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PERSONAL PROPERTY TAXES IN BANKRUPTCY

By: Ingrid A. Jensen[1]

This article summarizes general state law regarding personal property taxes and the treatment in bankruptcy of these taxes, including the type of claim and priority of tax liens.

Summary of State Law Provisions

The status of personal property is determined on December 31 of each year for the following year, referred to as "tax" or "assessment" day. MCL 211.2; MSA 7.2. Personal property is required to be assessed at 50% of its true cash (or fair market) value. Mich. Const. Art. 9, §3. Assessment of personal property is typically determined by the taxpayer by filing a personal property tax statement with the local taxing authority. If a personal property tax statement is not filed, is unavailable, or the information is not correct, the assessing officer has a duty to investigate the value of the property and assess the property as "he or she may deem reasonable and just." MCL 211.22; MSA 7.22.

If personal property taxes remain unpaid, the township or city treasurer "shall collect the tax by seizing the personal property" and selling the same. No property is exempt from sale. MCL 211.47; MSA 7.91. Unpaid personal property taxes become a lien on the property so assessed on December 1 (unless otherwise provided by city or village charter). MCL 211.40; MSA 7.81. (School taxes become a lien on July 1. See MSA 15.41612(2) and Section 44a(3) of Act No. 313 of the Public Acts of 1993.) Thus, the lien on personal property that arises on December 1 of any given year relates to the taxes assessed on December 31 of the preceding year. Under certain circumstances, a jeopardy assessment can be made by a treasurer, thereby accelerating the due date and lien date of the tax as of the date the jeopardy affidavit is filed with the county clerk. MCL 211.691; MSA 7.51(1).

The personal property tax lien continues until the tax is paid. It is "a first lien, prior, superior and paramount" and takes "precedence over all other claims, encumbrances and liens" upon the personal property. The lien is not "divested or destroyed" by transfer of the personal property, except property sold in the regular course of retail trade. MCL 211.40; MSA 7.81.

Priority of the property tax lien is determined in bankruptcy under state law. Leasing Service Corporation v First Tennessee Bank National Association, 826 F2d 434, 437 (6th Cir 1987). Under Michigan law, a personal property tax lien follows the property (except if sold in the regular course of retail trade) and has priority over preexisting liens. See In Re Ever Krisp Food Products Co, 307 Mich 182, 11 NW 2d 852 (1943); In Re Rite-Way Tool &

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[1] *Ms. Jensen is a shareholder of Law, Weathers and Richardson, P.C. and has practiced bankruptcy and real estate law in the Grand Rapids area since her graduation from Wayne State University Law School, cum laude, in 1984. This is her first article for the Newsletter.*

Manufacturing Co, 333 Mich 551, 53 NW2d 373 (1952); Michigan National Bank v City of Auburn Hills, 193 Mich App 109, 483 NW2d 436 (1992), lv den 441 Mich 911 (personal property tax lien has priority over a preexisting security interest in the same assets); Michigan Attorney General Opinion No. 6528 (1988). At least in the nonbankruptcy context, arguably the lien follows proceeds from the sale of assets subject to the tax.

Interplay Between State Law and Bankruptcy Law

When a bankruptcy petition is filed and personal property taxes are involved, the analysis should turn first to the type of claim accorded to the tax. The answer depends on several key dates—the date of assessment, the date of the bankruptcy filing and the lien date(s). Although the same analysis applies to real property taxes, payment of such taxes is basically guaranteed at some point by a sale of the land. Thus, the type of claim—and therefore the possibility of payment of that claim—is not as important.

Administrative Claim Status

Generally speaking, under Section 503 of the Code, a personal property tax will be an administrative claim if it is incurred by the estate and was assessed after the petition was filed. For example, assuming the other requirements of Section 503 of the Code are met, if a chapter 11 case is filed on June 1, 1993, personal property tax for 1994 will be an administrative expense because the tax will be assessed post petition (December 31, 1993) and will become due during the administration of the case.

Priority and Secured Claims Status

A tax is a priority claim under Section 507(a)(7)(B) of the Code if it is assessed before the commencement of the case and "last payable without penalty after one year before the date of the filing of the petition." This language is rather convoluted, but essentially means that a tax, to qualify for priority claim status, must have become due without penalty within one year prior to the bankruptcy filing. An example of a priority tax claim follows.

Assume a bankruptcy petition is filed on July 31, 1993. Assume further that the 1993 taxes became due on July 1, 1993. The 1993 taxes (assessed on December 31, 1992) would have priority claim status because they were assessed before the commencement of the case and became payable without penalty during the year prior to the date the petition was filed. The same result would probably occur if the taxes became due on December 1, 1993, although the language of the statute is somewhat murky.

