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FINAL EXAM

[Editor's Note: For those of you who have been agonizing over Bob Mollhagen's Final Exam questions in the December, 1991 issue, here are the answers. For ease of reference, the questions are repeated before the answers. (Due to space limitations, Part A of the exam is not included.) Many thanks to Bob for providing the exam answers to us.]

The Thomas M. Cooley Law School

Hillary Term, 1991
Monday, April 15, 1991, at 3:00 p.m.

Bankruptcy Workshop
(Chapter 11 Reorganizations)
Robert D. Mollhagen*
Adjunct Professor

PART B

Adequate Protection/Relief from Stay Problem

Below is the Adequate Protection/Relief from Stay Problem followed by 4 questions. The questions refer to the problem. You should answer each question. Each answer is worth the possible points indicated. Keep your answers short. Lengthy answers will be discounted.

Problem

United Corporation filed a Chapter 11 petition on April 1, 1991. Assume the following facts (amounts owed are as of April 1, 1991, unless otherwise indicated):

- United owes $300,000 to Friendly Bank secured by a first priority, properly perfected security interest in inventory, accounts receivable and proceeds. United currently has $100,000 of accounts receivable ($50,000 of which has been generated in the two week period before filing), $100,000 of inventory and cash proceeds of accounts receivable of $150,000 in an account at Second Bank.

- United owes Associated Lenders $500,000 secured by a first priority, properly perfected security interest in all United machinery and equipment, including after-acquired property. A UCC-1 was properly filed on April 15, 1986. The collateral has a 10 year remaining useful life with no salvage value. All of United's machinery and equipment is valued at $600,000 (in place-going concern) and $520,000 (commercially reasonable liquidation).

- The Internal Revenue Service filed a Federal Tax Lien on February 1, 1991 in the Secretary of State UCC Division records for $75,000 for payroll taxes.

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- United owes Allied Equipment Dealers $100,000 on a note in an original amount of $150,000 which was borrowed to purchase a milling machine for use in United's manufacturing operations. On May 1, 1988, 15 days after United purchased and took possession of the milling machine, Allied properly perfected its security interest in the milling machine. The milling machine is valued at $120,000 (commercially reasonable liquidation) and $90,000 (forced sale/auction).

- Further assume that the value specified above will control for purposes of the following questions.

Questions

1. You represent Associated Lenders. Assume you filed a motion for relief from stay on behalf of Associated Lenders on May 1, 1991.

   a. At hearing, what will you argue is the amount of Associated Lenders' secured claim? (3 points)

   b. What Bankruptcy Code subsection and/or case govern your analysis and why? (2 points)

   c. Will the Bankruptcy Judge grant lift of stay? Why or why not? (2 points)

   d. Is Associated Lenders entitled to post-petition interest on its secured claim? Why or why not? (2 points)

   e. What adequate protection, if any, could the Bankruptcy Judge order for Associated Lenders and why? (5 points)

ANSWER:

a. If Associated Lenders' believes United's prospects for reorganization are poor and truly wants relief from stay as soon as possible, then Associated should focus its arguments at any hearing on commercially reasonable liquidation values. Associated is in a first secured position on all machinery and equipment except the milling machine. Associated is in a second secured position behind Allied Equipment Dealers on the milling machine. Therefore Associated Lenders' secured claim is $400,000 ($520,000 - $120,000) + $20,000 ($120,000 - $100,000) = total $420,000.

If Associated believes that United's prospects for reorganization are strong and that the primary motivation for the Motion for Relief from Stay is to receive adequate protection payments and/or §507(b) administrative expense priority for any adequate protection shortfall, Associated should argue for going concern values. The secured claim of Associated can then be computed as $600,000 - $100,000 (Allied Secured's claim) = $500,000. Even with going concern value, there is no equity cushion and adequate protection payments to cover depreciation will probably still be necessary. Additionally, Associated will be in a better position to have a fully secured claim at confirmation.

b. §506(a) - secured claim of creditor secured by a lien on property of the estate is equal to value of creditors' interest in estate's interest in the property; In Re American Kitchen Foods, Inc. 9 CBC 537 (Bankr. D. Maine, 1976) - commercially reasonable disposition valuation standard.

c. The Bankruptcy Judge will likely determine that adequate protection is required to protect Associated Lenders with respect to depreciation. If United does not affirmatively make an adequate protection offer, the Bankruptcy Judge will either grant lift of stay or grant of lift of stay unless United offers and provides adequate protection to cover the depreciation.

d. Associated Lenders is not entitled to post-petition interest on its secured claim at this point based on either the $420,000 or $500,000 collateral value. Post-petition interest may only accrue on a secured claim under §506(b) when the value of the collateral exceeds the amount of the claim. Here the claim is $500,000 and the maximum collateral value assuming an in-place going concern valuation standard is $500,000.

e. The Bankruptcy Judge could order or condition continuance of the stay based on monthly payments under §361(1) to cover depreciation based on the value of the collateral securing Associated's $500,000 debt in a range of $3,500 per month ($420,000/120 months) to $4,166 per month ($500,000/120 months). Alternative-

ly, the Bankruptcy Judge could order or give United the option to provide a satisfactory replacement lien under §361(2).

