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GOOD FAITH, WILLFULNESS AND NON-DISCHARGEABLE TAX LIABILITIES IN BANKRUPTCY

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Don't be surprised if during your next excursion to the Bankruptcy Court you happen to witness a debtor arguing to the Court that wages are not taxable, that the Sixteenth Amendment was never ratified or that only gold or silver currency can be taxed. These contentions are probably being read or recited by the debtor from an "untaxing package" which the debtor obtained. The number of people protesting their obligation to pay any taxes has increased in no small part due to the concerted effort of the Internal Revenue Service to contact people who are not filing tax returns.

The Internal Revenue Service is attempting to advance voluntary compliance with the Internal Revenue Code by increasing its number of contacts with people who are not filing tax returns. The purpose of the contact is to assist the taxpayer to comply with the tax laws. As a result, many taxpayers who have not been filing tax returns for one or more years are now being contacted by personnel from the Internal Revenue Service for the first time. Some of the people being contacted are deciding to protest the tax system.

The term "tax protestor" has been defined by some courts to mean a person that questions or challenges the constitutionality of income or other taxes and refuses to pay based upon that belief. In re Hazel, 68 B.R. 287 (Bankr. ED Mich. 1987); Weston v. Commissioner, 775 F2d 147 (6th Cir. 1986). In the 1980's tax protestors usually challenged their federal tax liabilities in the United States Tax Court. Those challenges included arguments that income was not taxable as it constituted an even exchange for labor or that the Sixteenth Amendment did not permit an imposition of taxes on wages. Those types of challenges to the Internal Revenue Code were found by the Tax Court to be without merit and the Tax Court often held that the Internal Revenue Service was entitled not only to the tax deficiency at issue but also penalties and in some instances damages against the taxpayer for having instituted a frivolous suit. Weston v. Commissioner, 775 F2d 1047 (6th Cir. 1985); Perkins v. Commissioner, 46 T.C. Memo 1046, aff'd. 746 F2d 1187 (6th Cir. 1984); Beard v Commissioner, 82 T.C. 766, aff'd. 793 F2d 139 (6th Cir. 1984).

The Tax Court case law that developed in the 1980's prompted some protestors to redirect their challenges to the taxing system to the bankruptcy courts. It was their intent to utilize the bankruptcy laws to obtain a discharge to eliminate the taxes, penalties, and interest which they incurred as a result of their failure to comply with the Internal Revenue Code.

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A tax protestor who files a petition for relief under Chapter 13 of the Bankruptcy Code faces the "good faith" test as a major obstacle to receiving a discharge of tax liabilities:

> Except as provided in subsection (b), the court shall confirm a plan if . . . the plan has been proposed in good faith and not by any means forbidden by law[.]

11 USC § 1325(a)(3). Congress has not defined the term "good faith" in either the Bankruptcy Act or the Bankruptcy Code, leaving to the courts the task of providing substance to the words "good faith".

The Sixth Circuit Court of Appeals has utilized a twelve factor test in determining whether the debtor's filing for relief was in good faith, for purposes of section 1325(a)(3). The Court has emphasized that good faith is an amorphous notion largely defined by factual inquiry. In re Okoreeh - Baah, 836 F2d 1030, 1033 (6th Cir. 1988). The Court has held that the following factors are meaningful in evaluating the debtor's good faith, although no single factor is dispositive of the issue:

(1) the amount of the proposed payments and the amount of the debtor's surplus;
(2) the debtor's employment history, ability to earn and likelihood of future increase in income;
(3) the probable or expected duration of the plan;
(4) the accuracy of the plan's statements of the debts, expenses and percentage repayment of unsecured debt and whether any inaccuracies are an attempt to mislead the Court;
(5) the extent of preferential treatment between classes of creditors;
(6) the extent to which secured claims are modified;
(7) the type of debt sought to be discharged and whether any such debt is non-dischargeable in Chapter 7;
(8) the existence of special circumstances such as inordinate medical expenses;
(9) the frequency with which the debtor has sought relief under the Bankruptcy Reform Act;
(10) the motivation and sincerity of the debtor in seeking Chapter 13 relief;
(11) the burden which the plan's administration would place upon the trustee; and,
(12) whether the debtor is attempting to abuse the spirit of the Bankruptcy Code.

In re Caldwell, 895 F2d 1123, 1126 (6th Cir. 1990). The party who seeks the discharge under Chapter 13 bears the burden of proving good faith utilizing these criteria.

The federal bankruptcy courts and federal district courts in Michigan have held that the good faith requirement set forth in 11 USC § 1325(a)(3) cannot be met by a tax protestor. The debtor in In re Hazel, 68 B.R. 287 (Bankr. ED Mich. 1986), aff'd. 95 B.R. 481 (E.D. Mich. 1988) failed to file federal income tax returns for the years 1978 through 1985 with the exception of the year 1979. For the 1979 year he filed an altered Form 1040 on which he deducted all of his wages under the heading of "NONTAXABLE RECEIPTS - EISNER v. MACOMBER". The debtor owed the Internal Revenue Service approximately $36,000.00 at the time he filed his petition for Chapter 13 relief and submitted a Chapter 13 plan providing for payment of approximately one percent of his federal tax liability. The Bankruptcy Court and later the District Court reviewed the debtor's plan utilizing the factors discussed above to determine whether the plan met the good faith requirement set forth in 11 USC § 1325(a)(3). Both courts found that the debtor's Chapter 13 plan abused both the spirit and purpose of Chapter 13. The courts found that through his plan, the debtor attempted to discharge federal tax liabilities which he never reported and which he never intended to pay. The Bankruptcy Court used strong language in explaining why the tax protestor's Chapter 13 plan could not be confirmed.

