BANKRUPTCY LAW NEWSLETTER

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FROM THE COURT:

Submitted by Mark Van Allsburg:
Clerk of the Bankruptcy Court

Chapter 13 Attorneys Fees: On October 14, 1997, the "Memorandum Regarding Allowance of Compensation and Reimbursement of Expenses for Court-Appointed Professionals" which is included in the Local Bankruptcy Rules as Exhibit 9 was amended. Paragraph 15 of that memorandum now reads as follows:

15. In Chapter 13 cases, the Court may approve compensation of a debtor's attorney in an amount not to exceed $1,250 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 $1,250 are performed, and are documented by the filing of an itemized fee application as required herein, the Court may award a fee in excess of $1,250 in Chapter 13 cases.

AutoCop: The last issue of the *Bankruptcy Law Newsletter* contained information about new intake software (called AutoCop) which will be implemented by the end of this year. As of this date, it has been decided that the chapter 13 trustees will continue to set first meeting dates and send first meeting notices as they have done in the past. Therefore there will be no

change in the present procedure. However, the Court will begin sending notices advising creditors of the commencement of chapter 13 cases if the debtor files a petition either without schedules or without a plan. These notices will commence upon implementation of AutoCop. The notices will advise creditors that they will receive another notice from the trustee when the first meeting has been scheduled.

Automation News: As you are aware, you can communicate with the Court by e-mail. The internet address for the clerk's office is **"clerk_miwb@miwb.uscourts.gov".** In addition, we have a web page at "**www.miw.uscourts.gov".** At the moment there is only rudimentary information on our web page. However, within the next 60 days we hope to install software which will allow us to post the motion day calendars to our web page. This should prove to be a valuable resource to the bar.

Court Fees to Increase: The Judicial Conference has approved changes to the Judicial Conference Schedule of Fees [See 28 USC 1930(a)]. Examples of changes: Administrative fee of $30 will be added to Chapter 11 cases [making effective fee $830]; reopening fee may now be deferred trustees pending discovery of additional assets; fee for motions for relief from stay will now be set at ½ the adversary filing fee [i.e. $75]; and the $20.00 amendment fee may now be waived "for good cause." As of today, we have not received the date on which these changes will be effective - but it is likely to be soon.

MINOR MICHGAN EXEMPTIONS PIANOS, FLOOR RUGS, AND POOL TABLES.

By: Peter A. Teholiz*

When a practitioner prepares a bankruptcy petition for a client, he or she has the immediate and practical problem of determining whether to select exemptions allowed under 522 (d) of the Bankruptcy Code, or whether to select exemptions:

"under Federal law, other than subsection (d) . . . . or State or local law that is applicable on the date of the filing of the petition . . . " 11 USC 522 (b)(2).

Typically, the practitioner recommends Michigan exemptions only when the case involves tenancies by the entireties or when it involves IRA's. The remaining Michigan personal property exemptions are usually ignored, even when the Michigan exemptions are chosen. This is unfortunate, because the state of the law in dealing with these "minor" exemptions allows for creativity on the part of the lawyer.

There are two Michigan cases that suggest the parameters of defining exemptions. In Slumpff v McGuire & Hansen, 253 Mich 473 (1931), the Court held that two floor rugs were household goods or furniture within the meaning of the exemption statute. In doing so, the Court explained that the "modern tendency is to extend rather than limit exemptions." Id at 475. Contrast this with Kehl v Dunn, 102 Mich 581 (1894), where the Court,

although stating that exemption statutues are construed with "great liberality", held that a piano was not a household good or furniture. [1] Interestingly, Slumpff did not cite or distinguish Kehl, and both Courts cited a Vermont case, Dunlap v Edgerton, 30 Vt 224 (1858) in support of their decision. Trying to harmonize these two cases leads to the conclusion that one cannot shoehorn an item from one category into another (a piano, being a musical instrument, is not a household good or furniture), but if the item seems to fall within the category, the category can be construed broadly to encompass such (arguably, a rug is a household good; therefore it is). As the Vermont Court in Edgerton stated (at 288):

"[W]here the article comes within the class that is exempt, it is to be hold as a matter of law that it is ecempt, and it is not for the jury to say whether it is necessary in the partilar case or not."