2. You represent Friendly Bank. You advise United that Friendly Bank will not consent under 11 USC §363(c)(2)(A).

   a. List the types and amounts of cash collateral in which Friendly has an interest and indicate why. (4 points)

   b. Does Friendly Bank have an interest in post-petition inventory? Why or why not? (4 points)

ANSWER:

   a. Proceeds to be received from the $100,000 of date of petition accounts receivable; eventual proceeds of $100,000 of date of petition inventory; $150,000 existing cash proceeds of accounts receivable in Second Bank account.

   b. No; under §552(a) any inventory acquired by United post-petition is not subject to the pre-petition security interest of Associated Lenders; and such security interest is not protected by the exception in §552(b).

3. What is the amount of the secured claim, if any, of the Internal Revenue Service and why? (5 points)

ANSWER:

$50,000; at best, using in-place going concern values, all machinery and equipment is subject to the security interest of Associated Lenders and Allied Equipment Dealers with no excess available for the Federal Tax Lien; the Federal Tax Lien, by virtue of the 45 day superpriority rule (§6323(c), IRC) constitutes a first lien against the $50,000 of accounts receivable generated in the 2 week period prior to the Chapter 11 filing and could attach to some inventory although this cannot be determined from the facts. At a minimum the secured claim of the Internal Revenue Service is $50,000 and could be as high as $75,000. Extra Credit: Even though the Federal Tax Lien was filed within 90 days of the petition date of April 1, 1991, it is a statutory lien which is not avoidable as to the property of the debtor existing at the date of the Chapter 11 petition.

4. Assume the case is converted to Chapter 7 on February 1, 1992, and that all machinery and equipment is sold for 75% of the commercially reasonable liquidation value previously indicated. Assume the amounts owed to each secured creditor as of the petition date have remained the same (assume no adequate protection payments were made and no interest has accrued post-petition). What claims and in what amounts does Associated Lenders now have in the Chapter 7 and why? (5 points)

ANSWER:

The machinery and equipment subject to Associated Lenders' first lien would bring $300,000 ($400,000 x 75%). The milling machine would bring $90,000 and leave no excess available to Associated Lenders' after payment to Allied Equipment dealers for its first secured position. It can be inferred from the facts that at the hearing on Associated Lenders' Motion for Relief from Stay, the Bankruptcy Judge determined that Associated Lenders secured claim was adequately protected. If so, Associated Lenders would have a §507(b) superpriority claim of least $120,000 ($420,000 collateral value using commercially reasonable liquidation value less $300,000) and as high as $200,000 ($500,000 less $300,000). Associated Lenders would have a $300,000 secured claim and an unsecured claim of up to $80,000.

Part C

Chapter 11 Plan of Reorganization Questions

1. Welding Company's Chapter 11 Plan of Reorganization provides the following payments to the class of general unsecured claims (Class V):

5/1/91 (effective date)	$ 40,000
5/1/93 (two years later)	$ 75,000
5/1/94 (three years later)	$100,000

Welding Company's Disclosure Statement states that in liquidation, after payment of applicable priority claims, a payment of $200,000 will be made to Class V. Assume liquidation would take two years to complete. Assume the appropriate present value discount rate is 12%. Assume the Plan is not unanimously accepted by impaired classes.

   (a) Will the Plan satisfy the "best interests of creditors" test? Why or why not? (4 points)

(b) What Code section governs your answer? (2 points)

(c) Can a Plan be confirmed under "cram down" if the "best interest of creditors" test is not satisfied? Why or why not? (4 points)

ANSWER:

(a) Yes, the present value of the $200,000 liquidation payment in two (2) years using a 12% discount rate is $159,400 ($200,000 x .797). The present value of the payments provided to Class V under the Plan is $170,875 ($40,000 x 1.0 = $40,000 + $75,000 x .797 = $59,775 + $100,000 x .711 = $71,100). The Class V general unsecured claims will therefore receive more under the Plan of Reorganization then under a Chapter 7 liquidation.

(b) §1129(A)(7)(A)(ii).

(c) No; cram down under §1129(b) may only be used to confirm a plan that fails the requirements of 1129(a)(8).

2. You are presented with a Chapter 11 Plan of Reorganization and voting results [in brackets] as follows:

III. Treatment of claims and Interest

A. Class 1 -- Allowed Secured Claim of Left Bank. This class is impaired. [Left Bank votes to accept the Plan].

B. Class 2 -- Allowed General Unsecured Claims. The holders of allowed claims in this class shall receive 30% of their allowed claims in cash on confirmation. [Twelve creditors filed ballots rejecting the Plan; twelve creditors filed ballots accepting the Plan; allowed unsecured claims total $120,000; the aggregate amount of claims accepting the Plan was $70,000; the aggregate amount of claims rejecting the Plan was $20,000.]

