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BANKRUPTCY PRACTICE IN THE "OLDEN DAYS"

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I have lived to see wooden duck decoys, shotguns and split bamboo fly rods I purchased new attain increased value as used antiques, but I was still a bit startled when one of my young partners asked if I would write a brief article about bankruptcy practice in the "olden days." If you can believe it, he was referring to the period between the end of World War II in 1945 and the following 15-20 years.

While I never was neither expert nor a specialist in bankruptcy law or practice, I did involve myself in it during that period. But, since that time, my involvement has been limited to participating in the congressional redrafting of the basic bankruptcy law and fighting hard but unsuccessfully for a simple solution to the problems created by the Supreme Court in the Marathon Oil decision. As you recall, that decision declared the new bankruptcy law unconstitutional because it conferred judicial power on Article I bankruptcy judges which could only be permissibly conferred upon Article III judges. Since most everyone in the field of bankruptcy practice liked the new law, the correction of the fault the Supreme Court found with the new law seemed to fall within the recipe, "If it ain't broke, don't fix it." This could have been done very simply by making bankruptcy judges Article III judges rather than by the far more complicated and less desirable amendment courses which were ultimately pursued. As you know, bankruptcy judges serve a term of 14 years, which is only one year less than the term served by the average Article III judge, and whoever heard of anyone reducing salaries any time during modern history.

Back in the "olden days," as my young partner calls them, bankruptcy practice was riddled and controlled by a "Good Old Boy" network much as today--sort of, "You got the liver last week, this one's mine."

I first got this message when, as a new associate of Warner, Norcross & Judd, in 1946 and 1947, I was given an occasional claim to file in a bankruptcy proceeding on behalf of a firm client. I would usually attend the "first meeting of creditors" where a number of the "Good Old Boy" bankruptcy practitioners such as Ed Benson, Walter K. (Karl) Schmidt, Ben DeGroot, and others would be in attendance.

I would watch in surprise as names of creditors who had filed claims were read off and the powers of attorney were voted by various of the lawyers for one or more "trustees" who had been placed in nomination also by one of the lawyers. The surprise resulted not from the identity of the claimants, but of the lawyers who voted the claims. A very significant portion of these claimants were regular clients of our law firm. As I learned more of how the system functioned, I discovered that our clients belonged to various credit associations that pursued delinquent companies for collections and also saw to the filing through the associations' attorneys of appropriate claims in bankruptcy proceedings together with whatever incidental powers were customarily annexed to such claims.

There were no U.S. trustees then, of course, but there was a "stable" of regular trustees who were mostly retired business people or entrepreneurs such as George LaBour, Alan McCurdy, Bill Nichols and others. These "regulars" would gratuitously handle what needed to be done in the no-asset and very small asset cases and in return would expect to receive their fair share of appointments as trustees of estates which promised to be compensatory. It was an unwritten (as far as I know) rule among these "regulars" that they would first offer employment as attorney for the trustee to the creditor's lawyer who nominated them and obtained their election.

During the early part of the relevant period, Chester Woolridge was the Referee in Bankruptcy. Chet operated partially as a federal employee or officer and partly as an independent entrepreneur. He, at that time, maintained a courtroom in what is now the Trust Building and later in such rooms as might be made available in the present Art Museum (the old Federal Building). All filings were then, as now, made in the U. S. Clerk's office which was then at the north end of the second floor of the present Art Museum. Whenever a petition under any of the Chapters of the Bankruptcy Act was filed, it was left on the clerk's counter for several days where it was available for public perusal.

It then took very little imagination to work the mechanics of the system by scanning the list of unsecured creditors for your regular clients and making sure

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you filed the claim. In this manner I occasionally became attorney for a trustee. With the pursuit of preferential payments, fraudulent transfers, turnover orders and plenary suits, the job of attorney for the trustee was usually a busy one and gradually led to exposure and experience in most of the nuances of the bankruptcy field. Whatever I learned of bankruptcy law was learned by the doing, since, when I was in law school in California, bankruptcy was an optional third-year course as were admiralty and taxation. Being from the San Francisco Bay area at that time, I brilliantly chose admiralty with which, in all my years of practice, I have never been involved.

