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MUST NEW VALUE REMAIN UNPAID?

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Can a recipient of a preferential transfer reduce his liability by subsequent new value extended, even if the Debtor pays the subsequent new value?

Under a majority of decisions, transferees have been denied reductions for new value extended, if the new value was paid. In a recent decision, Honorable JoAnn C. Stevenson rejected the majority view, holding that a transferee **may** be entitled to a reduction for new value, even if the new value is later paid! In re Check Reporting Services, Inc. (Boyd v. The Water Doctor), Case No. SL 89-00270 (Bankr. W.D. Mich. May 18, 1992). While the decision is currently found in Westlaw (1992 WL 110221), the very helpful hypotheticals and digest of cases included in Judge Stevenson's analysis do not appear in Westlaw. The court expects the slip opinion to be published in June. Preference litigators would be well advised to thoroughly analyze this opinion, since it may be the most detailed and best analysis of this issue written to date, and it will undoubtedly be critically evaluated across the country.

Under Section 60c of the old Bankruptcy Act, a recipient of a preference who extended new value could reduce his preference liability only to the extent of the new value "remaining unpaid." Bankruptcy Act of 1898, § 60c. Courts interpreting the old § 60c also developed the "net result rule", where total eligible new value advances during the preference period were subtracted from the total of preferential transfers, without regard to the timing of the advances or transfers. This allowed a carry forward of new value to offset later preference payments. The net result rule was designed to promote the goal of equality of creditor distribution. However, § 60c and the net result rule did not further the policy of encouraging creditors to deal with a struggling debtor. Instead, creditors who had already extended new value before receiving a pref-

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erence were discouraged from extending additional credit, since new value became ineligible when paid, and such payment also constituted a potential recoverable preference - a double recovery for the estate. To remedy this, Congress modified the new value and net result rules so that new value could only be used to reduce preference payments received before the new value advance. In rewriting the new value provisions, however, the drafters elected to omit the "remaining unpaid" language. Unfortunately, there is no legislative history shedding light on this omission or the specific intent of the new language of § 547(c)(4), which provides:

> (c) The trustee may not avoid under this section a transfer -
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> > (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor -
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> > > (A) not secured by an otherwise unavoidable security interest; and
> > >
> > > (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor. (Emphasis supplied).

Many of the post-code cases have incorporated the "remaining unpaid" requirement into § 547(c)(4)(B). In the Matter of Bishop, 17 B.R. 180 (Bankr. N.D. Ga. 1982), is one of the first cases addressing new value issues under § 547(c)(4). The Bishop court established three requirements under § 547(c)(4):

> For § 547(c)(4) to apply, three requirements must be met. First, the creditor must extend new value as defined in § 547(a)(2). . . . Secondly, the new value must be unsecured. Section 547(c)(4)(A). Finally, the new value must go unpaid. Section 547(c)(4)(B).

The Bishop court provided no significant analysis or justification for imposing the requirement that new value must "go unpaid" and did not reconcile this result with the specific no "otherwise unavoidable transfer" language in § 547(c)(4)(B).

Bishop is cited with approval in numerous subsequent decisions holding that new value must remain unpaid in order to be eligible new value under § 547(c)(4). In re Ford, 98 B.R. 669 (Bankr. D. Vt. 1989); In re Prescott, 805 F.2d 719 (7th Cir. 1986); In re Formed Tubes, Inc., 46 B.R. 645 (Bankr. E.D. Mi. 1985); In re Columbia Packing Co., 44 B.R. 613 (Bankr. D. Mass. 1984); In re Hancock-Nelson Merchantile Co., 22 B.R. 1006 (Bankr. D. Minn. 1991); In the Matter of Global Int'l Airways Corp., 80 B.R. 990 (Bankr. W.D. Mo. 1987); In re American Int'l Airways, Inc., 56 B.R. 551 (Bankr. E.D. Pa. 1986); In re Prescott, 805 F.2d 719 (7th Cir. 1986). In fact, Judge Stevenson refers to the Bishop test in In re Camelot Motors Corp., 86 B.R. 520 (Bankr. W.D. Mi. 1988), although the ability of the transferee to use paid new value was not at issue.

The majority opinions tend to ignore or rationalize around the absence of a clear statutory requirement that new value must remain unpaid, electing to analyze the statutory goals of equitable distribution. For instance, in In re Hancock-Nelson Mercantile Co., supra, the court reasoned that the subsequent advance rule contemplated by § 547(c)(4) essentially returns the value of the earlier preference to the debtor, in whole or in part. Id. at 1016. Where, however, the debtor pays for the new value, that value passes back out of the debtor's operation to the creditor; as a result, the § 547(c)(4) defense is not available to the creditor. Id. at 1017.

Similar in conceptual analysis and in lack of statutory analysis is In re Kroh Bros. Development Co., 930 F.2d 648 (8th Cir. 1991), where the court indicated that the trustee is able to avoid preferential transfers for the purpose of equal distribution of assets among creditors. A creditor who subsequently advances new value to the estate returns all or part

of preference to the estate. Id. at 652. However, "when a debtor pays for the new value" there is in effect no return of the preference. Id. Kroh Bros. concludes that "the relevant inquiry. . . is whether the new value replenishes the estate. If the new value advanced has been paid for by the debtor, the estate is not replenished and the preference unfairly benefits the creditor. Id.

