "file with the court" is shortened to "file," the other words are unnecessary
1007	Chapter 13 Statement abolished, debtor files schedules in all chapters
2008	U.S. trustee notifies person selected as trustee of how to qualify (From Rule X-1004)
2009(c)	U.S. trustee appoints trustee for jointly administered estates (From Rule X-1005)
2009(e)	Trustees for partnership and partners: abrogated because the exercise of discretion by the U.S. trustee is not subject to advance restriction by court rule
5005(b)(2)	An entity, other than the clerk, transmitting a paper to the U.S. trustee shall promptly file a verified certificate of service
5005(b)(3)	Clerk is not required to transmit any paper to U.S. trustee if U.S. trustee requests in writing that the paper not be transmitted
5005(c)	A paper intended to be transmitted to the U.S. trustee but erroneously delivered to the clerk, the judge, the case trustee, the attorney for the trustee, or the district clerk, shall be transmitted to the U.S. trustee; the court may deem the paper to have been transmitted to the U.S. trustee on the date originally delivered

Rule	Change
5010	U.S. trustee appoints a trustee in a reopened case only if the court determines that one is necessary; this reverses the practice of appointing a trustee unless the court orders otherwise
9029	Local rules may not prohibit or limit use of Official Bankruptcy Forms (Official Forms must be accepted in every bankruptcy court)
	Meetings of Creditors
2003(a)	Meeting of creditors in chapter 12 case is set for 20 to 35 days after petition is filed
2003(a)	Provision for enlarging time for meeting of creditors applies in chapter 12 cases
2003(a)	U.S. trustee schedules meeting of creditors (From Rule X-1006)
2003(b)	U.S. trustee presides at meetings of creditors and equity security holders (From Rule X-1006)
2003(c)	U.S. trustee records meetings of creditors and preserves the recording for two years
2003(f)	U.S. trustee may call special meetings of creditors
2003(g)	Clerk notices final meetings called by U.S. trustee in cases with net proceeds exceeding $1,500
	Miscellaneous Matters
2011(a)	On request, clerk certifies that a trustee has qualified
7004(g)	The provisions of Civil Rule 4 incorporated by the Bankruptcy Rules are the provisions in effect on January 1, 1990 (See Rule 9032 in General section)

Rule	Change
7062	Orders on the use, sale, or lease of estate property and orders authorizing the assumption or assignment of executory contracts or unexpired leases added as exceptions to the 10-day stay of judgments
	Monitoring
2011(b)	Clerk notifies court and U.S. trustee if person appointed or elected as interim trustee does not qualify in a timely manner
2015(a)(6)	Reports on progress toward consummation of chapter 11 plan: abrogated, see § 1106(a)(7)
2015(a)(7)	Application for final decree in chapter 11 case: abrogated, see Rule 3022
3015(a)	Filing a chapter 12 plan
3022	Court shall enter a final decree after a chapter 11 case is fully administered; the court may act on its own motion
5009	If chapter 7, 12, or 13 trustee files final report and certifies that the case has been fully administered, there is a presumption that the case is fully administered unless U.S. trustee or party in interest files an objection within 30 days
	Noticing
1017(a)	20-day notice of a hearing on a motion to dismiss must be sent to all entities entitled to receive notice under Rule 2002, except as provided in §§ 707(b), 1208(b), and 1307(b)
1017(a)	Procedures for noticing a § 707(b) motion for dismissal
1019(2)	Notice of conversion: abrogated (notice of the conversion is required by Rules 1017[d], 2002[f][2], and 9022)
1019(6)	Clerk or other person notices entities listed on schedule of unpaid, postpetition debts about filing claims

Rule	Change
1019(6)	Postpetition claims in case converted from chapter 12 to chapter 7 to be filed pursuant to Rules 3001 and 3002
1019(6)	Court to fix time for filing claims arising from rejection of executory contracts and unexpired leases in chapter 12 case converted to chapter 7
2002	U.S. trustee cannot be required to give notices (not a "person" as defined in § 101[41], former Rule X-1008[c])
2002(a)(5)	Clerk or other person gives 20-day notice of hearing on conversion or dismissal of chapter 12 case
2002(a)(9)	Clerk or other person gives 20-day notice of chapter 12 confirmation hearing
2002(f)(7)	Clerk or other person notices entry of confirmation order in a chapter 12 case
2002(f)(8)	Notice of chapter 7 trustee's final account required only if net proceeds exceed $1,500
2002(i)	Notices to be given to § 1114 committees
2002(i)	U.S. trustee to receives certain notices even if the court restricts noticing
2002(k)	Notices to be given to U.S. trustee (From Rule X-1008) (includes all applications for compensation, even those for less than $500)
2002(k)	No notices to U.S. trustee in SIPA cases
2003(a)	Meeting of creditors in chapter 12 case is set for 20 to 35 days after petition is filed
2003(g)	Clerk notices final meetings called by U.S. trustee in cases with net proceeds exceeding $1,500
2011(b)	Clerk notifies court and U.S. trustee if person appointed or elected as interim trustee does not qualify in a timely manner
3015(d)	Plan or summary shall be included with notice of confirmation hearing in chapter 12 or 13