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CONSTITUTIONAL LIMITS ON THE MODIFICATION OF LIENS PART ONE -- DO LIENS REALLY SURVIVE BANKRUPTCY?

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INTRODUCTION

The courts are split over the issue of whether lien modification may be accomplished through the plan confirmation process or whether a debtor must use the claims allowance and objection process. In the typical scenario, a creditor who holds a lien on the debtor's property files a secured claim, and the debtor fails to object to the claim which is then deemed allowed. Meanwhile, the debtor proposes a plan of reorganization which expressly or implicitly modifies the creditor's lien rights. The unwary creditor fails to object and the plan is confirmed. After the time for appeal has expired, the creditor realizes that it may have lost its lien rights and belatedly objects to the plan. As one commentator has noted, "The tension between these two processes [claims allowance and confirmation] is obvious: what happens if the provisions of a confirmed plan with respect to the treatment of a creditor are inconsistent with the allowed claim filed by the creditor?" See 2 KIETH M. LUNDIN, Chapter 13 Bankruptcy § 6.10, at 6-17 (2d ed. 1994).

Part I of this article describes the split of authority. For a general discussion of the conflicting cases, see H. Gray Burks, IV, Obtaining the Release of Liens Through Reorganization Plans: The Circuits Sharpen the Debate with Penrod and Cen-Pen, NORTON BANKR. L. ADVISOR (Sept. 1995), at 1. See also, Hon. James D. Gregg, Lien Extinguishment in Pending Chapter 13 Cases, 7 NACTT Quarterly 6 (July, 1995). Part II sets forth an alternative analysis that focuses on the constitutional requirements for the modification of liens through the reorganization process. Part II will be published in a subsequent edition of this newsletter.

A. Three Conflicting Views

The courts have proffered various answers to this question and the opinions can be roughly classified into three different categories. First, there are those courts which give broad preclusive effect to plan confirmation and hold that unless the plan provides otherwise, plan confirmation terminates preexisting liens. If a court ascribes to this theory which recognizes the primacy and finality of the confirmation process, then the creditor will be barred from collaterally attacking the terms of the confirmed plan and the creditor will lose the lien. These cases rely primarily on the Bankruptcy Code sections which provide that property of the estate becomes "vested" in the reorganized debtor "free and clear" of any or all "claims and interests" upon confirmation of the plan which "binds" both debtor and creditors. See 11 U.S.C. §§ 1141, 1227 and 1327.

The second approach holds that liens survive confirmation, notwithstanding the plain language of the statutes regarding the effects of confirmation. This approach is generally described as the majority view and many of these cases are based on the premise that a debtor cannot modify or extinguish a lien in the absence of an objection to the creditor's secured claim. The so-called "claims allowance" approach is predicated on the statutory rule that a filed claim is "deemed allowed unless a party in interest . . . objects." 11 U.S.C. § 502(a). These cases also rely heavily on the traditional common law rule that "liens survive bankruptcy" as annunciated in the 19th century Supreme Court case of Long v. Bullard, 117 U.S. 617 (1886). If the court follows the claims allowance approach, it will refuse to give res judicata effect to the confirmed plan and the creditor's lien rights will be preserved.

The *third* approach recognizes the possibility of lien modification through the plan confirmation process, but requires that the creditor receive adequate pre-confirmation notice of the proposed plan provisions. Under this so-called "middle-of-the-road" approach, a court will give effect to the provisions of a confirmed plan that modify or terminate a creditor's lien interests, but only if the creditor received adequate notice and an opportunity for a hearing in accordance with the fundamental rights of due process. Each of these conflicting lines of decisions is discussed below.

1. Primacy of the Confirmation Process

Of the various United States Courts of Appeals, the Seventh Circuit has given the broadest preclusive effect to the confirmation of plans in cases arising under both Chapter 11 and Chapter 13. Several courts including the Seventh Circuit have held that a creditor's lien may be modified or extinguished by the confirmation of a Chapter 11 plan of reorganization.[1]

a. *Penrod*

For instance, in Matter of Penrod, 50 F.3d 459 (7th Cir. 1995), the Seventh Circuit held that upon confirmation of a Chapter 11 plan, all liens are automatically extinguished unless expressly preserved in the plan. In Penrod, a pig farmer defaulted on $150,000 promissory note that was secured by a lien on the livestock. Thereafter the farmer filed for bankruptcy protection under Chapter 11. The lienholder filed a proof of claim and no one filed an objection. The debtor's proposed plan of reorganization placed the creditor into a sep class which was to be paid in full with interest. The plan, however, did not mention the lien. After the plan was confirmed, the reorganized debtor sold the pigs to a third party without notifying the secured creditor in violation of the original security agreement. The creditor filed suit in state court seeking to enforce its lien on the proceeds of the sale and the reorganized debtor brought a motion in bankruptcy court alleging that the creditor had violated the confirmation order. The bankruptcy court refused to hold the creditor in contempt, but concluded that the creditor's lien was extinguished by confirmation of the plan. Consequently, the bankruptcy court enjoined the creditor from further attempts to enforce the lien. The district court affirmed the bankruptcy court and the creditor appealed to the Seventh Circuit.

The court of appeals framed the issue as follows: "whether preexisting liens survive a reorganization when the plan (or the order confirming it) does not mention the liens. What in other words is the default rule when the plan is silent?" Id. at 462. At the outset, the court of appeals made a somewhat disparaging reference to

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[1] See, e.g., In the Matter of Penrod, 50 F.3d 459 (7th Cir. 1995) (when plan of reorganization, or order confirming it, makes provision for payment of secured creditor's claim, but does not mention whether secured creditor's prepetition lien is preserved, lien is extinguished, provided that secured creditor participated in reorganization); Minstar, Inc. v. Plastech Research, Inc. (In re Arctic Enterprises, Inc.), 69 B.R. 71, 79-80 (D. Minn. 1986) (prepetition liens were extinguished by confirmation of chapter 11 plan where plan did not expressly preserve the lien); In re Northeast Office and Commercial Properties, Inc., 178 B.R. 915 (Bankr. D. Mass. 1995) (confirmation of Chapter 11 plan operated to extinguish attachment lien not expressly preserved either in plan itself or in order confirming plan); In re Danks, 123 B.R. 652, 653 (Bankr. W.D. Okla. 1991) (creditor who had filed unsecured proof of claim, and who voted to accept Chapter 11 plan requiring him to release lien, was estopped from asserting, post-confirmation, that his claim was secured); In re Henderberg, 108 B.R. 407, 412 (Bankr. N.D.N.Y. 1989) ("This Court is of the view that a confirmed Chapter 11 plan defines creditors' claims, and any preconfirmation rights of creditors exist only to the extent that they are accounted for in the plan."); In re Fischer, 91 B.R. 55, 57 (Bankr. D. Minn. 1988) (judgment creditor's lien rendered "null and void" by the confirmation of debtor's chapter 11 plan). But see Manistee County v. Reef Petroleum Corp. (In re Reef Petroleum Corp.), 92 B.R. 741 (W.D. Mich. 1988) (taxing authority's failure to object to order confirming debtor's Chapter 11 plan and to sale of personal property subject to tax lien did not affect the validity of lien, even though court had disallowed the taxing authority's secured claim).