See Parson v Kimmel, 206 Mich 676 (1919) (a 14-month bred heifer was a "cow" within the meaning of the exemption statute, implying that a younger calf might not have been).

The basic exemption statute in Michigan is MSA 27A.6023; MCLA 600. Paragraph 1(a) exempts

"All family pictures, all arms and accouterments required by law to be kept by any person, all wearing apparel of every person or family, and provisions and fuel for comfortable subsistence of each householder and his or her family for 6 months."

This is one of the few Michigan exemptions that does not contain a monetary limitation. Moreover, the case law in this area (as with other Michigan exemptions) is somewhat sparse. Hence, this can serve as a fertile ground for the attempted preservation of assets.

An initial question is who qualifies as a "householder"?

"The term 'householder' sometimes covers the case of a man without a family or wife or children who keeps up a house, but it also embraces usually the head of an actual family dependent on him, whether housekeeping or not"

Pettit v Muskegon Booming Co., 74 Mich 214 (1889). An updated term might be "head of household". Thus, an adult child who still lived with his or her parents would not be a householder. See Stilson v Gibbs, 53 Mich 280 (1884) (adult child living with debtor qualifies as part of Debtor's household). Traditionally, a householder was male, but there is some authority to suggest that the term extends to female heads of households as well. See Kruger v LeBlanc, 75 Mich 424 (1889). It is very likely that such would be the result today.

Paragraph 1(a) of the exemption statute provides four distinct categories of exempt assets. It is unclear what the first category (family pictures) consists of. Arguably, it could be limited to pictures of the family; i.e., pictures that

[1] Curiously, the Court in Kehl noted that the piano was used in the teaching of the debtor's four children, "all sons". It is interesting to speculate whether if the debtor had had daughters, the same result would have occurred.

would be of little value to anyone but the debtor. However, it could also be argued that the category is comprised of pictures owned by the family. If this is the case, then potentially valuable works of art might fall within its scope.[2] Moreover, these two options are not mutually exclusive -- a portrait of a family member by Mary Cassatt or Winslow Homer could fall within either of these categories. There are no cases that deal with this exemption, so it provides ample opportunity for being creative.

Similarly, there are no cases dealing with the category of arms and accouterments. However, because this category is limited, by its term, to items "required by law", the likelihood of its use will be limited to specific cases. Note, though, that because of the limiting language, a hunting rifle would not be exempt under this category.

The category of wearing apparel is one of the few areas where the Michigan exemption is more liberal than its federal counterparts, since under the latter, there is a monetary limitation that does not exist under the former. Thus, by the plain language of the statute, any wearing apparel -- mink coats, designer suits and gowns, Imelda Marcos' shoe collection -- is exempt. One realizes, of course, that the larger the value involved, the more likely it is that a Court will attempt to find some way to undo the effect of the exemption statute (fraudulent conveyances or denial of discharge, e.g.). Nonetheless, this category potentially has great scope.

There are no Michigan cases involving whether jewelry falls within the exemption for wearing apparel. Arguably, under the rationale of Kehl, jewelry, being a separate category of goods, should not be exempt as wearing apparel. This conclusion is bolstered by Weadock v Swart, 163 Mich 602 (1910). In this case, Mr. Weadock checked into a hotel owned by the Swarts and had his gold watch and chain stolen. Weadock, understandably upset, sued the Swarts, who defended on the grounds of a statute that provided immunity for innkeepers for their customers' loss of "money, bank-notes, jewelry, articles of gold and silver manufacture, precious stones, personal ornaments, railroad mileage books or tickets, negotiable or valuable papers and bullion" unless such were deposited in the hotel safe. In denying this defense, the Court quoted from a New York case that held that a watch was not jewelry, but an "article of ordinary wear by most travelers of every class, and of daily and hourly use by all."[3] Although not an exemption case, Weadock draws a distinction between jewelry and wearing apparel that would seem to be equally applicable to the

[2] This article is not designed to discuss all of the aspects of pre-bankruptcy planning and the impact of transferring non-exempt assets into exempt assets on the eve of bankruptcy. Such planning can run afoul of fraudulent conveyance laws, and may even result in a denial of discharge. These are issues that every practitioner must weigh prior to the filing of a bankruptcy, whether he or she recommends state of federal exemptions. "But if [a person] buys [property], and holds it, rather for sale or speculation than for the particular use which alone exempted it, and it is not, in fact, needed or kept for such use, it would not be exempt." O'Donnell v Segar, 25 Mich 367, 372 (1872).

