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SALES OF ESTATE PROPERTY

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Under the Bankruptcy Code, a Debtor-in-Possession, a Chapter 11 Trustee and a Chapter 7 Trustee are granted administrative flexibility in conducting asset sales. The assets may be sold singularly, in units, in bulk or in some combination thereof. The goal is always to obtain the highest possible bid and concomitant return to the estate. Accordingly, the Trustee or Debtor-in-Possession may structure the transaction in whatever manner best serves the estate and, subject to compliance with the Bankruptcy Code and related (Federal and Local) Rules of Bankruptcy Procedure, may consummate the transaction unless an objection is timely filed by a party with standing to object. After reviewing the provisions of 11 USC §363, this article highlights some recent decisions involving sales of property free and clear of the interests of entities other than the estate.

11 USC §363 AND RELATED RULES OF BANKRUPTCY PROCEDURE

Section 363 of the Bankruptcy Code defines the rights and powers of the trustee or Debtor-in-Possession with respect to the use, sale, or lease of property of the estate, and the rights of third parties that have an interest in the subject property. The trustee[1], after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate. 11 USC §363(b)(1). At least 20 days notice by mail of a proposed sale of estate property, other than in the ordinary course of business, is required,

[1] For these purposes, a Debtor-in-Possession has all the rights and powers of a Bankruptcy Trustee. See 11 USC §1107.

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"unless the court for cause shown shortens the time or directs another method of giving notice". FED. R. BANKR. P. 2002(a)(2).

The notice must include the time and place of any public sale, the terms and conditions of any private sale, and the time fixed for filing objections. FED. R. BANKR. P. 2002(c)(1). Notice of the sale of any property, including real estate, is sufficient if it generally describes the property. *Id.* The Western District of Michigan, L. BANKR. R. 18 (W.D. MICH.) requires all motions, complaints and orders filed in proceedings relating to the sale of real property to contain both full and complete legal descriptions, in recordable form, and street addresses, if any, of the real property in question.

The debtor, the trustee, all creditors and indenture trustees must receive notice. FED. R. BANKR. P. 2002(a). In a Chapter 11 reorganization, unless otherwise ordered, all equity security holders must receive notice of the hearing on the proposed sale of all or substantially all of the debtor's assets. FED. R. BANKR. P. 2002(d)(3). Elected or appointed committees, representatives of the United States and the U.S. Trustee should also receive notice. FED. R. BANKR. P. 2002(i), (j), and (k). A motion for authority to sell property free and clear of liens and other interests constitutes a contested matter and service must be made on the parties who have liens or other interests in the property to be sold. FED. R. BANKR. P. 6004(c) and 9014. Objections to the sale must be filed and served not less than five days before the date set for the proposed action or within the time fixed by the court. FED. R. BANKR. P. 6004(b). A hearing must be conducted if objections are timely filed.

Section 363(e) provides that upon request of an entity holding an interest in property which has been or potentially will be sold, the Court, with or without a hearing, must prohibit or condition such sale as is necessary to provide adequate protection of such interest. The term "adequate protection" is flexible, as the circumstances of each case dictate the necessary relief to be granted. Though flexible, if it cannot be provided by the debtor or the trustee, then the proposed sale will be prohibited. While interested parties may seek other forms of adequate protection in connection with a proposed §363 sale, as noted in the legislative history to the Bankruptcy Code, the most common form of adequate protection is attachment of their interest to the sale proceeds. H.R.REP. NO. 95-595, 95th Cong., 1st Sess. 345 (1977) *reprinted in* 1978 U.S.C.C.A.N. 5787.

Bankruptcy Code §363(f) further authorizes the trustee to sell property encumbered by an interest free and clear of any such interest provided one of its five subsections is complied with:

> "(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if -
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> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
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> (2) such entity consents;
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> (3) such interest is a lien and the price at which said property is to be sold is greater than the aggregate value of all liens on such property;

> (4) such interest is in bona fide dispute; or
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> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest."

Although the term "interest" is not defined, the term "claim" is defined in the Bankruptcy Code, and as stated, a holder of a claim against the debtor has an interest in property of the debtor. 11 USC §101(5). *See also,* 2 Lawrence P. King, COLLIER ON BANKRUPTCY ¶363.07 at 363-33 (15th Ed. 1994), the right to look to the estate property for satisfaction of a dispute creates an interest in property within the meaning of §363(f).

The right to convey property free of a non lien interest was considered in In re Creative Restaurant Management, Inc., 141 B.R. 173 (W.D. Mo. 1992) which involved the extent to which a Bankruptcy Court can authorize an asset sale free and clear of remedies sought by the National Labor Relations Board ("NLRB"). Pre-petition, the NLRB filed a complaint against the company alleging unfair labor practices. The Bankruptcy Court later entered an order confirming an amended and modified plan of reorganization which provided for the sale of virtually all the debtor's assets. Pursuant to the agreement between the debtor and the purchaser, the sale was to be free and clear of all liens and encumbrances, whether known or unknown. The plan itself did not specify the source of the Bankruptcy Court's authority to immunize the purchaser from any potential NLRB obligations. The Bankruptcy Court held that §363(f) rather than §105 defined the court's authority. 141 B.R. at 176.

In interpreting § 363(f), the first issue considered in Creative Restaurant was which, if any, of the remedies sought in the NLRB complaint constituted an interest. The court held that any back pay or reinstatement claim necessarily gave rights to payment ergo NLRB's interest in the property, and thus the debtor was authorized to sell the assets free and clear of those claims if at least one of the five conditions of §363(f) was met. The court found both §363(f)(4) "bona fide dispute" and 363(f)(5) "acceptance of a money satisfaction of such interest" (each discussed below) were satisfied with regard to the back pay and reinstatement claims.

See also In re Rose, 113 B.R. 534 (W.D. Mo. 1990) where the court permitted a sale free of the reserved life estate of Debtors' grantors. It should be noted that family farmers (or the Chapter 12 trustee) may sell farmland or farm equipment subject to an interest without being required to comply with §363(f). 11 USC §1206. If the property is sold, the sale proceeds are subject to such interest. *Id.* The Eastern District of Michigan - LBR 2.22 (EDM) prescribes certain procedures and conditions for selling property free and clear of liens without a hearing.

Section 363(k), unless the court for cause orders otherwise, allows a secured lien holder purchasing property from the estate in a sale outside the ordinary course of business to bid in and offset its claim against the purchase price. Section 363(k) does not specify whether the right to credit bid is applicable when property is sold pursuant to a plan of reorganization.

When property of the estate is sold by a trustee with court approval pursuant to §363(f), the purchaser acquires title clear of all claims in bankruptcy, and the property may not be brought back into the estate in the absence

of fraud or collusion in the conduct of the sale. In re WPRV-TV, Inc., 143 B.R. 315 (D. P.R. 1991), *vacated on other grounds*, 165 B.R. 1 (1992), *rev'd on other grounds*, 983 F.2d 336 (1st Cir.1993), The standard of appellate review remains an "abuse of discretion" and the burden of proof as to the validity, priority or extent of the interest in the property to be sold is on the entity asserting the interest. 11 USC §363(o)(2).