One of the more interesting cases in which I acted as attorney for the trustee was in the matter of Ray Deitrich, Inc. Mr. Deitrich had been a famous designer of automobiles back when they had running boards, spare tires fitting into a slot on the front fender, a real trunk on the back of the car, and wood spoke wheels. The more modern designs in vogue after World War II had left Mr. Deitrich in the same class as street car designers until he became the successful bidder and designer of a bullet-proof presidential limousine for President Truman. He equipped a factory in Grand Rapids and actually completed and delivered the presidential limousine. However, like many designers, inventors and artists, he was a poor businessman. The money received for the delivered car was significantly less than enough to pay his many trade creditors, and he filed for liquidation and bankruptcy. Unfortunately for Mr. Deitrich, his legal advice had not been better than his business acumen, for he had filed a set of corporate articles containing a substantial enough stock subscription agreement to pay all of the creditors in full in addition to administrative expenses.

He survived, however, and was hired later by the Checker Cab Company in Kalamazoo, whose owner, a Mr. Marx, had been a longtime admirer of him, and also perhaps because the Checker Cab body style had not changed much since Deitrich's heyday.

Another case worth recounting is one wherein I represented Curtis Wire Products Company of Petoskey, which had purchased a number of thousands of dollars worth of receiver certificates from the receiver of Petoskey Plating Company which was in a Chapter XI proceeding. The Chapter XI proceeding failed after some period of operating, and Petoskey Plating Company went into bankruptcy liquidation.

The receiver certificates purported to be a first lien on all of the assets of the debtor. One Herman Kays, who operated a finance company in Petoskey, had loaned substantial funds (way above his company's lending limit) to Petoskey Plating Company before its receivership and held as security a first mortgage on all of its assets. When the arrangement proceedings failed, there were just enough assets to pay either the receiver certificates or Mr. Kays' finance company mortgage, but there was not enough for both. Hence, a battle of priority ensued with Chet Woolridge presiding over the hearings.

The law, at least at that time, was that a first mortgage could be subordinated to the liens granted to receiver certificates by order of the bankruptcy referee only if the mortgagee had notice and an opportunity to be heard on the issue before the certificates were authorized. The attorney for the receiver, a Mr. Gillett of Petoskey, testified that he had mailed a notice of the hearing to Mr. Kays and that he had also personally called him on the telephone and discussed the matter with him. He testified that Mr. Kays said he had no objection to the receiver certificates or to their being granted a prior lien on the assets of the debtor, and that he would not attend the scheduled hearings at which the certificates were to be authorized.

Herman Kays, on the other hand, testified that he had never received the notice of the hearing and specifically denied ever having had a telephone conference with Mr. Gillett as Mr. Gillett had testified. To substantiate his testimony, he produced a canceled check payable to one Mr. Crist of Cheboygan and bearing the same date as the alleged telephone conference to which Mr. Gillett had testified. He explained that he had drawn the check at a hotel in Cheboygan where he was staying and that it was in payment for a six-foot sturgeon that Crist had speared in Black Lake. He testified that he had not returned to Petoskey until the following day, and hence during the entire day of the relevant telephone call he was in Cheboygan. In further support of his testimony, Mr. Kays produced a copy of the North Woods Call, a local Petoskey weekly newspaper. The paper, which was dated the day following the contested telephone call, featured on its front page a large picture of Herman Kays standing beside the huge sturgeon (which was frozen, since the entire incident occurred in the month of January) hanging by its tail from a tree in front of Mr. Kays' house in Petoskey. The picture was coupled with a narrative related to the reporters by Mr. Kays as to how he had personally speared the huge fish on Black Lake, how it had with its great strength broken his spear, and how he had leaped into the frigid water and managed to wrestle the creature up onto the ice. (For this feat he was awarded the "Sportsman of the Year" award by the Petoskey Sportsmen's Club.) In the hearing he laughed off his prevarication as a mere "fish story."