"the old saw that 'liens pass through bankruptcy unaffected.'" The Penrod court acknowledged that under the traditional common law rule, a secured creditor may bypass the bankruptcy proceeding and enforce its lien by bringing a foreclosure action in state court and the discharge in the bankruptcy court will not affect the validity of the lien. Penrod, 50 F.3d at 459 (citing inter alia Long v. Bullard, 117 U.S. 617 (1886) and Dewsnup v. Timm, 502 U.S. 410, 416-17(1992)). The court then proceeded to identify several statutory exceptions to the common law rule, including the one which provides that a plan of reorganization may expressly preserve or impair secured claims. Penrod, 50 F.3d at 462 (citing 11 U.S.C. § 1123(b)(1)). In Penrod, however, the plan did not expressly address the lien. Therefore, the question was whether the lien was automatically extinguished by default where the plan itself is silent on the issue. The court answered this question by concluding that the "default rule for secured creditors who file claims for which provision is made in the plan of reorganization is extinction . . . ." Penrod, 50 F.3d at 462-63 (citing 11 U.S.C. § 1141(c)).

At the conclusion of the opinion, the Penrod court briefly touched upon the due process issue. The court of appeals acknowledged that the creditor's lien was a property right; however, the court concluded that the creditor had received due process because the creditor had a right to appeal the order confirming the plan.

"There is nothing to Mutual Guaranty's suggestion that our interpretation raises a question under the due process or takings clauses of the Fifth Amendment because a lien is property within the meaning of the clause. It is, United States v. Security Industrial Bank, 459 U.S. 70, 76-77, 103 S.Ct. 407, 411-12, 74 L.Ed.2d 235 (1982), but Mutual Guaranty could have protected it by appealing from the order confirming the plan of reorganization. . . ." Id. at 463.

Curiously, in its brief discussion of the due process issue, the Penrod court never mentioned the adequacy of the notice that was given to the creditor. Instead, the court focused on the quality of the hearing and the right of appeal. The failure to discuss the apparent lack of adequate notice is especially interesting in light of the way in which the court had framed the issue on appeal, i.e., "What . . . is the default rule when the plan is silent?" Id. at 462 (emphasis added). It is precisely this silence which calls into question the constitutionality of the procedure which deprived a creditor of its lien interest without any prior specific notice that the lien would be terminated.

b. Pence

Consistent with its views on the effect of confirmation in Chapter 11 cases as set forth in Penrod, the Seventh Circuit has also given broad preclusive effect to the confirmation of a Chapter 13 plan. In Matter of Pence, 905 F.2d 1107 (7th Cir. 1990), the Seventh Circuit held that a mortgage holder could not collaterally attack an order confirming a Chapter 13 plan for purposes of challenging a valuation of property given in exchange for release of a mortgage lien on a debtor's residence.[2]

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[2]Matter of Pence, 905 F.2d 1107 (7th Cir. 1990). See also McDonough v. Plaistow Cooperative Bank (In re McDonough), 166 B.R. 9, 14 (Bankr. D. Mass. 1994) (lienstripping not

In Pence, the debtor proposed a Chapter 13 plan under which she would give her commercial property to the bank in satisfaction of a debt and in exchange the bank would release its mortgage on the debtor's residence. The bank did not object to the plan and the plan was confirmed. Pence, 905 F.2d at 1108 (The opinion does not indicate whether the bank had filed a secured claim in the bankruptcy proceeding). Thereafter, it became apparent that the market value of the commercial property was not sufficient to cover the debt and the bank moved to revoke the confirmation order and lift the stay so that it could foreclose on the debtor's residential mortgage. The bankruptcy court denied the bank's motion and the district court affirmed. The issue on appeal was whether the bank was bound by the confirmed plan which extinguished its mortgage on the residential property. The bank argued that it had never received a copy of the proposed plan; however, the bankruptcy court had ruled to the contrary, and the court of appeals refused to overturn the bank's factual finding. Nevertheless, the Seventh Circuit concluded that the bank was bound by the plan, even if it had not received a copy of the plan prior to confirmation.

The Pence court rejected the bank's argument that its lien survived bankruptcy under the rule of Long v. Bullard, and under the Seventh Circuit's prior decision in Tarnow, 749 F.2d 464, 465 (7th Cir. 1984). In distinguishing these cases, the Pence court stated, "[t]hese cases stand for nothing more than the proposition, now codified in 11 U.S.C. § 506(d), that unless action is taken to avoid a lien, it passes through a bankruptcy proceeding." Pence, 905 F.2d at 1109. This restrictive interpretation of Long v. Bullard and section 506 was later reiterated by the Seventh Circuit in Penrod. See 50 F.3d at 459.

The court of appeals stated that "the plan treats the secured claim in a fair and equitable manner, providing for full payment of the debt." Pence, 905 F.2d at 1109. Compare 11 U.S.C. § 1129(b)(2) (statutory definition of "fair and equitable" treatment of impaired secured creditor under Chapter 11 cramdown). However, in its recitation of the facts, the court had previously noted that under the plan the creditor was forced to accept the debtor's commercial property that was "probably worth substantially less than" the creditor's claim. Thus, contrary to the court's assertion in its analysis, it appears that the creditor was not fully paid on its claim. Moreover, even if the creditor was entitled to receive 100 percent payment under the plan, the creditor was still deprived of its lien on the debtor's residence. This lien was a

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only can, but should be accomplished through Chapter 13 plan rather than adversary proceeding); In re Williams, 166 B.R. 615, 619-20 (Bankr. E.D. Va. 1994) (Chapter 13 debtor was not required to file contested matter to avoid bank's judgment lien on debtor's residence, and debtor could provide for avoidance of judicial lien in Chapter 13 plan by providing that debtor's interest in real estate would vest free and clear of lien upon confirmation of plan, where bank did not object to plan); Lee Servicing Co. v. Wolf (In re Wolf), 162 B.R. 98. 106-107 (Bankr. D. N.J. 1993) (Chapter 13 debtor may modify secured creditor's claim and cancel its lien to extent permitted under Bankruptcy Code by so providing in the plan without adversary proceeding, objection to claim, or motion); In re Edwards, 162 B.R. 868, 871-72 (Bankr. D. Colo. 1993) (under plain meaning of section 1327, the treatment of a confirmed plan is binding on creditor whether or not creditor has an allowed claim).

protected property interest which existed in addition to the creditor's claim in bankruptcy. The creditor should not have been deprived of its lien without adequate notice, regardless of what treatment it received with respect to its claim.[3]

With respect to the issue of due process, the Pence court stated:

"[E]ven assuming that Pacesetter failed to receive written notice of the confirmation hearing, it is still not entitled to avoid the binding effects of the reorganization plan. Due process does not always require formal, written notice of court proceedings; informal actual notice will suffice. In this case, Pacesetter, a sophisticated and organized creditor, had knowledge of Mrs. Pence's bankruptcy petition and should have known that a reorganization plan would have to be filed within fifteen days of the petition. See Fed. R. Bankr. Rule 3015. Creditors, especially lending institutions like Pacesetter, must follow the administration of the bankruptcy estate to determine what aspects of the proceeding they may want to challenge. Pacesetter was not entitled to stick its head in the sand and pretend it would not lose any rights by not participating in the proceedings." Pence, 905 F.2d at 1109 (emphasis added) (citations omitted).