Until now, the only significant case opposing the majority rule was In the Matter of Isis Foods, Inc., 39 B.R. 645 (Bankr. D.C. 1984), where the court rejected the "unpaid" requirement set forth in Bishop. The Bishop court held that:

> Section 547(c)(4) does not contain any language that even suggests that the new value rule contained therein is somehow limited to unpaid invoices.
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> That section contains only two exceptions to the set off of new value advanced after a payment: (1) when the new value is secured by an otherwise unavoidable security interest; and (2) when, on account of the new value given, the debtor makes an otherwise unavoidable transfer to or for the benefit of the creditor. Neither exception is applicable under the facts of this case. The dictum in the cases relied upon by the appellee to the effect that the new value must be "unsecured" and go "unpaid" is an inaccurate and confusing paraphrase of the clearly stated statutory purpose.
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> The confusion engendered by the gloss formerly placed on the judicially evolved net result rule should be avoided in cases involving the construction and application of the new subsequent advance rule provided in § 547(c)(4). Application of the clear and unequivocal language of § 547(c)(4) to the facts as found by the bankruptcy court requires that appellant's new value defense be recognized. . .
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> Id. at 653.

Isis Foods is followed and cited with approval in In re Paula Saker & Co., 53 B.R. 630 (Bankr. S.D. N.Y. 1985).

The majority decisions, however, ignore the double penalty problem. If the "payment" of new value is also sought to be recovered as a preference, recovery on that "payment" by the trustee produces a double recovery. The estate is not diminished if paid new value is eligible new value. As a result, the trustee can recover the amount of **all** preferences less **all** subsequent new value advances.

In The Water Doctor, Judge Stevenson points out that Bishop's requirement that new value remain unpaid has no statutory basis. Judge Stevenson rejects the notion that a transfer may **both** "pay" previous new value from the creditor, thus disqualifying the new value defense to an earlier preference, **and** be preferential in and of itself. Judge Stevenson argues that Bishop and its progeny fail to adequately analyze the multilayered exchanges of preferential transfers and new value extensions which typically occur in preference cases. In particular, the majority decisions fail to acknowledge that the trustee should not be able to assert that paid new value is ineligible if the trustee is also asserting that the paying transaction was in fact an avoidable preference. Judge Stevenson concludes that the term "unpaid," as used by Bishop and its progeny, glosses over the statutory language requiring that the debtor did not make an "otherwise unavoidable transfer" on account of the new value. Thus, Isis Food's refusal to adopt the "unpaid" requirement arose out of a precise reading of § 547 (c)(4)(B), and not out of a lack of recognition that new value for which the creditor was already compensated should not be considered in defense of a preference. Judge Stevenson held that "though in the minority, the Isis opinion is more firmly rooted in the statutory language than Bishop and its progeny. As a result, Isis is a hurdle that the Trustee must overcome in order to urge the adoption of the Bishop interpretation by this Court."

While conceding that the "several layers of negatives" contained in § 547(c)(4)(B) made analysis of the statute complicated, Judge Stevenson stated that this provision is not necessarily ambiguous. The Water Doctor court attempts to dissect the meaning of the triple negative - "not make an otherwise unavoidable transfer" - language of § 547(c)(4)(B) through the use of numerous hypotheticals. The space limitations of this article preclude detailed analysis of these hypotheticals, but they are very helpful in applying the law to different sets of facts.

Whether one agrees or disagrees with Judge Stevenson's decision in Water Doctor, it is certainly an opinion that requires careful scrutiny by all bankruptcy attorneys. The court's analysis is a comprehensive and well-reasoned decision on the convoluted statutory language of § 547(c)(4)(B). Certainly, this opinion will earn deserved commentary and review. By removing the "remaining unpaid" requirement from § 547(c)(4)(B), Judge Stevenson has provided creditors' rights attorneys with the proper interpretation of this defense to preference lawsuits.

RETIREMENT DINNER FOR HONORABLE DAVID E. NIMS, JR.

After a long and distinguished career on the bankruptcy bench, Judge David E. Nims, Jr. will be retiring on September 30, 1992. On that day, a retirement dinner will be held in his honor at Egypt Valley Country Club, 7333 Knapp, N.E., Ada, Michigan. A reception will be held at 6:30 p.m. Dinner will be at 7:30 p.m. The ticket price will be $40 per person.

All attorneys, spouses, and friends are cordially invited to attend. This promises to be a most enjoyable and memorable event, so please mark your calendars accordingly.

Also, please RSVP this invitation by sending your check payable to Timothy J. Curtin to him at 171 Monroe Avenue, Suite 800, Grand Rapids, Michigan 49503, no later than September 1, 1992. Directions to the country club are available upon request.

AD HOC COMMITTEE FOR
JUDGE NIMS' RETIREMENT

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 Joseph M. Ammar with the assistance of Larry VerMerris.

Patterson v. Shumate, 60 U.S.L.W. 4550 (June 15, 1992). In this unanimous decision, authored by Justice Blackmun, the United States Supreme Court held that an anti-alienation provision contained in an ERISA-qualified pension plan constitutes a restriction on transfer enforceable under "applicable nonbankruptcy law" and, therefore, a debtor may exclude his interest in such a plan from the property of the bankruptcy estate.

Section 541(c)(2) excludes from the bankruptcy estate property of the debtor that is subject to a restriction on transfer enforceable under "applicable nonbankruptcy law." According to the Court, a plain reading of § 541(c)(2) entitles a debtor to exclude from property of the estate any interest in a plan or trust that contains a transfer restriction enforceable under any relevant nonbankruptcy law. The text of § 541(c)(2) did not support the Trustee's contention that "applicable nonbankruptcy law" is limited to state law. Instead, the provision encompasses any relevant nonbankruptcy law, including federal law such as ERISA. The Court concluded that the anti-alienation provision contained in the ERISA-qualified pension plan satisfied the literal terms of § 541(c)(2). As a result, the debtor's interest in the pension plan was excluded from the bankruptcy estate.

This decision affirms the result reached in In re Lucas, 924 F.2d 597 (6th Cir. 1991). For a discussion of retirement arrangements and exemptions in bankruptcy, please see the lead article in the January, 1992 Newsletter.