[3] Weadock at 606, quoting Ramaley v Leland, 43 NY 539 (1871).

exemption statutes. Weadock also places a watch within the category of wearing apparel, but not jewelry.

The last category, provisions and fuel for comfortable subsistence for 6 months, also provides some room for the shielding of assets. From a farmer's standpoint, harvested crops can fall within this category, Stilson v Gibbs, 53 Mich 280 (1884), although it is unclear whether growing crops do. King v Moore, 10 Mich 538 (1862) (Court split on this issue; case decided on another ground); compare MSA 27A.6023(1)(d); MCLA 600.6023(1)(d) (specifically listing crops "growing or otherwise"). From a non-agrarian standpoint, the language seems to exempt stored foodstuffs, utility deposits, and perhaps even arranged deposits or pre-payments at a grocery store. The latter two items are unusual, to say the least, but such creative lawyering is invited by the statute. Two words of caution, however. First, the category involves "comfortable" subsistence. That probably excludes caviar and champagne. Second, it is the item itself, not the ability to purchase the item, that is exempt. See King v Moore, supra (exemption for animals limited to those animals on the debtor's farm at the time of the levy; if legislature had intended to exempt the ability to purchase all of the animals listed, it would have done so). Thus, money in a bank account is probably not exempt, even though it could be used to purchase the provisions or fuel.

Paragraph 1(b) of MSA 27A.6023; MCLA 600.6023 exempts:

"All household goods, furniture, utensils, books, and appliances, not exceeding in value $1,000.00."

Because of the dollar limitation, the issue of what falls within this section is rather diminished. The paucity of case law regarding this paragraph reflects such. As indicated previously, a piano does not fall within this section, Kehl, supra, while a rug does. Slumpff, supra. Moreover, the Vermont case cited favorably in both Kehl and Slumpff goes on to include chairs, tables, bedsteads, sofas, carpets and looking glasses as items within the exempt category. The only other Michigan case involving this exemption is Vanderhorst v Bacon, 38 Mich 669 (1878), where the Court held that the household goods of a man who ran a boardinghouse were exempt under this section, even though they might also be exempt as tools of the trade. This case is more important for this latter proposition -- that exemption categories are not mutually exclusive and the same type of item can be exempt under two or more categories -- than whether a specific item falls within this category. See Stilson v Gibbs, supra (a farmer's stored crop can be exempted under both "household provisions" and "tools of the trade" sections).

Of importance in today's world is whether a television, personal computer or other electronic equipment, qualify under this exemption. Unfortunately, there are no reported Michigan cases that deal with this subject. Kehl suggests that these items are not exempt as either household goods or furniture, although the omnipresence of a television set in modern American

households could serve to distinguish Kehl (at least for a television). Furtherance, the statute allows an exemption for "appliances", a category that probably includes these items. Because of the dollar limitation of the exemption, we are not likely to see any court decisions in Michigan resolving this issue soon. Compare, In re Griffiths, 86 BR 639 (Bankr. WD Wash, 1988) (telephone, telephone answering machine, color television, VCR and console stereo exempt under Washington statute exempting "household goods, appliances, furniture and home and yard equipment") with In re Stroman, 78 BR 785 (Bankr. DSC 1987) (2 VCRs not exempt under South Carolina statute exempting "household furnishings, household goods, wearing apparel, appliances, books, animals, crops or musical instruments that are held primarily for personal, family or household use. . . ").

MSA 27A.6023(1)(d); MCLA 600.6023(1)(d) is the second paragraph that provides for exemptions in an unlimited value. It derives from Michigan's agrarian past and exempts

"To each householder, 10 sheep, 2 cows, 5 swine, 100 hens, 5 roosters, and a sufficient quantity of hay and grain, growing or otherwise, for properly keeping such animals and poultry for 6 months."

