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The editorial staff of the *Michigan Business Law Journal* welcomes suggested topics of general interest to the Section members, which may be the subject of future articles. Proposed topics may be submitted through the Publications Director, Robert T. Wilson, The Michigan Business Law Journal, 150 W. Jefferson, Suite 900, Detroit, Michigan 48226-4430, (248) 258-1616, or through Daniel D. Kopka, Senior Publications Attorney, the Institute of Continuing Legal Education, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, (734) 936-3432.

**MISSION STATEMENT**

*The mission of the Business Law Section is to foster the highest quality of professionalism and practice in business law and enhance the legislative and regulatory environment for conducting business in Michigan.*

*To fulfill this mission, the Section (a) provides a forum to facilitate service and commitment and to promote ethical conduct and collegiality within the practice; (b) expands the resources of business lawyers by providing educational, networking, and mentoring opportunities; and (c) reviews and promotes improvements to business legislation and regulations.*
I am very proud to be able to write to you as our new Section Chair. By my count, I am the 34th Chair of this Section. This signifies a long tradition of business lawyers working together to better the business bar. The Business Law Section is one of the largest in the State Bar system, and also one of the most diverse. It may be difficult to be relevant to each of our members, but that is just what we intend to do.

Our mission statement summarizes our goals – to lead the business agenda in Michigan, and to foster the highest quality of professionalism in the practice. The Section has undertaken a number of programs to further those goals, such as the Business Law Institute, the Michigan Business Law Journal, Boot Camp with ICLE, recent or proposed amendments to all the basic business organization statutes in the state, and the Task Force on Attorney-Client Privilege Issues. We will continue to move forward on these projects, and I will try to push us to do more.

I am very excited about our new Forum on Small Business. This group is focusing on issues faced by lawyers dealing with smaller, closely held companies, especially start-ups and family-owned enterprises. Only six months old, it is already prompting the State’s small to medium-sized firms to participate in Section activities, some for the first time.

We are also taking our talents on the road. We have recently held functions in Kalamazoo and the Tri-Cities area, featuring some of our best speakers from past Business Law Institutes. These have allowed local members to conveniently access quality CLE, and to begin thinking of themselves as part of the Section. We intend to continue these offerings.

We are also reaching out to the law schools in the State, meeting with student business groups. When combined with the scholarship program, and followed up by Boot Camp and joint activities with the Young Lawyers Section, we hope to build a base from which the Section can grow for many years.

But we won’t stop there. I want to use the technology tools now available to us. How can we energize our Web site? Should we set up a blog that would allow a member in Marquette to share insights with one in Monroe? Can we do a podcast, and of what? If you are a tech-savvy member willing to help, please call me.

Our committees are where much of the Section’s work gets done. They foster statutory progress, advocate for change, share insights, and allow practitioners with similar interests to get to know each other. Committees also serve as a training ground for future Section leaders. I hope you will consider joining one.

This Section has a proud history of accomplishment, fostered by its people. We are now honoring our founding members with the Stephen H. Schulman Outstanding Business Lawyer Award. This is named after the late Professor from Wayne State Law School who was so instrumental in developing our business laws. Our first awards went to Hugh Makens, Cy Moscow, Mart Oetting, and Jim Bruno.

Currently, we have great people participating in Section activities. In addition to my fellow officers, Michael Khoury, Diane Akers, and Dee Dee Fuller, and our current council members, the committee chairs work hard to pursue their committees’ goals.

So, we are making great strides on many fronts, with contributions from many corners. Even more importantly, I can see a new generation ready to contribute their talents to our Section. I and my team will do what we can in the next year, but that is where the future of our great Section lies.

I look forward to working with each of you in the coming year. I invite your comments, questions, and suggestions. I ask for your support. When I hand over the reins to my successor, I will have done my best to make our Section even better than it is today.
Inaugural Schulman Award Bestowed Upon Four Outstanding Michigan Business Lawyers

by Erik I. Lark*

Four of the state’s most remarkable business lawyers were honored at this year’s Business Law Section Annual Meeting on September 26 in Novi. Section members took a moment to reflect upon the distinguished careers of Cyril Moscow, Martin Oetting, Hugh Makens, and James Bruno as each of the four received the Section’s Stephen H. Schulman Outstanding Business Lawyer Award.

The Award, created this year by the Section, was developed to annually commemorate the attorney who, over the course of his or her career, has consistently exemplified the characteristics the Section seeks to foster and facilitate, including the highest quality of practice, utmost professionalism, unwavering dedication to service and commitment, and the promotion of ethical conduct and collegiality within the practice of law. The award was named for Wayne State University Law Professor Schulman in recognition of his profound influence on thousands of law students and colleagues, his tireless work reforming Michigan’s Corporation Law and his years of dedicated service to the Business Law Section. Professor Schulman received many teaching awards, served as faculty adviser and regular contributor to *The Wayne Law Review* for several decades, and was co-reporter for the Business Law Section’s Subcommittee on the Revision of the Michigan Business Corporation Act.

This year’s honorees represent the very best in Michigan business lawyers. They have been actively involved in their firms, communities, and the Business Law Section and through their examples have demonstrated the collegiality and civility too often missing in the legal profession.

Cyril Moscow, a partner in the corporate and securities and insurance departments at Honigman Miller Schwartz & Cohn and an adjunct professor in Law at the University of Michigan for many years, is also a recognized lecturer, author, and editor. He is a former chair of the Business Law Section and is currently chair of the Michigan Business Corporation Act Revision Subcommittee.

Martin Oetting has been practicing law for more than 50 years and is now Of Counsel to Clark Hill in its corporate practice group. He participated in drafting the 1972 and 1989 Michigan Business Corporation Acts and he served as chairman of the Corporation, Finance and Business Law Section of the State Bar of Michigan. Mr. Oetting is currently a trustee of the Harold and Carolyn Robison Foundation, the Tuberculosis Foundation, and a director and secretary of the Detroit Executive Service Corps.

Hugh Makens, a partner at Warner Norcross & Judd, has been involved in the securities industry for over 35 years as an attorney, regulator, and advisor. He has been active in the Michigan, Federal, and American Bar Associations, holding various leadership and committee positions throughout his career, including serving as chair of the Business Law Section of the State Bar of Michigan. Mr. Makens is also an adjunct professor at Michigan State University College of Law.

James Bruno is a business attorney, shareholder, and member of the Board of Directors at Butzel Long. He has served as chair of the Business Law Section of the State Bar of Michigan and has held various leadership and committee positions within the Section. He has been editor of the “Business Problems and Planning” column of *The Michigan Bar Journal* for many years, and his articles are commonly cited in legal briefs and court decisions.

The nearly 4,000 members of the Business Law Section are encouraged to look to these four influential attorneys as a benchmark for their own careers as business lawyers in the State of Michigan.

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*Eric I. Lark, of Kerr Russell and Weber PLC, Detroit, is the immediate-past chairperson of the Business Law Section.*
The State Bar of Michigan Business Law Section

CONGRATULATES
Cyril Moscow, Martin Oetting,
James Bruno and Hugh Makens

On Being Honored With the Inaugural

Stephen H. Schulman
Outstanding Business Lawyer Award

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- The highest quality of practice
- The utmost in professionalism
- Dedication to service and commitment
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Corporate Officers Are Now Subject to Liability in Tort and Under the Michigan Consumer Protection Act

Introduction

On May 26, 2005, the Michigan Court of Appeals in Hartman & Eichhorn Bldg Co v Dailey,1 held that a corporate officer can be held personally liable for the tortious actions of the corporation and for violations alleged under the Michigan Consumer Protection Act (MCPA).2 The court reversed and remanded the lower court’s grant of summary disposition in the corporate officer’s favor on the issue of personal liability in tort and for violations alleged under the MCPA.3 Since this decision, a number of unpublished Michigan cases have relied on the Court of Appeals opinion to hold corporate officers personally accountable for torts the officer commits, and the Michigan Supreme Court has declined to revisit the personal liability issue, except with respect to liability under the MCPA against residential builder corporate officers.4

In Dailey, the homeowners and the builder corporation entered into a construction contract on July 19, 2000, to complete a second level addition and to install a garage on the homeowner’s property for $166,041. The corporate officer negotiated the contract. After problems arose during the construction process, the homeowners stopped making payments after paying the builder $105,347. The builder eventually stopped work on the project and sued the homeowners for the remainder of the contract price in Oakland County Circuit Court.5

On December 11, 2002, Oakland County Circuit Court Judge Colleen A. O’Brien dismissed the homeowners’ counterclaims of fraudulent misrepresentation, violation of the MCPA, and violation of the Building Contract Fund Act against the corporation’s officer individually. Although the court upheld some of the counterclaims against the builder, the corporation filed for Chapter 7 bankruptcy on August 25, 2003. The bankruptcy petition automatically stayed the civil court proceeding against the corporation. The court of appeals accepted the homeowners’ delayed application for leave to appeal and heard oral arguments on the issue of the corporate officer’s personal liability in January 2005.

Corporate Officer’s Personal Liability for Torts

A corporate officer can be personally liable for torts the officer personally commits, even though the corporation is also found liable for the tort. The Dailey court, citing Warren Tool Co v Stephenson,6 reasoned: “It is a familiar principle that the agents and officers of a corporation are liable for torts which they personally commit, even though in doing so they act for the corporation, and even though the corporation is also liable for the tort.”7 This is similar to the concept of a corporate alter ego amid evidence that a corporate officer committed fraud or illegal activity.8 Because the lower court’s grant of summary disposition in the corporate officer’s favor did not appear to be based on a determination that there was not enough factual support for the homeowner’s fraud claim against him individually, the court of appeals reversed the circuit court’s ruling and remanded the fraud claim. Since the court’s ruling in Dailey, supra, the court of appeals and Michigan federal district courts have repeatedly cited the Dailey opinion in support of the proposition that corporate officers can be held personally liable for torts they commit.9

Corporate Officer’s Personal Liability under the MCPA

A corporate officer may be held personally liable for violations of the MCPA, because the legislature intended to hold individuals accountable on the basis of their actions rather than their affiliations with any business entity. The imposition of personal liability under the MCPA was considered an issue of first impression in Dailey.

The Dailey court stated: “We agree with the [homeowners] that the Legislature intended to hold individuals, and not just their businesses, liable for conduct that violates the MCPA.”10 The Court further reasoned that the MCPA “does not expressly limit a victim’s choice of violating defendants to a certain class or type.”11 The Court went on to note that nothing in the MCPA states either way whether a corporate officer can be held personally liable in a civil suit.12 Torts generally apply to the actual “tortfeasor” and then to his or her employer via vicarious liability.13 To hold a company liable before determining the individual liability of employees of the corporation is backwards when considering tort liability.14

The MCPA regulates “[u]nfair, unconscionable, or deceptive methods, acts, or practices in the conduct of trade or commerce . . . .”15 The Court reasoned that the MCPA prohibits individual bad conduct, rather than, for example, a corporate board of director’s resolution, that can be separated from the actions of an individual. The Court further stated that, because the Michigan Legislature constructed the MCPA so that actions rather than affiliations yield liability, individuals are necessarily the act’s primary violators. It stands to reason that, absent express language to the contrary, the Legislature intended that those who actually violate the act would be the ones from whom victims could recover damages, regardless of the violators’ affiliation with any business entity.16
Thus, the Court reversed the lower court’s dismissal of the MCPA violations against the corporate officer as an individual.

Therefore, despite a corporate bankruptcy discharge or corporate dissolution, individual members and corporate officers of corporations may be personally liable on the basis of tort and/or a violation of the MCPA, which also allows for the recovery of attorney fees. The Michigan Supreme Court has yet to decide whether the MCPA applies to residential builders generally. However, given the Court’s decision not to revisit the individual corporate officer liability issue set forth by Dailey, it could be a significant victory for Michigan consumers as well as a cautionary tale for corporate officers.

**NOTES**


2. In this case, the individual officer was not only an owner/member but also the “qualifying officer” of the corporation. Section 2405 of the Michigan Occupational Code specifies that: “The qualifying officer shall be responsible for exercising the supervision or control of the building or construction operations necessary to secure full compliance with [article 24 of the Occupational Code] and the rules promulgated under this article.” See MCL 339.2405.


4. See id.


7. Dailey, supra at 549.


9. See Kent Tillman, LLC v Tillman Construction Co, et al, No 263232, 2006 Mich App LEXIS 154 (Jan 19, 2006) finding a legal basis for concluding that Tillman Construction Co.’s president was liable in his individual capacity for the tort of conversion based on accusations that he withdrew funds from the company's bank account without management approval. See also Alliance Associates, LC v Alliance Shippers, Inc., No 265101, 2006 Mich App LEXIS 1778 (June 1, 2006) (lower court dismissals of fraud and silent fraud claims against corporate owners alleged by shareholders concerning a profit sharing agreement were upheld on procedural grounds); MG Perry Construction Co v Oliver, No 265791, 2006 Mich App LEXIS 1733 (May 23, 2006); Best Investment Services, Inc. v Geell et al, No 263976, 2006 Mich App LEXIS 206 (Jan 24, 2006), a minority shareholder in a corporation who received a loan from Best Investment remains personally liable for any proven misrepresentations he made about the value of the security for the loan; PHD Michigan, LLC v Outfitters Assoc of America, No 04-73964, 2006 Mich LEXIS 49528 (July 20, 2006); Ammend v Biport, Inc., No 5:03-CV-31, 2006 Mich LEXIS 21023 (April 19, 2006).


11. Id. See also MCL 445.911(2).

12. Id.

13. Id.

14. Id.

15. MCL 445.903.

16. Dailey, supra at 551. See also MCL 445.911(7) that provides that, “when a person commences an action against another person, the defendant may assert . . . any claim under this act . . . [emphasis added].”

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Why Does the IRS Have That “Interesting” Letter I Wrote My Client?

Practitioners routinely tell clients that our communications with them are subject to the attorney-client privilege. However, there are some very common exceptions to the privilege as well as circumstances where waivers may occur, usually unknown and inadvertent.

There is a very significant exception to the privilege that engulfs many tax planning-related issues, and it routinely surprises many practitioners. There is typically no attorney-client privilege for “return preparation” or for advice regarding a return position. This is illustrated by two simple examples. First, let us assume a client with a delicate situation asks an attorney to prepare the returns. In the course of providing information to the lawyer, the taxpayer discloses information that is quite sensitive and not even deemed to be the practice of law, but rather, marketing assistance to the lawyer, the taxpayer discloses the information that is quite sensitive and never intended to be seen by the Internal Revenue Service (IRS). What is the result of having an attorney prepare the return or a sensitive schedule or portion of a return? There is a long-held return preparation exception to attorney-client privilege.1 This exception applies even though a licensed attorney does the work and he or she is working in a law firm as opposed to an accounting firm.2

A second example is the scenario in which the attorney does not prepare the return, but rather, he or she opines on a position to be claimed on the return. Are related communications privileged? No. Some of the best examples of this were opinion letters and extremely sensitive written communications by prominent national law firms that unfortunately became ensnared with some tax shelter promoters. In a scathing opinion by the Chief Judge of the District Court in the District of Columbia, such work was not even deemed to be the practice of law, but rather, marketing assistance in a shelter-peddling scheme.3

The attorney-client privilege has been under assault in the last several years in considerable litigation growing out of government tax shelter investigations. Suffice it to say that there has been some abhorrent professional conduct by various professionals. The corollary to this is that the IRS Restructuring and Reform Act of 19984 that gave return preparers (i.e., accountants) a limited version of the attorney-client privilege in civil settings with the IRS5 has been in large part obliterated by subsequent case law.6

The mere fact that a communication, such as a letter, memo, or email, is sent by or to an attorney does not mean it is privileged. If there is disclosure to a non-attorney, there is a waiver. The most common culprit is the carbon copy. For example, if the lawyer sends a letter, memorandum, or an e-mail to a client regarding a business transaction and also copies the accountant and the investment banker, there is a waiver. What if the lawyer sends a letter to an investment banker or an accountant, but that individual recipient is also an attorney? The analysis in the case law is that the recipient is “dualie” i.e., functioning in more than one capacity.7 If, as is usually the case, the recipient is found to be functioning as an investment banker or as an accountant, as the case may be, then the privilege is waived.

Why does all of this matter? With boosts in both funding and confidence from its highly successful tax shelter investigations, the IRS is very aggressively pursuing discovery in administrative proceedings of documentation behind common, non-abusive, commercial transactions. This author, like tax practitioners across the country, has had numerous discussions where an indignant business lawyer says, “of course this is privileged?” Unfortunately, that is usually the incorrect answer.

The purpose of this article is to put you on notice to be careful of what you put in written communications to clients and whom you copy. The IRS and parties to litigation may read your communication. One should strive, if at all possible, to preserve the attorney-client privilege in order to be able to give candid and objective advice not only to avoid bad client decisions, but also, to help clients properly achieve their desired goals. Forewarned is forearmed.

NOTES

2. Frederick.
5. IRC 7525.
7. Frederick.

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The Revised Bankruptcy Code: New Chapter 15 and Cross-Border Insolvencies

By José Bartolomei

Introduction

Michigan is home to many multinational companies that produce goods sold on the international market. As such, Michigan could be a prime jurisdiction for the origination and development of case law related to the new Chapter 15 of the United States Bankruptcy Code. Enacted as one of the many reforms found in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),1 Chapter 15 represents the most recent statutory developments in the internationalization of American bankruptcy jurisdiction. It also reflects an American recognition of the need for standard and streamlined laws among nations to deal with the ever-growing problem of multinational companies that go out of business. Chapter 15 augments, clarifies, and departs from the developed body of law centered on former section 304 of the Bankruptcy Code, the thin statutory basis for much of the American case law regarding international bankruptcy.2 This article outlines the basic provisions of Chapter 15 and highlights some of the emerging practices stemming from the new law.

Scope of Chapter 15

Congressional Intent

Before looking at the mechanics of Chapter 15, it is important to acknowledge both its Congressional and international origins. The chapter grew from years of work by the United Nations Commission on International Trade Law (UNCITRAL),3 which labored to create a model international commercial insolvency law that would allow for the recognition of, and multi-jurisdictional cooperation with, foreign bankruptcy proceedings. UNCITRAL considered the increasing sophistication of insolvency regimes throughout the world, as well as the international economic crisis that had originated in Latin America, Asia, and Eastern Europe that was affecting both the developed and developing worlds.4 The result was UNCITRAL’s Model Law on Cross-Border Insolvency (Model Law), whose objectives are repeated in new section 1501 of the U.S. Bankruptcy Code:

(a) The purpose of this chapter is to incorporate the Model Law on Cross-Border Insolvency so as to provide effective mechanisms for dealing with cases of cross-border insolvency with the objectives of—

(1) cooperation between—

(A) courts of the United States, United States trustees, trustees, examiners, debtors, and debtors in possession; and

(B) the courts and other competent authorities of foreign countries involved in cross-border insolvency cases;

(2) greater legal certainty for trade and investment;

(3) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors, and other interested entities, including the debtor;

(4) protection and maximization of the value of the debtor’s assets; and

(5) facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

Further, Congress instructs that “[i]n interpreting [Chapter 15], the court shall consider its international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions.”5 As other commentators have noted, this Congressional mandate adds a level of internationalism to American bankruptcy law that is unprecedented.6 Furthermore, Congress does not limit this mandate to apply Chapter 15 in a uniform manner consistent with other jurisdictions that have also adopted the UNCITRAL Model Law; the law only speaks of an application of Chapter 15 that is con-
sistent with the application of similar statutes adopted by foreign jurisdictions. This mandate does not limit the notion of comity embedded in Chapter 15 to those jurisdictions that have reciprocally implemented the UNCITRAL model. As such, a court interpreting Chapter 15 can look beyond the host of nations that have implemented the Model Law for applicable precedent.

