BANKRUPTCY LAW NEWSLETTER

Published by Federal Bar Association
Western District of Michigan Chapter

VOLUME 7, NO. 1 OCTOBER, 1994

CONSTRUCTIVE TRUSTS IN THE SIXTH CIRCUIT

By: Douglass G. Boshkoff*

A constructive trust is an equitable remedy designed to prevent unjust enrichment. It permits the victim of mistake, fraud and other wrongful acts to recover a specific asset. Assume, for example, that Bob, the owner of Blackacre, (FMV=$10,000) arranges a trade with Wilbur, the owner of Whiteacre, (FMV=$20,000). To induce Wilbur to transfer Whiteacre, Bob misrepresents the value of Blackacre, claiming that his property is worth at least $20,000. After the trade goes through, Wilbur discovers the fraud. He has several remedial options which will prevent Bob from enjoying the benefit of the misrepresentation. One of these is the imposition of a constructive trust on Whiteacre in favor of Wilbur. This is an equitable remedy to prevent unjust enrichment which requires the return of Whiteacre to Wilbur.

There is nothing controversial about this remedy where only the interests of Bob and Wilbur are concerned. Indeed, the result seems eminently fair. Now let us add a complicating factor. Immediately after the one-sided transfer, Bob becomes involved in bankruptcy proceedings. If Wilbur can still impose a constructive trust on this asset, Bob's creditors will lose $10,000 of asset value which would otherwise be available to satisfy their claims. The court which imposes a constructive trust on Whiteacre will require Wilbur to return Blackacre. The net loss to Bob's estate will be $10,000 ($20,000 - $10,000). Successful assertion of this equitable remedy is inconsistent with the prevailing view that, in bankruptcy, all Bob's creditors have an equal claim to his assets. Wilbur is a creditor and equity's willingness to eliminate the unfairness in the Bob-Wilbur transaction undercuts the evenhandedness of the bankruptcy payout.

All the above seems obvious and elementary. Nonetheless, bankruptcy courts have often enforced a constructive trust notwithstanding the fact that this action favors one creditor at the expense of all others. Creditors in positions similar to Wilbur commonly receive preferential treatment.

This point is dramatically illustrated by the facts of Koreag, Controle et Revision S.A. v. Refco F/X Assoc. Inc., 961 F.2d 341 (2nd Cir. 1992). Creditor by mistake had deposited funds in Debtor's bank account after the latter had commenced bankruptcy proceedings. Then, Debtor's trustee sought to obtain a turnover of these funds from the bank. Creditor objected, arguing that New York law imposed a

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constructive trust on the post-petition deposits which prevented any turnover. The lower court refused to consider the applicability of a state law constructive remedy to the deposited funds. The Second Circuit reversed and remanded with instructions to determine whether the New York law authorized equitable relief in a situation such as this. If it did, Creditor was entitled to return of its funds. The Second Circuit struggled to explain why one claimant should be protected before all others:

> "Property interests have an independent legal source, antecedent to the distributive rules of bankruptcy administration, that determine in the first instance the interests of claimant parties in particular property. It logically follows that before a particular property may be turned over, a bankruptcy court should determine whether the Debtor has a valid ownership interest in that property when the issue is properly posed by an adverse claimant.... It is also not the case that the [Debtor's] other creditors are prejudiced by such a threshold determination as to property ownership. [Creditor] is not merely asserting rights as an ordinary creditor or claimant in a bankruptcy proceeding. Its position is that [Debtor] does not own the Disputed Funds. A determination that the funds are not property of the estate therefore does not improperly affect other creditors of the estate, because they have valid claims only against the estate's bona fide assets. The situation is clearly distinguishable from an effort by a normal bankruptcy creditor, without any plausible ownership claim to a specific asset, to gain a preferred position vis-a-vis other creditors by initiating a separate legal proceeding."

Contrast this reasoning with that of the Sixth Circuit in a recent and highly significant decision which sharply restricts application of the constructive trust remedy in bankruptcy proceedings. In XL/DATACOMP, Inc. v. John Wilson, 16 F.3d 1443 (6th Cir. 1994), Creditor provided Debtor with funds that were to be used to purchase goods for Creditor. Because of Debtor's financial difficulty, the purchase could not be completed. Creditor lost its money and did not receive any property. Creditor then attempted to recover the funds through imposition of a constructive trust. This tactic was successful in the bankruptcy court. The Sixth Circuit reversed. "Because a constructive trust, unlike an express trust, is a remedy, it does not exist until a plaintiff obtains a judicial decision 'impressing' defendant's property or assets with a constructive trust." There was no such pre-bankruptcy determination in this case. Absent a pre-bankruptcy adjudication in its favor, Creditor could not recover the money paid under a constructive trust theory.

