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HOTEL REVENUES AS CASH COLLATERAL IN BANKRUPTCY CASES* Part Two

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III. Hotel Revenues as Real Property Rent

A minority of reported decisions have concluded that hotel revenues are rent. See Everett Home Town, 146 B.R. at 457-58; S.F. Drake I, 131 B.R. at 159-61; S.F. Drake II, 147 B.R. at 539; Morning Star Ranch Resorts, 64 B.R. at 821-23. Of these decisions, the S.F. Drake I court has the most detailed discussion regarding hotel revenues and its personal property and real property characteristics.[6]

In holding that hotel revenues are rent and not accounts under California law, the S.F. Drake I court acknowledged that: (1) there is a difference between the rights and duties of a tenant versus the rights and duties of a lodger; and (2) that a California statute termed the compensation for the occupancy of a hotel room a "rate." Yet, the court concluded such distinctions did not compel the conclusion that hotel revenues are accounts instead of rents. 131 B.R. at 159. The court relied heavily on the fact that both hotels and apartments provide "shelter" for their occupants.

> The Ashkenazy court concluded that hotel revenue is generated from the provision of services. Certainly hotels provide service, but so also do apartment and office buildings. Any services that a hotel provides are incidental to room occupancy. The hotel guest's primary objective is shelter. That shelter is provided by the land and improvements of the hotel. A hotelier cannot operate a hotel without the real property and improvements, no matter what the extent of the services provided.

Id. (footnote omitted).

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* Editor's note: The following article is the second of two parts. In part one, which appeared in the June issue of the Newsletter Doug Lutz discussed the general issue and those cases holding that hotel revenues are personal property subject to perfection under Article 9 of the UCC. In Part Two, Mr. Lutz reviews those cases following the minority rule that hotel revenues are rents and argues that Michigan courts should follow the minority position.

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The S.F. Drake I court distinguished a BAP opinion regarding the operation of a nursing home. See In re Hillside Assocs., Ltd. Partnership, 121 B.R. 23 (Bankr. 9th Cir. 1990). The Hillside Assocs. court held that nursing home revenues are not rent because the patients' residence is incidental to the fact that the nursing home provides health care services. "By contrast, the generation of hotel room revenue is not predominated by services. Rather, it is primarily derived from occupancy of the real property." 131 B.R. at 159.

The court next discussed policy reasons why hotel revenues are rents rather than accounts:

> There is logical appeal in the suggestion that revenue generated from occupancy of real property, for residential use, is rent. Why should the length of stay - a day, a week, a year - determine the validity of the parties' security agreement.
>
> It is important to note that, if room revenues are not rents, an agreement to that effect is never valid. Bankruptcy, or no bankruptcy, the inclusion of hotel room revenues in a rents, issues, and profits clause will always be void. However, if the room revenues are accounts, then the hotel owner who files [Chapter 11] is suddenly freed from the pre-petition consensual security interest by operation of § 552(a). This emancipation is not available to a debtor who collects rents by operating the real property of the bankruptcy estate as an apartment house or office building. Is the hotel operator more deserving? . . .
>
> . . . The validity of security agreements should not be contingent upon such vagaries as the length of occupancy or the extent of services provided. Revenues generated by the residential occupancy of real property should be "rents", without reference to the term of occupancy or level of services.
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> The term "account" is unsuitable for hotel room revenues. The operator of a hotel undoubtedly maintains an account for each occupant, as do operators of apartment and office buildings. As a practical matter, a time will come when the owner is entitled to be compensated. . . . That generic use of the term "account" does not compel the conclusion that hotel room revenues are accounts for U.C.C. purposes.
>
> Hotel room revenues are, or resemble, rents in that they are a primary component used by appraisers in valuing a hotel. The value of the income stream, rents, is a major factor in determining the value of the real property. To subtract room revenue from the consensual real property security greatly reduces the value of the creditor's collateral package.

Id. at 160.[7] The S.F. Drake II court acknowledged the majority decisions but affirmed the S.F. Drake I court's "common sense interpretation" of the issue 147 B.R. at 539.

IV. How Will a Michigan Bankruptcy Court Rule?

There is Michigan precedent consistent with part of the majority of jurisdictions' analysis. In Michigan, "a lease gives the tenant possession of the property leased and exclusive use or occupation of it for all purposes not prohibited by the terms of the lease." Macke Laundry Serv. Co. v. Overgaard, 17 Mich. App. 250, 253 (1988) In contrast, a licens permits a licensee to do an act or series of acts o the property without any permanent interest in th land. Id. at 254. Therefore, in Michigan, as in mo jurisdictions, the major difference between a tena and a licensee is the interest in property attained. tenant receives an estate in property. A licens

receives permission to use the property for a specific purpose.