If a bankruptcy case is filed on or after December 1, 1993, then the 1993 tax is a secured claim rather than a priority claim because under state law, the 1993 tax became a lien on December 1, 1993. (Note that the analysis is more complicated if the tax is split between summer and winter taxes since summer taxes become a lien on July 1. This article does not address this and assumes that all personal property taxes become a lien on December 1.) (A claim can not be both a priority and secured claim). Section 362 of the Code prevents a tax from becoming a lien post filing. In re Shoreham Paper Company, 117 BR 275 (Bankr. WD MI 1990). Thus, if a case is filed on November 30, 1993, a tax claim that qualifies as a priority claim does not transform into a secured claim on December 1, 1993.

Ironically, in some chapter 7 cases, it may be more advantageous for a municipality to have a priority claim rather than a secured claim. Section 724(b) of the Code requires a trustee to subordinate tax liens for the payment of certain administrative and priority claims, thereby limiting the ability of taxing authorities to collect tax claims secured by liens. The constitutionality of this provision with respect to both real and personal property taxes was discussed and confirmed in In re Kamstra, 51 BR 826 (Bankr WD MI 1985). For further discussion of Section 724, see Matter of Grand Rapids Packaging Corp, 54 BR 282 (Bankr WD MI 1985), and Nathan and Repko, *Subordination Under Bankruptcy Code Section 724(b)*, MI Bus LJ, Volume XV, No. 4.

On the other hand, a competing, consensual secured creditor (such as a UCC Article 9 secured creditor) might benefit from a bankruptcy filing prior to December 1. In such event, a tax claim will not be secured and will be prevented by the automatic stay from becoming secured. The secured creditor's lien will thus not be primed by the tax lien.

Unlike other tax obligations in Michigan, there is no statutory corporate officer, director or responsible person liability for unpaid personal property taxes. See, for example, MSA 7.656(27a), MSA 7.557(1351), MSA 7.536(2) and MSA 7.555(6) for personal officer and director liability for payment of single business tax, income withholding, sales tax and use tax, respectively. However, if a director or officer, with knowledge of the tax due, causes the corporation to remove the property subject to personal property tax from the jurisdiction, or dispose of the property without notice to the taxing authority, personal liability may be imposed. City of Muskegon v Amec, 62 Mich App 644, 233 NW2d 688 (1975). Under Section 523(a)(1)(A) of the Code, personal property taxes are not dischargeable. Thus, if corporate officer or director liability for personal property taxes can be imposed, then arguably the tax should be paid even in the event of a personal bankruptcy.

Many manufacturing and industrial chapter 11 cases involve significant personal property tax claims. Whether representing the municipality, the debtor, the trustee or other interested party, knowing the type of claim and the probable treatment (payment) of the claim is important. At first glance, what might appear to be an administrative claim is in fact an unsecured priority claim. Moreover, in some cases, it may be possible to "relegate" a tax claim to secured status and subordinate payment of it to administrative and other claims.

RECENT BANKRUPTCY DECISIONS

Monsanto Industrial Chemicals v Harris 161 BR 385 (ED Mich) issued 7/9/93. Judge Edmunds of the US District Court for the Eastern District of Michigan affirmed the decision of the bankruptcy court (Judge Shapero), which held a state court judgement entered against the Debtor to be non-dischargeable pursuant to 11 USC 523(a)(5).

Plaintiff was Defendant/Debtor's employer. Debtor was receiving workers compensation. The employer was obligated to pay a portion of the compensation directly to a receiver appointed to collect child support owed by the Debtor. When employer improperly failed to pay over to the receiver, the receiver won a judgment against the employer and the employer paid that judgment.

The employer then filed suit in state court seeking subrogation and contribution, and received a judgment against the Debtor in the amount of $14,162.51 plus interest. The order of judgment specifically stated that the Debtor was liable to the Plaintiff for "child support paid on his behalf" by the Plaintiff employer. An amended judgment was submitted using specific language of subrogation for money due to the ex-wife under the Child Support and Visitation Enforcement Act. The Debtor filed bankruptcy just before the entry of the amended judgment and the bankruptcy court only relied on the original language in making its determination.

Plaintiff employer filed a complaint to determine dischargeability which alleged that the debt was non-dischargeable support. Debtor countered with a motion for summary judgment, asserting that the Debtor's right to a fresh start required the court to narrowly construe non-dischargeable support as not including amounts owed to unrelated third parties. Further, Debtor argued that the state court judgment acted as an assignment of the debt, and since the Plaintiff was not an assignee specifically excepted from discharge, the debt should be dischargeable.

The bankruptcy court held, and the district court affirmed, that the debt was non-dischargeable. First, it is not to whom the debt is owed, but the nature of the debt itself, that makes it non-dischargeable support. Second, the debt was not assigned to the Plaintiff, but rather, arose out of subrogation.

