# BANKRUPTCY LAW NEWSLETTER

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## UNRESOLVED ISSUES RAISED BY IN RE ZIMMERMAN

By: Joseph A. Chrystler*

In one of the hottest topics of late involving consumer issues, the en banc decision of Judges Howard, Gregg and Stevenson in the In re Zimmerman, 158 BR 192 (Bankr, WD Mich 1993) is more than holding its own in the scorecard of decisions involving the same issue. To the best of my knowledge, only three jurisdictions have now held that Bankruptcy Rule 3002(c) cannot operate to establish a 'bar date' for the filing of claims in Chapter 13 cases, as follows:

Minnesota - (Hausladen - en banc)
Colorado - (Babbin)(one Judge)
Middle Tennessee - (Sullins - Judge Paine) (Gullatt - Judge Lundin on appeal)
Eastern Michigan - (Brenner - Judge Graves)

Paraphrasing the last verse in "Casey at the Bat," the score stands eleven to four, with many innings likely left to play, in that there are ten decisions in addition to Zimmerman that reject the Hausladen holding, as follows:

Matter of Andrew, 162 B.R. 46 (Bankr. M.D. Ga. 1993)
In Re Rome, 162 B.R. 872 (Bankr. D. Colo. 1993)
In Re Leightner, 161 Bankr. 60 (Bankr. D. Or. 1993)
In Re Stoiber, 160 B. R. 307 (Bankr. N.D. Ohio 1993)
In Re Chavis, 160 B.R. 804 (Bankr. S.D. Ohio 1993)
Matter of Keck, 160 B.R. 112 (Bankr. N.D. Ind. 1993)
In Re Crooker, 159 B. R. 790 (Bankr. E.D. Ky. 1993)
In Re Osborne, 159 B.R. 570 (Bankr. C.D. Cal. 1993)
In Re Turner, 157 Bankr. 904 (Bankr. N.D. Ala. 1993)
In Re Johnson, 156 Bankr. 557 (Bankr. N.D. Ill. 1993)

In another decision, albeit in a Chapter 12 case, the Tenth Circuit Court of Appeals has rejected the Hausladen holding in Jones v Arross, 9 F3d 79 (10th Cir. 1993), where a late filed claim was disallowed.

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Since the Zimmerman decision was handed down, two scenarios have come to mind whereby late filed Chapter 13 claims should perhaps be allowed and considered for payment, either in whole or in part, depending upon the circumstances.

Consider first the situation of husband and wife filing a joint Chapter 13 and having equity in property over and above valid lien and exemption claims of $15,000. These debtors claim exemptions pursuant to federal law. Timely filed and allowed general non-priority unsecured claims total $10,000, and there is a claim filed after the 'bar date' as an unsecured claim in the amount of $3,000 which, pursuant to the holding in Zimmerman, would be disallowed. Had these debtors filed their case under Chapter 7, their estate would be considered to be 'solvent,' and the Chapter 7 Trustee would be obliged to solicit late filed claims to eat up the $5,000 surplus created by the excess of the estate equity over timely filed claims. F.R.B.P. 3002(c)(6). This solicitation would likely generate the $3,000 late claim referred to, it would be paid in full, and the remaining surplus of $2,000 would be returned to the debtors.

The Chapter 13 Trustee must consider the effect of the Section 1325(a)(4) liquidation analysis in his report to the Court as to whether or not the debtors have satisfied all of the various confirmation standards, and whether or not the plan has his recommendation for confirmation. In this situation, should not the late filed claimant be accorded the same treatment as it would receive in a Chapter 7, that of having its claim allowed and paid in full?

