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A NEW DIRECTION FOR TREATMENT OF COSIGNED DEBTS?

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Sometimes the most obvious Code[1] provisions don't mean what they appear to say. Take, for instance, Code section 1322(b)(1) which provides, in part:

(b)...the plan may -
(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims.

This rather straightforward language was added to the Code by the 1984 Amendments but it has not settled the issue it apparently addresses. To understand the difficulty this language poses, one must examine the underlying problem it sought to resolve.

One of the earliest cases dealing with Chapter 13 plans separately classifying co-signed debt was In Re Kovich, 4 BR 403 (Bank. WD Mich 1980), which examined whether a debtor could treat a co-signed debt more favorably than other unsecured creditors. After thoroughly reviewing the existing case law on the subject, Judge Howard ruled that the Code did not prohibit separate classifications but that any such action must not unfairly discriminate against other classes. He then went on to outline four questions to be asked in each case to determine if there is unfair discrimination.[2] This four prong test served as the basis for determining unfair discrimination in any attempt

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1 11 USC sec 101 et. seq. or "Bankruptcy Code"

2 These are :
1. Is there a reasonable basis for the classification?
2. Is the debtor able to perform a plan without the classification?
3. Has the debtor acted in good faith in the proposed classifications?
4. Are the creditors being discriminated against receiving a meaningful payment?
4 B.R. at 407 see also In re Wolff, 22 B.R. 510 (9th Cir. BAP 1982) and In re Dziedzic, 9 B.R. 424 (Bankr. S.D. Tex. 1981)

to separately classify a body of claims.

The particular issue of classifying co-signed debts arises from the interplay of section 1322(b) and section 1301. Section 1301 provides that a creditor is stayed from taking any action against a codebtor unless certain very narrowly defined situations exist. While this would appear to benefit nondebtors immensely, the provision is actually for the protection of the debtor in that it does not allow a creditor to exert indirect pressure on the debtor through a relative, business associate or close friend who happened to cosign a consumer contract with the debtor. Thus, if the debtor does not provide for full payment of the debt in his Chapter 13 plan, the creditor is entitled to relief from stay to pursue the codebtor.[3]

Kovich and its progeny attempted to maintain the interest of section 1301 by allowing the debtor to use Section 1322(b)(1) to continue to hold cosigned creditors at bay during the life of the plan. The idea was simple, if the plan provided full payment of the debt then the creditor would not have cause under Section 1301(c)(2) for relief from stay.

This judicial structure was apparently codified in the 1984 Amendments which added the language above starting with "however..."[4] The legislative history suggests that Congress did intend to allow the classification of cosigned consumer debt, believing that it would serve as an incentive to debtors to reorganize rather than to liquidate.

"If as a practical matter, the debtor is going to pay the codebtor claim, he should be permitted to separately classify it in a chapter 13. A result which emphasizes purity in classifying claims does so at the price of a realistic plan. Neither debtors nor creditors benefit from such a rigid approach, and the Committee has determined that statutory authority to separately schedule such debts will contribute to the success of plans contemplating repayment of same. Accordingly, this authority is provided for in the proposed bill by amendment to section 1322(b)(1). S.Rep. No. 65, 98th Cong., 1st Sess., pp 17-18 (1983).

Thus Congress specifically authorized classification of cosigned debts in a chapter 13 plan. This is where the problem has developed. In drafting the language amending section 1322 (b)(1) Congress merely added the phrase "however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims." By this language and the positioning of the "however" did Congress mean that cosigned debts were permitted to be classified separate and apart from other unsecured debts or did they mean to go further and permit cosigned debts to be excepted from the preceding clause's proscription of any classification fostering "unfair discrimination"?

Likewise, what is the intent of the term "differently" in the amendment language? It has been argued that differently is not the same as unfair discrimination and therefore this language does not automatically authorize all discriminations in favor of cosigned claims.[5]

If cosigned debts are allowed to be classified under Section 1322 (b)(1) as long as they do not unfairly discriminate against other unsecured debt, it is unclear what change in the law the 1984 amendment created since a number of courts had pretty much adopted the rationale of Kovich. In addition, the underlying policy of Congress to encourage reorganization rather than liquidation would support the notion that debtors should be allowed to pay a cosigned debt in full through a chapter 13 while paying other unsecured creditors a lesser percentage as opposed to debtors filing a chapter 7, paying their unsecured creditors nothing and either reaffirming the cosigned debt or repaying the cosigner informally after the chapter 7 case is closed. Finally, by limiting the effect of the 1984 amendment, the courts continue to compromise the utility of section 1301 in that most creditors will be able to obtain relief from stay unless the debtor can assure the creditor (and the court) that he can pay the creditor in full while not discriminating against other unsecured creditors. If a debtor can only afford to pay unsecured creditors 10% while paying cosigned debts 100% why should cosigned creditors be allowed to leverage that relationship to coerce debtors into plans which may not be feasible just so they can protect their cosigners?

Despite these arguments, it appears that most courts have

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[3] See Section 1301(c)(2).

[4] See Bankruptcy Law and Practice in Michigan. page 11-11.

[5] In re Easley, 72 B.R. 948 (Bankr. M.D. Tenn. 1987); In re Battista, 180 B.R. 355 (Bankr. D.N.H. 1995); contra, see In re Dornon, 103 B.R. 61 (Bankr. N.D. N.Y. 1989); In re Thompson, 191 B.R. 967 (Bankr S.D. Ga. 1996).

adopted the standard that the modification language of the 1984 amendment should be interpreted to mean that cosigned debts can be separately classified as long as there is no unfair discrimination.[6] In fact, the four-part test of Kovich is still utilized by some courts to determine if the classification of the cosigned debt is appropriate.[7] One argument in favor of this position states that Congress could simply have provided that cosigned debts would be allowed any separate classification. Instead of giving that blanket authority, the language implies that some justification for special treatment must be provided. Thus in balancing the interests of all of the parties and the various Code provisions, it makes sense to require that separate classifications for cosigned debts not unfairly discriminate against other unsecured claims.

At lease one court has now chosen to approach this issue from a slightly different direction. In re Thompson , 191 B.R. 967 (Bankr. S.D. Ga. 1996), rejects the four-part test for unfair discrimination and even rejects the idea that unfair discrimination should be the test for allowance of a separate classification of a cosigned debt. Instead, the Thompson court would require the chapter 13 plan which proposes to classify a cosigned debt to meet the requirements of section 1325 and failing that it would deny confirmation based upon the particular subsection of 1325 wherein the plan was deficient.

In Thompson the debtors owed approximately $29,000.00 to a bank. This debt was secured by a mobile home, real estate and a pickup truck with a total value of $13,000.00. The debt was also secured by a cosignor (who happened to be the husband's mother) who pledged an $80,000.00 certificate of deposit as security for her personal liability.

The debtor's plan proposed to treat the cosigned debt as fully repayable while paying nothing to the other unsecured creditors. The court reviewed the legislative history and the balance between the various Code provisions and determined that "...Congress sacrificed complete equality of claims repayment in favor of an approach which considered the reality of debtor's motivations... It is clear, therefore that Congress intended to allow separate classification of codebtor debts and different degrees of payment to each unsecured class in such case."[8] Thompson acknowledges that this does not answer the question of whether such classification can be made without regard to its fairness.

The Thompson court discards the notion that "unfair discrimination" should be the determinant of the appropriateness of a codebtor classification. Instead, the court focuses on the requirement that any plan must satisfy the requirements of section 1325. In that regard, the issue becomes primarily one of whether the plan is proposed in good faith under section 1325(a)(3). In the instant case the Court made the determination that the plan was not proposed in good faith because the debtors were merely trying to preferred one unsecured creditor over the others in a disguised chapter 7. It also didn't help that the mother could satisfy the bank without suffering significant financial loss.

The Thompson Court set forth a tripartite analysis of when it felt classification should be allowed.[9] In essence, the Thompson Court looks to the "good faith" of the debtor rather than to the question of "unfair discrimination" in the plan. This is a rather subjective approach to this issue but it appears to address the various competing interests as well as anything so far postulated.

If this approach to the issue of classification of cosigned debts is adopted, the determination of when such a classification is appropriate will of necessity have to be on a case by case basis. On the other hand, if the underlying Congressional intent of protecting the debtors from undue influence in formulating plans is to be effectuated, and if the basic goal of encouraging debtor filing of chapter 13 over chapter 7 is to be achieved, this approach deserves strong consideration.