Unless the authorization and sale are stayed pending a timely appeal, purchasers are protected from the reversal or modification on appeal of an order authorizing a sale under §363 as long as they acted in good faith. 11 USC §363(m). However, it has been held that where the lien holder was not provided with prior notice of the sale, the purchaser should take subject to that lien or the sale could be rendered voidable at the lien holder's election. *See* Fernwood Markets v. Title Ins. Co., 73 B.R. 616 (Bkrtcy. E.D. Pa. 1987), *sub nom*, In re Fernwood Markets, 76 B.R. 501 (Bkrtcy. E.D. Pa. 1987). *But see*, In re Matter of Edwards, 962 F.2d 641 (7th Cir. 1992) where the court recognized the importance of finality in bankruptcy sales by finding a bona fide purchaser obtained good title, despite a second mortgagee's failure to receive notice of the proposed sale. Recently, however, in In re Ex-Cel Concrete Co., 178 B.R. 198 (9th Cir. BAP 1995) the BAP concluded that the lack of any notice to a senior lienholder constituted constitutional lack of due process which could not confer *in personam* jurisdiction on the Bankruptcy Court to adjudicate (Citicorp's) property rights, and that this was *per se* a jurisdictional defect sufficient to void the order of sale. 178 B.R. at 205.

An adversary proceeding must be commenced when a trustee seeks to sell property owned by the debtor and any co-owner. 11 USC §363(h), FED.R.BANKR.P.7001(3). An analysis of the four conjunctive elements of §363(h) may be worthy of a future article.

11 USC §363(f) AND CASE LAW INTERPRETING SAME

Since 11 USC §363 is phrased in the disjunctive, successful consummation of a "free and clear" sale depends on satisfying one of the enumerated conditions, the provisions of which are increasingly the subject of opinions from the Court. A summary of reported case law over the last several years is provided below.

1. Applicable Nonbankruptcy Law Permits Sale, §363(f)(1).

There is a paucity of recently reported case law wherein §363(f)(1) is the subsection satisfied[2]. In an unreported decision, an Idaho Bankruptcy Court in In re Pintlar

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[2] If certain Michigan real property was sold prepetition at a tax sale and the Debtor continues in actual and open possession, verify compliance with the statutory notice requirements of the 6 month right to a reconveyance contained in MCLA §211.140. *See*, Judge Gregg's opinion in Matter of Sabec, 137 B.R.659 (W.D.Mich.1992) which addresses the issue of whether a Chapter 13 Debtor may cure unpaid tax obligations owed to a tax deed claimant and pay that claim under a chapter 13 plan thereby retaining residential property. Judge Gregg's analysis in Sabec could be used in the context of §363(f)(1) as the Michigan Tax Act also provides that in case of failure to serve the required notice within five years from the date when a tax purchaser, his heirs or assigns became entitled to a state treasurer's tax deed, those claiming under such deed, or the certificates of purchase, are barred from asserting such title. MCLA §211.73a.

Corporation/Gulf USA Corporation, August 1, 1995 WL 496818 (BANKR.D.IDAHO), upheld a party's objection to the conveyance of certain real property free and clear of its interest categorized as an easement to dump mining tailings and other waste in the Couer d'Alene River in the future. Though the court opined that the present status of environmental laws should, as a practical matter, render future exercise of any such dumping easement unlawful, no environmental or other nonbankruptcy law was presented to permit the transfer to the EPA (and the State of Idaho) free and clear of such interest.

Though not cited specifically, 363(f)(1) precluded a sale by a Chapter 7 trustee free and clear of HUD's interests in approving the buyer of the housing project or approving removal of the property from the low income housing project in In Re Welker, 163 B.R. 488 (Bkrtcy. N.D.Tex. 1994). While the property could be sold free of HUD's liens, §363 did not supersede or preempt certain housing acts or the compelling public policy interests thereunder, thereby conditioning the sale upon compliance with HUD procedure. 163 B.R. at 489.

Michigan's Marketable Record Title Act (MCLA §565.101 *et seq.*) is a statute which may be relied on to satisfy 11 USC §363(f)(1). The Marketable Record Title Act is 'construed to effect the legislative purpose of simplifying and facilitating land title transactions by allowing persons dealing with the record title owner . . . to rely on the record title covering a period of not more than 40 years prior to the date of such dealing. To that end all claims that affect or may affect the interest thus dealt with, the existence of which claims arises out of or depends upon any act, transaction, event or omission antedating such 40 year period, are extinguished, unless within such 40 year period a notice of claim . . . is recorded. The claims so extinguished shall mean any and all interests of any nature whatever . . . and whether such person is natural or corporate, or private or governmental." MCLA §565.106, *emphasis added.*

Though there do not appear to be any reported decisions in our District, another plausible argument is that certain interests so burden the land that they affect marketable title. Madhaven v. Sucher, 105 Mich. App. 284, 306 N.W.2d 481 (1981), *citing* Porter v. Ridge, 310 Mich. 425, 17 N.W.2d 239 (1945). Marketable title is of such a character as should assure to the vendee the quiet and peaceful enjoyment of the property, which must be free from encumbrance. Madhaven, 306 N.W.2d at 483, citing, Barnard v. Brown, 112 Mich. 452, 70 N.W. 1038 (1897). A title may be regarded as "unmarketable" where a reasonably prudent man, familiar with the facts, would refuse to accept title in the ordinary course of business, and it is not necessary that the title actually be bad in order to render it unmarketable. Id., citing, Bartos v. Czerwinski, 323 Mich. 87, 34 N.W.2d 566 (1948); Stover v. Whiting, 157 Mich. App. 462, 403 N.W.2d 575, 578 (1987).

It should be remembered that easements and encroachments, particularly when they are open and notorious, do not automatically render title unmarketable. *See* Short Clove Assocs. v Ilana Realty, Inc., 154 B.R. 21 (S.D.N.Y. 1993) *quoted in* In re Oyster Bay Cove, Ltd., 161 B.R. 338 (Bkrtcy. E.D.N.Y. 1993) which is discussed below. Also, Michigan's Marketable Record Title Act is specifically inapplicable ". . . to bar or extinguish any easement or interest in the nature of an easement, the existence of which

is clearly observable by physical evidences of its use; . . ." MCLA §565.104.

2. Consent, §363(f)(2).

Many courts are inferring §363(f)(2) consent if no objection is formally raised after an interested party receives notice of the proposed sale. Matter of Tabone, Inc., 175 B.R. 855 (Bkrtcy. D.N.J. 1994). In Tabone, a notice of private sale issued by the trustee and served on the local taxing authority clearly stated that the sale was to be free and clear of all liens, and the order shortening time afforded all interested parties the opportunity to object or to seek clarification either by written submission or orally at the (sale) hearing. The court, in a subsequent disgorgement proceeding, held that as the township did not offer any objection, it was deemed to have consented to the sale for purposes of §363(f)(2).

In In re Shary, 152 B.R. 724 (Bkrtcy. N.D.Ohio 1993) §363(f)(2) consent was implied and the State of Ohio's failure to object to a sale precluded it from resisting transfer of a liquor license (based on unsatisfied pre-sale tax obligations). *See* In re Oyster Bay Cove, Ltd., *infra,* In re Elliott, 94 B.R. 343 (E.D. Pa. 1988), and In re Gabel, 61 B.R. 661 (W.D. La. 1985). Once these interested parties have received notice of the intended sale and the provisions providing for the conveyance to be free and clear of their respective interests, absent an objection, the Bankruptcy Court should infer that §363(f)(2) has been satisfied.