Even more significant is the court's realistic attitude toward what occurs when the remedy of a constructive trust is invoked. Compare the prior quotation from Koreag with the following statement by Judge Batchelder in XL/DATACOMP:

> "Understandably, creditors of bankrupt debtors often feel like restaurant patrons who not only hate the food, but think the portions are too small. To press the analogy, they also don't like having to wait in line for a table, possibly being seated only to find out the kitchen has just closed. The bankruptcy court is a little like a soup kitchen, ladling out whatever is available in ratable portions to those standing in line; nonetheless, scarcity begets innovation in the hungry creditor's quest to get a little more than the next fellow. This case involves just such an effort....
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> "The equities of bankruptcy are not the equities of the common law. Constructive trusts are anathema to the equities of bankruptcy since they take from the estate, and thus directly from competing creditors, not from the offending Debtor.... The Code recognizes that each creditor has suffered disappointed expectations at the hands of the Debtor; for this reason, it makes maximization of the estate the primary concern and entitlement to shares of the estate -secondary. Imposing a constructive trust on the Debtor's estate impermissibly subordinates this primary concern to a single claim of entitlement.
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> "...To permit a creditor, no matter how badly he was 'had' by the Debtor, to lop off a piece of the estate under a constructive trust theory

is to permit that creditor to circumvent completely the Code's equitable system of distribution."

The majority opinion in XL/DATACOMP is notable for its open and pronounced hostility toward equitable intervention in favor of one creditor. Judge Guy, concurring in result, suggested a less dramatic approach. Since applicable state law favored a lien creditor over the constructive trust claim, Judge Guy preferred to reject the plaintiff's claim by applying section 544(a).

Equitable intervention to protect one creditor is inconsistent with bankruptcy's goal of an evenhanded distribution. XL/DATACOMP is a major decision restricting such intervention within the Sixth Circuit. If the majority opinion commands respect in other circuits, this opinion may come to be regarded as one of the most significant bankruptcy decisions of the decade.

Suggested Additional Reading

Dan B. Dobbs, Law of Remedies 4.3(2) (2nd ed. 1993)

Emily L. Sherwin, Constructive Trusts in Bankruptcy, 1989 U. of Ill. L. Rev. 297.

Carlos J. Cveras, Bankruptcy Code Section 544(a) and Constructive Trusts: The Trustee's Strong Arm Powers Should Prevail, 21 Seton Hall L. Rev. 678 (1991).

CHAPTER 13 STATISTICS

By: Joseph Chrystler

The National Association of Chapter 13 Trustees Statistical Data Committee, of which I am a small part, has finished its annual compilation for the year ended September 30, 1993, and for anyone who is unaware that Chapter 13 is 'big business,' the numbers are quite startling. It certainly starts the mind working as to what the results might be if our Court were one of 'first resort,' rather than, supposedly, one of 'last resort,' after all other reasonable methods of debt resolution have been exhausted.

158 of 183 Standing Chapter 13 Trustees nationwide responded to the survey, which is compiled from the audited financial statements of the trustees, in the twenty-one national regions serviced by the United States Trustee system in 48 states, and in Alabama and North Carolina, which are still maintained under the supervision of the Administrative Office of the United States Courts. The report indicates total receipts in Chapter 13 cases of $1,854,935,270, total disbursements to counsel, creditors, trustee fees and other of $1,738,022,240, new cases for the year of 232,758, and cases in inventory at the end of the year of 501,778. When extrapolated to include the 25 trustees who did not respond, the numbers become; receipts - $2,148,656,631, disbursements - $2,013,230,904, new cases 269,614, and total cases in inventory of 581,232. Thus it appears we are a $2 billion dollar annual industry - - not exactly small potatoes. One wonders where that would place us on the Fortune 500 list!

In Region 9, comprised of Michigan and Ohio, receipts and disbursements were $191,532,214 and $178,249,864, respectively, outstripped only by Region 8 (Kentucky and Tennessee), and Region 21 (Florida and Georgia). My understanding is that the two Atlanta trustees have more cases pending than all of the Michigan trustees combined, and the two Memphis trustees alone equal our total number of cases. There are four other trustees in each of Georgia and Tennessee, each with a substantial caseload that combined in each state also outstrips the total Michigan cases in inventory. Somewhat surprisingly, each of Regions 6 and 7, which comprise all of Texas, and Regions 15, 16 and 17, comprising all of California, neither received or disbursed as much as our Region, based on reported results.