> To do so would lend assistance to those who seek to avoid the payment of taxes. This Court cannot use its constitutionally given authority to frustrate Congress, the Constitution itself, and laws of the United States. Moreover, the record indicates that the debtor's intention in filing the bankruptcy petition was to discharge the tax claim created

> by his own actions. To file a petition in bankruptcy in order to discharge a debt arising from illegal activities is clearly bad faith. We hold then that it is bad faith pursuant to 11 USC § 1325(a)(3) to file a petition in bankruptcy and seek confirmation of a plan that discharges tax claims arising from the debtor's unlawful refusal to pay those taxes. It does not matter that the debtor may have other legitimate debts. The presence of these debts will not allow a plan filed in bad faith to be confirmed. The element giving rise to bad faith is a bar to confirmation.

In re Hazel, 68 B.R. at 290.

A debtor's involvement with "constitutionalists" or tax protestors who convince the debtor that it is not necessary to pay taxes on wages, does not excuse the debtor from the good faith criteria set forth in 1325(a)(3). Schaffner v. Internal Revenue Service, 95 B.R. 62 (E.D. Mich. 1988). The Court must look at the debtor's pre-plan conduct in incurring the debt as a relevant factor in determining whether or not the Chapter 13 plan is proposed in "good faith". Memphis Bank and Trust Company v. Whitman, 692 F2d 427 (6th Cir. 1982), Schaffner v. Internal Revenue Service, 95 B.R. 62, 64 (E.D. Mich. 1988). The debtor's failure to file tax returns for a number of years prior to filing a petition for bankruptcy is an integral part of the totality of circumstances examined to find that the debtor had failed to establish that the plan was submitted in good faith. Schaffner, supra at 65.

The language in 11 USC § 1225(a)(3) is identical to that found in 11 USC § 1325(a)(3). Therefore, debtors filing for relief under Chapter 12 of the Bankruptcy Code must pass the same "good faith" test that a Chapter 13 debtor must satisfy before receiving a discharge of pre-petition liabilities.

A Chapter 7 or Chapter 11 debtor who protests taxes faces different barriers to eliminating pre-petition federal tax liabilities through discharge. The exception to discharge provisions contained in 11 USC § 523 apply to all Chapter 7 and Chapter 11 cases and in limited situations to Chapter 12 and Chapter 13 cases. The pertinent provisions of section 523, specifically concerning the discharge of federal tax liabilities, read as follows:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt
>
> (1) for a tax or a customs duty
>
> (A) of the kind and for the periods specified in section 507(a)(2) or 507(a)(7) of this title, whether or not a claim for such tax was filed or allowed;
>
> (B) with respect to which a return, if required
>
> i. was not filed; or
>
> ii. was filed after the date on which such return was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or
>
> (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax[.]

A recent Sixth Circuit opinion has clarified the standard to be applied in determining whether taxes are non-dischargeable pursuant to the second exception contained in 11 USC § 523(a)(1)(C), that is when a debtor willfully attempts to evade or defeat tax. In re Toti, 24 F3d 806 (6th Cir. 1994) involved a Chapter 7 debtor who failed to file federal income tax returns or pay federal income taxes for the taxable years 1974 through 1981. In February of 1990, Toti filed his petition for relief under Chapter 7 of the Bankruptcy Code and commenced an action seeking, among other things, the determination of the dischargeability of his tax liabilities. The government took the position that the liabilities were non-dischargeable pursuant to 11 USC § 523(a)(1)(C) in that the debtor had willfully attempted to evade or defeat the taxes.

In May of 1992, the Bankruptcy Court for the Eastern District of Michigan held that the taxes were dischargeable. The Bankruptcy Court utilized a criminal standard in applying the section 523(a)(1)(C) phrase "willfully attempted in any manner to evade or defeat such tax". By using the criminal standard, the Bankruptcy Court required the government to present evidence that the debtor engaged in a willful commission of an act to evade or defeat his tax liability which is the same standard as required by 26 USC § 7201 concerning federal tax evasion, a felony.

The government appealed the decision of the Bankruptcy Court to the United States District Court for the Eastern District of Michigan which concluded that the Bankruptcy Court had applied the wrong legal standard. The District Court applied the standard used in other civil tax cases-- "voluntary, conscious, and intentional"-- to hold that Toti's failure to file tax returns and to pay taxes were willful acts for purposes of 11 USC § 523(a)(1)(C). United States v. Toti, 149 B.R. 829, 834 (E.D. Mich. 1993).

The Sixth Circuit Court of Appeals concurred with the District Court in holding that a civil standard should be utilized when determining whether a debtor was willful in his attempt to evade or defeat tax liabilities. The Circuit Court held that the plain reading of 11 USC § 523(a)(1)(C) includes both acts of commission and acts of omission. The Court of Appeals concurred with the District Court's opinion that "the purpose of the Bankruptcy Code is to allow the honest debtor a fresh start". United States v. Toti, 149 B.R. 829, 833 (E.D. Mich. 1993). The Court of Appeals then applied that purpose to the facts in Toti as follows:

> Toti does not fall within the category of honest debtors. He had the wherewithal to file his returns and pay his taxes, but did not fulfill his obligation. It is undisputed that he did so voluntarily, consciously, and intentionally.

The Sixth Circuit Court of Appeals held that Toti willfully attempted to evade or defeat his tax liability within the meaning of 11 USC § 523(a)(1)(C) and, therefore, his debt was not discharged by his bankruptcy. In re Toti, 24 F3d 806 (6th Cir. (1994). The Court was particularly concerned with the fact that the debtor had the ability to pay the tax when it was incurred but chose not to fulfill that duty.

A taxpayer/debtor's belief in tax protestor type arguments will not spare the debtor from a finding that he acted "willfully" under 11 USC § 523(a)(1)(C). If the intended result of a taxpayer's action is that the United States does not receive tax payments, then the taxpayer has acted willfully, notwithstanding a good faith belief. In re Langlois, 155 B.R. 818,821 (N.D. N.Y. 1993); Hochstein v. United States, 900 F2d 543 (2d Cir. 1990).