In a second scenario, assume the debtors have proposed a plan to pay all of their projected disposable income for the minimum required period of thirty six months (further assume the Trustee or an allowed unsecured claimant has exercised his or her right or duty under 11 U.S.C. 1325(b)(2)(B) to object to the plan if it did not so provide), and that projected disposable income will pay all administrative, secured and priority claims in full, and produce a dividend of 100% to timely filed unsecured claims in twenty-eight months. Should the remaining eight months of projected disposable income be available for payment to claimants with untimely filed claims? An argument can certainly be made for the allowance and payment of these untimely claims to the extent possible from the additional eight months of projected disposable income, in that this is a minimum confirmation standard requiring thirty-six months of plan payments. Occasionally trustees get a case that completes a 100% payout in less than thirty-six months, but this is extremely rare. In most cases that end up operating this way it is because a large number of unsecured claimants did not file claims, thus shortening the plan life to less than thirty-six months.

Neither of the two scenarios presented above were addressed by Zimmerman because neither was included in any brief filed, nor in any of the oral argument as possible exceptions to the decision as arrived at, and thus was not before the Court. However, it is my opinion that the decision should have had some caveats attached that would have dealt with the two situations indicated, had these issues been properly placed before the Court. There may be even more situations that would appear to lend themselves to being exceptions to the general pronouncement in Zimmerman. However, at this writing I cannot think of any more.

At the time Zimmerman was argued my office submitted an amicus brief, and my

staff counsel, Alexander Lipsey, argued in favor of the eventual decision. I remain steadfast in my opinion that Zimmerman was correctly decided and that to find otherwise would be inappropriate for a wide variety of reasons, including, the difficulty in administering an estate where the actual body of claims may not be known right up until it is time to file the final report and account and anticipate closure of the case. However, I have come to recognize that there may be exceptions which, because the facts and circumstances are not the same, may cause the opinion to be revisited at same time in the future.

[Editor's Note: Mr. Chrystler does not provide an answer to the questions that he raises, no doubt in order to keep his options open, should such a case come before him. However, I have no such compunctions. Consequently, at the risk of being accused of making rash decisions, I would argue that the liquidation and disposable income analysis is dependent upon "allowed unsecured claims." Since Zimmerman holds that a timely filing is a prerequisite to allowance, an untimely claim should not be considered in the scenarios raised in the article, because such a claim could never be considered an allowed unsecured claim.--Peter Teholiz]

## RECENT BANKRUPTCY DECISIONS

In re Moreland (Resolution Trust Corp. v Moreland), Case No. 92-4258, 1994 WL 111342 (CA6 April 6, 1994). Debtor/Defendant Etheirine Moreland filed a Chapter 13 Bankruptcy Petition claiming a $5,000 homestead exemption under Ohio law. Her home had a fair market value of $22,000 with a first mortgage of $15,830.87 and a second mortgage of $2,126.78. Plaintiff, Resolution Trust Corporation ("RTC"), had a judgment lien on Debtor's property for $2,811.91.

Debtor filed a motion pursuant to 11 U.S.C. § 522(f)(1) to avoid RTC's lien on the ground that it impaired her homestead exemption under Ohio law. RTC responded that, under Ohio law, the Ohio homestead exemption could be asserted only upon sale of the subject real property, and, since no sale of Debtor's property was pending, there was no exemption to impair the lien. See Ford Motor Credit Corp. v Dixon, 885 F2d 327 (6th Cir. 1989). Rejecting RTC's argument, the bankruptcy court granted Debtor's motion, reasoning that Dixon no longer controlled the resolution of Debtor's exemption in light of the Supreme Court's decision in Owen v Owen, 111 S.Ct. 1833 (1991).

In Owen, the Supreme Court held that a judicial lien may be avoided pursuant to § 522(f), even if a particular state has defined and limited exempt property in a manner that excludes the property from lien avoidance. The bankruptcy court applied Owen and determined that the "execution" requirement of the Ohio homestead exemption upon Debtor's property occurs upon the filing of a bankruptcy petition. Accordingly, RTC's judicial lien impaired Debtor's homestead exemption.

The district court affirmed the bankruptcy court decision on grounds that RTC waived any objections to Debtor's claim of exemption within 30 days after the first meeting of creditors.