3. Sales Price Greater Than Aggregate Value Of All Liens, §363(f)(3)

A sale which extinguishes a lien may proceed under §363(f) if the proceeds from the sale of the asset exceed the aggregate value of all liens on the property. The Federal courts are divided as to the meaning of the phrase "value of all liens". Some courts follow the decision in In re Beker Industries Corp., 63 B.R. 474, 477 (Bkrtcy. S.D.N.Y. 1986), *rev'd on other grounds*, 89 B.R. 336 (S.D.N.Y. 1988) and hold the "value of all liens" means the actual economic value of the lien. In re WPRV-TV, Inc., *supra*; In re Milford Group, Inc., 150 B.R. 904, 906 (Bkrtcy. M.D.Pa. 1992); In re Oneida Lake Dev., Inc., 114 B.R. 352, 356 (Bkrtcy. N.D.N.Y. 1990); In re Terrace Gardens Park Partnership, 96 B.R. 707 (Bkrtcy. W.D.Tex. 1989). Consequently, these courts hold that §363(f)(3) protects only the secured party's equity in the security interest. If the trustee demonstrates that the (security) interest has no actual value, the property may be sold free and clear of same. Many of these decisions focus on the interplay of 11 USC §506(a) and §363(f)(3).

Other courts, however, hold that "value of all liens" means the face amount of the lien. *See e.g.*, Matter of Riverside Investment Partnership, 674 F.2d 634,640 (7th Cir. 1982); In re Julien Co., 117 B.R. 910, 919 (Bkrtcy. W.D.Tenn. 1990), In re Heine, 141 B.R. 185, 189 (Bkrtcy. S.D. 1992). Under this view, §363(f)(3) protects the entire amount of the secured debt. The court in In re Terrace Chalet Apartments, Ltd., 159 B.R. 821 (N.D.Ill. 1993) adopted the interpretation that §363(f)(3) protects more than actual value, reasoning that if §363(f)(3) protected only actual value, then §363(f)(5) is rendered superfluous. Terrace Chalet was followed in In re Perroncello, 170 B.R. 189 (Bkrtcy. D.Mass. 1994) where the court denied a Chapter 11 debtor's sale motion pending determination of the actual value of a judicial lien holder's claim against the property and the other parcels of real estate subject to the lien.

5. **Entity Compelled to Accept A Money Satisfaction of Its Interest, §363(f)(5).**

Section 363(f)(5) authorizes a sale free and clear of all interests if the creditors "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction" of their interest. Some courts have construed this provision as requiring full payment from the sale proceeds, but the same courts have assigned different meanings to the provision, depending on which Chapter of the Code the case was proceeding under. The words "could be compelled" indicate that the interest in question be subject to final satisfaction in some hypothetical way, not that there be actual payment in satisfaction of the interest from the proceeds of the sale in question. In re Healthco International, Inc., 174 B.R. 174 (Bkrtcy. D.Mass. 1994). While there is no procedure under nonbankruptcy law by which a lien holder could be compelled to accept less than full payment in satisfaction of its lien, there are such procedures under bankruptcy law: Chapter 11 cram down (§1129(b)(2)(A)) and Chapter 7 subordination of secured tax claimant's right to distribution of estate property (§724(b)).

In Healthco, the court acknowledged the argument that Congress could not have intended §363(f)(5) to be conditioned upon the existence of a remedy in the Code which it necessarily knew existed, but reasoned that this argument lost force in light of (f)(1), which expressly refers to "applicable nonbankruptcy law". Had Congress intended (f)(5) to exclude bankruptcy law it could have done so. 174 B.R. 176-177. Moreover, the court reasoned, it would be anomalous if the estate could deal with an undersecured claim under §§506(a) and 1129(b)(2)(A), but could not sell the collateral at a fair price without paying the claimant in full. 174 B.R. 177.

In Healthco, the court granted the Chapter 7 trustee's motion for authority to sell certain real estate free and clear of the county's tax lien. The trustee proposed to sell the property and to distribute the proceeds pursuant to §724(b) which would mean nothing would be distributed to the county. The county, while not disputing the adequacy of the sale's price, objected contending lack of adequate protection under §363(e) and failure to satisfy any of the requirements of 363(f). The court construed "money satisfaction of such lien interest" to mean a payment constituting less than full payment of the underlying debt. 174 B.R. 176.

See also, In re Terrace Chalet Apartments, Ltd., *supra* where the district court vacated a Bankruptcy Court's order and remanded the case for a determination as to whether the Chapter 11 debtor could satisfy the requirements of §1129(b)(2) and consequently, permit the debtor to sell its apartment complex free and clear of liens pursuant to §363(f)(5). Reasoning that by its express terms, §363(f)(5) permits lien extinguishment if the trustee can demonstrate the existence of another legal mechanism by which a lien can be extinguished without full satisfaction of the secured debt, *viz.* §1129(b)(2) cram down, the district court directed the Bankruptcy Court to carefully consider whether the debtor was acting in good faith particularly as its reorganization seemed problematic, the proposed sale contemplated the sale of the estate's sole asset, at the expense of a secured party's lien. 159 B.R. at 829-830.

Closer to home, Judge Cook in In re Grand Slam U.S.A. Inc.'s, 178 B.R. 460 (E.D. Mich. 1995), vacated the Bankruptcy Court's

order denying a chapter 7 trustee's motion to sell estate property free and clear of an Oakland County personal property tax lien. The administrative expenses owing to the U.S. Trustee and the State of Michigan exceeded the amount of the county's lien. Like cram downs in Chapter 11 cases, Judge Cook reasoned that §724(b) compels lien creditors in appropriate cases to accept a money satisfaction of their interests by the payment of less than the full amount of the debt. It does so by subordinating tax liens to administrative expenses. Although §742(b) contains "distribution" language, its operation falls squarely within the language of §363(f)(5), inasmuch as it creates a mechanism by which lien creditors are compelled to receive less than full payment for their interest. 178 B.R. 463-464.

In re A. G. Van Metre, Jr., Inc., 155 B.R. 118 (Bkrtcy. E.D.Va. 1993), *aff'd without opinion*, 16 F.3d 414 (4th Cir. 1994) in the context of the statutory tax lien, the court agreed that it would be illogical to require full satisfaction of the statutory tax lien as a condition to the approval of the sale under §363(f)(5) when §724(b) explicitly provided otherwise. Accordingly, as a result of negotiations filed by the trustee, a deed of trust held by a bank in the amount of $1.5 million was reduced to $700,000 in order to consummate the sale of the property with a purchase price of $785,000. The only other encumbrance on the property was a statutory tax lien for $18,000. Since the sale price exceeded the aggregate value of interest encumbering the property, the court found the sale warranted under §363(f)(3). After selling property free and clear of liens pursuant to court order, Chapter 7 trustee in Van Metre, sought permission to distribute anticipated net sale proceeds and proposed to pay administrative expenses ahead of tax liens against the property pursuant to § 724(b). The Bankruptcy Court reaffirmed its order authorizing sale of the property free and clear of liens under §363(f)(3) and (5).

