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BANKRUPTCY LAW NEWSLETTER

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ANNOUNCEMENT FROM THE BANKRUPTCY COURT

PAYMENT OF ADMINISTRATIVE FEE IN INSTALLMENTS

The Judicial Conference of the United States has recently approved an amendment to the Miscellaneous Fee Schedule to allow payment of the $30.00 administrative fee (applicable in chapter 7 and 13 cases) in installments. The combined fee will be paid in the same manner as the filing fee when that fee is paid in installments, and a new application form has been created to include both fees in the same form. These forms will soon be available at the court.

Upon proper application, the $130.00 filing fee and the $30.00 administrative fee will be paid in no more than four installments within 120 days of the filing of the petition. The 120 day period can be extended to 180 days upon motion and showing of good cause.

ANNOUNCEMENT

BROWN BAG LUNCH - JANUARY 14, 1994

A "brown bag" lunch will be held on January 14, 1994 from noon until 2:00 p.m.in the Jury Assembly Room, first floor of the Federal Building in Grand Rapids. Pat Mears, of the Grand Rapids office of Dykema, Gossett, will speak about the enforceability of escrow agreements in bankruptcy and Rick Mason of Ross & Hardies of Chicago will speak on the enforceability of pre-petition relief from stay agreements and similar agreements. The lunch is co-sponsored by the ABA and the Federal Bar Association of the Western District of Michigan, Bankruptcy Section. There may be a modest charge to cover the expenses.

ARTICLES SOLICITED

We generally attempt to run a lead article in each monthly Newsletter on a topic of current interest. Anyone who is interested in submitting an article for the Newsletter should contact Tom Sarb at (616) 459-8311.

RECENT BANKRUPTCY DECISIONS

David Stone and Colleen Stone* v. *Kirk and J.W.K. Land and Cattle Company, Inc., Case No. 91-5833 (6th Cir. November 1, 1993). Plaintiff, David Stone, worked for Amber Coal Company as a mechanic. This Company also employed Defendant, John Wilson Kirk, as an accountant. Mr. Kirk also did Plaintiffs' individual tax returns. In 1980, David Stone complained to Kirk about his high taxes. Kirk suggested to Mr. Stone that he invest in "master recordings" of certain country and western music stars, which were leased to others as tax shelters. Plaintiffs then invested approximately $90,000 in the "master recordings." Kirk failed to inform Plaintiffs about the investments' high degree of risk nor the fact that he received a hefty commission for leasing these "master recordings."

The investments proved costly for Plaintiffs. They lost the $90,000, the anticipated tax benefits were disallowed, and the IRS demanded penalties and interest on overdue taxes. Plaintiffs wound up owing the IRS $280,000 in back taxes, interest, and penalties.

In March of 1986, Plaintiffs brought suit in a Kentucky Federal District Court against, inter alia, Kirk and the J.W.K Land and Cattle Company. Plaintiffs complaint alleged federal securities fraud, common law fraud, treble damages under RICO, breach of contract and professional negligence.

In July of 1987, both Defendants filed Chapter 7 bankruptcy petitions. In October of 1987, Plaintiffs filed an adversary proceeding seeking to have their claims against Kirk held nondischargeable in bankruptcy pursuant to 11 U.S.C. §523(2), (4), and (6). This adversary proceeding was later consolidated with the district court case.

The district court directed a verdict in favor of Kirk on the issue of dischargeability under 11 U.S.C. §523(4) (fraud or defalcation while acting in a fiduciary capacity). However, the claim of nondischargeability under 11 U.S.C. §523(2) (money obtained by false pretenses, a false representation, or actual fraud) was submitted to the jury along with the securities fraud and RICO claims. The jury found that Kirk "acted with fraud and deceit" and that Plaintiffs claims were nondischargeable under 11 U.S.C. §523(2). Additionally, Plaintiffs damages were trebled under RICO and with interest totaled $1,792,400.