Given the Court of Appeals opinion in Toti, a tax protestor filing a petition for relief under either Chapter 7 or Chapter 11 will have a very difficult time obtaining a discharge of federal tax liabilities in the Sixth Circuit when the protest consists of acts of commission or, in some situations, acts of omission. A tax protestor filing a petition under Chapter 13 or Chapter 12 can expect to face similar difficulties in obtaining a discharge of any pre-petition liabilities in the Sixth Circuit because of the Court's interpretation of the "good faith" requirements set forth in 11 USC § 1325(a)(3). The result is that in the Sixth Circuit the chances that a tax protestor will succeed in discharging Federal tax liabilities in bankruptcy are negligible.

The next time you are in Bankruptcy Court and hear a debtor arguing that wages are not taxable, that the Sixteenth Amendment was never ratified, or that only gold or silver currency can be taxed, don't be persuaded to stop filing your own tax returns or reporting your income. The tax debts being argued about are probably non-dischargeable in the Sixth Circuit and the Internal Revenue Service will actively pursue collection of the liabilities after the stay is lifted.

RECENT BANKRUPTCY DECISIONS

6th Circuit and Supreme Court decisions are summarized by John Potter; Western District cases are summarized by Mary Hamlin; Eastern District cases are summarized by Jaye Bergamini; and the Supreme Court case is summarized by Peter Teholiz.

In re Burba, (Liberty National Bank v Ricky and Cynthia Burba), 1994 FED App. 0381P (6th Cir.), File Name 94a0381p.06, Case No. 93-6479 (6th Cir. 11/10/94). On November 9, 1989, Debtors, Ricky and Cynthia Burba, filed a Chapter 13 petition, listing Plaintiff, Liberty National Bank as a secured creditor. The confirmed Chapter 13 Plan treated the Bank's claim as secured to the extent of $9,775.00, the fair market value of the collateral, a 1988 Pontiac. Pursuant to 11 USC § 506(a) the remaining portion of the Bank's $11,892.33 claim was unsecured. Nevertheless, the Plan was to pay 100% to unsecured creditors over 60 months. Additionally, the Bank was to be paid 10.25% annual interest on its secured claim.

Debtors made Plan payments until July of 1992, when they converted the case to a Chapter 7. During the course of the Plan, the Chapter 13 Trustee paid $9,775.00 to the Bank, which represented the secured portion of its claim. No interest payments were paid on the claim and $557.75 was paid on the Bank's unsecured claim.

The Chapter 7 Trustee abandoned his interest in the car, and Debtors moved to redeem it pursuant to 11 USC § 722. Debtors claimed that they had paid the Bank the fair market value of the car under the Chapter 13 Plan and, therefore, owed nothing upon conversion to Chapter 7 because the lien was now extinguished. The Bank objected, stating that for purposes of redemption under § 722, its claim is redetermined.

The bankruptcy court held that because the secured portion of the Bank's claim had been paid pre-conversion, Debtors could redeem the car upon conversion to a Chapter 7, by paying only unpaid interest. The district court, citing In Re Hargis, 103 BR 912 (Bankr. ED Tenn 1989), affirmed, reasoning that the amount due under § 722 had been established in the Chapter 13.

In reversing the lower court, the Court of Appeals found that the Supreme Court's decision in Dewsnup v Timm, 112 SCt 773 (1992) undercut the Debtors' arguments. Before the lien on the collateral could be satisfied under 11 USC § 1325(a)(B)(ii), the interest on the deferred balance of the allowed secured claim would have to be paid. In re Colegrove, 771 F2d 119 (6th Cir. 1985).

Moreover, bifurcation of a claim pursuant to § 506(a) and stripping down the lien to the value of the collateral in a Chapter 13 proceeding does not survive for redemption purposes upon conversion to Chapter 7. The security reduction provision of § 506(a) should accrue to the benefit of a debtor only if the Chapter 13 Plan is completed. When a debtor fails to complete a Chapter 13 plan, for purposes of redemption the creditor's original lien rights stand and upon conversion to Chapter 7, the collateral can be redeemed through § 722 only upon payment of the current value of the collateral or the remainder of the debt, whichever is less.

In re C.J. Rodgers, Inc., (Grabscheid v Calvert Sales), FED App. 0377p (6th Cir. 1994), File Name: 94a0377, p.06. On October 19, 1990, Debtor, C.J. Rodgers, Inc. purchased equipment from Defendant, Calvert Sales, Inc. (Creditor) pursuant to an installment loan agreement whereby Creditor retained a security interest in the equipment. Debtor executed two financing statements and on October 26, 1990, it mailed them to the Michigan Secretary of State's UCC Section for filing. The financing statements did not contain Debtor's tax identification number, so the Secretary of State refused to file them and mailed them back to Creditor. Creditor claimed that it never received the unaccepted forms back or a time stamped copy of accepted forms from the Secretary of State. However, Creditor did receive and pay a bill from the Secretary of State for the filing fees.

Debtor, subsequently filed a Chapter 11 petition and the trustee sought to avoid the lien asserted by Creditor. The bankruptcy court ruled that the presentation for filing of a financing statement that does not satisfy the requirements of MCL § 440.9402 cannot be "filed" by presentation to the Secretary of State, even accompanied by the tender of a fee. The rejection of the financing statements by the Secretary of State because they did not contain the tax identification number of the Debtor was mandated by the statute. Consequently, they were not "held" under MCL § 440.9403(1). The district court and Court of Appeals affirmed.

In re Embrace Systems Corporation, Case No. GG94-84766 (Bankr. WD Mich.) 11/9/94. In this case the Debtor and a secured creditor had entered into a Stipulation for relief from the automatic stay. A Motion to approve the stipulation was not filed with the Stipulation. Judge Gregg declined to enter an Order approving the Stipulation because the parties had failed to comply with Bankruptcy Rule 4001. Bankruptcy Rule 4001 requires that a Stipulation for relief from the automatic stay and a Motion approving such a Stipulation must be served on parties in interest with an opportunity to object.

This is to ensure that due process is provided to all interested parties.