In Gouveia v Tazbir, 37 F.3d 295 (7th Cir. 1994), the court found a bankruptcy trustee's reliance on §365(f)(5) misplaced in a dispute surrounding and the sale of the debtor's land free of a reciprocal land covenant in favor of a neighbor's property. The covenant gave neighboring land owners a choice of money damages or equitable relief and, accordingly, since they could not be forced to accept money damages the court found §365(f)(5) to be inapplicable. In Gouveia, the debtor obtained permission from the zoning commission to build a music store on the property. The neighbors responded with a lawsuit to enforce a restrictive reciprocal covenant recorded on all the lots restricting the neighborhood to single story, residential property.

By the time the state court of appeals found the covenant enforceable and remanded for a permanent injunction, the debtor completed construction. Unable to operate her business, she filed a Chapter 11 petition. Debtor's efforts to sell the store free of the covenant were opposed by the neighbors and, following conversion of the case, the court overruled the trustee's arguments that under state law and the covenants the neighbors would be compelled to accept the legal relief because the store already existed on the property. The court pointed out that the neighbors had elected equitable relief and in fact had obtained a permanent injunction. The court held that the fact that the debtor chose to incur the risk of building the store before the neighbors had exhausted their appeal was no reason to force the neighbors now to

accept money damages. While the neighbors had the option to pursue money damages, they could not be forced to forego equitable relief. 37 F.3d 299. The Trustee could sell the property, subject to the covenant.

THE SALES AGREEMENT AND §363

A proposed Sales Contract is approved and compliance with 11 USC §363 is confirmed upon entry of an Order Approving Sale. The terms of the Sales Contract itself govern the performance of the parties. *See*, In re North Port Associates, Inc., 182 B.R. 810, 814 (Bkrtcy. E.D. Mo. 1995), In re Oyster Bay Cove, Ltd., 161 B.R. 338 (Bkrtcy. E.D.N.Y. 1993) and Bee-Gee, Inc. v Ariz. Department of Economic Security, 690 P.2d 129, 132 (Ariz. App. 1984) discussed below.

The Oyster Bay Cove decision permitted the Chapter 7 trustee to retain, as liquidated damages, a $250,000 deposit tendered by Ankari, the highest bidder at the trustee's auction sale. In Oyster Bay Cove, the court had approved the trustee's application to sell by public auction approximately 30 acres of vacant, partially improved land free and clear of liens. Annexed to the order were approved "Terms and Conditions of Sale" which provided, *inter alia*, that the property would be sold "as is" and subject to such facts as an accurate survey may show, including any covenants, restrictions and easements of record. Certain lien creditors were not given actual notice of the sale, but no lien creditor, although subsequently notified, objected. 161 B.R. at 340.

On the day of the auction, maps of the property were posted on the wall outside the courtroom. Ankari's $2.6 million bid for the entire property was the highest and an order was entered approving the sale. Closing of the sale was scheduled, however, neither the purchaser nor his attorney appeared. The trustee subsequently received authorization from the court to conduct a second auction sale of the property on similar terms, which sale was eventually consummated at a price $475,000 lower than Ankari's. The trustee then sought an order declaring Ankari in default and declaring the forfeiture of Ankari's deposit. 161 B.R. 341.

It refused to permit its order of sale from being collaterally attacked. In order to provide stability and finality to judicial sales, successful bidders at judicial sales of debtor's assets pursuant to §363 are bound and obligated to consummate the sale when it is authorized by the court. 161 B.R. at 342. Also, the court ruled that Ankari did not have standing to challenge the lack of notification to certain lien holders. Pursuant to §363(m) the lien holder would not have any rights against the property purchased, or against the purchaser as the final order of the court authorizing the sale free and clear of liens to a good faith purchaser is not affected. The trustee and the estate are responsible to any lien creditor, the innocent purchaser is fully protected. Id.

Further, the language of the sale order did not indicate that the property was to be sold free and clear of non-monetary restrictions of record which run with the land. 161 BR at 343. The court considered the entirety of both the sale order and the annexed terms of sale and found it clear that the sale was not to be free of such items as an offer of dedication for a road. The court found it incredible that Ankari, before making a $2.6 million bid, did nothing to confirm whether or not the sale was free and clear of the offer of dedication, especially in light of both the

language of the terms and conditions of the sale specifying that the property was being offered "as is", and the maps prominently displayed outside the courtroom on the day of the auction which clearly showed a road running through the property. The doctrine of caveat emptor was clearly applicable to the sale. 161 B.R. 343. Finally, no evidence was presented that the property did not have marketable title. Accordingly, the court found the sale proper and unavoidable and authorized the trustee to retain the $250,000 deposit as liquidated damages. 151 B.R. 345.

As indicated above, generally, the bankruptcy sale of property is not free of liens and encumbrances unless it is expressly so made. Bee-Gee, Inc. v Ariz. Department of Economic Security, 690 P.2d 129, 132 (Ariz. App. 1984). The court in Bee-Gee focused on the scope of the Bankruptcy Court's order confirming sale and the nature of the liability imposed by statutes concerning a successor's liability for the debtor's unpaid employment insurance contribution. In Bee-Gee, the Bankruptcy Court order authorized the sale of assets free and clear of liens, specifically identifying two lien holders of the debtor's dealership, Borg Warner Acceptance Corp. and American Honda Company. Following entry of the order, a purchase agreement was executed which included a provision that the buyer shall purchase seller's existing business and assets free and clear of all liens, pledges or encumbrances of any kind. 690 P.2d at 131.

Bee-Gee subsequently received a determination from the Arizona Department of Economic Security ("ADES") of unemployment insurance liability which Bee-Gee protested up through the court of appeals who affirmed that the Bankruptcy Court order did not purport to deal with claims against the debtor that were not actual liens on the property. It determined that at the time of the bankruptcy sale the tax liability created by the ADES was not a lien upon the assets sold and thus was not extinguished by the Bankruptcy Court's order making the sale free of liens. 690 P.2d at 133.

Bee-Gee sought to invoke the more expansive terms of the purchase agreement entered into subsequent to the Bankruptcy Court's order. The record, however, did not indicate that the Bankruptcy Court specifically approved of the terms of the parties' contract, thus authorizing the more expansive language of the purchase agreement. Id. Accordingly, the court concluded that the scope of the Bankruptcy Court's order did not encompass all of the terms of the parties' contract but merely authorized the sale of assets free of any existing liens.

In In re Governor's Island, 45 B.R. 247 (Bkrtcy. E.D.N.C. 1984), the Debtor commenced an adversary proceeding seeking to recover damages from the highest bidder at a public auction for his failure to consummate the purchase of a coastal island. The language contained in the purchase agreement provided that if the balance was not paid when due, the seller could retain the deposit (15% of the sales price) as liquidated damages.
Employing the doctrine of caveat emptor, the court found that Eways, who never visited the coastal island prior to its sale or examined the title or maps of same and otherwise made no inquiries beyond speaking by telephone to the debtor's counsel, was liable for $294,000, that being 15% of his $1,960,000 successful bid, 45 B.R. at 251, notwithstanding the general rule that a delinquent purchaser may be ordered to pay the deficiency resulting from a resale as the island was resold, after proper notice, for $1.1 million.