The Michigan courts have also addressed the status a hotel customer receives upon occupying a room. "One of the essential elements of the innkeeper-guest relationship at common law was that the person to whom accommodation was extended must be a transient, coming to the inn for more or less a temporary stay." Brams v. Briggs, 272 Mich. 38, 41 (1935) (emphasis added). Because the majority of hotel customers are transients using the property for a temporary stay, it can be argued that in Michigan the normal hotel customer is considered a guest. A hotel guest is a licensee, entitled only to temporary use of property without acquiring any proprietary interest. See Layton v. Seward Corp., 320 Mich. 418, 423-25 (1948)

In Michigan, the regulation of hotels is governed by statutory law. See MCLA §§ 427.1-.15, 427.101-.102, 427.201-.206. The Michigan statute does not, like other jurisdictions, title charges for hotel room occupancy "rates". Therefore, the statute itself does not specifically distinguish between charges for hotel room occupancy and rent.

A Michigan bankruptcy court could, after a review of state law, decide to follow the majority's conclusion that hotel revenues are accounts based upon common law innkeeper/guest principles. Michigan state law partially comports with the analysis of the majority, that hotel revenues are personal property because of common law innkeeper/guest and landlord/tenant principles, the plain meaning of U.C.C. § 9-104(j), and the differences between state landlord/tenant and hotel statutes.

However, this author believes the more well reasoned approach is to follow the minority's "common sense interpretation" that hotel revenues are rent.[9] At its core, "rent" is payment for the use, occupancy, and/or possession of property. See Munson v. County of Menominee, 371 Mich. 504, 513 (1963); J. Cameron, Michigan Real Property Law § 20.45 (1985); Black's Law Dictionary 1297 (6th ed. 1990); The Random House College Dictionary 1118 (1973). "Rent is the amount agreed to be paid for the use and enjoyment of land, and the occupation of the land is the consideration for it." Stott Realty Co. v. United Amusement Co., 195 Mich. 684, 690 (1917). A hotel guest clearly uses, occupies, and temporarily possesses a portion of a hotel's premises during his/her stay. The payment the hotel guest makes for the right to use, occupy, and possess the property falls within the broad definition of rent. Therefore, a Michigan bankruptcy court could just as easily determine that hotel revenues are rent without having to jump through the legal hoops presented by the majority.

An even more important consideration than attempting to manipulate the concept of "hotel revenues" into the definitions of "accounts" or "rents" is an analysis of the basic question -- what did the parties bargain for? The reported decisions have engaged in verbal fisticuffs regarding whether hotel revenues should be analyzed from a "service" or "shelter" view. The most important "view", for cash collateral purposes, should be the "view" of the parties to the agreement at the time it was executed. What was the parties' intent when the assignment of rents or mortgage, with an assignment of rents clause, was executed? Did they envision that hotel revenues would be included in any assignment of rents? Unless very unusual circumstances exist, the answer must be that the parties intended to include the hotel revenues as part of the collateral package. See S.F. Drake I, 141 B.R. at 161. The Bankruptcy Code, and all equity powers thereunder, should not be used to deprive a lender a portion of its collateral when state law does not conclusively endorse such action.[10] Cf. T. Jackson, The Logic and Limits of Bankruptcy Law 22 (1986) (bankruptcy law should not create rights but should vindicate rights that exist prepetition). Therefore, courts should conclude that postpetition hotel revenues are rents and cash collateral unless there is persuasive evidence the parties intended otherwise.

Endnotes

6. The Morning Star Ranch Resorts opinion is interesting because the court seems to assume that hotel revenues are rents subject to the Colorado assignment of rents statute. Although there is an excellent analysis of whether the creditor adequately

perfected its assignment of rents under state law, there is no discussion regarding the personal property or real property characteristics of hotel revenues. See 64 B.R. at 820-23. Subsequent Colorado bankruptcy courts have criticized Morning Star Ranch Resorts. See Sacramento Mansion, 117 B.R. at 605; M. Vickers, Ltd., 111 B.R. at 335.

7. It is important to note that the S.F. Drake I court decided the hotel revenues issue one month after the Ninth Circuit BAP ruled, with no discussion, that hotel revenues are personal property accounts under California law, subject to Article 9 perfection. Northview Corp., 130 B.R. at 546 n.4. The S.F. Drake I court does not discuss or acknowledge the existence of the BAP decision. However, in affirming S.F. Drake I, the District Court for the Northern District of California declined to follow Northview Corp. because it was unpersuasive and not binding precedent. S.F. Drake II, 147 B.R. at 539.