This exemption is limited to provisions for animals actually owned by the debtor and does not allow him or her to exempt sufficient funds to purchase all of them if the farm is not adequately stocked at the time of levy. King v Moore, supra. However, the exemption is not limited to farmers, but to "householders". Thus, the statute does not prohibit a debtor from exempting these animals, even though he or she is not a farmer. Put in a different light, there is no prohibition in the statute for a debtor to purchase such items prior to bankruptcy and then exempt them under this section. Such pre-bankruptcy planning may result in other issues being raised (see note 2, supra), but if the alternative is to have assets that will not be exempt, the risk of litigation may be worth it.

Paragraph 1(e) is perhaps the most litigated category of exemptions under the statute. This section exempts

"The tools, implements, materials, stock, apparatus, team, vehicle, motor vehicle, horses, harness, or other things to enable a person to carry on the profession, trade, occupation, or business in which the person is principally engaged, not exceeding in value $1,000.00."

Almost all of the cases involve the issue of whether a specific item falls within the scope of the exemption, and almost all construe the language broadly to allow the exemption. There are three cases of interest: Youdan v Kelley, 267 Mich 616 (1934), where the Court states that an automobile falls within this section, without any discussion of whether the vehicle was used in the debtor's business; Hutchinson v Whitmore, 90 Mich 255 (1892), where a farmer was allowed to exempt hay, oats, corn, a yearling steer, a spring calves, and a quantity of clover seed and cornstalks under this section (the dollar went a lot further a hundred years ago); and Goozen v Phillips, 49 Mich 7 (1882),

where the Court held that a pool table was not exempt as applied to a saloon-keeper.[4] The latter case is one of the few where an item was not found to fall within the exemption; given the broad "other things" language in the statute, it is questionable whether Goozen should be followed if there is any way of distinguishing the facts of the case.

The remaining two "minor" exemption categories in the exemption statute are rather limited in scope. Section 1(f) exempts money or benefits "paid, provided, or allowed to be paid" by an insurance company due to death or disability. This section can overlap with worker's compensation payments, discussed below. Section 1(g) allows an exemption for a householder of shares of a state savings and loan association in the amount of $1,000.00. This exemption is specifically not allowed if the person has a homestead exemption; i.e., the statute allows either an actual homestead or the ability to obtain a homestead (through the savings and loan association). See Morley Brothers v National Loan & Investment Co., 120 Mich 17 (1899). This exemption is only rarely seen today, due to the paucity of state savings and loan associations.

There are two other Michigan exemptions which are not located in the general exemption statute and which may be of help in a given case. First, MSA 24.12207; MCLA 500.2207 provides that a husband or wife may insure his or her life for the benefit of his or her spouse, children or a trust in their benefit, and that the insurance policy is exempt from the claims of creditors. The statute also specifically indicates that the cash value of such a policy is exempt from the claims of creditors. The exemption in the cash surrender value is lost once it is cashed in. Isaac Van Dyke Co. v Moll, 241 Mich 155 (1928). Similarly, MSA 17.237(821); MCLA 418.821 provides that workers compensation payments are exempt from the claims of creditors. Items purchased with the proceeds of workers compensation payments lose their exempt status, Martin v Wayne Circuit Judge, 228 Mich 396 (1924), and one Bankruptcy Judge within this District has held that the payments lose their exempt status upon receipt by the debtor. In re Wickstrom, 113 BR 339 (Bankr. WD Mich. 1990); see In re Williams, 181 BR 298 (Bankr. WD Mich. 1995). There is some Michigan authority, however, to suggest a contrary result if the proceeds are segregated. See In re Vary Estate, 401 Mich 340 (1977) and the cases cited therein (dealing with Social Security payments); Cf Pease v North American Finance, 69 Mich App 165 (1970) (garnishment of AFDC payments).