Congress undoubtedly thought when it passed the amendment to section 1322(b)(1) that it was clearly enunciating its desires relative to the treatment of cosigned debts. Sometimes "clear" language is not what is seems.

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6 In re Todd, 65 B.R. 249 (Bankr. N.D.Ill 1986); In re Easley, 72B.R. 948 (Bankr. M.D. Tenn. 1987); In re Gonzalez, 73 B.R. 259 (Bankr. D.P.R. 1987).

7 In re Perkins, 55 B.R. 422 (Bankr. N.D. Okla. 1985).

8 191 B.R. at 971.

9 This was summarized as: 1) Does the obligation fall under the plain language of section 1322(b)(1)? 2) Was the debtor the beneficiary of the obligation or was the obligation incurred primarily for the benefit of the codebtor or some other third party? and 3) Does the plan satisfy other applicable confirmation standards as stated in section 1325 of the Code?

RECENT BANKRUPTCY COURT DECISIONS

The Sixth Circuit and Supreme Court Decisions were summarized by John A. Potter. There were no Western and Eastern District decisions.

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UNITED STATES, PETITIONER v REORGANIZED CF&I FABRICATORS OF UTAH, INC., ET AL., No. 95-325, SUPREME COURT OF THE UNITED STATES, 1996 U.S. LEXIS 4048, June 20, 1996 Decided

This case presented two questions affecting the priority of an unsecured claim in bankruptcy to collect an exaction under 26 U.S.C. § 497(a), requiring a payment to the Internal Revenue Service equal to 10 percent of any accumulated funding deficiency of certain pension plans. First, whether the exaction is an "excise tax" for purposes of 11 U.S.C. § 507(a)(7)(E) (1988 ed.), which gave seventh priority to a claim for such a tax. And, second, whether principles of equitable subordination support a categorical rule placing § 4971 claims at a lower priority than unsecured claims generally. The Court held that § 4971(a) does not create an excise tax within the meaning of § 507(a)(7)(E), but that categorical subordination of the Government"s claim to those of other unsecured creditors was error.

The Employee Retirement Income Security Act of 1974 obligated CF&I Steel Corporation and its subsidiaries (CF&I) to make certain annual funding contributions to pension plans they sponsored. The required contribution for the 1989 plan year totaled some $ 12.4 million, but CF&I failed to make the payment and petitioned the Bankruptcy Court for Chapter 11 reorganization. The Government filed, *inter alia,* a proof of claim for tax liability arising under § 4971(a) of the Internal Revenue Code, 26 U.S.C. § 4971(a), which imposes a 10 percent "tax" (of $ 1.24 million here) on any "accumulated funding deficiency" of plans such as CF&I's. The court allowed the claim but rejected the Government's argument that the claim was entitled to seventh priority as an "excise tax" under § 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. § 507(a)(7)(E), finding instead that § 4971 created a penalty that was not in compensation for pecuniary loss. The Bankruptcy Court also subordinated the § 4971 claim to those of all other general unsecured creditors, on the supposed authority of the Bankruptcy Code's provision for equitable subordination, 11 U.S.C. § 510(c), and later approved a reorganization plan for CF&I giving lowest priority (and no money) to claims for noncompensatory penalties. The District Court and the Tenth Circuit affirmed 53 F.3d 1155 (1995).

The Court held that:

1. The "tax" under § 4971(a) was not entitled to seventh priority as an "excise tax" under 507(a)(7)(E), but instead is, for bankruptcy purposes, a penalty to be dealt with as an ordinary, unsecured claim.

(a) Here and there in the Bankruptcy Code Congress has referred to the Internal Revenue Code or other federal statutes to define or explain particular terms. No such reference is in § 507(a)(7)(E), even though the Bankruptcy Code provides no definition of "excise," "tax", or "excise tax." This absence of any explicit connection between § 507(a)(7)(E) and § 4971 is all the more revealing in light of this Court's history of interpretive practice in determining whether a "tax" so called in the statute creating it is also a "tax" for the purposes of the bankruptcy laws.

(b) History reveals that characterizations in the Internal Revenue Code are not dispositive in the bankruptcy context. In every case in which the Court considered whether a particular exaction called a "tax" in the statute creating it was a tax for bankruptcy purposes, the Court looked behind the label and rested its answer directly on the operation of the provision. See, e.g., United States v. New York, 315 U.S. 510, 514-517. Congress has given no statutory indication that it intended a different interpretive method for reading terms used in the Bankruptcy Act of 1978, see Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection, 474 U.S. 494, 501, and the Bankruptcy Code's specific references to the Internal Revenue Code indicates that no general cross-identity was intended. The Government suggests that the plain texts of §4971 and § 507(a)(7)(E) resolve this case, but this approach is inconsistent with this Court's cases, which refused to rely on statutory terminology, and is unavailing on its own terms, because the Government disavows any suggestion that the use of the words "Excise Taxes" in the title of the chapter covering § 4971 or the word "tax" in § 4971(a) is dispositive as to whether § 4971(a) is a tax for purposes of § 507(a)(7)(E). The Government also seeks to rely on a statement from the legislative history that all taxes "generally considered or expressly treated as excises are covered by" § 507(a)(7)(E), but § 4971 does not call its exaction an excise tax, and the suggestion that taxes treated as excises are "excise taxes" begs the question whether the exaction is a tax to begin with. There is no basis, therefore, for avoiding the functional examination that the Court ordinarily employs.

(c) The Court's cases in this area look to whether the purpose of an exaction is support of the government or punishment for an unlawful act. If the concept of a penalty means anything, it means punishment for an unlawful act or omission, and that is what this exaction is. The § 4971 exaction is imposed for violating a separate federal statute requiring the funding of pension plans, and thus has an obviously penal character.

(d) The legislative history reflects the statute's punitive character.

2. The subordination of the Government's § 4971 claim to those of the other general unsecured creditors pursuant to § 510(c) was error. Categorical reordering of priorities that takes place at the legislative level of consideration is beyond the scope of judicial authority to order equitable subordination under § 510(c).

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UNITED STATES, PETITIONER v THOMAS R. NOLAND, TRUSTEE DEBTOR FIRST TRUCK LINES, INC. No. 95-323 SUPREME COURT OF THE UNITED STATES, 116 S. Ct. 1524; 1996 U.S. LEXIS 2957; 64 U.S.L.W. 4328; 96-1 U.S. TAX CAS. (CCH) P50,252;Bankr. L. Rep. (CCH) P76,920, May 13, 1996, Decided

The issue in this case is the scope of a bankruptcy court's power of equitable subordination under 11 U.S.C. § 510(c). In the absence of any finding of inequitable conduct on the part of the Government, the Bankruptcy Court subordinated the Government's claim for a postpetition, noncompensatory tax penalty, which would normally receive first priority in bankruptcy as an "administrative expense," §§ 503(b)(1)(C), 507(a)(1). The Court held that the Bankruptcy Court may not equitably subordinate claims on a categorical basis in derogation of Congress's scheme of priorities.

The Internal Revenue Service filed claims in the Bankruptcy Court for taxes, interest, and penalties that accrued after debtor First Truck Lines, Inc., sought relief under Chapter 11 of the Bankruptcy Code but before the case was converted to a Chapter 7 bankruptcy. The Court found that all of the IRS's claims were

entitled to first priority as administrative expenses under 11 U.S.C. §§ 503(b)(1)(C) and 507(a)(1), but held that the penalty claim was subject to "equitable subordination" under § 510(c), which the Court interpreted as giving it authority not only to deal with inequitable Government conduct, but also to adjust a statutory priority of a category of claims. The court's creditors was affirmed by the District Court and the Sixth Circuit, which concluded that postpetition, nonpecuniary loss tax penalty claims are susceptible to subordination by their very nature.

