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BANKRUPTCY PROCEEDINGS: AN HISTORICAL PERSPECTIVE, EXCERPTS FROM BUMP'S LAW AND PRACTICE OF BANKRUPTCY (1877)

[Editor's Note: The following excerpts are taken from Orlando Bump's Law and Practice of Bankruptcy, published in 1877 by Daher, Voorhis & Co. The book was a treatise as well as a digest of all bankruptcy proceedings reported up to January 1, 1877. It is interesting to note similarities and differences with present law and practice. Perhaps of even more interest are the insights in the text to the social life of the latter part of the nineteenth century.]

COMMENCEMENT OF PROCEEDINGS IN INVOLUNTARY BANKRUPTCY

To warrant or justify the institution of such proceedings, the debtor must have done, or allowed to be done, something which the statute defines to be an act of bankruptcy. The statute was not intended to cover all cases of insolvency. It makes a discrimination between voluntary bankruptcy and involuntary bankruptcy. The debtor upon filing a voluntary petition setting forth his inability to pay his debts and his willingness to surrender all his estate, is declared a bankrupt by the court. The allegation can not be traversed, nor is any issue or inquiry as to its truth permitted. But while the debtor may on this broad basis call on the court to administer his estate, the creditor who desires to do the same thing is limited to a few facts or circumstances, the existence of which are essential to his right to appeal to the court. The reason for this wide difference in the proceedings in the two cases is obvious enough. When a man is himself willing to refer his embarrassed condition to the proper court, with a full surrender of all his property, no harm can come to any one but himself, and there can be no solid objection to the course he pursues. But when a person claims to take from another all control of his property, to arrest him in the exercise of his occupation, and to impair his standing as a business man, the precise circumstances on which he is authorized to do this should be well defined in the law. An act of bankruptcy is accordingly the special creature of statute law, and nothing is an act of bankruptcy unless it is expressly made so by the statute itself.

EXEMPTIONS

The exemptions which may be made are the necessary household and kitchen furniture, and such other articles and necessaries of such bankrupt as the assignee may designate and set apart, having reference in the amount to the family, condition, and circumstances of the bankrupt, but altogether not to exceed in value, in any case, the sum of five hundred dollars; and also the wearing apparel of such bankrupt, and that of his wife and children; and the uniform, arms, and equipments of any person who is or has been a soldier in the militia, or in the service of the United States; and such other property as now is, or hereafter may be, exempt from attachment or seizure, or levy on execution by the laws of the United States; and such other property not included in the foregoing exemptions, as is exempted from levy and sale upon execution or other process or order of any court by the laws of the State in which the bankrupt has his domicile at the time of the commencement of the proceedings in bankruptcy, to an amount allowed by the constitution and laws of

each State as existing in the year eighteen hundred and seventy-one.

As these provisions are founded upon the humane policy of providing means for the support of the poor man and his family, they are to be liberally rather than strictly construed; they should receive such fair construction as will best promote the beneficent intention of Congress.

The provision in regard to household and kitchen furniture is imperative on the assignee, though he must determine what furniture, under the circumstances, is necessary. The furniture, in order to be exempted, must be necessary. It can not be necessary, in the sense of the law, unless the bankrupt is a householder--the head of a family. He need not have a wife. His household may consist of servants, or any persons residing with him, and under his control. If he has an adopted daughter and her children living with him, but hires the servants, he is the head of the family, although he has neither wife nor children. These illustrations are enough to show what is intended when it is said that the bankrupt must keep house, or be the head of a family. It would make no difference whether he has a whole house or only a portion. If he has a wife or children, and furnishes his own rooms, he might still be entitled to the exemption, although he was merely boarding, for he would, even then, be the head of a family. It is not sufficient, however; that he be the head of a family merely. The furniture must also be necessary to him in his condition and circumstances. Only those articles are exempt which are necessary to enable him to keep house. This necessity need not be a stringent, imperative necessity. the statute does not so limit the exemption, nor declare that the articles must be strictly and indispensably necessary. The statute does not so limit the exemption, nor declare that the articles must be strictly and indispensably necessary. Those articles may be considered necessary which are commonly used among men of moderate means in that community. The articles and the amount will, of course, both vary, according to the locality and the business of the bankrupt. What would be necessary of a farm would not be necessary in a city, and vice versa. If he had furniture to the amount of $500, it would probably be exempt to that amount. Furniture to the amount of $355 has been declared little enough. The fact that the bankrupt's wife has furniture which is her separate property does not affect the question, for it is not the policy of the statute to leave him dependent upon her for the means necessary to enable him to keep house.