The logic embodied in this final sentence has often been used to justify terminating a creditor's liens. See, e.g., In re Basham, 167 B.R. 903, 906 (Bankr. W.D. Mo. 1994). However, the rationale for the Pence decision is even more dubious from a constitutional perspective than the court's subsequent opinion in Penrod. At least in Penrod it appears that the creditor received some written notice about the proposed plan, even though the plan was silent with respect to the treatment of the creditor's lien. See Penrod, 50 F.3d at 461. In Pence, however, the court went one step farther and in effect ruled that the creditor was on constructive notice of the possibility that it would lose its lien rights -- even if it never received written notice of confirmation hearing on the proposed plan. The Pence court apparently concluded that the creditor had actual notice of the debtor's filing for bankruptcy which was sufficient to place the creditor on inquiry notice that its lien interest would be modified by the plan of reorganization.

It is unclear why the Pence court adopted such a broad rationale after having previously determined that it would not upset the bankruptcy court's ruling that the creditor had in fact received written notice. The Pence court could have simply held that the creditor had received notice of the proposed plan and therefore, was bound by its terms. Instead, the court went out of its way to hold that the creditor was bound by the plan even if it did not have notice. To the extent that Pence can be read to hold that a creditor may be deprived of its lien interests without receiving any

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[3]Unlike Chapter 11, a Chapter 13 debtor does not receive a discharge of debts upon confirmation of the plan, but only upon the successful completion of the payments scheduled under the plan. Other courts have recognized the problems that can arise if a lien is terminated upon confirmation of the Chapter 13 plan and the debtor subsequently converts to a Chapter 7 liquidation. See, e.g., In re Jones, 152 B.R. 155 (Bankr. E.D. Mich. 1993) (Chapter 13 was designed to permit debtors who comply with their obligations under confirmed plan to retain their property free and clear of liens securing claims provided for under terms of plan; however, Chapter 13 confirmation order should specify that liens remain in place until plan is successfully completed).

written notice of the proposed deprivation, such a holding violates the minimum standards of due process.

Moreover, the fact that the creditor in Pence may have been a sophisticated lender does not necessarily mean that it can be deprived of its lien rights without prior notice as required by Due Process. While the Pence court was correct in its general observation that "due process does not always require formal written notice," it was incorrect in its conclusion that "informal written notice will suffice" given the facts in that ca The creditor was entitled to receive adequate written notice alerting it to the possibility that it could lose its lien if it did not promptly object to confirmation of the debtor's plan. Although the creditor is not entitled to "stick its head in the sand," neither should the debtor be allowed to terminate the rights of an unwary creditor without adequate notice.

If the creditor receives adequate notice that its lien interest will be adversely effected under the proposed plan and the creditor fails to object, then it is bound by the plan. The confirmed plan should be binding on the creditor, regardless of whether or not the creditor has previously filed a secured claim, and regardless of whether the secured claim has been deemed allowed under 502(a) because the debtor failed to object. The Code expressly authorizes (with some exceptions) the modification of a creditor's security interests pursuant to the proposed plan of reorganization. See 11 U.S.C. §§ 1123(a)(5)(E); 1222(b)(2); and 1322(b)(2). Of course, the "cramdown" provisions are supposed to protect liens of secured creditors who do not consent to the plan. See 11 U.S.C. §§ 1129(b)(2)(A)(I)(I); 1225(a)(5)(B)(I); and 1325(a)(5)(B)(I). However, if the unwary creditor fails to raise these objections, the plan may be still be confirmed. The only constitutional requirements are that the creditor receive adequate notice and reasonable opportunity to object at the confirmation hearing. Under this analysis, Pence and Penrod are highly questionable in terms of constitutionality because the affected creditors did not receive adequate notice that their liens would be extinguished.[4]

2. Primacy of the Claims Allowance Process

In contrast to the foregoing authority, numerous courts have held that liens cannot be modified or extinguished through the plan confirmation process, absent the secured creditor's consent.[5]

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[4]In a recently published case note on Penrod, the author concludes, "the balancing approach taken by Judge Posner in In re Penrod is fair to both debtors and creditors and is the best approach from a statutory, practical and administrative sense." See Beth A. Buchanan Staudenmaier, Survival of Liens: "Liens Pass Through Bankruptcy Unaffected" -- Or Do They? In re Penrod -- Challenging an Adage, 21 U. DAYTON L. REV. 445, 446 (1996). However, the case note fails to address the constitutional implications of Penrod.

[5]See, e.g., Cen-Pen Corp. v. Hanson, 58 F.3d 89 (4th Cir. 1995) (initiation of adversary proceeding is prerequisite to challenging validity or existence of lien); Sun Finance Company v. Howard (Matter of Howard), 972 F.2d 639 (5th Cir. 1992) (creditor is not bound by confirmed Chapter 13 even though creditor failed to object before confirmation where debtor had not filed an objection to creditor's claim; if no objection is filed to secured claim, creditor is entitled to rely upon its lien); Foremost Financial Services Corporation v. White (In re White), 908 F.2d 691 (11th Cir. 1990) (per curiam) (creditor's secured claim is deemed allowed and the related lien cannot be modified without a separate

protected property interest which existed in addition to the creditor's claim in bankruptcy. The creditor should not have been deprived of its lien without adequate notice, regardless of what treatment it received with respect to its claim.[3]

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Notwithstanding the broad language of sections 1141 and 1327 regarding the effects of plan confirmation, several courts have interpreted these statutes narrowly and have refused to terminate preexisting liens, regardless of the contents of the plan. This view is generally acknowledged to be the majority rule. See generally 2 LUNDIN § 6.14, at 6-39, 6-40. See also 5 WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW 2D §122:12, at 122-134, n.15 (Supp. 1996).

a. *Simmons*

The Fifth Circuit Court of Appeals was one of the first courts to hold that the confirmation process is superseded by the claim allowance approach. In In re Simmons, 765 F.2d 547 (5th Cir. 1985), the Fifth Circuit held that confirmation of Chapter 13 plan which treated lienor's claim as unsecured did not result in lifting of lien from debtor's homestead. The debtor in Simmons filed a petition for relief under Chapter 7 and then converted the case to Chapter 13. The debtor's plan classified the creditor's claim as unsecured and disputed, despite the existence of a construction lien held by the creditor. The creditor filed a secured claim and indicated that he accepted the plan, but noted that "creditor objects to his claim being scheduled as unsecured." The bankruptcy court confirmed the plan and debtor filed an adversary proceeding seeking a determination that the creditor's lien was canceled. The bankruptcy court refused to cancel the lien and the district court affirmed.