The Court held that:

A Bankruptcy Court may not equitably subordinate claims on a categorical basis in derogation of Congress's priorities scheme. The language of § 510(c), principles of statutory construction, and legislative history clearly indicate Congress's intent in its 1978 revision of the Code to use the existing judge-made doctrine of equitable subordination as the starting point for deciding when subordination is appropriate. By adopting "principles of equitable subordination," § 510(c) allows a bankruptcy court to reorder a tax penalty when justified by particular facts. It is clear that Congress meant to give courts some leeway to develop the doctrine. However, a reading of the statute that would give courts leeway broad enough to allow subordination at odds with the congressional ordering of priorities by category is improbable in the extreme. The statute would then empower a court to modify the priority provision's operation at the same level at which Congress operated when it made its characteristically general judgment to establish the hierarchy of claims in the first place, thus delegating legislative revision, not authorizing equitable exception. Nonetheless, just such a legislative type of decision underlies the reordering of priorities here. The Sixth Circuit's decision runs directly counter to Congress's policy judgment that a postpetition tax penalty should receive the priority of an administrative expense. Since the Sixth Circuit's rationale was inappropriately categorical in nature, this Court need not decide whether a bankruptcy court must always find creditor misconduct before a claim may be equitably subordinated. Further holding that (in the absence of a need to reconcile conflicting congressional choices) the circumstances that prompt a court to order equitable subordination must not occur at the level of policy choice at which Congress itself operated in drafting the Bankruptcy Code. Cf. In re Ahlswede, 516 F.2d 784, 787 (CA9) ("The [equity] chancellor never did, and does not now, exercise unrestricted power to contradict statutory or common law when he feels a fairer result may be obtained by application of a different rule"), cert. denied sub nom. Stebbins v. Crocker Citizens Nat. Bank, 423 U.S. 913, 46 L Ed. 2d 142, 96 S. Ct. 218 (1975); In re Columbia Ribbon Co., 117 F.2d 999, 1002 (CA3 1941) (court cannot "set up a subclassification of claims....and fix an order of priority for the sub-classes according to its theory of equity").

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In Re: ROBERT H. HARSHBARGER and MARY J. HARSHBARGER, Debtors. ROBERT H. HARSHBARGER and MARY J. HARSHBARGER, Plaintiffs-Appellants, v. FRANK M. PEES, Chapter 13 Trustee, Defendant-Appellee. No. 94-3090; 66 F.3d 775; 1995 U.S. App. LEXIS 26335; 1995 fed APP. 0286P (6th Cir.); Bankr. L. Rep. (CCH) P76,643; 34 Collier Bankr. Cas. 2d (MB) 233; September 19, 1995, Filed

Appellants Robert and Mary Harshbarger ("debtors") appealed the District Court's decision to uphold the dismissal of their voluntary Chapter 13 bankruptcy petition for failure to submit a plan that satisfied the requirements of 11 U.S.C. § 1325. Their Chapter 13 plan

deducted from disposable income monthly payments to repay monies borrowed from Mary Harshbarger's ERISA account. In 1985, Mrs. Harshbarger borrowed $6,400 from the ERISA account to put a down payment on a home. This loan was to be through monthly payroll deductions. The ERISA account provided for a right of set off, either in the future or immediately, if a participant fails to repay a loan. In August of 1992, the Harshbargers filed for Chapter 13 bankruptcy. When they submitted their Plan, $3,855.54 remained to be paid on the ERISA loan. Debtors' Plan proposed to continue the monthly payroll deductions and treat the ERISA-account loan as a separate class of unsecured debt that would be paid 100% "outside" of the Plan. The Plan exempts $61.17 per month from the estate's disposable income. It proposes pro rata distribution of the funds included as disposable income to the remaining unsecured creditors, amounting to a dividend of approximately 40%.

The Trustee objected to the Plan, reasoning that under 11 U.S.C. § 1325(b) the $61.17 is disposable income that must be evenly distributed among all unsecured creditors, not earmarked for reimbursement of the debtors' own ERISA account. The Bankruptcy Court ruled in favor of the Trustee. The District Court affirmed, ruling that only assets actually in the ERISA account, not future contributions or repayments, can be excluded from the bankruptcy estate under 11 U.S.C. § 541(c)(2).

Debtors reason that ERISA, as "applicable nonbankruptcy law," excludes the repayments from the bankruptcy estate because failure to reimburse the plan 100% would trigger set off against the account , causing "indirect alienation" of her pension benefits. The Trustee argued that only funds actually in an ERISA-qualified account are excluded from the estate under § 541(c)(2). The Trustee asserts that the payroll deductions at issue constitute repayments of a loan on the ERISA account that should have been included in the debtors' disposable income under 11 U.S.C. § 1325(b).

Debtors' Plan proposes to deduct $61.17 per month from the disposable income available to pay unsecured creditors so that Mrs. Harshbarger may restore her full interest in the ERISA account. This expenditure may represent prudent financial planning, but it is not necessary for the "maintenance or support" of the debtors. See In re Scott, 142 Bankr. 126, 133 (Bankr. E.D. Va. 1992). Accordingly, the District Court was correct in affirming the decision to reject the Plan.

Section 541(c)(2) excludes a debtor's beneficial interest in a trust that is subject to a restriction on transfer enforceable under "applicable nonbankruptcy law." This exempts a debtor's beneficial interest in an ERISA-qualified account from the bankruptcy estate. Patterson v. Shumate, 504 U.S. 753, 119 L. Ed. 2d 519, 112 S. Ct. 2242 (1992). Thus, the funds already in Mrs. Harshbarger's ERISA-qualified account, including the money she repaid prior to filing for bankruptcy, are not part of the bankruptcy estate. However, the money debtors wish to repay the ERISA account in the future is not similarly excluded. The $61.17 monthly payroll deductions are not funds already in the ERISA account. Debtor's Plan must treat these funds as part of the disposable income in the bankruptcy estate. The Court reasoned that it would be unfair to creditors to allow Debtors to commit part of their earnings to payment of their own retirement fund while at the same time paying their creditors less than a 100% dividend." In re Jones, 138 Bankr. 536, 539 (Bankr. S.D. Ohio 1991)

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In Re: FERNCREST COURT PARTNERS, LTD., Debtor. AKRAM DANIEL, Plaintiff-Appellant, v. AMCI, INC.; CORSON & BUCKEY, INC., Defendants-Appellees. No. 94-3263 66 F. 3d 778; 1995 U.S.

App. LEXIS 27137; 1995 FED App. 0290P (6th Cir.); Bankr. L. Rep. (CCH) P76,653; 34 Collier Bankr. Cas. 2d (MB) 250; 27 Bankr. Ct. Dec. (CRR) 1142, September 22, 1995 Filed

Plaintiff Akram Daniel challenged the district court"s decision affirming the bankruptcy court's award of a brokers' commission to Defendants AMCI, Inc. and Corson & Buckey, Inc. ("Corson & Buckey") for their assistance in attempting to sell the single asset of the Bankruptcy. The Court affirmed the district court decision.

Ferncrest Court Partners, Inc., ("Debtor"), owned a residential complex called Ferncrest Apartments. Home Life Insurance Co. ("Home Life") held a first mortgage on the property to secure a $2 million loan. Daniel, the original owner of the property, held a second mortgage to secure a loan. On June 4, 1990, Debtor filed a voluntary petition in bankruptcy under Chapter 11. The only asset of the bankruptcy was that property.

On February 4, 1991, Home Life filed a motion for relief from automatic stay in order to pursue its state remedies and Debtor objected. Four days later, Debtor applied to the court for the authority to hire real estate brokers in an attempt to sell the property privately. Both secured parties were aware of Debtor's motion but neither filed objections. On March 1, 1991, Debtor and Home Life entered into a stipulation whereby Home Life agreed to a 60-90 day period during which time Debtor could attempt to find a purchaser, subject to the bankruptcy court's approval. In return, Home life was provided relief from the stay and could pursue its rights as the primary secured party once the time period had expired.

On March 19, 1991, Daniel filed a motion for relief from the automatic stay in order to resume foreclosure proceedings in state court. The bankruptcy court granted Debtor's request to retain real estate brokers, at which time debtor hired Corson & Buckey, a real estate broker licensed in Ohio, and AMCI, the original manager of the apartments and a real estate broker licensed in Missouri. Pursuant to the listing contract, the brokers would receive a commission when they procured a purchaser "ready", willing and able to purchase...for any price acceptable to the Owner."

On April 30, 1991, the court granted Daniel's motion for relief from automatic stay. As a result of the broker's efforts, on May 7, 1991, Andrew Green signed an offer to purchase the property for $1,450.000. Debtor accepted the offer and on May 28, 1991, filed a motion with the bankruptcy court to sell the property to Green. Daniel received notice of the proposed sale on June 10, 1991. One day later, Daniel filed an objection to the sale, disclosing for the first time that on April 30, 1991, Home Life had assigned to him its interest in the property. This allowed Daniel to bid the amount of the secured debt without having to produce any cash.