The Court of Appeals reversed the lower court decisions, stating that Owen was not dispositive of the situation. The Dixon case defines the time when an exemption is available. It does not deny a debtor the opportunity to claim a homestead exemption and avoid a creditor's judgment lien. Under Dixon, when a judicial sale is pending, the debtor can avail himself of the Ohio homestead exemption and seek to avoid a

judicial lien that impairs that exemption. Owen, on the contrary, defines the extent to which states can limit exemptions in the context of lien avoidance. The policy advanced in Owen, is the equivalency of the treatment accorded to federal and state exemptions and not permitting states the ability, through limits and restrictions, to circumvent federal lien avoidance provisions.

Finally, RTC was not required to object to Debtor's claim of homestead exemption within 30 days. Debtor was entitled to claim the exemption and RTC did not waive any rights by not objecting.

Boyd v Manufacturers National Bank of Detroit, Case No. 1:93-CV-759 (WD Mich. April 11, 1994). Judge Bell affirmed the bankruptcy court's order granting MNB's Motion for summary judgment on the Trustee's claim for equitable subordination. The Court held that a court reviewing a motion for summary judgment must draw inferences in favor of the party opposing the motion, but the court is limited to inferences which a trier of fact could reasonably draw from the facts. The Court held that in this case, the record, as taken as a whole, could not lead a rational trier of fact to find in favor of the Trustee.

The Court held that the bankruptcy court properly applied the summary judgment standard found in Street v J.C. Bradford & Co., 886 F2d 1472 (6th Cir. 1989). In Street, the 6th Circuit identified ten principles for "new era" summary judgment practice. Under Street, courts must apply the federal directed verdict standard for summary judgment motions. The court must draw all reasonable inferences in the respondent's favor, but the respondent must come forward with evidence, not merely arguments. The facts established may be made by inferences, but the inferences must be reasonable. Further, the respondent must produce "more than a scintilla of evidence" to overcome the motion. Finally, the court has discretion to determine whether the respondent's claim is "implausible".

The Court next held that the bankruptcy court properly applied the summary judgment standard to the record in this case. Under 11 USC § 510(c)(1), which allows a court to reorder priorities among creditors under "principles of equitable subordination", the Trustee has the burden of proving: 1) that MNB was Debtor's fiduciary and that it engaged in inequitable conduct (the "fiduciary standard"); or 2) that MNB engaged in extraordinarily inequitable conduct (the "non-fiduciary standard"). Citing Badger Freightways, Inc. v Continental Illinois National Bank and Trust Co. (In re Badger Freightways, Inc.), 106 BR 971 (Bankr. ND Ill 1989) the Court held that whether a lender exercised control through an outside manager sufficient to establish a fiduciary relationship requires factual allegations demonstrating the existence of a "arrangement" to control the debtor. The Court held that the facts did not provide a sufficient foundation to reasonably infer that an arrangement existed between MNB and Debtor's former manager to control Debtor.

The Court reviewed MNB's actions in the light of control inherent in the lending relationship and also held that the Trustee did not present facts which could support the inference that MNB engaged in "extraordinary inequitable conduct". The Court noted that it is permissible for a non-fiduciary lender to act strategically to protect its own interests, acknowledging that a lender may have some leverage over the debtor. The Court further noted that there

is nothing inherently wrong with a creditor carefully monitoring his debtor's financial situation or suggesting the course of action the debtor ought to follow. The Court noted that it was the Trustee's burden of proof under the non-fiduciary standard was to show that MNB was guilty of gross misconduct tantamount to fraud, over-reaching or spoliation. Because the Trustee did not present some evidence of corrupt motive on the part of MNB, there was nothing improper about MNB's monitoring of Debtor's financial situation or suggesting changes, even though the suggestions were accompanied by some degree of financial leverage.

Boyd v Mid-Cape Motors, Inc. (In re Check Reporting Services, Inc., Case No. 1:93-CV-877 (WD Mich. April 15, 1994). Judge Quist affirmed the bankruptcy court's order granting summary judgment in favor of the defendant, Mid-Cape Motors, Inc.