8. As in other jurisdictions, in Michigan, depending on the factual circumstances, a normal hotel customer's status as a guest may be elevated. See Layton v. Seward Corp., 320 Mich. at 424 (determination whether a person is a guest depends on the facts; whether payment is made daily, weekly, or monthly is only one fact to consider); R.L. Polk & Co. v. Melenbacker, 136 Mich. 611, 613-14 (1904) (fact that hotel guest was charged a weekly rate did not change his status as a guest); see also MCLA § 427.207 (leases of greater than two months are excluded from Michigan' Innkeeper's Lien Act).

9. Current Senate Bill 540 concurs with the "common sense interpretation." There is a specific provision protecting postpetition interests in "rents or fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels or other lodging properties" without regard to whether the interest is perfected under state law. S. 540, 103rd Cong., 1st Sess. § 206 (1993).

10. A review of all decisions in the majority evidences a struggle with state law in an attempt to determine whether hotel revenues are accounts or rents. The majority courts have pieced together an analysis of state law focusing on U.C.C., landlord/tenant, licensees and accounts. However, not one decision gives the unequivocal answer that in their jurisdiction the state courts have determined hotel revenues are accounts. Therefore, these courts are forced to make the legal extrapolation that hotel revenues are accounts with no compelling precedent.

RECENT BANKRUPTCY DECISIONS

The Recent Bankruptcy Decisions for the Supreme Court and Sixth Circuit are summarized by John A. Potter; the Western District of Michigan bankruptcy and district court opinions are summarized by Vicki S. Young; and the Eastern District of Michigan bankruptcy and district court decisions and relevant State of Michigan cases are summarized by Jaye M. Bergamini. Larry Ver Merris assists in the preparation of the case summaries.

U.S. Dept. of Treasury* v. *George Fabe, Superintendent of Insurance of Ohio, 61 U.S.L.W. 4579 (S. Ct. June 11, 1993)

In April of 1986 an Ohio state court declared American Druggists' Insurance Company insolvent and directed respondent, George Fabe, Superintendent of Insurance of Ohio, to serve as liquidator. The United States, as obligee on various bonds issued by the company, filed claims exceeding $10 million in the state liquidation proceedings, asserting first priority pursuant to 31 U.S.C. § 3713(a)(1)(A)(iii). This federal statute provides that "A claim of the United States Government shall be paid first when . . . a person indebted to the government is insolvent and . . . an act of bankruptcy is committed."

Fabe sought declaratory relief in federal court to establish that the Ohio priority statute is exempted from preemption by the federal priority statute under the McCarran-Ferguson Act. The Ohio law prioritizes claims as follows: (1) administrative expenses; (2) specified wage claims; (3) policy

holders' claims; (4) general creditors' claims; and (5) federal, state, and local government claims.

The district court granted summary judgment for the United States, concluding that the Ohio priority statute does not involve the "business of insurance" as standardized in Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1982).

The Sixth Circuit reversed, holding that the Ohio law regulates the "business of insurance" because it protects an insured's interest by spreading or diverting the risk of insolvency among other creditors. 939 F.2d 341 (6th Cir. 1991). Certiorari was granted to resolve the conflict among the courts of appeals.

In its opinion, the Supreme Court stated that the McCarran-Ferguson Act was enacted in response to its opinion in U. S. v. Southeastern Underwriters Assn., 322 U.S. 533 (1944). Southeastern held that "an insurance company that conducted a substantial part of its business across state lines was engaged in interstate commerce and thereby subject to [federal] antitrust laws." Previously, it had been assumed that issuing an insurance policy was not a transaction in commerce. Consequently, in response to the states' fears that their power to regulate insurance was being eroded, Congress enacted the McCarran-Ferguson Act. This Act's purpose was to give support to the states' traditional role of regulating the "business of insurance."

The Court then reasoned that "statutes aimed at protecting or regulating this relationship [between insurer and insured], directly or indirectly, are laws regulating the "business of insurance.'" SEC v National Securities, Inc., 393 U.S. 453, 460 (1969). Thus, to the extent the Ohio statute regulates policy holders, it is a law enacted for the purpose of regulating the "business of insurance." Accordingly, the federal priority statute must yield to the conflicting provisions of the Ohio statute to the extent it furthers policy holders' interest. However, to the extent the statute furthers the interests of other creditors, it is not a law enacted for the purpose of regulating the business of insurance.

Furthermore, the preference accorded administrative expenses for the insolvency proceedings is deemed necessary to further the goal of protecting policy holders. In contrast, preferences conferred upon employees and general unsecured creditors do not escape preemption, since their connection to the ultimate aim of insurance is too tenuous. Affirmed in part, reversed in part and remanded for further proceedings.