The issue on appeal was whether the debtor could extinguish the lien through confirmation of the chapter 13 plan. In its opinion affirming both lower courts, the Fifth Circuit held that confirmation of debtor's

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hearing on the debtor's objection to secured claim); Southwest Bank of Alabama v. Thomas (In re Thomas), 883 F.2d 991 (11th Cir. 1989) (confirmation of Chapter 13 plan does not vest property in debtor free and clear where creditor did not file claim; creditor's failure to file claim does not result in loss of lien); Simmons v. Savell (In re Simmons), 765 F.2d 547 (5th Cir. 1985) (confirmation of Chapter 13 plan which treated lienor's claim as unsecured did not result in lifting of lien from debtor's homestead); Bisch v. United States (In re Bisch), 159 B.R. 546 (9th Cir. BAP 1993) (taxpayers' failure to provide for federal tax lien in their confirmed Chapter 13 plan and the failure of the IRS to file any objection to confirmation of taxpayers' plan did not affect validity of lien or right of IRS to enforce its lien against taxpayers' real property postpetition); Fireman's Fund Mortgage Corp. v. Hobdy (In re Hobdy), 130 B.R. 318 (BAP 9th Cir. 1991) (confirmed Chapter 13 plan which substantially reduced the amount of creditor's secured claim violated due process and was not binding where debtor had failed to object to creditor's timely claim); Wright v. Commercial Credit Corp., 178 B.R. 703 (E.D. Va. 1995) (adversary proceeding is required whenever party asks bankruptcy court to determine extent of lien or to value collateral forming basis of lien; lien stripping cannot be achieved in context of chapter 13 plan, with no adversary proceeding to support it); Kuebler v. Commissioner (In re Kuebler), 156 B.R. 1012 (Bankr. E.D. Ark. 1993), aff'd, 172 B.R. 595 (E.D. Ark. 1994) (when Chapter 13 plan does not address creditor's secured claim, creditor's lien simply passes through bankruptcy and remains enforceable in rem after discharge is granted and case is closed); In re Fewell, 164 B.R. 153 (Bankr. D. Col. 1993) (confirmation of Chapter 13 which substantially understated amount of mortgagee's secured claim for prepetition mortgage arrearage merely affected mortgagee's right to recover on its claim pursuant to plan and did not deprive mortgagee of its right to recover arrearage outside debtor's Chapter 13 case); Sears Roebuck & Co. v. Burgess (In re Burgess), 163 B.R. 726 (Bankr. M.D. Pa. 1992) (Chapter 13 plan that treated a secured creditor as a general unsecured creditor, did not "provide for" creditor, so that property did not revest free and clear of creditor's interest); Matter of Beard, 112 B.R. 951 (Bankr. N.D. Ind. 1990) (Chapter 13 plan will not eliminate lien simply by failing or refusing to acknowledge it or by calling creditor unsecured even where plan is confirmed without objection).

Chapter 13 plan did not have the effect of canceling the creditor's statutory lien. In support of its ruling, the court of appeals noted that a claim is deemed allowed unless a party in interest objects. Simmons, 765 F.2d at 551-52 (citing § 502(a)). The court further noted that the claims objection process involved a contested matter which may entail a separate adversary proceeding if a party seeks to challenge the validity, priority, or extent of a lien under Rule 7001. In contrast, the confirmation process did not require an adversary proceeding and, therefore, was not an adequate substitute for the claims allowance process. In summary, the Simmons court concluded as follows:

"To hold that confirmation of [debtor's] repayment plan had the effect of dissolving [creditor's] statutory lien because the validity of his secured claim could have been decided at the confirmation hearing, had a party in interest request the court do so, would requires us to ignore the rule of Long v. Bullard; and to read section 506(d) out of the Code. This we will not do. Therefore, having reviewed the essential elements of a Chapter 13 plan in the light of Code provisions concerning the effect of confirmation, particularly section 1327 and 506, and persuaded that giving sway to Congress' intent that liens pass through bankruptcy unaffected does not frustrate Chapter 13's fresh start policy, we hold that [creditor's] statutory lien on [debtor's] homestead remained unimpaired by the order of confirmation." Simmons, 765 F.2d at 558 (citing In re Willey, 24 B.R. 369, 371 (Bankr. E.D. Mich. 1982) (secured creditor retains lien against collateral even when its claim is treated as unsecured under a confirmed Chapter 13 plan)).

The Simmons court did not directly address the issue of due process; however, the court clearly opined that the notice and hearing procedures associated with the confirmation of a Chapter 13 plan were not sufficient to deprive a creditor of its lien rights. Rather, the court held that a debtor must file an objection to the creditor's secured claim and file a separate adversary proceeding to challenge the creditor's lien.

b. Howard

In 1992, the Fifth Circuit reaffirmed its decision in Simmons and its adherence to the primacy of the claims allowance approach. In Sun Finance Company v. Howard (Matter of Howard), 972 F.2d 639 (5th Cir. 1992), the court of appeals held that a creditor was not bound by a confirmed Chapter 13 which modified the creditor's secured claim where the debtors had not previously objected to the claim. As with the case in Simmons, the Fifth Circuit panel in Howard was primarily concerned with upholding the primacy of the claims allowance process under the Code. The Howard court reiterated that, "Strict adherence to the requirement that an objection be filed to challenge a secured claim is necessary to protect this important interest under the Code." In contrast to Simmons, however, the Howard court did not emphasize the importance of a separate adversary proceeding. Instead, the court directed its attention to the lack of adequate notice to the creditor. In Howard, the court noted that the creditor had not received a copy of the proposed plan and did not have actual notice that its claim would be reduced and its lien extinguished. Under these circumstances, the due process analysis could have provided an alternative means of achieving the same result, i.e., the notice was constitutionally insufficient, and therefore, the creditor's liens would have remained in effect. Instead, the Howard court expressly declined to address the due process issue. The court's refusal to address the creditor's due process is consistent with its ruling in favor of the creditor on statutory grounds, thereby obviating the need to rule on the constitutional issues.

c. Cen-Pen

The Fourth Circuit has recently issued an opinion in which it strongly embraces the "claims allowance" view. In Cen-Pen Corp. v. Hanson, 58 F.3d 89 (4th Cir. 1995), the Fourth Circuit held that the initiation of an adversary proceeding is prerequisite to challenging the validity or existence of a lien against property of the estate in a Chapter 13 proceeding. In Cen-Pen, a husband and wife filed a chapter 13 plan under which Cen-Pen was treated as an unsecured creditor and would receive 25 percent of its claim. The plan also provided that "to the extent the holder of a secured claim does not file a proof of claim, the lien of such creditor shall be voided upon the entry of the Order of Discharge. . . ." Apparently, Cen-Pen failed to file a secured claim and, therefore, its lien was extinguished according to the terms of the plan. The plan was confirmed without objection and the debtors received their discharge one year later. Thereafter, Cen-Pen filed a complaint in bankruptcy court seeking a ruling on the validity of its liens. The debtors argued that the liens were extinguished upon confirmation of the plan. The bankruptcy court agreed that the residence was vested in the debtors free and clear of all liens under the plan. The district court reversed and reinstated Cen-Pen's liens and the debtors appealed.