During an adjournment of the hearing, information was developed from the North Woods Call photographer and his records that the picture had in fact been taken early in the morning of the day of the important telephone call, the time being determinable by the direction of the shadow cast by the huge fish hanging by its tail in front of Mr. Kays' house in Petoskey. In this manner, the maligned sturgeon, then three years dead, obtained its revenge and by itself demolished the testimony of Mr. Kays.

In throwing out Mr. Kays' entire testimony and finding it to in fact be incredible, Chet Woolridge employed in his opinion the famous quote: "Oh, what a tangled web we weave when first we practice to deceive."

Mr. Kays promptly thereafter left Petoskey for parts unknown, not because of the money he lost, but because residents took much greater umbrage with the "fish story" which resulted in the highly esteemed Sportsman of the Year award going to a deceiver.

ECENT BANKRUPTCY DECISIONS

The following are summaries of recent decisions rendered by federal district and bankruptcy courts in Michigan that address important issues of bankruptcy law and procedure. These summaries were prepared by Patrick E. Mears with the able assistance of Larry A. VerMerris.

In re Roach, Case No. K 88-388-CA9 (W.D. Mich. December 29, 1988). The Chapter 13 debtor appealed to the district court from a decision rendered by Bankruptcy Judge James Gregg declining to hold the Veterans Administration in contempt of court. That governmental agency had refused to pay the Chapter 13 trustee $200.00 in monthly benefits due the debtor. Judge Gregg's decision is reported at 90 Bankr. 286 and was discussed in the October, 1988, issue of this Newsletter. On appeal, District Judge Douglas Hillman affirmed Judge Gregg's decision, finding that the anti-assignment provision in 38 USC 3101(a) prohibits the bankruptcy court from directing the Veteran's Administration to pay these benefits over to a trustee in order to fund a Chapter 13 plan.

In re Green, Case No. K 87-200-CA4 (W.D. Mich. December 28, 1988). The State of Michigan, an unsecured creditor of the Chapter 13 debtors, husband and wife, appealed the decision of Bankruptcy Judge Laurence Howard confirming the debtors' plan. In his decision, Judge Howard permitted the debtors to continue tithing to their church even though the amount of the monthly tithe exceeded the amount paid to the trustee on a monthly basis. Judge Howard's decision is reported at 73 Bankr. 893. Judge Howard dismissed the State's objection on the ground that, were he to do otherwise, he would violate the debtors' constitutional right to free exercise of religion.

On appeal, District Judge Richard Enslen affirmed Judge Howard's decision. The State argued that, by confirming the plan, the First Amendment's Establishment Clause was violated by entangling the State with a particular religion. Judge Enslen rejected this argument by finding that the government involvement was "minimal." According to Judge Enslen, "the bankruptcy court has merely deemed the church-related expenses to be a reasonable component in a budget and plan under Chapter 13. There is no direct governmental involvement, nor is there any application of governmental machinery."

Frank J. Kelley, et al. v. Thomas Solvent Co., et al., Case Nos. K 86-164 and K 86-167 (W.D. Mich. December 2, 1988). This decision was rendered in the context of two civil actions commenced by the United States of America and the State of Michigan against Thomas Solvent Company, five related corporations, Thomas Solvent's president, and others for recovery of fraudulent conveyances under Michigan law and for the cleanup of hazardous wastes. After taking discovery, the two plaintiffs and a third-party plaintiff, Grand Trunk Western Railroad Company, moved for summary judgment on the grounds that (i) Thomas Solvent Company intended to hinder, delay and/or defraud its creditors by transferring assets to "spinoff" corporations after Thomas Solvent received information that it was under investigation for contributing to a hazardous waste site; and (ii) the spinoff corporations were successor corporations to Thomas Solvent so that they too would be liable for the cleanup costs.

After reviewing the evidence presented, Judge Enslen granted the motions for summary judgment but asked for supplemental briefs before fashioning remedies. Judge Enslen found that the spinoff corporations received from Thomas Solvent "valuable assets and profitable businesses" but gave very little in return. The Court also found that Thomas Solvent, by deliberately placing assets beyond the reach of its creditors while being aware that a contamination problem existed, intended to defraud those creditors. Finally, Judge Enslen held that the spinoff corporations were liable as successors of Thomas Solvent since they were "mere continuations" of that company. In support of this holding, the Court noted that, with respect to the spinoff companies, there was a continuity of shareholders, directors, and officers and the spinoffs "operated substantially the same business in products and services as had Thomas Solvent Company."