C. Class 3 -- Shareholder Interests. This class will keep its stock. [The shareholders vote unanimously to accept the Plan].

(a) Is the Plan confirmable? Why or why not? (4 points)

(b) How would you modify the Plan so that it could be confirmed? (4 points)

(c) Upon what Code section and/or case would you rely to obtain confirmation of the Plan as so modified? (2 points)

ANSWER:

(a) No. Section 1126(c) requires an acceptance by 2/3 in amount (the requirement is met) and more than 1/2 in number (this requirement is not met) of those creditors voting.

(b) The Plan could be modified so that it could be confirmed by either:

1. Increasing the distribution to Class 2 to 100% of allowed claims in cash on confirmation; or

2. Providing for a "new value" contribution by Class 3 shareholders sufficient to satisfy the "new value exception," if the Bankruptcy Judge determines that exists.

(c) 1. §1129(a)(8)(B) - Class not impaired and §1126(f) deemed acceptance.

2. In Re Landau Boat Co., 13 B.R. 788 (Bankr. Missouri 1982); In the Matter of Greystone III Joint Venture, 1991 W.L. 239280 (5th Cir. 1991). (Note: new value exception portion of Greystone opinion had been withdrawn.)

3. You are presented with a Chapter 11 Plan of Reorganization which provides the following treatment for the secured claim of Secure Bank;

III. Treatment of Claims and Interests

* * * * *

B. Class 2 -- Allowed Secured Claim of Secure Bank. The allowed secured claim of Secure Bank shall be paid in four equal annual installments of $100,00

each commencing one year after the date of confirmation of the Plan. Secure Bank shall retain its first lien on all machinery and equipment according to the terms of the original security agreement.

The balance owed to Secure Bank as of the date of petition was $500,000 including accrued interest at 12% per annum. The machinery and equipment was valued at $250,000 at an earlier hearing on Secure Bank's Motion for Relief from Stay. Assume Secure Bank votes to reject the Plan and makes an §1111(b)(2) election.

(a) Under what Bankruptcy Code subsection must the Plan proponent proceed to obtain confirmation of the Plan? Why? (3 points)

(b) Does the prior valuation of $250,000 govern at the confirmation hearing? Why or why not? (3 points)

(c) If the Court values the machinery and equipment at $275,000 at confirmation and the appropriate discount rate is 10%, can the Plan be confirmed. Why or why not? What Bankruptcy Code subsection(s) govern your answers? (4 points)

ANSWER:

(a) §1129(b)(1) and §1129(B)(2)(A). Secure Bank is impaired and failed to accept the Plan. The Plan proponent may seek confirmation under 1129(b) notwithstanding the failure of Secure Bank to accept under §1129(a)(8).

(b) No. Value is determined in the light of the purpose of the valuation, the proposed disposition or use of the property and in conjunction with any hearing on such disposition or use or on a Plan effecting such creditor's interest. §506(a) Therefore the value determined at the earlier lift of stay hearing does not govern or control the value for purposes of the confirmation hearing.

(c) No. By virtue of the §1111(b)(2) election, the secured claim of Secure Bank is $500,000. Secure Bank voted to reject the Plan. Therefore, for the Plan to be confirmed as to Secure Bank under §1129(b), the plan proponent must satisfy the fair and equitable test for secured claims under of 1129(b)(2). Secure Bank must receive under the Plan deferred cash payments which total at least the allowed amount of its secured claim, or $500,000. §1129(b)(2)(A)(i)(II). The total of the payments to be made to Secure Bank under the Plan is $400,000. Note: The conjunctive requirement of §1129(b)(2)(A)(i)(II) that the present value of the deferred payments equal or exceed the value of the collateral, here $275,000, is met because the present value at 10% of the four $100,000 payments is $316,000 computed as follows: ($100,000 x .900 + $100,000 x .826 + $100,000 x .751 + $100,000 x .683).

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 Jahel H. Nolan with the assistance of Larry Ver Merris.

Dewsnup v. Timm, et al., Case No. 90-741 (U.S. Supreme Court January 15, 1992) (Blackmun, J.). This case involved the issue of whether a Chapter 7 debtor may "strip down" a creditor's lien on real property to the value of the collateral as judicially determined when that value is less than the amount of the claim secured by the lien.

On June 1, 1978, respondents loaned $119,000 to Aletha Dewsnup and her husband. The loan was accompanied by a deed of trust granting a lien on two parcels of Utah farm land owned by the Dewsnups. The Dewsnups defaulted the following year. Under the terms of the deed of trust, respondents at that point could have proceeded against the real property by accelerating the maturity of the loan, issuing a note of default, and selling the land at a public foreclosure sale to satisfy the debt. Respondents did issue a notice of default in 1981. Before the foreclosure sale could take place, however, petitioner sought protection under Chapter 11 of the Bankruptcy Code. That bankruptcy petition was dismissed, as was a subsequent Chapter 11 petition. In June of 1984, the petitioner filed a petition seeking liquidation under Chapter 7. Because of the pendency of these bankruptcy

proceedings, the respondents were not able to proceed to the foreclosure sale.

