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TITLE AND THE DEBTOR

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The filing of a petition for relief under any chapter of Title 11 creates an estate comprised of all legal and equitable interests of the Debtor in property as of the commencement of the case, as well as those interests recovered or recoverable through transfer and lien avoidance, and exempt property. Owen v Owen, 21 BCD 1164 (U.S. Sup. Ct. 1991); 11 U.S.C. §541(a). That proposition is virtually uncontested in theory. However, in practice, one can often find the issue in dispute, or at least in some confusion, in pleadings filed with the Bankruptcy Court. Invariably, such confusion results from the inability or outright refusal of parties (usually the Debtors) to accept the necessary corollary to §541(a): the filing of a petition for relief under any chapter of title 11 divorces the Debtors from any claim to title in property that they still commonly think of as "theirs". The filing of the Bankruptcy petition has the effect of divesting the Debtor of "all legal and equitable interests" he possesses in property at the time of filing, 11 U.S.C. § 541(a)(1), and vests those interests in "a Bankruptcy estate". In Re Robison, 16 BCD 356, 357 (ED MO 1987), quoting Commercial Credit Business Loans, Inc. v Northbrook Lumber Company, Inc., 22 BR 992, 995 (ND Ill 1982).

This divorce is effected by operation of law under §541, and is final unless reversed by some other section of the Bankruptcy Code, such as abandonment under 11 U.S.C. §554, exemption under §522, or revesting under a

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[1] This article represents the personal opinion of Michael V. Maggio, University of Notre Dame Law School, 1984. The article in no way reflects the position or policies of the Office of the United States Trustee or the United States Department of Justice.

plan confirmed under §1141(b), 1227(b) or 1327(b). The practical results of such confusion can be seen, for example, in the Chapter 7 Debtor who files a motion to sell property of the estate, the Chapter 7 Debtor who files a "Chapter 20" to retain property owned free and clear of secured claims, the Chapter 11 Debtor with a trustee appointed who nonetheless wants to pay Debtor's counsel out of estate assets, and the Chapter 13 Debtor who wants to sell property in the Bankruptcy Court.

THE FILING OF A TITLE 11 PETITION DIVORCES THE DEBTOR AND TITLE

As noted above, the filing of a petition for relief under Title 11 creates an estate comprised of all the Debtor's legal and equitable interests in property as of the commencement of the case. 11 U.S.C. §541(a). Upon filing, these interests are exclusive to the estate, and are not shared. Under 11 U.S.C. §323(a), the trustee is the sole representative of the estate - no allowance is made for a Debtor or any remaining interest in a Debtor. §363(b) and (c) give the trustee the right, under certain conditions, to sell or lease property of the estate. §363 does not require the consent of the Debtor to a sale of estate property. (But see §1303, which give the Chapter 13 Debtor certain rights to sell property of the estate pre-confirmation, exclusive of the trustee; by the omission of the granting of such rights to a Chapter 7 Debtor in the text of Chapter 7, such rights are denied by implication to the Chapter 7 Debtor). Indeed, although §363 recognizes that the interests of the Debtor's spouse or co-owners may continue in the property or the proceeds of the property, (See, §363(e), (f), (g), (h), (I) and (j)) no such rights are recognized in the Debtor. The Debtor's rights in the property were terminated as of filing under §541.

Collier's recognizes this point in a discussion of why former §8 of the Bankruptcy Act (which provides that the death or insanity of a Debtor did not abate a previously filed Bankruptcy case) was omitted from the Bankruptcy Code:

> Former §8 of the Bankruptcy Act has been omitted from the Code as unnecessary. The reasoning behind the omission is that once the estate is created, no interest in estate property remains in the Debtor. As a result, if the Debtor were to die during the case, only property exempted from property of the estate or acquired by the Debtor after commencement of the case and not included as property of the estate would be available to the representative of the Debtor's probate estate. The Bankruptcy proceeding would continue in rem with respect to estate property, and the discharge would apply in personam to relieve the Debtor, and thus his probate representative, of liability for dischargeable debts.

King, 4 Collier on Bankruptcy, § 541.01, page 541-8 (1993). See also, Federal Rule of Bankruptcy Procedure 1016 (which provides that the death or incompetency of the Debtor shall not abate a liquidation case under Chapter 7 of the Code, while a reorganization under Chapters 11, 12 or 13 may or may not be dismissed); Armstrong v Peterson (In re Peterson), 897 F2d 935 (8th Cir. 1990) (Chapter 7 Debtor died post-petition; held that his exempt property remained exempt and was available for distribution to his heirs).

The Bankruptcy Code does allow some

avenues by which title to property may return to the Debtor. If the Debtor is in Chapter 11, 12 or 13, the Debtor may seek the confirmation of a plan which may revest the property of the estate in the Debtor under § 1141(b), 1227(b) or 1327(b), respectively. The Debtor may exempt some property or a portion of the sale proceeds of property under §522. The Debtor may be the beneficiary of an abandonment of property by the trustee under §554, either by the filing of an abandonment under §554(a) or (b), or by operation of §554(c) at the closing of the case (however, §554(d) makes clear that unless property is abandoned or administered, the property remains property of the estate, and by implication not property of the Debtor, unless removed from the estate by some other avenue under the Code, e.g., exemption or sale). A Debtor may also purchase property of the estate under §363, provided that the Debtor is not a Debtor in possession, in which case the prohibition of 18 U.S.C. §154(1) may proscribe such purchases by a fiduciary of the estate. The Debtor may also redeem property of the estate under §722, or reaffirm a secured claim upon property under §524(c). The Debtor may also recover property or avoid liens under §522(f), (h) and (i) to the extent that the transfer or lien impairs an exemption of the Debtor. Lastly, the Debtor may receive a distribution from a Chapter 7 estate if, at the end of the case, there has been sufficient property to pay all claims in full with interest. §726(a)(5) and (a)(6).