While the new Chapter 15 is similar to former section 304 of the Bankruptcy Code, the new chapter has a greater scope than both that statute and its case law precedents. Former section 304 only addressed the filing of an ancillary case in the United States by a foreign representative seeking relief to protect or administer property of the estate. Chapter 15, however, not only applies in the same instance as former section 304, but also applies when

- Assistance is sought in the U.S. by a foreign court or foreign representative in connection with a foreign proceeding;
- Assistance is sought in a foreign country in connection with a case brought under the Bankruptcy Code;
- A foreign proceeding and a case under this title with respect to the same debtor are pending concurrently; or
- Creditors or other interested persons in a foreign country have an interest in requesting the commencement of, or participating in, a case or proceeding under the Bankruptcy Code.

The Foreign Representative and the Foreign Proceeding

The changes to the United States Bankruptcy Code enacted by the BAPCPA also redefine two terms that specify the parameters of Chapter 15: “foreign representative” and “foreign proceeding.” The term foreign representative was formerly limited to either a “trustee, administrator, or other representative of an estate in a foreign proceeding.” It now includes a “a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor’s assets or affairs or to act as a representative of such foreign proceeding.” The expansion of the definition to include an appointed body of persons makes it clear that a debtor-in-possession can qualify as a foreign representative for purposes of Chapter 15’s provisions. Likewise, the inclusion of a person or body appointed on an interim basis allows a U.S. court to recognize a representative that is appointed on an emergency or interim basis, as is done in many jurisdictions, including the United States.

The definition of “foreign proceeding” also has been updated. Previously, the definition limited such a proceeding to one based on the place of the debtor’s domicile, residence, principal place of business, or location of the debtor’s principal assets. The new definition removes this limitation entirely, defining a foreign proceeding as one in which “under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation.”

The expansion of the definition means that a foreign proceeding can be recognized even if it is based in a jurisdiction other than the home country of the debtor. This distinction is important, as it allows for the treatment of both main and non-main foreign proceedings under the auspices of Chapter 15. While one might presume that a foreign proceeding is limited to a proceeding under judicial supervision, the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency (UNCITRAL Guide) states that a foreign proceeding will qualify “irrespective of whether it has been commenced and supervised by a judicial body or an administrative body,” and that the term “foreign court” is intended to include non-judicial bodies.

Recognition of the Foreign Proceeding Under Chapter 15 as a Main or Non-main Proceeding and the Effect of Such Recognition

The recognition of a foreign proceeding is the basis for most of Chapter 15’s operations, protections, and allowances. A foreign representative applies for recognition of the foreign proceeding in which the foreign representative has been appointed by filing a petition for recognition by the bankruptcy court pursuant to section 1515. A petition needs to be accompanied by the following items:

- A certified copy of the decision commencing such foreign proceeding and appointing the foreign representative;
- A certificate from the foreign court affirming the existence of such foreign proceeding and of the appointment of the foreign representative; or
• In the absence of evidence referred to in paragraphs (1) and (2), any other evidence acceptable to the court of the existence of such foreign proceeding and of the appointment of the foreign representative.15

The petition also must be accompanied by a statement identifying all foreign proceedings, if any, regarding the debtor that are known to the foreign representative.16 English translations of the documents detailed above are required at the time of filing. (The court may require any additional documents to also be translated into English.)17

Once the bankruptcy court receives the petition and the documents to be concurrently filed, section 1516 allows the court to presume that, if the documentation shows that the foreign proceeding is indeed a foreign proceeding and that the person or body making the petition is a foreign representative, both facts are true.18 The court can also presume that the documents submitted in support of the petition for recognition are authentic, whether or not they have been legalized.19 Both of these presumptions allow the court to quickly act on a petition for recognition, an efficiency that grants the petitioning foreign representative quick access to Chapter 15’s relief provisions without having to meet burdensome evidentiary standards.

After notice and a hearing, section 1517 states that a court shall enter an order recognizing a foreign proceeding if:

• such foreign proceeding for which recognition is sought is a foreign main proceeding or foreign non-main proceeding within the meaning of section 1502;
• the foreign representative applying for recognition is a person or body; and
• the petition meets the requirements of section 1515 [discussed above].20

The court can then make a designation that the foreign proceeding being recognized shall be recognized either

• as a foreign main proceeding if it is pending in the country where the debtor has the center of its main interests; or
• as a foreign non-main proceeding if the debtor has an establishment within the meaning of section 1502 in the foreign country where the proceeding is pending.21

As discussed in more detail below, the distinction between a foreign main proceeding and a foreign non-main proceeding is important for purposes of determining what relief the court will apply.

Finally, it is interesting to note that section 1517(c) dictates that a petition for recognition of a foreign proceeding shall be decided upon at “the earliest possible time.” This reflects the speed at which Chapter 15 is meant to operate in providing relief to duly qualified foreign representatives.

Recognition under section 1517 is expressly subject to section 1506, which provides a U.S. court with the ability to deny recognition of a foreign proceeding where such recognition would be “manifestly contrary to the public policy of the United States.”22 By using the term “manifestly contrary,” Congress makes it clear that the public policy exception is limited to concerns that would violate the most fundamental policies of the United States.23 Caselaw examples of what issues might trigger section 1506 scrutiny would include foreign proceedings that would violate due process rights24 or those that would impair property interests.25

Relief Available Under Chapter 15

Relief Upon Filing (“Gap-Period” Relief)
The practitioner needs to note one crucial notion when dealing with a Chapter 15 matter: The filing of a petition for recognition under Chapter 15 does not operate as an order for relief. This is different from the filing of a petition under Chapters 7 or 11 of the Bankruptcy Code, which does trigger the issuance of an order for relief that provides an array of immediate help for the petitioning debtor. Under Chapter 15, the petitioning foreign representative has the right to ask for certain relief upon the filing of a petition for recognition, and any petition for recognition should be coupled with such a request. This relief is to be provided by the court during the “gap” period between the filing of the petition for recognition and the ruling on that petition. Such “gap” period relief includes

• The staying of any action to execute against the debtor’s assets (note that this stay is limited to an action related to execution; it would not stop litigation to liquidate a claim);
• Entrusting the administration of all or part of the debtor’s assets located in the United States to the foreign representative (or another person authorized by the court);
• Suspending the right to transfer, encumber, or otherwise dispose of any assets of the debtor;
• Allowing for the taking of discovery and examination of witnesses for gathering any information related to the debtor’s assets, affairs, rights, obligations, or liabilities; and
• Granting any additional relief that may be available to a trustee or debtor-in-possession (other than the power to exempt property, avoid liens imposed for nonpecuniary claims, and avoid and recover transfers).26

The legal standard that a bankruptcy court will use in determining whether to grant gap-period relief to the petitioning foreign representative is the same as the standard used by a federal court for evaluating a request for injunctive relief (many of the former section 304 cases can serve as precedent, since section 304 also promulgated an injunctive relief standard).27 This standard forces the foreign representative to establish that (1) the debtor’s interests will be irreparably harmed if the injunction is not issued, and (2) either the foreign representative is likely to succeed on the merits of the litigation or sufficiently serious questions related to the merits of the case make them fair grounds for litigation, and the petitioner faces the most hardship.28 Irreparable harm may be demonstrated by litigation in the U.S. against the debtor that would cause the debtor’s estate to suffer unrecoverable costs. It may also be demonstrated by establishing that the debtor may be subject to conflicting judgments in different jurisdictions.29

Relief Upon Recognition
A foreign representative may seek and obtain a wide range of relief upon recognition of the foreign proceeding by the bankruptcy court. The type of relief afforded to the foreign representative depends on whether the foreign proceeding is recognized by the bankruptcy court as a “main” or a “non-main” proceeding. The distinction is an important one, as it determines the range of possibilities available to the foreign representative to manage and control the U.S. assets of the foreign debtor (and the evidentiary threshold that the court needs to find to take jurisdiction over such assets). Section 1502 provides the appropriate definitions for each:

(1) “foreign main proceeding” means a foreign proceeding pending in the country where the debtor has the center of its main interests.30

(2) “foreign nonmain proceeding” means a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment.31

The bankruptcy court can presume, in the absence of evidence to the contrary, that the debtor’s registered office serves as the “center of the debtor’s main interests.”32 However, for a multinational debtor that has manufacturing activities in one country, sales staff in another, and its headquarters in a third, the “center” of the “main interest” may be difficult to locate. In this case, bankruptcy courts may look to the directive provided by Congress in section 1508 to apply Chapter 15 in a manner consistent with the application of “similar statutes adopted by foreign jurisdictions.” This presumably allows the bankruptcy court to look to foreign court decisions that have already interpreted the determination of what constitutes a debtor’s main or non-main proceeding.33

For purposes of evaluating the statutory definition of a foreign non-main proceeding, the term “establishment” is defined as “any place of operations where the debtor carries out a nontransitory economic activity.”34 While Chapter 15 does not provide any further detail on what “nontransitory economic activity” might mean, the UNCITRAL Guide states that the term “has been inspired by … the European Union Convention on Insolvency Proceedings.”35 Any economic activity that is not transitory (e.g., cargo transport through a jurisdiction) should suffice for this standard.

If the foreign proceeding is viewed by the bankruptcy court as being a foreign main proceeding, Chapter 15 affords the petitioner a wide array of relief, listed in section 1520, upon recognition. Recognition triggers the automatic stay that is normally issued in a plenary case, but only with respect to the debtor and property of the debtor that is located in the territorial jurisdiction of the United States.36 Recognition also makes certain provisions (in sections 363, 549, and 552) relating to post-petition transactions; operations (including the use, sale, or lease of property of the debtor); and the post-petition effect of a security interest applicable to the debtor and its property located in the United States. Application of sections 363 and 552 adds to the powers of a foreign representative an automatic right to operate the

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debtor’s business and exercise the power of a trustee under sections 363 and 542. However, section 363(b)(1) limits the foreign representative from taking any action outside of the ordinary course of business without court approval.

**Elective Relief**

In addition to the relief automatically available to the foreign representative once the bankruptcy court recognizes the foreign proceeding (whether as a “main” or “non-main” proceeding), the foreign representative can also request further relief, including the relief listed in section 1521. Like the gap-period relief stated in section 1519, these elective remedies need to be predicated on a finding that the interest of creditors and other interested entities, including the debtor, are sufficiently protected. They include the following:

- Staying the commencement or continuation of actions concerning the debtor’s assets, obligations, or liabilities to the extent not stayed under section 1520(a)
- Staying any execution against the debtor’s assets to the extent it has not already been stayed under section 1520(a)
- Suspending the right to transfer, encumber, or otherwise dispose of any assets of the debtor to the extent not already suspended under section 1520(a)
- Providing for the examination of witnesses or the taking of discovery related to the debtor’s assets, affairs, rights, obligations, or liabilities
- Extending the gap-period relief provided by section 1519(a)
- Granting any additional relief that may be available to a trustee in a bankruptcy case (outside of certain avoidance actions that are only allowed pursuant to section 1523 and only with regard to a bankruptcy case filed under another chapter of the Bankruptcy Code)

If the foreign proceeding at issue before the bankruptcy court is a foreign non-main proceeding, the court needs to make a finding, before affording the foreign representative any of the elective relief stated under section 1521, that such relief relates to assets that under U.S. law should be administered in the foreign non-main proceeding or that the relief concerns information required in that proceeding. Applying this standard calls for the bankruptcy court to make an educated guess about the extraterritorial application of U.S. law on the disposition of assets in a foreign jurisdiction—an exercise fraught with peril. However, the House report on the BAPCPA makes it clear that this additional hurdle is designed to limit relief to assets having some direct connection with a non-main proceeding.

As with the gap-period relief afforded under section 1519, the standards, procedures, and limitations applicable to an injunction shall apply to the elective relief provided in section 1521.

**As with the gap-period relief afforded under section 1519, the standards, procedures, and limitations applicable to an injunction shall apply to the elective relief provided in section 1521.**
ference between the new and old language is the elevation of comity as not just one of the concepts to be considered by the court but as the primal notion for the court to consider in deciding whether to grant additional relief beyond that afforded under sections 1519–21.

Cooperation with Foreign Courts and Foreign Representatives, and Coordination of Multiple Proceedings

The latter provisions of Chapter 15 concern themselves with cooperation and coordination between the American judicial system and foreign jurisdictions. Sections 1525 and 1526 mandate that a court or any trustee or examiner appointed by a court shall cooperate to the maximum extent possible with a foreign court or foreign representative. Each section also empowers a court or trustee/examiner to communicate directly with a foreign court or foreign representative (subject, in the case of a court, to the rights of a party in interest to notice and participation, and, in the case of a trustee/examiner, to the supervision of a court). American courts already engage in such cooperation and communication.

Section 1527 continues this mandate with a non-exclusive list of examples of cooperation for purposes of sections 1525 and 1526:

- appointment of a person or body, including an examiner, to act at the direction of the court;
- communication of information by any means considered appropriate by the court;
- coordination of the administration and supervision of the debtor’s assets and affairs;
- approval or implementation of agreements concerning the coordination of proceedings; and
- coordination of concurrent proceedings regarding the same debtor

The coordination of multiple bankruptcy cases, whether filed under Chapter 15 or another chapter of the Bankruptcy Code, is addressed in sections 1528 and 1529. A practitioner seeking to coordinate a client’s multiple, reorganizational goals will need to pay careful attention to the limitation placed on filing a plenary bankruptcy case (i.e., a case filed outside of Chapter 15, such as a liquidation case filed under Chapter 7 or a reorganization case filed under Chapter 11). Section 1528 limits the filing of a plenary case after recognition of the foreign main proceeding to instances where the debtor actually has assets in the United States. The breadth and reach of a subsequent plenary case would only be limited to assets of the debtor that are within the territorial jurisdiction of the U.S. (and, to the extent necessary to implement coordination and cooperation with foreign courts of representatives, to other assets of the debtor that are within the jurisdiction of the court pursuant to 11 USC 541(a) or 28 USC 1334(e), to the extent that such other assets are not already subject to the jurisdiction and control of a foreign proceeding recognized by the American courts under Chapter 15).

The drafters of Chapter 15 were obviously concerned about conflicts between two courts supervising the assets of one multinational debtor. Still, for the client that needs to use certain avoidance and recovery mechanisms present in a full plenary case, seeking recognition of a foreign proceeding either before or concurrently with the filing of a plenary case could impose certain limitations on the right to use avoidance powers.

Chapter 15 also provides for certain consistencies within the Bankruptcy Code, depending on the timing of the filing of the petition for recognition of the foreign proceeding and the filing of a plenary case involving the same debtor. If a plenary bankruptcy case is already active when the petition for recognition is filed, any gap-period relief granted under section 1519 or any elective relief granted under section 1521 must be made consistent by the court with the relief granted in the active plenary case. Then, the automatic relief imposed by section 1520 upon recognition will not be automatically triggered. If the plenary case is filed after the recognition of the foreign proceeding, any relief under section 1519 or 1521 must be retroactively modified or terminated by the court to the extent that it is inconsistent with the bankruptcy case; if the foreign proceeding is a foreign main proceeding, the automatic stay imposed by section 1520(a) upon recognition shall be modified or terminated to the extent that it is inconsistent with any relief granted under the plenary case. These timing and conflict rules, while necessary to eliminate any inconsistencies between different chapters of the Bankruptcy Code, require the practitioner to carefully balance

Sections 1525 and 1526 mandate that a court or any trustee or examiner appointed by a court shall cooperate to the maximum extent possible with a foreign court or foreign representative.
the client’s goals with the danger of filing the wrong petition or case at the wrong time.

**Conclusion**

Through the careful statutory framework that UNCITRAL and Congress implemented in drafting and enacting Chapter 15, the Bankruptcy Code’s new international section provides a tremendous avenue for multinational companies seeking a streamlined bankruptcy. However, the new law calls for precision. The practitioner will need to carefully synchronize the client’s goals and concerns with the various delineations provided by Chapter 15, both in terms of the definitional requirements to qualify for Chapter 15 recognition and in terms of timing and coordination. The simple assumption that filing a Chapter 15 petition for recognition will provide a foreign debtor with the same exact protections and provisions as those found under Chapters 7 and 11 will prove disastrous. While Chapter 15 offers bankruptcy lawyers and their clients a wonderful new tool, it is one that requires careful usage.

**NOTES**

2. Former section 304 provided the only bankruptcy statutory basis for the treatment of foreign bankruptcy proceedings in the U.S. Court. It read as follows: § 304. Cases ancillary to foreign proceedings
   (a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.
   (b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may—
      (1) enjoin the commencement or continuation of—
         (A) any action against—
            (i) a debtor with respect to property involved in such foreign proceeding; or
            (ii) such property; or
         (B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
      (2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
      (3) order other appropriate relief.
   (c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—
      (1) just treatment of all holders of claims against or interests in such estate;
      (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
      (3) prevention of preferential or fraudulent dispositions of property of such estate;
      (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
      (5) comity; and
      (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.


3. For more information about UNCITRAL and for downloads of any of the UNCITRAL texts used or cited in this article (including the Model Law and the UNCITRAL Guide), see http://www.uncitral.org/uncitr al/en/index.html.