The issue on appeal was whether a debtor could modify or extinguish a lien through the chapter 13 plan confirmation process. The court of appeals acknowledged that "[a]lthough at first blush 1327 appears to support appellants' argument, we are persuaded that other provisions of the Bankruptcy Code and Rules undercut it." The Cen-Pen court noted that as a general rule, liens survive bankruptcy, unless the debtor takes "affirmative steps" to extinguish the lien. The court concluded that this general rule should prevail notwithstanding that express language in the plan which stated that creditors who did not file a secured claim would lose their liens. According to the Cen-Pen court, the creditor's lien could not be modified through the confirmation of the debtor's Chapter 13 plan, because an objection to confirmation is merely a contested matter, whereas an adversary proceeding is necessary to challenge the validity of a lien. In support of this conclusion, the court cited to Bankruptcy Rule 7001(2) which requires the filing of an adversary proceeding "to determine the validity, priority, or extent of a lien or other interest in property." In effect, Cen-Pen ruled that the filing of an adversary proceeding is the only method of avoiding liens under the Code. Accordingly, the Cen-Pen court concluded that the creditor was not bound by the debtor's confirmed plan.

As an alternative basis for its ruling, the Cen-Pen court also held that the Chapter 13 plan was not binding on the creditor because it did not "provide for" the creditor's claim as required under section 1327(c). The court observed that the plan did not expressly address the creditor's claim or provide or the treatment of the lien; nor did the plan provide for full payment of the claim. Without explicitly embracing the view, the Cen-Pen court also noted that, "[s]everal courts have held that a plan 'provides for' the lien held by a secured creditor only when it provides for payment to the creditor in an amount equal to its security." Cen-Pen, 58 F.3d at 94 (citations omitted). Compare Pence, 905 F.2d at 1110 (lien is automatically extinguished upon confirmation where creditor received full payment plus interest on its secured claim).

3. The "Middle of the Road Approach"

a. *Linkous*

In what has been described as the "middle-of-the-road-approach," the Fourth Circuit has held that a secured creditor's lien interest may be modified through the confirmation process, but only if the creditor received adequate notice that its lien would be adversely affected by the propose plan. Piedmont Trust Bank v. Linkous (In re Linkous), 990 F.2d 160 (4th Cir. 1993) (cited in In re Basham, 167 B.R. 903, 905 (Bankr. W.D. Mo. 1994)).

In Linkous, the debtor listed two debts owed to the bank that were secured by a mobile home and an automobile. The debtor's proposed Chapter 13 plan stripped down the two secured loans to the fair market value of the collateral and treated the remaining balances as unsecured pursuant to section 506(a). The debtor mailed a summary of the plan to all the creditors. The summary indicated the amount of the monthly payments and the number of payments, but it did not explicitly state that the secured loans would be treated as partially unsecured. The secured creditor did not appear at the confirmation hearing and the Chapter 13 plan was confirmed.

After the confirmation hearing, the secured creditor filed a motion to revoke confirmation and dismiss or convert the case. In its motion, the creditor conceded that it received a copy of the plan summary; however, as a result of a clerical error, it was not brought to the attention of the appropriate person within the creditor's organization. The bankruptcy court rejected the creditor's motion finding that it was too late to challenge the confirmed plan. The district court reversed in part and vacated the confirmation order on the grounds that the creditor had not received adequate notice that its liens would be modified by the plan. The debtor appealed.

The Fourth Circuit framed the issue on appeal as follows: "whether [creditor] received adequate notice of the section 506 valuation of its secured claims against Linkous." The creditor argued that the notice was not adequate because it did not specifically indicate that the court would conduct a hearing on the valuation of collateral under section 506(a). In support of its argument, the creditor cited to Rule 3012 which provides that a court may determine the value of a secured claim pursuant to section 506(a) "after a hearing on notice to the holder of the secured claim."

Relying on a case from the Eleventh Circuit, the Linkous court ruled that a 506(a) valuation hearing could be held in conjunction with a Chapter 13 confirmation hearing, but only if the notice of hearing specified that the hea would also address the valuation of the secured property. The Eleventh Circuit's holding in In re Calvert, was based upon the court's interpretation of the procedural requirements set forth in Rule 3012 and the Calvert opinion did not discuss the issue of due process. The Linkous court took this procedural rule from the Calvert case and, in effect, converted it into a constitutional mandate:

"In order to satisfy due process requirements, 'the notice [of the proceedings] must be of such nature as reasonably to convey the required information. . . .' In the present case, the information required by statute is that Linkous plans to hold a section 506 valuation hearing. Therefore, in order "reasonably to convey the required information," Linkous' notice to creditors must state that such a hearing will be held. Consequently, the notice to [creditor] was inadequate as it did not make reference to an intent to reevaluate the secured claims pursuant to § 506(a)." Linkous, 990 F.2d at 162-63 (quoting Mullane v. Cen. Hanover Bank & Trust, 339 U.S. 306, 314 (1950)).

Apparently, the majority in Linkous believed that it was necessary to find a constitutional violation in order to overcome the res judicata effect of the confirmed Chapter 13 plan. In support of its holding, the majority reasoned:

"[A] bankruptcy court confirmation order is generally treated as res judicata. However, we cannot defer to such an order on res judicata grounds if it would result in a denial of due process in violation of the Fifth Amendment of the United States Constitution. The United States Supreme Court has concluded that '[a]n elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.' Accordingly, we cannot accord the bankruptcy court's order the finality which would attach if notice given to Piedmont was adequate." Id.

The majority in Linkous found that although the creditor had received notice of the confirmation hearing, the notice did not specify that the hearing would include a valuation of the secured collateral. The Linkous majority acknowledged that the creditor has some responsibility to remain involved in the bankruptcy process. Linkous 990 F.2d at 163 (citing In re Pence, 905 F.2d 1107, 1109 (7th Cir. 1990)). Nevertheless, the majority opinion concluded that the debtor should have the burden of informing a secured creditor of its intent to reclassify the secured claims as partially unsecured. Thus, the court held that the creditor did not receive adequate notice that the debtor was seeking a valuation of the collateral pursuant to section 506(a) and that the lack of adequate notice constituted a violation of due process. Accordingly, the Fourth Circuit affirmed the district court's order vacating the bankruptcy court's confirmation order with respect to the secured collateral.

To some extent, the majority in Linkous bootstrapped a perceived statutory or rules violation into a constitutional issue. The majority was correct in their premise that the parties are not bound by a confirmed plan if the implementation of the plan would result in a violation of the creditor's constitutional right to due process. However, it does not necessarily follow from this premise that a technical violation of the Bankruptcy Code or Rules will automatically result in a deprivation of due process. The constitutional adequacy of the notice should be based on a functional test in accordance with the broad parameters set forth by the Supreme Court in Mullane and its progeny.

For example, the plan summary which the creditor received in Linkous did not expressly state that the creditor's claims would treated as partially unsecured. Thus, the majority could have logically concluded that the creditor did not have adequate notice that its lien rights might be compromised under the plan. Contra Penrod, 50 F.3d at 463. (No violation of due process where lien rights were automatically extinguished even though plan was silent with respect to lien retention). The Linkous case should not be read to stand for the proposition that the notice must contain a reference to any particular code section or some other formalistic requirement. Rather, Linkous should be cited for the general rule that a creditor's lien rights may be modified through the confirmation process, but only if the creditor receives adequate notice and an opportunity to object.