In 1987, the petitioner filed an adversary proceeding in Bankruptcy Court in which she contended that the debt she owed respondents exceeded the fair market value of the land securing it and that the Bankruptcy Court should reduce the lien to the land's fair market value pursuant to 11 U.S.C. § 506(d). Dewsnup reasoned that the respondents would have such an allowed secured claim only to the extent of the judicially determined value of their collateral, since under § 506(a) an allowed claim of a creditor secured by a lien on property in which the estate has an interest is a secured claim to the extent of the value of the creditor's interest and the estate's interest in the property. The Bankruptcy Court refused to grant this relief. After a trial, it determined that the then value of the land subject to the deed of trust was $39,000. The District Court, without a supporting opinion, summarily affirmed the Bankruptcy Court's judgment of dismissal with prejudice. The Court of Appeals also affirmed.

The Supreme Court stated that § 506(d) did not allow Dewsnup to "strip down" respondent's lien to the judicially determined value of the collateral, because the respondent's claim was secured by a lien and had been fully allowed pursuant to § 502. Therefore, it cannot be classified as "not an allowed secured claim" for purposes of the lien-avoiding provisions of § 506(d).

The Court also said that the contrasting positions of the parties and their amici demonstrate that § 506(d) and its relationship to other Code provisions are ambiguous.

The Court stated that although not without its difficulty, the position espoused by respondents and the United States as amicus curiae that the words "allowed secured claim" in § 506(d) need not be read as an indefeasible term of art defined by reference to § 506(a) but should be read, term by term, to refer to any claim that is first allowed and second secured generally is the better of the several approaches argued in this case. The Court, writing on a clean slate, might be inclined to agree with Dewsnup that the quoted words must take the same meaning in § 506(d) as in § 506(a). However, the practical effect of Dewsnup's argument is to freeze the creditor's secured interest at the judicially determined valuation in contravention of the pre-code rule that liens on real property passed through bankruptcy unaffected. Congress must have enacted the Code with a full understanding of the latter rule, and given the statutory ambiguity here, to say that Congress intended to grant to debtor the broad new remedy against allowed claims to the extent that they become "unsecured" for purposes of § 506(a), even though the new remedy is mentioned nowhere in the Code or in the legislative history, is implausible and contrary to basic bankruptcy principles.

Rafoth v. National Union Fire Insurance Co., Case Nos. 91-3228, 91-3271, 91-3445 (6th Cir. January 24, 1992). This case involves the issue of whether the Bankruptcy Court can conduct a jury trial. Plaintiff Rafoth sought a declaratory judgment of coverage and payment under a fidelity a declaratory judgment of coverage and payment under a fidelity bond. The Bankruptcy Court decided that the adversary proceeding was a core proceeding and the defendant was not entitled to a jury trial. After a bench trial, the defendant appealed. The district court decided that the defendant was entitled to a jury trial in Bankruptcy Court. After the appeal, the plaintiff failed to respond to defendant's claim for a jury trial.

The Court of Appeals, in an opinion by Judge Silver, stated that since the defendant is entitled to a jury trial, the issue was where it should take place. The court stated that first, there was no statutory language that supports jury trials in bankruptcy courts. The relevant statutory provision offered almost no guidance. Second, no present bankruptcy rule provides for jury trials. The court stated that when one reflects upon the system established by Congress, it is apparent that it intended to create a specialized court to handle bankruptcy matters in an expedited and efficient manner. The system is not set up to handle lengthy jury trials. To introduce this method of litigation into the system would be at the expense of all other matters handled by the bankruptcy courts. Accordingly, as the relevant statutes do not reveal any congressional intent that bankruptcy courts conduct jury trials, the Court of Appeals refused to imply that bankruptcy courts are authorized to conduct them. The jury trial therefore must take place in district court.

In re Michigan Lithographing Co., Case No. SG 90-80574 (Bkrtcy. W.D. Mich. February 3, 1992). This decision, authored by Judge Jo Ann C. Stevenson, addresses the issue of whether failure to record a notice of lis pendens with the Kent County Register of Deeds is a violation of Section 117 of the Michigan Construction Lien Act and whether such failure renders a construction lien unenforceable against a trustee in bankruptcy under 11 U.S.C. §544(a)(3) where the construction lien was timely and properly recorded and the lien foreclosure suit timely commenced in state court.

Owen-Ames-Kimball ("OAK") did substantial construction work on the Grand Rapids facility owned by Michigan Lithographing Company. As of February 1, 1989, Michigan Litho owed OAK a substantial sum under the construction contract. OAK recorded its claim of lien with the Kent County Register of Deeds officer and timely commenced suit against Michigan Litho and various other defendants in Kent County Circuit Court to foreclose its construction lien on the facility.