In re Nail, 92-31378, (Bankr ED Mich), Judge Spector, reported 1/25/94. Debtor filed a no asset chapter 7, followed 14 months later by a chapter 13 that listed a disputed non-priority unsecured debt due to MESC for unemployment taxes. MESC filed a section 507(a)(7) priority claim and the Debtor objected. Judge Spector found the claim to be a valid priority claim, relying on In re Suburban Motor Freight, 998 F2d 338 (6th Cir. 1993)

Edwards v Federal National Mortgage Association, 93-CV-73350-DT (ED Mich) Judge Woods issued 1/13/94. Plaintiff/Debtor appealed an order issued by bankruptcy Judge Graves which, sua sponte, lifted the stay as against her mortgage company, but at the same time, confirmed her chapter 13 plan which sought to cure an arrearage that lead to the foreclosure of her mortgage.

The Debtor was 8 days away from a sheriff's sale on foreclosure of her mortgage when she filed her first petition under chapter 13. The case was dismissed when she failed to gain confirmation of her plan. Before the sale could go forward, she filed her second chapter 13. The mortgage company objected to confirmation but did not ask for lift of stay. The bankruptcy court held a confirmation hearing, at which it confirmed the plan, but without a motion from the creditor, sua sponte lifted the stay as to the mortgage company.

The Debtor immediately filed a motion for reconsideration. In the meantime, the sheriff's sale was held. At the hearing on the motion for reconsideration, Judge Graves admitted that his previous order lifting the stay and confirming the plan was palpable error. So he fixed it by dismissing the petition and denying the Debtor's request that he set aside the foreclosure sale.

The Debtor appealed, alleging that the court's failure to set aside the mortgage sale was error, since it prevented her from filing a third plan, which would have probably succeeded in curing the mortgage arrearage. She also alleged that the creditor's week by week adjournment of the sale during the second case, prior to the lift of stay, violated the automatic stay.

The District Court denied the appeal with respect to the claim that the automatic stay was violated by the week to week adjournments. It also held that the sale itself, as finally consummated, was proper. However, it remanded the case back to Judge Graves because he failed to make a record of the basis of his decision when he declined to set aside the sale on the Debtor's motion for reconsideration. The bankruptcy court was instructed to state what it relied on in refusing to set aside the foreclosure sale on the Debtor's motion.

In re Thompson (Merritt v Thompson) 162 BR 748 (Bankr ED Mich 1993) issued 12/14/93. Judge Spector analysed the elements of malice necessary to make a claim non-dischargeable under 11 USC 523(a)(6).

The Defendant/Debtor is the mother of a 3 year old daughter. Prior to filing under chapter 7, she alleged to both law enforcement authorities and to the Detroit News that her daughter's father, the Plaintiff, had sexually abused the child. The father sued for libel and slander, but before the state court case could go to trial, the Debtor filed bankruptcy. The father filed a claim for $250,000 damages in the bankruptcy estate and alleged that the damages were non-dischargeable under 523(a)(6), because the Debtor's conduct was willful and malicious.

The Debtor was accused of making slanderous accusations in two different venues: First, to law enforcement authorities, and second to the Detroit News. Judge Spector found that the comments made to the authorities were made based on the sincere belief that the child had been harmed. But the comments made to the news media were a different story.

The relationship between the Debtor and the child's father was bitter and contentious. Spector found that, while her motives in reporting the suspected abuse to the authorities were good, the Debtor only spoke with the newspaper out of malice and ill-will towards the Plaintiff.

Spector found that actual malice, as defined in New York Times v Sullivan 376 US 254 (1964) (actual malice exists if a defamatory statement is published with knowledge that it is false or with reckless disregard of whether it is false or not), while often essential to a determination of liability in defamation cases, is not essential to the determination of nondischargeability under 523(a)(6). A statement made by a Debtor acting purely out of malice is within the scope of 523(a)(6).

The court found that the statements made to the newspaper served no legitimate purpose, since they were not in the best interests of the child. The Debtor's sincere or good faith belief in the truth of the statements did not protect her from the court's judgment that she only repeated them to the newspaper in an attempt to hurt the

father. Because the statement alleged a crime, it constituted defamation per se.

The Plaintiff father was an attorney who had served as a district court judge in Livingston County. While on the bench, he had been the subject of a criminal investigation and was censored by the Judicial Tenure Commission. Nevertheless, the court found that he was not a general purpose public figure. Had he been such a person, the Debtor's statements might have been deemed privileged.

The father had the burden of showing the falsity of the statements. The court found he had met his burden with clear and convincing evidence, although it specifically did not hold clear and convincing to be the standard of proof necessary.

On the issue of damages, the court found that, even though the father would have been entitled to certain presumed damages for the affront to his dignity and the emotional harm caused by the per se defamation, the father failed to argue in favor of such damages and in fact waived the favorable presumption in his trial brief, which accepted the burden of having to prove them. He then apparently failed to meet his burden. He further failed to show any actual pecuniary loss in the form of a reduction of earnings or income. He did prove, and was awarded damages for, out of pocket expenses for counseling he received after the slanderous accusations were published, in the amount of $1,050.