On June 25, 1991, Defendants appealed the district court judgment. The Court of Appeals found that the tax shelter being sold by Kirk was a security and he committed fraud upon Plaintiffs. Additionally, as a matter of law, Defendant's debt to Plaintiffs was nondischargeable. Although, the trial court erred in submitting the nondischargeability issue to the jury, it was, nevertheless, a harmless error. As to the RICO issue, because Kirk was not involved in the operation or management of the RICO entity, he cannot be found liable for treble damages under the RICO statute.

In re John Paul Fitzgerald (Fitzgerald* v. *Fitzgerald), Case No. 92-6520 (6th Cir. November 10, 1993). Plaintiff, Jean Fitzgerald, a registered nurse and Defendant, John Fitzgerald, an anesthesiologist, were married in 1969. In July, 1983, the parties received a divorce. As part of this divorce judgment, Defendant agreed to pay Plaintiff $1,500 per month as alimony. The agreement also provided that (1) Defendant would assist Plaintiff with educational expenses; (2) each party would retain the automobiles, household goods and furnishings in their respective possession; (3) Defendant would pay all marital debts; (4) Defendant would pay Plaintiff a lump sum of $14,000 within one year of the agreement; (5) Defendant would pay Plaintiff's attorney's fees of $3,000; and (6) Defendant would name Plaintiff the irrevocable beneficiary of a life insurance policy. On June 28, 1990, Defendant filed for bankruptcy under Chapter 7. Plaintiff brought an action seeking a determination that Defendant's continuing obligation to pay monthly alimony pursuant to the divorce judgment was nondischargeable under 11 U.S.C. §523(a)(5) and that the accrued but unpaid alimony arrearage was similarly

nondischargeable. At the time the bankruptcy petition was filed, Plaintiff was earning $32,261 annually and Defendant was earning $85,170 annually.

On March 20, 1992, the bankruptcy court held that the alimony payments were not in the nature of support under 11 U.S.C. §523(a)(5). Relying on the "present needs" test of Long v. Calhoun, 715 F.2d 1103 (6th Cir. 1983), the court found that although the parties intended the obligation to be support, the monthly payments did not presently have the effect of providing necessary support. On appeal, the district court reversed the bankruptcy court, holding that the bankruptcy court (1) erred in applying the "present needs" test; and (2) erred in finding that Plaintiff was self-supporting at the time of the divorce because she was unemployed at that time.

The Court of Appeals affirmed the district court's decision. Circuit Judge Kennedy, as author of the instant opinion and the Calhoun opinion, regretted that Calhoun had been applied more broadly than intended. Fortunately, the "present needs" test in other circuits has been rejected when applied to alimony or child support. The majority of circuits focus on the intent of the parties at the time of the divorce. Moreover, Calhoun was not intended to intrude into the states' traditional authority over domestic relations at the risk of injustice to the non-debtor spouse or children. Unlike Calhoun, where it was necessary to determine whether something not denominated as support in the divorce decree was really support, here the only question was whether something denominated as alimony is really alimony and not, for example, a property settlement in disguise. The alimony payments were to permit Plaintiff to achieve a standard of living compatible with what she might expect had the marriage continued. Other terms of the Fitzgerald agreement provided for the division of property and the payment of debts.

Since Debtor failed to point to any factor which suggested the alimony payments here were not alimony, Congress has directed that they are non-dischargeable.

Rachman* v. *L.C.F., Inc., Case No. 5:92-CV-100 (W.D. Mich. Sept. 24, 1993). Judge Miles granted the plaintiff's motion to refer the proceeding to the bankruptcy court.

Rachman, the Chapter 7 trustee, filed a lawsuit in circuit court against Lake City Forge, Inc., claiming infringement of trademark, misappropriation of trademark, and breach of its contract with the debtor. Lake City removed the case to federal district court based upon the court's original federal question jurisdiction under 28 U.S.C. § 1441 regarding the trademark counts. The Trustee filed a motion to refer the proceeding to the bankruptcy court pursuant to 28 U.S.C. § 157(a).