Other interesting statistics from the report

	Region 9	National Average
Trustee fee percentage	6.58	7.54
Cases active - average	2,605	3,196
New cases - average	1,035	1,492
Percentage of Chapter 13 filings to all filings	23.87	31.30

Percentage of receipts disbursed--average	92.64	92.15
Percentage of cases completed -average	41.93	32.89
Number of cases converted to Chapter 7--average	138	186
Number of cases dismissed short of completion- average	417	784
Number of days from filing to first disbursement--average	81	108
Percentage of plans originally proposed at 100% to unsecured creditors	36.54	28.60
Average percentage disbursed to unsecured creditors	34.46	30.04
Average dollars disbursed per case	4,595	4,494
Average attorney fee -- non-business case	$879	$1,010
Administration cost per case - average	$231	$255
Funds disbursed to - average: (as a percentage of total funds disbursed)		
Secured creditors	63.09	57.62
Priority creditors	7.11	11.82
Unsecured creditors	24.01	23.02
Other - counsel for Debtor, Clerk fees and other administrative expense	5.79	7.54

Major areas of trustee expenses are as follows: (as a percentage of total expenses of trustee administration expenses):

Rent	8.20	8.63
Computer costs - not including initial purchase	6.09	6.74
Total employee cost, including taxes and fringe benefits	57.11	55.63

Only four Regions had a greater percentage of cases completed than our Region 9, which had an average completion rate of 41.93%. Region 16, not surprisingly, which comprises Los Angeles and environs, had the lowest completion percentage, 8.18%. This is the area with the major problem of pro se filings and petition filings that are dismissed without a plan ever being filed. Many Debtors achieve several additional months of free apartment, condo or home occupancy in this area with out the necessity of ever filing a plan. The next lowest Region as to plan compilation was at 20.35%, so in this instance the results in Region 16 really skew the national average.

Twenty-two trustees nationwide, in virtually every instance those with substantial caseloads where the additional expense can be more easily absorbed, report having some form of a formal Debtor education program. Some Courts have made attendance mandatory, some have not. Twelve trustees report the formation of a creditor participation program to help Debtors reestablish realistic credit relationships upon successful plan completion. Again, these are primarily in areas with substantial filings. The trustees in Columbus, Ohio and San Antonio, Texas have spearheaded this effort, and report excellent results and no loan defaults to date.

In conclusion, and to end on a bit of a self-serving note perhaps, we seven Chapter 13 Trustees in Michigan, together with our eight colleagues in Ohio who form Region 9, take a great deal of pride in what we do and the way we do it. Each of the fifteen trustees has been in place for many years. We are always open to suggestions as to how to make the system work better, and the integrity of the bankruptcy system and our role within it in dealing with all parties, debtors, creditors, debtor counsel, creditor counsel, the Court, the Clerk's office and the United States Trustee system is now, and should always be, our primary concern. We meet at least once annually to share 'war' stories and try to find workable solutions to new case administration problems, and occasionally meet with our Tennessee and Kentucky counterparts who operate in the Sixth Judicial Circuit

RECENT BANKRUPTCY DECISIONS

6th Circuit and Supreme Court decisions are summarized by John Potter; this month's Western District cases are summarized by Vicki Young; and

Eastern District cases are summarized by Jaye Bergamini.

In Re Laguna Associates Limited Partnership, (Laguna Associates v. Aetna Casualty & Surety Company), Case No. 93-1573, 1994 Fed App 0270p, File Name: 94a0270, p.06, (6th Cir. 7/27/94). In July of 1988, Aetna Casualty & Surety Company loaned $19.4 million to Beztak Company, a Michigan partnership, to build Lakeside Terrace Apartments, in Sterling Heights, Michigan. To ensure Beztak remained involved in the management of the Apartments, the mortgage prohibited Beztak from transferring the property unless Beztak: (1) Demonstrated the proposed transferee met Aetna's customary credit and experience standards; and, (2) At least one of the Beztak partners retained a five percent general partnership interest in the proposed transferee.

On February 11, 1992, Laguna Associates Limited Partnership (Laguna) was formed. Laguna's sole general partner was Laguna General, Inc., a Michigan corporation, and its sole limited partner and 99 percent owner was Beztak. On March 5, 1992, contrary to the terms of the mortgage, Beztak recorded a deed transferring all of its rights and duties in the Apartments to Laguna. The next day, Laguna filed a Chapter 11 petition. Later, Aetna filed a motion for relief from stay so it could foreclose on the Apartments. The bankruptcy court granted Aetna's motion, concluding that Laguna filed its petition in bad faith. In making its conclusion, the bankruptcy court found that Debtor: was created at the eleventh hour; was not engaged in an ongoing business; lacked sufficient cash flow; had few unsecured creditors; had as its sole asset a heavily encumbered property, was driven by a desire to prevent foreclosure on the Apartments; and filed for bankruptcy one day after gaining possession of the Apartments. On appeal, the District Court affirmed.