In re Healy, 161 BR 389 (ED MI 1993) Judge Clevland reported 1/26/94. The District Court reversed the Bankruptcy Court's finding that the Debtor's repayment of non-dischargeable educational loans would be an undue hardship.

The Debtor was a teacher who moved from the east coast to Michigan when her betrothed took a position as an engineer with General Motors. She took a low paying job with a private parochial school. When the engagement was broken off, she nevertheless continued to reside with her former beau, despite the fact that she had to commute a distance to her job. Further, she acted as summer babysitter to his two children from a former relationship, for which he paid her only $50 per week; the district court observed that said sum amounted to about $1.25 per hour, paid by a person who earned more than $50,000 per year.

The district court adopted the 2nd Circuit's standard of review of hardship cases, as set forth in Brunner v New York State Higher Ed. 831 F2d 395 (2nd Cir. 1987), which contains a three part test:

1. The Debtor cannot maintain, based on current income and expenses, a minimal standard of living for herself and her dependents, if forced to repay the debt;

2. Circumstances exist which indicate that this status is likely to persist for a significant portion of the repayment period of the student loans; and

3. The Debtor has made good faith efforts to repay the items.

The district court found that the first element required not only examination of the Debtor's expenditures, but also required that the Debtor show that she had maximized her income. In this case, the Debtor had, prior to obtaining a master's degree in education, supported herself as a secretary, a field in which she earned double what she was paid as a teacher. Further, the Debtor had made no effort to take on additional paid work, apart from her token babysitting "job", even though her schedule left her sufficient time to do so.

Where the bankruptcy court did not require that she abandon her preferred vocation to earn more money, the district court found such unwillingness on her part caused her to fail to meet her burden of proof on the first element of the Brunner test.

Debtor also failed, in the eyes of the district court, to prove that her circumstances were unlikely to change for a significant portion of the student loan repayment period, which ran for up to 20 years. The district court found clearly erroneous the bankruptcy court's finding that the Debtor's circumstances were unlikely to change. The court reiterated the Debtor's previous work experience, earning ability and the voluntary nature of her career choice.

The Debtor similarly failed to convince the district court that she had made a good faith effort to repay the debt. The court observed that she filed bankruptcy less than one year after finishing her master's degree, and had made no

effort to negotiate her payments with her lenders. The record reflected that she spent more time shopping for a lawyer willing to take her case than she had seeking a means to pay her debt.

The case was remanded to the bankruptcy court with instructions to enter a judgment declaring the debts to be non-dischargeable.

In re Evenson, 92-21779 (Bankr ED Mich) Judge Spector, issued 3/17/94. In an usually brief memorandum opinion, Judge Spector has adopted the position articulated by Judge Stevenson of the Western District, in the case of In re Moss, 143 BR 465; 27 CBC 2d 918 (Bankr WD MI 1992) with respect to the ability of the debtor to exempt an IRA account under 11 USC 522(d)(10)(E).

The Debtor's wife claimed an exemption in an IRA account under her name and control, pursuant to § 522(D)(10)(E). The trustee objected to the exemption, claiming that the account did not meet the definitional test of the exemption, in that her right to receive the benefit of the account was not restricted to circumstances "on account of illness, disability, death, age or length of service." Instead, the account was governed by a standard IRA contract which have the Debtor the exclusive control over the fund. The court noted that her ability to withdraw the funds was only tempered, not restricted, by the fact that if she withdrew money before she was 59.5 years old, the law required that she pay a 10 percent penalty, in addition to her ordinary taxes.

Judge Spector took note of Judge Gregg's contrary position on the issue, as set forth in In re Hall, 151 BR 412; 28 CBC 2d 789 (Bankr. WD MI 1993), and he agreed with Hall that "the answer to whether an individual retirement plan is exempt lies in the statutory language itself.", and "[e]ffect must be given to every word, phrase or sentence of a statute." Hall, 151 BR at 425.

But in analyzing the language of the exemption, Spector ultimately sided with Judge Stevenson on the issue and he held that the Debtor's IRA was not protected by 11 USC 522(d)(10)(E). He went on to limit the opinion to the specific IRA in question, stating that "There is nothing in the legislation establishing IRA's or the tax regulations regarding them which prohibits a person from including in the IRA contract a provision that the trustee may not disburse until age 59.5 except for certain of the hardships specified in 26 USC 72(t)." (Note: This is the statute which governs IRS's. Spector notes that it contains "some factors . . . which are clearly consistent with 522(d)(10)(E)'s 'on account of' test." However, it is likely that many IRA contracts will include more restrictions than required by the Tax Code?)