In re Pontiac Hotel Associates, 92 Bankr. 715 (E.D. Mich. 1988). In this appeal from an order entered by former Bankruptcy Judge George Brody, counsel requested District Judge George Woods to allow compensation for fees and costs associated with preparing an application for payment of fees and for other costs that had not been itemized in that application. In his decision, Judge Woods held that Judge Brody was correct in disallowing the request for reimbursement of costs that were not itemized by counsel. Judge Woods noted that, although Local Bankruptcy Rule 142 did not specifically require this detail, Judge Brody did not abuse his discretion in requesting it. Judge Woods, however, reversed the bankruptcy court's order disallowing the recovery of the costs of preparing the fee application. Judge Woods declared that counsel was "entitled to compensation for preparing its fee application in accordance with the bankruptcy court's requirement."

It should be noted that Bankruptcy Judge Arthur Spector's decision in In re Vogue, 92 Bankr. 717 (Bankr. E.D. Mich. 1988) [analyzed in the November, 1988 issue of this Newsletter] held to the contrary in refusing to compensate counsel for the costs incurred in preparing a fee application. In his decision, Judge Spector mentioned the District Court's Pontiac Hotel decision but declined to follow it. Judge Spector noted that, unlike the case before him, no person had objected to the allowance of the fees requested by counsel in Pontiac Hotel. Since Judge Brody had denied the request for compensation sua sponte, the record below was not fully developed. Therefore, Judge Spector concluded, "the persuasiveness of such opinions therefore must be suspect." Judge Spector also stated that, since the Pontiac Hotel decision was unpublished (at that time), he did not believe that he was bound or persuaded to follow it.

In re Elkins, Case No. SG 87-01773, Adversary Proceeding No. 87-0539 (Bankr. W.D. Mich. December 13, 1988). This adversary proceeding was commenced by a Chapter 7 trustee to recover alleged fraudulent conveyances made by the debtor to various parties including a seller of realty to the debtor on land contract. The trustee moved for summary judgment against the vendor, seeking to recover a $15,000 down

payment made to him by the debtor. The vendor also moved for summary judgment, requesting dismissal of the action. In support of his motion, the trustee first argued that the vendor was not protected by the provision in MCLA 566.19 that protects good faith "purchasers" for value. The trustee reasoned that since the vendor received money from the debtor, the vendor was not a "purchaser" but a seller not entitled to protection. Bankruptcy Judge Jo Ann Stevenson rejected this argument, stating that the trustee's construction of the term "purchaser" was too narrow. The trustee than argued that the vendor was an "initial transferee" of the debtor under 11 USC 550(a) and (b) and, therefore, could not employ the "good faith" defense available to mediate transferees. Judge Stevenson also rejected this argument since the immediate transferees of the $15,000 from the debtor were the debtor and his wife. "[T]he fraudulent transfer occurred when Debtor Elkins, while insolvent, took $15,000.00 which would have been available to pay his creditors and transferred that money to himself and his wife as tenants by the entirety." Since the vendor was a mediate transferee acting in good faith, Judge Stevenson granted the vendor's summary judgment motion and denied the trustee's.

In re Sterling Steel Treating, Inc., Case No. 86-02999-R, Adversary Proceeding No. 87-0831-R (Bankr. E.D. Mich. December 30, 1988). In this Chapter 7 case, the debtor was engaged in the business of heat treating steel. After filing a Chapter 11 petition, the debtor was unable to reorganize and its case was converted to Chapter 7. Thereafter, the trustee conducted a public auction of the debtor's real and personal property. The property was to be sold on an "as-is" basis. A trailer containing hazardous wastes was located on the debtor's realty although the trustee was unaware of its contents. The bidders at the sale could have inspected the trailer and discovered these wastes if they had attempted to do so.