U.S.* v. *WRW Corp., et al., 986 F.2d 138 (6th Cir. 1993)

In 1985, civil penalties of $90,350 were assessed against the defendant WRW Corporation for violating the Federal Mine Safety and Health Act. Afterwards, WRW liquidated its assets and ceased doing business.

Three individual defendants, who were WRW's sole shareholders, officers, and directors, were then indicted and convicted for willful violations of the Act. Later, the United States sought to recover the civil penalties imposed on WRW from the individual defendants personally liable for the penalties.

One of the defendants, after release from prison, filed a Chapter 7 bankruptcy and listed his liability for the civil penalty as a dischargeable debt. The district court granted the United States summary judgment on this issue, holding that the penalties were nondischargeable debt.

The district court also denied defendants' motion to dismiss the action because the imposition of the civil penalty following criminal convictions violated the Fifth Amendment's double jeopardy clause, which prohibits multiple punishments for the same offense.

In affirming the district court's decision denying Defendants' motion, the court of appeals considered whether the civil penalty was excessive in relation to its remedial goal of ensuring safe mining practices to the extent of being a second punishment. In its reasoning, the appellate court, citing the Halpern decision, concluded that the penalty assessment was "not so extreme and

divorced from the United States' expenses in" investigating and prosecuting defendants. United States v. Halpern, 490 U.S. 435 (1989). In other words, the government is entitled to "rough remedial justice" in the form of compensation, without being deemed to have imposed a second punishment.

The court of appeals also affirmed the district court's decision that the civil penalty against one defendant was not dischargeable in bankruptcy under 11 U.S.C. § 523(a)(7).

That defendant's most viable argument was that the debt did not fall under § 523(a)(7) because the district court's decision implied that the civil penalty did not compensate the government for actual pecuniary loss. Furthermore, the doctrine of judicial estoppel should bar the United States from arguing that the debt is not compensation for actual pecuniary loss under § 523, since it previously argued that the debt compensates the government for investigatory and prosecutorial expenses.

The court of appeals accepted the government's argument that the debt has a remedial compensatory purpose because it results in rough repayment of prosecutorial and investigative expenses, but is not compensation for actual pecuniary loss since the size of the penalty is not derived from a showing of actual loss. Instead, the penalty is based on the Act's remedial purpose of promoting mine safety. Accordingly, there was no actual pecuniary loss to the Government in the traditional sense, but only prosecutorial and investigative expense.

In re Michigan Lithographing Company (Owen-Ames-Kimball Co. v. Michigan Lithographing Co., et al.), Case No. 92-2035 (6th Cir., July 2, 1993).

For the reasons set forth in the Opinion of Judge Stevenson in Owen-Ames-Kimball Co. v. Michigan Lithographing Co., 140 B.R. 161 (Bankr. W.D. Mich. 1992), the Sixth Circuit held that failure to record a notice of lis pendens on a timely recorded construction lien does not render the construction lien unenforceable against a bankruptcy trustee with bona fide purchaser status under 11 U.S.C. § 544 (a)(3)

In re Norbert Arango, 992 F.2d 611 (6th Cir. 1993).

In April 1991, the defendant, Third National Bank in Nashville, received a $87,283.82 judgment against the plaintiff-debtor, Norbert Arango. The bank recorded the judgment as a judicial lien against Arango's property. In September, Arango filed a Chapter 7 petition and claimed as exempt all property held as tenants by the entirety. This entireties property included three parcels of real property, personal property, stocks, and checking accounts.

Arango then initiated an adversary proceeding pursuant to 11 U.S.C. § 522(f) to avoid the bank's judicial lien. The bankruptcy court denied Arango's request to avoid the bank's lien, and the district court affirmed.

Under Tennessee law husband and wife hold jointly a present possessory interest in entireties property. Individually, each spouse possesses right of survivorship. Accordingly, each spouse, without the consent of the other, may convey his or her right of survivorship. Third Nat'l Bank v. Knobler, 789 S.W.2d 254 (Tenn. 1990). Therefore, in order to convey marketable title, if the survivorship interest is held by a third party, both spouses and the third party must consent. Consequently, Arango argued that under 11 U.S.C. § 522(f)(1), he should be able to avoid the bank's lien on his survivorship interest, since it impairs his wife's and his ability to convey a present possessory interest.