At first blush, it may appear that the Fourth Circuit's decision in Linkous is inconsistent with its subsequent ruling in Cen-Pen wherein the majority held that the creditor's lien could not be modified through the Chapter 13 plan, absent an objection to the creditor's claim and a separate adversary proceeding. In contrast, the Linkous court apparently assumed that the liens could be modified through the plan confirmation, so long as the creditor received adequate notice. The majority opinion in Cen-Pen cites Linkous for the general proposition that an affected creditor must receive adequate notice in order for the confirmed plan to have a preclusive effect under section 1327. Cen-Pen, 58 F.3d at 93 (citing Linkous, 990 F.2d at 162)). However, the Cen-Pen majority does not address the possible conflict regarding the issue of whether a lien can be modified through the confirmation process.

The cases can be partially reconciled on the basis that the plan in Cen-Pen called for the complete extinguishment of the creditor's lien rights unless the creditor filed a claim prior to confirmation; whereas the Linkous plan simply reduced the value of the secured portion of the creditor's claim and treated the remainder of the claim as unsecured. Compare Cen-Pen, 58 F.2d at 91-92 with Linkous, 990 F.2d at 161. The Cen-Pen court viewed the debtor's proposed plan as a challenge to the "validity, priority, or extent of a lien" and, thus, required an adversary proceeding under Rule 7001(2). In contrast, the Linkous plan merely sought to value the collateral pursuant to section 506(a) which can be accomplished by motion practice under Rule 3012. Thus, the Linkous majority assumed that a valuation hearing under section 506(a) and Rule 3012 could be combined with a confirmation hearing under section 1327 because both proceedings are properly categorized as "contested matters" under Rule 9014. In Cen-Pen, however, the majority ruled that a confirmation hearing was not an adequate substitute for an adversary proceeding and could not be utilized to extinguish the creditor's lien.

At a deeper level, however, there is a fundamental conflict between the cases. From a constitutional perspective, it should not make much difference whether the debtor's plan seeks to extinguish the creditor's lien rights completely as in Cen-Pen or simply reduce the value of the creditor's secured claim as in Linkous. In both situations, the creditor is being deprived of a property interest and should be entitled to notice and hearing. With respect to the type of hearing, there is no constitutional requirement that the hearing consist of an adversary proceeding as opposed to a contested matter. It is not difficult to envision a case in which the creditor's lien rights are extinguished, but the plan provides that the creditor's claim will be paid in full. See, e.g., Pence, 905 F.2d at 1110. Under these circumstances, the creditor is deprived of a property right because it loses its security, but the creditor may not suffer any real economic harm if the plan is successfully completed and the debt repaid with interest. On the other hand, a plan may value a secured claim at a nominal amount and treat a substantial remaining balance as unsecured. Thus, even though the secured creditor retains a lien on the debtor's property, the creditor may ultimately receive little or nothing on its claim depending on the treatment of unsecured creditors under the plan. Under a due process analysis, there would seem to be no valid reason for requiring the additional procedures of an adversary proceeding in the former case where the creditor has relatively little at stake, and yet allow a debtor to strip down the value of the creditor's secured claim through a simple motion and hearing. The contrast between Linkous and Cen-Pen illustrates the tensions between the statutory and constitutional approaches to the problem of lien modification.

CONCLUSION

As is demonstrated by the various lines of cases described above, reasonable minds can differ with regards the issue of whether the confirmation process can be used to modify a creditor's lien interests, or whether a debtor is required to pursue a separate adversary proceeding pursuant to the claims allowance process, or a separate contested matter pursuant to the valuation process. The statutes which govern the effects of plan confirmation under Chapter 11, 12 and 13 state unequivocally that upon confirmation, the property of the estate shall become vested in the reorganized debtor "free and clear" of any or all "claims and interests of creditors." Thus, when the statutory provisions are read in isolation, and given their "plain meaning," the logical conclusion is that all liens are extinguished upon confirmation of a plan of reorganization unless they are expressly preserved in the plan. As a general rule of statutory construction, courts should use the "plain meaning" of the language of the statute which they are called upon to interpret. See, e.g., Pioneer Investment Services v. Brunswick Assocs., 507 U.S. 380, 113 S. Ct. 1489, 1495 (1993); U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 109 S. Ct 1026, 1030 (1989). But cf. Dewsnup v. Timm, 502 U.S. 410, 434-35 (1992) (Writing in dissent, Justice

Scalia criticizes the majority for failing to adhere to the doctrine of plain meaning in interpreting section 506 of the Code).[6] Although the "free and clear" language in these sections seems self-explanatory, it also appears to conflict with the other Code sections governing the allowance of claims and the valuation of liens.

Another general rule of statutory construction states that conflicting interpretations of statutes should be avoided if possible. Rake v. Wade, 508 U.S. 464, 471 (1993). Unfortunately, it appears that the differences between the statutory provisions are irreconcilable, *i.e., either* the confirmation of a plan has a binding effect which extinguishes liens, or it does not. There is no obvious way to harmonize the conflicting statutory provisions. When thus confronted with conflicting statutes, the logical response would be to examine the statutory history to determine the true intent of Congress. Conn. Nat'l Bank v. Germain, 503 U.S. 249, 112 S. Ct. 1146, 1150 (1992) (Stevens concurring). The Supreme Court has recognized that under some circumstances, a court may refuse to apply the plain meaning rule where it would result in consequences that are contrary to the Congressional intent. See, e.g., Penn. Dept. of Public Welfare v. Davenport, 495 U.S. 552, 110 S. Ct. 2126, 2134 (1990). See also Dewsnup v. Timm, 502 U.S. at 417 (1992). Once again, however, a court seeking to interpret the Congressional intent behind these conflicting statutes is thwarted by the total absence of any relevant statutory history. See Williams, 166 B.R. at 620 ("The Legislative Histories of §§ 1322(b) and 1327 provide no insight into the philosophy of the provisions beyond the words themselves."). See also 2 LUNDIN § 6.12, at 6-30, n.88 and accompanying text ("There is no illuminating legislative history."). Thus, the courts are left to struggle to devise their own solutions to this intractable problem of statutory interpretation.

As demonstrated above, most courts have adopted the claims allowance approach which requires a debtor to file an objection to a secured creditor's claim as a prerequisite to modifying a creditor's lien interests through the bankruptcy process. A significant minority, however, has adopted the contrary position and has held that under the plain meaning of sections 1141 and 1327, debtors can modify or extinguish a creditor's lien interests through the confirmation of a plan of reorganization, and that, absent a timely objection to confirmation, creditors are bound by the plan.

In his treatise on Chapter 13 Bankruptcy, Judge Lundin persuasively argues that, as a matter of statutory interpretation, the claims allowance process must give way to the finality of the confirmation process in Chapter 13:

"The better rule is a simple rule: The filing of a proof of claim by a secured claim holder is the predicate to allowance of a claim and to participation in distributions under the plan; the filing of proofs of claim has nothing whatsoever to do with the effects of confirmation under § 1327. The confirmed plan binds secured claim holders without regard to whether they file proofs of claim; the

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[6]For a thought-provoking exegesis on the Supreme Court's interpretation of the Bankruptcy Code, see Bruce A. Markell, Conspiracy, Literalism, and Ennui at the Supreme Court, 41 FED. B. NEWS & J. 174 (March/April 1994).

confirmation of the plan vests all property -- including all property subject to liens -- in the debtor 'free and clear' of the lien rights of secured claim holder 'provided for' by the plan except to the extent that the plan or order of confirmation provides otherwise." 2 LUNDIN § 6.14, at 6-50.