Two individuals purchased the debtor's assets at auction for $186,300 and this sale was thereafter confirmed by bankruptcy court order. Prior to closing, the purchasers discovered the existence of the wastes and disposed of them with the EPA's approval. At the closing, the purchasers withheld $25,000 from the purchase price as compensation for the cleanup costs although the actual cost amounted only to $8,500. The trustee thereupon commenced an adversary proceeding against the purchasers for recovery of the $25,000. In their answer, the purchasers alleged that the trustee should have been aware of the wastes and that the purchasers could not have reasonably discovered their existence. The trustee and the purchasers thereafter filed separate motions for summary judgment.

In deciding these motions, Bankruptcy Judge Steven Rhodes first found that as "owners and operators" of the site on which the hazardous wastes were located, the debtor, trustee, and the purchasers were all responsible for their removal under CERCLA. Judge Rhodes then rejected the purchasers "third party defense" under 42 USC 9607(b), viz. a party will not be held liable under CERCLA upon proving that the hazardous condition was due to the act of a third party with whom the defendant had no agency or contractual relationship. Since the purchasers had "reason to know that the property was contaminated" but made no inquiry concerning that contamination, the purchasers did not "innocently acquire" that property. Finally, Judge Rhodes rejected the trustee's defenses of "unclean hands" and caveat emptor. In conclusion, Judge Rhodes held that the cleanup costs should be borne equally by the estate and the purchasers.

In re Oberlies, Case No. 88-09429 (Bankr. E.D. Mich. December 21, 1988). The individual debtor commenced a Chapter 7 case and his wife did not join him in the petition. In the debtor's schedules, he selected the state exemptions and claimed that his personal residence and the proceeds received from the sale of other realty were exempt as entireties property. The trustee ojected to this exemption on the ground that four joint creditors existed and that he was entitled to administer these assets for their benefit, citing Judge Nims' decision in In re Trickett, 14 Bankr. 85 (Bankr. W.D. Mich. 1981). The debtor opposed this objection, arguing that since these creditors had released his wife from liability, the trustee could not exercise the Trickett power and the exemptions should be sustained. This decision, authored by Bankruptcy Judge Arthur Spector, contains an excellent discussion of the power of a trustee to administ entireties property in a bankruptcy case Judge Spector concluded that a trustee may administer these assets but only for the benefit of joint creditors and that these creditors may waive their rights to receive the proceeds of the sale of these assets. If this waiver is effective, the trustee may not then administer those assets. Since the record was "insufficient to adjudge that waivers of these creditor's joint claims [had] been effected," the trustee's objection to the debtor's exemptions was sustained. However, Judge Spector directed the trustee to contact the joint creditors to determine whether they wish to waive their rights to participate in the "joint assets estate."

In re By-Rite Oil Co., 91 Bankr. 771 (Bankr. E.D. Mich. 1988). In another decision authored by Judge Rhodes, he denied a motion filed by defendants in an adversary proceeding for his recusal. The defendants argued that, because of Judge Rhodes' prior rulings in the underlying bankruptcy case, his impartiality "might reasonably be questioned" in the adversary proceeding. In his opinion, Judge Rhodes reviewed the operative statute, 28 USC 455(a), and the case law decided thereunder. The standard developed by the courts is "an objective standard, requiring disqualification only if a reasonable person with all of the facts would conclude that the judge's impartiality might reasonably be questioned." Furthermore, the bias required for disqualification of a judge must be "personal or extrajudicial." A judge's comments, stated impressions and rulings made in the action are not grounds for his recusal. After reviewing the facts before him, Judge Rhodes denied the motion as unwarranted.

In re DeLorean Motor Co., 9 Bankr. 766 (Bankr. E.D. Mich. 1988) This decision, authored by Bankruptc Judge Ray Reynolds Graves, contains a extensive discussion of the standards fo determining a motion for summary judg ment under Rule 56 of the Federal Rul of Civil Procedure. The Chapter trustee of the defunct automobi manufacturer commenced an adversa proceeding against numerous third pa ties for conversion. Judge Grav denied the trustee's motion for summa judgment against two of the defenda upon finding that the trustee failed to tablish the absence of a general issue material fact.