In re Omegas Group, Inc., XL/DataComp, Inc. v John R. Wilson, Trustee, Case No 92-5922/5934, 1994 FED App 0051P (6th Cir.) February 18, 1994. On October 16, 1990, Debtor, Omegas Group, Inc. ("Omegas") filed a Chapter 11 bankruptcy petition in the Western District of Kentucky. On October 16, 1990, Plaintiff, DataComp, Inc., filed an adversary proceeding complaint seeking to recover $1.1 million it paid to Omegas under a constructive trust theory. DataComp contended that the money was paid to Omegas as part of a "joint venture" in September of 1990, under assurances that Omegas could avoid bankruptcy with such payment. When Omegas filed bankruptcy shortly afterwards, DataComp claimed it was defrauded and Omegas had a fiduciary duty towards DataComp, as a joint venturer. Consequently, the funds were part of a constructive trust and not part of the bankruptcy estate pursuant to 11 USC § 541(d).

The bankruptcy court held that DataComp could recover $302,142.00 as held in a constructive trust by Omegas. The bankruptcy court found that DataComp entered into an agreement with Omegas establishing a relationship of "in a sense a joint venture" which imposed a fiduciary duty on Omegas. DataComp than moved to amend the judgment seeking to recover the entire amount paid to Omegas. The bankruptcy court denied DataComp's motion. The parties cross appealed. The district court affirmed the bankruptcy decision.

The Court of Appeals, in a 24-page opinion, reversed the district court. The Court stated that nowhere in the Bankruptcy Code does it say "property held by the debtor subject to a

constructive trust is excluded from debtor's estate." Courts which have excluded property from a debtor's estate typically do so under the authority of 11 USC § 451(d). See, Vineyard v McKenzie (In re Quality Holstein Leasing), 752 F2d 1009 (5th Cir. 1985).

The problem with the court's analysis in Quality Holstein Leasing, and with the majority of courts which have addressed bankruptcy claims based on a constructive trust, is that such a trust is a legal fiction that only exists by judicial action. A debtor who, prior to bankruptcy, serves as a trustee of an express trust generally has no right to the trust assets, and the bankruptcy trustee must give them to the beneficiary. A claim filed in bankruptcy asserting rights to assets "held" in "constructive trust" for the claimant is nothing more than a claim. Unless, a court has already impressed a constructive trust upon such assets or a legislature has created a statutory right to certain kinds of funds, such as construction funds, the claimant is not a beneficiary of a constructive trust held by the debtor.

In essence, the usual creditor's argument on a constructive trust theory is as follows: "Judge, due to debtor's fraud (or whatever), our property rights as beneficiaries of the constructive trust arose pre-petition. Therefore, we stand not in the position of unsecured creditors, nor even equal to the trustee in the position of judgment creditors, but as the rightful owner of the *res* held in trust. Oh, and by the way, would you mind conferring on us these ownership rights and declaring that they arose pre-petition?" Sommer v Vermont Real Estate Inv. Trust (In re Vermont Real Estate Inv Trust), 25 BR 813, 817 (Bankr D Vt 1982); City Nat'l Bank of Miami v General Coffee Corp. (In re General Corp.), 828 F2d 699, 704 (11th Cir. 1987).

In this case, the Court of Appeals agreed that the constructive trust in favor of DataComp came into existence pre-petition. Nevertheless, the bankruptcy court erroneously concluded that Omega and DataComp were in a joint venture. The relationship was that of a debtor-creditor. Even if there was a constructive trust under state law, federal bankruptcy law dictates to what extent that interest is property of the estate.

A constructive trust is at odds with Bankruptcy Code's policy of ratable distribution of estate assets to creditors. Section 541(d) simply does not permit a claimant to impose the remedy of constructive trust for alleged fraud committed against it by the debtor in the course of their business dealings and thus take ahead of all creditors. A constructive trust, unlike an express trust, is a remedy, it does not exist until a plaintiff obtains a judicial decision. Accordingly, a creditor's claim of entitlement to a constructive trust is not an "equitable interest" in the debtor's estate existing pre-petition and, thus excluded from the estate under 11 USC § 541(d).

Constructive trusts are anathema to the equities of bankruptcy since they take from the estate, and thus directly from competing creditors, not form offending debtors who committed the fraud. To permit a creditor, no matter how badly he had been "had" by the debtor, to lop off a piece of the estate under § 541(d) and a constructive trust theory is to permit that creditor to circumvent the Code's equitable system of distribution.

The Court of Appeals did not address the issue of property already impressed with a constructive trust by a court in a separate proceeding pre-petition, nor with property impressed with a trust by state statute (such as builder trust fund statutes). DataComp's remedy under the Bankruptcy Code would be an action to deny discharge under § 523.

Judge Guy in a separate opinion concurred in the result, stating that under Kentucky law a constructive trust only comes into being at the time of its judicial creation. Therefore, at the time of Omegas' bankruptcy petition filing, DataComp did not have an equitable interest in the money paid to Omegas. Consequently, the bankruptcy trustee's section 544(a) strong arm power would not have been compromised by the operation of a post-petition constructive trust.