In holding that the doctrine of caveat emptor applies to title as well as to the quality and condition of the property, the Bankruptcy Court noted that a purchaser "is charged with notice of such material facts as a record of the proceedings under which he derives title discloses, and he will be presumed to have examined the same before becoming a purchaser". 45 B.R. at 253, *quoting Thompson on Real Property*, §§2473 and 4470 (1978). 'To permit a purchaser to question the title to property subsequent to sale would introduce an element of uncertainty as to all such sales and expose the estate to a liability in the future". 45 B.R. at 254. The court reasoned that "it would indeed be inequitable to allow a purchaser, who had made no investigation, to withdraw from the sale because of title defects, when to do so would deprive the estate of the benefit of the bid of a diligent bidder who had discovered the defect and was, nevertheless, willing to make the purchase". *Id.*

Eways' argument that the debtor could not convey marketable title was also rejected, primarily because Eways though with opportunity, never examined the island to determine its size and the extent of the marshes. The court ruled that an obligation to provide a marketable title does not imply any obligation to furnish a title that will be satisfactory to the vendee or his attorney, or one that he would be willing to accept. 45 B.R. at 256 *quoting* Burkhead vs. Farlow 266 N.C. 595, 146 SE 2d 802 (1966) thereby rejecting Eways' contention that the debtor did not have a connected chain of title for at least 60 years.

In another action involving the purchase of a hotel, the purchasers were denied recovery of a deposit made pursuant to a court-approved contract with a bankruptcy trustee. In the Matter of Garfinkle, 672 F.2d 1340 (11th Cir. 1982), Penthouse International Ltd. ("Penthouse") was the successful bidder for a Miami Beach ocean-front hotel. An Order approving and confirming sale of assets free and clear of liens was executed, and the next day a statewide casino gambling referendum was soundly defeated. Thereafter, the trustee proceeded to discharge his contractual obligations by delivering a commitment of title insurance to Penthouse.

Penthouse objected to the commitment for title insurance claiming that certain entries constituted defects in title and demanded that the trustee cure the defects upon pain of recission. 672 F.2d at 1343. The contract required the Trustee to convey "good, marketable and insurable title". Though the court declined to uphold the purchaser's objections, it recognized that the operative part of the contract defined acceptable title in terms of exceptions to the policy and required only that the Trustee in bankruptcy deliver a title insurance policy with no exceptions other than those specifically listed as permissible. 672 F.2d at 1345. When the purchaser objected to a navigational servitude and certain mineral reservations, the Court found that the servitude in no way affects the utility of the hotel property, the quality of the property or the quality of the title being given. *Id.*

Penthouse also objected to a temporary beach easement and erosion control line established to prevent construction beyond a certain point at the beach. The evidence at trial showed that both the easement and the control line were restrictions common to the subdivision and thus permissible exceptions to the title insurance policy. 672 F.2d at 1346. In addition, the Court ruled that the evidence showed that they did not affect the value, use,

or marketability of the property; in fact, such exceptions benefited the property.

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.

In Re: Butcher, (Bankr. ED Mich) 95-CV-70325-DT. The District Court reversed the Bankruptcy Court's ruling, which had recognized a constructive trust on property of the estate, thereby excluding that property from the estate.

The Debtor was an officer and director of a corporation which developed property and sold condominium units. The real property which was developed was, according to the chain of title, actually owned by the Debtor, even though the corporation had actually paid all taxes, done the development, held itself out as owner of the property, and signed all deeds to the purchasers. The Debtors ownership was declared in two places only: (1) the deed as recorded; and (2) on her Bankruptcy Schedules.

The IRS levied the property and the purchasers of the property, who though they were buying from the corporation, filed an Adversary Proceeding to have the property excluded from the estate as being held, constructively, in trust.

The Bankruptcy Court found that a constructive trust existed and excluded the property from the estate, thereby denying the claim of the IRS to proceeds from the property. The Debtor appealed and the District Court reversed.

The District Court held that the imposition of a constructive trust was beyond the equitable powers of the Bankruptcy Court. Section 541(d) provides that property in which the Debtor holds legal title is property of the estate. Further, the 6th Circuit in *In Re Omega Group, Inc.*, 16 F.3rd 1443 (6th Cir. 1994) held that unless a Court has already impressed a constructive trust upon certain assets or a legislature has created a specific statutory right to have particular kinds of funds held as if in trust, the claimant can not properly represent to the Bankruptcy Court that he was, at the time of the commencement of the case, a beneficiary of a constructive trust held by the Debtor.

* * * * *

In Re: Blain, (Bankr. ED Mich) 94-CV-74718. The District Court reviewed two fee applications, and remanded a portion of one attorney's fee application back to Judge Spector, for specific application of the lodestar standard of review, while affirming the Bankruptcy Court's disposition of the other.

Debtor filed Chapter 13, then converted to, in Order, Chapter 7, Chapter 11 and finally Chapter 7. Debtor's counsel, Sander Simen, petitioned for $19,984.00 in

fees, in addition to the initial $1,000.00 retainer for the Chapter 13 and an additional $5,000.00 for the Chapter 7. Counsel claimed that the facts of the case were extremely complicated, in part because of the general disorganization of the Debtor and due to the existence of a parallel business, which also filed Bankruptcy, with overlapping leases and guarantees. The petitioner demanded that the Court apply the lodestar method of fee calculation, although no mention of the lodestar method is made on the record.

Citing *In Re: Boddy,* 950 F.2d 334 (6th Cir. 1991) the District Court held that the lodestar method is the proper starting point for review of fee applications. However, in the case presented, Judge Spector had apparently disallowed portions of the fee application, without explanation. While a Judge may exclude portions of a fee application that are insufficiently supported before arriving at an appropriate fee determination using the lodestar method of calculation, if the Court disallows hours, it must explain which hours are disallowed and show why an award of those hours would be improper. While the burden is on the petitioner to justify a fee request, the Bankruptcy Court must expressly discuss the amounts that are not supported by the application and provide a reasoning to support the decision. Here, the denial of the fee stated only "The U.S. Trustee's Objection to the fee application ... is sustained for the reason that the application overstates the value of services rendered".

The fee application was remanded for a determination consistent with the ruling.

In a separate fee application contained in the same case, the District Court upheld the Order of the Bankruptcy Court, which disallowed some fees to an attorney who was appointed as special counsel, not general counsel.

The petitioner, Stephen Sadin, was appointed as special counsel for the Debtor in connection with a specific piece of litigation that was successfully concluded. However, he also applied for appointment as co-counsel to general counsel, Simen, but an Order confirming that appointment was never entered. Nevertheless, Sadin performed services to the Debtor which were in the nature of general counsel representation. Further, he shared part of the original retainer paid by the Debtor to Simen. The Bankruptcy Court held that the failure to be appointed by Order under §327 is fatal to a petitioner for the fees due to a professional in a Bankruptcy case.

The District Court then reviewed the claim for equitable relief, and determined that the petitioner was not entitled to fees, inasmuch as he was an interested party in the case, in conflict with the Debtor and ineligible for employment as general counsel under the circumstances. The petitioner was owed money by the Debtor, pre-petition, for services rendered. The District Court found no abuse of discretion by the Bankruptcy Court in denying the petition for payment for services rendered to the Debtor, outside the petitioners appointment as special counsel.

* * * * *

In Re: Boyd, (Bankr. ED Mich) 94-47749-R. The Debtor filed an Adversary Proceeding to discharge a mortgage and release a lien on real property claimed exempt as homestead. The Court granted the Debtor's summary disposition, voided the mortgage and released the lien.