Gerald E. Lindquist v United States of America and M. Scott Michael, United States Trustee For Region IX, Adv. Pro. No. 94-8194, (Bankr. WD Mich.) 11/7/94. The Plaintiff was a Chapter 7 panel trustee from August 19, 1988, through December 1, 1993. On December 1, 1993, a notice was sent to the Plaintiff from the Assistant US Trustee for the Western District of Michigan stating that he would not be reappointed to the chapter 7 trustee panel. Plaintiff filed a complaint against the US Trustee alleging that the Defendants' actions: (1) were "unreasonable, arbitrary, and capricious"; (2) "constitutes an abuse of their discretion"; (3) were "undertaken without due process of law"; and (4) violated 5 USC 552 (F.O.I.A.). Defendants filed a Motion to Dismiss on the basis that the Bankruptcy Court lacked jurisdiction pursuant to 28 USC 1334 and 11 USC 105.

The issue in this case is "whether this court has jurisdiction to hear a dispute between a chapter 7 panel trustee and the U.S. Trustee when that dispute is not related to a specific case pending before the court." Judge Howard explained how the bankruptcy court is a court of limited powers and that 28 USC § 1334 confers jurisdiction over title 11 case to the district court. 28 USC § 157 confers jurisdiction from the district court to the bankruptcy court. The Plaintiff asserted that the conduct of the Defendants related to cases under title 11 and therefore, the bankruptcy court had jurisdiction. Judge Howard held that the bankruptcy court did not have jurisdiction over the case because it was not a case arising under title 11, nor was it related to a case under title 11. The Judge found that 11 USC § 586, which sets forth the U.S. Trustee's power to appoint or remove a trustee panel, is outside of the jurisdiction of the bankruptcy court as set forth in 28 USC § 1334.

In re Kinross Manufacturing Corporation, Case No. HM89-90192, (Bankr. WD Mich.) 11/7/94. Central Savings Bank ("Bank") filed a complaint against the Trustee and Firemans Fund Insurance Company ("Firemans") alleging that the Trustee breached his duty to preserve and protect the assets of the estate by failing to obtain insurance on the assets. The business premises of the Debtor, on which the Bank held a lien, were broken into, resulting in vandalism and theft. The property in question was sold during the administration of the case and all that remained was $11,000.00. The Bank asserted that these funds plus the Trustee's blanket bond underwritten by Firemans should be utilize to satisfy a judgment against the Trustee. The Trustee and Firemans filed motions for summary judgment.

The Trustee's motion for summary judgment was premised on the theory that the funds left in the estate were to pay for his fees and expenses, and that the Bank should have filed an objection to those under 11 USC § 326(d). Having failed to do so, the Trustee reasoned, the Bank's complaint was moot. Judge Howard disagreed. If the Bank were successful it might have an administrative claim under 11 USC § 503(b) and any distributions may have to be made on a pro-rata basis.

Firemans' motion for summary judgment was premised on the theories that (1) the Trustee had no duty to obtain insurance to protect a secured creditor and (2) that a surety is not liable for the mere negligence of the Trustee. On the first issue, Judge Howard held that "any trustee has a duty to conserve the assets of the bankruptcy estate. The trustee's duty will be measured against the standard of 'the exercise of due care, diligence and skill ... of an ordinarily prudent man in the conduct of his private affairs under similar circumstances and with a similar object in view.'" Judge Howard found that whether or not a trustee has a duty to insure assets of the estate must be determined based on the particular facts of a case.

On the second issue, Judge Howard held that Firemans can be liable for the mere negligence of the Trustee. The standard is set forth in Ford Motor Credit Co. v Weaver, 680 F2d 451, 461 (6th Cir. 1982) which states:

> "A bankruptcy trustee is liable in his official capacity for acts of negligence. *** A bankruptcy trustee is liable personally only for acts of willfully and deliberately in violation of his fiduciary duties."

Judge Howard found that there existed genuine issues of material facts and denied the Defendants' respective motions for summary judgment.

In re Kimberly Powell, U.S. District Court, W.D. Mich., File No. 1:94-CV-696. This case was on appeal in the United States District Court following a Final Order entered by the Bankruptcy Court on August 15, 1994. Judge Gibson denied the Debtor's motion for a new trial.

The Debtor filed a Chapter 7 proceeding and A.W.E.T., Inc. filed a complaint to determine the non-dischargeability of debt based on the Debtor's willful and malicious conduct in intentionally interfering with a business relationship. After a trial, Judge Howard found that the debt to A.W.E.T., Inc. was non-dischargeable and a Judgment was issued in the amount of $12,800.00. The Judgment was signed on June 8, 1994, and was docketed on June 14, 1994. It was received by Debtor's counsel on June 18, 1994. Debtor's counsel filed a motion for a new trial on June 28, 1994. Judge Howard denied the motion as untimely. Bankruptcy Rule 9023 applies Rule 59 of the Federal Rules of Civil Procedure and requires that motions for new trial be served not later than 10 days after entry of the judgment. Bankruptcy Rule 9021 provides that a judgment is effective when it is entered pursuant to Bankruptcy Rule 5003. Bankruptcy Rule 5003(a) provides that the date of entry on the docket is applicable. In this case, the Judgment was entered on the Court's docket on June 14, 1994. Therefore, Defendant had 10 days from that date in which to file a motion for a new trial. However, the motion for a new trial was not filed until June 28, 1994, and, therefore, was not timely. Judge Gibson affirmed the Order of Judge Howard denying the motion for a new trial.

Cletus Bernard Archambault, Case No. SK-94-80648 (Bankr. WD Mich.) 11/16/94. The issue in this case was whether or not the Bankruptcy Court can, pursuant to 11 USC § 105(a) in an individual Chapter 7 case, issue a preliminary injunction enjoining a creditor continuing litigation against a non-debtor. In this case, the Debtor had filed a Chapter 7 proceeding. There was a Judgment entered not only against the Debtor, but also against the Debtor's spouse, who did not join in the petition. The creditor continued to pursue the non-filing spouse with a court proceeding. The Debtor then filed a complaint seeking a temporary restraining order and a preliminary injunction enjoining the creditor from proceeding against the non-filing spouse.