An important point to note, however, is that not one of these provisions allows a Debtor to unilaterally obtain title to any estate asset, or to unilaterally remove equity from the estate over and above the Debtor's allowed exemptions. To confirm a plan in any Chapter the Debtor must satisfy the liquidation analysis, and be accountable for any equity to the creditors, in essence purchasing the equity from the creditors on contract. The Debtor's exemptions under §522 are limited. The trustee can object to the exemptions, and if there is equity in the property for the estate, over and above the exemption limit, then the Debtor cannot reach all the equity under a capped exemption. As to abandonment, presumably a trustee would never abandon property that had equity in it for the estate after costs of administration, nor would the Court compel such an abandonment. If the Debtor purchases property, then the Debtor is usually buying any equity he receives.

As for redemption, §722 limits redemption to property that is exempt or has been abandoned by the trustee, so a Debtor may not unilaterally redeem equity out of the estate against the wishes of the trustee. Equally, §522(f), (h) and (i) apply only to otherwise exempt property. Reaffirmation under §524 is even more limited. Nothing in §524 transfers title of reaffirmed property from the estate to the Debtor. Therefore, unless reaffirmation is used in conjunction with some other provision which does transfer title (e.g., exemption or abandonment), then the Debtor has promised to pay a secured claim against the estate and owns no property himself. Lastly, the right to any excess after the payment in full of all claims is in theory the least discretionary but in practice the most uncertain, since the Debtor may be subordinated to even late filed claims under Federal Rule of Bankruptcy Procedure 3002(c)(6). Nor is the right to the excess a right to title to any asset, but merely a right to be paid from proceeds, as are so many of these provisions.

This review is "black letter" law, but has been included to stress one point: the filing of a title 11 petition divorces a Debtor from all title to all property, and title may be recovered by the Debtor only by the consent and action of the Bankruptcy Court and the trustee. The Debtor's rights under these sections are not even contingent rights (except for §726(a)(5)

and (a)(6), but are discretionary with the Bankruptcy Court.

THE CHAPTER 7 DEBTOR WHO WISHES TO SELL ESTATE PROPERTY

Upon occasion, a Debtor files a motion to sell property of the Chapter 7 estate. The motivation may simply be that the Debtor has exempt equity in the property, while the estate has no equity, and the Debtor wishes to sell the property quickly in Bankruptcy Court to realize the equity while making it clear to all that the Debtor is not trying to "hide" any equity over and above the exemptions from the estate. The motivation may be laudable, but unfortunately the Debtor is incorrect. First, under §363, only a trustee or a Debtor in possession (or a Chapter 13 Debtor under §1303) has standing to sell property of the estate. "[T]he Bankruptcy Code vests in the Bankruptcy Trustee the exclusive right, power and authority to sell the property of Chapter 7 Bankruptcy estates. As Chapter 7 Debtor, Debtors did not have the right to sell their home, an asset of the Bankruptcy estate." In Re Manfred Paul Robinson, 16 BCD 356, 357 (ED Mo. 1987). More fundamentally, the Debtor has nothing to sell. As demonstrated above, the Debtor does not have title to property unless the trustee has abandoned the property.

Therefore, if the Debtor needs to sell property to realize exempt equity quickly, the proper course is to ask the trustee to consider the abandonment of the property. Failing that, the Debtor may file a motion to request that the Court direct that the property be abandoned under §554(b). Once the property is abandoned, the Debtor has title to the property again and can sell the property on the open market without Bankruptcy Court authority.

CHAPTER 20 AND PROPERTY FREE AND CLEAR IN CHAPTER 7

A "Chapter 20" is the filing of a Chapter 7 case to discharge unsecured debt, followed by the filing of a Chapter 13 case in order to deal with claims that survive the discharge against property or the Debtors (e.g., secured claims against property or nondischargeable debts). A "Chapter 20" allows the Debtors to retain property that the Chapter 7 estate has no interest in, and which otherwise would be abandoned by the Chapter 7 estate and foreclosed upon by the secured creditor. The United States Supreme Court permitted this practice in Johnson v Home State Bank, 111 S.Ct. 2150 (1991).

Although rare, it sometimes happens that a Chapter 7 Debtor will have totally unencumbered property, as well as totally secured property, and will file a Chapter 13. The question then arises as to what property becomes property of the Chapter 13 estate. The Debtor may say that all the property flows from the Chapter 7 estate to the Chapter 13 estate. However, Johnson does not require, or permit, that result.

To understand why, consider a Debtor who owns two parcels of land. Parcel A is a sizeable acreage of vacation land far from town, and totally unencumbered. Parcel B is the family home in the Debtor's name alone, which the Debtor must retain, and which has no equity in it for the estate or the Debtor. At the filing of the Chapter 7, both parcels become property of the Chapter 7 estate. If the Chapter 13 is filed before the closing of the Chapter 7 or the filing of an abandonment by the Chapter 7 trustee, then the Debtor owns neither parcel. The Chapter 13 estate, like the probate estate referred to in the Collier's extract above, owns only the Debtor's exemptions from the Chapter 7 case, and after acquired property, and the change of property from the estate from any one of the various

avenues referred to above. Nothing about the filing of a Chapter 13 effects any transfer of title from the Chapter 7 estate to the Chapter 13 estate.

In this situation, the Chapter 7 trustee should abandon the home, since there is no equity in it for creditors. The Debtor then has title to Parcel B again. Under §1306(a)(1), that post-chapter 13 filing acquired property interest becomes property of the Chapter 13 estate. The Debtor can then propose a Chapter 13 Plan which will allow the Debtor to retain the home, cure the arrearages, etc. Meanwhile, the Chapter 7 trustee should sell Parcel A, and distribute the proceeds to the unsecured creditors.

Both parcels cannot and should not become property of the Chapter 13 estate for a variety of reasons. First, absent abandonment or an exemption, there is no means by which title to the two parcels can be transferred from the Chapter 7 to the Chapter 13 estate. Second, any other result would be inequitable to the unsecured creditors, for the unsecured creditors will have their claims discharged in the Chapter 7 case. Their only hope of repayment in whole or part is the unencumbered Parcel A. If Parcel A is not liquidated but rather put into the Chapter 13 case, then the unsecured creditors will be discharged in the Chapter 7 and will receive nothing, while the Debtor receives a windfall, keeping both parcels merely for the price of curing the mortgage on Parcel B, which the Debtor was going to have to pay anyway, and paying any post-chapter 7 creditors.