At a hearing regarding Debtor's motion to sell the property to Green, Daniel bid $1,451.000 on the property. In light of the higher amount offered by Daniel, the court awarded the property to Daniel. Daniel then disposed of the property at foreclosure, submitting the winning bid of $1.5 million. After completion of the sale, the brokers sought payment of their commission from the sale proceeds. Daniel, however, refused to pay. After a hearing on the matter, the bankruptcy court awarded the brokers the requested commission. The district court affirmed.

Daniel contended that as a matter of Ohio law, the brokers were not entitled to their commission. The bankruptcy court disagreed and approved the payment of the brokers' commission as an administrative expense after determining that: 1) the brokers had completed performance under the brokerage contract; and 2) Daniel, as successor-in-interest to Home Life, had "acquiesced" to the use of the brokers.

Daniel next contended that the lower courts erred in determining that the commission was a legitimate administrative

expense under § 503(b)(1)(A) and in failing to discuss the requirements of § 506(c) prior to awarding the commission.

Section 503(b)(1)(A) provides for the payment of "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after commencement of the case."Daniel contended that the district court erred in concluding that § 503 authorized the payment of the commission since the bankruptcy court had not approved the sale to Green and, therefore, the brokers had not produced a willing and able purchaser. The Court dismissed this argument since the brokers had produced a willing and able buyer.

As a general rule, in order to prevail on a § 506(c) claim, the claimant bears the burden of proving that the costs were reasonable, necessary, and a benefit to the secured party. In re Daily Medical Equipment, Inc., 150 Bankr. 205, 208 (Bankr. N.D. Ohio 1992). In the alternative, recovery may be had where the claimant establishes that the secured party directly or impliedly consented or caused the expense. In re Swann, 149 Bankr. 137, 143 (Bankr. D.S.D. 1993) (citing Matter of Great Northern Forest Products, Inc., 135 Bankr. 46, 62 (Bankr. W.D. Mich. 1991); In re Staunton Indus., Inc., 75 Bankr. 699, 702 (Bankr. E.D. Mich. 1987). Both the bankruptcy court and the district court determined that Daniel, by virtue of his status as successor-in-interest to Home Life, acquiesced or consented to the broker expense.

Home Life, as first secured creditor, stipulated to Debtor's right to pursue a private sale for a limited amount of time. In return, Debtor agreed to lift the automatic stay against Home Life. Daniel, as successor-in-interest to Home Life, is therefore bound by Home Life's consent. Furthermore, Daniel failed to object to Debtor's retention of the real estate brokers until the brokers had performed under the contract. Given this acquiescence, the Court would not allow Daniel to defeat the Debtor's and brokers' legitimate expectations.

Daniel made the alternative argument that Home Life's consent was ineffective as it consented only after making a motion for relief from the automatic stay. The Court found that Daniel waived this argument by failing to present it to either the bankruptcy or district court. Daniel, as successor-in-interest to Home Life, consented to the retention of the brokers, making it unnecessary to determine whether the commission was necessary, reasonable and beneficial to Daniel. The Court held that the commission is a proper administrative expense under §§ 503(b)(1)(A) and 506(c).

A dissenting opinion was provided in this case by the Hon. Wendall A. Miles, United States District Judge for the Western District of Michigan, sitting by designation.

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In Re: THE GIBSON GROUP, INC., Debtor, CANADIAN PACIFIC OREST PRODUCTS LIMITED, Plaintiff-Appellant, v. J.D. IRVING, LIMITED, BLUM INTERNATIONAL INC., WEST INDIES PULP & PAPER LTD., Defendants-Appellees. No. 94-3567; 66 F.3d 1436; 1995 U.S. App. LEXIS 27577; 1995 FED App. 0298P (6th Cir.); Bankr. L. Rep. (CCH) P76,651;28 Bankr. Ct. Dec. (CRR), September 28, 1995, Filed

This appeal addressed the question of whether Congress intended to confer exclusive authority to file an action to avoid preferential or fraudulent transfers, pursuant to 11 U.S.C. §§ 547 and 548, on a trustee or debtor-in-possession, or whether a creditor might have standing to file such an action. The issue decided whether Canadian Pacific Forest Products Limited had standing to file an action to avoid allegedly preferential and fraudulent transfers made by the debtor-in-possession, The Gibson Group, Inc. The bankruptcy court dismissed Canadian Pacific's complaint for lack of standing--even though the

debtor-in-possession refused to file an action-and Canadian Pacific appeals from the district court's decision affirming the bankruptcy court. Canadian Pacific also appealed the district court's decision affirming the bankruptcy court's denial of its subsequent motion to supplement the record to prove standing.

In reversing the district court, the Court of Appeals found that Congress had not precluded the bankruptcy court from granting standing to a creditor if such standing furthers Congress's purpose in creating the avoidance actions found in 11 U.S.C. §§ 547 and 548 in the context of a Chapter 11 reorganization. A bankruptcy court may permit a single creditor in a Chapter 11 case to initiate an action to avoid a preferential or fraudulent transfer instead of the debtor-in-possession if the creditor: 1) has alleged a colorable claim that would benefit the estate, if successful, based on a cost-benefit analysis performed by the bankruptcy court; 2) has made a demand on the debtor-in-possession to file the avoidance action; 3) the demand has been refused; and, 4) the refusal is unjustified in light of the statutory obligations and fiduciary duties of the debtor-in-possession in a Chapter 11 reorganization. The Court also held that, while the creditor has the initial burden to allege facts showing that the refusal to file suit is "unjustified," the debtor-in-possession in a Chapter 11 reorganization. The Court also held that, while the creditor has the initial burden to allege facts showing that the refusal to file suit is "unjustified," the debtor-in-possession must rebut the presumption if the creditor carries its initial burden. Contrary to the district court's view, the Court found that a creditor need not plead facts alleging the debtor-in-possession's reason or motive for the inaction, but may meet its burden to allege unjustified inaction through notice pleading by alleging the existence of an unpursued colorable claim that would benefit the estate. See Fed. R. Civ. P. 8; Fed. R. Bankr. P. 7008 (making Fed. R. Civ. P. 8 applicable in bankruptcy adversary proceedings). If the debtor-in-possession gives not reason for its inaction when a demand is made, the bankruptcy court may presume that its inaction is an abuse of discretion ("unjustified") if the complaint alleges a colorable claim.

Where the trustee "defaults in the performance of any duty, such as seeking to set aside a fraudulent transfer a creditor could initiate an avoidance action with the permission of the court, after making a demand upon the trustee and if the trustee defaulted in his duty." In re Automated Business Sys., 642 F.2d at 200 (6th Cir. 1981). Other Circuits have recognized derivative standing where the trustee or the debtor-in-possession abdicates its duty to conserve the estate by filing avoidance actions that would benefit the estate, although appellate courts differ somewhat as to the circumstances under which a creditor may initiate an avoidance action. The Seventh Circuit in *In the Matter of Xonics Photochemical, Inc.*, 841 F.2d 198 (7th Cir. 1988), a Bankruptcy Code case, agreed in dicta with this Court's reasoning in *In re Automated Business Sys., Inc.* regarding when a creditor can bring suit. See also *In re McKeesport Steel Castings Co.*, 799 F.2d 91, 94 (3d Cir. 1986) where the court reasoned that the rule that individual creditors cannot act in lieu of the trustee is often breached when sufficient reason exists to permit the breach. Thus, because the creditor had a colorable claim for expenses and was the only creditor that would zealously pursue that claim, it had standing to bring a § 506(c) action.

Canadian Pacific made a written demand on Gibson and the Committee to bring an action to avoid Gibson's pre-petition transfers. After Gibson and the Committee refused to act, Canadian Pacific sought permission from the bankruptcy court to file an avoidance action. On the face of the complaint, Canadian Pacific has stated a colorable claim under 11 U.S.C. §§ 547 and 548 that would benefit the estate if successful. Canadian Pacific has alleged

unjustified inaction on the part of the defendants and, in light of their refusal to give a reason for failing to act, the decision to grant the motion under Civil Rule 12(b)(6) was erroneous.