4. For example, see the recently enacted Ley de Concursos Mercantiles, Mexico’s updated national bankruptcy law.

5. 11 USC 1508.
7. See note 2, supra.
8. 11 USC 1501(b)
11. See 11 USC 303.
15. 11 USC 1515(b)(1)–(3).
16. 11 USC 1515(c).
17. 11 USC 1515(d).
18. 11 USC 1516(a).
19. 11 USC 1516(c).
20. 11 USC 1517(a)(1)–(3).
21. 11 USC 1517(b)(1)–(2).
22. 11 USC 1506.
24. See, e.g., Vistorix SS Co, SA v Salen Dry Cargo, AB, 825 F2d 709, 714 (2d Cir 1987) (“Under general principles of comity as well as the specific provisions of section 304, federal courts will recognize foreign bankruptcy proceedings provided that foreign laws comport with due process and fairly treat claims of local creditors.”).
25. See, e.g., Bank of New York v Treco (In re Treco), 240 F3d 148, 158–60 (2d Cir 2001) (denying recognition to Bahamian proceeding that subordinated secured claims to administrative claims where “security interests have been recognized as property rights protected by our Constitution’s prohibition against takings without just compensation”).
26. 11 USC 1519(a)(1)–(3).
27. 11 USC 1519(e).
29. Id., citing In re MMG LLC, 256 BR 544 (Bankr SDNY 2000) (expenses litigation that can drain the assets of the sale proof of irreparable harm), and In re Gruppo Covarra, SA de CV, Case No 05-13925 (docket no 9) (Bankr SDNY June 1, 2005) (conflicting judgment enough proof of harm to issue injunction).
30. 11 USC 1502(4).
31. 11 USC 1502(5).
32. 11 USC 1516(c).
34. 11 USC 1502(2).
35. UNCITRAL Guide ¶ 75. See also Keenan, supra N.6, at 205–206.
36. 11 USC 1520(a)(1).
38. 11 USC 1522(a).
39. 11 USC 1521(a)(1)–(7).
40. 11 USC 1521(c).
42. 11 USC 1521(e).
43. HR Rep No 31, 109th Cong, 1st Sess, Pt I § 1521 (2005) (“This section does not expand or reduce the scope of relief currently available in ancillary cases under sections 105 and 304 nor does it modify the sweep of sections 555 through 560.”).
44. 11 USC 1522(c).
45. 11 USC 1522(b).
46. 11 USC 1507(a).
47. 11 USC 1507(b)(1)–(5).
48. See note 2, supra.
49. 11 USC 1525–1526.
50. Id.
51. See Gropper, supra n.2, at 168, discussing the concurrent court hearing held by courts in different national jurisdictions to coordinate sale hearings:

Despite difficulties encountered in certain situations, cross-border cooperation and joint hearings have become almost routine in many cases. In the insolvency of Solv-Ex Corporation, courts in Albuquerque, New Mexico … and Calgary, Alberta … approved a protocol whereby both courts held joint hearings to approve a sale of assets. More recently, in the joint case of Livent, Inc., which operated theaters in Canada and the United States, the two courts held a hearing by closed-circuit satellite television regarding the sale of assets in both nations to a single purchaser, and entered complementary orders approving the sale.

52. 11 USC 1527(1)–(5).
53. 11 USC 1528.
54. Id. Bankruptcy code section 541(a) defines the property of the estate to include a wide array of possessory and legal rights held by the debtor both before and after the commencement of a plenary case. 28 USC 1334(e) provides the district court corollary to the bankruptcy court’s jurisdiction to property of the debtor’s estate:

The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction—

(1) of all the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate; and

(2) over all claims or causes of action that involve construction of section 327 of title 11, United States Code, or rules relating to disclosure requirements under section 327.

55. HR Rep No 31, 109th Cong, 1st Sess, Pt I § 1528 (2005) (“In a full bankruptcy case, the United States bankruptcy court generally has jurisdiction over assets outside the United States. Here that jurisdiction is limited where those assets are controlled by another recognized proceeding, if it is a main proceeding.”).
56. 11 USC 1529(1).
57. 11 USC 1529(2).

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By Laura J. Eisele and John A. Simon

Introduction
The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) wrought the most sweeping changes to the Bankruptcy Code since its enactment in 1978. Since BAPCPA became generally effective on October 17, 2005, bankruptcy practitioners and scholars have wrestled with its provisions – both in construing and applying the statute’s text. Parts of the statute are unclear, such that they are susceptible to “plain meaning” interpretations that would violate general principles of bankruptcy practice, not to mention common sense. In addition, the BAPCPA changes have fundamentally altered the nature of business bankruptcy practice in many respects. For instance, the revisions have granted substantial amounts of leverage to certain players in business bankruptcy cases, such as utility companies and landlords. BAPCPA has also established deadlines with respect to certain key events in a Chapter 11 case, which put tremendous pressure on business debtors to effect certain key parts of their restructuring much sooner than was required under prior law. The BAPCPA amendments have also significantly increased the cost of doing business in bankruptcy. Finally, BAPCPA has changed various substantive areas of business bankruptcy practice, including making the retention of important employees in Chapter 11 cases more difficult and saddling creditors’ committees with enhanced disclosure obligations.

Caselaw and new business bankruptcy practices have begun to arise from the chaos to form the practical body of law that will apply to bankruptcy cases going forward under the new statute. Some of the caselaw has brought clarity to the confusing language in parts of the statute, and other caselaw has resolved substantive legal questions left open by the text. In addition, as with any new statute, clever attorneys have developed methods to circumvent or minimize the impact of the changes imposed by BAPCPA on certain key issues. This article discusses highlights of the business bankruptcy issues and, in some cases, solutions that have become evident during the initial months of BAPCPA’s effectiveness.

BAPCPA Has Proved Difficult To Interpret Due to Drafting Deficiencies

A legion of critics has alleged that portions of BAPCPA were poorly drafted. In an article published before BAPCPA became effective, one bankruptcy judge opined:

The list of drafting errors and incomprehensible provisions grows every day as bankruptcy professionals digest BAPCPA. . . . Whether by design or default, bankruptcy practitioners and judges will spend decades unraveling cross-references that lead nowhere and interpreting new terms of art that fail to communicate. If the drafters intended to make bankruptcy more complicated and expensive by making the bankruptcy law less coherent and more difficult of application, they succeeded.²

One of the most publicized examples of the drafting shortcomings in the business bankruptcy portions of BAPCPA is the revision to Section 1112(b) on the conversion to Chapter 7 or dismissal of a Chapter 11 case. Recently, in the TCR of Denver, LLC Chapter 11 case, the Bankruptcy Court for the District of Colorado picked apart the drafting issues in this Section in detail as it reviewed a Chapter 11 debtor’s motion for voluntary dismissal of its bankruptcy case.³
Under the pre-BAPCPA Bankruptcy Code, Section 1112(b) provided that a court "may" convert or dismiss a Chapter 11 if "cause" exists. The pre-BAPCPA Section 1112 included ten independent examples of situations that could constitute "cause" to support the conversion or dismissal of a Chapter 11, including inability to confirm a plan and unreasonable delay that is prejudicial to creditors. The TCR Court noted that BAPCPA added to Section 1112(b) several new specified standards for a movant to show "cause" to dismiss or convert a case, including gross mismanagement of the estate, failure to maintain appropriate insurance that poses a risk to the estate or to the public, unauthorized use of cash collateral that is harmful to creditors, failure to attend a Section 341 meeting of creditors, failure to pay taxes, and failure of the debtor to pay any post-petition domestic support obligation (e.g., alimony or child support), among others.4 However, while the old Bankruptcy Code listed the factors for "cause" using the disjunctive "or," new Section 1112(b)(4) lists the items of "cause" using the conjunctive "and."5 Therefore, the TCR Court reasoned, in accordance with the plain language of the statute, it would appear that all 16 specifically identified factors demonstrating "cause" under Section 1112(b)(4) must be met by any movant, including a debtor-in-possession, before a case could be dismissed under Section 1112(b). And yet, if this was correct, a corporate Chapter 11 could never be dismissed because there would obviously be no situation where a corporate debtor would have a domestic support obligation as would be required by Section 1112(b)(4)(P).6

Thus, the TCR Court aptly noted that the application of the plain meaning rule of statutory construction to Section 1112 would lead to an illogical result. The Court remarked: This is a case where the language of BAPCPA passed by Congress tends to defy logic and clash with common sense. This is an example of a specific revision to the Bankruptcy Code, if followed by the Court and applied as Congress seems to intend – i.e., by way of strict construction – would result in an absurd decision and totally unworkable legal precedent. These drafting problems have the potential of bringing the bankruptcy system to a halt while debtors, creditors, and the courts try to figure out just exactly what Congress intended.7

The Court determined that Congress' intent in modifying Section 1112(b) through BAPCPA was to expand the bases for dismissal or conversion of a Chapter 11 case and to make the Section stricter as to debtors.8 The Court stated that Congress could not have intended to require all the listed factors to apply simultaneously if it intended to broaden the grounds for dismissing a case.9 Therefore, the Court held that a disjunctive reading of the factors was appropriate, and that the debtor could dismiss the case without proving all the elements of cause under Section 1112(b)(4). In essence, the TCR opinion is evidence that judges will impose their own common sense interpretations where BAPCPA’s text is patently unclear or incorrect.

BAPCPA Has Provided Additional Leverage To Certain Creditor Constituencies

In General

BAPCPA also granted enhanced rights to certain creditors, including utility companies and landlords. These additional rights have upset the traditional balance of power in some relationships in business bankruptcy cases.

Utilities

Prior to enactment of BAPCPA, pursuant to Section 366 of the Bankruptcy Code, utilities could not discontinue service solely because the debtor filed for bankruptcy or did not pay its pre-petition bills, and utilities could discontinue service if they did not receive "adequate assurance of payment" for post-petition services within 20 days after the petition date. Courts often held that a debtor's pre-petition history of paying bills on time, together with the administrative expense priority provided to utilities for post-petition services, constituted "adequate assurance of payment." Thus, a debtor could typically avoid posting a deposit with the utility to provide the requisite assurance of payment.10

Section 366 now defines “adequate assurance of payment” as: (i) a cash deposit; (ii) a letter of credit; (iii) a certificate of deposit; (iv) a surety bond; (v) a prepayment of utility consumption; or (vi) another form of security that is mutually agreed on between the utility and the debtor or trustee.11 In addition, the Bank-
Bankruptcy Code now expressly provides that a mere grant of administrative expense priority, which was sometimes used by debtors prior to BAPCPA to satisfy the requirements of Section 366 with respect to utilities, does not constitute an assurance of payment.\footnote{12}

Furthermore, under the BAPCPA amendments, a utility’s right to modify or terminate service under Section 366(c)(2) appears to be effective notwithstanding the automatic stay of Section 362. Nothing in Section 366 requires the utility to obtain court approval before modifying or terminating service if the utility deems the assurance of payment unsatisfactory.

On its face, Section 366(c)(2) of the Bankruptcy Code appears to provide utilities with absolute discretion to extract deposits from debtors. Because of a utility’s ability to terminate service, business debtors will have to obtain clarity that they have established the requisite assurance of payment (and thus are assured of continued utility service) through orders obtained from the court or negotiations with the utility completed in the first 30 days of a bankruptcy case. After notice and a hearing, on request of a party, a court may modify the amount of an assurance of payment.\footnote{15} However, in determining whether an assurance of payment is adequate, a court may not consider: (i) the absence of any security before the petition date; (ii) the debtor’s timely payment of utility charges prior to the petition date; or (iii) the availability of administrative expense priority for the utility’s claims.\footnote{14} In addition, pursuant to Section 366(c)(4) of the post-BAPCPA Bankruptcy Code, a utility may recover or set off against a security deposit provided by the debtor before the petition filing without notice or an order of the court.\footnote{15} The BAPCPA changes plainly permit utilities to exert much more pressure on bankrupt debtors.

Business debtors have attempted to minimize the impact of the new BAPCPA utilities provisions by modifying their requests in their motions for prohibitions against utilities altering or discontinuing services (which are typically filed as “first day” motions) to account for the changes in the law. In several large cases, the debtor has obtained a Bankruptcy Court ruling that a deposit equal to 50 percent of a utility’s monthly bill constitutes adequate assurance of payment.\footnote{16} The debtors in some cases have also obtained Bankruptcy Court approval of a procedure for resolving disputes with respect to the adequate assurance provided to a utility, essentially requiring the utility to serve written objections on the debtor within a specified notice period or be deemed to have consented to the debtor’s proposed adequate assurance of payment.\footnote{17}

The extent to which requests such as these will be granted in a given case will depend on the opposition presented by the utility creditors, who might argue, among other things, that a proposed deposit is too small in relation to their exposure or that the debtor’s procedures for determining adequate assurance of payment are improper because they result in a delay greater than the 30-day period after the petition date prescribed by Section 366(c)(2).

The first opinion interpreting the BAPCPA revisions to Section 366, in the Lucre case in the Western District of Michigan, confirmed the considerable extent of utilities’ additional leverage under the new statute.\footnote{18} In the Lucre case, the debtor was a telecommunications carrier that bought energy from Consumers Energy and long distance service from Sprint. The debtor was the end-user of those services. The debtor also bought telecommunications services from two other providers, IXC and Opex, which the debtor did not use itself, but rather provided to its customers.

After filing its Chapter 11 petition, the debtor offered its utilities creditors specific amounts of cash deposits, plus administrative claims for postpetition services, as assurance of payment under Section 366. Only Opex responded to the debtor’s proposal, rejecting the deposit as too low. The debtor then requested that the Bankruptcy Court continue the automatic injunction against discontinuation of services under Section 366(a) against its utilities, even though the utilities had not accepted the adequate assurance of payment offered by the debtor as contemplated by the new Section 366(c). The debtor based its argument, in part, on the fact that all of the utilities but one failed to respond to the debtor’s proposal.

The Lucre Court distinguished between the debtor’s utilities that provided services the debtor consumed itself, namely Consumers Energy and Sprint, and the utilities whose services the debtors merely purchased and provided to third parties, IXC and Opex. The Court held that only utilities that provided services consumed by the debtor itself provided “utility services” as such term is used in Section 366(c) and were thus entitled to the
benefits of that new subsection (c). Accordingly, the Court held that Section 366(c) did not apply to IXC and Opex. The Bankruptcy Court further held that it did not have discretion to continue the Section 366(a) injunction because Section 366(c) plainly requires as a condition to the continuation of the injunction that either the utility accept the adequate assurance offered by the debtor or the debtor accept the adequate assurance offered by the utility. The Court noted that although Section 366(c)(3) gives the debtor the right to seek the Court’s modification of adequate assurance agreed to between the debtor and the utility, this right does not arise until the parties have agreed on the adequate assurance under Section 366(c)(2). Thus, the sum of the primary Lucre holding is that the debtor has no recourse to modify the adequate assurance the utility has demanded until the debtor first accepts the utility’s proposal. The Lucre debtor and its utilities never agreed to adequate assurance, and, therefore, the Court denied the debtor’s request for an extension of the automatic Section 366(a) injunction as to Consumers Energy and Sprint. In an aside, the Court also noted that Section 366(c) might include an implied obligation for a utility to bargain in good faith with the debtor prior to discontinuing services under that Section. These dicta may become relevant later, in a case where a utility refuses to negotiate with a debtor in reliance on the utility’s rights under Section 366(c).

The Lucre holding, if followed by other courts, will provide utilities with enormous leverage in business bankruptcy cases. Under Lucre, the debtor will be required to accept a utility’s proposal in the early stages of a case, and the debtor will bear the burden to challenge subsequently that proposal if it finds it unreasonable.

**Landlords**

Landlords have also received an improvement in their position in bankruptcy under BAPCPA. Under Section 365(d)(4) of the pre-BAPCPA Bankruptcy Code, any unexpired lease of nonresidential real property that was not assumed or rejected within 60 days after the petition date was deemed rejected, unless the court, for cause, extended the time within which the debtor could assume or reject the lease. However, the court could extend the deadline for additional periods of time, without concrete limits on further extensions, based upon a nebulous concept of “cause,” which asked basically whether the debtor was ready to make meaningfully the financial decision to assume or reject the leases. It was not unusual to see courts grant business debtors eight or more extensions over a period of years.

Under BAPCPA, Section 365 now limits a debtor’s ability to extend the assumption deadline to the earlier of (i) 120 days from the date of the order for relief, or (ii) the date of the entry of an order confirming a plan. The court, for cause, can extend the 120-day period for up to a maximum of 90 days. Any further extensions can be granted by the court only with the prior written consent of the lessor. Thus, debtors have, at most, only 210 days to assume or reject a nonresidential real estate lease, unless their landlord agrees to a further extension.

These changes will cause significant issues for business debtors that have real estate leases. As a practical matter, a debtor will be required to know whether it wishes to assume or reject leases in the first few weeks of its bankruptcy case in order to prepare for the event that a landlord will not agree to grant the debtor more time to make a decision. This will require a substantial amount of advance planning immediately before filing and in the very early stages of a case, when a debtor is typically focused on stabilizing its business and dealing with emergencies such as financing and supply issues. If a debtor is unable to make a decision within the short period permitted under BAPCPA, sharp landlords should consider extracting concessions, such as additional deposits or other payments, in exchange for granting any further extensions of the debtor’s time to assume or reject a lease.

**BAPCPA Has Imposed Strict Time Constraints On A Chapter 11 Debtor’s Ability To Obtain Confirmation Of Its Plan**

As a result of BAPCPA, the Bankruptcy Code now limits a debtor’s ability to obtain extensions of the time period during which only the debtor may propose and obtain confirmation of a Chapter 11 plan. The initial exclusivity period remains at 120 days for filing a plan and 180 days to solicit acceptances and confirm a plan. However, the BAPCPA amendments limit extensions of those periods to dates that are 18 and 20 months, respectively, after the petition date. In contrast, in many cases commenced prior to BAPCPA, debtors
obtained extensions of their exclusive time in order to file a plan for several years after their petitions were initially filed.

It is too soon to tell the actual impact that this change will have on the Bankruptcy Code. The restrictions on exclusivity have not been tested or challenged in any case as of yet. The key factor in determining the extent to which this BAPCPA change will revolutionize Chapter 11 practice, as many have predicted, will be whether courts permit non-debtor parties to file competing plans after exclusivity has expired. Under the text of the statute and prior practice, it would seem likely that courts will permit the filing of competing plans 18 months after the petition date.

In large cases, the new BAPCPA exclusivity deadlines may be very difficult to meet. Substantial advance planning may be required prior to filing a petition for a large Chapter 11 debtor in order to ensure that this timing may be met. “Prepackaged” bankruptcies will become more common, and debtors that enter into Chapter 11 in a distressed filing will face even greater risks, as they may not have had the opportunity to account adequately for their restructuring needs in formulating a plan in advance. Creditors and other parties seeking to use bankruptcy as a framework for mergers and acquisitions will have greater influence in the bankruptcy process as a result of the restrictions imposed by BAPCPA’s restrictions on exclusivity.

**BAPCPA Has Made Bankruptcy More Expensive For Business Debtors**

BAPCPA added a new Section 503(b)(9) to the Bankruptcy Code that provides trade creditors with an administrative expense claim for the value of any goods the debtor received from such trade creditors within 20 days prior to the commencement of the bankruptcy case, provided the goods were sold to the debtor in the ordinary course of its business.29 This effects a huge change in the cost of filing for bankruptcy. Prior to BAPCPA, trade creditors primarily relied on their state law reclamation rights under Section 2-702 of the Uniform Commercial Code, as preserved through old Section 546(c) of the Bankruptcy Code, to attempt to obtain an administrative claim or junior lien in the bankruptcy case on account of goods shipped to the debtor in the 10 or 20 days, as applicable, prior to the petition date. In recent years, reclamation claimants’ special rights in bankruptcy had been reduced to almost nothing, other than the possible ability to obtain the goods back from the debtor due to various defenses. This included the argument that the goods were not on hand at the time of the reclamation demand, and the argument that a prior lender’s lien had subsumed the value of the goods.30 Thus, prior to BAPCPA, trade creditors often received no more than a general unsecured claim because of their reclamation claims.