It might be answered that the Debtor could waive the discharge, either formally or informally by simply scheduling the unsecured creditors in the Chapter 13. If that is what the Debtor sincerely intends, however, then the Debtor should have originally filed a Chapter 13 petition. Second, if the Debtor has already received the discharge, then the discharge may not be revocable under §727(d) except upon certain conditions, and then only if the request is made by the United States Trustee, the case trustee or a creditor (but not the Debtor), and only if the request is made no later than one year after the granting of the discharge or no later than the closing of the Chapter 7 case, whichever is later. If the discharge remains in force, then the Debtor may pick and choose creditors to pay, or even change his mind as to who to pay, with impunity. To allow the transfer of the unencumbered Parcel A to the Chapter 13 estate upon such terms would be very unwise, and exceedingly inequitable to unsecured creditors.

If Parcel A does not become property of the Chapter 13 estate, how does Parcel B become property of the estate under Johnson? The Johnson opinion focused upon the nature of the secured claim against the real estate, and held that since the secured claim against the property survived the Chapter 7 discharge, then the claim could be included in the Chapter 13. Therefore, since there are no secured claims against Parcel A, there are no claims against Parcel A which survive the Chapter 7 discharge, and no claims against Parcel A that can be included in the Chapter 13 case. The secured claim against Parcel B, however, can be scheduled in the Chapter 13 case.

More fundamentally, in Johnson, the Bankruptcy Court had granted relief from the automatic stay as to the property before the filing of the Chapter 13 petition. 111 S.Ct. 2152. That is the pattern of all the leading cases on "Chapter 20". In most cases, the automatic stay had been lifted signifying that the Chapter 7 estate had no interest in the property and the Chapter 7 trustee would abandon the property expressly or at the closing of the case. In Re Johnson; Society National Bank v Barrett (In Re Barrett), 964 F2d 588 (6th Cir. 1992); In Re Hodurski, 156 BR 353 (Bankr. D. Mass. 1993); Helbock v Strause (In Re Strause), 97 BR 22 (Bankr. SD Cal. 1989); Jim Walter Homes, Inc. v

Saylors (In Re Saylors), 869 F2d 1434 (11th Cir. 1989). Some cases were also "no asset" cases, which would invariabley lead to the automatic abandonment of title back to the Debtors at the close of the case under §554(c). In Re Strause; In Re Saylors; Downey Savings and Loan Assoc. v Metz (In Re Metz), 820 F2d 1495, 1396 (9th Cir. 1987). In Saylors, the Chapter 7 trustee had filed his final report and abandoned all interest in the Debtor's property a week after the Chapter 13 filing. 869 F2d at 1435.

Therefore, title to our hypothetical Parcel B, the totally secured home, will pass back to the Debtor by the decision of the Chapter 7 trustee to abandon the property either expressly or by operation of §544(c) at the closing of the case, or his decision not to contest a relief from stay motion or the Debtor's claim to the property. The Debtor does not obtain title simply by filing the Chapter 13 petition. Indeed, if the Debtor files a Chapter 13 and schedules both Parcel A and Parcel B as both property of the Chapter 13 estate, the Chapter 7 trustee can and should contest the Debtor's claim to Parcel A on the grounds that Parcel A does not belong to either the Debtor or the Chapter 13 estate, and that to allow the Debtor to seize Parcel A back would be inequitable to creditors.

PAYING THE CHAPTER 11 DEBTOR'S ATTORNEY AFTER APPOINTMENT OF A TRUSTEE

The Bankruptcy Court may order the appointment of a trustee in a Chapter 11 case for a variety of reasons. Those reasons may generally be summarized as follows: the Court believes that the business can be reorganized or at least is not yet convinced the business cannot be saved, but substantial questions have been raised as to whether the Debtor in possession is capable of effecting the reorganization. Understandably, the forner Debtor in possession, now merely a Debtor, often does not agree with this result. As a party in interest, the Debtor has a right to pursue his own litigation strategy. While he was Debtor in possession it was assumed that his strategy was the estate's and the estate paid for the attorney for the Debtor in possession. Should the estate now pay for the Debtor's attorney?

The answer hinges in part on when the case was filed, for last fall's amendments to the Bankruptcy Code made a substantial change in the language of §330.

The former language of §330 provided that the Court could award compensation to a "trustee, to an examiner, to a professional person employed under §327 or 1103 of this title, or the Debtor's attorney" and that compensation was to be for actual, necessary services, based on the nature, the extent, and the value of such services, and the cost of comparable services. In essence, even after the Debtor ceased to be a Debtor in possession, he could obtain compensation for his attorney provided the attorney benefitted the estate, as opposed to benefitting the Debtor alone.

The Code language has now changed. Section 330(a)(1) now provides that the Court may award compensation to "a trustee, an examiner, {or} a professional person employed under §327 or 1103." The new §330(a)(1) conspicuously omits the attorney for the Debtor from the list of those entitled to compensation from the estate. Section 330(a)(4)(B) addresses this in part, authorizing the compensation of the attorney for the Debtor in a Chapter 12 or Chapter 13 case. Therefore, when a Debtor files a Chapter 11 petition and as a Debtor in possession obtains the appointment of Debtor's counsel under §327, that attorney for the Debtor in possession may be compensated by the estate. However, the appointments of a Chapter 11 trustee terminates the rights of a Debtor in

possession under §1101(1). This raises the legal question of whether the appointment of a Chapter 11 trustee terminates the Debtor's attorney's right to compensation for future services. That question has not yet been addressed by the Bankruptcy Court for the Western District of Michigan.