Another leading commentator has also suggested that plan confirmation process under Chapter 13 should prevail over the claims allowance process:

"One of the principal purposes of chapter 13 was to provide individual debtors with effective ways of dealing with secured creditors, and a secured creditor may be provided for in a plan even if it does not file a claim. Therefore, a secured creditor ignores a chapter 13 case at its peril. Because all parties are entitled to rely on the res judicata effect of a chapter 13 confirmation order, a confirmed chapter 13 plan is binding on all creditors." 5 COLLIER ON BANKRUPTCY ¶ 1327.01[3] at 1327-9.

These arguments are equally applicable to the effects of confirmation of a plan of reorganization under Chapters 11 and 12. However, even assuming that the statutory scheme allows debtors to modify creditors' lien interests through the confirmation process, the debtor must still comply with the requirements of due process. The cramdown provisions are designed to protect secured creditors by requiring that, unless the creditor agrees to the proposed treatment, the plan must provide that the creditor retain its lien and receive the allowed amount of its claim with interest, or the creditor must receive the collateral. Thus, in theory, a plan should not be confirmed unless the nonconsenting secured creditor retains its liens or receives the collateral.

Nevertheless, in the absence of any objections, courts routinely confirm plans that modify the rights of secured creditors. If there is no timely appeal, a secured creditor may be bound by the res judicata effect of the confirmed plan, even if the plan did not comply with the cramdown requirements. Under these circumstances, the critical issue is whether the creditor received adequate notice that its lien rights would be impaired under the plan. Indeed, many of the cases that have sought to limit the effects of section 1327 can be explained by the courts' apparent (but often unstated) concern that the creditors' due process rights were being violated.

Based on a review of the existing Supreme Court precedent, a few general principles can be gleaned which establish the minimum constitutional requirements for modifying liens through the bankruptcy confirmation process. These principles will be discussed in Part II of this article which will appear in a subsequent edition of the newsletter.

NONDISCHARGEABILITY - RELIANCE UPON REPRESENTATION

By: Norman C. Witte*

Judge Gregg added to the recen[t] spate of non-dischargeabilit[y] opinions coming out of th[e] Western District in a cas[e] involving investments in oil an[d] gas leases. At issue wer[e] investments made by more tha[n] thirty plaintiffs in we[lls] developed and operated by t[he] debtors during the 1970's. [At] trial only one of the plainti[ffs] appeared to give live testimon[y]. In addition, depositi[on] transcripts of two decease[d] plaintiffs were also admitted int[o] evidence.

The court fir[st] considered whether acts whi[ch] are defined fraudulent under applicable securities law are *per se* non-dischargeable under 11 U.S.C.§523(a)(2)(A). Controlling Supreme Court and Sixth Circuit cases examined by the Court mandated that actual justifiable reliance be proved by a preponderance of the evidence in order to establish fraud under §523(a)(2)(A). While in some cases the universe of securities fraud causes of action and §523(a)(2)(A) causes of actions might overlap, the court determined that these actions were not identical. Therefore, a violation of securities laws did not result in a *per se* non-dischargeable debt, and the plaintiff still had to establish actual reliance.

The court found the record bereft of such proof. Only one plaintiff testified live, and he could not recall the details of his investment of some 20-odd years earlier. The court found the deposition testimony submitted by the plaintiff to be of similar ilk.

The court next moved to plaintiffs' argument that their claims were not dischargeable under 11 U.S.C. §523(a)(4) which excepts from discharge debts for fraud or defalcation in a fiduciary capacity, embezzlement, or larceny. The court found that a §5239(a)(4) action for fraud in a fiduciary capacity in the Sixth Circuit requires the existence of an express, trust, which was not present in the case under consideration. Defalcation actions under the same section do not require fraudulent intent, the court held, but do require evidence of some misappropriation of funds. The plaintiffs made no such allegation. Plaintiff's embezzlement argument failed for the same reason. *Kinsler v Pauley* (In re Pauley), Bankr WD Mich, Case No GK 94-80389, Adv. P No 94-8030, 2/24/97, Gregg, J.

Preferences - Date of Transfer

In this opinion Judge Howard determined that for preference purposes transfers pursuant to a periodic garnishment on the debtor's wages take place when wages are earned by the debtor rather than when the writ is served upon the employer.

Debtor was subject to a judgment in favor of Old Kent Bank. The bank obtained a writ of periodic garnishment against the debtor and served the writ upon the debtor's employer more than 90 days prior to the bankruptcy. Nine payments which the court found to have been made pursuant to the writ occurred within the 90 days preceding bankruptcy. After filing bankruptcy, the debtor brought an adversary proceeding against the bank seeking to recover the transfers as preferences under 11 U.S.C. §547(b). The debtor asserted the right to recover the transfers under 11 U.S.C.§522(g)(1).

The court's analysis began with 11U.S.C. §5479(e) which states among other things that for preference purposes a transfer is made when the transfer is perfected, but not until the debtor acquires rights in the property transferred. The bank focused on the question of "perfection" of the transfer, while the debtor looked to the date in which she first acquired an interest in the wages.

The issue of when the debtor acquired rights in the transferred property was on of the state law. The court noted that although there was a Michigan Supreme Court decision holding that a garnishment of a bank account was perfected at the time of service of the writ, this decision was not controlling in the case of a periodic garnishment on wages. The court found *Royal York* of *Plymouth Ass'n v Coldwell Bankr Schweitzer Real Estate Services,* 201 Mich App 301; 509 NW2d 279 (1992) more persuasive. In that case, the court determine that a garnishment against real estate commissions was not effective against commissions for sales not yet closed. Just as the *Royal*

York court determined that a garnishment could not obligate a garnishee defendant to pay over commissions not yet earned by the defendant, the bankruptcy court found that wages are not due (and thus the employee acquires no interest in them) until they are earned by the employee. The court noted that this holding was consistent with rulings of bankruptcy courts in other jurisdictions. *Guernsey v Old Kent Bank* (In re Guernsey), Bankr WD Mich, Case No HK96-84319, Adv P No 96-8223 12/11/96, Howard, C.J.

Nondischargeability - Statement Respecting Financial Condition

This decision by Judge Stevenson, like Judge Gregg's opinion in *Kinsler*, involved a number of plaintiffs asserting joint non-dischargeability claims against a *pro per* debtor. And, as in the *Kinsler* case, the debtor prevailed.

Debtor solicited a number of his coworkers to invest in a rental business. As events developed, the business was not as successful as planned, and the investors obtained a judgment against the debtor in state court. Debtor eventually filed bankruptcy.

The investors then brought an adversary proceeding alleging that their claims were nondischargeable because they were based upon a material misrepresentation under 11U.S.C.§5239(a)(2)(A). The representation which the debtor was alleged to have made was that he owned the existing business he was contributing to the new enterprise free of any debt. This was not true; the asset in question was subject to a lien in the amount of $80,000.00. At trial, the plaintiffs agreed that they were not seeking relief under 11 U.S.C.§523(a)(2)(B), which excepts from discharge debts incurred through the use of a false statement in writing respecting the debtor's financial condition.