Under new Section 503(b)(9), debtors are required to pay, as an administrative expense, the trade debt they incurred in the ordinary course of business for the 20 days leading up to the case. In contrast to the pre-BAPCPA situation, where trade creditors typically received only general unsecured claim treatment (i.e., eventual payment of a fraction on the dollar) due to the erosion of the value of reclamation rights, under BAPCPA debtors will have to pay 20-day claims dollar-for-dollar. This has significantly changed the cost/benefit analysis a company faces in filing bankruptcy and provided a valuable boon to trade creditors.

Other business-bankruptcy law changes under BAPCPA have also increased, or at least accelerated, costs that debtors will have to pay in their bankruptcy cases.

**BAPCPA Has Made It More Difficult To Obtain Approval Of Key Employee Retention Plans**

In recent years, large companies in Chapter 11 often established incentive payment programs for their high-level executives and other key employees. Through these plans, known as key employee retention programs or (KERPs), a debtor company could offer its employees sizeable severance payments and retention or “stay” bonuses, to induce them to continue to work for the company through its bankruptcy.
Prior to BAPCPA, the Bankruptcy Code did not provide for specific standards for review and approval of KERPs. Rather, debtor companies used Section 363(b) of the Bankruptcy Code—the general provision authorizing the use, sale, or lease of the debtor’s property outside the ordinary course of business—to obtain court approval of a KERP. Using a debtor-friendly standard applied under Section 363, courts would investigate the debtor’s business judgment in entering into the KERP, essentially asking whether a sound business justification supported the KERP. Debtors invariably pointed to their need to ensure retention of their most important personnel in order to successfully reorganize (or liquidate, as may have been the case) and thereby maximize value for their bankruptcy estates and creditors, as ample justification of their business decision to enter into a KERP. Based upon variations of this argument, courts often approved KERPs they found reasonable.33

Before BAPCPA, many observers felt that KERPs were being abused to provide a windfall to management of bankrupt companies at the same time as their creditors received pennies on the dollar and their employees were laid off as part of the restructuring process. In response to this criticism, Section 503 of the Bankruptcy Code, as amended by BAPCPA, now sets forth limitations on the payment or allowance of claims for retention bonuses or severance pay to the debtor’s insiders (which include officers, directors, and other persons in control of the debtor). Specifically, a new Section 503(c) prohibits payments to insiders to induce them to remain in the debtor’s employ using “stay” bonuses, unless the payment is essential to retain a person who has a bona fide job offer from another business at the same or a greater rate of compensation, and the amount of the payment is less than a specified cap.34 This new Section also proscribes severance payments to insiders, unless the payment is part of a program generally applicable to all full-time employees and the payment is below a specified cap.35 Finally, Section 503(c) bars any other non-ordinary course transfers or obligations (i.e., non-stay and non-severance payments) in favor of officers or managers that are not “justified by the facts and circumstances of the case.”36

Debtors may use various tactics to attempt to establish KERPs without violating BAPCPA’s more stringent standards. One method is to structure the KERP so that it does not include stay bonus payments (which are subject to the new requirements of Section 503(c)(1)) or severance payments (which are covered by Section 503(c)(2)). This would put the KERP in the domain of Section 503(c)(3), which, as described above, only bars transactions that are not justified by the facts of the case. Courts have much more latitude to approve a KERP under Section 503(c)(3) than Sections 503(c)(1) or 503(c)(2).

In connection with its Section 363 sale of substantially all of its assets, the debtor in the Nobex case37 pursued this angle when it sought to pay “sale-related incentive pay” to two of its executives. The debtor structured the incentive pay as a percentage of the sale proceeds above certain stated levels. Furthermore, the debtor asked for authority to pay the managers subject to the “board’s ultimate conclusions about the post-petition contributions of each to successful implementation of the sale procedure, including obtaining approval of and closing a Sale.” The debtor argued that the incentive program was not a retention or severance program but instead was “designed and intended to ensure complete implementation of the sale procedure.” Accordingly, the debtor cited Section 363 of the Bankruptcy Code, in addition to Section 503(c)(3), as authority for approval of the program.

The United States Trustee objected to Nobex’s incentive program, arguing that Section 503(c)(3) applies only where insiders are hired post-petition, and that the Nobex plan was just a disguised retention bonus program that should be subject to the strict standards of Section 503(c)(1). The Court approved the debtor’s program, finding that because of the debtor’s structuring of the program, Sections 503(c)(1) and (c)(2) did not apply.38 The Court further held that Section 503(c)(3) applies to insiders hired prior to the petition date, and Section 503(c)(3) essentially constituted a reiteration of the standard under Section 363—in other words, the business judgment test. The Court found that the proposed employee payments were tied to the purchase price and thus provided an incentive for the employees to obtain the best return for creditors. Furthermore, the Court found that the program was not a disguised retention plan because it did not provide compensation merely for the executives to stay with the debtor. It found also that the program was not a disguised severance plan because the executives could
have left the company immediately after the sale and still received the incentive payment due to their efforts supporting the sale.

Another means by which a debtor could avoid the exacting requirements of Sections 503(c)(1) and 503(c)(2), with respect to retention and severance payments, is to structure its KERP to pay only non-insiders (i.e., employees who are not officers, directors, or other control persons). In the Refco case, the liquidating debtors argued that the restrictions of Section 503(c)(1) did not apply to incentive payments under their KERP because the employees covered by the program were not insiders (i.e., the KERP employees were not officers, directors, or control persons). The Court agreed, finding that the employees were included in the KERP because they were important to the administration of the estate, and not because they were insiders. Therefore, the Court approved the KERP.

In seeking approval of a KERP, a liquidating debtor might also argue that there is no ongoing “business,” and thus stay payments are not restricted under section 503(c)(1). The debtor in the FLYi case attempted this approach as it wound down its operations. FLYi’s wind-down plan called for the immediate termination of its operations and the execution of a “wind-down employee plan.” The plan included payment provisions to provide an incentive to employees to stay with FLYi to perform necessary wind-down tasks, such as managing the claims process, liquidating assets, and filing necessary reports.

FLYi argued that its KERP incentive payments were permissible because FLYi was immediately ceasing business and not reorganizing. Therefore, FLYi asserted, the employees covered by the KERP were not receiving payments to “remain with the debtor’s business,” as described in Section 503(c)(1), and thus the restrictions of Section 503(c) did not apply to the KERP. FLYi argued that the term “business” in Section 503(c)(1) meant a viable ongoing business and that FLYi’s liquidation was not a “business.” In the end, the Court did not have to rule on the issue, because the parties modified the wind-down employee plan to comprise a severance program rather than a stay payment program. However, the meaning of the word “business” in the statute is not clear, and thus FLYi’s argument may be a viable approach in liquidation cases until courts determine otherwise.

Creditors’ Committees Have New Disclosure Obligations Under BAPCPA

Another BAPCPA revision to the Bankruptcy Code that has recently been reviewed in Bankruptcy Court is the new provision of Section 1102 that places disclosure and information access obligations on a creditors’ committee. Section 1102(b)(3) requires a committee to provide “access to information” to creditors who hold claims of a kind represented by the committee, even if they are not members of the committee, as well as “solicit and receive comments from” the aforementioned creditors. These obligations have raised significant concerns with respect to the validity and operation of creditors’ committees. For instance, to the extent a committee discloses attorney-client privileged information to a non-member, it could be deemed to waive the privilege. In addition, the new information disclosure requirements could make it difficult for a committee to maintain its confidentiality obligations in the bankruptcy case. Committees often execute confidentiality agreements with debtors and other parties to obtain confidential information from such parties. If a committee could be required to give information to non-members, other parties might be unwilling to give confidential information to the committee, which would put the committee at a significant disadvantage.

One potential “fix” to address the issues arising from the new requirements of Section 1102 is for a committee to file a motion early in the case to obtain an order limiting and clarifying its disclosure obligations. This is the tactic selected by the official committee of unsecured creditors in the Refco case. The Refco committee, which was privy to confidential information of the debtors and other parties, became concerned that its compelled disclosure of confidential information could prevent it from fulfilling fiduciary duties and possibly violate disclosure requirements under securities laws. Therefore, the committee filed a motion seeking an order that the committee would not be required to disclose confidential and/or material non-public information, as well as information that could cause a waiver of privilege.

In entering an order granting the committee’s motion, the Refco Court provided guidance on how Section 1102 should be interpreted and applied. The Court noted that Section 1102(b)(3) does not define the “informa-
tion” subject to disclosure, and thus looked to Section 704, which has long required that Chapter 7 trustees “unless the court orders otherwise, furnish such information concerning the estate and the estate’s administration as requested by a party in interest.”43 The Court noted that three general concepts could be derived from the case law interpreting the trustees disclosure requirements under Section 704 and be applied in the Section 1102 context: (i) the trustee’s obligation to provide information is “fairly extensive,” in furtherance of the trustee’s duty to keep parties informed, such that the trustee generally bears the burden to show the reasons why information should not be disclosed; (ii) the trustee’s obligation to furnish information is not unlimited, and a trustee may obtain an order protecting against disclosure that would waive the attorney-client privilege or breach confidentiality obligations; and (iii) the parameters of a protective order should be influenced by whether a party has requested information for a purpose that is inconsistent with the trustee’s fiduciary duties. The Court also reviewed reporting requirements under the Bankruptcy Act of 1898, which had mandated that a committee report to creditors “concerning the progress of the proceeding.” The Court noted that these requirements only obligated a committee to provide a limited amount of information to other parties – specifically, a fair presentation of the status of the debtor.

The Refco Court also reviewed the functions of the creditors’ committee to determine the extent to which restrictions on the committee’s disclosure obligations were appropriate. The Court noted that a committee, in its role as a key party in a bankruptcy case, receives confidential information that the committee has a fiduciary duty not to disclose. The Court also observed that disclosure of certain information could violate securities laws and cause the waiver of privileges, including the attorney-client privilege.

In the end, the Refco Court entered an order that protected the committee from disclosing confidential and non-public or proprietary information, as well as information, which if disclosed, could result in a waiver of privilege or violate an agreement or legal requirement, including securities laws. The order further required the committee to consider, in determining whether to provide information to a requesting party, the willingness of such party to execute a confidential-agreement or restrict trading. Finally, the order also contained a process for the Court to resolve promptly any disputes regarding the disclosure of information. Committees in other cases are likely to seek similar relief as the Court granted in Refco, in order to obtain certainty with respect to their disclosure obligations under the BAPCPA changes to Section 1102.

Conclusion
The courts and bankruptcy practitioners continue to assimilate the dramatic revisions effected by BAPCPA. Indeed, some of BAPCPA’s most critical changes to business bankruptcy law, such as the limitation on exclusivity, have not yet been battle-tested in any case. There is little doubt that additional opinions and new techniques to explain and work around BAPCPA will continue to result from ongoing practice under the statute.

NOTES
1. 11 USC 101 et seq.
4. USC 1112(b)(4).
5. Id.
6. TCR, 338 BR at 499.
7. Id. at 495-496.
8. Id. at 500.
9. Id.
11. 11 USC 366(c)(1)(A).
12. 11 USC 366(c)(1)(B).
15. 11 USC 366(c)(4).
16. See, e.g., In re Refco, Inc., No 05-60006 (Bankr SDNY December 9, 2005); In re J.L. French Automotive Castings, Inc., No 06-10119 (Bankr D Del March 8, 2006).
17. See, e.g., In re Refco, Inc., No 05-60006 (Bankr SDNY December 9, 2005); In re Musicland Holding Corp., No 06-10064 (Bankr SDNY February 2, 2006); In re Dana Corporation, No 06-10354 (Bankr SDNY March 29, 2006).
19. Id. at 154-155.
20. Id.
21. Id. at 154.
22. Id.
23. Id.
24. Id.
25. 11 USC 365(d)(4).
26. Id.
27. 11 USC 1121(c).
28. 11 USC 1121(d).
29. 11 USC 503(b)(9).
30. See, e.g., In re Pittsburgh-Canfield Corp., 309 BR 277 (BAP 6th Cir 2004).
31. 11 USC 366(c)(1)(A).
32. 11 USC 365(d)(4).
33. See In re Georgetown Steel Co., 306 BR 549, 555-56 (Bankr SDSC 2004) (citing other cases approving KERPs).
34. 11 USC 503(c)(1).
35. 11 USC 503(c)(2).
36. 11 USC 503(c)(3).
37. In re Nobex Corp., No 05-20050 (Bankr D Del 2005).
38. In re Nobex Corp., No 05-20050 (Bankr D Del January 19, 2006).
41. In re FL/Y Inc., No 05-20011 (Bankr D Del 2005).
42. In re Refco Inc., No 05-60006 (Bankr SDNY January 20, 2006).
43. 11 USC 704(a)(7).


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Introduction

This article analyzes cases before the federal bankruptcy courts in the Eastern and Western Districts of Michigan involving the avoidance of a mortgage on a bankruptcy debtor’s real property. While all bankruptcy courts must consider certain issues in these cases, each court differs in its interpretation of the law. As this article will show, there is a need for definitive rulings on these issues from a higher level.

Mortgage Avoidance Actions in General

Background

The concept of avoiding a mortgage or other lien recorded on real property is not new to bankruptcy law. However, as more refinancing and mortgage options have become available to individuals in recent years, mortgage avoidance cases have become noteworthy in Michigan. This article focuses on cases filed before the October 17, 2005, effective date of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). While the legislative changes to bankruptcy law have eliminated some of the issues now being litigated before the courts in pre-BAPCPA cases, the sheer number indicates that litigation of mortgage avoidance cases will continue, at least in the short term.

Mortgage avoidance actions typically occur in cases filed by individuals under Chapter 7 of the Bankruptcy Code. Generally speaking, Chapter 7 allows individuals to discharge all of their debts except for those carved out by specific provisions in the Bankruptcy Code or those declared non-dischargeable by the bankruptcy court. Once an individual files a bankruptcy petition, a Chapter 7 trustee is assigned to the case. The trustee is charged with investigating the value of the debtor’s assets, liquidating any assets of value, and distributing a portion of the liquidation proceeds to creditors of the estate. In addition, the trustee has the power to sue on behalf of the estate for the benefit of the debtor and creditors. This includes initiating an adversary proceeding in bankruptcy court to avoid a mortgage granted by the debtor to a creditor before the bankruptcy filing.

Origination of a Mortgage Avoidance Case

A mortgage avoidance action generally involves an individual who has purchased real property or refinanced a mortgage on real property. The individual either (1) grants a mortgage on his or her real property to secure a loan for the purchase of the property, or (2) refines one or more existing loans on the property and grants a mortgage to a new creditor, which extinguishes the prior mortgage. Upon closing, the mortgage is sent to the appropriate county recorder’s office to assign a liber and page number to the document for the public record. Less than a year after the transaction, the individual files for bankruptcy, becoming a debtor under the Bankruptcy Code. The Chapter 7 trustee assigned to the case then reviews the debtor’s real property documents for information about the perfection of mortgages or other liens on the real property to determine whether the interest can be avoided under bankruptcy law.

The recording of the mortgage before a debtor’s bankruptcy filing triggers a mortgage avoidance action under section 547 of the Bankruptcy Code. Pursuant to section 547(b)—also known as the preference statute—a trustee may avoid the transfer of a debtor’s interest in property

1. to or for the benefit of a creditor;
2. for or on account of an antecedent debt owed by the debtor before such transfer was made;
3. made while the debtor was insolvent;
4. made—
   A. on or within 90 days before the date of the filing of the petition; or
   B. between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
5. that enables such creditor to receive
more than such creditor would receive if—
A. the case were a case under chapter 7 [of the Bankruptcy Code];
B. the transfer had not been made; and
C. such creditor received payment of such debt to the extent provided by the provisions of [the Bankruptcy Code].

To establish a preferential transfer under section 547, or in this case an avoidable mortgage, the trustee must satisfy each of the five elements of section 547(b).

Status of Mortgage Avoidance Cases in Michigan's Bankruptcy Courts

Upon review of eight mortgage avoidance actions initiated by Chapter 7 trustees in the Eastern and Western Districts of Michigan, the only common theme that emerges is the lack of a common theme. The results of summary judgment or other dispositive motions are mixed, as courts have granted summary judgment in favor of creditors, in favor of trustees, or in favor of neither of these groups. The few appellate decisions in these cases do not make the picture any clearer. In the Eastern District, where the majority of these actions were initiated, summary judgment granted in favor of the trustee by the bankruptcy court was reversed by the federal district court on appeal. In the Western District, the Sixth Circuit Court of Appeals affirmed the reversal of a bankruptcy court judgment in favor of the creditor, albeit in an unreported decision. Until definitive rulings come down from the Sixth Circuit, however, the future litigation of these actions at the bankruptcy court level will likely continue to produce uncertain results.

Critical Questions to Consider in Mortgage Avoidance Cases

In a review of the reported cases or bankruptcy court opinions made available to the public, five distinct issues emerge: (1) the timing of a transfer of the debtor’s interest in real property, (2) whether a transfer is made on account of an antecedent debt, (3) whether the transfer constitutes a contemporaneous exchange for new value; (4) whether the transfer is essentially an enabling loan; and (5) whether the earmarking doctrine applies to the transfer.

When Does a Transfer of the Debtor’s Interest in Property Occur?

One of the issues commonly litigated in mortgage avoidance cases concerns the timing of the transfer of the debtor’s interest in the real property for purposes of section 547. According to Bankruptcy Code section 547(e)(2), and for bankruptcy purposes, the “time” at which a transfer is made depends on the number of days between the time when the transfer attaches or “takes effect” and the time when the transfer is perfected. If perfection occurs 10 days or less after attachment, or when the transfer “takes effect,” then the transfer date relates back to the time of the attachment or transfer. On the other hand, if perfection occurs more than 10 days after the transfer “takes effect,” then the transfer is “made” at the time of perfection.

Before determining the timing of a transfer for purposes of the statute, two critical sub-issues require consideration. The first is the exact time when the transfer attaches or “takes effect.” Some bankruptcy courts consider the granting of the mortgage as the transfer; thus, the date of the mortgage instrument is the date when the transfer takes effect. Other courts, however, regard the disbursement of the loan proceeds by the creditor as the transfer, and the date of disbursement constitutes when the transfer takes effect. Accordingly, the effective date of the transfer depends upon the court’s interpretation of the law.

The second timing sub-issue concerns the definition of perfection, which is governed by state law. Under Michigan law, perfection occurs when the Register of Deeds records an entry into an entry book. In connection with the mortgage avoidance cases, bankruptcy courts discovered that various county Registers of Deeds did not maintain the entry book identified by the Michigan statute. In those situations, the courts had no way of determining when a mortgage was recorded and, accordingly, perfected for the purposes of section 547(e)(2). To clarify this issue, four of the bankruptcy judges in the Eastern District of Michigan certified a question to the Michigan Supreme Court. The Supreme Court, however, declined to answer the question.

Was the Transfer Made on Account of an Antecedent Debt?