The assignee must look to the policy and spirit of the law. This allowance is to be made with reference to the family, condition, and circumstances of the bankrupt. In considering the family, he must have regard to the number composing it; in inquiring after the condition, he must ascertain the social status, and whether ill health prevails or not; and, in regard to the circumstances, he must inquire how the bankrupt is employed, what his income is, how many of the family earn their own living, whether they contribute to the support of the others, and also how much and what property he is entitled to absolutely and unconditionally. The phrase, "other articles and necessaries," is an indefinite expression. It must, however, be construed as limited by the context, and as relating to things not precisely furniture or wearing apparel, but manifestly useful to the individual or his family in a like sense. It does not include articles of mere fancy, taste or convenience. It may include family pictures, keepsakes, and many other things of small value. It may also include provisions, money, a sewing machine, the tools of a tradesman, the books of a professional man, the auction stand and flag of an auctioneer, a cow, silver spoons, and a moderate quantity of material for carrying on a trade, but not land, or gold watches or pianos or other articles of mere luxury or ornament, or a pew, or clock, or desks, or a fowling-piece, fishing tackle, breastpin or paintings, or manufactured articles kept for sale.

EXAMINATIONS

The district court may, on the application of the assignee in bankruptcy, or of any creditor, or without any application, at all times require the bankrupt, upon reasonable notice, to attend and submit to an examination. The district court may, in like manner, require the attendance of any other person as a witness. For good cause shown, the wife of any bankrupt may be required to attend before the court, to the end that she may be examined as a witness; and if such wife do not attend at the time and place specified in the order, the bankrupt will not be entitled to a discharge unless he proves to the

satisfaction of the court that he was unable to procure the attendance of his wife.

The wife of a bankrupt can only be required to submit to an examination upon the application of some person who has authority to make it. The assignee and creditors must both show good cause for gathering the order by a petition duly verified. A prima facie case must be established. Such a case is not made out by showing that the bankrupt has committed frauds of which she is probably cognizant. It is not the intention of the statute to destroy the usual and proper confidence between husband and wife. The cases in which she can be examined are where she is, on reasonable grounds, suspected of having or of having had property in her possession which should have been surrendered to the assignee, or to have participated actively in any other fraud upon the statute. In that case, she being a party to the fraud, may be fully examined concerning it, and conversations which are of the res gestae, may be inquired into. So also, if she offers a debt for proof, she may be fully examined concerning it.

DISCHARGE

The specifications must be in the prescribed form, and set forth some act which is a valid ground for withholding the discharge. This must be some one of the acts specifically designated by the statute, or some defect or irregularity that defeats the jurisdiction of the court over the debtor, or deprives it of the power to grant the discharge, may also be made by motion. Proceedings in bankruptcy are strictly statutory proceedings, and if the formal and jurisdictional requirements of the statute have been met and complied with, the discharge can only be refused for some ground specially set forth in the statue. Hence the existence of fiduciary debts, or fraud in the creation of the debt, is not a sufficient ground. By the express terms of the statute, however, no discharge can be granted if the bankrupt has willfully sworn falsely in his affidavit annexed to his petition, schedule, or inventory, or upon any examination in the cause of the proceedings in bankruptcy, in relation to any material fact concerning his estate or his debts, or to any other material fact; or if he has concealed any part of his estate or effects, or any books or writings related thereto; or if he has been guilty of any fraud or negligence in the care, custody, or delivery to the assignee of the property belonging to him at the time of the presentation of the petition and inventory, excepting such property as he is permitted to retain under the provisions of the statute; or if he has caused, permitted, or suffered any loss, waste, or destruction thereof; or if, within four months before the commencement of such proceedings, he has procured his lands, goods, money, or chattels to be attached, sequestered, or seized on execution; or if, since March 2, 1867, he has destroyed, mutilated, altered, or falsified any of his books, documents, papers, writings, or securities, or had made, or been privy to the making of any false or fraudulent entry in any book of account or other document, with intent to defraud his creditors; or has removed, or caused to be removed, any part of his property from the district, with intent to defraud his creditors; or if he has given any fraudulent preference contrary to the provisions of the statute; or made any fraudulent payment, gift, transfer, conveyance, or assignment of any part of his property; or has lost any part thereof in gaming; or has admitted a false or fictitious debt against his estate; or if, having knowledge that any person has proved such false or fictitious debt, he has not disclosed the same to his assignee within one month after such knowledge; or if, being a merchant or tradesman, he has not, at all times, since March 2, 1867, kept proper books of accounts...

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.

