TRANSACTIONS AND TRIALS

BERMAN AND SABLE NEWSLETTER

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Following this issue, we will be taking a summer break until September. We know that many of our readers will miss this valuable beach reading, but we are confident that some lighter, summer reading can be found.

So - You Want to Make a Federal Case Out of It!

By Maria K. Tougas

You come to your lawyer with a "strong" case, but do you have the right place (i.e. Court)? Have you ever heard someone, especially after a bad experience in a State Court, remark: "Well, a judge never would have done **that** in Federal Court", or "The Federal Courts are sooo much better", or "Cases progress much faster in Federal Court" (my personal favorite!). While debate rages over whether or not there is truth to any of the above, the underlying question is, how do you know whether you must or should make a federal case out of it?

The answer is …sometimes you have a choice, and sometimes you don't. Federal Courts, unlike State Courts, are courts of limited jurisdiction, and the presumption is that a case is litigated in the State Court, unless federal jurisdiction is specifically mandated under Article III, Section 2 of the United States Constitution. There are three levels of Federal Courts. The District Courts are comparable to trial courts in the state system. Each state has at least one District Court. Some states have more than one court location (called "Divisions") and larger states have more than one District. The Appellate Courts at the federal level are divided into Eleven Circuits, based on which State the District Court case was decided in. At the top, of course, is the United States Supreme Court. There are some cases in which the Supreme Court has original jurisdiction. These are cases affecting Ambassadors and Public Ministers, and cases in which a state is a party.

For all other cases, a litigant must start at the District Court (trial) level and if the decision is adverse, appeal to the Circuit Court (appellate) level. The grounds for bringing a case in the Federal District Court are usually either "Diversity" (28 U.S.C. § 1332) or "Federal Question" cases (28 U.S.C. § 1331). In a "Diversity" case, a plaintiff can file in either Federal or State Court, but in "Federal Question" cases, the Plaintiff must file in the Federal District Court.

The most popular Diversity case is where the case is between citizens of different states. Even if there is Diversity, the amount in controversy must exceed $75,000.00 for the case to be brought in Federal District Court. This minimum threshold amount is set by federal statute (28 U.S.C. § 1332). Diversity is determined at the time an action is commenced and depends upon the domicile of the parties. For individuals, their domicile is considered to be the state in which they permanently reside. For corporations, domicile generally depends on the location of the company's principal place of business, and for banks, it is the state in which they are chartered, or in the case of National Banks, the state in which any branch office is located. In order to sue

(Continued on page 2)

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in Federal District Court on the grounds of Diversity, there must be "Pure" Diversity. In other words, none of the parties on one side of the case (either plaintiffs or defendants) can be domiciled in the state where the action is brought.

A case involves a "Federal Question" if it "arises under" the United States Constitution or laws or treaties of the United States. Some Federal laws give Federal agencies the option to sue in Federal or State Courts. Cases which involve a Federal Question include cases based on admiralty and maritime jurisdiction, or cases in which the United States is a party. While it is not always true that every law gives rise to a Federal Question, the general rule is that there must be a substantial claim founded "directly" on a federal law. The amount in controversy in Federal Question cases generally also requires a $75,000.00 threshold. Bankruptcy cases, patent or copyright cases, or a case involving Federal fines, penalties, forfeitures or seizures, are also always brought in Federal District Court, regardless of the amount in controversy. (Note that bankruptcy cases are always brought in Bankruptcy Courts which are a division of Federal Courts.)

If these rules seem complicated and hard to remember, next time you need to decide between State and Federal Court, try asking yourself the question (this works particularly well if you are a *Shakespeare in Love* fan!): "To Be or Not To Be [in Federal Court], that is a [Federal] Question" …and if it's not a Federal Question, but Diversity exists among the parties, suit can still be brought in Federal District Court. Then you can decide for yourself whether it is as great as they say.

LEGAL TERMINOLOGIES

Do you know the definitions of these terms?