Lake City argued that the case should not be referred to the bankruptcy court because the case involved interpretation of "laws of the United States regulating organizations or activities affecting interstate commerce," i.e., the federal trademark laws, and would therefore be withdrawn pursuant to 28 U.S.C. § 157(d). Further, Lake City argued that if the case could be referred, the Court should withdraw it in the interest of justice because the bankruptcy court would only be authorized to make findings of fact and conclusions of law and, therefore, a second trial would be required in the district court.

The Court held that under Local Rule 57, the case at bar must be referred to the bankruptcy court. The Court interpreted 28 U.S.C. § 157(d) and held that withdrawal is mandatory only if the case affects both Title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce. The Court noted that a case only affects both Title 11 and other laws if the case poses "substantial and material considerations of both statutory schemes." The Court noted that although the proceeding may require interpretation of trademark laws, the Court would not be required to decide interplay between the trademark laws and the bankruptcy laws at issue. The Court also held that cause did not exist for permissive withdrawal of the case. The only "cause" for withdrawal argued by Lake City was that withdrawal would save judicial resources. The Court held that a de novo review

does not require a new trial, but that the district court may rely solely on the findings of fact of the bankruptcy court, or it may seek new evidence. Because the district court would not be required to conduct a second trial in this matter upon de novo review, withdrawal was not justified.

In re Adams (Adams v. Sparks), Case No. 1:93-CV-141 (W.D. Mich. Oct. 14, 1993). Judge Hillman affirmed Judge Gregg's November 4, 1992 opinion which held that a judgment debt was non-dischargeable as a "willful and malicious" injury under 11 U.S.C. § 523(a)(6).

The debtor/appellant and the appellee were involved in a traffic accident pre-petition. The debtor collided with the appellee when he proceeded through a red light at an intersection. Evidence was presented that the debtor was travelling in excess of 50 m.p.h., that he accelerated prior to running the red light, and that he was operating the vehicle without insurance, with a suspended license, and after he had been drinking. A judgment was entered against the debtor in favor of the appellee. The appellee filed an adversary proceeding in the debtor's bankruptcy case seeking to establish the judgment as non-dischargeable under 11 U.S.C. § 523(a)(6). Following a trial, Judge Gregg ruled that the debt was non-dischargeable.

On appeal, the debtor argued that Judge Gregg was clearly erroneous in his interpretation of the facts and should be reversed. The debtor further argued that Judge Gregg misapplied 11 U.S.C. § 523(a)(6) regarding "willful and malicious injury."

The Court held that Judge Gregg's interpretation of the facts was not clearly erroneous. The Court noted that because Judge Gregg reviewed the exhibits, the testimony of witnesses, the demeanor of the witnesses and determined that the debtor's account of events which resulted in the collision could not be accepted, he had made a choice between two permissible views of the evidence. Citing Anderson v. City of Bessemer City, 470 U.S. 564, 573 (1985), the court noted that "where there are two permissible views of evidence, the fact finders choice between them cannot be clearly erroneous."

The Court next reviewed the willful and malicious conduct standard under 11 U.S.C. § 523(a)(6). Noting that the statute requires a finding of both willful and malicious conduct, the Court defined those types of conduct. The Court held that a "willful" act is necessarily an intentional act and, under the Sixth Circuit standard, intent is inferred, the actor need not intend to cause the specific injury but merely acts where the consequences of his acts are substantially certain to cause injury and do in fact cause injury. The Court agreed with Judge Gregg's opinion that when the debtor operated a vehicle without insurance and with a suspended license, drove at a minimum of 50 m.p.h., and accelerated through a red light at a congested intersection, debtor knew or should have known with substantial certainty that an accident or injury would occur. The Court further held that malicious "is a conscious disregard of one's duties or without just cause or excuse" and that it does not require ill-will or specific intent to do harm. The Court noted that specific intent by the debtor to harm the appellee was not necessary to support the charge of malice, but rather a conscious disregard for the rights of others by the debtor was necessary. The Court agreed with Judge Gregg that the actions of the debtor, as described above, demonstrated a conscious disregard for the rights of others and therefore constitute malice. The Court affirmed Judge Gregg's finding that the debtor's conduct was both willful and malicious and, therefore, the judgment debt was non-dischargeable under 11 U.S.C. § 523(a)(6).