In re Construction Alternatives, Inc., Case No. 92-3961 (6th Cir. August 10, 1993). On May 16, 1990, debtor/defendant, Construction Alternatives, Inc., an Ohio corporation, contracted

with an Ohio school district to remove asbestos from four schools. Debtor was required to provide the district a performance bond under Ohio law. On April 6, 1990, plaintiff, Indiana Lumberman's Mutual Insurance Company ("Lumberman's") issued a surety bond as part of debtor's bid on the project.

On May 14, 1990, and August 20, 1990, the IRS filed notices of tax liens against debtor for $13,146.61 and $30,194.90, respectively. On August 21, 1990, debtor filed a Chapter 11 bankruptcy petition. On August 21, 1990, debtor had completed work on the project and was due to receive final payment from the school district. However, debtor had not paid all its suppliers on the project. Lumberman's, pursuant to its surety obligations, paid some of the suppliers.

On September 4, 1990, debtor and the school district determined that $39,705 remained owing on the contract. On September 6, 1990, debtor filed a turnover complaint in bankruptcy court, seeking to have the $39,705 ("the Fund") turned over to it as debtor-in-possession. Lumberman's and the IRS then filed answers to the complaint. Debtor then filed a motion for summary disposition, alleging that the IRS's lien was superior to that of Lumberman's and the IRS was entitled to the Fund. Lumberman's responded in kind, asserting that debtor held the Fund in trust for the equitable interest of Lumberman's in the Fund, which was not part of the bankruptcy estate. Lumberman's also contended that it had an equitable lien on the Fund, through subrogation to the rights of the school district and the suppliers it paid. This lien was superior to the IRS lien, it argued.

The bankruptcy court granted the debtor's motion. The court rejected the assertions made by Lumberman's, reasoning that no express trust had been created by the surety agreement and no constructive trust existed. Consequently, the Fund was property of the bankruptcy estate to which the IRS lien attached. The district court affirmed the bankruptcy court. The Court of Appeals affirmed the district court decision.

On appeal, Lumberman's argued that debtor did not have the right to receive final payment when it filed its bankruptcy petition. Therefore, debtor had no property interest in the final payment to which a tax lien could attach. The Court of Appeals disagreed, concluding that the debtor had earned the right to receive its final progress payment. And a tax lien arises "upon assessment and attaches to all property and rights to property ... including property which the taxpayer subsequently acquires." United States v. Safeco Ins. Co. of Am., 870 F.2d 338, 340 (6th Cir. 1989) (quoting 26 U.S.C. §6321). Accordingly, the IRS's liens were valid.

Lumberman's then contended that as a surety obligated to pay suppliers on the project, it had an equitable lien on the Fund, by subrogation to the rights of the suppliers it paid on behalf of debtor and by subrogation to the rights of the school district. The Court of Appeals stated that the school district's contract with debtor gave no right to the school district to retain final progress payment. Therefore, it had no claim to the Fund. Moreover, none of the unpaid suppliers had rights to the Fund, since none of them filed construction liens that would permit the school district to retain any part of the Fund to satisfy unpaid supplier obligations. Even if Lumberman's had an equitable lien, it would not have priority over the IRS lien under the "first in time, first in right" rule.

Next, Lumberman's argued that the tax liens did not attach to the Fund because debtor held the Fund as Lumberman's trustee of its equitable interest in the Fund. The Court of Appeals reasoned that no trust was created by operation of the surety agreement or by operation of law. Accordingly, debtor was vested with both the legal and equitable interests in the Fund to which the tax liens could attach.

Finally, Lumberman's contended that sureties' liens are given priority over tax liens, even if unperfected at the time the tax lien was filed. 26 U.S.C. §6323(c). The Court of Appeals stated that 26 U.S.C. §6323(h) provides that a "security interest" exists if "the property is in existence and the interest has become protected under local law against a subsequent judgment lien creditor." Before the alleged security interest of Lumberman's in the Fund would take priority over a subsequent lien under local law, Lumberman's would have to have perfected its security interest by filing a financing statement under Ohio law. O.R.C.A. §§ 1309.21, 1309.23 (Anderson Supp. 1992). Accordingly,

because Lumberman's did not do so, it did not have a security interest under 26 U.S.C. §6323(c).

Cantrell v. GAF Corporation, 999 F.2d 1007 (6th Cir. 1993). Plaintiffs/employees brought action against defendants/employers to recover for injuries for negligence, intentional tort, and strict liability arising from exposure to asbestos. The district court entered judgment pursuant to a jury verdict in favor of employees. The jury awarded $750,000 to each worker in compensatory damages, $250,000 to each spouse for loss of consortium, and $500,000 in punitive damages to each worker. The Court of Appeals affirmed the district court decision.