Assuming that the appointment of a trustee does not automatically terminate the Debtor's attorney's status as a professional appointed under §327 (which assumption is not supported by the Code language, but which is necessary for a continued discussion), the new Code language is much clearer as to the requirements for compensation. Under §330(a)(3)(A) and (C) to be compensable the services must be "necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title." Section 330(a)(4)(A)(i) and (ii) further provide that the Court may not award compensation for unnecessary duplication of services or for services that were not reasonably likely to benefit the Debtor's estate or necessary to the administration of the estate.

Based upon this new language it is even clearer that the Debtor's attorney in a Chapter 11 should not be compensated for pursuing the Debtor's own agenda as opposed to the estate's. The Debtor's attorney cannot assume that the preparation of a Plan and Disclosure Statement after the appointment of a Chapter 11 trustee is compensable; the question arises as to whether the trustee is doing a Plan as well, whether that presents an unnecessary duplication, and whether the Debtor's Plan was for the benefit of the estate or the Debtor personally. Equally, if a Chapter 11 trustee is appointed, the Debtor's attorney should not assume that he will be compensated for opposing the actions of the Chapter 11 trustee. The question will arise as to how that opposition would benefit the estate or be necessary to the administration of the estate; a benefit to the Debtor alone, or to the Debtor's principal, will not suffice.

CHAPTER 13 AND THE SALE OF PROPERTY BY THE DEBTOR

The Chapter 13 Debtor, unlike the Chapter 7 Debtor, is authorized exclusive of the Chapter 13 trustee to sell property of the estate pursuant to §363(b), under certain conditions, and subject to the same notice requirements. 11 U.S.C. §1303. Therefore, a Chapter 13 Debtor may sell property of the estate upon notice and hearing, just as a trustee could under §363(b), even though §541(a)(1) will have divested the pre-confirmation Chapter 13 Debtor of title of the property just as it divested the Chapter 7 Debtor of title.

CONCLUSION

The subject of title is rarely raised in Bankruptcy Court. Other than §541, the Bankruptcy Code does not devote much attention to the concept, leaving it to the reasoning process set forth at the outset of this article. The concept of title is indeed a state law or common law topic, not a Bankruptcy Code topic. Yet following the thread of title through the operation of the Bankruptcy Code can illuminate various aspects of the operation of the Code, and facilitate an explanation of why certain things should or should not be done under the Bankruptcy Code in Bankruptcy Court.

RECENT BANKRUPTCY COURT DECISIONS

Eastern District cases are summarized by Jaye Bergamini and Western District cases are summarized by Vicki S. Young. There were no Sixth Circuit and Supreme Court decisions.

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NBD Bank, N.A. v Linquist (In Re VanOrden), Case No. 1:95-CV-79 (WD Mich September 5, 1995). Judge Bell reversed the Bankruptcy Court's dismissal of two adversary proceedings involving NBD Bank ("NBD").

Richard VanOrden ("VanOrden") and Richard Fletcher ("Fletcher") each executed guaranties in favor of NBD. When VanOrden and Fletcher defaulted on their guaranty obligations, NBD brought actions against VanOrden and Fletcher's wives to recover fraudulent transfers which their husbands allegedly made to them. Thereafter, both VanOrden and Fletcher filed Bankruptcy. NBD filed a motion with the Bankruptcy Court seeking an order determining that its fraudulent conveyance actions against the wives were not stayed by the Bankruptcy filings. However, the parties instead agreed to remove NBD's actions against the wives to the Bankruptcy Court. Thereafter, by stipulation of the parties, VanOrden and Fletcher's Chapter 7 Trustee, Gerald Linquist (the "Trustee"), intervened in NBD's fraudulent conveyance adversary proceedings. The Bankruptcy Court then granted the Trustee's motion to dismiss the adversary proceedings so that the Trustee could refile complaints against the wives in an effort to start "over with a clean slate".

NBD filed a Motion for Reconsideration. NBD requested that the Bankruptcy Court reinstate the adversary proceedings, dismiss the Trustee as a party and remand the actions back to state court where they could be administratively closed during the pendency of the Bankruptcy cases. Thereafter, the Trustee filed separate adversary proceedings against VanOrden and Fletcher's wives. The Bankruptcy Court then denied NBD's motion.

NBD appealed, arguing that the Bankruptcy Court's dismissal of the adversary proceedings and failure to remand the actions prejudice NBD. 28 U.S.C. §1452(b) provides that a court may remand causes of action on "any equitable ground." The Court held that one equitable ground for which a motion to remand may be granted is that the Court's failure to remand will prejudice a party to the action. The Court held that NBD may be prejudiced by the Bankruptcy Court's refusal to remand the actions because (1) it was questionable whether 11 U.S.C. §108(c) would toll the statue of limitations during the pendency of the Bankruptcy proceeding with respect to NBD's claims against the wives, and (2) although speculative, NBD may lose its preferential position against the wives to another creditor who could obtain a priority position over NBD if NBD forced to file new cases. For these reasons, the Court held that NBD's cause of action should be reinstated and remanded to state circuit court.

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In re: Dow Corning Corporation, (Bankr. ED MI 1995) 95-20512. Judge Spector issued two separate written opinions on interesting procedural questions, relating to a motion for lift of stay, and a motion for stay pending appeal.

Prior to filing chapter 11, the debtor Dow Corning Corporation ("DCC") was a

party defendant to a CERCLA action filed in the federal district court for the Eastern District of Michigan, brought by Waste Management, Inc., for recovery of cleanup costs for of a landfill near Kakawlin, Michigan. The matter was on a fast trial track, with case management deadlines approaching at the time DCC filed it's petition in May 1995.

Waste Management and two of the co-defendants to the suit brought a motion for lift of stay, arguing that cause for lift of stay is shown under §362(d)(1) in that the district court was virtually certain to withdraw reference of the CERCLA action to the bankruptcy court under 11 U.S.C. §157(d). Waste Management's claim against DCC is a subject which most courts have held to require "consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce."

DCC and the creditors committees opposed the relief, pointing out that thousands of tort claims across the country were stayed by the filing, many of which were subject to trial schedules and case management orders. DCC further stated an intent to bring an adversary proceeding to determine the validity of certain disputed indemnity agreements, which were central to the CERCLA action and the issue of DCC's ultimate liability.