The issue before the 6th Circuit was whether the Bankruptcy Court had abused its discretion in granting relief from the automatic stay. In affirming the lower court decisions, the Court of Appeals determined that an implicit prerequisite to the right to file is "good faith" on the part of the Debtor, the absence of which may be cause for dismissal under 11 § 1112(b). Moreover, there is no substantive difference between the cause requirement under 1112(b) and the cause requirement under § 362(d)(1). Accordingly, a lack of good faith constitutes "cause" for relief from an automatic stay. In consideration of the "bad faith" factors enumerated in other Sixth Circuit cases, the evidence before the bankruptcy court was sufficient to support a finding of bad faith by Debtor.

In re Williams Brothers Asphalt Paving Co., Inc., (Williams v Johnson), Case No. 1:93-CV-387 (WD Mich 8/12/94). Judge McKeague affirmed Judge Stevenson's decision which awarded summary judgment to trustee, Raymond Johnson, on his complaint for declaratory judgment. The Court held that a pre-petition right of refund for crude oil overcharges was property of the bankruptcy estate and outside a sale of all of the Debtor's assets to its former owner, the appellant, because the appellant failed to disclose the Debtor's right to the refund when purchasing the assets.

The Trustee sold the Debtor's name, books, records, and remaining assets to the Debtor's former owner for $500. The sale was approved by the bankruptcy court after notice to all creditors. Prior to making the offer to purchase the Debtor's assets, the appellant learned that the United State, Department of Energy was receiving applications for refund of crude oil overcharges which had been recovered from certain crude oil producers. The overcharges occurred pre-petition. The appellant applied for the refund on behalf of the Debtor, but was denied to be entitled to a refund of $16,741. After the sale, the Trustee learned of the anticipated refund and filed his complaint for declaratory judgment.

The Court held that because the refund reimbursed the Debtor for increased expenses incurred pre-petition, the right to receive the refund was property of the Debtor's bankruptcy estate. Further, the Court held that because the notice to creditors advising of the sale of the Debtor's assets to the appellant was insufficient in that it did not describe the property to be sold, the sale could be invalidated. Further, even if the sale had not be invalidated, the appellant's failure to disclose the existence of the potential claim to the Trustee before purchasing the remaining assets was a breach of his duty to make full disclosure, invalidating his purchase of the assets to the extent the approval sale could be deemed to include the claim for the refund.

In re Tranter, (Tranter v Stokes), Case No. HG-92-82619 (Bankr. WD Mich, 8/17/94). Judge Howard granted summary judgment for the Debtor, holding that the State of Michigan's post-petition tax sale of the Debtor's real property was a violation of the automatic stay.

The Debtor filed an adversary proceeding asking the court to set aside a sale of its real property which had been bid off to the state of Michigan for non-payment of real property taxes and subsequently sold to a third party. The state and the third party buyer moved for summary judgment on the basis that the Debtor lacked a sufficient interest in the property because the applicable redemption periods had run. The Debtor argued that the bankruptcy estate had a valid interest in the property and that the automatic stay barred the running of the redemption period.

The issue in this case is whether the Debtor's bankruptcy filing stays the statutory procedure regarding tax sales. The court gave a detailed analysis of Michigan General Property Tax Act. Under that Act, property with unpaid taxes can be sold after three years. The sale is held on the first Tuesday in May, and if there are no private bidders at the sale, the property is bid off to the state. Thereafter, the tax payer has until the first Tuesday in May of the following year in which to redeem the parcel from the preceding year's tax sale. Although the statute provides that the expiration of the first redemption period, "vests" title to the property in the state, that title is subject to defeasance if the Debtor redeems the property. A second redemption period runs for six months until the first Tuesday in November of the year following the tax sale. When parcels are bid to the state, the redemption period is extended until owners of the property have been notified of a hearing before the Department of Treasury. A third redemption period then extends for 30 days following the date of the hearing. Upon the expiration of the third redemption period, titled vests permanently with the state.

The Court noted that the expiration of the first redemption period automatically triggered the running of the second redemption period which extended until owners were notified of a hearing before the Department of Treasury. However, the state had to take affirmative action post-petition to effectuate the notice and hearing required to commence the third redemption period. The automatic stay enjoins acts, not time. In this case, the state still had to take affirmative action post-petition to trigger the third redemption period. Further, although the act provided that title would vest in the state, the title did not "absolutely" vest in the state because the Debtor had an opportunity to redeem the property after the expiration of that redemption period. For this reason, the Debtor still had an interest in the real property until the expiration of the third redemption period and the state's notice of hearing which occurred after the Debtor's bankruptcy filing constituted violation of the automatic stay.