Defendant, in its appeal, contended that, inter alia, where the cumulative effect of damages awarded in multiple lawsuits is to cause a defendant to file a Chapter 11 bankruptcy petition, the deterrence and retribution goals of punitive damages can no longer be served. In addition, defendant asserted that the punitive damage awards should be reversed to preserve funds for compensatory damages for other asbestos claimants. Citing Cathey v. Johns-Manville Sales Corp., 776 F.2d 1565 (6th Cir. 1985), the Court of Appeals held that relief from multiple punitive damage awards should not be sought from a federal court in a diversity action but from the legislature under whose law the action is decided. Moreover, the bankruptcy court is better suited to address defendant's concern that such awards will deplete funds available for asbestos victims who seek compensatory damages.

In re Neuman (U.S. v. Neuman), Case No. 1:93-CV-586 (W.D. Mich. Aug. 9, 1993). Judge Gibson denied the United States' motion for leave to appeal an interlocutory "order" entered by the bankruptcy court on July 6, 1993. The court held that it did not have jurisdiction to hear the appeal because the bankruptcy court had not entered a final order, only an opinion of the court.

The debtors objected to the claim of the Internal Revenue Service for unpaid taxes which the IRS filed over four months late. The IRS, relying on the opinion in In re Hausladen, 146 B.R. 557 (Bankr. D. Minn. 1992), and allegations of insufficient notice of the bankruptcy filing, argued that its claim should be allowed. The bankruptcy court considered this case together with In re Zimmerman, Case No. SG 91-86620, and issued an en banc opinion holding that claims that are filed late in Chapter 13 cases must be disallowed, rejecting the decision in Hausladen. As to the IRS claim in this case, the bankruptcy court set the matter for an evidentiary hearing on the notice issues raised by the IRS. In this appeal the U.S. sought leave to appeal the opinion to the extent it rejected Hausladen.

The court reviewed the standard for granting leave to appeal interlocutory orders. It noted that a district court may hear an interlocutory appeal if the issue involved is a "controlling issue of law for which a substantial basis for differing opinion exists and [if] an immediate appeal will materially advance the ultimate termination of the litigation." Yet the court also noted that in this case the bankruptcy court had not entered an "order" in connection with its en banc opinion, and therefore the court held that it did not have jurisdiction to hear the interlocutory appeal. The court further noted that under the standard, an immediate appeal in this case would not materially advance the termination of the litigation because the U.S. may prevail in the evidentiary hearing concerning the issue of sufficiency of notice and may be permitted to file its late proof of claim.

Blatchey v. Butcher, Case No. 1:91-CV-979 (W.D. Mich. Aug. 16, 1993). Judge Gibson granted plaintiffs' motion to change venue from the District Court for the Western District of Michigan to the District Court for the Eastern District of Michigan, where one of the defendants' bankruptcy case was pending, and denied defendants' motion to dismiss the action as to one of the defendants who died during the pendency of the case.

In deciding plaintiffs' motion to change the venue of the case, the court reviewed 28 U.S.C. § 1404(a). The court noted that under that statute it could transfer the action to any other district or division where the case may have been brought. The court noted that the issues were whether the Eastern District of Michigan would have had jurisdiction over the action, whether venue would have been proper there originally, and whether the transfer of the case would be in the interest of convenience and justice.

The court considered whether the Eastern District of Michigan would have had jurisdiction

over this matter under 28 U.S.C. § 1334. The substantive issue before the court related to ownership of real property. The defendants alleged that the property is owned by a defendant who is a debtor in a bankruptcy proceeding pending before the Bankruptcy Court for the Eastern District of Michigan. The court reviewed Sixth Circuit law and held that the case was a "related to proceeding" under 28 U.S.C. § 1334(b), and, therefore, the Eastern District of Michigan would have had original jurisdiction over the action. Further, because the bankruptcy case was pending in the Eastern District of Michigan, under 28 U.S.C. § 1409(a), venue for the action would have been proper there as well. Finally, the court reviewed whether a transfer of venue would be proper in this case. Citing L. Perrigo Co. v. Warner-Lambert Co., 810 F. Supp. 987, 990 (W.D. Mich. 1992), the court reviewed seven factors that must be considered in determining whether to transfer venue. The court held that it would be more convenient for the parties and witnesses if the action were tried in the Eastern District of Michigan and that the transfer would be in the interest of judicial economy, efficiency, and justice. Therefore, the court held that the case should be transferred to the Eastern District of Michigan.