Metzler v. United States, Case No. 92-20755 (E.D. Mich. September 20, 1993). Plaintiffs sued the IRS for return of moneys derived from the improper levy and sale of their personal property. Judge Gadola, finding that the IRS acted improperly, ordered disgorgement of the funds, with interest.

A state court judgment was entered against Plaintiffs' son, in favor of a bank. The bank caused a writ of execution to be issued, and the court officer seized a boat pursuant to the writ. Plaintiffs disputed the seizure and claimed title to the boat, as against their son. The state court ordered the execution stayed pending determination of the title to the boat. The boat was sold in violation of the stay, for substantially more than was required to pay the bank.

Meanwhile, the boat was determined to belong to the Plaintiffs, not their son. Without regard to the title dispute, the IRS stepped in and levied the excess proceeds for payment of the son's tax obligations. Plaintiffs sued the IRS to recover the money.

The IRS argued that the state court determination of title was not binding on the IRS, because the IRS was not in privity with the bank, for purposes of collateral estoppel. Judge Gadola found that since the IRS had acquired its interest in the funds through the bank, as a result of the bank's levy, the IRS was in privity and was collaterally estopped from denying the determination of title. Further, because the funds were paid over to the IRS in violation of the state court stay of proceedings, the IRS held those funds in constructive trust for the Plaintiffs.

The court found that the IRS knew that the title was in dispute when it attached the funds. In fact the agent in charge of the case stated that he had no idea who owned the boat when he seized the funds. After title was determined to belong to the Plaintiffs, the IRS continued to deny the Plaintiffs a return of their proceeds. Such actions made it unconscionable for the IRS to retain the funds, in the opinion of Judge Gadola.

United States* v. *Brown, et al., Case No. 91-73030 (E.D. Mich. October 5, 1993). Defendants were members of a partnership which took out a SBA loan. The partnership sold its assets to a corporation formed by Defendants. SBA allowed the sale and released the partners from liability on the condition that the Defendants personally guarantee the loan assumed by the corporation. Defendants agreed.

The corporation defaulted on the loan and filed Chapter 11. The corporate assets were sold and the majority of the proceeds of the sale were applied, at the discretion of the lending bank, to obligations not guaranteed by the SBA. The Plaintiff sued the Defendants on the guarantee of the SBA loan. Defendants affirmatively defended alleging 1) lack of consideration; 2) statute of limitations; 3) res judicata and/or collateral estoppel, and 4) misapplication of proceeds.

Judge Gadola was not impressed with the Defendants' reasoning on any of the stated defenses and he granted summary disposition to the Plaintiff. He found that the forbearance and release agreement with the partnership that cleared the way for a sale of assets to the corporation was good consideration to the Defendants. The statute of limitations ran from the date written demand for payment was made of the guarantors, in accord with the language of the guarantee itself. Res judicata/collateral estoppel was claimed based upon a written settlement agreement between the lending bank and the Defendants which settled a different lawsuit. The Court found that the SBA was not a party to the settlement and the guarantee in favor of the SBA had never been settled. As to misapplication of the proceeds, even though the lending bank first paid other outstanding obligations and recovered costs and attorney fees from the proceeds, the Court found that the language of the guaranties clearly gave the lender complete discretion to apply the proceeds as it saw fit. It also gave the SBA the discretion to allow the lender to retain a portion of the proceeds in satisfaction of other debts of the corporation not guaranteed by the SBA. Thus, when the lender and the SBA cooperated and applied the proceeds of the sale to corporate obligations that were less collectible or not guaranteed, the Defendant guarantors had no grounds for objection, since such discretion was a matter of contract among the parties.