The court of appeals affirmed the district court, reasoning that even if one spouse conveys away his or her survivorship interest, they still can convey the entire interest they hold, i.e., the "joint right to the use, control incomes, rents, profits, usufucts, and possession" of the entireties property. Therefore, the bank's lien does not impair Arango's present possessory interest in the property, because it cannot foreclose its lien against such interest under Tennessee law.

United States v. *Sherman Sharpe*, Case No. 92-1984 1993 U.S. App. Lexis; 1993 WL 195775 (6th Cir., June 11, 1993).

In December of 1986, defendant Sherman Sharpe, an attorney and Chapter 7 trustee for the Eastern Division of Michigan, was appointed trustee for the estate of Jim's Garage, a Detroit restaurant. Over a 16-month period beginning in December, 1987, Sharpe issued checks from the estate to himself totaling $80,000. These checks were not used to pay estate expenses. Sharpe eventually returned the $80,000 to the estate plus $14,138.59, which supposedly represented earnings on investments made with the funds. In December, 1991, Sharpe was charged with 12 counts of embezzlement under 18 U.S.C. § 153, 12 counts of conversion under 18 U.S.C. § 645, and one false statement under 18 U.S.C. § 1001.

After trial Sharpe was found guilty on all the conversion charges under 18 U.S.C. § 645 and acquitted of the false statement charge. The district court judge directed a verdict with respect to the embezzlement charges under 18 U.S.C. § 153, because the government had not established fraud.

In his appeal, Sharpe contended, *inter alia*, that § 645 requires more than wrongful conversion, it requires fraudulent intent.

In affirming the district court's decision, the court of appeals stated that § 645 provides a statutory definition for "embezzlement" and does not rely on common law definition. Accordingly, § 645 does not require proof of fraudulent intent.

In re Howard P. Batie, Case No. 92-6037, 1993 U.S. App. Lexis 12847; Bankr. L. Rep. (CCH) P75,278 (6th Cir., June 2, 1993).

In 1985, the defendant-debtor, Howard P. Batie and a corporation wholly owned by him, purchased a Boeing 727 from the plaintiff-creditor, Investors Credit Corporation. As a condition of the sale, the creditor required Batie and his corporation to warrant that they had a net worth of at least $2 million. At the sale closing, Batie provided financial statements that he and his corporation each had a minimum net worth of $2 million. In fact, neither party had a net worth of $2 million, and Batie knew it at the time the financial statements were provided to Investors Credit. Batie and his corporation eventually defaulted on the loan.

In December, 1989, Investors Credit obtained a $1 million judgment against Batie in federal district court following a jury verdict for fraud and breach of contract. In May, 1990, Batie filed a Chapter 11 petition. Investors Credit then filed an adversary proceeding claiming that Batie's debt was nondischargeable under 11 U.S.C. § 523(a)(2)(B). This section of the Bankruptcy Code provides that a debt is not dischargeable if the loan was obtained by a writing "(i) that is materially false; (ii) respecting . . . the debtor's financial condition; (iii) on which the creditor . . . reasonably relied; and (iv) that the debtor . . . published with intent to deceive."

Investors Credit then filed a motion for summary judgment, arguing that Batie was collaterally estopped by the district court jury verdict to contest whether the elements of § 523(a)(2)(B) had been met. Following further briefing and argument on the issue of whether Batie had the requisite "intent to deceive" under § 523(a)(2)(B)(iv), the bankruptcy court granted Investors Credit's motion. It was upheld by the district court.

On appeal, Batie argued that he did not believe the creditor would rely on the financial statements and submitting them was a mere formality. Consequently, he did not have an "intent to deceive" under § 523(a)(2)(B)(iv).

The court of appeals, in affirming, the lower court decision, held that summary judgment would be inappropriate if "intent to deceive" only included a subjective intent to have another party rely on false financial statements, but that the requirements of § 523(a)(2)(B)(iv) is met if a debtor is reckless when submitting financial statements that he knows are not true. In re Martin, 761 F.2d 1163 (6th Cir. 1985).

In re Cook, Case No. 1:92-CV-895 (W.D.) Mich. June 23,1993).

Judge Bell summarily affirmed Judge

Howard's decision reported at 148 B.R. 273 (Bankr. W.D. Mich. 1992), which modified the debtors' Chapter 12 plan to include the debtors' post-confirmation lottery winnings as income to be distributed to creditors under the plan.

In February 1990, the bankruptcy court confirmed the debtors' Chapter 12 plan, which provided a 10 percent dividend to unsecured and undersecured creditors. In August 1992, the debtors won $6 million in the Michigan lottery. Upon their receipt of the first annual winnings payment, the debtors paid off their plan. The Chapter 12 Trustee, the United States Trustee, and Old State Bank each moved for modification of the debtors' plan under 11 U.S.C. § 1229 to provide a 100 percent dividend to creditors. Judge Howard held that under the unusual circumstances of the case the modification must be granted.