In deciding defendants' motion to dismiss the action as to the deceased defendant, the court reviewed Fed. R. Civ. P. 25(a), which requires an opposing party to file a motion for substitution within 90 days after a death of a party is suggested on the record. One of the defendants died during the pendency of the case. The surviving defendants served a suggestion of death on all parties. Before the 90 days expired, the court stayed the proceeding until further notice. The defendants moved to have the case dismissed against the deceased defendant upon the expiration of the 90 days. The court held that the 90-day period under Fed. R. Civ. P. 25(a) was tolled by the court's stay of proceedings, and, therefore, plaintiffs' failure to file a motion for substitution did not warrant a dismissal of the action as to the deceased defendant.

In re Auto Specialties Manufacturing Company (Boyd v. Sachs), Case No. 1:93-CV-413 (W.D. Mich. Aug. 30, 1993). Judge Bell affirmed the bankruptcy court's decision holding that defendant Sachs did not receive a preference when he received payment under a letter of credit because the payment did not improve his position vis-a-vis other creditors under 11 U.S.C. § 547(b)(5).

In this case, a bank originally issued to the debtor a letter of credit dated May 13, 1987, in the stated amount of $400,000 with Sachs as the beneficiary. The expiration date was the earlier of its surrender for cancellation or June 1, 1989. On February 9, 1988, the letter of credit was modified to provide that Sachs could immediately draw $300,000 on the letter of credit without satisfying the conditions originally required under the terms of the letter of credit. Sachs immediately drew on the letter of credit consistent with the new agreement. Approximately eight months later, the debtor filed for relief under Chapter 11 of the Bankruptcy Code. The trustee brought this adversary proceeding alleging that, as a result of the February 9, 1988, transaction, the bank and Sachs were recipients of a $300,000 preferential transfer.

The bankruptcy court reasoned that because the bank was fully secured it would have been made whole under a hypothetical Chapter 7 liquidation. Since the payment of the letter of credit was conditioned on reducing the debtor's debt to the bank, under the hypothetical Chapter 7, Sachs would have been entitled to draw $400,000 under the original letter of credit on October 3, 1988, when the bank was paid in full. Sachs only received $300,000 under the modified credit, and therefore the bankruptcy court concluded there was no question of fact that Sachs would have received as much in a hypothetical Chapter 7 case as he did through the alleged preferential transfer.

The district court noted that under 11 U.S.C. § 547(b)(5), a comparison must be made between what the creditor actually received and what it would have received under a Chapter 7 distribution. This test requires the court to look at the status of the creditors on the date that the debtor filed its bankruptcy petition, as if the bank had been paid in full. The court noted that the trustee improperly sought to evaluate Sachs' distribution as of the date of the transfer and in light of what actually occurred post-petition. The court reasoned that because there would have been a hypothetical distribution to the bank on October 3, 1988, the condition for drawing the letter of credit would have been met and Sachs would have been entitled to draw $400,000 on

October 3, 1988, well before the letter of credit expired. Therefore, the trustee failed to meet its burden of proof as to the elements of a preferential transfer, because Sachs did not receive more than he would have received under a hypothetical Chapter 7 case.

Williams v. Trott & Trott, 822 F.Supp. 1266 (E.D. Mi. 1993). Federal District Court Judge Edmunds split the hair of debt collection versus debt reinstatement in this unusual case under the Federal Fair Debt Collection Practices Act (FDCPA). Plaintiffs sued the defendant law firm for violation of the FDCPA, claiming that correspondence from the law firm failed to carry certain statutory warnings and notice of rights and that the attorneys collected attorney fees not allowed by the mortgage note in question.

The defendants act as counsel for a number of mortgage companies. In this case, the firm's client sent notice of default directly to the Plaintiffs, warning them of the impending foreclosure action to be taken by Trott & Trott. The letter advised the plaintiffs to contact the defendants if they wished to make payment to "cure this default" and/or "obtain the reinstatement or payoff amount."

The plaintiffs contacted the defendant attorneys, who responded by sending a letter providing the information on reinstatement as requested by the plaintiffs. The plaintiffs ultimately cured the default and paid the attorney fees incurred by the mortgagee, as consideration for the forbearance of the foreclosure action.

The plaintiffs sued under the FDCPA, and the parties filed opposing motions for summary disposition. Judge Edmunds found that the defendant's response to the plaintiffs' request for information, pursuant to the letter of the mortgagee, did not constitute a communication intended to collect or enforce a debt. Rather, she found that the letter was in furtherance of the goal of "reinstating" the debt in default, as opposed to "collecting" that debt. Hence, she found that the attorneys were not acting as debt collectors under the FDCPA. Further, the attorney fees collected, which exceeded the statutory amount of $37.50 provided for by M.C.L.A. §600.2431, were in effect consideration for the forbearance and reinstatement of the mortgage note, a voluntary action on the part of the mortgagee. The attorney fees made the mortgagee whole and, although not expressly authorized by the agreement or permitted by law, nevertheless were allowable because they were collected in furtherance of the reinstatement, not the foreclosure.