The court made note of the likelihood of the district court's withdrawal of the reference, and held that the central issue to be decided was not whether the stay should be lifted, but when. Since the filing of bankruptcy is intended, in part, to afford the debtor "breathing room" from litigation, the court questioned whether there would be any benefit to DCC if it delayed in lifting the stay. The issue to be determined was whether the delay in liquidating the movant's claims against DCC, which would result if the stay was not lifted, caused a sufficient and avoidable hardship to the movant, so that relief from the stay would be warranted. In pondering the timing of the lifting of the stay, the court noted that the burden of proof is on the parties opposing the relief sought. Although the court took note of the time and expense incumbent in the defense of any CERCLA litigation, it found that the debtor and the committees had not met their burden of proof in opposing the motion, so lift of stay was granted without delay.

Judge Spector also filed an opinion on the motion of the chapter 11 tort claimants committee's for a stay of an order pending appeal.

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In Re: Trevarrow Lanes, Inc., In Re: RFZ Ltd., (Bankr. ED Mich) 183 BR 475. Debtor Trevarrow Lanes is a corporation which owns a bar, lounge and bowling alley. Debtor RFZ is the lessee of the facility, and owner of the liquor license. Both filed chapter 11 after a lender allegedly reneged on a promise of financing for renovations to the facilities. The failure of financing lead the debtors to fall behind in their tax payments. The debtors also had significant secured debt owed to creditor Brunswick. The debtors sought confirmation of plans, over the objection of the IRS, the State of Michigan and Brunswick.

The IRS objected to confirmation under §1129(a)(9), because the plan classified penalty and interest as unsecured. Such classification is allowed. *In re: Suburban Motor Freight* 36 F.3d 484 (6th Cir 1994).

The IRS also objected to the plan's failure to pay the statutory interest rate on the taxes. The debtor presented evidence as to the appropriate interest rate needed to make the IRS whole over the life of the plan. The court found that the rate proposed met the test of present value under §1129(a)(9)(C). The IRS also objected because the payments were not evenly amortized over the life of the plan.

There is no requirement that the payments be equal over the life of the plan. *In re: Gregory Boat Co.* 144 BR 361 (Bankr. ED MI 1992).

Brunswick objected to the feasibility of the plan under §1129(a)(11). The plan projected income into the future greatly in excess of the historical performance. Further, the debtors prior estimates of future income had been highly inaccurate. The debtors had never met an income target or revenue projection. The nature of the bowling business is highly cyclical, and since the facility was located in Flint, a city subjected to periodic industry layoffs which greatly affect recreational industries, even more doubt was cast on the projections. In the inimitable words of Judge Spector, "The debtors purport to believe that they are riding on the deck of an ocean liner, S.S. General Motors, when in truth they are strapped to the back of a porpoise."

Brunswick rejected the plan and the debtor sought cram-down under §1129(b)(2)(A). Brunswick argued that the proposed interest rate of 9.5% was substantially below the current market rate that lenders would charge the debtor if the debtor were to seek a loan on the same terms as offered the crammed-down secured creditor, therefore the plan interest is contrary to the rule in the 6th circuit established by *Memphis Bank & Trust v Whitman* 692 F.2d 427 (6th Cir. 1982) However, the 9.5% offered by the debtor was 2.25% over prime, and Brunswick had previously financed the debtor at 12%, which was just 1.5% over prime. The court rejected the objection to the proposed interest rate.

Brunswick also argued that the treatment of the class of unsecured creditors violated the absolute priority rule under §1129 (b)(2)(B)(ii), because the shareholders, whose equity interest would be canceled upon confirmation, would then take a new equity position, post-confirmation, in exchange for a new investment of $30,000. The unsecured creditor class which objected was scheduled to be paid only 40%, and was therefore impaired.

Judge Spector held that the post-confirmation repositioning of the shareholders would violate the absolute priority rule. The right to buy new shares in the debtor was apparently limited to the current, soon to be former, shareholders. Thus the plan provision is tantamount to a stock warrant, which gives the shareholders a property interest despite the fact that the unsecured class which objected is impaired. Thus the plans as proposed violated §1129(b)(2)(B).

The debtors argued that the new value exception to the absolute priority rule would apply, as set out in *Case v Los Angeles Lumber Products Co.* 308 US 106 (1939) However, Judge Spector held that there was no exception to the absolute priority rule. Further, he found that the proposed investment of new value was not proven to be essential to the reorganization effort.

Confirmation was denied.

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In Re: University of Michigan v Agency Rent-a-Car, (Bankr. ED Mich) 95-CV-70736-DT. The Westra family incurred substantial medical bills at the University of Michigan Medical Center ("UMMC"). Both parents were employed, and covered by health insurance. governed by ERISA. The coordination of benefits provision of each plan called the other primary. The wife's plan, 65 Security Plan, had a COB provision that was gender based; it designated the primary plan as the husband's. The court held that since such a provision was invalid, 65 Security Plan was primary and the husband's carrier, Agency Rent-a-Car, was excess.

65 Security Plan became insolvent and paid only 10% of the claims. UMMC seeks payment of the balance of the bills from

Agency. Agency defends, claiming that the court's prior determination that it was the excess carrier only, limited its liability to those charges which were not covered by 65 Security Plan at the time of service, without regard to the subsequent insolvency.

Agency's plan provided that when there was a COB provision in place, the benefits paid by the other plan would reduce the amount that Agency was liable to pay. Therefore, the issue was not coverage, per se, but payment of benefits. Whatever 65 Security Plan did not pay was the responsibility of Agency.

Agency challenged the standing of UMMC to assert the claim, since it is the health care provider and not the beneficiary. However, the 6th Circuit has held that a health care provider may assert an ERISA claim as a "beneficiary" of an employee benefit plan if it has received a valid assignment of benefits. *Cromwell v Equicor-Equitable HCA Corp.* 944 F.2d 1272 (6th Cir 1992). UMMC had obtained an assignment of benefits from the covered employee and therefore had standing to assert the claim under ERISA.