Four factors must be considered in determining whether to grant or deny a motion for preliminary injunction: (1) the likelihood that the movant will eventually prevail on the merits; (2) whether the injunction would save the movant from irreparable injury; (3) whether the injunction would harm others; and (4) whether the public interest would be served by the injunction. Unsecured Debtor's Committee v Delorean (In re Delorean Motor Co.) 755 F2d 1223, 1228 (6th Cir. 1985). Judge Stevenson granted the Plaintiff's motion for preliminary injunction after reviewing each of the four factors. She determined that injunctive relief is appropriate where the debtor and non-debtor are closely related. Patton v Bearden, 8 F3d at 349. She went on to state that "such relief is also appropriate where the underlying facts are extreme and the failure to grant such relief would effectively deny the Debtor the fresh start afforded by Chapter 7 by allowing movant an end-around the automatic stay."

In re Everlock Fastening Systems, Inc., (Everlock Fastening Systems, Inc. v Health Alliance Plan), 171 BR 251 (Bankr. ED 1994), Judge Shapero. Plaintiff Debtor-in-Possession filed an adversary proceeding against its health insurance carrier seeking to recover as a preferential payment, a $73,000 premium it paid for the health care coverage of its employees a few hours before filing its petition under chapter 11. The payment was made by cashiers check, in a manner determined by the court to be outside the ordinary course of business under § 547(c)(2)(B). The court looked to the timing of the payment, the amount and the manner in which the payment was made, and the general circumstances of the transaction, in accord with In re Yurika Foods, 888 F2d 42 (6th Cir. 1989). In the course of the parties' prior dealings, fewer than 16% of the payments made by the Debtor-in-Possession were as late as the one in question, and none had been made by cashiers check, as had the one in question.

Defendant Health Alliance Plan (HAP) relied on the affirmative defense of new value under § 547(c)(1)(B). The facts showed that even though the contract between the parties called for the premium to be paid in advance of the month for which the coverage was provided, the payment in question had actually been made on the 19th of the month for which coverage was already in effect.

The court analyzed the new value defense according to the factors set out in In re Lewellyn & Co., 929 F2d 428 (8th Cir. 1991):

1. Did HAP give new value in exchange for the payment?
2. Did both the DIP and HAP intend the payment to be contemporaneous?
3. Was the payment in fact substantially contemporaneous?

The court found that the there was a valid transfer for new value, intended and actually substantially contemporaneous. The DIP's demand for recovery of the alleged preference was denied.

In re Sumpter, (USA v Sumpter), 170 BR 908 (ED Mich. 1994), Judge Cleland. The District Court denied the appeal of debtor and affirmed the Bankruptcy Court's determination that the tax debt of the debtor was non-dischargeable pursuant to § 523(a)(1)(C), where the debtor made several fraudulent transfers of property in an attempt to evade or defeat a tax.

The debtor and his spouse created a trust in favor of their children. The trust provided that no loans would be made to the debtor, who was a settlor. Despite that provision, the debtor took several "loans" from the trust.

Within a brief span of time, in the face of notices of an outstanding federal tax obligation and notices of intent to levy, the debtor and his wife gave the trust mortgages on 6 pieces of property, took a loan from the trust for $90,000, and then deeded the properties to the trust.

The IRS claimed that the transfers of property were fraudulent, and a willful attempt to evade or defeat the collection of a tax. In his deposition, the debtor admitted that one of his considerations in deeding the mortgaged property to the trust was to avoid the ability of the IRS to levy. Based on that testimony, the Bankruptcy Court granted the IRS' motion for summary disposition. However, on appeal the debtor denied that such admitted intent on his part was willful within the meaning of § 523(a)(1)(C) because he claimed that the value of the properties would not have been sufficient to support a levy by the IRS. He argued that the trial court should have examined the value of the properties in question, not just the admission of intent.

The district court rejected the debtor's argument, characterizing it as spurious. Said the court: "This provision does not require, as the appellant suggests, that an attempt to evade or defeat a tax be successful; but only that it be willful."

Metropolitan Life Insurance v Honigman, Miller, Schwartz & Cohn, 94-CV-72288-DT, (ED Mich. 10/18/94), Judge Hackett. District Court affirmed the Bankruptcy Court ruling that after dismissal of the debtor's chapter 11 proceeding, the Bankruptcy Court lacked jurisdiction to compel debtor's counsel to disgorge $90,000 retainer paid prior to the commencement of the chapter 11.

Plaintiff held a $23 million mortgage against the sole asset of a limited partnership debtor. The debtor retained the Defendant and paid it $90,000, as a retainer. The chapter 11 was filed on June 22, 1993. The firm made proper application for appointment, and disclosed the retainer. The Plaintiff moved for dismissal of the petition and the motion was granted on July 15, 1993, on grounds of bad faith and no reasonable likelihood that the plan could be funded or confirmed. The debtor appealed the dismissal and the dismissal was affirmed in November 1993.

The Plaintiff filed a motion in May 1994 in the bankruptcy court for disgorgement of the retainer paid the firm. The Plaintiff claimed that the firm had non-waivable conflicts that would have precluded its representation under §327, and that the retainer should be disgorged under §327(a), 328(c) and 330. The Plaintiff also argued that the retainer paid the firm was part of the collateral of the Plaintiff. At the hearing on the motion, the bankruptcy court ruled that it lacked jurisdiction to hear the motion because the petition had been dismissed in July 1993.

On appeal, the Plaintiff argued that the bankruptcy court erred because the district court had granted a stay of the dismissal order pending appeal, and the bankruptcy court had inherent power to rule on the motion, even though no express language retaining jurisdiction was contained in the dismissal order.

The district court held that while the stay pending appeal preserved the status quo, it did not return jurisdiction to the bankruptcy court.

As to the inherent power of the court, and the issue of retention of jurisdiction, the court found that although there was law on both sides of the issue and the 6th Circuit had not yet ruled on the need for specific language retaining jurisdiction, retention of jurisdiction is a matter of discretion for the trial court. The district court held that the bankruptcy court had not abused its discretion in refusing to exercise jurisdiction over the motion.