On appeal, the debtors argued that the modification to their plan should be denied because: (1) the lottery winnings are not property of the estate, and therefore cannot be considered for the modification; (2) the lottery winnings cannot be a basis for the modification under § 1229; (3) the motions for modification were untimely; (4) even with the lottery winnings, the increase in the debtors' income was not sufficient to warrant the modification; and (5) the movants were estopped from seeking the modification in light of the confirmation.

Judge Bell held that none of the debtors' arguments was meritorious. The court noted that Judge Howard's extensive and thoughtful opinion had already fully addressed the issues raised by the debtors, and that on appeal the debtors failed to present more persuasive arguments.

In re Zimmerman, Case No. SG 91-86620; ***In re Neuman,*** Case No. SG 92-01892 (Bankr. W.D. Mich. July 6, 1993).

The court consolidated these cases and issued an en banc opinion holding that claims that are filed late in Chapter 13 cases must be disallowed, rejecting the decision in In re Hausladen, 146 B.R. 557 (Bankr. D. Minn. 1992).

In Zimmerman, the debtor objected to the Michigan Department of Treasury's claim for unpaid taxes, which the state filed almost five months late. The state, relying on Hausladen, argued that its claim should be allowed. In Neuman the debtor objected to the Internal Revenue Service's claim for unpaid taxes, which the IRS filed over four months late. The IRS, relying on Hausladen and allegations of insufficient notice of the bankruptcy filing, argued that its claim should be allowed.

The court's analysis of whether the claims should be disallowed turned on its interpretation of 11 U.S.C. §§ 501, 502 and Fed. R. Bankr. P. 3002. The court noted that under § 502, a proof of claim filed under § 501 is deemed allowed unless an objection is filed. Further, the court noted that "the merits of a claim will be analyzed under § 502 only if the claim meets § 501's requirements." Section 501 is silent as to the time within which a proof of claim must be filed, but contemplates the procedural requirement of a time limit. The court held that this procedural void is filled by Fed. R. Bankr. P. 3002, which specifies the time for filing claims and requires that claims be filed in accordance with its provisions. The court reasoned that § 502 addresses the substantive matters concerning claims, whereas Fed. R. Bankr. P. 3002 complements § 502 by providing the procedure for filing claims.

To further clarify the issue, the court differentiated between the terms "disallowed" and "barred" claims. The court specifically adopted the practice of using the term "bar" to describe claims that are not filed according to the procedural requirements under Fed. R. Bankr. P. 3002 and using the term "disallow" to describe claims that are substantively defective.

In re Kuriakuz, 91-10669-R (Bankr. E. D. Mich., June 16, 1993).

A creditor appealed Judge Rhodes's denial of its motion to dismiss this Chapter 13 case pursuant to 11 U.S.C. § 109 (alleging that the debtor was not an individual with regular income sufficient to meet the requirement of 11 U.S.C. § 101), and his denial of the creditor's motion to dismiss based on bad faith. The creditor's bad faith claim rested, in part,

on the premise that its claim had been declared nondischargeable in a Chapter 7 proceeding in 1978. The district court affirmed in part and remanded for further findings of fact on the good faith issue under 11 U.S.C. § 1325.

On remand, the creditor offered testimony to show that, in the course of making a claim for wage losses against his insurance company shortly before filing, the debtor gave testimony about his interest and income from a grocery store held in his wife's name that was at variance with his bankruptcy statement of affairs. Judge Rhodes held the filing to be in bad faith and stated four factors which led to his decision: (1) the creditor's claim had previously been held nondischargeable on fraud grounds; (2) the discrepancies between the debtor's statement of income for his own benefit and that declared to his creditors demonstrated a continuing pattern of fraud and led the court to conclude that the debtor did not have a sincere and genuine intent to repay his creditors; (3) the plan originally proposed repayment of 7.7 percent, and the nondischargeable debt constituted 97 percent of the debt to be repaid; and (4) the debtor readily doubled his first proposed payments to the trustee when advised that the trustee routinely recommended denial of confirmation to any plan which proposed less than 10 percent repayment.