An involuntary Chapter 11 petition was filed against Michigan Litho on February 8, 1990, one year and five days after the recording of the construction lien. OAK's suit to foreclose its construction lien was removed to the Bankruptcy Court. The court stated that even if it could be assumed that the failure to file a lis pendens had the effect under the prior Mechanics Lien Act of terminating the lien, the court rejected out of hand the trustee's statement that the operative language of the Construction Lien Act does not markedly differ from that of the former Mechanics Lien Act. The court stated that one need only carefully read and compare the language of the two to discern the quite obvious distinctions. The former states that the filing of the notice of lis pendens has the effect of continuing the lien, while the latter simply directs that the plaintiff will record a notice of lis pendens. Moreover, § 117(2) of the Construction Lien Act does not provide the penalty for failure to record a notice of lis pendens.

The court believed that (1) the absence in the Act of any specific and unequivocal statement that the failure to record a notice of lis pendens within the one-year period automatically terminates the lien as to third parties and (2) the nonexistence of Michigan case law so interpreting the Act cut heavily against the trustee's argument that one could become a bonafide purchaser by ignoring what was recorded, relying only on what was not recorded.

In re Cole Brothers, Inc., HT 91-84932 (Bkrtcy. W.D. Mich. January 28, 1992.) This opinion, authored by Judge Laurence E. Howard, involves two motions to assume executory contracts filed by the Debtor.

On September 13, 1991, the Debtor filed a voluntary petition seeking relief under Chapter 11. The Debtor was a dealer of products for both John Deere Industrial Equipment Company and John Deere Company. It sought to assume several contracts between itself and John Deere Industrial Equipment Company and John Deere Company. Under the various dealer agreements, John Deere was obligated to provide the debtor with floor plan financing for new equipment and for trade-in goods from purchasers as well as to provide retail financing to qualified customers of the Debtor. John Deere argued that § 365(c)(2) of the Bankruptcy Code prevented the Debtor from assuming any of the contracts comprising the dealership agreement.

The court started by determining that the contracts between the Debtor and John Deere were executory. The court then turned to whether the Debtor was permitted under § 365 to assume the various agreements. As a contract to extend credit is personal in nature, § 365(c)(2) prohibits a debtor from forcing a nonconsenting creditor to provide financing.

The court stated that the dealer finance arrangements entered into with both John Deere Companies were contracts for financial accommodations. An agreement which, standing alone, required John Deere to provide retail financing to qualified customers of the Debtor would be barred from assumption under § 365(c)(2) of the Code. The court went on to say that were it to analyze each contract separately, the prohibition of § 365(c)(2) would compel it to eviscerate the entire dealership arrangement between the Debtor and the John Deere Companies. The Debtor might be allowed to assume the contract which established Cole Brothers as a dealer of John Deere products, but the Debtor would be left without the ability to assume any of the financing contracts.

The court stated that it did not think that it should determine the Debtor's motion to assume by piecemeal analysis. The court said that it must determine whether the entire dealer arrangement is an agreement for financial accommodation or for debt financing barred from assumption by § 365(c)(2) of the Code. The court stated that the thrust of all the agreements was to establish the Debtor as a dealer of John Deere products. It was the ability to operate as a John Deere dealer that the Debtor sought to assume. The financing agreements were necessary to the dealership but did not so overshadow the other provisions of various agreements so that the court would consider the relationship as a whole to be one of financial accommodation. The court went on to say that when contracts providing for the extension of credit or for financial accommodation are only incidental to or part of a larger arrangement involving the debtor, the court is not called upon under § 365(c)(2) to deny the debtor the right to assume or reject.

In the Matter of Standard Oil & Exploration of Delaware, Inc., Case No. GG 91-82102 (Bkrtcy. W.D. Mich. January 24, 1992). This opinion authored by Judge James D. Gregg, involves the issuing of preconfirmation administrative priority notes by the debtor in order to obtain fresh capital and the exchange of these notes for stock issued at or after confirmation of the plan as an exempt transaction under § 1145 of the Bankruptcy Code.

Standard Oil and Exploration of Delaware developed and operated oil and gas wells in northern Michigan with its principal asset being the Sand Lake project. It had 838 equity security holders. The Sand Lake project consists of two phases. Phase one was comprised of twelve wells in various stages toward completion. Phase two envisioned the addition of five new wells. The Debtor asserted that it needed additional funds to complete the Sand Lake project phase one, to commence and complete Sand Lake project phase two, to pay Chapter 11 administrative expenses, and to enter into a gas contract, acquire additional leased acreage, and construct additional pumping wells. The company was unable to get financing from various financial institutions and asserted that obtaining additional funds was in the best interest of the Debtor and its estate. The Debtor sought authorization to issue up to $6,500,000 in 8 percent promissory notes and 13 percent senior subordinated cumulative notes.