In August of 1990 the Debtor and his creditor, Perry, signed a Mortgage Note for $15,000.00 with 8% interest. The entire transaction is contained within the Note, no separate mortgage was obtained. The Note contained all the requisite indicia of a mortgage under MCL 565.154, but for the terms of repayment. As to those terms, the Note stated that repayment was to be determined by the lender.

The creditor did not record the Note until April of 1994, at which point the Debtor was substantially in arrears of an arrangement to pay $200.00 per month on the Note. The Debtor filed Bankruptcy in August of 1994, obtained a Discharge and thereafter discovered through a title search that the mortgage had been recorded. The Debtor filed an Adversary Proceeding to discharge the lien.

The Court found that, because of the failure of the mortgage Note to recite the exact terms of payment, it did not meet the requirements of the statute and was not a valid mortgage.

The creditor next claimed that an equitable mortgage was in place, since no person disputed that it had been the intent of the parties to create a valid mortgage in favor of the creditor. Equitable mortgages can be present where one party advances money to another upon the faith of a verbal agreement by the latter to secure its payment by a mortgage upon certain lands and improvements, which is not executed, or which, if executed, is so defective or informal as to fall short of being a duly executed mortgage, equity will impress upon such land and improvements a lien in favor of the creditor who advances the money in satisfaction of his debt. *Schram v Burt*, 111 F.2d 557 at 561 (6th Cir. 1940). However, the Court in the case presented found that the creditors did not take all the appropriate steps to obtain a mortgage. It was the creditors' lack of thoroughness and diligence in protecting their own position that lead to the problem.

The Court declined to find an equitable mortgage, and granted the Debtor's Motion for Summary Disposition.

* * * * *

In Re: Ruggeri Electrical Contracting, Inc., (Bankr. ED Mich) 93-49180, United States v Paul Borock, Trustee, A/P 95-5049.

Judge Rhodes held that a levy against the Debtor's bank account, 20 days prior to the filing of the Bankruptcy, entitled the IRS to keep the cash, the estate having no further interest in the funds.

The Debtor's bank account was levied, and the Bank held the funds the requisite 21 days. On the 20th day post levy, an involuntary petition was filed against the Debtor. An Order for Relief was entered, Paul Borock was appointed Trustee, and the $47,422.00 attached was turned over to him, by Stipulation, pending further Order of the Court. The IRS filed the Adversary Proceeding to compel turnover of the funds from the Trustee. The Trustee defended.

The Trustee relied on *U.S. v Whiting Pools,* 462 US 198 (1983) wherein the Supreme Court held that a pre-petition seizure of personal property by the IRS did not take the property out of the estate of the Debtor. The IRS sought to distinguish the facts of the case presented from *In Re: Whiting Pools*, since *Whiting Pools* involved tangible personal property, title to which did not pass at the time of levy, but rather at the time of the sale pursuant to levy. Further, there was a right of

redemption after levy, not present when a bank account is attached.

The Court discussed the history of cases since *Whiting Pools*. There is a split of authority on the question of whether *Whiting Pools* applies to only tangible personal property, or to intangible property (such as cash and accounts receivable) as well.

The Court held that the distinction was not a matter of the type of property involved in the levy, but rather the pivotal question is whether the property is saleable or non-saleable. When the IRS levies on saleable property, the Debtor has two remaining identifiable interests. The right to redeem and the right to any surplus of funds following sale. However, when the levy attaches to a nonsaleable asset (cash or cash equivalent) the Debtor does not retain any substantive property interest which the notice and sale provisions of the levy statute are designed to protect.

Further, the Court held that while *Whiting Pools* has no specific language restricting the holding to tangible property, there is language which appears to restrict the holding to saleable property. Further, *Whiting Pools* recognizes that there are circumstances in which title to the seized property will pass immediately to the IRS, at which point §542 would not apply.

The Court found that the cash seized was not property of the estate.

* * * * *

In Re Trost (Buckstop Lure Company v Trost), (Bankr. WD Mich 8/12/95), Case No.: SL 92-85533. Judge Stevenson denied Debtor, Fred Trost's ("Trost") Motion to Reopen the Adversary Proceeding which granted Buckstop Lure Company's Motion to Revoke his Discharge (opinion reported as *Buckstop Lure Company v Trost (In Re Trost)*, 164 BR 740 (Bankr. WD Mich 1994).

Trost, almost one year following the entry of an Order revoking his Discharge, filed a Motion seeking to have the Adversary Proceeding reopened pursuant to 11 U.S.C. §350(b) and Fed.R.Bankr.P. 5010. The Court, after distinguishing between a "case" and an "Adversary Proceeding", noted that §350(b) and Fed.R.Bankr.P. 5010 do not apply in this matter because Trost's Chapter 7 case is still open. The Court noted, however, that the style of Trost's Motion is not controlling and that it had the authority to consider the Motion as if it were properly pled, despite the fact that the incorrect code section and Bankruptcy Rule were cited.

The Court treated Trost's request as a Motion for relief from judgment or Order pursuant to Fed.R.Bankr.P. 9024 which incorporates Fed.R.Civ.P. 60. Trost alleged several mistakes by the Bankruptcy Court including the following: (1) Buckstop Lure knew about Trost's fraudulent activities before he received his Discharge; (2) Trost did not have the requisite intent to commit fraud because he believed his stock was worthless nor did he know that his Chapter 7 Petition had been filed; (3) Trost lacked the ability to form the requisite fraudulent intent because at the time of the trial he was under the influence of Prozac; (4) Trost did not have effective assistance of counsel before and after the trial; and (5) the Court applied the incorrect standard of proof.

The Court denied Trost's Motion because the same was untimely filed. The Court noted that although Trost had filed the Motion within one year from the entry of the Order revoking his Discharge, the relevant inquiry is whether it was reasonable for Trost

to wait 360 days to file the Motion. The Court, citing *Smith v Secretary of Health & Human Services,* 776 F.2d 1330 (6th Cir. 1985), reviewed the factors which should be considered to determine what constitutes a "reasonable period" of time under Fed.R.Civ.P. 60(b)(1), including, interest of finality, the reason for the delay, the practical ability of the litigant to learn earlier are the grounds relief upon, and the prejudice to other parties. Applying these factors, the Court held that Trost's Motion was untimely. Furthermore, the Court held that Trost's failure to file the Motion sooner did not constitute excusable neglect under the standard set out in *Pioneer Investment Services v Brunswick Associated Limited Partnership,* 113 Sup. Ct. 1489 (1993).

For the purpose of finality, the Court also addressed the substantive issues raised by Trost's Motion. The Court reaffirmed its holding that Buckstop Lure bore the burden of proving its case by a preponderance of the evidence rather than the clear and convincing standard proposed by Trost. The Court noted that subsequent to its decision, the Sixth Circuit decided *Barclays/American Business Credit, Inc. v Adams (In Re Adams),* 31 F.3d 389, 394 (6th Cir. 1994) which supports the Court's determination with respect to this issue. The Court further held that even if Trost's counsel failed to file an appeal on behalf of Trost, the error was attributable to Trost. Furthermore, failure to timely appeal is not the type of "mistake" contemplated by Fed.R.Civ.P. 60(b)(1). The Court noted that just because Trost was unhappy with the Court's decision does not evidence a "mistake" contemplated by Fed.R.Civ.P. 60(b)(1). The Court also rejected Trost's argument that Buckstop Lure had knowledge of the alleged fraudulent activity prior to Trost's Discharge and Trost's inability to form requisite fraudulent intent.