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In Re: GEORGE CHOMAKOS and NIKKI CHOMAKOS, Debtors. DAVID W. ALLARD, JR., Chapter 7 Trustee of the Estate of George Chomakos and Nikki Chomakos, Appellant, v. FLAMINGO HILTON, Appellee. No. 94-1712; F.3d 769; 1995 U.S. App. LEXIS 31806; Bankr. L. Rep. (CCH) P76,6941995 FED App. 0327P (6th Cir.) November 13, 1995, Decided; November 13, 1995, Filed

This is a bankruptcy case in which the trustee sought to recover pre-petition gambling losses from the operator of a state-regulated casino. The casino operator contended that the opportunity for the debtors to win more than the sums they bet, coupled with the entertainment value that the casino provided its customers, constituted "reasonably equivalent value" and "fair consideration" for the bets at issue. The bankruptcy court accepted this contention and held that the bets were not voidable under the Bankruptcy Code or under the Uniform Fraudulent Conveyance Act. The district court affirmed the bankruptcy court's decision on appeal. The Court of Appeals affirmed the district court decision.

Debtors, George and Nikki Chomakos, filed a bankruptcy petition on August 2, 1990, after having lost several thousand dollars at a casino operated by Flamingo Hilton Coporation in Las Vegas, Nevada. The petition sought relief under Chapter 11 of the Bankruptcy Code, but the matter was soon converted into a Chapter 7 case. The trustee then commenced an adversary proceeding against Flamingo in the United States Bankruptcy Court for the Eastern District of Michigan.

The trustee alleged that Debtors had been insolvent for six years prior to the filing of the petition; that during this time they transferred various sums to Flamingo for the purpose of gambling; that they made some of these transfers during the year preceding the filing; and did not receive a reasonably equivalent value or fair consideration in exchange. Invoking 11 U.S.C. § 548(a), the trustee sought to recover losses incurred during the year preceding the bankruptcy filing. Under Mich. Comp. Laws § 566.11 et seq., Michigan's version of the Uniform Fraudulent Conveyance Act, the trustee sought to recover losses incurred throughout the entire six-year period in which Debtors were alleged to have been insolvent.

The bankruptcy court found that the debtors should be deemed to have been insolvent from and after January of 1988; and the combined net losses of the two debtors during the period when they were insolvent came to $7,710. In an opinion published as In re Chomakos, 170 Bankr. 585 (Bankr. E.D. Mich. 1993), the bankruptcy court held that the relief requested by the trustee should be denied because defendant Flamingo gave reasonably equivalent value in exchange for the debtors' money. The order denying relief was appealed to the district court. That court affirmed the decision and the trustee filed a timely notice of appeal.

The trustee may undo as constructively fraudulent any property transfer made by the debtor within one year before the filing of the petition if the debtor was insolvent on the date of the transfer and "received less than a reasonably equivalent value in exchange for [the] transfer. . . " 11 U.S.C. § 548(a)(2)(A) and (B)(j). "Value" is defined as "property, or satisfaction or securing of a present or antecedent debt of the debtor. . . ." 11 U.S.C. § 548(d)(2)(A).

Under Michigan's Uniform Fraudulent Conveyance Act, a conveyance made by one who is insolvent is fraudulent as to creditors if made without a fair consideration. Mich. Comp. Laws § 566.14. "Fair

consideration" is given for property, Mich. Comp. Laws 566.13 provides, "when in exchange for such property. . . as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied. . . " The Michigan statute does not have a time limit corresponding to that in the Bankruptcy Code; the two provisions are substantially the same otherwise. The point in time to determine whether Mr. and Mrs. Chomakos received property of reasonably equivalent value in exchange for the money they wagered at the casino is the point at which their bets were placed. See *In re Morris Communications NC, Inc.*, 914 F.2d 458, 466 (4th Cir. 1990), quoting Collier on Bankruptcy § 548.09 at p. 116 (15th ed. 1984). The games of chance in which Debtors participated (slot machine games and blackjack) were not FCC lotteries for federal cellular telephone license, and a casino gambler is not kept waiting for months to learn whether a particular bet is successful. The principle, however, is the same in both cases.

The existence of an economic value may be immaterial, however, if the dollar value of the gambler's chance of winning - augmented, perhaps, by an element of entertainment value - is not "reasonably equivalent" to the amount of money wagered. We believe that the evidence presented by Flamingo showed a reasonable equivalency here, and the trustee presented no evidence to the contrary.

The intangible property rights accruing to Debtors when they placed their bets differed significantly from the benefits accruing to the donors in the church contribution cases. A debtor who contributes to a church may receive spiritual and social returns of great value to the debtor, but such returns are not likely to be of much benefit to creditors. A debtor who places a bet in a fair and lawful game of chance, on the other hand, may receive hard cash in return. Without reasonably generous payouts and competitive odds, Flamingo could not hope to attract the repeat customers on whom, according to the evidence, Flamingo and other casino operators depend for survival. "The quid pro quo," as the bankruptcy court observed, "was established in the context of a state regulated business, existing in an open competitive marketplace responding and responsive to desires of legitimate tourists pursuing and engaging in a legal and legitimate pursuit." *Chomakos,* 170 Bankr. at 592.

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CITY OF COVINGTON, Plaintiff-Appellant, v. COVINGTON LANDING LIMITED PARTNERSHIP, Defendant-Appellee. No 94-6038; 71 F.3d 1221; 1995 U.S. App. LEXIS 36366; 1995 FEDApp. 0376P (6th Cir.); Bankr. L. Rep. (CCH) P76, 734; 34 Collier Bankr. Cas. 2d (MB) 822; 28 Bankr. Ct. Dec. (CRR) 377; December 22, 1995, Filed

This case arises out of the Chapter 11 bankruptcy of Covington Landing Limited Partnership (the "partnership"), the entity that operates vessels on the riverfront in Covington, Kentucky, which house restaurants, bars and retail shops. The premises on which these facilities are located have been leased from the City of Covington since 1988. Due to the sale of one of the two original vessels operated by the partnership, the bankruptcy court modified the lease between the City and the partnership. The City appeals, contending that it did not consent to the bankruptcy court's ability to modify the lease, and that, absent its consent, the bankruptcy court lacked the power to order the modifications. the City further contends that it did not agree to the specific modifications made by the court. The district court's decision was affirmed which was affirmed by the Court Appeals.

Covington Landing is a limited partnership. Prior to the bankruptcy, the partnership owned and operated two adjacent barge vessels anchored

in the Ohio River. One vessel, the Wharf, consisted of multiple levels of restaurants and retail enterprises operated by third parties under lease arrangements with the partnership. The other vessel, the Spirit of America, was a replica of a river steamboat and contained a large restaurant with seating for 550 patrons. The entire complex is located on riverfront property leased by the City of Covington to the partnership in 1988, pursuant to what the parties call the Mooring lease.

The partnership filed a voluntary Chapter 11 petition in October 1992, and began investigating the sale of one of the vessels. A buyer offered to purchase the Spirit planning to operate the vessel in Missouri. It was necessary for the bankruptcy court to approve the sale because it was outside the ordinary course of business and it affected the partnership's rights to the riverfront property in question, because the Mooring lease obligated the partnership to operate "Floating Restaurant Facility(ies) with not less than 550 seats." On April 12, 1993, the bankruptcy court held a hearing on the proposed sale.

The partnership explained that, while the sale proceeds would permit it to formulate and carry out its plan of reorganization, it was essential that the City not declare the sale to be a material breach of the lease such that the partnership would lose its rights to operate the Wharf facility. The partnership also was concerned regarding the future rights to the space to be vacated by the Spirit. The partners committee reported the City's agreement to allow the partnership eighteen months to utilize the space vacated by the Spirit. The City approved the sale, both as lessor and as a creditor, stating that it would not view the sale as a breach of the Mooring lease, and that it did not want the partnership to lose its rights to the Wharf area.

The parties then negotiated amendments to the Mooring lease but could not reach an agreement. The City then filed a motion requesting the court to require the partnership to assume or reject the Mooring lease, taking the position that the partnership was entitle to a lease for the Wharf facilities only, and that the partnership had not rights to the river frontage vacated by the Spirit. The bankruptcy court denied the City's motion in October 1993.

After an evidentiary hearing to determine appropriate rental terms, the court divided the Mooring lease into two separate leases, one pertaining to the Wharf area, and the other pertaining to the area formerly occupied by the Spirit. The court approved both leases in its January 1994 order confirming the chapter 11 plan, expressly finding, pursuant to 11 U.S.C. § 365(b)(1), that the partnership had cured or provided adequate assurances that it would cure all defaults under the Mooring lease; the proposed rental payments under the two leases would compensate the City for any actual pecuniary losses; and the anticipated rent revenue from the Wharf and the anticipated revenues and/or development right limitations set forth in the Spirit lease gave the City adequate assurance of future performance under both leases. The bankruptcy court thus ordered the parties to execute both leases. The parties subsequently agreed to an order adding a paragraph to the Spirit lease (but not the Wharf lease) which stated that the City executed the Spirit lease while reserving its right to appeal.