In re Phillips, 153 B.R. 758 (Bankr.E.D. Mi. 1993). Plaintiff sued defendant debtor under 11 U.S.C. §523 (a)(2), (4) and (6) to determine the dischargeability of a debt that arose when the debtor allowed insurance to lapse on a leased car that was subsequently damaged in an accident caused by the debtor. The plaintiff attempted to categorize the debtor's failure to advise it about the lapse of the insurance coverage as "silent fraud" after the parties had entered into the lease. Judge Shapero denied the claim and awarded the debtor her costs and fees under §523(d) for the plaintiff's failure to show any substantial justification existing in law or in fact for the §523(a)(2) allegations.

As to the claim under §523(a)(4), the court stated that the trust or fiduciary relationship must necessarily exist separate and apart from the act from which the debt arose. It must exist before the transaction that creates the debt. (See, e.g., In re Crane, 154 B.R. 60, where Judge Shapero found that a fiduciary relationship existed as a matter of statute separate and apart from the transaction that gave rise to the debt.)

With respect to the claim under §523(a)(6), the plaintiff offered no proof as to the reasons or circumstances that gave rise to the lapse of the insurance. A showing of malicious or willful conduct under the code requires proof of intent or a lack of just cause or excuse, which burden the plaintiff failed to bear.

In re Crane, 154 B.R. 60 (Bankr.E.D. Mich. March 16, 1993). Plaintiff sued defendant debtor to determine the dischargeability of a debt under 11 U.S.C. §523(a)(2), (4), and (6). The debt arose when the debtor failed to pay over funds received under the Builders Trust Fund Act (M.C.L.A. §570.151) to the plaintiff, its subcontractor on three construction jobs. The debtor had used the funds to pay its general overhead expenses, before it paid the plaintiff.

Judge Shapero denied the claim made under 11 U.S.C. §523(a) (2) and (6), but granted the relief requested under (a) (4), finding that the Builders Trust Fund Act (1) created the fiduciary relationship between the parties necessary to satisfy the defalcation standard of the code; and (2) created a presumption of intent to defraud, upon the presentation of evidence that the contractor had received money paid to him, in trust, under the statute, and had used any of the funds to pay some of his personal business expenses before paying in full all monies due to subcontractors and other beneficiaries under the Builders Trust Fund Act.

The plaintiff was not required to trace disbursements of any of the funds received by the debtor, which were commingled through his accounts. The plaintiff was able to bear its burden of proof by showing that the debtor had been paid for the plaintiff's work and the plaintiff had not received its payment in full, although the debtor had used some of the trust fund money to pay other seemingly legitimate business expenses.

In re Ehrhart, Case No. 91-20755 (Bankr.E.D. Mi., June 17, 1993). At the time of filing, the debtor's ex-wife, the defendant, owed him $10,000, secured by a second mortgage on property she was awarded in the divorce judgment entered in 1981. The debtor owed the defendant $23,000 in back child support. The trustee sued the defendant to collect on the note payable to the debtor. The defendant claimed the right to offset the note against the child support arrearage.

Judge Spector analyzed Michigan law to determine who "owned" the support arrearage; the defendant or her dependent children, for whom she received the support. Relying on Kalter v. Kalter 155 Mich. App. 99 (1986), Judge Spector found that the Michigan Court of Appeals has treated support and property issues as matters that offset each other, without regard to the question of ownership versus trusteeship of the support money due. Accordingly, he denied the trustee's complaint for turnover under 11 U.S.C. §542(b).

In re Lock, Case No. 92-09763 (Bankr.E.D. Mi., September 15, 1993). In a case involving a debtor's challenge under 11 U.S.C. §523(a)(5) to the dischargeability of a child support arrearage in the amount of $164,000, which included substantial interest, Judge Rhodes examined the seemingly contradictory opinions of Long v Calhoun, 715 F.2d 1103 (6th Cir. 1983) and Singer v Singer, 787 F.2d 1033 (6th Cir. 1986).