In re Zack, 94-CV-70952-DT (ED Mich. 11/7/94), Judge Rosen. The district court affirmed the bankruptcy court's order denying confirmation of the debtors' chapter 11 plan, and dismissing the case for lack of good faith.

Debtors filed their petition in pro per. The husband was incarcerated in the federal penal system. The assets of the estate consisted for the most part of contingent and disputed claims against creditors and third parties. The debtors requested that the Court appoint counsel on their behalf, which Judge Graves declined to do. On the day of the confirmation hearing, Judge Graves gave the husband the opportunity to adjourn the hearing, if he felt unprepared to proceed. He chose to go forward. Judge Graves denied confirmation and dismissed on grounds of lack of good faith.

The appeal claimed that the trial court erred by not allowing the debtor time to prepare for the confirmation hearing, by dismissing the petition based on a failure to give due credit to the value of the "assets" of the estate, and by failing to allow the debtors to engage in certain discovery.

The district court found no merit in any aspect of the debtors' appeal and affirmed the order dismissing the petition.

Joseph Productions v WTVS Channel 56, 94-70152 (ED Mich. 10/21/94), Judge Borman. Defendant WTVS appeals a bankruptcy court decision following trial for breach of contract. The bankruptcy court found that WTVS was liable to the debtor/plaintiff (Joseph) for damages of $145,000. The district court found clear factual error on the part of the trial court, and reversed.

Joseph did post-production work for WTVS. The contractual agreement of the parties changed over time, and eventually the president of Joseph sent a letter to WTVS, outlining the agreement under which the parties were working. The letter from the debtor to WTVS was found to be the contract which governed the parties.

Under that contract, Joseph agreed to do certain work for a combination of cash, attribution of contribution to the production of a certain program (known as a "rolling credit') and "billboard" advertising, (a non-specific acknowledgement of contribution to public television) . The total cash to be paid was $13,000. The "billboard" advertising was valued in the contract at $165,000. The dispute between the parties arose with respect to the billboard portion of the contract.

Joseph sued WTVS for damages under the contract, claiming that at the time the parties reached their agreement for a mixture of cash and advertising credits, Joseph thought it could sell the billboard portion of the contract to outside parties for cash, and that it relied on that belief in agreeing to the small amount of cash for its services.

The bankruptcy court found that even though Joseph had drafted the contract, WTVS knew that Joseph intended to sell the billboard credits, and that such a sale was prohibited under federal law. Accordingly, the bankruptcy court found that there had been a mistake made by Joseph in entering into the contract, that the mistake made the contract voidable, and that WTVS must bear the risk of the mistake because it knew that Joseph was making the mistake at the time the contract was formed. The bankruptcy court awarded Joseph cash damages for services rendered to WTVS.

The district court reviewed the facts of the case and found that the bankruptcy court had committed clear error in its findings of fact. The testimony of Joseph's president was that he never told WTVS that he intended to resell the billboard credits for cash. Further, the actions and dealings of the parties clearly showed that Joseph knew that the maximum amount of cash it was entitled to under the contract was $13,000.

The district court found that the bankruptcy court had committed clear error and it reversed the judgment entered against WTVS.

In re Bowers, Bowers v Bowers, 93-CV-75005-DT (ED Mich.) Judge Duggan. The District court affirmed the decision of Bankruptcy Judge Rhodes, which held that an obligation owed by debtor wife to Plaintiff ex-husband pursuant to a judgment of divorce, was non-dischargeable pursuant to § 523(a)(6).

In the September 1982 judgment of divorce, debtor wife was awarded the residence, and the husband was granted a lien against all the wife's property to secure payment of $305,000. Prior to the entry of the judgment, the home had been foreclosed by the first mortgagee. During the redemption period, the wife had hired an agent, who bargained with the mortgagee on the wife's behalf. The agent, who by contract had an undisclosed relationship with the wife, bought the property from the mortgagee. The wife assigned her interest in the agency agreement to her mother, but continued to live on the property until it was sold to a third party in February 1987. Since the husband's lien postdated the foreclosed mortgage, it was not an impediment to closing the sale. The wife did not pay the husband any of the sale proceeds.

The wife filed chapter 7 in November 1990. The husband filed an adversary proceeding objecting to the discharge of his debt. Although the complaint did not specifically allege a violation of § 523(a)(6), the facts as plead were sufficient to make out a case under that section for wilful and malicious injury. The debtor wife never moved for a more definite statement of the Plaintiff's complaint.

The bankruptcy court found that the debt due the husband was non-dischargeable under § 523(a)(6), and that the wife had intentionally concealed her ownership interest in the property, which injured the husband.

The debtor argued on appeal that the court erred, and that the Plaintiff husband had failed to prove by clear and convincing evidence that she had intended by her actions to injure him. First, the district court held that the applicable standard of proof to be a preponderance of evidence, not clear and convincing evidence. Further, it held that the plaintiff was not required to prove that the defendant acted with specific intent to harm the plaintiff. Rather, pursuant to Vulcan Coals v Howard, 946 F2d 1226 (6th Cir. 1991), a wrongful act done intentionally, which necessarily produces harm and is without just cause or excuse, may constitute a willful and malicious injury. Under that standard, the court found that the intentional tort of conversion satisfies the section's requirements for nondischargeability where the debtor intentionally transfers property without authorization or approval of the person entitled to the property.

The district court found that the debtor's conduct was deceptive and ill-willed, and designed to hinder the plaintiff's ability to collect money owed to him pursuant to the divorce judgment. Hence, the trial court correctly held that the debt to the Plaintiff husband was nondischargeable, to the extent of the profit realized on the sale of the property in the amount of $124,000, pursuant to § 523(a)(6).