The City, before the district court, contended that the bankruptcy court lacked the power under 11 U.S.C. § 365 to redraft the lease as it did without the City's consent. The district court held that the agreed order was ambiguous, and that the bankruptcy court was justified in looking to extrinsic evidence to ascertain its meaning, namely, the remarks of counsel at the April hearing. The district court held that the bankruptcy court properly construed the order in light of this extrinsic evidence when it found that the partnership had eighteen months to find a replacement for the Spirit, and that the parties agreed that the court would supply the terms of the amended lease if they could not reach an agreement themselves. The

district court held that the bankruptcy court's findings were not clearly erroneous.

The City contended that the appeal presented a legal question of whether the bankruptcy court had the power under 11 U.S.C. § 365 to modify the Mooring lease. Section 365 is intended to provide a means whereby a debtor can force another party to an executory contract to continue to perform under the contract if (1) the debtor can provide adequate assurance that it, too, will continue to perform, and if (2) the debtor can cure any defaults in its past performance. The provision provides a means whereby a debtor can force others to continue to do business with it when the bankruptcy filing might otherwise make them reluctant to do so. The section thus serves the purpose of making the debtor's rehabilitation more likely.

Section 365 does not speak to the situation in which the parties to the contract negotiate an amended contract. "To the extent that the amended lease represents a true renegotiation of the obligations of [the parties] it falls entirely outside of § 365's concern. . . Nothing in the Code suggests that the debtor may not modify its contracts when all parties to the contract consent." Richmond Leasing Co. 762 F.2d at 1311. The City agreed to the sale of the Spirit, agreed that the sale would not constitute a default, agreed that the partnership would retain rights to the Wharf space under a modified rental schedule, and agreed to future action with respect to the space vacated by the Spirit. These agreements fundamentally changed the parties' leasehold relationship, putting this case outside strict application of § 365. The outcome of this case thus depends not solely on § 365, but on the legal effect of the agreements made by the parties in this particular case.

An agreed order, like a consent decree, is in the nature of a contract, and the interpretation of its terms presents a question of contract interpretation. This court recently has clarified that the interpretation of a consent decree is question of law reviewed de novo. Huguley v. General Motors Corp., 67 F 3d. 129, 132 (6th Cir. 1995).

The bankruptcy court expressly found that the partnership eighteen months in which to find a substitute use for the Spirit space. This finding is clearly supported in the record. Twice during the April 12 hearing counsel for the City represented to the court that the City adhered to the eighteen-month period. The issue raised by the partners committee concerned whether eighteen months was sufficient; the City never stated that it did not intend to allow partnership at lease eighteen months.

In approving the modified leases in its confirmation of the plan of reorganization, the bankruptcy court implicitly held that the City was entitled to the benefits of the Mooring lease that had not been waived by virtue of its consent to the sale of the Spirit. Consequently, the court analyzed the leases under § 365, expressly finding that the partnership had cured or provided adequate assurances that it would cure any defaults; that the rental payments under the modified leases compensated the City for actual pecuniary losses; and that the City was given adequate assurance of future performance under the modified leases. Accordingly, the Court concluded that the bankruptcy court's findings were not clearly erroneous. The bankruptcy court did not exceed the powers delegated to it by the parties, the terms of the modified leases are consistent with the agreement of the parties, and the City obtained the benefits of the Mooring lease that were not waived by virtue of its consent to the sale of the Spirit.

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In Re: DOW CORNING CORPORATION, Debtor. HEIDI LENDSEY, et al.; OFFICIAL COMMITTEE OF TORT CLAIMANTS, et al., Plaintiffs-Appellees, v. DOW CORNING CORPORATION; et al, Defendants-Appellants. 1996 App. LEXIS 13146; 1996 FED

App. 0154A (6th Cir.) April 9, 1996, Decided

This was an appeal to determine the subject matter jurisdiction of federal district courts, sitting as bankruptcy courts, over proceedings "related to" a case filed under Chapter 11 of the Bankruptcy Code, and the ability of federal district courts to transfer such proceedings to the district court in which the bankruptcy case is pending. The principal issue presented is whether the district court erred, as a matter of law, in its determination that claims for compensatory and punitive damages asserted in thousands of actions against numerous nondebtor manufacturers and suppliers of silicone gel breast implants could have no conceivable effect upon, and therefore were not related to, the bankruptcy estate of The Dow Corning Corporation. The district court held that it did not have "related to" jurisdiction over those claims pursuant to 28 U.S.C. § 1334(b) and concluded that they could not be transferred to it pursuant to 28 U.S.C. § 157(b)(5). The Court of Appeals reversed and remanded the matter to the district court.

Due to the litigation burden imposed by what is one of the world's largest mass tort litigations, and the threatened consequences of the thousands of product liability claims arising from its manufacture and sale of silicone breast implants and silicone gel, Dow Corning filed a petition for reorganization under Chapter 11 of the Bankruptcy Code on May 15, 1995, in the United States District Court for the Eastern District of Michigan. The district court had jurisdiction over that proceeding pursuant to 28 U.S.C. § 1334(a). As a result of Dow Corning's Chapter 11 filing, all breast implant claims against it were automatically stayed pursuant to 11 U.S.C. § 362(a).

Dow Corning filed a motion pursuant to 28 U.S.C. § 157(b)(5) to transfer to the Eastern District of Michigan opt-out breast implant claims pending against it and its shareholders, Dow Chemical and Corning Incorporated. Dow Corning's motion covered claims that had been removed to federal court and were pending in the multidistrict forum, as well as claims pending in state courts which were in the process of being removed to federal courts pursuant to 28 U.S.C. § 1452(a). Dow Corning envisioned its transfer motion as the first step in ensuring a feasible plan of reorganization, and indicated that it would seek to have the transferred actions consolidated for a threshold jury trial on the issue of whether silicone gel breast implants cause the diseases claimed. Numerous other Defendants joined in Dow Corning's motion.

The district court issued two opinions and orders regarding the Section 157(b)(5) transfer motions. With respect to opt-out breast implant cases pending against Dow Corning, the district court asserted jurisdiction under Section 1334(b) and permitted transfer pursuant to Section 157(b)(5). The district court, however, denied the remainder of the transfer motions on the ground that, as a matter of law, it lacked subject matter jurisdiction over the claims sought to be transferred because they were not "related to" Dow Corning's bankruptcy proceeding pursuant to 28 U.S.C. § 1334(b). In denying the transfer motions, the district court also directed that individual federal courts nationwide dismiss or sever Dow Corning and/or remand the combined opt-out actions to state court, and enjoined the nondebtor codefendants from removing any other cases from state to federal court pursuant to 28 U.S.C. § 1452 if the only basis for such removal was 28 U.S.C. § 1334(b) or 28 U.S.C, § 1367(a). In a September 14, 1995 order, the district court extended its rulings to include opt-in breast implant claims.

Defendants subsequently filed appeals seeking review of the district court's partial denial of their motions to transfer. Those appeals primarily concerned questions pertaining to the scope of a district court's jurisdiction when it sits in bankruptcy, and its power to fix venue for the trial of wrongful death and personal injury tort

claims that are "related to" a bankruptcy proceeding. In deciding this issue the Court of Appeals viewed the issue as one of statutory construction and attempted to balance four different competing interests: those of the individuals bringing breast implant claims; Dow Corning's interests in formulating a reorganization plan; Dow Chemical and Corning Incorporated's interests as shareholders of Dow Corning: and the judicial system's interest in allocating its limited resources effectively and efficiently.

The first issue to be resolved was whether the district court had subject matter jurisdiction over breast implant claims pending not only against the debtor, Dow Corning, but also over certain claims pending against the nondebtor defendants. In addressing the extent of a district court's bankruptcy jurisdiction under Section 1334(b) over civil proceedings "related to" cases under title 11, the Court start with the premise that the "emphatic terms in which the jurisdictional grant is described in the legislative history, and the extraordinarily broad wording of the grant itself, left no doubt that Congress intended to grant to the district courts broad jurisdiction in bankruptcy cases. *In re Salem*, 783 F.2d at 634. Congressional intent was "to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate." *Celotex Corp. v. Edwards*, 131 L. Ed. 2d 403, 115 S. Ct. 1493, 1499 (1995).