Pew v Michigan River Outfitters, Inc., In re Michigan River Outfitters, Inc., Case No. 1:94 CV-124 (Bankr. WD Mich, 8/9/94). Judge McKeague reversed Judge Howard's decision and granted the appellant's motion for relief from stay. The court held that the appellant effectively terminated its lease with the Debtor under Michigan law prior to the bankruptcy filing, entitling it to relief from the automatic stay in order to evict the Debtor.

The Debtor entered into a ten year real property lease with the appellant. Prior to the bankruptcy filing, the appellant notified the Debtor that the lease was terminated immediately. Following this letter, the appellant sent the Debtor a second letter demanding delinquent rental payments, and without mentioning the termination of the lease, giving the Debtor 20 days to cure. The Debtor tendered the rental payment which the appellant accepted. Thereafter, appellant sent Debtor a third letter detailing the Debtor's lease violations and terminating the lease. The Debtor once again attempted to render its rental payment which the appellant refused.

Following its third termination notice, appellant commenced a state court eviction proceeding against the Debtor. During the pendency of this action, the Debtor filed its bankruptcy proceeding. Although the state court was aware of the bankruptcy filing, the court awarded judgment for possession in favor of the appellant. The bankruptcy court enjoined appellants from taking action to evict the Debtor pursuant to the automatic stay. The appellants filed a motion for relief from stay which the bankruptcy court denied.

The appellant argued that the lease was terminated pre-petition, and therefore, was excepted from the automatic stay under 11 § USC 362(b)(10). Judge Howard held, and the District Court agreed, that under § 362(b)(10), the lease must have terminated by the expiration of the stated term. "Stated term" refers only to the term which is provided for the duration of the lease. Because the lease in this case did not terminate under its stated term, 11 USC § 362(b)(10) did not apply in this case.

The appellant further argued that under 11 USC 365(c)(3), the trustee in this case could not assume its lease because it had been terminated pre-petition under applicable non-bankruptcy law. The Court analyzed the appellant's attempts to terminate the lease and determined that the appellant had in fact terminated the lease pre-petition. Following a detailed discussion of what constitutes waiver of default under lease agreements, the court held that although the appellant's first two notices were waived by its acceptance of the rental payment, the final notice of termination was not waived, and the lease was terminated.

Craft v United States, Case No. 1:93-CV-306 (WD Mich, 9/12/94). In this case, Judge Quist upheld the validity of an IRS levy from a single spouse upon entireties property.

In 1972, Mr. and Mrs. Craft purchased real estate by the entireties. In 1989, the IRS filed a Notice of Federal Tax Lien against the property for unpaid taxes of Mr. Craft. Five months later, the Crafts quitclaimed the property to Mrs. Craft, alone. In 1992, Mr. Craft filed a chapter 7 petition, received his discharge, and the case was closed.

Mrs. Craft attempted to sell the real estate, but the IRS refused to release its lien. Consequently, Mrs. Craft initiated an action to quiet title to the property. While the action was pending, the parties agreed to release the lien, sell the property, and turn over half of the proceeds to Mrs. Craft. The remainder of the proceeds were held in escrow, pending the result of the case. Both parties then moved for summary judgment.

Judge Quist reviewed the recent federal caselaw regarding entireties property, including the Leroy Lane cases and Fischre v United States. After doing so, he concluded that at the time that the conveyance to Mrs. Craft had been made, the entireties estate terminated. "At that point, each spouse took an equal half interest in the estate and the government's lien attached to Mr. Craft's interest." Consequently, he awarded summary judgment in favor of the IRS and awarded the escrowed funds to it.

Eberhardt v Comerica Bank, 93-75151 (ED Mich) Judge Gadola, issued 7/28/94. Debtor/Appellant sold a customer software and arranged a lease of hardware from a company, which sold the paper to Comerica Bank. In addition to the lease between the customer and the lessor, the Debtor also entered into a lease of the equipment with the lessor. The Debtor contended that the second lease was for the same equipment and was intended to act as security for payment of the first lease with the customer.

The customer went bankrupt and the first lease was uncollectible. Comerica sued the Debtor on the second lease, claiming that the "transfer" of the equipment to the customer was a violation of the boilerplate which provided that "lessee shall not assign, sell...sublet or lend equipment...without lessor's prior written consent." Comerica claimed that the "transfer" constituted a conversion and a non-dischargeable debt under 523(a)(6).

At the trial, the Debtor specifically reserved its cross-examination of witnesses on the point of the purpose and intent of the parties with respect to the double lease arrangement. At the close of the Debtor's proofs, Comerica made a motion for judgment on partial findings under FRCP 52(c). The bankruptcy court granted the motion, finding that absent a written consent by the lessor to the "transfer", there was a non-dischargeable debt by conversion on the part of the Debtor.