In re Eagle-Picher Industries, Inc., Case No. 91-4108 (6th Cir. May 7, 1992). This case involves the propriety of granting a Chapter 11 corporate debtor a preliminary injunction enjoining a separate civil action against nondebtor officers of the debtor.

Prior to the filing of the corporate debtor's Chapter 11 petition, plaintiff filed suit against the debtor and nondebtor officers. Plaintiff then filed a motion for relief from stay, which was denied. The debtor sought a preliminary injunction staying the civil action against the nondebtor officers. The bankruptcy court issued the preliminary injunction and the district court affirmed.

The Sixth Circuit first held that because the plaintiff did not present significant questions of disputed facts in its offer of proof, the bankruptcy court did not err in reaching its own conclusion without benefit of a full evidentiary hearing.

The Sixth Circuit next upheld the granting of the preliminary injunction. In deciding whether to issue a preliminary injunction the court should consider (1) the likelihood of the plaintiff's success on the merits; (2) whether plaintiff will suffer irreparable injury without the injunction; (3) the harm to others which will occur if the injunction is granted; and (4) whether the injunction would serve the public interest. Although the bankruptcy court focused more on the last three factors in granting the preliminary injunction, the four factors are factors to be balanced and not prerequisites that must be satisfied. Accordingly, the granting of the preliminary injunction enjoining the civil action against the nondebtor officers was proper.

In re Nordic Village, Inc., Case No. 89-3656 (6th Cir. April 27, 1992). The United States Supreme Court (in an opinion reported at 112 S.Ct. 1011 and discussed in the March, 1992 Newsletter) reversed the judgment and opinion previously entered in this case, in which the Sixth Court affirmed the district court's judgment that the United States had waived its sovereign immunity with respect to the Trustee's claim. The Supreme Court then held that the United States did not waive its sovereign immunity under § 106(c). Therefore, the district court lacked jurisdiction to entertain the Trustee's claim for monetary relief. In accordance with the Supreme Court's judgment, the Sixth Circuit reversed the district court's judgment.

In re Griggs, Case No. 91-5794 (6th Cir. May 18, 1992). In this opinion, the Sixth Circuit allowed a creditor under § 546(b) to perfect its security interest in the debtors' mobile home postpetition pursuant to a Kentucky statute. The county clerk had failed to note the creditor's lien on the certificate of title. However, the Kentucky statute allowed creditors to correct such mistakes. The Sixth Circuit found that the Kentucky statute was within the scope of § 546(b). Therefore, the creditor could complete the perfection of its security interest.

In re Vereyken, Case No. 91-1174 (6th Cir. May 21, 1992). This case involves the effect of a federal tax lien on the interest of a land contract vendor.

The land contract vendors sold their restaurant on land contract. The land contract vendees failed to pay employment taxes, and federal tax liens were filed against the restaurant property. The vendees also defaulted in their land contract payments. The vendors then obtained a forfeiture judgment. On the vendees' last day of redemption, the vendees filed a Chapter 11 petition. The vendors subsequently received relief from stay and obtained a writ of restitution authorizing them to retake possession.

The vendors failed to obtain the government's voluntary discharge of the tax liens. Therefore, the vendors filed an action in state court to quiet title to their real property, which the government removed to federal court. The district court granted summary judgment for the vendors and the government appealed.

In Michigan, the vendor under a land contract for the sale of real property retains legal title to the real property subject to an equitable obligation to convey legal title to the vendee upon full payment. The vendor retains the legal title as security for payment of the purchase price. The vendee is vested with equitable title.

The vendees in this case failed to build up any equity. The Sixth Circuit acknowledged that the government was correct that its liens attached to the vendees' interest, but the vendees' interest was in effect worthless in dollar terms, since there was nothing to which the liens attached, except perhaps the vendees' right to a deed upon full payment. The government was unwilling to pay off the land contract to obtain the vendees' equity of redemption.

The Sixth Circuit rejected the government's argument based on the merger doctrine that its liens attached to the vendor's legal title after the forfeiture of the vendees' land contract interest.

The Sixth Circuit also rejected the government's argument that it was entitled to priority under 26 U.S.C. § 7425, which provides that land contract forfeitures are subject to government liens when the government has not been given notice of the sale. The Sixth Circuit ruled that having its liens saved from being extinguished and retaining whatever priority it had before the forfeiture was of no help to the government because its liens did not attach to the vendors' legal title. Therefore, the district court did not err in granting summary judgment to the vendors.

In re Daulton, Case No. 91-3892 (6th Cir. June 5, 1992). In this case, the Chapter 7 debtor sought to enjoin the State of Ohio from proceeding in a criminal action against him.

The debtor's debts were discharged in a Chapter 7 case. Two creditors had a security interest in the debtor's tobacco crop. The debtor sold the tobacco crop in his fourteen-year-old daughter's name. Proceeds were paid to the daughter, which she then disbursed to the debtor. The proceeds were not paid to the two secured creditors.

A criminal complaint was filed against the debtor for the alleged fraudulent sale of the tobacco crop.

The Sixth Circuit affirmed the district court's decision that the debtor was provided a full and complete hearing regarding his claim that the criminal action was improperly brought, that the state criminal case was not filed in bad faith and that the bankruptcy court did not abuse its discretion by refusing to enjoin the criminal action.

According to the Sixth Circuit, the mere fact that a debt has been discharged in bankruptcy does not preclude a criminal action from proceeding based on the debtor's alleged criminal conduct in relation to the debt. The state criminal action against the debtor did not seek restitution for the discharged debt and thus did not contravene the bankruptcy court's judgment. Therefore, it was proper that the bankruptcy court and district court refused to enjoin the criminal proceeding.

In re Barrett, Case No. 91-3673 (6th Cir. May 21, 1992). This case involves the issue of serial bankruptcy filings and a Chapter 13 debtor's good faith.