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In re: Voplex Corp., Newco, Inc. v Voplex, (Bankr. ED Mich) 95-CV-74702-DT. Appeal from the Eastern District Bankruptcy Court, by creditor Newco. Newco filed two proofs of claim in the Voplex estate; one for administrative expense for storage of materials ($11,000) and one for breach of contract and lost profits ($338,000). Bankruptcy Judge Graves disallowed the administrative expense entirely and reduced the other claim to $14,700. Newco appeals.

Newco supplied vinyl covered straps to Voplex, for subsequent resale to Ford Motor. Voplex supplied the metal strap, and Newco covered it with foam and wrapped in vinyl. The parties initially entered into a spot purchase order for 60,000 straps. The terms of the order required Newco to deliver the first 1000 straps, and if the straps met the specifications, Voplex was required to purchase the remaining 59,000. Newco purchased the materials necessary to complete this order and delivered the first 1000 straps, which were accepted. While the initial spot order was being filled, the parties entered into a subsequent contract under a "blanket purchase order" for 180,000 parts. A blanket purchase order was described as being an order "for the life of the part". Newco later argued that the life of the part was 7 years, although Judge Graves found no evidence to support that claim, and held that the contract was for one automotive model year.

Voplex began shipping the metal straps to be covered under the blanket purchase order, to Newco, while the original spot order was still being performed. A question arose concerning some yellowing of the vinyl in the original product first shipped. Newco tested its materials and denied responsibility for the problem. Voplex canceled its contract.

Newco contended that Voplex was responsible for the lost profits on the blanket order, the balance due on the spot order, and failure to pay for the parts already shipped. These damages constituted the balance of its claim for breach of contract.

Newco's claim for administrative expense was based on its demand that Voplex remove the materials purchased by Newco for completion of the contract, from Newco's facility. The demand for removal was accompanied by a demand for payment for those materials. Failure to remove (and pay for) the materials would, according to Newco, result in a storage charge of $100 per day to Voplex. Newco further prevented Voplex from removing its metal straps from Newco's facility until it received payment for its bill.

The court affirmed Judge Graves disallowance of the claim for administrative

expense based on the claim of storage charges for the material. Newco claimed that its letter to Voplex, which Voplex ignored, constituted a contract based on silence or inaction under Michigan law. *Auburn v Brown* 60 Mich App 258 (1975). But since Newco demanded not only that the material be removed, but that it be paid for as well, Judge Graves ruling that Voplex's silence did not create a contract for storage was not clearly erroneous, and the charges for storage were disallowed.

The claim for breach of contract contained charges for storage (disallowed), materials, finished goods sold and delivered, and lost profits. Lost profits of $274,000 were the largest part of the claim, and were based on interpretation of the term "blanket purchase order". Newco testified that the term covered the life of the part, which was assumed to be 7 years. However, the printed contract apparently referred to one year, and Judge Graves held that there was no evidence to support a 7 year commitment. Since lost profits must be established by a sufficiency of proofs, that portion of the claim was properly disallowed.

Judge Graves found that Voplex had received and failed to pay for $14,700 of parts on one invoice. The District Court reviewed the record and added another $667 to those damages, allowing a total of approximately $15,300. The balance of Newco's claim was for materials it had purchased in anticipation of performing on the blanket purchase order. Newco claimed that it was entitled to those costs as incidental damages to a breach of contract under U.C.C. article 2. MCLA 440.2710 defines incidental damages as including any commercially reasonable charges, expenses or commissions incurred, resulting from a breach of contract. Here Newco argues that the failure to pay for the goods sold and delivered was a breach of contract, which entitled Newco to payment of incidental damages for materials it purchased in anticipation of performing the contract.

However, Judge Graves found, and the District Court affirmed, that the alleged breach of contract by non-payment occurred substantially after the materials were purchased. Therefore, the purchase of the materials was not incidental to the breach, and Newco could not recover their cost.

LOCAL BANKRUPTCY NOTICE

Enclosed is a preliminary draft of proposed amendments to Bankruptcy Rules which appeared in a recent edition of Bankruptcy Service - Lawyers Edition.

As can be seen, there is a public commentary period concerning the propriety of these proposed amendments ending on March 1, 1996.

1—Preliminary draft of proposed amendments to Bankruptcy Rules released

The Judicial Conference Advisory Committee on the Bankruptcy Rules has proposed amendments to the Bankruptcy Rules and requested comment from the bench, bar, and public. All suggestions and comments are to be submitted to the Secretary of the Committee on Rules and Practice and Procedure, Administrative Office of the United States Courts, Washington, D.C. 20544 by no later than March 1, 1996. To provide persons and organizations wishing an opportunity to comment orally on the proposed amendments, a hearing is scheduled to be held in Washington, D.C. on February 9, 1996. Those wishing to testify should contact the Secretary of the Committee at least 30 days before the hearing. The Advisory Committee Notes on the proposed amendments are summarized below.

Bankruptcy Rule 1019(3) and (5) are amended to delete such phrases as "superseded case" and "original petition" because they give the erroneous impression that conversion of a case to a different chapter of the Bankruptcy Code results in a new case or a new petition for relief, and to make stylistic improvements.

Rule 1020 is added to provide procedures and time limits for a small business to elect to be considered a small business in a Chapter 11 case under §§ 1121(e) and 1125(f) of the Code as amended by the Bankruptcy Reform Act of 1994 ("BRA 1994").

Rule 2002(a) is amended to provide for notice of a meeting called for the purpose of electing a Chapter 11 trustee under Code § 1104(b), as amended by BRA 1994. The court for cause shown may order the 20-day period reduced pursuant to Rule 9006(c)(1).

Rule 2002(n) is amended, consistent with the 1994 amendment to Code § 342(c), to provide for the inclusion of certain information in the caption of every notice required to be given by a debtor to a creditor. As provided in § 342(c), the failure of a notice given by the debtor to a creditor to contain the information required by § 342(c) does not invalidate the legal effect of the notice.