The District Court reversed, holding that the Bankruptcy Court erred in its application of FRCP 52(c). Since the Debtor had reserved his cross-examination on the salient point of the parties' intent and agreement with respect to the double lease arrangement, the issue had not been fully heard, as required under the rule.

Further, the District Court found that the Bankruptcy Court had failed to make a record of separate findings that the injury which resulted from the alleged conversion was both willful and malicious, as required by the Bankruptcy Code. Conversion of property may only be the basis of a finding of non-dischargeability under 523(a)(6) if the conversion was willful and malicious.

The judgment of the Bankruptcy Court was reversed and the case was remanded for further proceedings.

Bonfiglio v Harkema Associates, (ED Mich) 94-71031, Judge Gadola, issued 8/24/94. Debtor/Appellant purchased an interior design business from Harkema. The buy and sell agreement contained a provision granting the seller a security interest in equipment, fixtures and inventory of the business, which allowed for the sale and disposal of collateral, and granted the seller a "floating secured interest on all other equipment and inventory acquired by the Debtor."

The Debtor sold a portion of the collateral in order to reduce the space needed to operate the business. The collateral was not replaced and the proceeds of the sale were not paid over to the creditor. The seller moved to take back the business and the Debtor then filed chapter 7.

The seller sued the Debtor claiming that the debt was non-dischargeable because of a conversion of the collateral, under 523(a)(6). The Bankruptcy Court found that, while the Debtor's decision to downsize was a reasonable one, it was "malicious on the Debtor's part to sell the property, not replace it, and not pay or remit the proceeds" to the seller.

Prior to the Debtor's filing of chapter 7, the parties had arrived at a value of the remaining inventory and equipment, and had reduced that agreement to writing. At the time of the bankruptcy proceeding, the seller repudiated that agreement and claimed damages in excess of difference between the contract price and the remaining inventory.

The Debtor's counsel withdrew shortly before the trial and the Debtor filed a memorandum on some issues, but requested the right to supplement it upon receipt of his litigation file from his former counsel. The bankruptcy court did not allow him time to address those damage issues for which he needed his file, despite his written "reservation" of the right of supplementation.

The District Court found the Bankruptcy Court's findings of fact to be clearly erroneous on the issue of damages. Only the value of the collateral at the time of an unlawful sale would be non-dischargeable, provided that the lien was valid. However, the District Court found that the seller had no lien on the equipment and inventory sold, because the security agreement as quoted only granted the seller a lien on the replacement inventory, not on the original inventory. There was no general reservation of a security interest in the original inventory and equipment.

It also found that the bankruptcy court improperly denied the Debtor the right to time to review his file, in order to properly prepare his case.

The District Court reversed the Bankruptcy Court in full, and held the debt to be dischargeable.

Harvey v Peisner & Peisner, (ED Mich) 93-CV-72539-DT, Judge Edmunds, issued 8/22/94. In an action by the Plaintiff under the Fair Debt Collection Practices Act, the Court found that the Defendant law firm violated the Act by sending the Plaintiff Debtor a letter advising her that a levy of execution, previously filed, was being renewed, when the letter did not contain statutory warnings concerning the purpose of the letter.

Defendant law firm represented Sears. In 1986, it took a judgment against the Plaintiff in a collection action, and filed a levy against the Plaintiff's house. It did nothing in the ensuing years to collect the debt. When the levy period was about to expire, it sent the Plaintiff a letter advising her that the levy was going to be renewed, and that her house could be sold at public auction to satisfy the debt. That letter did not contain the statutory warning language, as required by the Act.

The law firm argued that the letter was sent as part of on-going litigation and was therefore exempt from the Act pursuant to Green v Hocking, 9 F3d 18 (6th Cir. 1993).

The Court found that the Green case did not apply, since the actions of the law firm were post-judgment and therefore more akin to those of a debt collector, not an attorney. The Court found that the letter violated the Act, and awarded $100 statutory damages and attorney fees.

Harvey v Comerica Bank and Shermeta, Chimko & Kilpartrick, (ED Mich), 93-CVG-74861-D, Judge DeMascio, issued 7/22/94. Plaintiff/Debtor sued Defendant law firm under the Fair Debt Collections Practices Act, alleging that it sought and obtained writs of garnishment without giving the Debtor the statutory warnings required by the Act.

Plaintiff also complained that the law firm had violated the discharge injunction obtained after the Debtor filed a petition under chapter 7 and received a discharge of the debt in question. Manufacturers Bank obtained a judgment against the Plaintiff in 1990, some time prior to its merger with Comerica. The Debtor subsequently filed chapter 7 and received a discharge. In 1993, Comerica retained the law firm to collect the judgment, allegedly without knowledge of the previous bankruptcy proceeding. The law firm obtained and served writs of garnishment against the Debtor's employer and bank accounts.

