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BANKRUPTCY

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I. Distinction between Actions by Creditors under Michigan Law in Michigan Courts and Proceedings in a Federal Bankruptcy Court

As County Treasurer, you proceed to foreclose real property taxes in the circuit court in the County in which you are located. That court, which is a state court, will generally have jurisdiction over your foreclosure proceeding. If the owner of the property or another creditor attempts to stop you from foreclosing the property or from selling it after the foreclosure proceedings have been completed, the Judge who has jurisdiction over the foreclosure in your County's circuit court will almost always be the Judge handling such matters.

However, if the property being foreclosed has a connection with a person, corporation, or other business entity, which is subject to the jurisdiction of a federal bankruptcy action, the property you are foreclosing will or could fall under the jurisdiction of such federal bankruptcy court and you will be required to follow orders entered in that court as well.

When there is a federal bankruptcy, the federal bankruptcy judge has the power to stay (stop) your circuit court foreclosure of the property in question and you will have observe all orders which apply in that bankruptcy proceeding if they apply to the property being foreclosed.

II. General Description of the Three Types of Bankruptcy Proceedings for Individuals and Companies

There are three types of bankruptcy proceedings which could apply to property being foreclosed by a County Treasurer. One type is governed by Chapter 7 of the bankruptcy code. The second type is governed by Chapter 11 of the bankruptcy code and the third type is governed by Chapter 13 of the bankruptcy code.

A. A Proceeding under Chapter 7 of the Bankruptcy Code

In a Chapter 7, a trustee is appointed from a panel of trustees. It is the duty of the trustee to examine the debtor's schedules and statement of financial affairs, to object to the debtor's claim of exemptions, to pursue claims against creditors of the estate for preferences and/or fraudulent transfers, liquidate assets for the benefit of creditors and distributes the assets to creditors. A Chapter 7 may be filed by an individual, a partnership, an LLC and a corporation.

B. Reorganization Proceeding under Chapter 11 of the Bankruptcy Code

In a Chapter 11 case, which is commonly called a reorganization proceeding, the company or individual filing for Chapter 11 remains in possession of their assets and assumes the role of the trustee. The goal of a Chapter 11 is to restructure the finances of the company or person, propose a plan of reorganization and emerge from bankruptcy as a viable entity. A trustee can be appointed in a Chapter 11 case. Individuals can file for Chapter 11, however, a Chapter 11 is better suited for companies given the cost and complexity of a Chapter 11 proceeding.

C. Proceeding under Chapter 13 of the Bankruptcy Code

In a Chapter 13 case, like a Chapter 7 case, a trustee is appointed. The trustee's role in a Chapter 13 case, however, is slightly different. A debtor in Chapter 13 proposes a plan to repay some or all of their debts by dedicating some of their income to repay their creditors over a span of 3-5 years. The trustee assumes the role, most commonly, as a disbursing agent receiving the debtor's plan payments and making disbursement to the creditors pursuant to the terms of the Chapter 13 plan. Corporations may not file Chapter 13, only individuals and unincorporated entities such as sole proprietorship may file a Chapter 13.

III. The Impact of a Bankruptcy Filing on the Collection of Delinquent Real Property Taxes Results in an Automatic Stay which will Prevent Action to Foreclose Real Property for Non-Payment of Property Taxes

A. Discussion of the Automatic Stay

Upon the filing of any bankruptcy proceeding under any chapter of the bankruptcy code, an automatic stay is imposed. The automatic stay, as the name implies, stays automatically most actions against the debtor or property of the debtor. For example, the filing of bankruptcy stops your sale for foreclosure and stays eviction actions.

The filing of bankruptcy, whether a voluntary or involuntary filing operates as a stay against all entities, including governmental units. Among the actions that are stayed upon the filing of bankruptcy include the commencement or continuation of any actions against the debtor that were or could have been commenced before the filing of bankruptcy or to recover a claim against the debtor that arose before the filing of bankruptcy, the enforcement against the debtor or against property of the estate of a judgment obtained before bankruptcy, any act to obtain possession of property of the estate or to exercise control over property of the estate, any act to create or perfect or enforce any lien against property of the estate, any act to collect or recover a claim against the debtor that arose before the filing of bankruptcy.