The court stated that § 364(b) of the Bankruptcy Code authorized a debtor to obtain credit outside the ordinary course of business after notice and a hearing. The Debtor's only method of obtaining the additional funds appeared to be through the unconventional method of issuing exempt notes. The Court found that under these facts the issuance of the notes was necessary and outside the ordinary course of business. Therefore, under § 364(b) if the issuance is authorized the purchaser of each note will hold a general administrative claim pursuant to § 503(b)(1)(A).

The Debtor asserted that pursuant to § 364(f) of the Bankruptcy Code, these notes would be exempt from the registration and prospectus delivery requirements of securities law. Section 364(f) states that certain securities are exempt from the requirements of Section 5 of the 1933 Act, the Trust Indenture Act of 1939, and state or local securities laws involving registration. To be exempt, the issuance must satisfy two elements. First, the court must determine that the debtor-in-possession is not an underwriter as defined in § 1145(b) of the Bankruptcy Code. Second, the court must determine that the issuance involves nonequity securities.

The court determined that the Debtor was not an underwriter pursuant to § 1145(b)(1)(A)(B)(C). However, the debtor may be an underwriter if it is an issuer under § 1145(b)(1)(D). The definition of "issuer" includes in addition to an issuer any person directly or indirectly controlling or controlled by the issuer or any person under direct or indirect common control with the issuer. The court stated that it agreed with those cases which hold that § 1145(b)(1)(D) is intended to include as its definition of "issuer" only the control person language of § 2(11) of the 1933 Act. Section 1145(b)(1)(D) therefore does not totally encompass the broad definition of issuer under § 2(4) of the 1933 Act. The court concluded that if § 1145(b)(1)(D) were so construed, no debtor-in-possession or trustee would ever be able to issue exempt securities as envisioned by the Bankruptcy Code. Thus, the Debtor was not an issuer.

Next the court looked at the issue of whether the notes were nonequity securities. Examples of nonequity securities include bonds, debentures, promissory notes, and certificates of indebtedness. A note is a security. Even though a note may be later converted to stock, such right to convert does not in itself transform the note into an equity security. The court stated that the notes to be issued may be subsequently exchanged for stock in the reorganized Debtor if the proposed plan is confirmed. On the other hand, if the plan is not confirmed, the 8 percent and 13 percent noteholders would remained entitled to administrative priority distribution, or, to the extent that the proceeds from the 13 percent notes were not released from the escrow account pursuant to court order, those noteholders would be repaid with interest. The 8 percent and 13 percent notes, although convertible to stock if the plan is confirmed, are not included within the parameter of the definition of an equity security under the Bankruptcy Code. The court determined that the 8 percent and 13 percent notes that the Debtor proposed to issue were therefore nonequity securities as required by § 364(f). The court stated that the Debtor may issue both types of notes pursuant to § 364(f).

The court also noted that the Debtor had complied with the adequate disclosure requirement under securities law and that the Debtor would still be subject to the antifraud provisions under §§ 17(a) and 12(2) of the 1933 act and Rule 10b(5) of the Securities Exchange Act.

In re Dietz d/b/a Con-Co Ceramic Tile f/d/b/a Avon Tile & Marble, Case No. 90-12399 (Bkrtcy. E.D. Mich. January 10, 1992). This decision, authored by Judge Arthur J. Spector, involves a creditor with a nonpriority,

unsecured claim filing a late proof of claim and requesting that it be considered an amendment to its timely filed informal claim.

Beaver Distributors, Inc. commenced a lawsuit in state court against Constance Dietz, now the Debtor. Shortly thereafter, the Debtor filed a petition for relief under Chapter 13 and scheduled Beaver as a creditor holding an unsecured claim. On December 4, 1990, all parties listed on the matrix were served with a notice of the bankruptcy filing, which advised that the meeting of creditors would be held on January 10, 1991 and that the last date for filing a proof of claim was April 10, 1991. Eleven days after attending the creditors' meeting, Beaver's credit manager mailed a letter to the Chapter 13 trustee in which she expressed misgivings about the Debtor's proposed plan. The letter also stated that Debtor owed Beaver over $20,000. A copy of this letter was received by the Bankruptcy Court on February 1, 1991. Beaver did not file a proof of claim until April 16, 1991, six days after the bar date. The Debtor's plan was confirmed on April 17, 1991.

Beaver argued that its letter and/or other actions taken prior to the bar date constituted an informal proof of claim, the defects of which were cured by its amending proof of claim filed after the bar date.

The court stated that a properly completed proof of claim is denominated as such and includes the name and the address of the creditor, the basis for the claim, the date that the debt was incurred, the classification of the claim, the amount of the claim, and copies of any documents supporting the claim. Notwithstanding the substantial conformity requirement of Rule 3001(a), many courts have stated or implied that a document that does not substantially conform to the official form may, if certain minimal criteria are met, constitute an informal proof of claim. Under the appropriate circumstances, such a claim may then be amended after the filing deadline has passed to bring the document into compliance with Rule 3001(a).