Judge Rhodes found that although Calhoun has been applied throughout the Sixth Circuit to circumstances similar to those present in this case, careful doctrinal analysis shows it to be more narrow than its fairly wide citation would lead one to believe. Specifically, Judge Rhodes found that the four part test enumerated by the Calhoun court to determine whether divorce obligations are nondischargeable support obligations should be limited to facts such as those present in Calhoun--i.e., a negotiated divorce settlement that allowed for indemnification of the debtor's former spouse through assumption of marital debt, which the ex-spouse wished to construe as being "in the nature of support."

Judge Rhodes found the Singer case to be more applicable to the questions presented by the instant parties. Singer, although decided three years after Calhoun, did not use the Calhoun four part test. Rather, the Singer court simply looked at the obligation in question and determined whether it was in the nature of support, without addressing whether the support was necessary or reasonable.

Since the arrearage had been litigated extensively in the state court, the balance was both liquidated and definitively classified as support. When asked to decree the "reasonableness" of the amount due, pursuant to Calhoun, Judge Rhodes specifically declined to act as the "super divorce court" some commentators have suggested the Calhoun decision created within the mandate of bankruptcy courts throughout the Sixth Circuit.

In re Sardo Corporation, Case No. 91-09826 (Bankr.E.D. Mi., May 28, 1993). In this case on appeal from a decision by Bankruptcy Judge Steven Rhodes, District Judge Woods reached a different conclusion than District Judge Gadola on the issue of the subordination of a property tax lien to the administrative expenses of sale of the property under 11 U.S.C. §724(b). In Oakland County Treasurer v Allard (In re Kerton Industrial, 151 B.R. 101 (E.D. Mi. 1991), Judge Gadola reversed Judge Shapero's

decision to subordinate the lien of the county treasurer to the administrative expenses of the sale under §724(b), reasoning that there were no expenses of the estate before the sale, and therefore the sale was of no benefit to the estate. Here, Judge Woods discussed Kerton Industrial and found it to be unpersuasive. He specifically examined In re KC Machine & Tool Co., 816 F.2d 238 (6th Cir. 1987), on which Kerton Industrial is based in part. Where Judge Gadola found that benefit to the estate, as discussed in 11 U.S.C. 544(b), was a prerequisite to the surcharge of expenses under 724(b), Judge Woods found 724(b) to be self-supporting. Accordingly, he upheld Judge Rhodes (and presumably would have upheld Judge Shapero) and granted the motion of the trustee to surcharge the sale proceeds for the administrative expenses. The county treasurer was thereby denied any recovery from the sale of the property, since the expenses exceeded the tax lien.

Senters v. Ottawa Savings Bank, 442 Mich. 851 (1993). The Michigan Supreme Court reversed the Court of Appeals and denied the defendant's claim of an equitable lien against property it had foreclosed on pursuant to advertisement, where prior to the expiration of its redemption period the defendant mortgagee paid off a construction lien foreclosed before the sale took place.

Plaintiff tendered the defendant the amount necessary to redeem the property from the defendant's foreclosure by advertisement, but did not pay on the defendant's demand for reimbursement of the amount of the foreclosed construction lien redeemed by the defendant. The circuit court denied the plaintiff's claim for redemption at the lower amount and allowed the defendant to add the construction lien amount to the redemption amount for the first mortgage, or in the alternative held that the defendant was entitled to an equitable lien for the amount paid to redeem the construction lien. The Court of Appeals reversed and awarded the plaintiff the right to redeem at the lower amount but granted the defendant an equitable lien for the amount of the redemption of the construction lien.

The Supreme Court reversed the Court of Appeals on the issue of the equitable lien and held the defendant to a strict construction of the statute governing foreclosure of mortgages by advertisement. It found that the statute only allows the successful bidder to add interest, taxes, and insurance that have been properly filed with the register of deeds. The court opined that the defendant had several options available to it that would have allowed it to collect the amount of the construction lien in addition to its mortgage amount. However, it found that the strategy employed by the defendant had foreclosed the possibility of collecting the additional sums expended outside the scope of the foreclosure by advertisement statute (M.C.L.A. §600.3240; M.S.A. §27A.3240). Further, the Supreme Court found that there were no grounds under Michigan common law to grant an equitable lien to the defendant for the cost of redeeming the construction lien. In the absence of a written contract, an equitable lien will be established only where there is the clear intent, inferred from the relationship of the parties, to use the property in question as security for a debt. Since the relationship of the parties in the case at bar was strictly statutory, as a result of the defendant's election to foreclose by advertisement, the defendant was bound by the limits of the procedure that it chose to employ to collect its mortgage note.