Rule 2007.1 is amended to provide procedures for the election of a Chapter 11 trustee under Code § 1104(b) as amended by BRA 1994. The amended rule requires the United States trustee to file an application for court approval of the appointment of the elected person in accordance with Rule 2007.1(c). Court approval is necessary primarily because of the requirement under § 1104(b) that the person be disinterested. The procedures for reporting disputes to the court derive from similar provisions in Rule 2003(d) applicable to Chapter 7 cases. An election may be disputed by a party in interest or by the United States trustee. For example, if the United States trustee believes that the person elected is ineligible to serve as trustee because the person is not "disinterested," the United States trustee may file a report disputing the election. The word "only" is deleted from Rule 2007.1(b), redesignated as subdivision (c), to avoid any negative inference with respect to the availability of procedures for obtaining review of the United States trustee's acts or failure to act pursuant to Rule 2020.

Rule 3014 is amended to provide a time limit for secured creditors to make an election under Code § 1111(b)(2) in a small business Chapter 11 case in which a conditionally approved disclosure statement is finally approved without a hearing.

Rule 3017(a) is amended to provide that it does not apply to the extent provided in new Rule 3017.1, summarized below, which applies in small business cases.

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Rule 3017(d) is amended to give the court flexibility in fixing the record date for the purpose of determining the holders of securities who are entitled to receive a disclosure statement, ballot, and other materials in connection with the solicitation of votes on a plan. For example, if there may be a delay between the oral announcement of the judge's order approving the disclosure statement and entry of the order on the court docket, the court may fix the date on which the judge orally approves the disclosure statement as the record date so that the parties may expedite preparation of the lists necessary to facilitate the distribution of the plan, disclosure statement, ballots, and other related documents. The court may set a record date pursuant to subdivision (d) only after notice and a hearing as provided in § 102(1) of the Code. Notice of a request for an order fixing the record date may be included in the notice of the hearing to consider approval of the disclosure statement mailed pursuant to Rule 2002(b). If the court fixes a record date pursuant to subdivision (d) with respect to the holders of securities, and the holders are impaired by the plan, the judge also should order that the same record date applies for the purpose of determining eligibility for voting pursuant to Rule 3018(a).

Rule 3017.1 is added to provide procedures, consistent with Code § 1125(f) as added by BRA 1994, for the conditional and final approval of a disclosure statement in a small business Chapter 11 case. The procedures for electing to be considered a small business are set forth in Rule 1020. If the debtor is a small business and has elected to be considered a small business, § 1125(f) permits the court to conditionally approve a disclosure statement subject to final approval after notice and a hearing. If a disclosure statement is conditionally approved, and no timely objection to the disclosure statement is filed, it is not necessary for the court to hold a hearing on final approval.

Rule 3018(a) is amended to give the court flexibility in fixing the record date for the purpose of determining the holders of securities who may vote on a plan. For example, if there may be a delay between the oral announcement of the judge's decision approving the disclosure statement and entry of the order on the court docket, the court may fix the date on which the judge orally approves the disclosure statement as the record date for voting purposes so that the parties may expedite preparation of the lists necessary to facilitate the distribution of the plan, disclosure statement, ballots, and other related documents in connection with the solicitation of votes. The court may set a record date pursuant to Rule 3018(a) only after notice and a hearing as provided in § 102(1) of the Code. Notice of a request for an order fixing the record may be included in the notice of the hearing to consider approval of the disclosure statement mailed pursuant to Rule 2002(b). If the court fixes the record date for voting purposes, the judge also should order that the same record date shall apply for the purpose of distributing the documents required to be distributed pursuant to Rule 3017(d).

Rule 3021 is amended to provide flexibility in fixing the record date for the purpose of determining the holders of securities of record who are entitled to receive distributions under a confirmed plan. In a large case, it may be impractical for the debtor to determine the holders of record with respect to publicly held securities and also to make distributions to those holders at the same time. Under this amendment, the plan or the order confirming the plan may fix a record date for distributions that is earlier than the date on which distributions commence. This rule also is amended to treat the holders of bonds, debentures, notes and other debt securities the same as any other creditors by providing that they may receive a distribution only if their claims have been allowed. Finally, the amendments clarify that distributions are to be made to all interest holders (not only those that are "equity security holders" under § 101 of the Code) whose interests have not been disallowed.

Rule 8001(a) is amended to conform to BRA 1994 which amended 28 USCS § 158. As amended, a party may—without obtaining leave

of the court—appeal from an interlocutory order or decree of the Bankruptcy Court issued under § 1121(d) of the Code increasing or reducing the time periods for filing a Chapter 11 plan under § 1121.

Rule 8001(e) is amended to provide a procedure for electing under 28 USCS § 158(c)(1), as amended by BRA 1994, to have an appeal heard by the District Court rather than by a Bankruptcy Appellate Panel.

Rule 8002(c) is amended to provide that a request for an extension of time to appeal must be "filed" (rather than "made") within the applicable time period. This amendment is intended to avoid uncertainty as to whether the mailing of a motion or an oral request in court is sufficient to request an extension of time, and to enable the court and the parties in interest to determine solely from the court records whether a timely request for an extension has been made. The amendments also give the court discretion to permit a party to file a notice of appeal more than 20 days after the expiration of the time to file a notice of appeal otherwise prescribed, but only if the motion for an extension was timely filed within a period not exceeding 10 days after entry of the order extending the time. This amendment is designed to protect parties that file timely motions to extend the time to appeal from the harshness of the present rule as demonstrated in Anderson v Mouradick (In re Mouradick), (1994, CA9) 13 F3d 326, where the court held that a notice of appeal filed within the three-day period expressly prescribed by an order granting a timely motion for an extension of time did not confer jurisdiction on the appellate court because the notice of appeal was not filed within the 20-day period specified in subdivision (c).