§523(a)(2)(A) expressly excepts from its coverage statements regarding the debtor's financial condition, the court observed, and so the two provisions were mutually exclusive. The plaintiffs were not relying on any writing and so could not satisfy that requirement of §523(a)(2)(B). Thus, the case hinged upon whether the alleged misrepresentations were statements respecting the debtor's financial condition.

The court noted that there were two varying interpretations by other courts regarding the exclusion to §523(a)(2)(A). The first read the excluding phrase narrowly to encompass only financial statements such as might be prepared by an accountant. A more expansive reading would construe the exception to include general statements regarding the debtor's assets.

The court adopted the more expansive view, with some modification. At the threshold, the court had to make a determination whether a "statement" had been made. Assuming one had, the court then examined that statement to determine whether it was made "respecting the debtor's or an insider's financial condition." The court concluded that a statement regarding the existence or lack of liens on an asset was a financial statement because it was the type of information an investor would typically consider before investing. Accordingly, the court found that the representations before it were not actionable under §523(a)(2)(A). *Armbrustmarcher v Redburn* (In re Redburn), Bankr WD Mich, Case No SL 92-86573, Adv P No 93-8098, 12/6/96, Howard, C.J.

RECENT BANKRUPTCY COURT DECISIONS

The Western District cases were summarized by Dean Reitberg.

Dischargeability Under §523(a)(6)

The issue facing the U.S. District Court in *Hall* was whether a debtor-employer who failed to purchase and maintain workers' disability compensation insurance may be found to have caused willful and malicious injury to his subsequently injured employee and therefore fall within the discharge exception as defined by 11 U.S.C. §523(a)(6). Federal District Court Judge Quist upheld the Honorable Jo Ann C. Stevenson's grant of summary judgment in favor of the Debtor, agreeing that §523(a)(6) "requires a willfully-caused injury, not just willful conduct." Accordingly, the Debtor was discharged from paying the disability award.

Right to Setoff under §553(a)

In the matter of *Wiegand v Tahquamenon Area Credit Union (In re Wiegand)*, 199 B. R. 639 (W.D. Mich. 1996), U.S. District Court Judge Quist affirmed the Honorable Jo Ann C. Stevenson's bench opinion in which she held that the Debtors' exempt property remained subject to the credit union's right of setoff.

In the Bankruptcy Court, Judge Stevenson had dismissed the Chapter 7 Debtors' Motion to hold the Credit Union in contempt for failing to turnover to them post-discharge funds held in a credit union account which the Debtors had exempted. In upholding the Bankruptcy Court's ruling, Judge Quist affirmed that while the Debtors had properly exempted the funds in their credit union account, the credit union nonetheless possessed a right to set off the Debtors' account against the Debtors' prepetition debt to the credit union under Michigan Law. Moreover, the credit union could exercise its setoff right despite both the discharge of the credit union's debt and the account's exempt status.

Note: The decision in *Wiegand* appears to be contrary to Judge Howard's ruling in *In re Miel*, 134 B.R. 229 (Bankr. W.D. Mich. 1991)(I.R.S. not permitted to setoff Debtor's exempted tax refund against taxes owing).

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STEERING COMMITTEE

Committee members will be notified of the next Steering Committee meeting.

BANKRUPTCY NEWS

The following is a summary of future events:

FBA Bankruptcy Seminar - June 27th and 28th, Boyne Highlands, Harbor Springs, Michigan.

Website Address: http://www.miw.uscourts.gov

Pro Bono Program - The kick-off cocktail party was well attended and the response to the program has been exceptional. For anyone who was not able to attend and is interested in learning more about the program please contact Mary K. Viegelahn Hamlin, Federal Bar Association Liaison at: (616) 345-5156.

For those attorneys in the Upper Peninsula, a reception will be held on August 26, 1997 prior to Judge Stevenson's Court session (tentatively 8:30 a.m.). Invitations will be forth coming to attorneys practicing in the Upper Peninsula region.

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 month of April, 1997. These figures are compared to those made during the same period one year ago and two years ago.

Bankruptcy Chapter	April of 1997	April of 1996	April of 1995
Chapter 7	762	589	412
Chapter 11	9	3	6
Chapter 12	0	1	3
Chapter 13	276	206	127
Totals	1047	799	548

Bankruptcy Chapter	January - April of 1997	January - April of 1996	January - April of 1995
Chapter 7	1997	1659	1223
Chapter 11	21	20	18
Chapter 12	2	2	5
Chapter 13	752	636	422
§304			1
Totals	2772	2317	1669

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- **Avoiding Chapter 13: Are Workouts Possible? + Secured Creditor Problems**
- **Preferential Transfers in the Sixth Circuit**
- **Chapter 13 Case Update**
- **Sixth Circuit Critique**

Participants include: Henry Hildebrand, Esq. ◆ Professor Jeffrey W. Morris ◆ Hon. Laurence E. Howard ◆ Hon. James Gregg ◆ Hon. Jo Ann C. Stevenson ◆ Hon. Steven Rhodes ◆ Hon. Raymond Graves ◆ Hon. Walter Shapero◆ Hon. Arthur Spector◆ and others too numerous to mention!!

<u>Registration Fee:</u> $175.00 (includes 2-day seminar; valuable handouts; Thursday night cocktail party; Friday morning continental breakfast & Saturday breakfast buffet)

<u>Optional Activities</u>: Thursday afternoon golf available on Heather Course; Friday afternoon golf outing on either the Donald Ross Memorial Course or the Hill Course; Friday evening speakers' barbecue dinner

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- **Sixth Circuit BAP Update**
- **Chapter 13 Puzzles: Do The Pieces Fit?**
- **Fraudulent Conveyances & LBO's**
- **Employment Salmagundi**
- **Avoiding Chapter 13: Are Workouts Possible? + Secured Creditor Problems**
- **Preferential Transfers in the Sixth Circuit**
- **Chapter 13 Case Update**
- **Sixth Circuit Critique**

Participants include: Henry Hildebrand, Esq. ◆ Professor Jeffrey W. Morris ◆ Hon. Laurence E. Howard ◆ Hon. James Gregg ◆ Hon. Jo Ann C. Stevenson ◆ Hon. Steven Rhodes ◆ Hon. Raymond Graves ◆ Hon. Walter Shapero◆ Hon. Arthur Spector◆ and others too numerous to mention!!

<u>Registration Fee:</u> $175.00 (includes 2-day seminar; valuable handouts; Thursday night cocktail party; Friday morning continental breakfast & Saturday breakfast buffet)

<u>Optional Activities</u>: Thursday afternoon golf available on Heather Course; Friday afternoon golf outing on either the Donald Ross Memorial Course or the Hill Course; Friday evening speakers' barbecue dinner

<u>Hotel Registration:</u> Early reservations encouraged as accommodations limited. Call Boyne Highlands at (616) GO-BOYNE and ask for Reservations.

<u>FOR EARLY REGISTRATION INFORMATION AND BROCHURE</u>:
Call Brett Rodgers or Jill Coy at (616) 732-9000, Ext. 16
or 1-800-632-1330, Ext. 16
Fax (616) 732-9005, Attn: Jill Coy