The "usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy." *Pacor*, 743 F. 2d at 994. An action is "related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively). A proceeding "need not necessarily be against the debtor or against the debtor's property" to satisfy the requirements for "related to" jurisdiction. However, "the mere fact that there may be common issues of fact between a civil proceeding and a controversy involving the bankruptcy estate does not bring the matter within the scope of section [1334(b)]." Id. (stating also that "judicial economy itself does not justify federal jurisdiction"). Instead, "there must be some nexus between the 'related' civil proceeding and the title 11 case."

The 6th Circuit adopted the Pacor test for determining whether a civil proceeding is "related to" a bankruptcy proceeding under Section 1334(b) in *Robinson*, 918 F. 2d at 583 (noting in doing so that circuit courts have "uniformly adopted an expansive definition of a related proceeding under section 1334(b)"). The majority of the other circuits have likewise adopted the Pacor test for "related to" jurisdiction. In addition, the Supreme Court in *Celotex* also cited Pacor with approval in addressing the broad scope of the jurisdiction grant in Section 1334(b). *Celotex*, 115 S. Ct. at 1498-99.

The next issue addressed was whether the district court, sitting in bankruptcy, had the power to fix the venue for the trial of personal injury tort and wrongful death claims asserted in non-bankruptcy forums pursuant to 28 U.S.C. § 157(b)(5).

The purpose of Section 157(b)(5) is "to centralize the administration of the estate and to eliminate the 'multiplicity of forums for the adjudication of parts of a bankruptcy case.'" A.H. Robins Co. I, 788 F. 2d at 1011. Centralization of claims increases the debtor's odds of developing a reasonable plan of reorganization which will work a rehabilitation of the debtor and at the same time assure fair and non-preferential resolution of claims.

A "bankrupt debtor who is a defendant in a personal injury action may move under section 157(b)(5) to transfer the case to one of two venues: (1) the district where the bankruptcy is proceeding; or (2) the district where the claim arose." *In re Pan Am Corp. I*, 16 F. 3d at 516. The question for the Court's consideration was whether

Section 157(b)(5) allows for the transfer of personal injury and wrongful death claims pending against nondebtor defendants who have been sued with a debtor under claims of joint and several liability. Citing A. H. Robins, the Court stated that Section 157(b)(5) should be read to allow a district court to fix venue for cases pending against nondebtor defendants which are "related to" a debtor's bankruptcy proceedings pursuant to Section 1334(b). This approach will further the prompt, fair, and complete resolution of all claims "related to" bankruptcy proceedings, and harmonize Section 1334(b)'s broad jurisdictional grant with the oft-stated goal of centralizing the administration of a bankruptcy estate.

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In Re: CENTURY OFFSHORE MANAGEMENT CORPORATION, Debtor. GRASSO PRODUCTION; AIR LOGISTICS INCORPORATED, Appellants, v. BMO FINANCIAL INCORPORATED; BANK OF MONTREAL, Appellees. No. 95-5492, 83 F.3d 140; 1996 U.S. App. LEXIS 10453; 1996 FED App. 0133P (6th Cir.) May 7, 1996, Decided

This case involves the priority under Louisiana law of liens on certain oil and gas properties owned by Century Offshore Management Corporation, the debtor in a Chapter 11 bankruptcy proceeding that began in August 1993 in December 1993, the Bank of Montreal and BMO Financial, Inc. (collectively, the "Bank"), secured creditors of Century with consensual mortgages and security interests on substantially all of the oil and gas properties owned by Century, filed a complaint in the bankruptcy proceeding seeking to determine the validity, extent, and priority of their mortgages. Based on discovery and pleadings, the Bank moved for summary judgment that its mortgages were senior in rank to all other claimants. Appellants, Grasso Production Management and Air Logistics, Inc., opposed the Bank's summary judgment motion, and asserted, that they hold statutory lien claims on certain of Century's oil and gas properties that are superior in priority to the consensual mortgages held by the Bank. Grasso claimed $774,301.73 in unpaid services due it as "contract operator" of certain oil and gas facilities. Air Logistics claimed $410,272.92 for transportation services to and from these offshore facilities. Thus the case involves claims in excess of $1 million. In four short sentences delivered from the bench about the needs of commercial banks, the Bankruptcy Judge found in favor of the Bank. The District Court affirmed.

The issue on appeal was whether mechanic's and materialman's liens under the Louisiana Oil, Gas, and Water Wells Lien Act rank from the date services were first provided or from the date of first unpaid service. At the outset, we note that, although this issue is one of first impression in Louisiana, the decision of this Court will have little prospective effect. As described below, 1995 amendments to the Oil, Gas, and Water Wells Lien Act make clear that statutory liens rank from the date services were first provided, not the date of first unpaid service. However, because the 1995 amendments do not appear to be retroactive, the case is based on the older lien act.

Under the pre-1995 Oil, Gas, and Water Wells Lien Act, oil and gas well contractors are granted a "privilege" (i.e. a lien) in the well and its proceeds for the value of their labor. The Act states, in relevant part:

Any person who performs any labor or service in drilling or in connection with the drilling of any well or wells in search of oil, gas or water. . . has a privilege on all oil or gas produced from the well or wells, and the proceeds thereof inuring to the working interest therein. . . . for the amount due for labor of service. . . . La. Rev. Stat. 9:4861 (1996) (Historical and Statutory Notes). To preserve the privilege granted by §

4861, a contractor must record a notice of claim in the appropriate parish records within 180 days after the last day of the performance of labor or services. La. Rev. Stat. 9:4862(A)(1) (1996) (Historical and Statutory Notes).

When so recorded, the privileges are superior to all other privileges, mortgages, or other security interests against the property, except . . . privileges or mortgages filed or recorded . . . prior to the date on which the first labor . . .covered by the privilege herein granted is furnished. La. Rev. Stat. 9:4862(A)(2) (1996) (Historical and Statutory Notes).

The Bank/Appellee successfully argued in the lower courts, that because a contractor has a privilege under 9:4861 only "for the amount due" for labor or service, the privilege only comes into existence on the date of the first unpaid invoice for labor or services. Until an amount is due, no privilege exists. Once a privilege exists, it will be superior to other mortgages except those recorded prior to the date of the first unpaid invoice, because under § 4862(A)(2) the first invoice marks the first labor "covered by the privilege herein granted." Thus, under the Bank's reading of §§ 4861 amd 4862. the Bank has priority if its mortgage is recorded prior to the contractor's first unpaid invoice. The summary judgment evidence shows that Appellants filed all of their invoices at least eighteen months after the Bank had recorded its mortgages.

The found that the purpose of the Oil Well Lien Act is to protect those who contribute labor, services, and equipment to the drilling of wells from the default of those who engage them. The legislature has clearly placed the risk of the contractor's insolvency or failure to pay on those with an interest in the lease. The legislature has made a policy decision that the lease owners are in a far better position to ensure payment for the subcontractor's services than is the subcontractor, and that the onus should be on the lease owners to ensure that the contractor it hires is solvent and that it actually makes payment to the subcontractor. *Guichard*, 657 So. 2d at 1312-13 (citations omitted). For the same policy reason, the burden falls on a bank when contractors who have been constructing and operating a well, and thus enhancing the value of the bank's collateral, do not get paid by the lease owner. Of course, this is only true for contractors who were already on the job before the bank took an interest in the property. Contractors who come along after the bank has gotten a consensual mortgage will know from the public records that their statutory liens do not have priority. Presumably, these late-coming contractors will be less likely to work for long periods without being paid.

The public policy argument in favor of contractors is supported by reference to the revised and amended Louisiana Oil, Gas, and Water Wells Lien Act that was passed in 1995. Section 4862 defines the scope of the privilege for labor, services, or supplies:

The following persons have a privilege over the property described in R.S. 9:4862 to secure the following obligations incurred in operations:

(1) A contractor for the price of his contract for operations. . .

(4) A person who performs trucking, towing, barging, or other transportation services for an operator or contractor, for the price of transporting movables to the well site.

(5) A person who transports, to or from a well site located in the waters of the state, persons who are employed in rendering labor or services on the well site, for the price of transporting those persons.La. Rev. Stat. 9:4862(A) (1996). Thus, under the new Lien Act the privilege clearly secures the entire cost of labor or services, not just any unpaid amounts.