Richard and Dorothy Fishell v United States Trustee, Case No. 93-1182, Unpublished (6th Cir. 1994). On November 16, 1990, Debtors/Plaintiffs, Richard and Dorothy Fishell, filed a Chapter 11 Petition. A year later, on November 13, 1991, the United States Trustee

filed a motion to convert the case form Chapter 11 to Chapter 7. The motion alleged, *inter alia*, that since Debtors had not yet filed a plan and disclosure statement, the case should be converted. The bankruptcy court granted the motion, noting that a plan or disclosure statement had never been filed, Debtors were doing nothing for creditors, and the litigation was expensive and protracted. The district court affirmed the bankruptcy court decision.

Debtors' bankruptcy estate consisted of four parcels of real estate. Two parcels were unencumbered. The third parcel was subject to a mortgage held by Robert Soltow. The fourth parcel was subject to a mortgage held by Patricia Andre. Ms. Andre was granted a relief from the automatic stay and it went to foreclosure sale. Debtors then sold there redemption right in this property for one dollar, without notifying the bankruptcy court or the creditors. The redemption period subsequently expired. The Andre property was the primary asset in which Debtors had relied on for their reorganization. The Saltow property had been deeded over to Robert Saltow pre-petition because Debtors were in default on the mortgage note given by them to Soltow. This property was also the subject of several claims which would likely be tied up in the courts for two to three years. The other two properties were residences and not producing income.

The Court of Appeals affirmed the district court, finding sufficient evidence to support grounds for conversion under 11 USC 1112(b): 1) "continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;" and 2) "an inability to effectuate a plan of reorganization." With the sale of the estates primary asset on which Debtors relied for a reorganization and 14 months passing without filing a plan, dismissal was appropriate.

In re Middle Earth Graphics, Inc., v Schwarz Paper Company, Inc., Case No. 1:93-CV-925 (WD Mich 2/18/94). Judge Quist affirmed Judge Gregg's order holding that certain payments received by the creditor, Schwarz Paper Company, Inc., from a third party who had guarantied the debtor's obligation to Schwarz could not be avoided as a preferential transfer.

Debtor is a manufacturer of game boards. Schwarz supplied the Debtor with its raw materials. The Debtor sold its finished products to Cadaco, Inc. After the Debtor experienced some financial difficulty, Schwarz proposed that Cadaco agree to pay Schwarz directly for the products it received if the Debtor failed to pay Schwarz within a reasonable time. After negotiation, Cadaco delivered a letter to Schwarz in which it guarantied payment within a reasonable time for products prepared by the Debtor on its behalf. Within the 90 days before bankruptcy, pursuant to its guaranty, Cadaco paid $67,626.60 directly to Schwarz on behalf of the Debtor. The Chapter 7 trustee sought to avoid the transfer as preferential, alleging that all of the elements of a preferential transfer were satisfied and that the transfer had involved an interest of the Debtor. The Bankruptcy Court held that because the payment Cadaco made directly to Schwarz was based upon a guaranty and was not an interest of the Debtor, the payment was not a preference and could not be avoided. The trustee appealed.

The Court reviewed the earmarking doctrine which states that "funds loaned to a debtor that are 'earmarked' for a particular creditor do not belong to the debtor because he does not control them." In re Hartley, 825 F.2d 1067, 1069 (6th Cir. 1987). The Court noted that the Bankruptcy Court held that the letter by Cadaco to Schwarz constituted a legally binding payment guaranty, and that the payment on the guaranty was not conditioned upon the Debtor's permission. The Court directly relied on the analysis in In re Trinity Plastics Inc., 138 B.R. 203 (Bankr. S.D. Ohio 1992) and held that Cadaco had satisfied a direct, unconditional promise to pay Schwarz to induce Schwarz to deliver the stock to the Debtor its direct benefit. Therefore, Schwarz did not receive a preferential transfer which could be avoided by the trustee.

In re Trost, Buckstop Lure Co. v. Trost, Case No. SL 92-85533 (Bankr. W.D. Mich. March 7, 1994). Judge Stevenson revoked debtor Fred Trost's Chapter 7 discharge pursuant to 11 U.S.C. 727(d), holding that

debtor fraudulently and intentionally concealed his entitlement to payments and ownership of assets.

Pre-petition, the plaintiff, Buckstop Lure Co., Inc. obtained a $4,000,000 judgment against Trost. Trost thereafter filed bankruptcy and received a discharge from the Bankruptcy Court. Following the discharge, Buckstop filed an adversary proceeding seeking to revoke Trost's discharge pursuant to 11 U.S.C. 727(d)(1) and (2). After conducting a trial, the Court held that although revoking a discharge is an extraordinary remedy and that 727 should be liberally construed in favor of the debtor and strictly against the party objecting to discharge, Buckstop had proved by a preponderance of the evidence that Trost had engaged in a calculated pattern of deception designed to mislead the court and manipulate the bankruptcy process for the debtor's own benefit to the detriment of his creditors. Although the Court noted that the defendant was dishonest about several pre-petition transactions and assets, it based its opinion on two of the defendant's most egregious deceptions.