Another mortgage avoidance issue is whether the mortgage was granted on account of an antecedent debt. Although not defined...
in the Bankruptcy Code, “antecedent debt” is described in *Black’s Law Dictionary* as “[a] debtor’s prepetition obligation that existed before a debtor’s transfer of an interest in property.” 17 The obligation at issue in mortgage avoidance actions is the debtor’s duty to repay the funds loaned for the purchase of real property. Depending on the court’s interpretation of the effective date of the transfer (and assuming that mortgage recordation is determinable), if perfection of the mortgage relates back to the time of the transfer under section 547(e)(2), then the transfer is not on account of an antecedent debt and, thus, is not avoidable.18 However, if the effective date of the transfer and the perfection date fall outside the 10-day window, the court considers the transfer to be on account of an antecedent debt; thus, it is an avoidable transfer.19

**Was the Transfer a Contemporaneous Exchange for New Value?**

The next issue is whether the transfer constitutes a contemporaneous exchange for new value. Section 547(c)(1) of the Bankruptcy Code provides an exception to an otherwise avoidable transfer to the extent that (1) the transfer was intended by the debtor and creditor to be a contemporaneous exchange for new value, and (2) the transfer is in fact a substantially contemporaneous exchange.20 “New value” is defined in part as “money or money’s worth in goods, services, or new credit.”21 In a mortgage situation, new value consists of the loan made to the debtor at the time of closing; therefore, this defense arises in cases where the debtor obtains a mortgage to finance the purchase of real property.22 Whether in fact a contemporaneous exchange occurs in this context depends on the length of time between the effective date of the transfer and the perfection date. If the court determines that 10 or more days have elapsed between attachment and perfection, the transfer is not a contemporaneous exchange and is therefore avoidable by the trustee.23

**Did the Creditor Give New Value or an “Enabling Loan” to the Debtor?**

Like the previous subsection, another timing-related issue is whether the transfer meets the requirements of an “enabling loan” or purchase-money mortgage. Under section 547(c)(3), a transfer is not avoidable if it (1) is made to secure collateral for a loan, (2) enables the debtor to acquire such collateral (and such collateral is in fact acquired), and (3) is perfected within 20 days after the debtor receives possession of such collateral.24 This exception overrides the 10-day rule seen previously, providing more time for perfection. Thus, a mortgage that provides funds to purchase the real property collateral and that is perfected within 20 days after the debtor receives possession of the real property collateral is not an avoidable mortgage.

The decisions by the bankruptcy court in the Eastern District of Michigan in this area have identified two issues in the enabling loan defense: what constitutes possession under the statute, and when is the mortgage perfected for purposes of Michigan’s recording statute.25 Until the courts reach a definitive answer regarding the recording question, use of the enabling loan defense is questionable.26 In the context of refinancing, however, bankruptcy courts outside of Michigan clearly hold that this defense does not apply when one loan is simply substituted for another.27

**Does the Earmarking Doctrine Apply?**

The earmarking doctrine often arises as a defense when a trustee seeks to avoid a refinanced mortgage. A judicially created exception to a preference action, the earmarking doctrine states that “if a third party provides funds for the specific purpose of paying a creditor of the debtor, the funds may not be recoverable as a preferential transfer because the proceeds never become part of the debtor’s assets.”28 This doctrine essentially negates the element of section 547(b)(1) or (2) regarding the debtor’s transfer of an interest in property. If the earmarked funds are not the debtor’s property, then there is no preferential transfer because the funds never became part of the debtor’s assets.29 Creditors asserting this defense in a refinanced mortgage situation argue that the loaned funds are used to pay a specified antecedent debt, essentially replacing one creditor for another, and that, therefore, the transfer does not constitute an avoidable preference.30

The success rate of the earmarking doctrine varies in Michigan bankruptcy courts. Some courts determine that the refinancing situation involves two distinct transfers: the payment of the borrowed funds to the original creditor, and the granting of the mortgage by the debtor to the new creditor.31 In these cases, the earmarking doctrine is inapplicable to the second transfer, i.e., the trans-
fer that the trustee seeks to avoid, because it involves a transfer that occurred when the new creditor perfected its interest in the debtor’s real property.\(^2\) In contrast, other bankruptcy courts consider the earmarking doctrine applicable in a refinancing situation, reasoning that “[w]hen a third party lends money to a debtor for the specific purpose of paying off a designated creditor, that money is not an ‘interest of the Debtor in property’ and, therefore, is not property of the estate.”\(^3\)

Accordingly, the viability of an earmarking defense depends on the interpretation of the court adjudicating the mortgage avoidance action.

**Conclusion**

In the absence of definitive answers to the questions posed by the bankruptcy courts, the success of a mortgage avoidance action depends largely on judicial interpretation of the controlling issue or issues in the case. Unfortunately, the Michigan Supreme Court did not provide an answer to a seemingly important issue of Michigan property law, leaving the interpretation of recordation to the federal courts. As a result, mortgage avoidance actions in Michigan will likely remain notable for some time.

**NOTES**

1. See, e.g., Glen Canner, Karen Dyman, and Wayne Passmore, *Mortgage Refinancing in 2001 and Early 2002*, 88 FED RES BULL 469–82 (Dec 2002), available at http://www.federalreserve.gov/pubs/bulletin/2002/1202lead.pdf (“Mortgage refinancing has become a widespread practice in recent years because of a combination of factors, including lower interest rates; the widespread adoption of new technologies that have reduced mortgage transaction costs; and gains in home values and equity, which have increased the opportunities to borrow additional amounts. In addition, the general disappearance of mortgage prepayment penalties during the late 1980’s encouraged refinancing activity.”).


4. 11 USC 101 et seq. (hereinafter the “Bankruptcy Code”).

5. 11 USC 547(b).


   a transfer is made—

   (A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time, except as provided in subsection (c)(3)(B); or

   (B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or

   (C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—

   (i) the commencement of the case; or

   (ii) 10 days after such transfer takes effect between the transferor and the transferee.

The 2005 amendments to the Bankruptcy Code increased the 10-day rule to 30 days.

10. See, e.g., *Gold v interstate Fin Corp* (*In re Schmiel*), 319 BR 520, 524–25 (Bankr ED Mich 2005) (defining the transfer at issue as the granting of the mortgage by the debtors to the creditor); *Gold v National City Home Loan Serv* (*In re Hamanna*), 319 BR 851 (Bankr ED Mich 2005) and *Kobut v Quicken Loans, Inc* (*In re Wohlfeil*), 322 BR 302 (Bankr ED Mich 2005) (both finding that the transfer occurred upon the date of delivery of the mortgage to the debtor, not the date of recording).

11. See, e.g., *In re Schmiel*, 319 BR at 525.

12. *Lim v Chase Home Fin, LLC* (*In re Comps*), 334 BR 235 (Bankr ED Mich 2005) (holding that mortgage transfer takes effect on the date on which the proceeds of the loan are disbursed).


14. Id.; Michigan Supreme Court, Certification Pursuant to MCR7.305 p.6 (April 17, 2006).

15. Id.


18. *In re Comps*, 334 BR at 240.

19. See, e.g., *In re Schmiel*, 319 BR at 525; *In re Maracle*, Dist Ct Op at 3.

20. 11 USC 547(c)(1) provides that the trustee may not avoid under this section a transfer—

   (1) to the extent that such transfer was—

   (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

   (B) in fact a substantially contemporaneous exchange.

21. In full, 11 USC 547(a)(2) states, “‘[n]ew value’ means money or money’s worth in goods, services, or new credit, or release of a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation.”


23. *Id.; In re Arnett*, 731 F2d 358, 364 (6th Cir 1984).

24. 11 USC 547(c)(3); see also *Collier on Bankruptcy* ¶ 547-66–547-67 (15th ed 2005). Former 11 USC 547(c)(3) states that, under this section, a trustee may not avoid a transfer

   (3) that creates a security interest in property acquired by the debtor.
(A) to the extent such security interest secures new value that was—
   (i) given at or after the signing of a security agreement that contains a description of such property as collateral;
   (ii) given by or on behalf of the secured party under such agreement;
   (iii) given to enable the debtor to acquire such property; and
   (iv) in fact used by the debtor to acquire such property; and
(B) that is perfected on or before 20 days after the debtor receives possession of such property.

The Revised Bankruptcy Code changed the 20-day term to 30 days.


26. Author’s opinion, based upon the Michigan Supreme Court’s decision not to answer the certified question regarding the recording issue.

27. Palmer v Key Bank USA (In re Conley), 318 BR 812 (Bankr ED Ky 2004) and Guinn v Irwin Mortgage Corp (In re Patterson) 330 BR 631 (Bankr ED Tenn 2005) (both holding the enabling loan exception inapplicable to refinancing loan).

28. In re Schmiel, 391 BR at 525.

29. Similarly, the “diminution of the estate” defense asserted as a defense in several mortgage avoidance actions, argues that where a debtor exchanges one secured debt for another, the estate is not diminished. See, e.g., Lee; see also Shapiro v Homecomings Fin Network Inc (In re Davis), 318 BR 119 (Bankr ED Mich 2004), reconsideration denied, 319 BR 532 (Bankr ED Mich 2005).


31. In re Schmiel, 319 BR at 528 (acknowledging that two “separate and distinct” transfers are at issue in the context of refinancing and granting a new mortgage).

32. Id.

33. In re Davis, 318 BR at 123; see also In re Lee, 339 BR at 169–71.

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Landlord-Tenant Issues Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)

By Debra Beth Pevos

Introduction
The provisions of the Bankruptcy Abuse and Prevention and Consumer Protection Act of 2005 (BAPCPA) went into effect October 17, 2005. While most practicing attorneys are generally familiar with the Act’s effect on consumer bankruptcies and its stricter scrutiny of individuals who choose to file under the provisions of Chapter 7 (liquidation), the general civil practitioner should be aware of the significant effect of several provisions of the revised Bankruptcy Code on landlord-tenant issues.

Revisions to Section 362 (Automatic Stay)
Under Bankruptcy Code Section 362(a), the establishment or continuation of certain legal proceedings against the debtor are stayed. Section 362(a) prevents the filing or continuation of an eviction proceeding, as well as the enforcement of a judgment for possession or for money damages against a debtor. Before the BAPCPA revisions to the Code, the automatic stay continued in effect as to a landlord-tenant proceeding until a case was closed or dismissed or the debtor received his or her bankruptcy discharge.

Also under prior Code provisions, once a bankruptcy proceeding was commenced by a tenant, a creditor-landlord was required to file a motion seeking “relief from the automatic stay” to commence or continue an eviction proceeding against the debtor-tenant. A landlord-creditor would have to file a motion under Section 362(d) of the Code seeking relief from the stay “for cause,” including the “lack of adequate protection” relating to the landlord’s interest in the property or because the debtor-tenant lacked equity in the property and the property was not necessary for the debtor’s effective reorganization.

Through significant changes to the automatic stay provisions of Section 362, the BAPCPA deals with the problem of so-called “repeat filers.” Under revised Section 362(c), if a case is dismissed within one year after the dismissal of a prior bankruptcy proceeding (other than a Chapter 11 or Chapter 13 reorganization filed after a BAPCPA Section 707(b) dismissal of a prior case), the provisions of the automatic stay with respect to any lease terminate 30 days after filing the later case unless the debtor can demonstrate good faith as to the creditors to be stayed. The hearing to continue the stay must be completed within 30 days of the new filing. On motion of a party in interest to continue the automatic stay, the court can extend the stay in particular cases as to any creditor. Furthermore, the court can continue the stay (and impose conditions or limitations on extending the stay) “if the party in interest demonstrates that the filing of the later case is in good faith as to creditors to be stayed.”

Section 362(c)(3) of the Code provides a presumption that a new case was not filed in good faith (which can be rebutted by clear and convincing evidence to the contrary) if, as to all creditors, (1) more than one previous case in which the individual was a debtor was pending within the last year, or (2) a previous case was dismissed because the debtor failed to file or amend certain documents without substantial excuse; (b) failed to comply with adequate protection orders of the court (i.e., payment orders); (c) failed to perform the terms of a plan confirmed by the court; or (d) has had no substantial change in his or her financial or personal affairs since the dismissal of the next most previous case. The presumption will also be made if there is no reason to conclude that the new case will end with the debtor receiving a discharge (in a newly filed Chapter 7 proceeding) or fully performing a confirmed reorganization plan (under a case filed under either Chapter 13 or Chapter 11).

Section 362(c)(3)(C)(ii) provides that there is a presumption that a new case was not filed
in good faith as to a particular creditor if, in a previous case in which the individual was the debtor, the creditor had commenced a relief from stay action under Section 365(d) to terminate, condition, or limit the automatic stay, and as of the date of the previous case’s dismissal, the creditor’s action was still pending or had been resolved by terminating, conditioning, or limiting the stay as to the actions of the creditor.

Under Code Section 362(c)(4), if a debtor had two or more cases pending in the previous year that were dismissed, there shall be no stay under Section 362 upon the filing of the later case. On the request of a party in interest, the court is to promptly enter an order confirming that no stay is in effect.10

A new exception to the automatic stay for landlord-tenant matters as to all individual bankruptcy filings is found under Code Section 362(b)(22). Under that section, the automatic stay only continues for 30 days after a filing relating to eviction proceedings, unlawful detainer actions, or similar proceedings against a debtor “involving residential property in which the debtor resides as a tenant under a lease or rental agreement,” and with respect to which the lessor obtained before the date of filing a judgment of possession against the debtor.

A caveat to Section 362(b)(22) is found under Code Section 362(l), which provides that the stay will terminate under Section 362(b)(22) on the 30th day after filing the petition unless the debtor files a petition with the bankruptcy court, together with a certification under penalty of perjury, that (1) under applicable non-bankruptcy law “there are circumstances under which the debtor would be permitted to cure the entire monetary default that gave rise to the judgment for possession” after the judgment for possession was entered, and (2) the debtor “has deposited with the clerk of the court any rent that would become due during the 30-day period after the [bankruptcy] filing.”

If the debtor files such a petition and certification, and during the 30-day period after filing the debtor files with the court and serves upon the landlord a further certification that the debtor has cured the monetary default which gave rise to the judgment, the termination of the stay under Section 362(b)(22) shall not apply, unless ordered to apply by the court under Section 362(l)(3). Under Section 362(l)(3), a landlord can file an objection to any certification filed by the debtor under subsection (l), and the court will conduct a hearing on the matter within 10 days of such a filing.

Sections 362(l)(4) and 362(l)(5) contain other provisions relating to the obligations of the court and the debtor for issuing orders of default, filing certifications, and issuing notifications relating to the interrelated provisions of Sections 362(b)(22) and 362(l). If a debtor does not timely file a certification under subsection (l), the court clerk is to issue and serve a certified copy of the court docket indicating the absence of a filed certification and the fact that no stay is in effect pursuant to Code Section 362(b)(22).11 If a judgment of possession relating to residential property has been entered pre-petition against the debtor, the debtor is required to indicate this on his or her bankruptcy petition,12 and must include the name and address of the judgment lessor on any certifications filed with the court.13

The matters to be addressed in the certification are set forth under Section 362(l)(5)(B). Code Section 362(l)(5)(D) provides that the clerk of the court is to arrange for the prompt transmittal of the rent deposited under Section 362(l).

Another new exception to the automatic stay relating to landlord-tenant matters is found at Code Section 362(b)(23). This stay exception relates to eviction proceedings that seek possession of “residential property in which the debtor resides as a tenant under a lease or rental agreement based on endangerment of such property or the illegal use of controlled substances on such property.” Under Section 362(b)(23), the provisions of Code Section 362(m) come into effect if the lessor files with the court and serves upon the debtor a certification under penalty of perjury that (1) such an eviction action has been filed, or that (2) the debtor, during the 30-day period preceding the date of the filing of the certification, has endangered the property or has illegally used or allowed to be used a controlled substance on the property.

Under Section 362(m), if a lessor files a certification of endangerment of residential property or illegal use of a controlled substance on such property under Code Section 362(b)(23), the stay terminates 15 days after such certification is filed and served, unless the debtor files and serves the landlord with an objection to the truth or legal sufficiency of the landlord’s certification.14 If the debtor files such an objection, Section 362(b)(23) will not apply unless ordered to apply by

**Through significant changes to the automatic stay provisions of Section 362, the BAPCPA deals with the problem of so-called repeat filers.**
Attorneys representing landlords or tenants should remember that the BAPCPA revisions to the Section 362 automatic stay do not apply to all situations.

Assumptions and Rejections of Leases for Non-Residential Property

Under Section 365 of the former Bankruptcy Code, the debtor in a Chapter 11 proceeding (reorganization) had 60 days from the date of filing to assume or reject an unexpired non-residential real property lease. Bankruptcy courts routinely extended this time upon a debtor’s motion that showed good cause for such an extension. Under the BAPCPA revisions to Section 365(d)(4), an unexpired lease for non-residential property of the debtor is deemed rejected, and the trustee/debtor is to immediately surrender such property to the lessor if the trustee or debtor “does not assume or reject the unexpired lease” by the earlier of the date that is 120 days after the filing or the date of entry of an order confirming a plan. Section 365(d)(4)(B) permits the court to grant one 90-day extension of the period to assume or reject such a lease, for cause, if a motion is filed before the expiration of the 120-day period. No further extensions are permitted unless the debtor has the “prior written consent of the lessor in each instance.”

The changes to Section 365(d) under BAPCPA may make it more difficult for Chapter 11 debtors to effectively reorganize. Now, debtors may feel compelled to make more hurried decisions relating to certain leased locations, and they may not have the opportunity to systematically analyze whether operational changes made during the reorganization proceedings can make a marginal location more profitable. In addition, the shorter time periods for rejections or assumptions may make it more difficult for a debtor to market and assign a valuable lease. In fact, a debtor may feel compelled to reject a lease because of the shorter time limitations under revised Section 365, leaving a landlord with vacant space from which he or she might otherwise have continued to collect rent. Under Section 365(d)(3), a debtor in a Chapter 11 proceeding is required to remain current on post-petition obligations under a lease for real property, thereby providing a landlord with significant protection. This may be a compelling consideration for a landlord in a situation in which a Chapter 11 debtor-tenant requests written consent from the landlord for an extension of the time to assume or reject a lease under Section 365(d)(4).

Deposits to Utility Providers

Section 366(a) of the Code prevents a utility from discontinuing service to the debtor based on a debt owed to the utility for prepetition services. Section 366(b), however, provides that the utility may “alter, refuse or discontinue service” if neither the debtor nor the trustee, within 20 days of filing the case, furnishes “adequate assurance of payment” in the form of a deposit or other security for services after the date of filing. On the request of a party in interest, and after notice and a hearing, the court may order “reasonable modification of the amount of the deposit or other … adequate assurance of payment.”
With respect to a case filed under Chapter 11, BAPCPA revisions to Section 366(c)(2) provide that a utility may alter, refuse, or discontinue service if during the 30-day period beginning on the petition’s filing date the utility does not receive from the debtor or trustee “adequate assurance of payment for utility service that is satisfactory to the utility.” Section 366(c) defines “assurance of payment” as a cash deposit, letter of credit, certificate of deposit, surety bond, prepayment of utility consumption, or “another form of security that is mutually agreed on between the utility and the debtor or the trustee.”