The debtor executed a promissory note in favor of the bank which was secured by a mortgage on the residence. The debtor defaulted and the bank began foreclosure proceedings. On the day of the scheduled foreclosure sale, the debtor filed his first Chapter 13 petition. The case was converted to Chapter 7 and the bank obtained relief from stay. The debtor received a Chapter 7 discharge.

A few days before the rescheduled foreclosure sale, the debtor filed a second Chapter 13 petition. The debtor's income fell far short of his projections and no payments were made under the plan. The bankruptcy court found that the debtor filed his second Chapter 13 case in bad faith, dismissed the Chapter 13 case without prejudice and ordered the debtor to pay the bank's attorney fees. The bank again rescheduled the foreclosure sale but the debtor filed his third Chapter 13 petition which stayed the sale.

Despite the debtor's bad faith in filing his second Chapter 13 petition, the bankruptcy court, after considering the totality of the circumstances, found that the debtor filed his third Chapter 13 petition in good faith. The district court affirmed.

The Sixth Circuit noted that under Johnson v. Home State Bank, 111 S. Ct. 2150 (1991), serial filings in Chapter 7 and Chapter 13 are not precluded merely because they are serial in nature.

The Sixth Circuit then held that a bankruptcy court's determination that a debtor's Chapter 13 plan is filed in good faith based on the totality of the circumstances must be reviewed under the clearly erroneous standard, even if the debtor has made serial filings.

The Sixth Circuit also held that as long as the bankruptcy court sufficiently considered the debtor's prior conduct under the totality of circumstances test, the exact manner in which the bankruptcy court weighed the prior conduct is irrelevant given the bankruptcy court's discretionary power in making a determination of good faith. The Sixth Circuit stated that the bankruptcy court found that there had been a change of circumstances which indicated that the debtor intended to pay the bank in full. The bankruptcy court reached this conclusion after fully considering the debtor's misconduct in the prior filing. The bankruptcy court also accounted for the debtor's prior bad behavior by ordering the debtor to pay the bank's attorney fees and costs resulting from the thwarted foreclosures. The bankruptcy court found that the debtor was not employed in a fairly stable job at a substantial income sufficient to repay the entire debt. The bankruptcy court also considered that the debtor was willing to reaffirm his personal liability under the mortgage, which had been dischargeable in the Chapter 7 case. Since the bankruptcy court's findings were not clearly erroneous, the Sixth Circuit affirmed the decisions of the bankruptcy court and district court.

In re Bencker, Case No. 1:91-CV-102 (W.D. Mich. June 11, 1992).

In this decision by Judge Bell, the district court affirmed the bankruptcy court's decision that a purchase agreement between a mobile home dealer and the debtors was an executory contract capable of assumption pursuant to § 365 and that debtors' Chapter 13 plan provided adequate protection to the IRS.

The IRS filed federal tax liens of approximately $170,000 against the debtors, which attached to all of the debtors' real and personal property. The debtors' home was later destroyed by fire. The debtors then entered into an agreement with the mobile home dealer to purchase a new mobile home for $43,999.56. Since the insurance company was prepared to pay $86,000 on the debtors' insurance policy, the dealer delivered the home, but retained the title pending receipt of the purchase price. Before the mobile home was paid for the IRS levied against the insurance proceeds.

The debtors then filed a Chapter 13 bankruptcy petition, and the bankruptcy court later determined that the insurance proceeds were property of the estate.

The district court first rejected the dealer's argument that the appeals were moot because the IRS did not obtain stays pending appeal, the insurance proceeds were distributed to the dealer, and the court could not grant relief by ordering the return of the disbursed funds because the dealer was not a named party to the appeal.

The district court next held that since legal title remained with the dealer, the purchase agreement was an executory contract capable of assumption pursuant to § 365 and In re Terrell, 892 F.2d 469 (6th Cir. 1989). The district court rejected the IRS's argument that the contract was not executory since title passed upon delivery of the mobile home pursuant to § 2-401(2) of the Uniform Commercial Code. Instead, the specific title provisions of the Mobile Home Commission Act superseded that general title provisions of the UCC. Under that Act, ownership is transferred by transfer of the certificate of title.

An executory contract is a contract on which performance remains due on both sides. The debtors were obligated to pay the purchase price. Upon payment, the dealer was obligated to transfer title. Therefore, the purchase agreement between the debtors and the dealer was an executory contract.

Lastly, the district court held that the bankruptcy court's finding that the IRS stipulated on the record that other assets in the estate were adequate protection for its claim was not clearly erroneous.

In re Superior Ground Support, Inc., Case No. HM 91-90012 (Bankr. W.D. Mich. May 19, 1992). In this decision by Judge Howard, defendant Ford Credit moved for summary judgment on the claims raised by plaintiff Nashville Eagle, which sought the abandonment and turnover of two deicing units used in servicing airplanes.

The Chapter 11 debtor manufactured and assembled deicing units. The process involves affixing a cab, heating coils, and other parts to a truck chassis. The final product is self-propelled.

Nashville Eagle entered into a purchase order for three deicing units. It paid the purchase price in full before receiving delivery of the units. One out of the three deicing machine was delivered to Nashville Eagle. Ford Credit maintained a purchase money security interest in the deicing units as a result of supplying the truck chassis. First of America asserted liens in the debtor's inventory and equipment, but agreed that Ford Credit's security interest had priority. Nashville Eagle claimed that it had superior and protected status as a buyer in the ordinary course of business under MCLA 440.9307(1).

Ford Credit claimed that Nashville Eagle could not be considered a buyer because a completed purchase and sale had not occurred. Based on the Michigan Motor Vehicle Code, Ford Credit asserted that a completed sale does not take place until formal title to the vehicles has passed.