Pre-petition, the Defendant, Mid-Cape Motors, Inc. entered into a credit card processing agreement with Debtor whereby Debtor processed Visa and Master Card transactions for Mid-Cape. Following the bankruptcy, Mid-Cape sold its claim and assigned the same to Comerica Bank. The Trustee filed an action against Mid-Cape, alleging that Debtor had unintentionally made payments to Mid-Cape. Mid-Cape responded that, even if it had received improper payments, the payments were simply applied toward the account balance which Debtor owed to Mid-Cape. The bankruptcy court held that because Debtor's debt to Mid-Cape was never paid in full, the Trustee could not recover the alleged unintentional payments. Further, the Court noted that the Trustee did not acquire any new rights against Mid-Cape as a result of the post-bankruptcy assignment to Comerica.

On appeal, the Trustee argued that Mid-Cape's assignment to Comerica was an assignment of less than Mid-Cape's entire claim. The Court noted that despite this argument, at the date of the bankruptcy, Mid-Cape had a claim against Debtor and that even if Debtor had unintentionally made payments to Mid-Cape, the payments merely reduced the amount of Debtor's admitted debt.

Leedy v Agribank, FCB (In re Leedy), Case No. 1:94-CV-134, I:94-CV-135 (WD Mich April 25, 1994). Judge Gibson affirmed the bankruptcy court's order finding Debtor in contempt of court and ordering him to transfer real estate pursuant to default provisions under his Chapter 12 Plan.

Debtor's confirmed Chapter 12 Plan included default provisions which required Debtor to transfer real estate to Agribank in the event of a loan default that was not cured. Debtor defaulted on the loan and the default was established by a bankruptcy court hearing. Debtor subsequently failed to transfer the real estate and, at a second hearing, Debtor was found in civil contempt because he failed to transfer the real estate. Debtor's only defense, that the plan was induced by fraud, was not timely raised under 11 USC § 1230(a).

On appeal, Debtor argued that the bankruptcy court erred in failing to modify his plan in light of evidence of fraud by Agribank. The Court held that under 11 USC § 1230(a), a debtor has 180 days from the entry of the confirmation order to request revocation of the plan. If the debtor fails to raise the fraud in the same time period, even if he has not discovered it, he is barred from further raising it. The Court further held that because Debtor did not seek to modify or revoke his plan based on

the fraud within the 180 days prescribed by 11 USC § 1230, the alleged fraud was not appropriate basis for Debtor failing to comply with the terms of the plan.

Fischre v U.S., Case No. 5:93-CV-11 (WD Mich April 25, 1994). Judge McKeague held that under Michigan law, a judgment lien based on the sole obligation of one spouse may legitimately attach to that spouse's individual interest in the entireties property without illegitimately burdening the entireties estate or the other spouse's interest in the property.

The action was brought by Plaintiffs, husband and wife, to quiet title to real property owned by the entirety. Plaintiffs asked the Court to remove a cloud on their title caused by an abstract of judgment filed by the United States recording the United States' judgment against the husband individually. Plaintiffs argued that because the judgment lien was based on a personal liability of the husband, as a matter of law, the lien could not attached to their entireties property.

The Court noted that under Michigan law, tenants by the entirety, who must be husband and wife, hold under a single title with right of survivorship. Neither husband or wife acting alone can alienate any interest in the property, nor can creditors of one levy upon the property. A lien based on a debtor obligation of one spouse only, does not attached to the entireties property. The Court held that while the judgment lien may presently be a nullity as to the entireties property per se, it may nonetheless attach to the debtor spouse's survivorship interest. An individual interest in entireties property is not realized and remains inchoate until the entireties estate is terminated by death of one spouse, divorce, or joint conveyance. As long as the entireties estate is intact, the property is not subject to levy in execution by the creditors of one spouse. However, the Court noted that each spouse's survivorship interest is distinct, cognizable and sufficient to support attachment of a creditor's lien.

The Court held that in this case, the judgment lien was a nullity insofar as it might appear to attach to encumber the wife's enjoyment of the entireties estate. However, the lien attached to the husband's individual interest and could remain on record with the register of deeds for that limited purpose.