Uni-Products, Inc. v. ***Bearse***, AP #92-3134 (Bankr. E.D. Mich., April 23, 1993)

The debtor-in-possession sued to determine its ownership interest in a piece of manufacturing equipment. The DIP alleged that the seller was an unperfected, and therefore unsecured, creditor. The seller alleged that he intended to sell, but because of the DIP's financial troubles, specifically "retained title" in the machine until it was paid for in full. Judge Spector's 26-page opinion is a thorough review of the law of sale, delivery, and title to goods under UCC article 2. He finds that the transaction in the machine met all of the requirements of a sale, and none of the requirements of a bailment, lease, or any other arrangement by which the seller would purport to retain true title to the equipment pending payment in full. Accordingly, he found the seller to be an unperfected secured creditor and therefore subordinated to the DIP.

In re Kilpatrick, #91-20720 (Bankr. E.D. Mich., May 3, 1993)

Creditor moved for lift of stay against the Chapter 13 debtor based on the debtor's alleged post-petition violation of an injunction issued by the Shiawassee County Circuit Court. The creditor sought a declaration that the injunction of the circuit court, upholding a covenant not to compete and enjoining the debtor's business activities, was valid and enforceable. The creditor also sought lift of stay to return to circuit court and proceed against the debtor for contempt of court and enforcement of the circuit court order. The debtor attempted to "reject" the non-compete agreement as an "executory contract" on filing the Chapter 13 petition.

Judge Spector denied the motion for lift of stay. He dismissed the debtor's contention that the covenant not to compete was an executory contract subject to rejection under 11 U.S.C. § 365. He found that the creditor's rights under the covenant not to compete constitute a claim that might give rise to a right to payment; hence a claim under 11 U.S.C. § 101(5) (B).

The creditor argued collateral estoppel in that the circuit court had already determined money damages were not an adequate remedy and only injunctive relief would redress the creditor's claim. Judge Spector disposed of that issue by finding that the evidence presented by the creditor with regard to the circuit court record was inadequate to make out a conclusive case in favor of injunctive relief, and he threw the issue of the creditor's damages into an adversary proceeding to determine dischargeability.

The creditor also argued, and the judge rejected, that the stay should be lifted to allow the circuit court to pursue criminal contempt charges against the debtor. Judge Spector found that the Shiawassee County Circuit Court could hold the debtor in criminal contempt only if the claim on which the injunction was premised is declared to be nondischargeable.

NBD Bank v ***DeLeeuw***, AP 92-0373 (Bankr. E.D. Mich., May 13, 1993).

Plaintiff creditor filed a complaint to determine the dischargeability of a debt pursuant to 11 U.S.C. § 523(a)(2), (6). The debtor was the principal of a corporation that borrowed money from NBD and pledged its accounts receivable as collateral. Prior to the debtor's filing, NBD discovered that one of the corporation's major accounts was paying its bill by making its checks jointly payable to the corporation and certain of its unsecured trade creditors, with the knowledge and acquiescence of the debtor, in violation of NBD's lien rights. NBD sued the debtor in Wayne County Circuit Court. It ultimately obtained judgment on its complaint for fraud and conversion by default.

NBD filed a motion for summary disposition, alleging that the judgment it obtained, premised upon fraud and conversion, collaterally estopped the debtor from denying that the debt was non-dischargeable under 11 U.S.C. § 523(a)(2), (6). Debtor defended on the grounds that he filed his petition under chapter 7 before the 21-day appeal period had expired, and therefore the judgment of the circuit court was not "final." Judge Shapero rejected the debtor's contention that the judgment was not "final," as required to serve as the basis for collateral estoppel.

The debtor further contended that the judgment did not conclusively determine that the debt was based on fraud and conversion and therefore nondischargeable. He argued that the bankruptcy court had the right to inquire into the underlying facts which would form the basis of an action to determine dischargeability, since the state court judgment did not specifically address those issues with findings of fact.

Judge Shapero distinguished the doctrines of res judicata and collateral estoppel. He found that the state court judgment on those counts of the plaintiff's complaint which sounded in fraud, although taken by default, should be given collateral estoppel effect. Three factors led to the decision: (1) the plaintiff bank's complaint in circuit court was well pled, and it contained all the necessary factual elements to make out a case under 11 U.S.C. § 523(a)(2), (6); (2) the debtor failed to file an answer even after being granted a motion to set aside the first default and an extension of time in which to answer, all of which afforded the debtor a full and fair opportunity to respond to the allegations; and (3) the debtor's counsel knowingly "consented" to the entry of the default, evidenced by his statements to plaintiff's counsel the day before the hearing to enter the default judgment, that he did not object to the entry of the judgment because the debtor was going to file bankruptcy the next day.

ANNOUNCEMENT OF APPOINTMENT OF CHAPTER 7 TRUSTEE

The United States Trustee's Office is pleased to announce that Marcia R. Meoli has been named to the Western District of Michigan Chapter 7 Trustee Panel and will be assigned cases primarily in the Kalamazoo and Southwest Michigan area.