The court found that a sale of a motor vehicle does not result until the certificate of title provisions are satisfied. According to the court, the Motor Vehicle Code preempts the Uniform Commercial Code in regard to transfers of ownership of motor vehicles. The court concluded that the protection afforded to a buyer in ordinary course of motor vehicles does not result without compliance with the Michigan Vehicle Code's provisions on the transfer of ownership. If the deicing units are motor vehicles, the Michigan Vehicle Code's provisions on the transfer of title governs the determination of when a sale occurs and whether Nashville Eagle can be deemed a buyer in the ordinary course of business. However, the court declined to rule on the factual question of whether the deicing units were motor vehicles subject to the Motor Vehicle Code.

In re Check Reporting Services, Inc. (Boyd v. The Water Doctor), Case No. SL 89-00270 (Bankr. W.D. Mich. May 18, 1992). This opinion, authored by Judge Stevenson, involves the proper interpretation of § 547(c)(4)(B)'s provision that a preference defendant may assert as a defense only that new value "on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor." The court held that a preference defendant may be able to assert the new value defense even if the new value is later paid. Please see the lead article in this month's Newsletter for a discussion of this important case.

In re Holly's, Inc., Case No. GG 91-84931 (Bankr. W.D. Mich. April 28, 1992). In this lengthy opinion, Judge Gregg addresses numerous issues involving a subordination agreement and the granting of relief from the automatic stay.

Holly's, Inc. (Holly's) and Grand Rapids Hotel Limited Partnership, d/b/a Holiday Inn Crowne Plaza (Partnership) filed Chapter 11 petitions. The bank filed motions for relief from the automatic stay and requested that the debtors be compelled to reject a management agreement between the Partnership and Holly's. Under the management agreement, Holly's managed the Holiday Inn Crowne Plaza and agreed to subordinate its management fee to the bank. Pursuant to the management agreement, the Partnership agreed not to pay Holly's management

fees until the bank and other contractually higher priority creditors were paid.

The court found that the management agreement was an executory contract containing two promises intending to subordinate the management fee earned by Holly's to the bank if the Partnership defaulted. Outside of bankruptcy, the two promises to the bank, as a third-party beneficiary, were enforceable.

The court held that the Partnership's negative promise not to pay Holly's until other contractually higher priority creditors were first paid was not a subordination agreement, but rather a negative covenant. The negative covenant was unenforceable in the bankruptcy case since it conflicted with the equality of distribution principle.

In addition, Holly's affirmative promise to subordinate its right to receive future management fees was a subordination agreement, unenforceable with regard to Holly's post-petition earnings. According to the court, § 510(a) does not provide carte blanche to a creditor under the guise of a subordination agreement to collect a debtor's post-petition earnings to be applied to pre-petition debt. To hold to the contrary would allow an unsecured creditor to possess greater rights than a secured creditor under the Bankruptcy Code. However, the court further held that the affirmative promise subordination clause was enforceable against Holly's in its bankruptcy case with respect to its pre-petition earnings.

The court next held that the Partnership's negative promise and Holly's affirmative promise were legally separate and severable provisions from the rest of the management agreement. According to the court, both promises were nonexecutory and were not assumable or rejectable by the debtors. The court did not require the debtors to seek to assume or reject the management agreement before plan confirmation.

In regard to the automatic stay, the court found that "cause" did not exist pursuant to §362(d)(1) to warrant modification of the automatic stay with respect to the Crowne Plaza for mismanagement or fraud. However, failure to provide for post-petition real and personal property taxes may constitute "cause" to warrant modification of the stay under § 362(d)(1). Therefore, the Partnership was required to pay into an escrow account funds sufficient to account for post-petition real and personal property taxes. Additionally, even though there was no equity in the Partnership's hotel property, relief from stay was denied under §362(d)(2) because the property was necessary for an effective reorganization. Since relief from the stay was denied, the bank was entitled to adequate protection of its interest in the real and tangible personal property of the hotel facility. The adequate protection included monthly payments of $20,000 by the Partnership to compensate the bank for diminution in value, if any, with the remainder credited to the principal balance; a separate account for refurbishing the hotel property's operating assets; maintenance of fire and casualty insurance; funding of a property tax account; a replacement lien to the bank on the Partnership's post-petition property; the provision of periodic financial reports to the bank; and the employment, at the bank's expense, of an auditor with the ability to review the Partnership's records.

This opinion contains an excellent discussion of the standards a court should consider when deciding whether to grant relief from stay. This opinion is also noteworthy for its discussion of subordination agreements, executory contracts, and third-party beneficiaries.

In re Luke (Luke v. Internal Revenue Service), Case No. SL 91-82126 (Bankr. W.D. Mich. June 3, 1992). This decision, authored by Judge Stevenson, involves the dischargeability of certain claims of the IRS for unpaid federal income taxes.

The debtor filed his Chapter 11 petition on April 15, 1991. As of the date of the debtor's commencement of the adversary proceeding, there were federal income taxes due but unpaid for each tax year from 1984 to 1988.

The debtor argued that the taxes were dischargeable pursuant to § 523 (a)(1)(B)(ii).

The IRS claimed that it was entitled to summary judgment because the court cannot discharge a debt prior to a plan confirmation and because the taxes for the tax years 1987 and 1988 were nondischargeable under § 523(a)(1)(A). Section 523(a)(1)(A) makes certain taxes which are priority claims under § 507(a)(7) nondischargeable and incorporates the time periods in § 507(a)(7).

The court first held that it may determine the dischargeability of debts prior to confirmation.

The court next held that § 507(a)(7)(A) was applicable. In order to be accorded priority status and thus also be nondischargeable, under § 507(a)(7)(A)(i), the tax year in question must be one "ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition." The tax return for the year in question, 1987, was last due on April 15, 1988, and no extension was granted. The date three years before the filing of the petition was April 15, 1988. In order to qualify, the return for 1987 must have been last due after April 15, 1988. However, it was last due on April 15, 1988. Therefore, the 1987 taxes were not entitled to priority and were not nondischargeable under § 523(a)(1)(A). As a result, the court granted the IRS's motion for summary judgment in part, since only the taxes for the 1988 tax year were nondischargeable.