Section 366(c)(3) provides a procedure for bringing the issue of the sufficiency of assurance of payment or the amount thereof before the court. In making a decision under Section 366(c)(3) as to whether an “assurance of payment” is adequate, the court may not consider (1) whether there was no security for utility services before the bankruptcy filing, (2) whether the debtor made timely payments for utility services before the bankruptcy filing, or (3) whether an administrative expense priority was available for the utility provider.21 A utility is also entitled to recover or “set off” against a security deposit provided to the utility by the debtor before the bankruptcy filing without notice or order of the court.22

Conclusion

Although the primary object of the BAPCPA was to reduce perceived abuses to the bankruptcy system by consumer-debtors, the statute has made sweeping changes in other areas that will affect attorneys involved in landlord-tenant matters. In particular, the significant changes to the Section 362 automatic stay should be reviewed by counsel who regularly represent landlords, since the previous practice of filing a motion for relief from stay under Code Section 362(d) may no longer be necessary. The Act has also streamlined the procedure for landlords to evict debtor-tenants who are “repeat filers,” have already been evicted, have caused damage to their rental property, or who have used illegal substances on the rental premises. Commercial landlords should be advised of the shortened time periods under the BAPCPA for Chapter 11 debtor-tenants to assume or reject commercial real property leases, and of the appropriateness of working with such tenants who wish to remain in tenancy while reorganizing. In addition, attorneys should also be aware of the changes made to the timing and procedures relating to debtors providing security deposit to utility providers, and to the rights of such utility providers to set off against a pre-petition security deposit amounts owed for pre-petition services.

Because of these many revisions, any attorney who routinely represents landlords should thoroughly review the BAPCPA changes to the Bankruptcy Code as they relate to landlord-tenant issues.

NOTES

2. 11 USC 101 et seq.
3. Former Code § 362(c)(2).
5. Former Code § 362(d)(2).
6. BAPCPA section 707(b) provides for the court, after notice and hearing, to dismiss the Chapter 7 (liquidation) proceedings of an individual debtor whose debts are primarily consumer debts upon a finding that the granting of relief would be an abuse of the provisions of the Bankruptcy Code. The court may also, with the Debtor’s consent, convert the case to a case under Chapter 11 or Chapter 13 of the Bankruptcy Code.
7. 11 USC 362(c) (emphasis added).
8. See 11 USC 362(c)(3)(C).
9. Other than a case refiled under Code Section 707(b); see note 5.
13. Id.
14. See 11 USC 362(m)(2).
15. See 11 USC 362(m)(2)(B).
17. See 11 USC 362(m)(2)(D).
18. See 11 USC 360(m)(3).
20. See 11 USC 366(b).
22. See 11 USC 366(c)(4).

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**Introduction**

The new provisions regarding reclamation and administrative expense claims under the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) have created considerable buzz among debtors, creditors, and the attorneys who advise them. Much has been written about the amended Section 546(c) and new Section 503(b)(9) – though not, unfortunately, by either Congress or the courts. The lack of both legislative history and judicial interpretation has meant that bankruptcy practitioners are still feeling their way through amendments that could signal a sea change in the pre- and post-petition relationship between debtors and their trade vendors – or prove to be merely a tempest in a teapot.

At first blush, it appears that Section 546(c) and Section 503(b)(9) pack a powerful one-two punch, enlarging the rights of creditors that provided goods to a debtor in two important ways. Section 546(c) expands the time for making the reclamation demand from 10 to 45 days, while Section 503(b)(9) grants creditors an administrative expense claim for the value of goods provided to the debtor within 20 days before the commencement of the bankruptcy case, even if the creditor fails to make a written demand for the goods. Together, the two sections would seem to place unsecured creditors that provided goods to the debtor in a far stronger position than under the previous incarnation of the Bankruptcy Code. Yet it is unclear precisely how each section should or will be applied, and Section 546(c) in particular may be of limited utility in practice.

**Reclamation Rights Under Section 546(c)**

The outlines of the newly-expanded reclamation right under Section 546(c) are somewhat fuzzy. Whereas the prior version of the section grounded the seller’s reclamation right in the seller’s “statutory or common-law right . . . to reclaim such goods” (generally, UCC 2-702), the amended Section 546(c) deletes the phrase “statutory or common-law,” and simply refers to the seller’s “right . . . to reclaim such goods.” As numerous commentators and at least one court have wondered, does this mean that Congress intended to create a new, self-contained, federal right of reclamation? And if so, what exactly is that right?

The likeliest answer – suggested by the court in *In re Tucker*, 329 BR 291 (Bankr D Ariz 2005) – is that Congress’ “intent was to incorporate and expand on the U.C.C. reclamation rights, rather than to supplant them entirely.” It seems implausible that Congress could really have intended, with the elimination of a four-word phrase, to render case law developed under the UCC inapplicable to reclamation claims in the bankruptcy context. It seems equally unadvisable that the courts, in construing the new Section 546(c), should not look to the UCC, the old Section 546(c) and their interpretive case law. Indeed, courts are routinely entering orders establishing post-BAPCPA reclamation procedures that exactly mirror pre-BAPCPA reclamation procedures, indicating that there is significant continuity between courts’ treatment of the old and new sections.

Another fuzzy area in the new Section 546(c) is the seller’s time for making its reclamation demand. Section 546(c)(1) sets the time for making the demand as follows: “(A) not later than 45 days after the date of receipt of such goods by the debtor; or (B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.” One article advises that sellers “may give a written rec-
lamation demand to the debtor within forty-five days after the debtor receives the goods or within twenty days after commencement of the case, whichever is later.”11 Other commentators warn that courts may take a literal view of Section 546(c)(1)(B) and “conclude that the smaller window applies,” requiring demand to be made within 45 days after receipt or 20 days after commencement of the case, whichever is earlier.12 If a seller truly has a choice between compliance with subsection (A) or compliance with subsection (B), the seller (though risking consumption of the goods) could conceivably wait a full 44 days after the petition date before making a reclamation demand. While a prudent seller will make its demand no later than 20 days after commencement of the case, it seems inevitable that a less-than-prudent seller (or one relying on the “whichever is later” view) will make its demand on the 21st day or later, resulting in a flurry of motion practice on the timeliness of the demand.

The new Section 546(c) even manages to muddy the waters while trying to clarify them. Section 546(c)(1) expressly provides that a seller’s right to reclaim goods is “subject to the prior rights of the holder of a security interest in such goods or the proceeds thereof.” All well and good so far: this provision codifies in the Bankruptcy Code a limitation that already existed under bankruptcy caselaw interpreting UCC 2-702.13 The value of a seller’s claim was always limited to “the extent that the value of the specific inventory in which the reclaiming seller asserts an interest exceeds the amount of the floating lien [of the secured lender] in the debtor’s inventory.”14 The equitable doctrine of marshaling was unavailable to reclamation claimants under pre-BAPCPA case law,15 and the amendment to Section 546(c) does nothing to disturb the status quo. At least in this regard, sellers are no better or worse off than they were before the enactment of BAPCPA.

But, the amended Section 546(c)(1) does not import the UCC and common law limitation that a seller’s rights are also subject to the prior rights of a purchaser in good faith or buyer in the ordinary course. Professor Epstein has pointed out that under the principle of statutory construction of expressio unius, a court could well find that a seller’s reclamation right under Section 546(c) is not subject to the prior rights of a purchaser in good faith or buyer in the ordinary course.16 This probably goes too far: first, because it is highly unlikely that Congress intended entirely to uncouple the reclamation right in Section 546(c) from its origins in UCC 2-702, which does make reclamation subject to the prior rights of good faith and ordinary course buyers; and second, because the explicit inclusion of such buyers’ rights was probably thought to be unnecessary. Logically, and under prior caselaw, possession by the debtor of the goods to be reclaimed is a prerequisite for the seller’s reclamation right.17 After all, the seller can’t reclaim what isn’t there. Congress may have believed that the good-faith or ordinary-course buyer needs less protection than the secured lender, since such a buyer generally removes the goods from the debtor’s possession. Or, the omission may have been an oversight, leaving courts to “read in” the limitations of UCC 2-702.

In at least one case, though, the court simply followed the literal letter of the law. In re Sidler, Inc., No. 05-89610 (PJS) (Bankr ED Mich), the Bankruptcy Court for the Eastern District of Michigan entered an order establishing procedures for the treatment of reclamation claims that authorized the debtor to return goods to “sellers (a) who timely demand in writing reclamation of goods, (b) whose goods the Debtor has accepted for loading dock at the same time, each expecting to drive away with the same goods. Under the letter of the law and the terms of the court’s order, it appears that the reclaiming seller’s rights are superior, and that the good faith purchaser is out of luck.

Although the hypothetical situation above never actually occurred,18 it does point to the more general and more pressing question: what happens to the seller’s reclama-

Amended Section 546(c)(1) does not import the UCC and common law limitation that a seller’s rights are also subject to the prior rights of a purchaser in good faith or buyer in the ordinary course.
Although Section 546 superficially appears to benefit sellers, it may in the end do more harm than good.

Reclamation is not and never has been a self-executing remedy. Even before the enactment of BAPCPA, a creditor was required to pursue its reclamation rights diligently or risk losing them altogether. Prior to BAPCPA, however, the “diligent” pursuit of rights could entail filing a motion seeking reclamation, filing an adversary proceeding, seeking a temporary restraining order, or some “other proceeding in bankruptcy court.” And the time that a creditor could delay and still be considered “diligent” varied with the circumstances. Now, however, if the only possible remedy under Section 546(c) is the actual return of the goods, a motion seeking reclamation, or “other proceeding,” clearly will not be enough. Nor will a seller have the ability to wait a couple of months or even just weeks to retain counsel and seek judicial intervention because any delay at all could be fatal to the seller’s ability to recover. The only way to preserve the right to the return of goods is to file immediately a complaint for injunctive relief in an adversary proceeding, demanding return of the goods, along with a motion for a temporary restraining order to prevent the debtor from consuming or selling the goods.

Precisely at the moment that the least information is available to creditors (including information regarding the extent, validity, and perfection of the liens of secured creditors – the existence of which might make reclaiming sellers think twice about whether it is worth investing much time and effort in pursuing reclamation), and the debtor most needs the flexibility to use both cash and inventory, the revised Section 546(c) may do harm to both parties. Sellers may make ill-advised decisions to pour money into the pursuit of a reclamation claim that, because of the existence of an undersecured lender or because the goods have already been consumed or sold, is worth little or nothing. Debtors may be prevented from running their businesses – to the detriment of the estates and all creditors – by the entry of multiple temporary restraining orders. Thus, although Section 546 superficially appears to benefit sellers, it may in the end do more harm than good.

Administrative Priority Under Section 503(b)(9)

While sellers are not likely to benefit greatly from the amended Section 546(c), they will probably fare better under Section 503(b)(9).
But, understanding and operating under Section 503(b)(9) carries its own challenges. For example, Section 503(b)(9) grants an administrative expense claim for the “value” of goods delivered in the 20 days pre-petition, but fails to define “value”30; the section requires that “the goods have been sold to the debtor in the ordinary course of such debtor’s business,” but does not suggest what “ordinary course of such debtor’s business” might mean28; and the section gives no guidance as to the timing of the payments to be made thereunder – that is, whether claims under Section 503(b)(9) must be paid immediately, according to applicable credit terms, or at confirmation.30

That last issue – the timing of the payments – is one that was the subject of numerous motions in the Dana Corporation Chapter 11 case. The court had already granted the debtors’ first-day motion for an order authorizing (but not requiring) the debtors to pay claims under Section 503(b)(9) “in the ordinary course of the Debtors’ business and on such terms and conditions as the Debtors deem appropriate.”31 In response, various creditors filed motions to compel immediate payment of their claims under Section 503(b)(9); U.S. Manufacturing Corporation (USM), a Michigan corporation, was among the most tenacious. USM analogized its claim under Section 503(b)(9) to an administrative expense claim for goods provided to the debtor post-petition, which the debtor must pay according to the applicable business terms.32 USM argued:

USM’s goods shipped in the ordinary course of business and thus entitled to administrative priority under § 503(b)(9) should be treated the same as goods shipped post-petition. In other words, USM’s § 503(b)(9) claim should be paid promptly in the ordinary course of the Debtor’s business according to the contract terms. The new statute was clearly designed to help vendors survive their customers’ bankruptcies.33

USM’s argument – though not based on any legislative history – is a cogent one. But here, as in Sidler, the court had no opportunity to evaluate and rule on the argument, since USM withdrew its motion before the scheduled hearing.34 Still, the issue is sure to resurface.

Sellers face additional obstacles in getting paid under Section 503(b)(9) in the twin spectres of Section 503(b)(9)’s “ordinary course” requirement and the limitation contained in 11 USC 502(d).35 Section 502(d) provides, in essence, that if a seller has received an avoidable preferential payment from the debtor, any claim the seller has against the debtor will be disallowed unless the seller first returns the preferential payment. If a debtor can show that goods were not sold in the ordinary course, then in one blow it will have demolished the seller’s prima facie case under Section 503(b)(9) and the primary defense to a preference claim. Of course, no one yet knows what “ordinary course” means in the context of Section 503(b)(9), and the new ordinary course defense to a preference claim under 11 USC 547(c)(2) has only begun to be tested through litigation. Thus, this issue too is certain to be of great significance to creditors with claims under Section 503(b)(9).

Impact of the Amended Section 546(c) and New Section 503(b)(9)

The overarching question with respect to Section 503(b)(9) is not: what was Congress thinking? But rather, how will this affect debtors and creditors in practice? Will creditors watch the value of their reclamation claims disappear while they rush to obtain restraining orders? Will debtors be forced to put a halt to business operations while they inventory the goods of reclamation claimants? Will debtors contemplating bankruptcy begin demanding that creditors apply payments to their most recent invoices in order to minimize exposure under Section 503(b)(9)? Will the necessity of paying Section 503(b)(9) claims at confirmation create an insurmountable obstacle to the confirmation of debtors’ plans?

As a practical matter, little is likely to change under the new sections. Reclamation claims may be rendered worthless – but they were often worthless even under the old Section 546(c) because of the prior rights of a secured lender. The amended Section 546(c) may take away the old Section 546(c)’s alternatives of an administrative expense claim or lien, but Section 503(b)(9) grants twice the administrative priority available under the old Section 546(c).37 A seller may have to wait until the conclusion of the case in order to receive payment on its Section 503(b)(9) claim, but even so, it is certainly no worse off than it was before the enactment of BAP-CPA.
The greatest import of Section 503(b)(9) is likely to be the requirement under the Bankruptcy Code that Section 503(b)(9) claims, like all administrative expense claims, be paid upon confirmation of the debtor’s plan of reorganization. The existence of significant Section 503(b)(9) claims may prevent some debtors from confirming a plan of reorganization.

As the following practice tips demonstrate, however, planning and foresight on the part of both debtors and creditors can help minimize any negative impact of the new sections.

**Practice Tips – 11 USC 546(c)**

**For Creditors**

A seller that believes it may have a valid reclamation demand should give written notice on the petition date or as soon thereafter as possible in order to preserve its rights. The longer the seller waits, the less likely it is that its goods will still be on hand on the demand date. Once the seller has fulfilled this minimum requirement, though, it would be prudent to analyze whether it is even worthwhile to try to pursue a reclamation claim. The seller should find out whether the debtor has a secured lender with a lien on inventory, and whether the secured lender appears to be undersecured. The seller should also estimate the value of goods provided to the debtor between 21 and 45 days before the petition date and the likelihood that the debtor still has possession of those goods. As discussed above, however, these analyses need to be undertaken very quickly, since it is not clear that a seller has any remedy (other than a general unsecured claim) if the goods in question are consumed or sold.

If the secured creditor is seriously undersecured, if the value of the goods in question is low, or if it is unlikely that the debtor still has possession, then an aggressive pursuit of reclamation may be a case of spending dollars to chase pennies – and the seller could still end up with no more than a general unsecured claim if the goods are consumed in the meantime. At the same time, depending on the circumstances, some action beyond merely making a reclamation demand may be warranted, even if the seller does not wish to go to the lengths of filing a complaint and seeking a temporary restraining order. In Sidler, for example, the debtor proved willing to negotiate with “squeaky wheel” reclamation claimants, and ultimately agreed to allow some administrative expense claims on a consensual basis for sellers’ claims under Section 546(c).

**For Debtors**

The most important thing for a debtor to do is to put on the brakes and get the reclamation process under firm control. The expansion of the reclamation period means that even smaller debtors may be faced with a deluge of reclamation claims. A debtor that has purchased a high volume of inventory in the 45 days pre-petition should make a first-day motion for an order establishing procedures for resolving reclamation claims and prohibiting sellers from seeking other means to reclaim their goods outside of the established procedures. Debtors should also anticipate that reclamation claimants will seek temporary restraining orders and should be prepared to move quickly to seek to have such orders dissolved.

**Practice Tips – 11 USC 503(b)(9)**

**For Creditors**

As soon as possible, a seller should file a motion to compel immediate payment of its administrative expense claim. While it is still not clear when claims under Section 503(b)(9) are to be paid, there are compelling arguments for payment in the ordinary course. Additionally, such a motion may well bring the debtor to the negotiating table. Another opportune time to raise the issue of payment of an administrative expense under Section 503(b)(9) is when the professionals in the case are seeking approval of their fee applications. The Sixth Circuit has held that 11 USC 726 requires professionals to disgorge fees in order to make pro rata distributions to creditors at the same priority level. Attorney fee claims and Section 503(b)(9) claims are both administrative expense claims at the same priority level. Thus, a Section 503(b)(9) claimant whose claim has not been paid would have reasonable grounds to object to a professional’s fee application. The objection may not succeed – the professional may demonstrate to the court’s satisfaction that it will be able to disgorge the fees in the event that the case is administratively insolvent – but the objection may nonetheless give the creditor additional leverage in dealing with the debtor and its counsel.

A seller should also begin its ordinary course analysis as soon as possible, in order to establish both that it is entitled to a claim
under Section 503(b)(9) and that it is not liable for a preference and thus not barred by Section 502(d). Until a court rules otherwise, the same ordinary course analysis used under Section 547(c)(2) will probably suffice for Section 503(b)(9) as well.

For Debtors
Before filing, a debtor should assess the total amount that it might owe as administrative expenses under Section 503(b)(9) and budget for that amount, to be held in reserve, in any post-petition financing. Thus, if the expenses are allowed, the debtor will be prepared to meet them either immediately or at confirmation. The debtor should also begin preference and ordinary course analyses early in the case, focusing on those creditors that have or could assert claims under Section 503(b)(9), to determine both whether the seller has made out a prima facie case under Section 503(b)(9) and whether the seller might be liable for a preference that would bar its recovery under Section 502(d).

NOTES
1. 11 USC 546(c).
2. 11 USC 503(b)(9).
3. Although the legislative history indicates that Congress began considering the amended reclamation and administrative expense claims at least as early as 2000, neither the US Congressional & Administrative News nor the House or Senate Reports contain any substantive discussion of either section or any indication of Congress’ intent in amending Section 546(c) and adding Section 503(b)(9).