In order to revoke a debtor's discharge under 11 U.S.C. 727 (d)(2), a plaintiff must establish that the debtor acquired or became entitled to acquire property of the estate and knowingly and fraudulently failed to report or deliver the property to the trustee. The plaintiff must prove that the debtor acted with knowing intent to defraud. The evidence in this case revealed that Trost failed to declare assets in the form of money due to him on his schedules for services performed pre-petition. The debtor made several contradictory explanations which the Court held indicated that the defendant intentionally omitted the expected payments from his original and amended schedules and lied to the trustee, opposing counsel and the Court to cover up the omission. The Court held that the debtor's failure to disclose the money due to him and his numerous attempts to deceive the court as to his expectation of payment was sufficient to warrant a revocation of discharge under 727(d)(2).

In order to revoke a debtor's discharge 11 U.S.C. 727(d)(1), a plaintiff must prove that the debtor committed fraud in fact in procurement of the discharge, and sufficient cause must have existed which would have prevented the discharge had they been known and presented at the time. Further, the plaintiff must prove that it was unaware of the fraud at the time the discharge was granted. The plaintiff in this case proved by a preponderance of the evidence that Trost fraudulently transferred stock shortly before filing of the bankruptcy in order to keep the stock from his creditors and that it was unaware of this transfer prior to Trost's discharge.

Overall, the Court noted that this was not case which presents one or two minor mistakes that might be written off as oversights. Instead, this case was one showing a calculated pattern of deception designed to mislead the Court and manipulate the bankruptcy process for the debtor's own benefit to the detriment of his creditors.

In re Sielaff, Case No. 93-8368 (Bankr. WD Mich Feb. 28, 1994). Judge Gregg held that the Debtor had an equitable interest in a vehicle which was titled in the name of his father, but for which he had made payments on with the knowledge and consent of the creditor. Therefore, when the creditor repossessed the vehicle post-petition, it was a willful violation the automatic stay.

The Debtor attempted to purchase a car on credit from Berger Chevrolet. Because the Debtor was not credit-worthy, Berger required that a co-signer sign the credit application. The Debtor's father signed the documents as the purchaser of the vehicle. The title to the vehicle indicated that the father was the owner and, for a period of time, the vehicle was maintained under hi s father's insurance policy. The Debtor did make the $20.00 down payment on the vehicle and took responsibility for making the monthly installment payments thereafter. Berger sold and assigned the vehicle sales contract to D & N Savings Bank, FSB. Because of the Debtor's health problems, his father made several of the installment payments on behalf of the Debtor and loaned money to the Debtor to make some of his payments. Throughout the loan relationship, payments were often, if not regularly, made late. D & N's lending department contacted the Debtor and the Debtor's father several times by telephone to

encourage or demand past-due payments. The Debtor directly received late notices and phone calls from D & N.

The Debtor filed a voluntary petition for bankruptcy relief and notified D & N of the bankruptcy filing. D & N elected to repossess the vehicle shortly after the bankruptcy filing. After receiving warnings from Debtor's counsel, D & N refused to return the vehicle to the Debtor because the vehicle was titled in his father's name. Debtor filed this motion to hold D & N in civil contempt for repossessing the vehicle in violation of the automatic stay.

To determine whether the automatic stay had been violated, the Court analyzed whether the vehicle was actually property of the Debtor's estate. Because the Debtor did not hold legal title to the vehicle, the Court considered whether the Debtor had an equitable interest in the car. The Court reviewed the Michigan Vehicle Code which defines "owner" of a vehicle as including the person who has exclusive use of a vehicle for more than thirty days. Relying on that definition and several other factors, the Court held that the Debtor had an equitable interest in the car. D & N's conduct throughout the entire loan relationship indicated that it viewed the Debtor as the ultimate purchaser of the vehicle. The Debtor had made approximately three-quarters of the payments on the vehicle. D & N admitted awareness and acceptance of the Debtor's arrangement with his father for payment and possession of the vehicle. D & N's internal documents showed repeated contacts and negotiations for payment with the Debtor.

As to damages, the Debtor requested actual damages and punitive damages for D & N's willful violation of the stay under 362(h). The Court held that 1) there must exist a specific and definite court order which has been violated; and 2) the person who violated the order must have had prior knowledge of it. The Court held that both elements existed in this case, but refused to award punitive damages. The Court noted that D & N's conduct was not egregious and that D & N, albeit mistakenly, believed that the Debtor had no legal or equitable interest in the vehicle which was protected by the automatic stay. Further, because no reported bankruptcy case in Michigan existed which interpreted Michigan law on this issue, D & N's conduct did not warrant punitive damages. The Court awarded the Debtor his actual damages, costs and attorneys' fees.