The IRS then filed a motion for reconsideration, which was granted on June 12, 1992. However, on June 12, 1992, the court also affirmed its June 3, 1992 opinion, finding that common usage dictates that "after" April 15, 1988 would not include April 15, 1988.

In re Dollar Corporation, 139 B.R. 192 (Bankr. E.D. Mich. 1992). In this case decided by Judge Shapero, the creditors' committee filed a complaint against Hyundai to recover on breach of contract and quantum meruit claims.

The Chapter 11 debtor had agreed to install assembly equipment at Hyundai's plant in Korea. The contract provided that any claim or dispute would be resolved by arbitration in Korea.

The court granted Hyundai's motion to stay the proceedings pending arbitration in Korea. The issues fit within the scope of the agreement to arbitrate in Korea. In addition, the fact that the issues arose in the bankruptcy context did not invalidate the arbitration provision. The court also found that the issues could be resolved more expeditiously by the arbitration process rather than the bankruptcy court and that arbitration in Korea would not adversely affect the creditors' interests.

In re Express Micro Mart, Inc., Case No. 91-092550-G (Bankr. E.D. Mich. April 8, 1992). This opinion, authored by Judge Graves, involves the issue of whether a plaintiff-creditor who obtains a state court default judgment may preclude the debtor from contesting the default in a subsequent bankruptcy proceeding to the extent to which the liability created by the default is nondischargeable under the Bankruptcy Code.

The creditor obtained a pre-petition state court default judgment against the debtor based on a conversion claim and fraudulent credit card billing. After the debtor's bankruptcy filing, the creditor sought a determination that its claim was nondischargeable under § 523(a)(2)(A) by filing a motion for summary judgment based on collateral estoppel principles.

The court first cited Spilman v. Harley, 656 F.2d 224 (6th Cir. 1981), for the factors to apply when determining whether collateral estoppel is appropriate in dischargeability proceedings: (1) the precise issue in the later proceeding must be raised in the prior proceeding, and (2) the issue was actually litigated and the determination was necessary to the outcome. The court found that these factors were satisfied. Therefore, the debtor was precluded from relitigating the issues in bankruptcy court and the creditor's motion for summary judgment was granted. This decision is contrary to the *practice* in the Western District, in which default judgments are not considered to have been actually litigated.

In re Peacock, Case No. 89-12174 (Bankr. E.D. Mich. April 8, 1992). This decision, authored by Judge Spector, involves the dischargeability of a debt that was omitted from the debtor's schedules.

The Chapter 7 debtor did not list any debt to the creditor in her schedules, nor was the creditor listed on the matrix. The debtor received a discharge in her no-asset case. After the case was closed, the creditor sued the debtor on a pre-petition debt. The debtor reopened her case and filed an adversary proceeding to determine whether the debt had been discharged.

The creditor, conceding that § 523(a)(3)(B) was inapplicable, relied on § 523(a)(3)(A) to except the debt from discharge. Section 523(a)(3)(A) excepts a debt from a discharge unless either of the following conditions is established: (1) the debt is scheduled in time to permit the creditor to file a timely proof of claim, or (2) the creditor obtained notice or actual knowledge that the debtor filed for bankruptcy in time to permit the creditor to file a timely proof of claim. Since the case was a no-asset case, no deadline for filing proofs of claim had been set. The creditor also had actual knowledge of the case. Therefore, the creditor could file a proof of claim which would be timely, since no deadline was established.

Since the second condition was established, the debt to the creditor was not excepted from discharge on account of § 523(a)(3)(A). Judge Spector stated that in a no-asset case in which § 523(a)(3)(B) is inapplicable, § 523(a)(3)(A) can be triggered if a debtor, realizing that a claim was omitted, notifies the creditor of the case, such as by letter. Alternatively, the debtor can reopen the closed case under § 350(b), amend the schedules to add the omitted creditor, and initiate an adversary proceeding to determine the dischargeability of the debt.

Judge Spector also pointed out that there are three ways to litigate dischargeability after a case is closed. First, if a creditor pursues a lawsuit on the claim, the debtors can assert the bankruptcy discharge as an affirmative defense and the court with jurisdiction over that lawsuit can decide whether the debt falls within any of the exceptions to discharge. Second, under Fed. R. Bankr. P. 4007(b), either the debtor or the creditor can move to reopen the case for the purposes of filing a complaint to determine dischargeability. Third, the debtor can bring an action in the bankruptcy court to enforce the discharge injunction against a creditor attempting to collect discharged claims, pursuant to § 524(a). The virtue of any of these procedures, as opposed to a motion to reopen to amend schedules, is that it will focus on the real dispute (if there is a real dispute) between the parties--the dischargeability of the debt.

ANNOUNCEMENT FROM THE BANKRUPTCY COURT

FIRST MEETING LOCATION

The staff at the bankruptcy court often finds forlorn debtors wandering about the halls of the federal building looking for a 341 meeting. These meetings are usually scheduled at 190 Monroe N.W. (Grand Rapids) or in other locations designated by the U.S. Trustee outside of Grand Rapids.

The majority of lost debtors probably are careless. They do not look at the notice and they assume that the meetings must be held at the court. However, some of the debtors tell us that they are directed to come to the court by their attorney. Filing attorneys should make it clear to their clients that FIRST MEETINGS OF CREDITORS ARE NOT HELD AT THE COURT.

CLOSING CHAPTER 11 CASES UPON SUBSTANTIAL CONSUMMATION OF THE PLAN

The bankruptcy court has recently adopted a procedure which will allow the closing of most chapter 11 cases soon after the confirmation of the plan. In many districts, bankruptcy courts close such cases after substantial consummation of the plan of reorganization as defined in 11 U.S.C. § 1101. It

has recently been decided that this court should do likewise.