Furthermore, "The privilege in favor of a claimant is established and is effective as to a third person when: (1) the claimant, who is a contractor, laborer, or employee begins rendering services at the well

site." La. Rev. Stat. 9:4864(A) (emphasis added). The new act also contains an explicit section on the ranking of privileges:

The privileges granted by this Part are superior in rank and priority to all other privileges or mortgages against the property they encumber except the following which are of superior rank and priority:

(2) Mortgages. . . on the operating interest and other property affected by such mortgages . . .that are effective as to a third person before the privilege is established. La. Rev. Stat. 9:4870(B). Finally, the new statute makes clear the investigative obligations facing a prospective lender, who must only search for work done in the last ninety days:

All obligations owed to a claimant arising from operations on the same operating interest, without a lapse of more than ninety consecutive days between an activity or event that establishes the privilege. . . are secured by a single privilege. . . if more than ninety consecutive days elapse between such activities or events, the privileges established before and those established after such time are separate. La. Rev. Stat. 9:4864(C).

Under Louisiana law, the new Oil Lien statute is not retroactive. La. Rev. Stat. 1:2. ("No Section of the Revised Statutes is retroactive unless it is expressly so stated."); La. Civ. Code art. 6. ("In the absence of contrary legislative expression, substantive laws apply prospectively only.") See also *Mitchell v. Dixie Roofing & Sheet Metal Co.*, 663 So. 2d 222, 227 (La.App. 1995). The court then determined that even though it is not retroactive, the new statute confirms the policy choice that the Louisiana Supreme Court in *Guichard* ascribed to the legislature: "to protect those. . . who contribute labor, services, and equipment to the drilling of wells from the default of those who engage them. "657 So. 2d at 1312. Furthermore, in the present case, based on the fact that general materialman's lien statutes favor contractors over lenders who extend money after work has begun, we read the new statute as consistent with the older law.

STEERING COMMITTEE

A meeting was held on August 23, 1996.

Dan Casamatta, Mike Donovan, Tim Hillegonds, Jeff Hughes, Bob Wright, Brett Rodgers, Tom Sarb, Bob Sawdey, Peter Teholiz, Rob Wardrop and Steve Rayman were present for the meeting. Michael Maggio, Jim Gregg and Mark Van Allsburg were guests of the Committee.

After the meeting was called to order, 1996 Seminar was discussed as well as appointment of 1997 Seminar directors and the location for the 1997 Seminar. The Committee vested Judge Gregg, Brett Rodgers and Pat Mears with responsibility for the 1997 Seminar.

The subject of elections was discussed. Anyone who might be interested in serving as our new vice-chair (and thus become chair two (2) years hence) to advise the Committee. **Elections will be held and anyone interested in serving should advise the Committee.**

The Committeedecided that, until further notice, it would not accept solicitations or advertisements in the Newsletter.

The Technology Committee discussed the status of getting a full copy of all of the Court's opinions put on the Internet.

The next meeting will be held on September 20, 1996 at noon at the Peninsular Club in Grand Rapids.

EDITOR'S NOTE

Anyone interested in submitting an article for publication in the Newsletter is encouraged to contact me. There is always space available for articles.

This year's seminar was held at Boyne Highlands on August 8-10, 1996. Attendance was outstanding, and based on the comments, it was enjoyed by all. Judge Gregg, Brett Rodgers and Pat Mears did a great job and should be commended for their efforts.

LOCAL BANKRUPTCY NOTICE

Enclosed from Mark VanAllsburg is a memo from the Court and the Court Motion Calendar for September, 1996.

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Robert E. Lee Wright, Chairman of the FBA Technology Committee, has expressed an interest on bankruptcy home page on the Web. Comments as to items to be included on the home page are welcomed. Please contact Eric Richards at the U.S. Bankruptcy Court ((616) 456-2693) or his e.mail:

(erichards@ck6.uscourts.gov.)

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the United states Bankruptcy Court for the Western District of Michigan (Lower Peninsula) during the months of May of 1996. These figures are compared to those made during the same period one year ago and two years ago.

Bankruptcy Chapter	May of 1996	May of 1995	May of 1994
Chapter 7	588	477	334
Chapter 11	8	8	10
Chapter 12	3	0	5
Chapter 13	194	150	135
Totals	793	635	484

Bankruptcy Chapter	January - May of 1996	January - May of 1995	January - May of 1994
Chapter 7	2657	2011	1775
Chapter 11	34	32	40
Chapter 12	5	9	10
Chapter 13	1021	674	665
§304	0	1	0
Totals	3717	2727	2490

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the United states Bankruptcy Court for the Western District of Michigan (Lower Peninsula) during the months of June of 1996. These figures are compared to those made during the same period one year ago and two years ago.

Bankruptcy Chapter	June of 1996	June of 1995	June of 1994
Chapter 7	470	379	378
Chapter 11	9	4	7
Chapter 12	0	3	0
Chapter 13	217	164	140
Totals	696	550	525

Bankruptcy Chapter	January - June of 1996	January - June of 1995	January - June of 1994
Chapter 7	3127	2390	2153
Chapter 11	43	36	47
Chapter 12	5	12	10
Chapter 13	1238	838	805
§304	0	1	0
Totals	4413	3277	3015

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the United states Bankruptcy Court for the Western District of Michigan (Lower Peninsula) during the months of July of 1996. These figures are compared to those made during the same period one year ago and two years ago.

Bankruptcy Chapter	July of 1996	July of 1995	July of 1994
Chapter 7	589	375	308
Chapter 11	1	7	6
Chapter 12	0	1	1
Chapter 13	266	144	116
Totals	856	527	431

Bankruptcy Chapter	January - July of 1996	January - July of 1995	January - July of 1994
Chapter 7	3716	2765	2461
Chapter 11	44	43	53
Chapter 12	5	13	11
Chapter 13	1504	982	921
§304	0	1	0
Totals	5269	3804	3446

From the Court:

Elevator Repairs in Marquette: Some months ago, we gave notice that the elevator in the Post Office in Marquette would be out of service in June. It may not come as too much of a surprise that the construction did not commence when scheduled and is just now getting underway. Therefore, it is expected that the elevator will be out of service from July 17 to October 17. Anyone who anticipates a problem with access to court hearings should call Colleen Treder at (906) 226-2117. For problems with access to first meetings, call James Boyd at (616) 941-3446. For problems with access to meetings with the U.S. Trustee, call Dan Casamatta at (616) 456-2002. Thanks for your patience with this project.

Judge Stevenson Announces Dress Code: Judge Stevenson has become increasingly concerned by the number of litigants who appear in court unsuitably attired. Therefore, she has decided to impose the following dress code on August 1. Please notify your clients of these requirements **before** they appear in court.

1. No shorts, tank tops, or t-shirts with writing.
2. Shoes and socks are required.
3. Men are to wear shirts with sleeves and a collar.
4. No denim will be allowed.
5. No hats will be allowed except for religious reasons.

Cases with Improper Venue. The court has received an increasing number of cases from debtors who reside in counties which are part of the Eastern District of Michigan. When the petition and schedules of these cases are reviewed, it appears that the venue of most cases is not properly with this court. The judges have recently decided to take action in such cases. They intend to issue orders to show cause for dismissal or for transfer of such cases to appropriate districts when the facts recited on the petition indicate that venue is improper in this court. If you file a case for a debtor who resides outside of this district, it would be a good idea to indicate in your cover letter the basis for venue.

Court Motion Calendar for August and September

	Monday	Tuesday	Wednesday	Thursday	FrIday
AUGUST	5 SG	6 GG	7 SK	8	9
	12	13 HG	14 HL	15	16 HK
	19	20 GG SM	21 SM	22 GK ST	23
	26	27 GL SG HG	28	29 GT	30 GT HK
SEPTEMBER	2 LABOR DAY	3 GG	4	5 GK	6
	9 SK	10 HG	11 HM	12 HM ST	13 HM ST
	16 SG	17 GG	18	19 GK	20 HK
	23`	24` GL	25	26 GT	27 GT HL

ISSUE SUMMARY

NAME OF CASE: _____

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CHAPTER: _____

RELIEF SOUGHT: _____

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ISSUE: _____

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BENCH DECISION: _____

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REPORT SUBMITTED BY: _____

PETER A. TEHOLIZ
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