Burns* v. *Accelerated Bureau of Collections of Virginia, Inc., 828 F.Supp. 475 (E.D. Mich. 1993). Plaintiff sued Defendant under the Fair Debt Collection Practices Act (FDCPA) and the Michigan Collection Practices Act (MCPA). The complaint was limited to an allegation that the Defendant's letter demanding payment contained language which "overshadowed" the validation notice requirements of the acts. The validation notice is the language that advises the debtor that she has a right to demand verification of the debt, and that if the debtor fails to dispute the validity of the debt, the collection agency will assume that the debt is valid.

The allegedly offensive language of the Defendant's missive advised the Plaintiff that, in addition to the statutory warnings given pursuant to the FDCPA and the MCPA, time was of the essence

and it was important that the debtor pay the account "today".

Courts have held that where additional language of a demand letter has the effect of overshadowing or standing in threatening contradiction to the validation notice, the latter is a violation of the act. Language can overshadow a notice by its type size or color, in relation to the notice, or by its aggressive tone, if it implies that a debtor who takes advantage of the right to object or demand verification will suffer a disagreeable consequence.

In the present case, Judge Newblatt found that the extra language was benign and that the validation notice was not overshadowed or contradicted.

In re Gonzales, 157 B.R. 604 (Bankr. E.D. Mich. 1993). Debtors filed a thirty-six month chapter 13 plan which proposed to retain sufficient income to pay monthly college related expenses for two adult children, and expenses of debtor wife's pursuit of a masters degree in a field unrelated to her current employment. A creditor objected to confirmation on the grounds that debtors were not dedicating all disposable income to the plan; that the debtors' proposed payment of college expenses were excessive discretionary expenses; and that the debtors two adult children were not legitimate dependents.

Judge Spector found that, although the debtors' children were above the age of majority at ages nineteen and twenty-one, since the Code doesn't define dependent, the Court would apply a reasonable person standard in deciding whether they were legitimately dependents of the debtors. Judge Spector reasoned that support of one's adult children who are engaged in the pursuit of higher education is a normal and reasonable course of action. Further, although adults, the children were considered dependents for tax and insurance purposes. Therefore, the $700 per month the debtors dedicated to the assistance of their children was both nondiscretionary and reasonable.

As to the masters degree program which the debtor wife was pursuing, Judge Spector found payment of those expenses to be discretionary and unreasonable. The debtor was gainfully and profitably employed by GM. The masters degree she was seeking was in anthropology, not related to her employment. The debtor did not testify as to any imminent loss of employment, although the stated goal was to obtain the masters as a step towards becoming a teacher, in the face of possible job loss. The Court likened the masters program to recreational expenses and denied confirmation of the thirty-six month plan.

Debtors subsequently amended the plan to forty-eight months, which the Court confirmed after calculating that the extended plan would pay the creditors as much as a thirty-six month plan stripped of the excessive discretionary spending.

REMINDER OF 1994 BANKRUPTCY SEMINAR

Mark your calendars for the Sixth Annual Federal Bar Association of the Western District of Michigan Bankruptcy Section Seminar, which will take place on July 21-23, 1994 at the Park Place Hotel in Traverse City, Michigan. Application forms will be distributed in spring, 1994.

STEERING COMMITTEE MINUTES

A meeting of the Steering Committee of the Bankruptcy Section of the Federal Bar Association of the Western District of Michigan was held on November 19, 1993 at the Peninsular Club. Present: Judge Laurence E. Howard, Judge Jo Ann C. Stevenson, Dan Casamatta, Jim Engbers, Brett Rodgers, Denise Twinney, Bob Wright, Pat Mears, Steve Rayman, Jeff Hughes, Tom Sarb, and Tim Hillegonds.