Return Day	Estoppel
Law Day	Writ
Res Ipsa Loquiter	Sovereign Immunity
De Minimis Non Curat Lex	Common Law
Escheat	Stare Decisis

Answers to last issue's "Initials" quiz:

PJR:	**Prejudgment Remedy**
TRO:	**Temporary Restraining Order**
DIP:	**Debtor In Possession (Chapter 11)**
ADR:	**Alternative Dispute Resolution**
UCC:	**Uniform Commercial Code**
EBITDA:	**Earnings Before Interest, Taxes, Depreciation and Amortization**
TPZ:	**Town Planning and Zoning Commission**
CGS:	**Connecticut General Statutes**
USC:	**United States Code (Federal Statutes)**
LLP:	**Limited Liability Partnership**
UPA:	**Uniform Partnership Act**
UCONN:	**Our beloved Huskies**
CUTPA:	**Connecticut Unfair Trade Practices Act**
FIRREA:	**Federal Institutions Reform, Recovery and Enforcement Act of 1989.**

(How well did YOU do?)

The "Art" of Replevin

By Michael P. Berman

Replevin: "An action whereby the …person entitled to repossession of goods …'MAY' recover those goods from one who …wrongfully detains such goods." So says Black's Law Dictionary. No other legal process has been more abused, maligned, misused, scrutinized, or misunderstood than the action of Replevin. No less an authority than the Supreme Court of the United States (those nine gentlefolk who sit in Washington, D.C.) have declared that if not used properly, State statutes authorizing Replevin actions are unconstitutional. Fuentes v. Shevin, 407 U.S. 67 (1972), Sniadech v. Family Finance Corp., 395 U.S. 337 (1969).

The operative word in the above definition is "MAY". Apparently, no one is prepared to guaranty the results. While the Replevin action may be used to repossess personal goods such as a television or a car, most of us in business see Replevin used more often in a commercial matter. Simply put, where an item of property (for example, a drill press machine, or a bunch of machines) is collateral for a debt, or is under an "equipment lease" and where there is a default of the debt or the "equipment lease", and the creditor or

(Continued on page 3)

"equipment lessor" (financer) wants to retake the machine to sell it to satisfy the debt or "equipment lease" obligation, and the "retaking" can't be accomplished with the Debtor's cooperation (sometimes called "peaceful possession") the only way to legally retake the machine is for the creditor or equipment lessor to bring an action for Replevin. Connecticut has a curious interweaving of two sections of the Statutes when it comes to Replevin, Conn. Gen. Stat. Sec. 52-515, et seq. (the Replevin statute) and Conn. Gen. Stat. Sec. 52-278a, et seq. (the Prejudgment Remedy statute). This is in large measure due to the U. S. Supreme Court's declaring Replevin statutes, such as previously existed in Connecticut, unconstitutional. It has often been said that since Replevin is a creature (a very apt word in this case) of statute, the statutes authorizing Replevin must be strictly construed.

As a practical matter these two statutes should be used together if the Replevin is to be effective. The Replevin statute enables the creditor to use the courts to enforce the creditor's remedy of repossession afforded in the underlying document and the Prejudgment Remedy statute enables the creditor to retake the machine and sell it at the very beginning of the action. The remedy to the Debtor, if it turns out after a full trial that the court should not have permitted the creditor to take the machine at the beginning of the action, is to allow the Debtor to recover damages from a bond the creditor was required to place in court at the time the court allowed the machine to be taken, in the amount of twice the value of the machine. Conn. Gen. Stat. Sec. 52-518.

The problem most Replevin proceedings encounter at the early stage, is that both statute sections (the Replevin statute and the Prejudgment Remedy statute) require affidavits to be submitted to the court with the original court papers, which state different things. The required statements under oath are not inconsistent, but are for different purposes. If the affidavit (only one affidavit need be filed, provided it satisfies both sections) is missing the required information from both statutory sections, the court papers are defective and, more times than not, the case has to be started over before it even gets out of the starting blocks. Starting over means new service of papers, great delay, additional expense which is not recoverable, etc., etc., etc., and the Debtor continues to hold onto, and use, the machine.

In short, although often missed, the Replevin statute requires the affidavit to include, among other things, a statement as to the true value of the goods sought to be repossessed as well as a statement that the person signing the affidavit believes that the creditor is entitled to immediate possession of the goods (Conn. Gen. Stat. Sec. 52-518); and the Prejudgment Remedy statute requires the affidavit to set forth, among other things, sufficient facts to show that there is probable cause the plaintiff will get a judgment in an amount equal to, or greater than the AMOUNT of the prejudgment remedy sought taking into account known defenses, counterclaims, or setoffs (Conn. Gen. Stat. Sec. 52-278c). The problem with this part of the affidavit is that the creditor is not seeking a judgment for an amount in a Replevin action. The creditor is merely seeking a judgment for possession. So, the creditor must supply sufficient facts in the affidavit, not only to justify a judgment of possession, but also to support a judgment in an AMOUNT. If the AMOUNT is missing, the affidavit is defective.