The District Court found that the law firm's post-judgment collection activities fell within the exception to the Act created by Green v Hocking, 9 F3d 18 (6th Cir. 1993), and it granted the law firm summary disposition on that portion of the Plaintiff's complaint. The Plaintiff's complaint of violation of the discharge injunction was referred to the bankruptcy court for further determination.

EDITOR'S NOTEBOOK

This issue marks the Seventh Anniversary of the Newsletter, a feat that all of us can take great pride in. From its beginnings, the Newsletter was designed to provide a summary of pertinent caselaw throughout the State, as well as to provide some in-depth analysis of bankruptcy related topics. This vision has been successfully carried through for the past six years, and it now moves forth into a seventh. Remarkably, the Newsletter has managed to keep the same relative form and purpose, in great part due to the hard work of its past editors (and in my case, due to institutional inertia). However, this form is not cast in granite. If anyone has any ideas for improving the Newsletter, or adding additional features, or just has general comments on the Newsletter, please write me and let me know.

Many people have contributed to the Newsletter over the years: the editors, the case summarizers, and the authors. The real contributors, though, are you, its readers. Without you, the Newsletter would have no purpose for being and could quietly disappear. You have been the reason that the Newsletter has survived for the past six years and you will be the reason that it will continue for a long time to come.

Following up on the August and September articles, Judge Quist has issued an opinion in Craft v US, which follows the Fischre decision. In fact, Craft goes beyond Fischre in awarding half of the entireties sales proceeds to the IRS upon sale. Craft is summarized elsewhere in this issue, but in this addendum to my September article, I believe that Craft has totally misread existing authority. The Government had made the same argument in the Leroy Lane cases, arguing first that its status as a "co-owner" of the property under the criminal forfeiture statutes had terminated the entireties tenancy and then secondly that a divorce had done so. In either case, the Government reasoned, the tenancy had been terminated and its interest attached to that of the husband. Both times, the 6th Circuit disagreed, stating in Leroy Lane II at 138:

> "When the tenancy by the entireties is destroyed, the government gets whatever Mitchell Marks possess after the entireties estate is destoyed. In this case, by virtue of the divorce court's distribution of the property, Mitchell was left with no part of the property."

Using this same logic, when the Crafts transferred their property and terminated the entireties estate, Mr. Craft was left with nothing to which the IRS lien could attach. Allowing the IRS to reach half of the ultimate sales proceeds is not supported by Leroy Lane I or II (or even by Fischre), and essentially eviscerates the existing 6th Circuit caselaw of Cole v Cardoza (which holds that a federal tax lien on a single spouse cannot attach to an entireties estate). Indeed, Craft suggests that Cole v Cardoza is now obsolete. Such a ruling cries out for an appeal.

Legal definition -- bar examination: what the superintendent of prisons has to do every so often.

Peter A. Teholiz, Editor

STEERING COMMITTEE MINUTES

A meeting of the steering committee of the bankruptcy section of the Federal Bar Association of the Western District of Michigan was held on September 16, 1994, at the Peninsular Club in Grand Rapids. Attending were : Brett Rodgers, Rob Wardrop, Peter Teholiz, Bob Sawdey, Steve Rayman, John Grant, Mike Maggio, Dan Casamatta, Bob Wright, Tom Sarb, Janet Thomas and Gordon Toering (for Tim Hillegonds).

1. Membership Issues. Bob Wright indicated that he had been contacted by various people who had asked how they could be placed on the mailing list for the Newsletter. He reported that he had told them to join the Federal Bar Association for the Western District of Michigan, as members received the Newsletter free. The Committee also decided that applications to join the FBA should be placed in the 341 room in Grand Rapids, so that they would be available for use. Committee members were also encouraged to have applications on hand for distribution to enquiring attorneys.

2. 1994 Seminar. Steve Rayman reported that all of the figures were in for the Seminar and that the Association made a profit of $3,496.00, all of which will be returned to the Federal Bar Association. He reported that the seminar was attended by 135 persons, 22 of whom 22 were from the Eastern District of Michigan. Steve also reported on the cost to duplicate the videotapes of the seminar and that he had already received four orders for the tapes. The price for the tapes alone is $75.00 and the price for the written material and the tapes is $100.00. Steve indicated that there may be a handling charge, depending on the number of orders and the ultimate costs for copying.

3. 1995 Seminar. Steve Rayman reported that most of the attendees at this year's seminar liked the idea of having several judges from outside the District (as well as the three District judges) as speakers, and so the 1995 seminar will try to continue this practice. Several names were discussed. Various names were also discussed regarding the main speaker. Steve reported that he had heard various comments about having more topics dealing with consumer bankruptcy issues, and he will keep this in mind when deciding on a speaker. The committee also decided to ask Jim Engbers to see about coordinating a golf outing for the seminar.