1. 1994 Seminar Educational Program. Steve Rayman reported that he has confirmed the following speakers for the 1994 Seminar: Judge John Schwartz, Chief Bankruptcy Judge for the Northern District of Illinois; Judge David T. Stosberg, Bankruptcy Judge for the Western District

of Kentucky; Ms. Sally S. Neely, of Sidley & Austin of Los Angeles, California (currently attorney for Kim Basinger in her Chapter 11 proceeding); and John C. Logan, from the Office of the U.S. Trustee. In addition, Judge Howard, Judge Gregg, and Judge Stevenson will also participate. Tentative plans are for Judge Stosberg and Judge Gregg to lead a Judges' "round table" that will be held (possibly twice) in small groups of approximately 25 attorneys. Judge Schwartz may also conduct a small group "round table" panel. Judge Stevenson and Judge Howard will sit on the Sixth Circuit Revisited panel and both may participate on other panels. Ms. Neely will be the keynote speaker for the seminar and may appear on a panel. Steve Rayman will follow up on making arrangements at the hotel for the various break out sessions.

2. 1994 Seminar Recreational Program. Jim Engbers volunteered to organize a golf tournament at the 1994 seminar. Denise Twinney and Janet Thomas will continue to coordinate social programs for the seminar.

3. Brown Bag Lunch. Pat Mears announced that a Brown Bag Luncheon program has been scheduled for January 14, 1994 at the Federal Building. The lunch will be co-sponsored by the ABA and the Federal Bar Association. At that time, Pat Mears will discuss enforceability of escrow agreements and Rick Mason of Ross & Hardies of Chicago will discuss pre-petition relief from stay agreements.

4. New Trustee. Dan Casamatta announced that Elizabeth Chalmers has recently been appointed as a standing trustee for this district.

The next meeting of the Steering Committee will be held on January 21, 1993 at noon at the Peninsular Club.

EDITOR'S NOTEBOOK

Congratulations are in order this month to John Potter and his wife, Sharon Greider, upon the birth of their son, Eli Robert, on November 15, 1993. John prepares the Recent Bankruptcy Decisions summaries for the Supreme Court and the Sixth Circuit. John survived the birth and his wife's auto accident one week before, and still managed to get in this month's current case summaries.

The United States Supreme Court has denied certiorari in TFL, Inc. v. Walhout, Docket No. 93-240, 1993 WL 322 949. As you may recall, the Sixth Circuit had held in the case of In re Tucker Freight Lines, Inc., 991 F.2d 796 (6th Cir. 1993) that a buyer breached his agreement with the Bankruptcy Trustee to purchase a Debtor's authority to operate as a commercial carrier in Indiana.

The Wall Street Journal edition on Thursday, October 7, 1993, reports on a demographic study of bankruptcy filers. The study noted a marked shift in the late 1980s and early 1990s toward filers being more well-educated, middle-class baby boomers with large credit-card debt. Increasingly, the bankruptcy debtor is likely to be female. Filings by women were 17% of the total ten years ago, but now are 28.6% of the total filers. The study also indicates that although baby-boomers make up 44% of the adult population, they account for 59% of personal bankruptcies. In addition, the study indicates that 12.4% of personal bankruptcy filers say medical expenses triggered their filings.

The American Lawyer October, 1993 edition analyzes the final fee applications in the LTV bankruptcy. Lead counsel for LTV, Davis, Polk & Wardwell, received final approval of a fee of $41 million plus expenses of $6.3 million over the seven years of the case, for an average of $488,000 per month. Average partner and associate hourly rates for Davis, Polk for its last fee application were $443 and $265, respectively.

Finally, I would like to apologize for the lateness of the October Bankruptcy Law Newsletter. The U.S. Postal Service bulk mailing department evidently decided that Christmas circulars should take priority. I hope each of you has a peaceful and joyous holiday season.

Thomas P. Sarb

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 period from January 1, 1993 through October 31, 1993. These filings are compared to those made during the same period one year ago and two years ago.

	1/1/93- 10/31/93	1/1/92- 10/31/92	1/1/91- 10/31/91
Chapter 7	3,854	4,546	4,257
Chapter 11	95	108	134
Chapter 12	29	23	21
Chapter 13	1,229	1,338	1,446
	5,207	6,015	5,858

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