The court went on to say that a written document filed with the Bankruptcy Court which contains a demand on the estate or otherwise expresses an intent to hold the debtor liable for an alleged debt will serve as an informal proof of claim. Applying the test to the letter in question, the court found that the letter was a written document and was received by the court, although not filed. The letter also communicated Beaver's intention to pursue a claim against the Debtor or the estate. Therefore, the court concluded that the letter constituted an informal proof of claim. A creditor's incentive to comply with Rule 3001 is maximized if the right to receive payment on an informal claim is made contingent upon the filing of an amendment, which in effect renders the informal proof of claim a formal one. Thus, the requirement of a conforming amendment vindicates Rule 3001 and relieves the trustee of the obligation to search high and low for any inartfully drafted or verbal claims. The court concluded, however, that Beaver's informal proof of claim by itself did not entitle Beaver to share in any distribution made by the trustee.

The court also decided that the untimely proof of claim filed by Beaver should be allowed as a document amending its informal claim because amendments of proofs of claim to correct defects or mistakes are liberally allowed where there is no fraud and no other party will be prejudiced as a result.

As to whether the allowance of Beaver's claim as timely would prejudice other creditors, the court concluded that the fact that other creditors would receive a smaller distribution than they would if Beaver's claim were not allowed does not establish the kind of prejudice that would preclude amendment. The court also stated that if Beaver's perfecting amendment were to relate back to the date its informal claim was filed, then the propriety of distributions already made by the trustee to creditors with unsecured claims could be called into question with the attendant implication of liability on the trustee's part. Therefore, the court held that Beaver's potential right to share in the distribution did not vest until its amending proof of claim was filed. Since Beaver's amendment would otherwise be subject to disallowance based on the prejudice to other creditors that would result, restricting the amendment to prospective application was consistent with the principle of liberally allowing amendments to proofs of claim.

WeatherVane Window, Inc. v. White Lake Construction Co., Case No. 121348 (Mich. Ct. App. December 27, 1991). This opinion, authored by Judge Maureen Pulte Reilly, involves an appeal from two orders entered in a receivership action in Muskegon County Circuit Court.

WeatherVane, Standale Lumber & Supply, and K & G Electric were among two dozen subcontractors and materialmen who worked on two jobs in 1985 under the general contractor White Lake Construction Company for its client American Adventures, Inc. American Adventures did not pay White Lake, who in turn did not pay its

subcontractors. White Lake filed a claim in a Chapter 11 bankruptcy proceeding against American Adventures as a secured creditor by virtue of a previously filed construction lien. While that case was pending, WeatherVane filed an action in Muskegon County Circuit Court against White Lake for the amount owed under its subcontract. The day prior to the filing of WeatherVane's action, WeatherVane and White Lake stipulated to a consent judgment to be entered on October 1, 1987 in favor of WeatherVane if full payment of WeatherVane's claim was not made prior to that date. White Lake agreed that it would hold in trust for WeatherVane any partial payments received from American Adventures until the consent judgment was satisfied. White Lake executed an assignment to WeatherVane of its construction lien rights against American Adventures to the extent of WeatherVane's claim. The consent judgment was entered on October 1, 1987.

Prior to the entry of the consent judgment, White Lake filed a Chapter 11 bankruptcy proceeding. White Lake's attorney notified the Muskegon County Circuit Court that an automatic stay had been issued and that the consent judgment should not be entered. In September of 1988, White Lake received as a general unsecured creditor a 16.2 percent distribution which was deposited in Shelby State Bank. WeatherVane sought to enforce its consent judgment by making several attempts to garnish the funds held by Shelby State Bank for White Lake.

The Bankruptcy Court in the White Lake action issued an order directing disposition of the monies White Lake had received from American Adventures. The court decided that the money in the Shelby State Bank account, certain stock certificates, and any future payments from the bankruptcy estate of American Adventures were impressed with a trust pursuant to the Michigan Builders Trust Fund Act to the extent needed to pay the subcontractors and materialmen. All the creditors except WeatherVane had agreed to a pro rata distribution. The Bankruptcy Court determined that WeatherVane's claim that it should get full, as opposed to pro rata, payment for its share was purely a state law claim, and the court abstained from resolving the dispute. In addition, the court authorized K & G to seek the appointment of a receiver for the trust funds in state court and ordered the Debtor to tender to the receiver, free of the automatic stay, all funds and stock it had received from American Adventures.

Pursuant to the directive of the Bankruptcy Court, K & G initiated a receivership action in Muskegon County Circuit Court, but WeatherVane would not waive any of its rights as a judgment creditor/garnishor/assignee. The Muskegon County Circuit Court appointed a receiver and ordered the distribution of funds pro rata.

The court reasoned that it was not consistent with the purpose of the Michigan Builders Trust Fund Act to allow one of several claimants to recover in full merely because that claimant acted first. The stipulated agreement and assignment between WeatherVane and White Lake was immaterial because White Lake could not assign funds that belonged to the trust fund to pay its corporate debt. WeatherVane appealed.