Subdivision (c) of Rule 8002 is amended further to prohibit any extension of time to file a notice of appeal—even if the motion for an extension is filed before the expiration of the original time to appeal—if the order appealed from grants relief from the automatic stay, authorizes the sale or lease of property, use of cash collateral, obtaining of credit, or assumption or assignment of an executory contract or unexpired lease under § 365, or approves a disclosure statement or confirms a plan. These types of orders are often relied upon immediately after they are entered and should not be reviewable on appeal after the expiration of the original appeal period under Rule 8002(a) and (b).

Rule 8020 is added to clarify that a District Court hearing an appeal, or a Bankruptcy Appellate Panel, has the authority to award damages and costs to an appellee if it finds that the appeal is frivolous. By conforming to the language of Rule 38 of the Federal Rules of Appellate Procedure, this rule recognizes that the authority to award damages and costs in connection with frivolous appeals is the same for District Courts sitting as appellate courts, Bankruptcy Appellate Panels, and Courts of Appeals.

Rule 9011 is amended to conform to the 1993 amendments to Federal Rule of Civil Procedure 11. The "safe harbor" provision contained in Rule 9011(c)(1)(A), which prohibits the filing of a motion for sanctions unless the challenged paper is not withdrawn or corrected within a prescribed time after service of the motion, does not apply if the challenged paper is a petition. The filing of a petition has immediate serious consequences, including the imposition of the automatic stay under § 362 of the Code, which may not be avoided by the subsequent withdrawal of the petition. In addition, a petition for relief under Chapter 7 or Chapter 11 may not be withdrawn unless the court orders dismissal of the case for cause after notice and a hearing.

Rule 9015 is added to provide procedures relating to jury trials in bankruptcy cases and proceedings, including procedures for consenting to have a jury trial conducted by a bankruptcy judge under 28 USCS § 157(e) that was added by BRA 1994. Subdivision (b) provides that, if the right to a jury trial applies, a timely demand has been filed pursuant to Federal Rule of Civil Procedure 38(b), and the bankruptcy judge has been specially designated to conduct the jury trial, the parties may

consent to have a jury trial conducted by a bankruptcy judge under 28 USCS § 157(e) by jointly or separately filing a statement of consent within any applicable time limits specified by local rule. The rule is not intended to expand or create any right to trial by jury where such right does not otherwise exist.

Certain statutes that are not codified in Title 11 or Title 28 of the United States Code, such as § 105 of BRA 1994, relate to bankruptcy administrators in the judicial districts of North Carolina and Alabama. Rule 9035 is amended to clarify that the Bankruptcy Rules do not apply to the extent that they are inconsistent with such federal statutory provisions.

2—Sixth Circuit: Creditor may initiate action to avoid preferential or fraudulent transfer

There is a split of authority on whether a creditors' committee or an individual creditor may exercise the trustee's avoiding powers in a Chapter 11 case. According to one view, if the trustee or debtor in possession unjustifiably fails to exercise the avoiding powers or otherwise abuses its discretion by not suing, a creditors' committee has the implied authority to bring an action on behalf of the estate with the approval of the Bankruptcy Court. This view also takes the position that, while individual creditors generally lack the authority to institute avoidance actions, the Bankruptcy Court may authorize an individual creditor in a Chapter 11 case to bring an avoidance action on behalf of the estate upon a showing of particularly extraordinary circumstances. On the other hand, contrasting authority holds that the trustee's avoiding powers may not be asserted by a creditors' committee or by an individual creditor. [See Bankruptcy Service, L Ed § 5B:9 and Bankruptcy Desk Guide § 17:9.] The Sixth Circuit, in Canadian Pac. Forest Prods. v J.D. Irving, Ltd. (In re The Gibson Group, Inc.) (1995, CA6 Ohio) 1995 US App LEXIS 27577, No. 94-3567, filed September 28, 1995, reversed the District Court, and held that a creditor or creditors' committee may have derivative standing to initiate an avoidance action under Code §§ 547 and 548 where: (a) a demand has been made upon the statutorily authorized party to take action; (b) the demand is declined; (c) a colorable claim that would benefit the estate if successful exists, based on a cost-benefit analysis performed by the court; and (d) the inaction is an abuse of discretion ("unjustified") in light of the debtor in possession's duties in a Chapter 11 case. Moreover, a creditor has met its burden to show standing to file an avoidance action if it has fulfilled the first three requirements and the trustee or debtor in possession declined to take action without stating a reason. The burden then shifts to the debtor in possession to establish, by a preponderance of the evidence, that its reason for not acting is justified, said the Sixth Circuit.

The creditor held a security interest in the Chapter 11 debtor in possession's accounts receivable. The creditor alleged a scheme whereby the debtor would use its accounts receivable to pay off a large portion of its debt to another creditor. The scheme involved the debtor issuing $3 million of credits to two of its customers, thus reducing their debt to the debtor by that amount. The creditor in this case alleged that these were fraudulent transfers under Code § 548(a). In return, the two customers agreed to sign promissory notes directly to a second creditor of the debtor for $3 million, reducing the debtor's unsecured debt to this other creditor by that amount. The creditor in this case alleged that this transfer occurred within 90 days before the debtor filed its bankruptcy petition and otherwise qualified as a preferential transfer under Code § 547(b).

After the debtor filed for Chapter 11 relief, the creditor in this case filed a motion with the Bankruptcy Court requesting authorization to prosecute, on behalf of the debtor's estate, an adversary proceeding to avoid and recover the allegedly preferential and fraudulent transfers. The Bankruptcy Court granted the creditor's motion, but reserved for later decision the issue of whether the creditor

LOCAL BANKRUPTCY STATICS

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 months of October of 1995. These figures are compared to those made during the same period one year ago and two years ago.

Bankruptcy Chapter	October of 1995	October of 1994	October of 1993
Chapter 7	476	347	357
Chapter 11	9	7	11
Chapter 12	1	1	0
Chapter 13	199	128	133
Totals	685	483	501

Bankruptcy Chapter	January - October of 1995	January - October of 1994	January - October of 1993
Chapter 7	3680	3111	3378
Chapter 11	55	71	87
Chapter 12	14	13	25
Chapter 13	1392	1216	1096
§304	1	0	0
Totals	5142	4411	4586

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