Ms. Meoli is a 1982 graduate of Loyola Law School and a 1979 graduate of U.C.L.A., both of Los Angeles, California. She is a shareholder in the law firm of Roper Bauer, P.C. of Zeeland, Michigan emphasizing bankruptcy, real estate and municipal law. Ms. Meoli was formerly an associate at McShane & Bowie of Grand Rapids emphasizing creditor bankruptcy and real estate law.

PUBLIC NOTICE APPLICATIONS FOR APPOINTMENT TO CHAPTER 7 PANEL OF TRUSTEES

The Office of the United States Trustee is now accepting applications for consideration for appointment to the chapter 7 panel of trustees to administer Chapter 7 bankruptcy cases filed in the United States Bankruptcy Court for the Western District of Michigan, Southern Division, **for the Grand Rapids, Michigan area.** The minimum qualifications for appointment are found in Title 28 of the Code of Federal Regulations, Part 58.

To be eligible for appointment, applicants must possess strong administrative, financial and interpersonal skills, as well as a working knowledge of the Bankruptcy Code. Fiduciary experience is preferred. A successful applicant would be required to undergo an FBI background check and must qualify to be bonded. Trustees receive compensation and expenses on cases in which they serve pursuant to 11 U.S.C. Sections 326 and 330.

ALL APPLICATIONS WILL BE CONFIDENTIAL AND SHALL BE RECEIVED AT THE ADDRESS LISTED BELOW ON OR BEFORE JULY 30, 1993:

Daniel J. Casamatta
Assistant U.S. Trustee
Office of the U.S. Trustee
190 Monroe, N.W., Ste. 200
Grand Rapids, MI 49503

PUBLIC NOTICE APPLICATIONS FOR APPOINTMENT TO CHAPTER 7 PANEL OF TRUSTEES

The Office of the United States Trustee is now accepting applications for consideration for appointment to the Chapter 7 panel of trustees to administer Chapter 7 bankruptcy cases filed in the United States Bankruptcy Court for the Western District of Michigan, Northern Division, **for the Upper Peninsula of Michigan.** The minimum qualifications for appointment are found in Title 28 of the Code of Federal Regulations, Part 58. To be eligible for appointment, applicants must possess strong administrative, financial and interpersonal skills, as well as a working knowledge of the Bankruptcy Code. Fiduciary experience is preferred. A successful applicant would be required to undergo an FBI background check and must qualify to be bonded. Trustees receive compensation and expenses on cases in which they serve pursuant to 11 U.S.C. Sections 326 and 330.

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Dan Casamatta
Assistant U.S. Trustee
190 Monroe, N.W., Ste. 200
Grand Rapids, MI 49503

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the Untied States Bankruptcy Court for the Western District of Michigan (Lower Peninsula) during the period from January 1, 1993 through June 30, 1993. These filings are compared to those made during the same period one year ago and two years age.

	1/1/93-6/30/93	1/1/92-6/30/92	1/1/91-6/30/91
Chapter 7	2,406	2,858	2,575
Chapter 11	59	63	84
Chapter 12	18	14	8
Chapter 13	723	829	880
	3,206	3,764	3,547

EDITOR'S NOTEBOOK

Senate Bill 1124 has been introduced in the United States Senate which would essentially codify the EPA's Lender Liability Rule, 40 C.F.R. §300.1100 (1992). (The EPA Lender Liability Rule is described in Vicki Young's article, "CERCLA Lender Liability Update," which appeared in the in the March, 1993 issue of this Newsletter.) The bill would also add a new Section 127 to CERCLA, limiting liability to the "actual benefit" conferred on a lender by a clean up action undertaken by another party.

This Newsletter is seeking a new editor. Bob Mollhagen, who was going to succeed me as editor, has now moved to the Bloomfield Hills office of Howard & Howard and will be resigning from the Steering Committee for the Bankruptcy Section of the Federal Bar Association Chapter for the Western District of Michigan. As a result of his move, Bob will be unable to take over as editor. If anyone is interested in taking over as editor, please contact Tom Sarb at 616/459-8311. The position requires approximately 5 to 10 hours of time per month, but has many rewards. Please feel free to call me if you wish to talk to me about it.

Finally I realize this edition of the newsletter is being mailed after the deadline for application for the open Chapter 7 trustee positions. Interested persons should contact Assistant U.S. Trustee Dan Casamatta to determine if applications will be accepted after July 30, 1993.

Thomas P. Sarb

Western Michigan Chapter of the
Federal Bar Association
250 Monroe Avenue, Suite 800
Grand Rapids, MI 49503

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