There are however several important exceptions to the imposition of the automatic stay. With respect to taxes, one exception to the automatic stay is to allow an audit by a governmental unit to determine tax liability, the issuance to the debtor by a governmental unit of a notice of tax deficiency, a demand for tax returns or the making of an assessment for any tax and issuance of a notice and demand for payment of such assessment. However, any tax lien that would otherwise attach to property of the estate by reason of such an assessment does not take effect unless such tax is a debt of the debtor that will not be discharged in the case and such property or its proceeds are transferred out of the estate to, or otherwise revested in, the debtor.

Another exception to the automatic stay is the creation of perfection of a statutory lien for an *ad valorem* property tax or a special tax or a special assessment on real property whether or not ad valorem, imposed by a governmental unit, if such tax or assessment comes due after the date of the filing of the petition.

The automatic stay remains in place with respect to any act against property of the estate until such property is no longer property of the estate. The stay of any other act continues until the earliest of the time the case is closed; the time the case is dismissed; or if the case is a case under Chapter 7 concerning an individual or a case under Chapter 9, 11, 12 or 13, the time the discharge is granted or denied.

B. Creation of a Bankruptcy Estate

The filing of the bankruptcy also creates an estate. The bankruptcy estate is a different legal entity than the debtor prior to the filing of bankruptcy. All of the debtor's assets, except exempt assets, become property of the bankruptcy estate.

C. Sale of Property as Permitted by Bankruptcy Court

The bankruptcy code allows the trustee (or debtor in Chapter 11) to sell property free and clear of interest. (§363f sale). The typical 363(f) sale order will provide that the property is sold free and clear of liens with liens attaching to proceeds in the order of their priority. The bankruptcy courts, in general, now, will enter orders confirming sales of real property. In a Chapter 11 cases, the bankruptcy court can order that the sale of property be free of stamp taxes or transfer taxes. Many orders of sale in Chapter 11 will contain this important language. The tax exemption provision technically only applies to sales under a Chapter 11 plan. However, courts have expanded this bankruptcy code provision to include sales of assets outside of a formal plan but in furtherance of a plan.

In Chapter 13 cases, there are “model” plans that the Chapter 13 trustees use. However, debtors can deviate from the “model” plan. The model Chapter 13 plan provides that upon confirmation of the plan, all property of the estate shall vest in the debtor. However, a number of practitioners regularly provide that upon confirmation all property of the estate will not vest in the debtor but remain property of the estate. Chapter 13 practitioners believe that by providing that property remains in the estate, that may provide great debtor protections in the event that the debtors fail to make payments to the creditors. In the Eastern District of Michigan, the model plan also provides that debtors may not incur debt in excess of \$1,000 without first obtaining approval from the court. Chapter 13 plans are modifiable. Plans may also provide for arrearages on mortgages to be cured over a reasonable period of time.

IV. What should you do if you Find Out that One of the Properties which is either Delinquent for Non-Payment of Real Property Taxes or has been Deeded to you as County Treasurer is Subject to the Jurisdiction of a Federal Bankruptcy Court

A. Consult with Bankruptcy Counsel

As soon as you are aware that one of your properties, which is in foreclosure, has been placed under the jurisdiction of a bankruptcy court, you may wish to consult with counsel to see whether you need to retain bankruptcy counsel because of the nature of the bankruptcy proceeding.

B. Matters which should be Reviewed by Bankruptcy Counsel

It is highly recommended that in any bankruptcy proceeding when one is advised of a pendency of a proceeding, that counsel be contacted immediately. Chapter 13 plans and pleadings should be reviewed to determine the exact power and nature of proposed sales and distribution of assets; Chapter 11 motions to sell property should be reviewed to insure that all creditors and parties in interest, including tax authorities have adequate notice of the pleadings and the in all cases the debtor has the

requisite permission and authority to sell and convey property. In any chapter, it is important to determine whether the debtor has requisite authority to sell and the disposition of the proceeds.

An important event in a Chapter bankruptcy proceeding is a discharge. A discharge as it implies, discharges the debts of the debtor. Certain debts, however, are not dischargeable. These types of non-dischargeable debts include child support payments, income tax liability, alimony, maintenance and support payments and debts found to be non-dischargeable by the bankruptcy court.

A discharge however does not end the case. In many instances, a debtor will receive a discharge in a Chapter 7 and the case remains open for quite some time afterwards. The property of the estate remains property of the estate after the discharge. The property remains part of the estate until the case is closed or the property is abandoned by the trustee. It is important to verify whether a debtor has received a discharge and the disposition of the property that the debtor seeks to sell or refinance.