Because of their antiquated language and low values, the personal property exemptions in Michigan are usually not given more than a cursory review by bankruptcy practitioners. This is unfortunate, because the statutes provide sufficient latitude to attempt to shield otherwise unprotected assets from the claims of creditors in many cases. While the "minor" Michigan exemptions will probably not drive the determination of whether a debtor should select federal or state

[4] "A saloon is supposed to be a place where customers are supplied with refreshment."

exemptions, they should not be overlooked in the analysis.

*Peter A. Teholiz is a shareholder with Hubbard, Fox, Thomas, White & Bengtson, P.C. and was a former editor of the Newsletter.

Hillman Advocacy Program
submitted by: Michael D. Wade

Applications are solicited for participation in the annual Hillman Advocacy Program sponsored by the Judges of the U.S. District Court, Western District. A learn-by-doing trial skills workshop, the 2 ½ day program features demonstrations, videotaping, and critiques by experienced faculty. The basic program is designed for attorneys having had fewer than 4 trials; an advanced section is available for more experienced litigators (4 years practice or more than 4 trials) intent on refining their trial skills. Space is limited! Register as early as possible as the program often fills by early December. Cost -- $200.00. Scholarships available. Program begins January 21, 1998 and concludes January 23, 1998. For information call Sarah Johnson at Smith, Haughey, Rice & Roegge, 200 Calder Plaza Building, Grand Rapids, Michigan 49503, 616-774-8000.

BANKRUPTCY COURT GIVES COLLATERAL ESTOPPEL EFFECT TO PRIOR DEFAULT JUDGMENT

Summary prepared by Eric S. Richards

In the bankruptcy court's most recent pronouncement on the doctrine of collateral estoppel, Judge Gregg issued an opinion granting creditors' motion for summary judgment in a nondischargeability action thereby giving preclusive effect to a prior state court default judgment against the debtor. See Robinson v Callender (In re Callender), _____ B.R. _____, 1997 WL 541304, Adv. No. 97-88158 (Bankr. W.D. Mich. 8/26/97).

Prior to the bankruptcy, the creditor/plaintiffs had filed a state court action alleging a variety of common law claims against the defendant including: Promissory Estoppel, Unjust Enrichment, Quantum Meruit, Fraud and Misrepresentation. The defendant actively defended the state court action until the eve of trial at which time he filed a petition under chapter 13 and the state court action was stayed. The defendant/debtor's chapter 13 case was subsequently dismissed for failure to make payments whereupon the plaintiff/creditors resumed the prosecution of their state court action. The defendant failed to appear for the rescheduled trial. Consequently, a default judgment was entered against him on all counts of the state court complaint. Shortly thereafter, the defendant filed a chapter 7 petition. The plaintiff/creditors filed an adversary proceeding in the bankruptcy court

seeking to except their state court judgment from discharge under bankruptcy court seeking to except their state court judgment from discharge under 11 U.S.C. Section 523 (a)(2)(A) because the debt was based on a claim of actual fraud. The plaintiff/creditors then moved for summary judgment arguing that the state court default judgment should be given collateral estoppel effect and that they were entitiled to judgment as a matter of law on their nondischargeability claim in bankruptcy court.

1. **No Federal Policy Exception to Full Faith and Credit.**

After describing the general principles of full, faith and credit, Judge Gregg noted the recent opinion from the United State Court of Appeals for the Sixth Circuit, in which the appellate court refused to recognize a federal policy exception to the application of the full faith and credit doctrine to a prior state court judgment, even if the underlying judgment was obtained by default. See Bay Area Factors v Calvert (In re Calvert), 105 F.3d 315, 322 (6th Cir. 1997). The Calvert decision partially overrules one of Judge Gregg's previous opinions in which he had recognized an exception to full faith and credit in cases where there had been a "true default," i.e., where the defendant had failed to file an answer in the state court action. See Vogel v Kalita (In re Kalita), 202 B.R. 889, 917 (Bankr. W.D. Mich. 1997).

2. **Default Judgment May Be Given Preclusive Effect If Not a "True Default".**

In Calvert, the Sixth Circuit instructed lower courts to look to the applicable state law to determine whether the prior state court judgment should be given preclusive effect in a subsequent nondischargeability action. See Calvert, 105 F.3d at 322. Under Michigan law, collateral estoppel precludes relitigation of issue in a subsequent case between the same parties where the issue was (1) "actually litigated" and (2) "necessarily determined" by a final judgment in the prior action. See People v Gates, 434 Mich. 146, 154, 452 N.W.2d 627 (1990).