U.S. Bancorp Mortgage Co. v Bonner Mall Partnership, 513 US --, 115 SCt --, 130 LEd2d 233 (1994). This case was originally before the Court due to Bancorp's objection to the Debtor's plan of reorganization. The 9th Circuit had ruled that the "new value" exception to the absolute priority rule had not survived the enactment of the Bankruptcy Code; this was the issue before the Court. While the appeal was pending, however, the parties settled the case and entered into a consent plan of reorganization. Bancorp filed a motion with the Supreme Court, requesting it to vacate the judgment of the Court of Appeals, and the Debtor contested the motion. In a unanimous opinion, the Supreme Court denied the motion and dismissed the case as moot.

The Court held that it had the power to vacate the decision of the Court of Appeals "as may be just under the circumstances." No such circumstances were present in this case. Bancorp's agreement to a settlement was a voluntary forfeiture of review of the Court of Appeals' decision, and constituted a failure of equity. Moreover the value of additional debate among the various Courts of Appeal outweighed any perceived benefits arising from vacating the lower court opinion. Vacating the judgment in this case would constitute a collateral attack on that judgment that would interfere with the orderly operation of the judicial system. The motion was denied.

EDITOR'S NOTEBOOK

December is normally marked by holiday parties and discussions of gifts and merriment. This year, though, it has included numerous seminars regarding the new bankruptcy amendments. The steering committee hosted a half-day seminar on December 14, which I thought went very well. I hope that you all had an opportunity to attend at least one seminar to learn the intricacies of the new provisions.

On a personal note, this issue marks the end of my year-long sojourn as the Editor of the Bankruptcy Law Newsletter. I have tried to do the best job that I could, but I recognize that there was no "perfect" edition, without any errors. Notwithstanding that fact, it has been a fun year, and I have enjoyed being your Editor.

I wish to thank all of the people who have contributed to the Newsletter this year, including the authors and the case summarizers. Without their efforts, this Newsletter would not be published. I would especially like to thank Lisa Stolnacke, the person in my office who actually did all of the typing and formatting for each edition of the Newsletter, and who made certain that it was sent to the printer on time. I could not have done this without her invaluable help.

Mary Hamlin will take over as the Editor of the Newsletter, beginning with the next issue. I know that she will do a fantastic job.

Lastly, the Eastern District has recently formed a committee to determine whether any of the local bankruptcy rules for the district need technical amendments. If anyone has any proposed changes or wishes for any additional information, they should contact Lisa Sommers Gretchko at 313-393-7307.

Peter A. Teholiz, Editor

STEERING COMMITTEE MINUTES

There was no meeting of the Steering Committee in December. The next meeting is scheduled for Friday, January 20, 1995, at noon at the Peninsular Club, in Grand Rapids.

LOCAL BANKRUPTCY NOTICE

BANKRUPTCY CASES TO BE REASSIGNED AS JUDGES ROTATE TRAVEL ASSIGNMENTS

Many bankruptcy cases in Marquette, Traverse City and Lansing will be reassigned on January 2, 1995, to reflect a change in the travel assignments of the three judges. For the last several years, two of the three bankruptcy judges have travelled to three locations outside of Grand Rapids. It has been agreed that this rotation will change at the beginning of the year. After January 1, 1995, Judge Stevenson will take Judge Gregg's cases in Marquette, Judge Gregg will take Judge Howard's cases in Traverse City and Judge Howard will take Judge Stevenson's cases in Lansing. The Court requests that attorneys and trustees who submit pleadings to the court after the first of the year use the appropriate judge's initials with such pleadings to reflect this change. Attorneys and parties in interest may assume that all cases will be transferred as indicated above unless a specific notice is sent with other information. The Court does not plan to send out notices of reassignment to attorneys or parties in each case.

Each of the judges handles his or her motion day calendar differently. Judge Stevenson intends to hold motion days in Marquette on Tuesday. She schedules chapter 13 matters at 9:00 a.m. and chapter 7 and 11 matters at 10:00 a.m. Adversary pretrials are held at 11:00 a.m. Contested matters expected to take any significant time and adversary proceeding trials will be scheduled for the afternoons.

Judge Howard will be holding Lansing motion days on Friday. He schedules chapter 13 matters at 9:00 a.m. as well as routine matters (generally uncontested) in other chapters. He also schedules adversary pretrials for 9:00 a.m. Contested matters and most chapter 11 motions would be scheduled for 10:00 a.m.

Judge Gregg will schedule adversary trials in Traverse City on Thursdays and motions on Fridays. He schedules chapter 13 matters at 9:00 a.m. and schedules many routine matters (e.g. preliminary hearings in relief from stay motions, reaffirmations and some chapter 7 matters) at 9:45 a.m. Chapter 11 motions and final hearings on motions for relief from stay are heard at 10:30 a.m. Pretrials and other matters in adversary proceedings are scheduled for 11:15 a.m.

If you have any questions about these changes, please give the judge's case administration team a call.

Additionally, the Court has amended its memorandum of compensation and reimbursement of expenses for court-appointed professionals. This memorandum is Exhibit 8 to local bankruptcy rules. A copy of the amended memorandum is enclosed.

Mark VanAllsburg, Clerk

This is exhibit 8 to
the Local Bankruptcy
Court Rules dated
March 1, 1993

EXHIBIT 8

MEMORANDUM REGARDING ALLOWANCE OF COMPENSATION AND REIMBURSEMENT OF EXPENSES FOR COURT-APPOINTED PROFESSIONALS

AS AMENDED ON NOVEMBER 18, 1994

Recently, parties in interest have been lodging more frequent objections to applications for the allowance of compensation and reimbursement of expenses. In an attempt to reduce the number of these objections, the Court has determined that it is in the interests of all debtors, creditors, their respective attorneys, and other parties in interest, including the United States Trustee, that the following general guidelines respecting the format of fee applications be established and published.

1. Professional persons approved and appointed by the United States Bankruptcy Court for the Western District of Michigan, pursuant to 11 U.S.C. §§ 327(a) and 1103(a), and Fed. R. Bankr. P. 2014, are required to comply with the standards for applications for compensation of professional persons as set forth in 11 U.S.C. §§ 328 and 330(a)(1) and Fed. R. Bankr. P. 2016. The burden of proof regarding all fee applications is imposed upon the applicant.