There is a lot of verbiage in these two statutes which must be read and understood. Standards for satisfying the statutory factual requirements justifying possession and establishing probable cause are not clearly defined. The Replevin affidavit should never be taken lightly. It must be kept in mind, also, that statements in an affidavit are fertile ground for cross-examination in the Prejudgment Remedy/Replevin Proceedings. There is B&S

FEDERAL TAX LIENS

How They Affect Security Interests and Future Advances

By Alena C. Gfeller

Everyone reading this should know that the failure to pay federal taxes (income, withholding, unemployment, etc.) can result in the implementation of a federal tax lien on the property of the taxpayer. However, not everyone knows the mechanism by which a federal tax lien is, in fact, filed and how such a lien filing will affect a lender's security interest in assets of the taxpayer. This article has been written as an informative attempt to clear up some of these issues.

A. Priority of Federal Tax Liens

Federal law governs the priority of a federal tax lien. Generally, the priority of the Federal Government ("IRS") is governed by §6323 of the Internal Revenue Code. Specifically, subsection (a) of §6323 provides

(Continued on page 4)

that "a federal tax lien shall not be valid as against any purchaser [or] holder of a security interest … until notice thereof has been filed." The statute makes it clear that a "holder of a security interest," comes within the protection of §6323(a). A security interest under the statute is defined as:

> [A]ny interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth.

Therefore, when an individual or entity has a perfected security interest with respect to the property which is the subject of the federal tax lien, and such security interest is prior to the date on which the federal tax lien is filed, the security interest prevails over the federal tax lien. Mantovani v. Fast Fuel Corp., 494 F.Supp. 72, 75 (1980). However, this priority of a perfected secured party, while existing on the date the federal tax lien is filed, may be reversed in favor of the IRS as to certain kinds of collateral or certain loan advances.

B. How Federal Tax Liens May Become Prior to Certain Security Interests and/or Future Advances

The Internal Revenue Code provides that to the extent a security interest secures a loan advance made more than 45 days after the Notice of Federal Tax Lien is filed (regardless of the nature of the collateral), the security interest is subordinate to the federal tax lien in the same collateral to the extent of such late future advance. *See*, Internal Revenue Code §6323(d). If the collateral is equipment, for example, and the equipment is sold or liquidated, the secured party may have a priority lien for a portion of the sale proceeds (to the extent the security interest secures an old loan or advance) and the federal tax lien may attach to the sale proceeds ahead of the secured party as to the remaining part of the secured party's loan, if the balance of such loan was the result of advances made more than 45 days after the Notice of Federal Tax Lien was filed.

Another caveat regarding priority of a federal tax lien relates to the type of collateral which may be involved. Under §6323(c)(2) of the Internal Revenue Code, regardless of the fact that the secured party never makes future advances 45 days or more after the filing of the federal tax lien, if the Secured Party (as is typical) has a blanket security interest on all of the Debtor's (Taxpayer's) assets, then, to the extent such security interest covers the Debtor's receivables, inventory and/or equipment the secured party may lose priority to the IRS in these items of collateral. According to the provisions of the Internal Revenue Code, a lender will have a priority security interest in those accounts receivables, inventory and/or equipment which are generated, acquired or come into "being" before the federal tax lien is filed and up to 45 days after the federal tax lien is filed. Internal Revenue Code §6323 (d). The bottom line is that the lender with the security interest in collateral which is acquired or comes into "being" before, or during the 45 days after, the filing of a federal tax lien - wins the priority battle with the IRS. Alternatively, the lender with the security interest in collateral which is acquired or comes into "being" after the 45-day period - loses the battle. *See*, Charter Federal Savings and Loan v. IRS, 1990 Lexis 12674 (1990, DC Conn) (Federal tax liens against debtor's accounts receivable have priority over lender's security interest in receivables where receivables were generated by debtor's performance of services more than 45 days after the federal tax lien filing). This result would also be the same for inventory and/or equipment acquired by the debtor more than 45 days after the federal tax lien filing. It should be kept in mind that these priorities in favor of the IRS come about, even if the security interest secures old debt.

In short, banks and other secured creditors must always be wary of federal tax liens and how the filing of a federal tax lien will affect the