* * * * *

In Re: Doerr (State Bar of Michigan v Doerr), (Bankr. WD Mich August 14, 1995), Case No.: HG 94-83255. Judge Howard granted the Attorney Discipline Board of the State Bar of Michigan ("the Board") Motion for Summary Disposition, holding that costs assessed by the Board against the Debtor, John P. Doerr (the "Debtor"), in connection with an attorney disciplinary action are non-dischargeable in a Chapter 7 Bankruptcy under 11 U.S.C. §523(a)(7).

Pre-Petition, the Debtor's license to practice law in the State of Michigan was revoked by the Board. Pursuant to Michigan Court Rule 0.128, the Board assessed costs against the Debtor in the amount of $275.67. The Debtor filed Chapter 7. Post-petition, the Board issued a Certificate of Non-Payment of Costs to the Debtor. The Board filed a Complaint seeking a determination that the costs assessed the Debtor in the disciplinary proceeding are non-dischargeable.

The Debtor argued that the Board's prayer for relief did not cite 11 U.S.C. §523(a)(7). However, the Board's complaint, along with the representations made by the Board's counsel at the pre-trial conference, and ultimately, the pre-trial order indicated that the Board was proceeding under 11 U.S.C. §523(a)(7). The Court held that the pre-trial Order controls the subsequent course of action taken in an Adversary Proceeding under Fed.R.Bankr.P. 7016(e). The Court noted that the Debtor had received notice that the Board was seeking a determination that the costs were non-dischargeable under 11 U.S.C. §523(a)(7) and that the Debtor never

specifically moved to modify or strike the pre-trial Order.

The Court adopted the rationale *In Re Haberman,* 137 B.R. 292 (Bankr. ED Wis 1992) and *In Re Betts,* 149 B.R. 891 (Bankr. ND Ill 1993) aff'd. 157 B.R. 631 (ND Ill 1993). The *Haberman* and *Betts* courts each held that costs assessed by their State's attorney disciplinary boards relative to a disciplinary action are a "fine, penalty or forfeiture" for the purposes of 11 U.S.C. §523(a)(7), and are therefore non-dischargeable in a Chapter 7 case. The Court emphasized that the reimbursed cost to the State Board did not represent any "actual" pecuniary loss because the Board was not dependent on reimbursement but rather its funding was provided from state appropriations.

As a final matter, the Court held that 11 U.S.C. §362(b)(4) permitted the Board to issue the Certificate of Non-Payment of Cos as a "continuation of an action or proceeding by governmental unit to enforce such governmental units, police or regulatory power" without violating the automatic stay.

* * * * *

In Re: Ludwick, (Bankr. WD Mich August 11, 1995) Case No.: SG 95-80271. The Bankruptcy Court, in an en banc opinion, imposed sanctions against attorney Andrew D. Morgan ("Morgan") and suspended him from practicing before the United States Bankruptcy Court for the Western District of Michigan for a period of two years.

Morgan represented the Debtor, Scott Ludwick ("Ludwick") in his Chapter 7 Bankruptcy case. Ludwick's Chapter 7 Trustee, John Porter ("Porter"), while preparing for Ludwick's §341 meeting, became suspicious as to the validity of Ludwick's signature on his Bankruptcy Petition. At the §341 meeting, Ludwick stated that he has never signed his Bankruptcy Petition. During an off the record discussion with Assistant United States Trustee, Michael Maggio ("Maggio") and Porter, Morgan first claimed that the signature on the Petition was indeed Ludwick's, but changed the story, indicating that it was possible that he or one of his employees had signed Ludwick's Bankruptcy Petition. Morgan claimed that Ludwick was facing a garnishment and therefore, the Petition was filed on an urgent basis. Therefore, Morgan admitted to Maggio and Porter, again off the record, that Ludwick had not signed the Petition, but that he could not recall who had actually signed the Petition.

Following the §341 meeting, the U.S. Trustee filed an ex parte motion for an Order directing the Debtor and the Debtor's counsel to appear and show cause why the case should not be dismissed and why sanctions should not be imposed or why the Court should not grant other relief. At that hearing, Morgan claimed that he had never admitted to anyone that someone in his office had signed the Petition, but that he had only said that it was possible that it had happened. Judge Stevenson determined that the hearing should be continued en banc to consider the possibility of suspending Morgan from practice before the Court.

At the en banc hearing, Morgan continued to attempt to retract his off the record admission to Maggio and Porter. Instead, Morgan testified that Ludwick may have signed the petition and, if someone in his office had forged Ludwick's name, it was because there was a note in the file that indicated that Ludwick was facing an imminent garnishment. However, Ludwick testified that

in fact, he was not facing a garnishment. Instead, he had threatened Morgan that he would contact the Attorney Grievance Commission concerning Morgan's delay in preparing and filing his Bankruptcy Petition.

All three Judges found Morgan to be an extremely unreliable witness and his explanation that the events to be entirely unbelievable based upon his inconsistent, vague statements, illogical arguments and overall demeanor. The Court found that it had given Morgan ample opportunity to explain the forgery, and he had refused to admit that he had forged the signature. Morgan testified that it was possible that his legal assistant had signed Ludwick's name to the Petition. However, Morgan also testified that it was very unlikely that his paralegal would have signed Ludwick's name to the Petition without his direction. The U.S. Trustee subpoenaed the paralegal to testify, but she failed to appear. Morgan testified that his paralegal was aware of the hearing but had a doctor's appointment, but he had expected her to appear. After receiving Morgan's testimony and the testimonies of Ludwick, Maggio and Porter's, and after comparing Morgan's authenticated signature with Ludwick's forged signature, the Court held that Morgan had forged Ludwick's signature on Petition.

Following the first en banc hearing, the U.S. Trustee filed a Motion to reopen proofs. At a second en banc hearing, Maggio introduced evidence that Morgan had forged his client, Mark VandeWetering's ("VandeWetering") name to a Motion to convert his case from a Chapter 13 to a Chapter 7. VandeWetering testified that he indeed had never signed the Motion to convert and was never informed that his case had in fact been converted. Morgan did not deny that he had forged VandeWetering's signature and, because of the similarity between Morgan's admitted signature and the forged VandeWetering signature, the Court held that Morgan had in fact forged VandeWetering's signature.

Morgan's paralegal also testified at the second en banc hearing that she was not served with a subpoena to appear at the first en banc hearing. She did, however, find an envelope addressed to her from the U.S. Trustee in the Morgan Law Office trash the day after the hearing. The envelope had been opened and its contents removed. After receiving a telephone call from Gail Beach, the Court reporter from the first en banc hearing, Morgan's paralegal met with Maggio. Morgan called the paralegal during her meeting with Maggio, and told her to walk out of her meeting because the matter had nothing to do with her. Morgan's paralegal testified at the second en banc hearing that Morgan had never discussed the first en banc hearing with her or told her that she had been subpoenaed to appear. Furthermore, she had never told Morgan that she was sick that day or that she had a doctor's appointment. Morgan failed to explain why he did not tell the truth concerning his paralegal's whereabouts for the first en banc hearing. The Court therefore concluded that he was trying to hide something. Although the Court was troubled by the fate of the Subpoena that was sent to the paralegal, it was unable to determine when Morgan, who regularly opened the office mail, intercepted the Subpoena. The Court, stating that it believed that Morgan intercepted the Subpoena before the first en banc hearing and would therefore be guilty of obstructing justice, declined to make a definitive finding on the issue because it was possible that Morgan intercepted the Subpoena after the first en banc hearing.