We believe that adoption of this procedure will be enthusiastically accepted by debtors in possession who are eager to see their cases terminated. Furthermore, neither the court nor the U.S. Trustee has any desire to monitor the cases for years after confirmation.

We encourage attorneys for debtors who have made the initial required payments under the plan to consider filing a motion for a final decree if the plan is substantially consummated. However, it should be clear that matters requiring the involvement of the court (e.g. objections to claims) must be resolved before such a motion can be granted. It should also be noted that closing the case does not bar subsequent reopening to provide for resolution of problems that may occur (e.g. failure to make payments required by the plan).

The court has developed a comprehensive written procedure for seeking a final decree in these cases. Call Jim Robinson for information and for our procedure and forms package.

PROOFS OF SERVICE

Some of the most important documents in a bankruptcy file are the proofs of service that establish that appropriate parties have been served with notices or orders during the course of a case. Properly prepared proofs of service can quickly settle arguments in which one party or another claims to have never been notified of an important event in a case. They can also decisively prevent a grievance or malpractice action when the argument erupts between attorney and client.

Therefore, it is surprising that the court receives many patently defective proofs of service. It seems obvious that a proof of service must state clearly the following things: (1) the case to which it applies, (2) the document(s) being served, (3) the persons upon whom the document is served, (4) the method of service, and (5) the date of service. Many proofs of service arrive in the mail with no cover letter, and we do not know which party in the ca is filing the document. It is not sufficient that proof of service refer to an attached document, sin the document may not be attached in fact and sin it may become separated. It is not sufficient tha proof of service state that all creditors were serv This only leads to later argument about which list creditors was used for service. A proof of servi should contain a list of the parties who were actua served or should incorporate by reference a speci existing and recorded list.

We intend to start sending notices to att neys when we receive proofs of service whi appear to us to be defective. The notice will try identify the problem. The intent is to encoura attorneys to review the proof of service form whi they now use.

Mark Van Allsbu

ASSIGNMENT OF JUDGE NIMS'S CASES

The Bankruptcy Court has announced th following Judge Nims's retirement, it intends reassign his cases as follows:

Case Nos. Ending With	Judge
1, 2, 3	Gregg
4, 5, 6	Stevenson
7, 8, 9, 0	Howard

ANNOUNCEMENT OF BANKRUPTCY FRAUD TASK FORCE

William P. Barr, the Attorney General of the United States, has recently directed that the United States Attorney's Office, the Federal Bureau of Investigation, and the Office of the United States Trustee designate individuals who are to be responsible for the investigation and prosecution of bankruptcy fraud. Accordingly, the United States Attorney's Office for the Western District of Michigan has established the Bankruptcy Fraud Task Force. This group will focus on existing and newly referred cases in a concerted effort to address bankruptcy fraud. Any questions or referrals for the Bankruptcy Fraud Task Force should be directed to one of the following people: Janice Kittel Mann, Assistant United States Attorney, United States Attorney's Office (456-2404); Orin T. Sprague, Special Agent, Federal Bureau of Investigation (456-5489); or Daniel J. Casamatta, Assistant United States Trustee, Office of the United States Trustee (456-2002).

STEERING COMMITTEE MEETING MINUTES

A meeting was held on June 19, 1992 at noon at the Peninsular Club. Present: Mark Van Allsburg, Andrew Vera (law clerk to Judge Lawrence E. Howard), Brett Rodgers, Patrick Mears, Robert Sawdey, Thomas Schouten, Joseph Ammar, Janet Thomas, and Marcia Meoli.

Arrangements were discussed for Judge Nims's retirement party at Egypt Valley Country Club on Wednesday, September 30, 1992. The party will be publicized through the Bankruptcy Law Newsletter and the Grand Rapids Bar Association Newsletter.

Registration for the 1992 Bankruptcy Seminar in Traverse City is running about the same as last year at this time. The seminar will be publicized in the Grand Rapids Bar Association Newsletter in addition to the Bankruptcy Law Newsletter.

Work is taking place on revisions to the local bankruptcy rules. The status of furnishing the attorneys' conference room was also discussed. In addition, it was decided that an index of past Newsletter articles will be prepared.

There being no further matters coming before the Committee, the meeting was adjourned. The next regular meeting of the Steering Committee will take place on Friday, September 18, 1992 at noon at the Peninsular Club. If necessary, a meeting of the Seminar planning committee will be specially called in July.

EDITOR'S NOTEBOOK

Chapter 7 Trustees were understandably disturbed by a prior decision of a circuit court in Wisconsin that a Chapter 7 Trustee could be personally liable for violating Wisconsin's Hazardous Waste Management Act. In that case, the Trustee failed to apply for a required license to store hazardous waste. On appeal, the Wisconsin Court of Appeals held that the Trustee could be personally liable, but only for knowing and intentional violations of the act. Now, in a decision after further appeal, the Supreme Court of Wisconsin has held that since the Trustee was acting in his official capacity and within the scope of his authority when he violated the Wisconsin Hazardous Waste Management Act, the Wisconsin courts did not have jurisdiction over an action brought against him in his personal capacity. State v. Better Brite Plating, Inc., (Wis.), 1992 WL105598. Although 28 U.S.C. § 959(b) requires that Trustees must comply with state law when managing and operating property in their possession as Trustees, suit was allowable against Trustees only in their official capacities, without leave of the appointing court, for acts done

in "carrying on business" connected with the property in trust. If the Trustee was not "carrying on business," the Trustee may be sued in his official capacity in state court only upon leave of the appointing court. In neither alternative may he be sued personally, held the Wisconsin Supreme Court. Therefore, it appears that justice was eventually done, but presumably at great personal expense to the Chapter 7 Trustee.