The Court of Appeals stated that the power to appoint a receiver was inherent in courts of equity. The court concluded that K & G requested that all the subcontractors and materialmen be allowed to file claims for the funds held in trust by White Lake and asked the court to determine the appropriate distribution of that money. The appointment of the receiver was ancillary to the release sought. The appointment was also an appropriate response to the directive of the Bankruptcy Court after the lift of the automatic stay when several creditors were seeking a pro rata share of the trust funds and one was seeking full payment of its consent judgment granted in another case in the same Circuit Court.

The court went on to say that White Lake's claim as a secured creditor under its construction lien was defeated because the superior claim of a prior secured creditor took precedence. White Lake's share of the American Adventures bankruptcy estate was allowed because of White Lake's status as a general unsecured creditor. Meanwhile, because the consent was never declared void by the Bankruptcy Court or Circuit Court, the court believed that the Debtor's intent to void the consent judgment was evidenced by its attorney's letter to the Circuit Court and by White Lake's motion for distribution in the Bankruptcy Court.

STEERING COMMITTEE MEETING MINUTES

A meeting was held on February 21, 1992 at noon at the Peninsular Club. Present: Janet Thomas, Peter Teholiz, Brett Rodgers, Patrick Mears, Bob Wright, Marcia Meoli, Tom Schouten, and Tom Sarb.

I. **1992 Bankruptcy Seminar** (at park Place Hotel).

Bob Wright announced on behalf of the Education Committee that, in addition to Judge Robert E. Ginsburg, Bankruptcy Judge for the Northern District of Illinois, Judge Robert D. Martin, Chief Bankruptcy Judge for the Western District of Wisconsin, will be a key-note speaker. The Education Committee will coordinate the speaking topic with the visiting Judges. Possible topics under consideration for seminar presentations include taxation issues, accounting issues, Sixth Circuit Revisited, cash collateral issues and divorce issues. Anyone with a topic to suggest should contact Bob Wright.

II. **Local Rules Committee.**

Bob Wright and Peter Teholiz reported that the Local Rules Committee had made several recommendations to the bankruptcy court for consideration with regard to amendments of the Local Rules.

III. **Interim Postage and Copy Costs.**

Tom Schouten discussed the problem faced by firms with regard to fronting copying and postage expenses for large mailings to the creditor list. Those mailing costs can exceed $51,000 per mailing in the larger cases. Tom Schouten will solicit comments from Western District bankruptcy practioners with regard to recommendation of a possible amendment to the Local Rules. Anyone having comments on this issue should direct them to Tom Schouten.

IV. **Next Meeting.**

The next meeting of the Steering Committee will take place at the Peninsular Club on Friday, March 20, 1992.

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 (Lower Peninsula) during the period from January 1, 1992 through January 31, 1992. These filings are compared to those made during the same period one year ago and two years ago.

	Jan. '92	Jan. '91	Jan. '90
Chapter 7	437	385	285
Chapter 11	10	17	12
Chapter 12	3	0	0
Chapter 13	147	151	149
	597	553	446

EDITOR'S NOTEBOOK

In a decision received too late to be included in this month's Recent Bankruptcy Decisions, the Supreme Court has reversed the Sixth Circuit and held that §106(c) doesn't waive the federal government's sovereign immunity from bankruptcy actions seeking monetary relief. U.S. v. Nordic Village, Inc., 60 U.S.L.W. 4159 (February 25, 1992), reversing In re Nordic Village, Inc., 915 F.2d 1049 (6th Cir. 1990).

In another decision of note, the U.S. Supreme Court has denied the debtor's certiorari petition to review the decision of the Sixth Circuit in the case of In re Mansfield Tire & Rubber Company (Dkt. no. 91-887). In Mansfield Tire, the Court of Appeals held that government claims against the debtor for pension excise taxes assessed for failure to meet minimum funding standards were entitled to priority as an excise tax, rejecting the debtor's motion that they be found to be a penalty, and therefore a general non-priority claim.

In an unusual move in a case that has drawn much attention, the Fifth Circuit has withdrawn the portion of its opinion in the Greystone case refusing to find a new value exception to the absolute priority rule. Phoenix Mutual Life Insurance Co. v. Greystone III Joint Venture, Case No. 90-8529 (5th Cir. February 27, 1992). Finally, the Michigan Court of Appeals ruled that a non-debtor wife lacked standing to set aside the property settlement entered into in connection with a post-petition divorce judgment. The wife claimed that the divorce judgment violated the automatic stay which came into place when her husband filed his bankruptcy petition. However, the Court ruled that the automatic stay is for the benefit of the debtor and if the debtor chooses to ignore the stay violation, other parties do not have standing to assert the stay violation to their advantage. Lopez v. Lopez. (Mich. App.) 1991 W.L. 200274.

Anyone interested in submitting an article for publication in this Newsletter should send it to my attention at the return address on the mailing page of this Newsletter. All submissions are welcome.

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