The Court required Morgan to reimburse Ludwick the attorney's fees which he had paid Morgan in that case. In addition, the Court imposed Fed.R.Bankr.P. 9011 sanctions against Morgan, requiring Morgan to compensate Ludwick for his additional attorney fees incurred in this matter and Porter's costs and fees incurred in bringing Morgan's deception to the attention of the Court.

The most troubling issue for the Court was that Morgan forged the signatures of his client and that he repeatedly lied to the U.S. Trustee and the Court about doing so. This "dishonesty" compelled the Court to impose a never before used remedy of suspending Morgan from practicing before the United States Bankruptcy Court for the Western District of Michigan for two years. The Court cited authority under L.Bankr.R. 13(d)(1). The Court also sent copies of its opinion to the office of the United States Attorney for the Western District of Michigan and the Attorney Grievance Commission.

* * * * *

In Re: RAH Development Co., Inc., (Bankr. WD Mich July 21, 1995), Case No.: GK 93-82253. Judge Gregg held that a sub-subcontractor, Troy Aggregate Carriers, Inc., ("Troy") held an equitable lien against the proceeds of a certain federal construction project contract that was subject to the Miller Act.

Pre-petition, the Debtor, RAH Development Co., Inc. (the "Debtor") entered into a construction contract with United States of America, Department of Veteran Affairs concerning certain construction at the VA Medical Center in Ann Arbor, Michigan (the "VA Project"). Four days after its Chapter 11 filing, the Debtor entered into a subcontract agreement with Sinacola Midwest, Inc. ("Sinacola") to provide certain subcontract services on the VA Project. Troy supplied various construction materials for the VA Project pursuant to a materials and service agreement between Troy and Sinacola. Troy did not have a direct contract with the Debtor, and was defined by the Court to be a "sub-subcontractor". The case was converted to a Chapter 7. Thereafter, Troy and the Debtor's surety, Old Republic Surety Company (the "Surety") each filed motions seeking determinations as to their priorities with respect to the balance of the VA Project contract proceeds (the "VA Proceeds"). The State of Michigan Laborers' Fringe Benefit Funds and Michigan Carpenters' Fringe Benefit Funds ("Benefit Funds") filed an objection to the Surety's motion and the Surety thereafter objected to Troy's motion. The Court consolidated the Surety's and Troy's respective motions. The Chapter 7 Trustee, the Benefit Funds and the Surety filed an emergency joint motion seeking a separate determination as to Troy's rights to the balance of the VA Proceeds. The joint movants reached a settlement premised upon their belief that Troy held no valid interest in the VA Proceeds. Therefore, the issues before the Court at this time were limited to whether Troy held an equitable lien or other similar interest in the VA Proceeds and/or whether the Court would impose a constructive trust against the VA Proceeds in Troy's favor.

Based upon the Supreme Court's decision in *Pearlman v Reliance Insurance Co.*, 371 U.S. 132 (1962), Troy asserted that it had an equitable interest in, akin to an equitable lien on, the VA Proceeds. Troy argued that *Pearlman* and its progeny established that unpaid subcontractors and

materialmen have what amounts to an equitable lien on undisbursed construction contract funds. The Court did an exhaustive review of the Supreme Court cases which preceded *Pearlman* with respect to public construction cases as well as *Pearlman* and its progeny and concluded that unpaid providers of labor and materials on Miller Act Construction projects possess an equitable interest in, akin to an equitable lien on, contract proceeds. Although none of the case law applied equally to subcontractors and sub-subcontractors. The Court therefore held that Troy, as an unpaid sub-subcontractor on the VA Project, had an equitable lien on the remaining VA Proceeds.

The Chapter 7 Trustee, the Surety and the Benefit Funds cited the Sixth Circuit's recent opinion in *XL/Datacomp, Inc. v Wilson, In re Omegas Group, Inc.*, 16 F.3d 1443 (6th Cir. 1994) to refute Troy's contention that the VA Proceeds could be impressed with a constructive trust in Troy's favor. The Court acknowledged that it would be bound by the *Omegas* decision, but because it had held that Troy was entitled to an equitable lien on the VA Proceeds, it would not be necessary that it reach the constructive trust issue.

STEERING COMMITTEE MINUTES

The Steering Committee Meeting was held at the Peninsula Club in Grand Rapids on August 18, 1995. Bob Wright chaired the meeting. Hal Nelson, Bob Sawdey, Tim Hillegonds, Brett Rodgers and Steve Rayman were the only members present. Michael Maggio of the Office of the U.S. Trustee was also present. The following business matters were discussed:

1. Steve Rayman gave a report regarding the seminar. Generally speaking, it was thought that the seminar was a success. There were 113 participants;

2. Pat Mears, Peter Teholiz, Tim Hillegonds, Tom Sarb and Steve Rayman were up for re-election. Surprisingly, all were re-elected unanimously;

3. The location for the 1996 seminar was discussed. It has been tentatively scheduled for Shanty Creek. Discussion was had regarding whether it should be held at the Grand Traverse Resort or at perhaps Boyne Highlands. Brett Rodgers is going to follow up on this along with the other people who are working on the next year's seminar, along with Pat Mears and Judge Gregg, who are also working on next year's seminar.

The next Steering Committee is scheduled for September 15, 1995 at noon. Undoubtedly, all of the Steering Committee Members who did not appear at any of the summer Steering Committee Meetings will attend.

LOCAL BANKRUPTCY NOTICE

Enclosed from Brett Rodgers is a notice of an Annual Meeting & Program regarding Expert Testimony in Court: Is a Dabert challenge in your future? The featured speaker is James K. Robinson and the Western District Federal Bench and Bar in a live demonstration and panel discussion.

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

Bankruptcy Chapter	August of 1995	August of 1994	August of 1993
Chapter 7	410	363	343
Chapter 11	3	11	11
Chapter 12	0	3	3
Chapter 13	178	164	122
Totals	591	541	479

Bankruptcy Chapter	January - August of 1995	January - August of 1994	January - August of 1993
Chapter 7	2778	2467	2614
Chapter 11	43	56	69
Chapter 12	10	11	21
Chapter 13	1033	945	831
§304	1	0	0
Totals	3865	3479	3535

STEERING COMMITTEE MEMBERS

Dan Casamatta (1996)	(616) 456-2002
John Grant (1997)	(616) 732-5000
Tim Hillegonds (1995)	(616) 752-2132
Mary Hamlin, Editor (1996)	(616) 345-5156
Jeff Hughes (1996)	(616) 336-6000
Pat Mears (1995)	(616) 776-7550
Hal Nelson (1997)	(616) 459-9487
Steven Rayman, Chair-elect (1995)	(616) 345-5156
Brett Rodgers (1997)	(616) 732-9000
Tom Sarb (1995)	(616) 459-8311
Bob Sawdey (1996)	(616) 774-8121
Tom Schouten (1997)	(616) 538-6380
Peter Teholiz (1995)	(517) 886-7176
Janet Thomas (1996)	(616) 726-4823
Rob Wardrop (1997)	(616) 459-1225
Bob Wright, Chair (1995)	(616) 454-8656