ŒRING COMMITTEE ƆTIONS

On January 13, 1989, the Steering Committee of the Bankruptcy Section conducted its regular monthly meeting. The following are the minutes of that meeting as prepared by Patrick Mears:

1. Present: Judge Laurence Howard, Judge JoAnn Stevenson, Timothy Curtin, Robert Sawdey, Ted Baehler, Brett Rodgers, Michael Donovan, Denise Twinney, John Piggins, and Patrick Mears.
2. Brett Rodgers reported that two persons recently joined the Bankruptcy Section of the Federal Bar Association and that the Section now has approximately 200 members.
3. Brett Rodgers stated that the Executive Committee of the Federal Bar Association has not yet decided whether or not the Bankruptcy Law Newsletter can be sold to organizations as a means of generating revenue. Brett hopes that a decision will be reached soon.
4. The photographs of former Bankruptcy Judges and Referees from this judicial district will be retouched and reproduced by Robinson Studios. They will then be displayed in Room 758 of the Federal Building.
5. John Piggins announced that he has spoken to a number of attorneys, clerks, and other officials that are associated with or have had significant contact with the Bankruptcy Appellate Panel in the Ninth Circuit. Most of the people he surveyed were satisfied with the operation of that Panel. The subcommittee on establishing an appellate panel in the Sixth Circuit will soon send out a survey to attorneys and judges in this district concerning this matter. Persons wishing more information on this topic should contact John Piggins.
6. The Section's Bankruptcy Seminar will be scheduled for sometime in August or September of this year in the Traverse City area.
7. The local bankruptcy rules will be circulated for public comment sometime in February of this year.
8. Bob Sawdey reported on his efforts to secure the proposal and passage of new federal legislation increasing the fees payable to private trustees. Bob Sawdey and Ted Baehler emphasized that such an increase is necessary to cover the trustees' overhead expenses and to provide them with incentives to recover property of the estate in the hands of non-debtors. Bob Sawdey has discussed this proposal with a number of governmental officials and has been informed that the Administrative Office will bring this matter up at the Spring 1989 meeting of The Commercial Law League of America.
9. The next Steering Committee noon luncheon will be held at the Peninsular Club on February 15, 1989.

EDITOR'S NOTEBOOK

The Bankruptcy Judges in the Western District of Michigan have recently prepared and are presently using form Definitive Orders in Chapter 11 cases. According to the Assistant United States Attorney for this district, Mark VanAllsburg, these Orders will supplement the Operating Instructions issued by his office. Blank copies of the Definitive Order forms are available from the Clerk's office. They contain provisions regarding the use of cash collateral, the purchase and sale of goods, and other matters.

From March 30 to April 2, 1989, the ABA's Business Law Section will conduct its Annual Spring Meeting in Houston, Texas. The program includes presentations on the topics of "Creditors Plans in Chapter 11," "Pre-Bankruptcy Planning--Legal and Ethical Considerations," and a "Lender Liability Update." The various subcommittees of the Business Bankruptcy Committee will conduct meetings during this time. If you require further information, contact Irene Tesitor, the Director of the Business Law Section, at the ABA's Chicago office. The telephone number is (312) 988-5588.

Judge Howard's decision in In re Anderson Industries, Inc. 55 Bankr. 922 (Bankr. W.D. Mich. 1985) applying fraudulent conveyance law to leveraged buy-outs was discussed at length in an article published in the December 22, 1988 issue of the *Wall Street Journal*. The article, entitled "Creditors of Buy-Out Firms That Fail Sue Ex-Holders" and located on page B-1 of that issue, reviewed the facts involved in the Anderson Industries case, noting that, when the LBO closed, the selling shareholders did not expect to be sued later for recovery of unpaid claims against the target company. The article suggested that, prior to consummating the sale, selling shareholders should obtain "an independent appraisal and solvency opinion" and provide for payment of all claims against the target existing at the time of the LBO.

Patrick E. Mears

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 during the period from January 1, 1988, to December 31, 1988. These filings are compared to those made during that same period one year ago.

	1/1/88 to 12/31/88	1/1/87 to 12/31/87
Chapter 7	2,762	2,415
Chapter 11	84	91
Chapter 12	33	85
Chapter 13	1,215	1,269