EDITOR'S NOTEBOOK

Well, here it is -- time to get another edition of the Newsletter out. I think that I'm starting to get the hang of it.

You will notice that this edition of the Newsletter is labeled as "March-April". The longstanding publications deadlines have required articles and summaries to be delivered by the 20th of the month, which gives the Editor approximately one week to do the editing and send the Newsletter to the Printer. Even when all of the deadlines are met, the finished product is not delivered to the membership until the beginning of the next month. As it seems somewhat silly to distribute a March Newsletter in April, I have decided to accelerate the date to accord with the printing schedule. Consequently, the April edition should actually be distributed in April, instead of in May. Everyone will still continue to receive a Newsletter each month; the Newsletters will just be dated a little more accurately.

Anyone interested in submitting an article for the Newsletter, please give me a call. We'll print just about anything, as long as it mentions bankruptcy. Or, if you are interested in doing case summaries, pick up the phone and let me know. The people who write the articles and case summaries really make this Newsletter what it is.

Legal Definition -- Corpus Delecti: What cannibals call the main course.

Peter A. Teholiz, Editor

STEERING COMMITTEE MINUTES

A meeting of the Steering Committee of the Bankruptcy Committee of the Bankruptcy Section of the Federal Bar Association of the Western District of Michigan was held on March 18, 1994 at the Peninsular Club in

Grand Rapids. Present were Pat Mears, Denise Twinney, Bob Sawdy, Brett Rodgers, Dean Reitberg (for Dan Casamatta), Tim Hillegonds, Tom Sarb, Tom Schouten, Peter Teholiz, Marcia Meoli, John Grant, Mike Lieb, Judge James Gregg, and Judge Robert Holmes Bell, Jr. of the District Court.

1. Seminar. There was no report from the education committee. Denise Twinney reported that the social committee was still working on various different activities.

2. FRBP 26. Judge Gregg reported that the Bankruptcy Court had partially opted out of the impact of Rule 26, and that its remaining provisions would probably be implemented through detailed pre-trial orders. He also indicated that the federal rules committee will probably have a bankruptcy representative in the future so that the impact on the bankruptcy rules could be assessed when a new rule change was contemplated for the federal rules. He also indicated that there is some national sentiment to separate the bankruptcy rules from the federal rules.

3. Chapter 11 Financing Presentation. Pat Mears reported that various financial institutions were planning a presentation on chapter 11 financing which will be held on April 21 in Grand Rapids. Further information will be sent out by the sponsoring institutions.

4. Miscellaneous. Pat Mears reported that the National Federal Bar Association is forming a bankruptcy section. Anyone interested can contact Pat for more details. A discussion was held regarding the upcoming ABI Bankruptcy seminar scheduled for June in Traverse City, and both Bob Sawdy and Judge Gregg indicated that the organizers did not know of the Section's seminar scheduled for July and that this problem should not reoccur in future years. Judge Gregg also indicated that more and more tax protesters are attempting to use the Bankruptcy Court as a new forum in which to litigate their various (dare I say frivolous?) claims.

5. Bankruptcy Appeals. Judge Robert Holmes Bell, Jr. of the District Court gave a short presentation regarding bankruptcy appeals. He indicated that there were 37 appeals filed in 1993 and that 8-15 appeals are pending at a given time. He also indicated that because of this scarcity of appeals, the District Court Judges are not as familiar with bankruptcy issues as are the parties to the appeals. Consequently, he counseled that practitioners should try to keep things simple on appeal and perhaps analogize to non-bankruptcy principles with which the Judges might be more familiar. They should try to explain the effect of the appeal on the administration of the remainder of the file. He also indicated that to the extent that the parties to an appeal could separate the disputed facts and law, it would make the appeal process easier, because the standard of review is different for each. Finally, he indicated that the District Court appears to have the resources to handle bankruptcy appeals in an expeditious manner, and so he did not see the need for a Bankruptcy Appeal Panel at the present time.

6. Next Meeting. The next meeting of the Steering Committee is scheduled for Friday, April 15, 1994 at noon at the Peninsular Club in Grand Rapids, Michigan.

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 through February 28, 1994. These filings are compared to those made during the same period one year ago and two years ago.

Bankruptcy Chapter	February 1994	Percent Increase (Decrease)	February 1993	Percent Increase (Decrease)	February 1992
Chapter 7	629	(8.9%)	691	(27.2%)	949
Chapter 11	13	(38.1%)	21	0%	21
Chapter 12	2	(66.7%)	6	20.0%	5
Chapter 13	233	4.9%	222	(28.4%)	310
TOTAL	877	(6.7%)	940	(26.8%)	1285

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

PEM

PETER A TEHOLIZ
HUBBARD FOX THOMAS WHITE & BENGTSON
5801 W MICHIGAN AVE
P O BOX 80857
LANSING MI 48908-0857