V. **Pointers which Should be Observed by County Treasurers when a Bankruptcy Applies to Property being Foreclosed**

A. **In General**

As to some practice pointers and tips, it is recommended that when you receive notice of a bankruptcy or suspect that a bankruptcy was filed to review the Bankruptcy Court docket on PACER. Anyone can review PACER, although you do need a subscription to PACER and to view the actual pages of a docket will cost 10 cents a page (unless you have very limited viewing of pages, then there is a minimum amount of pages one can view a month without charge).

It is also recommended that a Proof of Claim be filed in Chapter 11 cases and Chapter 13 cases. Chapter 7 cases are filed as “no asset” cases which advises creditors not to file claims unless they are advised to do so in the future. However, even in a Chapter 7 “no asset” case, a proof of claim can be filed. A proof of claim does not need to be filed by an attorney. The proof of claim, however, does need to be signed and attach to the proof of claim copies of underlying documentation to support the claim, such as tax bills.

In Chapter 13 and Chapter 11 cases, the plan needs to be closely reviewed to make sure that the debtor is treating the tax authority correctly both in dollar amount owed and in the appropriate interest rate to pay.

In all Chapters of the bankruptcy code, care needs to be made if a debtor or trustee seeks to sell the real property to make sure that the tax claims are paid from the proceeds of sale at closing.

B. Special Provisions which Apply in Chapter 7 Proceedings

Congress in 2005 amended the Bankruptcy Code to provide that the bankruptcy trustee in a Chapter 7 case could not subordinate perfected unavoidable tax liens arising in connection with *ad valorem* taxes on real or personal property. In the past, Chapter 7 trustees were able to subordinate tax liens in order to pay other claims, such as trustee fees.

VI. Municipal Bankruptcies

Municipalities under the provisions of Chapter 9 of the Bankruptcy Code may be permitted to file for bankruptcy protection. The Bankruptcy Code does not permit a municipality to be placed under the jurisdiction of the federal bankruptcy court unless it meets certain requirements. First, state law must permit the municipal entity to be subject to the bankruptcy court’s jurisdiction by meeting certain requirements before the

municipality may file a voluntary petition under Chapter 9 with a federal bankruptcy court. It is not possible for a creditor of a municipality to file a petition seeking to place the municipality under the jurisdiction of the Bankruptcy Code.

If state law permits (and Michigan state law so permits), a municipality may file a petition for bankruptcy protection in accordance with the provisions of Public Act No. 436 of the Public Acts of Michigan of 2012 (“Act 436”) with the written approval of the Governor. The provisions governing such a filing are found in section 26 of Act 436 which provides as follows:

“Sec. 26. (1) With the written approval of the governor, a local government may file a petition under chapter 9 and exercise powers pursuant to federal bankruptcy law if the local government adopts a resolution, by a majority vote of the governing body of the local government, that declares a financial emergency in the local government. Except as otherwise provided in this subsection, if the local government has a strong mayor, the resolution requires strong mayor approval. The resolution shall include a statement determining that the financial condition of the local government jeopardizes the health, safety, and welfare of the residents who reside within the local government or service area of the local government absent the protections of chapter 9 and that the local government is or will be unable to pay its obligations within 60 days following the adoption of the resolution.

(2) If the governor approves a local government to proceed under chapter 9, the governor shall inform the local government in writing of the decision. The governor may place contingencies on a local government in order to proceed under chapter 9 including, but not limited to, appointing a person to act exclusively on behalf of the local government in the chapter 9 bankruptcy proceedings. If the governor does not appoint a person to act exclusively on behalf of the local government in chapter 9 bankruptcy

proceedings, the chief administrative officer of the local government shall act exclusively on behalf of the local government in chapter 9 bankruptcy proceedings. Upon receipt of the written approval and subject to this subsection, the local government may proceed under chapter 9 and exercise powers under federal bankruptcy law.

(3) If the governor does not approve a local government to proceed under chapter 9, the local government shall within 7 days select 1 of the other local options as provided in section 7.”

Until recently when the City of Detroit filed such a petition, no Michigan Municipality had sought bankruptcy court protection.

Once the petition is filed with the bankruptcy court, the bankruptcy court will decide if the municipality in fact is eligible for bankruptcy court protection. In the Detroit case, which was filed in July, the judge has not yet heard arguments or decided whether the City is eligible for bankruptcy protection.