4. Local Rules Committee. Bob Wright indicated that with his assumption of the chair of the steering committee, he was stepping down as the chair of the subcommittee on local rules. The committee observed that the local rules have now been implemented and there does not appear to be a need for the subcommittee at this time. On a motion by Janet Thomas and supported by Brett Rodgers, the committee voted to formally disband the local rules subcommittee. Local rules issues will be handled by the committee as a whole as the need arises.

5. FBA Issues. Brett Rodgers reported on various items that had been discussed at the recent Federal Bar Association meeting.

6. Next Meeting. The next meeting of the steering committee is scheduled for Friday, October 21, 1994, at noon at the Peninsular Club, in Grand Rapids.

STEERING COMMITTEE MEMBERS (TERMS EXPIRE)

Dan Cassamatta (1996)
John Grant (1997)
Tim Hillegonds (1995)
Jeff Hughes (1996)
Pat Mears (1995)
Hal Nelson (1997)
Steven Rayman, Chair-elect (1995)
Brett Rodgers (1997)
Tom Sarb (1995)
Bob Sawdey (1996)
Tom Schouten (1997)
Peter Teholiz, Editor (1995)
Janet Thomas (1996)
Rob Wardrop (1997)
Bob Wright, Chair (1995)

BANKRUPTCY NOTICE FROM THE OFFICE OF THE UNITED STATES TRUSTEE

To Chapter 11 Bankruptcy Practitioners:

The United States Trustee's office in the Western District of Michigan, in an attempt to further improve bankruptcy administration in the District, will soon begin heightening its activity in monitoring postconfirmed Chapter 11 cases.

Practitioners remember that the Court modified its local rules in March, 1993 to require debtors to petition the Court for entry of a final decree when the debtor's plan becomes "substantially consummated." See, L. Bankr. R. 19(c) (W.D. Mich.). Substantial consummation is defined as "commencement of distribution under the plan." 11 U.S.C. Section 1101(2)(c).

Prior to enactment of this local rule provision, the Court had over 400 postconfirmed Chapter 11 cases that remained open (without a final decree). Because of the rule change and the hard work of Mr. James Robinson at the Bankruptcy Clerk of Court's office, the Court has reduced its open postconfirmed Chapter 11 caseload to 230 cases. Many of these cases however, should be closed pursuant to the local rules.

As such, the United States Trustee's office will begin taking action to ensure that open postconfirmed Chapter 11 cases are closed in an appropriate and timely fashion. The Clerk's office will provide the United States Trustee with a database of open cases in late September and early October, 1994. The United States Trustee's office will send a one-time reminder letter to these debtors and their counsel in October, 1994 with the hope that they will voluntarily close their cases. Then, in January, 1995, and at regular intervals thereafter, the United States Trustee will take appropriate legal action to ensure that open postconfirmed cases are properly closed.

This process is anticipated to be ongoing and will apply to present and future cases. However, because of personnel shortages, the United States Trustee's office will not be able to send future reminder letters to postconfirmed debtors and their counsel. Therefore, it would greatly assist case administration if debtor's counsel planned the filing of a petition for final decree in its Chapter 11 case administration procedures.

We certainly would appreciate any effort debtor's counsel could take to close postconfirmed Chapter 11 cases short of action by the United States Trustee's office. I am certain that with your cooperation, we can effectuate a timely and proper closing of these cases.

Bankruptcy Clerk of Court Mark Van Allsburg has also asked that I relate to you proposed language that the Judges wish to have included in future Chapter 11 confirmation orders. This language is intended to further facilitate proper closing of cases and is as follows:

> "The Debtor will petition the Court in accordance with the procedures set forth in L. Bankr. R. 19(c) (W.D. Mich.) for the entry of a final decree in this matter upon the substantial consummation of the plan at the earliest possible time, or within three months of the entry of the confirmation order, whichever is earlier.

Please ensure that this language is contained in all Chapter 11 confirmation order.

Should you have any questions or comments about our new procedures, please give me a call.

Dan Casamatta
Assistant U.S. Trustee

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 August 31, 1994. These filings are compared to those made during the same period one year ago and two years ago.

Bankruptcy Chapter	January 1 - August 31, 1994	Percent Increase (Decrease)	January 1 - August 31, 1993	Percent Increase (Decrease)	January 1 - August 31, 1992
Chapter 7	2824	(8.6%)	3090	(16.5%)6	3705
Chapter 11	64	(16.9%)	77	(13.5%)	89
Chapter 12	14	(44.0%)	25	31.6%	19
Chapter 13	1085	12.5%	964	(10.3%)	1075
Totals	3987	(4.1%)	4156	(15.0%)	4888

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