4. As of November 1, 2006, no published opinion addresses the new Section 503(b)(9). The only published opinion addressing amended Section 546(c), In re Tucker, 329 BR 291 (Bankr D Ariz 2005), was written before BAPCPA took effect. In Tucker, the court wondered, in a lengthy footnote, whether the amended Section 546(c) “creates its own reclamation right, rather than merely validating the right that exists under the U.C.C.” Tucker, 329 BR at 298 n8. As discussed infra, this is still very much an open question.

5. 11 USC 546(c) provides: Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller’s business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods –
   not later than 45 days after the date of receipt of such goods by the debtor; or
   not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in Section 503(b)(9).

6. 11 USC 503(b)(9) provides:
   After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including –
   (9) the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor’s business.

7. MCL 440.2702.

10. Compare, e.g., the reclamation procedures orders in In re Duna Corp, et al, No 06-10354 (BRL) (Bankr SDNY Mar 3, 2006) and In re FLY LLC, Inc, No 05-20011 (MFHR) (Bankr D Del Dec 5, 2005), with In re Delta Air Lines, Inc, No 05-17923 (PCB) (Bankr SDNY Sept 16, 2005) and In re Levitz Home Furnishings, Inc, No 05-45189 (BRL) (Bankr SDNY Oct 12, 2005).
13. See, e.g., In re Pittsburgh-Canfield Corp, 309 BR 277 (6th Cir BAP 2004); In re Steinberg’s, Inc, 226 BR 8, 10 – 11 (Bankr SD Ohio 1998) (“We choose to follow the well-reasoned majority position that a perfected secured creditor is a good faith purchaser [within the meaning of UCC 2-702] and thus has priority over a reclaiming seller.”).
14. Pittsburgh-Canfield, 309 BR at 287; see also Steinberg’s, 226 BR at 12 (holding that “the reclaiming seller is entitled to an administrative claim in any surplus proceeds remaining after the perfected secured creditor’s interest has been satisfied or released”).
15. Pittsburgh-Canfield, 309 BR at 291. Under the doctrine of marshaling, “[t]he bankruptcy court has the power to order a creditor who has two funds to satisfy his debt to resort to the fund that will not defeat other creditors.” In re Dow Corning Corp, 280 F 3d 648, 656 (6th Cir 2001) (internal quotation marks and citations omitted). But, marshaling may only be invoked by a junior secured creditor against a senior secured creditor. Pittsburgh-Canfield, 309 BR at 291.
17. See, e.g., In re McLouth Steel Products Corp, 213 BR 978, 984 (ED Mich 1997) (holding that one of the requirements of a valid reclamation claim is that the “debtor had possession of the goods at the time of the reclamation demand or the goods were not in the hands of a buyer in the ordinary course of a good faith purchase at the time of the demand”).
19. MCL 440.2702(3).
20. According to Howard Borin of Schafer and Weiner, PLLC, counsel for the debtor in Siddler, not a

As soon as possible, a seller should file a motion to compel immediate payment of its administrative expense claim.
single seller came forward to reclaim goods under the reclamation procedures established by the court.


22. Debtor’s Amended Brief in Response to Su-Dan Corporation’s Motion for Allowance and Payment of Administrative Expense Claim at 6, In re Sidler, Inc, No 05-89610 (PJS) (Bankr ED Mich Feb 21, 2006); The Official Committee of Unsecured Creditors’ Objection to Su-Dan Corporation’s Motion for Allowance and Payment of Administrative Expense Claim at 6, re Sidler, Inc, No 05-89610 (PJS) (Bankr ED Mich Feb 21, 2006).

23. The Official Committee of Unsecured Creditors’ Objection to Su-Dan Corporation’s Motion for Allowance and Payment of Administrative Expense Claim at 6, re Sidler, Inc, No 05-89610 (PJS) (Bankr ED Mich Feb 21, 2006).


25. Id. A creditor that sat on its rights could even be denied an administrative expense claim or lien.

26. Id at 986. The old 546(c), a seller could, at most, obtain an administrative expense claim based on goods that were delivered in the ten days before the commencement of the case. 503(b)(9) allows an administrative expense claim based on goods that were delivered in the twenty days before the commencement of the case.

27. Note also that Section 503(b)(9) elects the “ordinary course” of the debtor’s business as the standard, while Section 546(c)’s yardstick is the “ordinary course” of the seller’s business. The potential significance of these differing criteria has not yet been tested in the courts.

30. Other commentators have highlighted other flaws in the drafting, which seem to be more illusory or at least less likely to be seriously tested in court. For instance, Richard Levin and Alesia Ranney-Marinelli have pointed out that 503(b)(9) is so poorly drafted that it “is not expressly dependent on the seller’s not having claimed the goods” or “on nonpayment prepetition.”

31. Order, Pursuant to Sections 105(a), 363(b), 364(b) and 503(b)(9) of the Bankruptcy Code, Authorizing the Debtors to Pay Prepetition Claims of Certain Essential Suppliers and Administrative Claimholders and Granting Certain Related Relief at 4, In re Dana Corp, et al, No 06-10354 (BRL) (Bankr SDNY Mar 3, 2006).


33. Id at 5.

34. Presumably, the debtor preferred to settle with USM, rather than risk the creation of an unfavorable precedent.

35. 11 USC 502(d) provides: Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 545, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522(f), 522(h), 544, 545, 547, 548, 549 or 724(a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522(f), 542, 543, 550 or 553 of this title.


37. Under the old 546(c), a seller could, at most, obtain an administrative expense claim based on goods that were delivered in the ten days before the commencement of the case. 503(b)(9) allows an administrative expense claim based on goods that were delivered in the twenty days before the commencement of the case.

38. This is especially critical for sellers in the automotive supply industry, which in recent years has seen numerous bankruptcies. The realities of just-in-time supply chains mean that most goods are consumed within days or even hours of receipt by the debtor.

39. 21 to 45 days is the relevant time period because goods received by the debtor within 20 days before the commencement of the case are covered under 503(b)(9) (and, excruciatingly bad drafting by Congress notwithstanding, it is inconceivable that a court of equity would grant a seller both reclamation of and an administrative expense for the same goods delivered in the 20 days prepetition).

40. A seller whose cost-benefit analysis indicates that reclamation really is worth pursuing should be prepared to move quickly to file a complaint in an adversary proceeding and seek a temporary restraining order. It should be noted that many first-day reclamation procedures orders expressly prohibit sellers from seeking reclamation of their goods outside of the procedures established by the procedures order. A seller in a case with such a procedures order should, simultaneously with the filing of the adversary complaint, file an objection to the procedures order in the main bankruptcy case.


42. See 11 USC 507(a)(2).
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Michigan Toolmakers’ and Moldbuilders’ Liens: Practical Considerations

By Willard Hawley

Introduction
This article will review the Michigan Special Tools Lien Act and the Michigan Molder’s Lien Act. The goal is not to propose further legislative revision but rather to provide practitioners with a guide to some of the more common obstacles that arise when addressing these types of liens. With careful consideration of the issues—particularly jurisdictional issues—tooling manufacturers and their counsel will find the acts useful in securing payment for tooling.

On March 1, 2002, the Michigan Legislature enacted amendments to the Molder’s Lien Act that provided moldbuilders in the plastics industry with various new protections through the establishment of a lien on molds and procedures for the notification of the existence of the lien to the customer. Later that year, state lawmakers extended these protections to the metal fabrication industry’s special toolmakers and part manufacturers, enacting the Special Tools Lien Act on June 27, 2002.

The statutory language of the Special Tools Lien Act essentially tracks the language of the amended Molder’s Lien Act. Because the potential issues facing attorneys construing both acts are nearly identical, these issues will be addressed collectively. For the purposes of this article, the special tools, dies, molds, and forms referred to in both acts will be referred to simply as the “tooling” unless a specific distinction is necessary.

Who’s Who?
There are three basic categories of parties affected by the acts: the customer, the builder, and the part manufacturer.

The Molder’s Lien Act provides the following definitions:
(a) “Customer” means a person who causes a moldbuilder to fabricate, cast, or otherwise make a die, mold, or form for use in the manufacture, assembly, or fabrication of plastic parts, or a person who causes a molder to use a die, mold, or form to manufacture, assemble, or fabricate a plastic product.
(b) “Moldbuilder” means a person who fabricates, casts, or otherwise makes, repairs, or modifies a die, mold, or form for use in the manufacture, assembly, or fabrication of plastic parts.
(c) “Molder” means a person who uses a die, mold, or form to manufacture, assemble, or fabricate plastic parts.

The Special Tools Lien Act loosely tracks these definitions, substituting the terms “Special Tool Builder” for “Moldbuilder” and “End User” for “Molder.” The differences between the definitions, however, are important to note. The term “End User” in the Special Tools Lien Act does not mean the “Customer,” even though it is sometimes used in this sense within the metal fabrication industry, causing some confusion. Also notable is the Molder’s Lien Act definition of a “Moldbuilder,” which specifically includes a person who repairs or modifies a mold. The Special Tools Lien Act, in contrast, contains no reference to those who repair or modify a tool. In reality, this distinction probably matters in very few cases, because the lien granted to a special tool builder includes amounts that are owed for the repair and modification of the special tool. If a party only repairs a special tool, however, but does not design, develop, or manufacture that tool, the distinction could become relevant.

Part Manufacturer’s Lien
The acts provide for parts manufacturers (molders and end users) to have a lien, dependent upon possession, for the value of the parts manufactured with the tooling. They are also entitled to retain possession of the tooling until this amount is paid. The acts provide various mechanisms for notification of the claimed lien by registered mail (or publication if a return receipt cannot be secured) to both the customer and any party with a security interest perfected by filing.

Given the part manufacturer’s ability to retain possession of the tool until paid, as well as the fact that the possessory lien takes priority over all security interests in the tool pursuant to MCL 440.9333, it appears that priority disputes as to part manufacturers will continue to be somewhat limited. As Dennis Loughlin stated in his article on the Special Tools Lien Act in the Spring 2003 Michigan Business Law Journal, “There will never be two competing [part manufacturers] with liens on the same [tooling] under the Act because such a lien requires possession. The priority between [a part manufacturer’s] lien under the Act and a [builder’s] lien under the Act is determined by the order in which the liens attach. The first lien to attach has priority. [A part manufacturer’s] user’s lien under the Act is a possessory lien and thus has priority over security interests in the [tooling].”

Obtaining a Builder’s Lien

The acts have identical two-step requirements for obtaining a tool builder’s lien. First, the builder must permanently record on every special tool for which it intends to assert a lien the builder’s name, street address, city, and state.11 Second, the builder must “file a financing statement in accordance with the requirements of section [9-502] of the uniform commercial code, 1962 PA 174, MCL 440.9502.”12 The acts provide that a builder then has a lien on the tooling for the amount that the customer or the part manufacturer owes the builder for the fabrication, repair, or modification of that tooling.13 The permanent recording on the tool and the filing of the financing statement are construed to be actual and constructive notice of the builder’s lien on the tooling, and the acts provide that the lien attaches when these steps are complete.14 The specifics of how to attach the lien and the mechanics of the act are broken down in great detail in Mr. Loughlin’s article, cited above.

Jurisdictional Issues

The apparently simple steps for obtaining a lien contain pitfalls for the builder or its counsel. Those claiming a lien must remember that the statutes are Michigan law and thus may be of no force or effect with regard to other jurisdictions. This obvious point can be muddied by two factors: (1) the choice of law provisions in the underlying contracts, which may provide that a contract is governed by the laws of another state that has different (or, more likely, no) tooling lien statutes; and (2) the “battle of the forms” inherent in most commercial settings. Moreover, the reference in the acts to section 9-502 of the Uniform Commercial Code (UCC) may foster the misconception that the builder’s lien will be uniformly recognized in other jurisdictions like any ordinary security interest, the treatment of which is incorporated into Article 9. However, this may not be the case.

For instance, a Michigan tooling builder might visit its lawyer, explaining that it is delivering tooling to a part manufacturer with plants located both in Michigan and in another jurisdiction. The tooling builder is concerned that the part producer may not be able to pay; however, without being provided with the tooling, the part producer certainly will not be able to obtain payment from its customer, whose funds are needed for the part producer to pay the tooling builder. Parts may have to be run on the tooling to complete a part production approval process (PPAP) or other similar requirement. The lawyer will then instruct the client to permanently record the required identifying information on the tool, and will file in both jurisdictions financing statements that comply with UCC section 9-502. The client then delivers the tooling to the non-Michigan jurisdiction, and the part producer is subsequently paid by the customer. However, before the part producer makes payment to the builder of the tooling, the part producer files for bankruptcy protection.

In this situation, a secured lender with an all-asset lien may argue that in the absence of a choice of laws provision that clearly favors Michigan, the Michigan acts do not apply to create liens arising in the foreign jurisdiction. The tooling builder, therefore, is unsecured. In attempting to counter this argument, the builder relies on the specific language of the acts that its lien arose the moment that it had both permanently recorded the tool and filed its financing statement. Since these events occurred in Michigan, before the tooling was shipped, the lien attached in Michigan, arose under Michigan law, and remains in existence under Michigan law. Indeed, even if there were a conflict between the laws of the two jurisdictions, the Restatement (Second) of Conflict of Law provides that, “In the absence of an effective choice of law by the parties, greater weight will usually be given to the location of the chattel at the time that the security interest attached than to any other contact in determining the state of the
It is important to note that the acts are not entirely clear on the priority between a tooling builder and a previously perfected security interest covering the tooling. It will likely be argued in future cases that, since a transaction subject to Article 9 is itself subject to the Special Tools Lien Act and the Molder’s Lien Act, the acts should provide priority to a tooling lien as against a security interest perfected under Article 9. The problem with this position is that neither of the acts specifically contains provisions that are directly contrary to the priority scheme of Article 9 because they do not address Article 9 priorities.26

There is currently only one reported case construing the Molder’s Lien Act: *Gateplex Molded Products v Collins & Aikman Plastics, Inc*, 260 Mich App 722, 681 NW2d 1 (2004). There are no cases that have addressed the Special Tools Lien Act. Thus, attorneys are left with only the statutes and some legal commentary to construe the acts. Given the extreme diff-
One alternative approach may be to negotiate for a purchase money security interest (PMSI) that would be the lien of the typical all-asset secured lender’s lien. If this approach is undertaken, counsel for a builder of tooling should pay particular heed to UCC section 9-324(b), which requires a creditor claiming a security interest in inventory to send an authenticated notification to the holder of a conflicting interest in inventory to maintain priority in the inventory and its identifiable cash proceeds. At first glance, the tooling delivered by the builder to the part manufacturer may appear to be equipment under the Uniform Commercial Code. In many instances (particularly in the automotive sector, where the auto manufacturers typically own the tooling necessary to produce their products) the tooling has been purchased by the part manufacturer for resale to the auto manufacturer. In such instances, the tooling in the part manufacturer’s hands would presumably constitute inventory, not equipment. Relevant portions of UCC section 9-102(vv) state that “inventory” means the goods, other than farm products, that are held for sale or lease or to be furnished under a contract of service. As such, a PMSI without an authentication might then be followed by a sale to an automotive manufacturer, subsequent payment by the manufacturer to the parts manufacturer, and the inability later to trace the proceeds. This scenario is more likely if the tooling is not also covered by a builder’s lien.

The better practice would be to negotiate an agreement for direct payment from the customer to the builder (which may not be possible or commercially desirable), or to obtain an intercreditor agreement with other secured parties who might also claim a security interest in the tooling. Under this arrangement, a builder would enter into an agreement with the other secured parties to clarify its lien position and to provide for the segregation of proceeds and other mechanisms used to secure the payment obligation. Such an approach may create commercial barriers for a tool builder that is already competing against a market that has significant excess capacity. However, the goal for the tooling builder and its counsel must be to properly balance the competing interests of securing payment and getting the job in the first place.

The high value of the tooling, given the relatively small size of many builders, can make this a challenge; but as is almost always the case in negotiating these issues, this is much easier to do at the inception of the contract than at the end, before production schedules and other timing factors detrimentally affect the relationship between the builder and the part producer.

With careful consideration, counsel can be of great assistance in helping the tool builder protect its right to payment while still meeting the part producer’s expectations.

NOTES

1. 2002 PA 481, MCL 570.541 et seq.
2. 1981 PA 155, MCL 445.611 et seq. The full title of the act is “An act to provide for ownership rights in dies, molds, and forms for use in the fabrication of plastic parts under certain conditions and to establish a lien on certain dies, molds, and forms.”
3. MCL 570.541–571.
4. MCL 445.611.
5. See MCL 570.542.
7. Compare MCL 445.611(b) and MCL 570.542(d).
8. MCL 445.618 and MCL 570.553.
10. Loughlin at 29. While Mr. Loughlin’s article was specific to the Special Tools Lien Act, the application to the Molders Lien Act is identical.
11. MCL 445.619(1) and MCL 570.563(1).
12. MCL 445.619(2) and MCL 570.563(2).
13. MCL 445.619(3) and MCL 570.563(3).
14. MCL 445.619(3)–(4) and MCL 570.563(3)–(4).
15. Restatement (Second) of Conflict of Laws § 251.
16. Id. at § 252.
17. See UCC 9-203 (2)(b).
18. Black’s Law Dictionary (6th ed 1990). The full range of definitions supplied by Black’s will not be included here, but each one contains the element of a charge over property of another to secure performance of an obligation. The Bankruptcy Code likewise defines a lien as a “charge against or interest in property to secure payment of a debt or performance of an obligation” 11 USC 101(37).
22. MCL 440.9201 (2)(o)–(u).
23. For further discussion of this issue, see Eric I. Lark and Kevin T. Block, Recent Amendments to the Michigan Mold Lien Act, Mich Bus LJ, Summer 2002, at 5.
Will Hawley is an associate with McDonald Hopkins Co., LPA. His primary areas of practice include business and debt restructuring within Chapter 11 bankruptcy and utilizing out-of-court workouts. A graduate of Michigan State University and Wayne State University School of Law, Will has extensive experience resolving vendor/vendee issues within bankruptcy, particularly in the automotive and plastics industries.
The Michigan Business Mediation Program (MBMP) is a collaborative effort to provide Michigan businesses with a process to resolve disputes, if they choose, through mediation as an alternative to litigation. The parties working together to build this program include the ADR Section’s Access Task Force, the Dispute Resolution Association of Michigan (DRAM), MSU’s College of Law, and key players within the legal and business communities.

As we all know, conflicts arise even among the best-run businesses. There are times when litigating these disputes is the only answer. Without question, some cases deserve to be aggressively litigated. However, very few civil cases go to trial and the vast majority settle or are dismissed. Frequently these settlements are achieved in the course of mediation under the new Court Rules, MCR 2.410 and 2.411, at the end of contentious litigation.

As eloquently stated by Richard Hurford, Director of Litigation for Masco and immediate past Chair of the ADR Section of the State Bar:

Why avoid the inevitable until late in the litigation cycle when the vast majority of transactional costs have already been incurred? The vast majority of cases are ripe, at an early stage, for a mutually agreeable resolution that is in the best interests of both parties...Litigation is not a profit center...A balance must be struck as to when to resolve and when to litigate aggressively...