The bankruptcy courts are split on whether a "true default" satisfies the actually litigated requirement for the application of collateral estoppel under Michigan law. Compare Vogel v Kalita (In re Kalita), 202 B.R. at 916 (true default is not entitled to collateral estoppel effect under Michigan law) with Cresap v Waldorf (In re Waldorf), 206 B.R. 858, 867 n.3 (Bankr. E.D. Mich. 1997)(disagreeing with Kalita and suggesting in *obiter dictum* that true defaults would be entitled to collateral estoppel effect under Michigan law). [5] After noting the split of authority, Judge Gregg concluded that the instant case was not a true default because the defendant had filed an answer to the underlying state court complaint and he had vigourously defended the action right up until the eve of trial. Accordingly, because the defendant has substantially participated in the state court action prior to entry of the default

[5] Those of you who attended this summer's FBA Bankruptcy Seminar at Boyne Highlands may recall a spirited exchange between Judge Gregg and Judge Rhodes regarding the preclusive effect of true default judgments in Michigan.

judgment, Judge Gregg held that the fraud issue was "actually litigated" for purposes of establishing collateral estoppel.

3. Elements of Section 523(a)(2)(A) are Identical to Common Law Fraud.

With respect to the second requirement for collateral estoppel, Judge Gregg concluded that the fraud issue was "necessarily determined" by the prior state court default judgment because the elements of fraud under Michigan common law are virtually identical to the elements of a nondischargeability action for actual fraud under Section 523(a)(2)(A). It should be noted that Judge Gregg has previously held that debts arising from securities fraud are not per se nondischargeable because a violation of federal or state securities laws does not necessarily encompass all of the same elements that required to prove common law fraud or actual fraud for purposes of Section 523(a)(2)(A). See Kinsler v Pauley (In re Pauley), 205 B.R. 501, 508 (Bankr. W.D. Mich. 1997) (Plaintiff/creditor alleging that securities fraud claim was nondischargeable must prove all of the elements required under the Section 523(a)(2)(A) fraud exception, including the element of justifiable reliance).

4. No Ambiguity in State Court Judgment.

In response to the plaintiff/creditors' motion for summary judgment, the defendant argued that the default judgment should not be give preclusive effect because the state court entered judgment on all four counts of the plaintiffs' complaint; and thus, the judgment was ambiguous as to the precise basis of liability. In rejecting this argument, the bankruptcy court held that, "when a state court unambiguously grants a judgment on all of the counts in a multi-count complaint, then each and every count is entitled to collateral estoppel effect, including a count for fraud and misrepresentation." Callender, ____ B.R. ___, slip op at 12.

The Callender decision further refines the bankruptcy court's views regarding the collateral estoppel effects of prior state court default judgments in subsequent nondischargeability litigation. In sum, it appears that default judgments will be given preclusive effect under Michigan law, where: (1) there was at least some participation by the defendant in the state court action prior to entry of the default; and (2) the state court judgment clearly indicated that the defendant was found liable for a claim that would give rise to a nondischargeable debt under Section 523(a).

* Mr. Richards has served as a judicial clerk for the Hon. James D. Gregg since 1995. Mr. Richards recently joined the firm of Mika, Meyers, Beckett & Jones, PLC where he will be practicing in the areas of bankruptcy and litigation.

LOCAL BANKRUPTCY STATISTICS

CHAPTER	SEPTEMBER 1997	YTD - 1997
Chapter 7	692	6,121
Chapter 11	2	55
Chapter 12	1	10
Chapter 13	284	2,272
TOTALS	979	8,458

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Bob Wright	616-454-8656

Western Michigan Chapter of the
Federal Bar Association
250 Monroe Avenue, Suite 800
Grand Rapids, MI 49503

TO: PETER A. TEHOLIZ
5801 W. MICHIGAN AVENUE
P.O. BOX 80857
LANSING, MI 48908