## EDITOR'S NOTEBOOK

S.540, the omnibus bankruptcy bill that has been slowly winding its way through Congress, has finally been passed by the Senate. As passed, the bill contains numerous items that should keep us all busy for a long time. Chapter 10, the "small business" chapter, was dropped form the bill, but many of its provisions were incorporated into chapter 11. The bill raises the dollar eligibility for chapter 13 to $1 million in total secured and unsecured debts. It also allows a chapter 13 debtor to restructure a mortgage debt, even after foreclosure, as long as the redemption period has not expired. The bill overrules Deprizio, and raises chapter 7 trustee fees. The bill now goes to the House, where it is likely that a narrower version will be passed sometime this year.

The Newsletter is still looking for volunteers to either write an article or help in doing case summaries. Anyone who even has a passing interest should contact me to discuss the matter.

Legal Definitions -- In Camera: where you put the film.

Peter A. Teholiz, Editor

## STEERING COMMITTEE MINUTES

A meeting of the steering committee of the Federal Bar Association of the Western District of Michigan was held on May 20, 1994, at the Peninsular Club in Grand Rapids. Attending were: Steve Rayman, Mary Hamlin, Peter Teholiz, Bob Wright, Janet Martin, Bob Sawdy, Pat Mears, Brett Rodgers, Dan Casamatta, Jeff Hughes, Jim Engbers, Tom Sarb, Marcia Meoli, and Tom Schouten.

1. 1994 Seminar. Steve Rayman gave a report on the seminar. He indicated that all of the sessions had been established and that the speakers were all confirmed. There will be two morning sessions on Friday, July 22 of 4 different "classes." There will also be one full "class" on Friday morning. Sally Neely will be the keynote speaker for the Saturday morning breakfast, with an expanded version of the 6th Circuit revisited following. Steve said that full information will be mailed out in a separate mailing during the week of May 23 -- May 27, and that if people haven't received it by the time that they are reading these minutes, they should contact him immediately.

Steve also reported that an active social committee was working on items for the seminar. Jim Engbers is coordinating a golf outing, and Denise Twinney is organizing other efforts. These include a two-hour trip on the tall ship Malabar. Other offerings will be highlighted in the mailing for the seminar.

The committee also discussed the cost of the seminar, and noted that the increased number of outside speakers resulted in increased costs to hold the seminar. After a short discussion, the committee decided to raise the cost of the seminar by $10.00.

2. Asset-Based Lending Panel Discussion. Bob Sawdy reported that the panel discussion had been held as planned, and was attended by 6 banks and about 35-40 people. Generally, the panel discussion was thought to be pretty good, although perhaps not as useful for small bankruptcy cases.

3. Committee Positions. Pat Mears reported that there are 5 terms for the steering committee which expire at the annual seminar. Bob Wright provided the committee with the present policy, which allows the chair of the committee to select members to fill those terms, including reappointing the member whose term has expired. ANYONE WHO IS INTERESTED IN SERVING ON THE COMMITTEE SHOULD SEND A LETTER TO PAT MEARS INDICATING THIS. I would also add that the Editor of the Newsletter is automatically a member of the Committee, so that anyone who is interested in taking over this position should contact Peter Teholiz.

4. Summer Meetings. The committee agreed that it hold a June meeting, which is tentatively scheduled for June 17, at the Peninsular Club, in Grand Rapids. There will be no formal July meeting, although if there is any need for a meeting, it will take place at the seminar on July 22-23.

# 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 through January 31, 1994. These filings are compared to those made during the same period one year ago and two years ago.

| Bankruptcy Chapter | January 1 - April 30, 1994 | Percent Increase (Decrease) | January 1 - April 30, 1993 | Percent Increase (Decrease) | January 1 - April 30, 1992 |
|---|---|---|---|---|---|
| Chapter 7 | 1441 | (14.2%) | 1679 | (16.1%) | 2002 |
| Chapter 11 | 30 | (25%) | 40 | 0% | 40 |
| Chapter 12 | 5 | (58.3%) | 12 | 33% | 9 |
| Chapter 13 | 530 | 6.2% | 499 | (13.5%) | 577 |
| | 2006 | (10%) | 2230 | (15.1%) | 2628 |

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