2. An application must itemize each activity, its date, the professional who performed the work, a description of both the nature and substance of the work and the time expended thereon. Records providing no explanation of activities performed will be deemed inadequate and therefore noncompensable.

3. In order for time spent on activities such as court appearances, preparation for court appearances, conferences, telephone calls, drafting documents, and research to be compensable, the nature and purpose of the activity must be noted. Time entries for telephone calls must list the person with whom the applicant spoke and give a brief explanation of the conversation. Time entries for letters must state the addressee and give a brief explanation of the letter's contents. Time entries for documents must specify the document involved. Time entries for legal research must describe the matter or proceeding researched.

4. Applicants must not attempt to circumvent minimum time requirements or any of the detail requirements by "lumping" or "bunching" a number of activities into a single entry. Each type of service must be listed with a corresponding specific time allotment.

5. Time entries with unexplained abbreviations are noncompensable. Where computer time sheets are submitted to substantiate entries, a code key must be supplied, or the application will not be considered. In more complex petitions, a glossary of persons involved may be helpful.

6. The application must state the amount of any retainer paid, as well as the date of each previous application, the amount of compensation and expenses requested, the amount of compensation and expenses approved, the date of approval, and the amount received. The application must also indicate the total hours charged and give a summary of the hours and hourly rate charged by each professional.

7. If more than one professional has charged time for activities such as intra-office conferences or joint court appearances, the applicant must explain the need for each professional's participation in the activity.

8. All time listed must represent the actual time required to perform the activity and should be stated in tenths of an hour. "Rounding up" of time or minimum time increments of .25 hours are not permitted.

9. The rates charged must be commensurate with the level of skill required for a particular task; for example, attorney rates or paralegal rates may not be charged for nonlegal work, such as copying or delivering documents, preparing or filing proofs of service, or for trustee duties generally performed without the assistance of an attorney. When paralegals are utilized to perform services for an estate, they may be compensated as paraprofessionals and not reimbursed as overhead expenses.

10. No fees will be allowed for general research on law well known to practitioners in the area of law involved.

11. Reasonable time spent in preparing an application for compensation may be compensable.

12. The Court will consider whether tasks were performed within a reasonable number of hours and whether the requested hourly rate is reasonable based upon the customary rate charged by experienced practitioners.

13. The Court will not allow compensation for services which do not benefit the debtor estate; for example, fees for reading the work product of another attorney simply as a matter of interest or performing legal services mainly beneficial to the debtor, or the debtor's principals.

14. An application for reimbursement of expenses must list each expense, its date, and a description of the nature and purpose of the expense. For example, requests for mileage must include the date, destination, miles, per mile rate and the reason for the trip. Professionals should utilize the most economical method for necessary expenses; for example, coach air fare accommodations and commercial firm duplication for large numbers of copies. Courier service, express mail service and fax transmissions should not be used routinely, but, if used, should be as a result of justifiable reasons including time constraints.

15. In Chapter 13 cases, the Court may approve compensation of a debtor's attorney in an amount not to exceed $1,100 for services rendered through the time of confirmation, without the necessity of filing an itemized statement of services rendered, provided an agreement is filed with the Court which sets forth the agreed-upon fee for such pre-confirmation services. The required agreement shall be executed by the debtor and the debtor's attorney. If services with a reasonable value in excess of $1,100 are performed, and documented by the filing of an itemized fee application as required herein, the Court may award a fee in excess of $1,100 in Chapter 13 cases.

16. The Court may consider petitions for fees and expenses on a notice and objection basis as authorized by the Local Bankruptcy Rules for the Bankruptcy Court of the Western District of Michigan. The Court may, _sua sponte_ and without notice of hearing, or upon the motion of any party in interest or the United States Trustee after notice and hearing, order that payment of all, or some portion of, allowed interim fees be withheld for a particular period of time. Whenever payment of an applicant's fee has been deferred by the Court without a hearing, that applicant may file at any time a motion to rescind or modify deferral. Motions to rescind or modify deferral shall be set for hearing.

17. Attorneys should keep in mind that in most cases the reasonableness of the work done and the fee charged will depend upon the results attained. A part of the service to be performed by an attorney is to estimate, as to each prospective proceeding, the probability of success, the amount to be realized and the overall benefit to creditors.

This Court will consider applications for allowance of compensation and reimbursement of expenses which comport with the guidelines set forth in this memorandum.

Laurence E. Howard

Honorable Laurence E. Howard

J. Gregg

Honorable James D. Gregg

Jo Ann C. Stevenson

November 18, 1994

Honorable Jo Ann C. Stevenson

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 November 30, 1994. These filings are compared to those made during the same period one year ago and two years ago.

Bankruptcy Chapter	January 1 - November 30, 1994	Percent Increase (Decrease)	January 1 - November 30, 1993	Percent Increase (Decrease)	January 1 - November 30, 1992
Chapter 7	3833	(9.3%)	4227	(15.1%)	4980
Chapter 11	83	(24.5%)	110	(10.6)%	123
Chapter 12	17	(45.2%)	31	34.8%	23
Chapter 13	1498	(10.6%)	1355	(7.8)	1468
	5431	(5.1%)	5723	(13.2%)	6594

STEERING COMMITTEE MEMBERS

Dan Casamatta (1996)	616-456-2002
John Grant (1997)	616-774-0641
Tim Hillegonds (1995)	616-459-6121
Jeff Hughes (1996)	616-336-6000
Pat Mears (1995)	616-776-7550
Hal Nelson (1997)	616-459-9487
Steven Rayman, Chair-elect (1995)	616-345-5156
Brett Rodgers (1997)	616-732-9000
Tom Sarb (1995)	616-459-8311
Bob Sawdey (1996)	616-774-8121
Tom Schouten (1997)	616-538-6380
Peter Teholiz, Editor (1995)	517-886-7176
Janet Thomas (1996)	616-726-4823
Rob Wardrop (1997)	616-459-1225
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