COMMENTS AND SUGGESTIONS REQUESTED FOR BANKRUPTCY SEMINAR

The Bankruptcy Steering Committee requests that all members of the Bankruptcy Section submit their comments with regard to the 1993 seminar and their suggestions for the educational program for the 1994 seminar, which will take place on July 21 - 23 at the Park Place Hotel in Traverse City. Comments and suggestions should be submitted to Steve Rayman of Rayman & Hamlin at 303 North Rose Street; Ste. 440; Kalamazoo, Michigan 49007.

ARTICLES SOLICITED

We generally attempt to run a lead article in each monthly Newsletter on a topic of current interest. Anyone who is interested in submitting an article for the Newsletter should contact Tom Sarb at (616) 459-8311.

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the United States Bankruptcy Court for the Western District of Michigan (Lower Peninsula) during the period from January 1, 1993 through August 31, 1993. These filings are compared to those made during the same period one year ago and two years ago.

	1/1/93- 8/31/93	1/1/92- 8/31/92	1/1/91- 8/31/91
Chapter 7	3,090	3,705	3,416
Chapter 11	77	89	113
Chapter 12	25	19	20
Chapter 13	964	1,075	1,177
	4,156	4,888	4,726

STEERING COMMITTEE MINUTES

A meeting of the Steering Committee of the Bankruptcy Section of the Federal Bar Association for the Western District of Michigan was held on September 17, 1993 at the Peninsular Club. Present: Bob Sawdey, Denise Twinney, Vicki Young (for Tim Curtin), Peter Teholiz, Bob Wright, Brett Rodgers, Janet Thomas, Tom Sarb, Dan Casamatta, Tom Schouten, Scott Hogan (for Tim Hillegonds), and Steve Rayman.

1. 1994 Seminar at Traverse City Park Place Hotel on July 21 - 23. Appointments of educational and recreational chair-persons for the 1994 Bankruptcy Seminar were discussed.

A. Educational Program. Steve Rayman, assisted by Pat Mears and Bob Wright, will chair the 1994 seminar educational program.

Comments with regard to the 1993 seminar and suggestions for the 1994 program will be solicited in the Bankruptcy Law Newsletter. Further, Peter Teholiz will review the issue of certification of the seminar for continuing legal education credits.

B. Recreational Program. Janet Thomas and Denise Twinney agreed to co-chair the recreational program for the 1994 seminar.

2. Steering Committee Elections. Bob Sawdey, Janet Thomas, Bob Wright, Bob Mollhagen and Tim Curtin having completed their three-year terms on the Steering Committee, discussion was had with regard to election/re-election of members of the Steering Committee for terms ending in August, 1996. Bob Mollhagen notified the Committee that he was resigning and not seeking re-election due to his transfer to his firm's Bloomfield Hills office. Vicki Young reported that Tim Curtin would not seek reelection and nominated Jeff Hughes to serve in his place. Janet Thomas, Bob Sawdey, and Bob Wright all indicated that they wished to seek re-election to the Steering Committee. A motion was made that Janet Thomas, Bob Sawdey, and Bob Wright be re-elected to the Steering Committee for terms ending in August, 1996. Motion was seconded and, after discussion, passed unanimously. A motion was made that Jeff Hughes and Dan Casamatta be elected to the Steering Committee and, after discussion, passed unanimously.

3. New Business. Bob Wright reported a communication Pat Mears had received from the

Bankruptcy Court requesting the assistance of the Steering Committee in establishing a procedure for pro bono representation of indigent persons needing counsel in bankruptcy court. A discussion followed about the existing pro bono programs of the Grand Rapids and Kalamazoo Bar Associations. Steering Committee members concluded that Tom Clinton would be invited to the next Steering Committee meeting to discuss a liaison with the pro bono programs of the Grand Rapids and the Kalamazoo Bar Associations and any assistance the Steering Committee could provide to solicit additional bankruptcy attorneys to handle pro bono cases.

EDITOR NEEDED

I am looking for a replacement for me as editor of this Newsletter. If you might be interested in succeeding me, please call me (no obligation!) at (616) 459-8311 for details. The editing takes a few hours each month, but keeps you on top of what's happening in the bankruptcy world in the Western District. All inquiries welcome!

Thomas P. Sarb

THE EDITOR'S NOTEBOOK

On September 15, 1993, the Senate Judiciary Committee approved Senate Bill 540, the "Bankruptcy Amendments Act of 1993." The legislation was approved largely unchanged from that initially introduced into the Senate, with the exception of the removal of certain PBGC priority provisions. Since it is a Christmas tree type bill, there is some good and some bad in it. Of most concern, however, is that piecemeal legislation to the Bankruptcy Code is creating an inconsistent and unworkable system.

Thomas P. Sarb

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