The Supreme Court recently granted cert in the case of U.S. By and Through Internal Revenue Service v. McDermott, (Docket No. 91-1229), 1992 WL 24270. McDermott will present the Supreme Court with the question of the priority of federal tax liens in the proceeds of the sale of real property vis-a-vis a judgment creditor's lien in after-acquired property. In the case below, McDermott v. Zions First National Bank, N.A., 945 F.2d 1475, the Tenth Circuit ruled that the judgment creditor's lien had priority even in after-acquired property.

Elsewhere in this Newsletter is the annou ment of a dinner in honor of Judge David E. Nim Jr. on his retirement. Judge Nims's retirement mark the passing of an era. There are few attorn in the Western District who can claim to have b in practice before Judge Nims's appointment: assumed the bench in 1955. Virtually all of us h had our careers shaped in some manner by Ju Nims. He has worked long hours and issued m precedent-setting opinions, yet has maintained ar of civility, respect, and good humor in his co We often hear lawyers from outside the Wes District comment on how much they enjoy practi here. Judge Nims has been in large part respons for those qualities that make the bankruptcy prac in this district so attractive.

Thomas P. S

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the United St Bankruptcy Court for the Western District of Michigan (Lower Peninsula) during the period from January 1, 1 through May 31, 1992. These filings are compared to those made during the same period one year ago and years ago.

	1/1/92-5/31/92	1/1/91-5/31/91	1/1/90-5/31/
Chapter 7	2,408	2,222	1,694
Chapter 11	49	74	61
Chapter 12	11	7	6
Chapter 13	702	747	676
	3,170	3,050	2,437

FOURTH ANNUAL BANKRUPTCY SECTION SEMINAR
AUGUST 13-15
PARK PLACE HOTEL, TRAVERSE CITY, MICHIGAN

Presented by: Federal Bar Association of Western District of Michigan - Bankruptcy Section

THURSDAY, AUGUST 13, 1992

5:00-7:00 p.m.	Early Registration at Park Place Hotel
7:00 p.m. - ??	Cocktail Party - Presidential Suite 9th Floor

FRIDAY, AUGUST 14, 1992

7:45 - 8:00 a.m.	Registration - Coffee and Sweet Rolls
Session I 8:00 - 9:15 a.m. (Choose One)	**CURRENT CHAPTER 11 ISSUES** Timothy Curtin, Thomas Schouten, James Vantine, Jr. **CHAPTER 13 ISSUES** Roger Bus, Carol Chase, John Educato
Session II 9:30 - 10:45 a.m. (Choose One)	**TAXATION IN BANKRUPTCY** Robert Mollhagen, William Napieralski, Terry Zabel **DIVORCE AND BANKRUPTCY** Marcia Meoli, Janet Thomas, Thomas VanMeter
Session III 11:00 - 12:30 p.m. (Choose One)	**CRISIS MANAGEMENT - FINANCIAL CONSIDERATIONS** Dick Beal, Van Conway, James Frakie **CHAPTER 7 ISSUES** James Boyd, Robert Hendricks, Robert Wright
1:45 - Tee Off	Golf Outing at High Pointe Golf Club

SATURDAY, AUGUST 15, 1992

8:00 - 9:30 a.m.	**BREAKFAST MEETING** Speakers: Honorable Robert Ginsberg, United States Bankruptcy Court Northern District of Illinois Honorable Robert D. Martin, United States Bankruptcy Court Western District Wisconsin
9:45 - 11:00 a.m.	**6TH CIRCUIT REVISITED** Honorable Laurence E. Howard, Honorable Jo Ann C. Stevenson, Patrick E. Mears, Timothy Curtin
11:15 - 12:00 Noon	**OPEN FORUM:** Judges, Daniel Casamatta-Assistant U.S. Trustee; Mark VanAllsburg-Clerk of the Court; other experienced Trustees and/or practitioners

No Afternoon Programs

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Park Place Hotel reservations must be made before July 1, 1992, by using the reservation form enclosed. Please contact **Park Place** directly regarding day care and reservation details (1-800-748-0133). Alternate beach front rooms are available for $88-$188.00 per night at the brand new **Grand Beach Resort Hotel** by calling (616-938-4455) by June 6, 1992. Also, alternate rooms may be available for $110-$170.00 per night at the **Grand Traverse Resort** by calling (1-800-748-0303) by July 13, 1992.

The **Annual Golf Outing** will be a Scramble on Friday afternoon, August 14, at the **High Pointe Golf Club** with Tee-Times from 1:45-3:00 p.m. To register, mark yes on the registration form, then call High Pointe at (1-800-753-7888) and give them your handicap and credit card number to guarantee you reservation. The price is $44.00 for 18 holes including cart, limit of 50 players.

To register for a Friday afternoon **Canoe Outing**, call Mark VanAllsburg at (616-456-2693) and mark yes on the registration form.

If you have any questions, please call Dona (Chapter 13 Trustee's Office) at (616) 732-9000.

****

REGISTRATION FORM - PLEASE RETURN BY 7-1-92

Name _____ Address _____

Firm _____

Telephone _____

To reserve a place at the seminar, you **must** enclose a check payable to **Federal Bar Association (FBA)**, c/o Brett N. Rodgers, Chairman Bankruptcy Section, 1122 Leonard Street NE, Grand Rapids, MI 49503, for:

_____ $105.00 fee for FBA Member _____ $125.00 fee for Non-Member

Please choose one topic for each Friday Workshop Session:

Workshop Session I	_____	Ch 11 Issues	or	_____	Ch13 Issues
Workshop Session II	_____	Taxation	or	_____	Divorce
Workshop Session III	_____	Crisis Man.	or	_____	Ch 7 Issues

Please indicate your choice of the Golf Scramble and/or Canoe Trip and the number in your party:

Golf Scramble _____ No._____ Canoe Trip _____ No._____

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