In my opinion, the Michigan Business Mediation Program is one of the crucial initiatives that businesses in Michigan can favorably embrace in attempting to strike that balance. It will provide Michigan businesses with an appropriate “off ramp” from the litigation highway that can be intelligently and appropriately taken at an early time in the dispute resolution process when transactional costs can be minimized, business relationships can be preserved, and the parties to a dispute can be empowered to formulate “their own” resolution rather than having a resolution imposed upon them by a court, jury or arbitrator.

How Does It Work?
The MBMP is designed to provide businesses with a specific mechanism to reap the benefits of early mediation, while at the same time providing support to the nonprofit dispute resolution community. In the interest of reducing the costs of traditional litigation and producing a mutually satisfactory solution for all concerned, businesses that wish to join may first register without cost or obligation. Members then have the opportunity to sign a pledge stating that they agree to work toward resolving business disputes before litigation through mediation in appropriate cases. In the event mediation does not resolve the matter, signatories retain the option to pursue other avenues, such as litigation. The program connects the parties and determines their preference for when and where mediation should take place. The parties are then provided with a roster of experienced business mediators who provide mediation services at their regular rates. MBMP is asking our mediators to donate charitably 10 percent of their fee to DRAM for distribution to the community dispute resolution centers in order to support dissemination of mediation services to the public.

How is the MBMP Program Being Presented to Businesses and Their Lawyers?
The MBMP is being offered as a service to businesses. The focus of the program is to address the interests, concerns, and needs of businesses in the resolution of disputes by offering a process that is often better, faster, less expensive, and more efficient than traditional litigation. With no registration costs, businesses may sign on to the program if they are interested. They may also sign the pledge, send it in, and advise DRAM when they have a business dispute in need of mediation.

MBMP believes mediation is the answer for business disputes because typically the relationship between the parties is an extremely important factor. Mediation, by its
nature, focuses upon solutions rather than positions. Further, there are often business considerations underlying the dispute the resolution of which can benefit both sides. Mediation may have the flexibility to deliver innovative solutions, which a lawsuit cannot provide. In addition, any business that has experienced protracted litigation knows that it can involve large transactional costs, not only in dollars but also as a distraction from the core business. As a result, businesses are becoming increasingly aware that it is frequently in their best interests to resolve disputes early in the process. The MBMP provides them with this opportunity and a specific mechanism to do so.

MBMP is inviting interested businesses and their attorneys to join it in building the program within their own industries with the goal of addressing specialized concerns that may arise within different business segments. Interested persons should contact DRAM’s Director, David Gruber at resolve@tds.net or Tony Braun at (313)823-0192.

MBMP is also seeking to identify individual businesses in key segments of the market who would be interested in serving as champions of this program among their peers. These business segments include automotive suppliers, commercial real estate, construction, financial services, health services, manufacturing, retail, and technology.

Are There Similar Programs in Other States?
Nina Meierding, keynote speaker at the most recent ANDRI, together with Randy Lowry, Peter Robinson, and others built a very similar program in southern California a few years ago. Their program also involves paid mediators collaborating with the nonprofit community. It now enjoys widespread use and has worked very well in providing businesses and other professionals with the opportunity to resolve their disputes.

What Is on the Horizon for Training Business-to-Business Mediators?
Under the leadership of Mary Bedikian, MSU College of Law has a newly approved concentration in Alternative Dispute Resolution. The MSU College of Law ADR Program provides specialized mediator training for business-to-business disputes. The first 12-hour session was held June 9 and 10 at the MSU Management Training Center in Troy, Michigan and future training sessions are planned.

Why Should You Care?
DRAM believes the MBMP will allow the business community, its lawyers, and business mediators to collaborate in achieving timely and cost effective resolutions of business disputes. If you are interested in helping to build this program, DRAM needs help from attorneys, business leaders, and mediators who share the belief that this program will deliver value to all concerned.

MBMP is intended to provide a specific mechanism/program to bring parties into mediation, including a neutral intake process, a neutral site, experienced and specially trained mediators in business disputes, and a program that will promote and develop the mediation process in business cases. DRAM believes this program will improve as more businesses in each segment sign up and commit to early mediation as part of their dispute resolution process.

DRAM anticipates that MBMP will have statewide application and is recruiting lawyers who are interested in identifying, broadcasting, and/or presenting to business associations and entities statewide that stand to benefit from the program.

DRAM is also recruiting mediators who have background, training, and/or experience in mediating business disputes. The initial criteria for mediators will be qualification for SCAO approved court mediation. Interested mediators should email Tony Braun and attach their CV and rate schedule. We would also welcome hearing any questions, comments, or concerns you might have. Please don’t hesitate to contact either Dave Gruber, DRAM’s Director at (517) 485-2274, resolve@tds.net or Tony Braun at (313)823-0192, rlbraun@hotmail.com.

NOTE
1. According to the Michigan Supreme Court 2005 Annual Report, p 31, slightly more than two percent of circuit cases were disposed of by a jury or bench verdict in 2005. This report is available online at http://www.courts.michigan.gov/SCAO/resources/publications/statistics/2005/2005execsum.pdf.
Richard (Tony) Braun practices in the areas of business law, commercial litigation, product liability litigation, distribution law, complex civil litigation, toxic torts, insurance, and risk management. He also actively practices in ADR, both as an advocate in litigation and as a mediator. He is chair-elect of the State Bar’s ADR Section and serves as a member of the Section’s Executive Committee and as chairperson of the Access and Business Mediation Task Forces. He served as an Adjunct Professor in teaching Detroit College of Law’s first Litigation and Trial Advocacy Seminar and more recently the Dispute Resolution and Problem Solving at Michigan State’s College of Law. Mr. Braun was the 2004 recipient of the George Bashara Award for service to the ADR Section and is a member of the Wayne County Mediation Tribunal Association.
Labor and Employment—Retaliation

In Burlington N & Santa Fe Ry v White, No 05-259, 126 S Ct 2405 (June 22, 2006), the respondent accused her supervisor of sexual harassment. She was then reassigned to a different position, and then became involved in a dispute with her new supervisor and was suspended 35 days without pay. The petitioner concluded the respondent had not been insubordinate, reinstated her, and awarded her 35 days of back pay. Nevertheless, the respondent sued, charging the job change and suspension was an unlawful retaliation under Title VII. 42 USC 2000e-3(a). The respondent was awarded $43,000 compensatory damages at the U.S. District court level, which was upheld by the Sixth Circuit.

The Supreme Court affirmed, holding that 42 USC 2000e-3(a), the retaliation provision, does not confine the actions and harms it forbids to those that are related to employment or that occur at the workplace, differing from the substantive prohibition against discrimination at the workplace. 42 USC 2000e-2. The anti-retaliation provision covers those (and only those) employer actions that would have been materially adverse to a reasonable employee or job applicant in filing a claim against the employer. This means that the employer’s actions must be harmful to the point that they could well dissuade a reasonable worker from making or supporting a charge of discrimination. In this case, the new position’s duties were more arduous, and a month without pay would be found injurious by itself by many employees, even if they were later given back pay. Moreover, respondent received medical treatment for emotional distress during her suspension.

Labor and Employment—Statute of Limitations on Discrimination Claims

In Joliet v Pitoniak, 475 Mich 30, 715 NW2d 60 (2006), plaintiff had filed a claim against her employer for violation of the Civil Rights Act, MCL 37.2101 et seq, breach of contract, and misrepresentation. The alleged discriminatory acts occurred more than three years prior to the November 30, 2001 filing date. The trial court and court of appeals denied defendants’ motion for summary dismissal on statute of limitations grounds, ruling that the 3-year limit (MCL 600.5805(9)) tolled until the date of plaintiff’s last day of work, relying on Collins v Comerica Bank, 468 Mich. 628, 664 NW2d 713 (2003) and Jacobson v Parda Fed Credit Union, 457 Mich. 318, 577 NW2d 881 (1998).

The Supreme Court reversed, granting the defendants’ motion, holding that unless plaintiff had filed for discriminatory discharge, as in Collins, the statute of limitations runs from the date of the discriminatory acts, citing Magee v DaimlerChrysler Corp, 472 Mich. 108, 693 NW2d 166 (2005), and overruling Jacobson, since accrual begins when the adverse discriminatory acts occur, not when any actual damage results. MCL 600.5827. Thus, if a plaintiff’s complaint does not make out a claim of discriminatory discharge, a claim of constructive discharge for a separation from employment occurring after the alleged discriminatory acts cannot serve to extend the period of limitations for discriminatory acts committed before the termination.

Taxation—Property Tax—Mutual Mistake of Fact Refunds

In Ford Motor Co v City of Woodhaven, 475 Mich 425, 716 NW2d 247 (2006), petitioner filed incorrect personal property statements with the respondent, which accepted and relied on the statement to calculate petitioner’s property taxes. Petitioner later discovered the errors and sought refunds based on the “mutual mistake of fact” remedy in MCL 211.53a. The Michigan Tax Tribunal (MTT) refused to allow petitioner to amend one of its petitions, which named the incorrect taxing authority as defendant, and named multiple parcels in its petition, in contravention of MTT administrative rules. 1999 AC, R 205.1240. The MTT and the court of appeals, for different reasons, also concluded petitioner did not state valid claims of mutual mistake of fact within the meaning of MCL 211.53a. The court of appeals, for instance, ruled that this was not a mutual mistake on the same facts because petitioner believed certain of its assets were taxable and respondent that petitioner’s property statement was accurate, the problem was petitioner’s “sole mistake,” and contract law principles were not applicable to property tax law.

The Michigan Supreme Court ruled that “mutual mistake of fact” has a “peculiar ... meaning under the law” and should be understood in light of common law decisions. The Court defined mutual mistake of fact in Michigan common law to mean “an erroneous belief, which is shared and relied on by both parties, about a material fact that affects the substance of the transaction.” Although most material mistake decisions involved contract law, the definition itself could be applied here. The Court held that both parties were mistaken about the same thing – that the property statements were correct, so it was a mutual mistake under Michigan law. Further, the MTT abused its discretion when it denied petitioner’s motion to amend its petition; since the claim was no longer futile, the MTT had no reasonable grounds to disallow the amendment of the petition.

Contracts—Suits by Third Party Beneficiaries

In Kisiel v Holz, No 267487, 2006 Mich App LEXIS 2606 (Mich Ct App August 29, 2006), a general contractor constructing plaintiff’s residence entered into an oral contract with a subcontractor for excavation and pouring of concrete. After the residence was completed, cracks appeared in the basement walls and floors. Plaintiff named the subcontractor as a co-defendant, suing it for breach of contract,
nigent performance of contract, and breach of implied warranty of habitability. The trial court granted the subcontractor’s motion for summary judgment. On appeal, the Court of Appeals affirmed, holding that although the work performed by a subcontractor ultimately benefited the plaintiff as the property owner, he was not the intended third-party beneficiary of the contract between the general contractor and the subcontractor in the absence of clear contractual language or an express promise to the contrary. The plaintiff’s negligence claim failed because he did not allege a duty on the part of the subcontractor separate and distinct from the oral contract between the contractors. The implied warranty of habitability claim also failed because neither the general contractor nor the subcontractor was a builder-vendor as described in *Smith v Foerster-Bolser Constr, Inc*, 269 Mich App 424, 711 NW2d 421 (2006), because the general contractor had agreed to construct a new home on land already owned by the purchaser.

**Franchising—Breach of Contract**

In *Hamade v Sunoco Inc*, 271 Mich App 145, 721 NW2d 233 (2006), plaintiff had owned and operated a Sunoco gas station for many years, operating under a 1989 franchise agreement that had been extended year by year until 1996. In 1997, defendant stated that it would not sign a new agreement until plaintiff made certain improvements. Plaintiff did so, and signed the franchise agreement but alleged that he did so on an oral assurance that defendant would not open or license another gas station within a certain distance of plaintiff’s. In 2000, Sunoco approved a new station one mile from plaintiff’s, and later that year, plaintiff was sold an allegedly bad batch of gasoline by defendant. Plaintiff sued in 2001, alleging breach of contract and tortuous interference with a business relationship by intentionally delivering defective fuel, and a breach of Michigan’s Franchise Investment Law (MFIL). MCL 445.1501 et seq. After a protracted procedural history, the trial court ultimately summarily dismissed all of plaintiff’s claims in 2005.

On appeal, the Court of Appeals ruled that plaintiff did not fall under the definition of franchisee under MFIL, because he had never paid a franchise fee. MCL 445.1502(3)(c). There was no formal “franchise fee” in the agreement; although the relationship included minimum purchase and inventory requirements, which can be “indirect” franchise fees, but only if the price charged is above market and the inventory requirements are excessive. MCL 445.1503(1). The Court found that the evidence on the record did not support the allegation that the wholesale price charged the plaintiff was excessive or that the quota was unreasonable at the time the agreement was signed. MFIL is designed to apply to franchise agreements at formation, and cannot change them into franchise agreements mid-contract. The required improvements to the station in 1997 were not franchise fees, because the improvements primarily benefited the plaintiff. A $55,000 advance to plaintiff, absent excessive interest, and required attendance at seminars, absent mandatory fees, also did not establish the existence of franchise fees. The court also held that an integration clause in the 1997 agreement precluded any allegations of an oral agreement under the parol evidence rule.

**Taxation—Sales Tax—“Bad Debt” Refunds**

In *DaimlerChrysler Servs of N America, LLC v Department of Treasury*, No 264323, 2006 Mich App LEXIS 2285 (July 25, 2006), plaintiff sought relief from tax overpayments on cars sold by affiliated dealers in 1998 and 2000, under the “bad debt” provision of the General Sales Tax Act (GSTA). MCL 205.51 et seq. Under a financing agreement with the dealers, if the purchaser qualified for financing, the dealers paid the full purchase price, plus sales tax that was remitted to the state by the dealer. In cases where purchasers defaulted on the car loans, and plaintiff was not able to recoup the original purchase price, lower courts had ruled that plaintiff could not also recoup the excess sales tax paid, because the plaintiff was not a “taxpayer” under the meaning of the statute. The taxable moment occurred between the dealer (the seller of the vehicle) and the purchaser; the “bad debt” provision only applied to “sales at retail.”

The Court of Appeals noted that the pre-2004 GSTA defined a taxpayer as “a person subject to tax under this act” and included the definition of “person” as “...any group or combination acting as a unit...” MCL 205.51(1)(a), (h). The Court held that a taxpayer need not be a single retailer for the purposes of the bad debt provision; a sales finance company along with its affiliated dealers “acting as one unit” to make sales of motor vehicles and engaged in business in Michigan was a taxpayer for this provision as well.

**Taxation—Use Tax—Resale Vehicle Exemption**

In *Betten Auto Ctr, Inc v Department of Treasury*, Nos 265976, 265977, 265978, 2006 Mich App LEXIS 2416 (August 1, 2006), plaintiff had purchased “demonstration vehicles” for resale, which were driven by employees for a limited time on condition that they were not used for personal use and were allowed to be showed to customers during business hours. Defendants appealed from a ruling by the Court of Claims that these vehicles were exempt from the 6 percent use tax, MCL 205.91 et seq, under the resale exemption in MCL 205.94(1)(c). The number of exempted vehicles under MCL 205.94(1)(c) varies with the overall volume of car sales at the dealership, up to a maximum of 25 per calendar year.

On appeal, defendants argued that at least the demonstration vehicles beyond the first 25 should be taxed at the 6 percent rate, because the employees’ use of the vehicles was a “conversion” under MCL 205.97. For demonstration vehicles used before March 27, 2002, the Court of Appeals disagreed, holding that the MCL 205.97 applied only to consumers, and thus the employees’ use was not a conver-
sion. The dealerships clearly were not consumers because they did not purchase the vehicles for personal, family, or household use “with no intention of resale,” and the employees specifically agreed not to use the vehicles for personal reasons. In 2002, the Legislature amended MCL 205.93(2), which applied a reduced use tax rate of 2.5 percent and a $30 monthly charge for vehicles “held for resale” that did not fall within the MCL 205.94(1)(c) “demonstration vehicle” exemption. The Court held that the “resale exemption” also mentioned in MCL 205.94(1)(c) directly conflicted with the purpose of the 2002 amendment, and thus the 2.5 percent tax rate did apply to vehicles beyond the number allowable as exempt demonstration vehicles under MCL 250.94(1)(c) that were used by the dealership employees after March 27, 2002.

**Labor and Employment—Americans with Disabilities Act**

In *EEOC v Watkins Motor Lines, Inc*, 2006 US App LEXIS 23177 (6th Cir 2006), the court of appeals upheld a district court granting of the defendant’s motion for summary judgment. The district court held that the plaintiff’s morbid obesity, unrelated to any physiological cause is not an impairment under the Americans with Disabilities Act of 1990 (ADA), and thus plaintiff’s discharge from his job was not a violation of the ADA. Moreover, the defendant did not perceive the plaintiff to be substantially limited in major life activities, which would have also qualified plaintiff to sue under the ADA. 42 USC 12102(2)(A), (C).

On appeal, plaintiff argued that the defendant perceived him as having an ADA impairment, and thus fell under the protection of the act. The court held that obesity (even morbid obesity) is not normally an impairment, but gross obesity or obesity caused by another underlying physical or mental impairment may constitute an impairment.

**Labor and Employment—Family and Medical Leave Act**

In *Killian v Yorozu Auto Tenn, Inc*, 454 F3d 549 (6th Cir 2006), plaintiff, an hourly spot-welder, filed for a two-week medical leave under the Family and Medical Leave Act (FMLA). 29 USC 2601 et seq. During surgery, her doctor found her condition was more serious, and plaintiff requested a one-week leave extension from the company nurse. The nurse did not have the authority to grant such an extension, and when plaintiff tried to rectify the situation by filing additional medical certification for the extended leave a day after her original leave was to expire, the company fired her. Plaintiff ultimately found a job as a cosmetologist after using a retaining grant. At trial, defendant’s leave policy was found, on its terms, to have violated FMLA, and plaintiff was awarded $55,000.

The Sixth Circuit affirmed, noting that plaintiff did not violate the FMLA notice requirements, 29 CFR 825.302, and even if so, violations of the notice requirements did not constitute grounds for dismissal. 29 CFR 825.304(a). Finally, defendant was obligated to provide 15 days for plaintiff to provide medical certification after its request. 29 CFR 825.311. Remedy for failure to this was also delayed leave, not termination. Defendant could not use a fitness-for-duty requirement to terminate plaintiff, since this policy was uniformly applied to all employees. In terms of the damage award, the Court ruled the trial court’s ground for awarding it was in error, since plaintiff had not demonstrated a causal connection between the FMLA leave and her termination. However, alternate grounds, interference with FMLA rights, were present. Since plaintiff’s leave was proper, defendant’s refusal to reinstate her was interference with her FMLA rights under 29 USC 2614(a). Finally, plaintiff’s enrollment in school after an eight-month search for an equivalent job was not a failure to mitigate damages.
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