

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE WESTERN DISTRICT OF PENNSYLVANIA**

IN RE:

Gerald Thomas	( Bankruptcy No. 97-28232 JKF ( Chapter 13 (dismissed)* (
Diane Meyers	( Bankruptcy No. 98-20274 JKF ( Chapter 13 (
Elaine Mitchell	( Bankruptcy No. 98-23115 JKF ( Chapter 13 (
Clara Ervin	( Bankruptcy No. 97-23213 JKF ( Adversary No. 98-2439* ( Chapter 13 (
John M. Duff and Vivian G. Duff	( Bankruptcy No. 98-20905 JKF ( Chapter 13 (
Debtors	(

=====  
National Tax Funding, L.P.,  
and Capital Asset Research  
Corporation, Ltd.

Movants

v.

Gerald Thomas

Diane Meyers

Elaine Mitchell

Clara Ervin

John M. Duff and Vivian G. Duff

Respondents

( Motion KMR-1 ( ( ( Motion Under Bankruptcy Rules ( 9023 and 9024 to Amend the ( Orders [of] December 3, 1999, ( or, in the Alternative, for an ( Evidentiary Hearing ( ( ( Bankruptcy No. 97-28232 JKF ( Chapter 13 (dismissed) ( ( Bankruptcy No. 98-20274 JKF ( Chapter 13 ( ( Bankruptcy No. 98-23115 JKF ( Chapter 13 ( ( Bankruptcy No. 97-23213 JKF ( Adversary No. 98-2439 ( Chapter 13 ( ( Bankruptcy No. 98-20905 JKF ( Chapter 13 ( (
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APPEARANCES:

George M. Cheever, Esquire, for Movants

Eileen D. Yacknin, Esquire, Margaret Freed, Esquire, Richard S. Matesic, Esquire, and Olivia Lorenzo, Esquire, for Debtors

**MEMORANDUM OPINION<sup>1</sup>**

The matter before me is National Tax Funding's and Capital Asset Research Corporation's (hereafter collectively "CARC") Motion Under Bankruptcy Rules 9023 and 9024 to Amend the Orders of This Court Dated December 3, 1999, or, in the Alternative, for an Evidentiary Hearing. In the December 3, 1999, Memorandum Opinion I held that, based on the Commonwealth Court's decision in Maierhoffer v. GLS Capital, Inc., 730 A.2d 547 (Pa. Cmwlth. 1999), *appeal denied* 749 A.2d 473 (Pa. 2000)(TABLE), the City's liens had been assigned to CARC. Based on the Bankruptcy Code and the Municipal Claims and Tax Liens Act ("MCTLA"), 53 P.S. §7101 et seq., I held that CARC did not have priority claims nor were its liens perfected. In its Motion to Amend, CARC raises additional points. CARC's basic contention is that the liens it holds on Debtors' properties are entitled to either secured or priority status because (a) CARC is the assignee of the City's tax liens and

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\*The Thomas case was the lead case until it was dismissed without prejudice by order dated May 2, 2000. Another order was entered on May 15, 2000, making the Ervin Adversary Proceeding the lead case. This motion was filed before Thomas was dismissed. Only Debtors Meyers and Ervin filed a response, in the form of a brief, to CARC's Motion to Amend.

<sup>1</sup>This Memorandum Opinion constitutes the Court's findings of fact and conclusions of law.

(b) it need not take any action to perfect its liens because it is an assignee. While essentially raising the same arguments it did in the proceedings which culminated in the December 3, 1999, Memorandum Opinion, CARC identifies four points for reconsideration. It asserts that

1. the liens assigned to CARC cannot be avoided;
2. the liens assigned to CARC retain the §507(a)(8) priority they had when held by the City of Pittsburgh;
3. CARC's claim for penalties should be allowed; and
4. the question of whether CARC is entitled to use the City of Pittsburgh's Treasurer's Sale and Tax Collection Act procedures to sell Debtors' property should not have been addressed.

1. Whether the Liens Can be Avoided

CARC argues that the December 3, 1999, ruling was incorrect because no party had raised the issue of perfection of CARC's liens and therefore the Memorandum Opinion was advisory. However, in order to determine the objections to the secured status, the amount of CARC's claims and CARC's objections to its treatment in the chapter 13 plans, I had to determine the status of its claims. Secured creditors holding tax claims must be paid in full whereas unsecured tax claims need not be unless, *inter alia*, debtors have sufficient equity in assets to require same. Examination of whether CARC's liens were perfected was a necessary part of that determination. The Memorandum Opinion, therefore, was not advisory.

CARC also contends that its liens cannot be avoided because someone searching the public record would discover its

claims. As I explained in the prior opinion, on the date the bankruptcy was filed, assignments to NTF had not been recorded, nor have they ever been recorded as to CARC (the lien servicer). CARC holds no liens, merely the contractual right to collect claims through its contract and corporate affiliation with NTF. Regardless of the notice a lien searcher would have of a governmental claim,<sup>2</sup> the lack of recording in the name of the entity that actually holds the claim on the date the bankruptcy is filed renders the lien unenforceable and subject to avoidance through the Bankruptcy Code for the reasons explained in the December 3 Memorandum Opinion. The Motion to Amend on this ground is denied.

2. Whether the Liens Retain §507(a)(8) Priority

CARC challenges the reference in the December 3, 1999, Memorandum Opinion to §507(d) which provides that an entity subrogated to the rights of a holder of a §507(a)(8) claim is not subrogated to its priority. CARC argues that because §507(d) applies only to subrogees, and it is an assignee, it acquired the City's priority when it purchased the liens.

The December 3, 1999, Memorandum Opinion stated that "... if, under state law, CARC could assume a governmental priority, it cannot [do so under the Bankruptcy Code] by virtue of §507(d) which prohibits claims subrogated to rights under

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<sup>2</sup>For the City to retain its priority, tax liens need be filed only when the tax is unpaid for three years. 53 P.S. §7143. See also 53 P.S. §§7103, 7106. A searcher in the first three years would not find any lien of record.

§507(a)(8) from having priority status". Memorandum Opinion of December 3, 1999, at 22. Assuming that CARC is correct and §507(d) does not apply to it because it is an assignee and not a subrogee, CARC's claims still do not have §507(a)(8) priority because by the plain language of that section the priority depends on the holder of the claims being a "governmental unit". As CARC concedes, it is a private corporation, not a governmental entity.

The claims at issue are those that were formerly held by a taxing body but are now in the hands of a private entity that is not a governmental unit. Under the Bankruptcy Code, liens held by governmental units are entitled to priority under §507(a)(8). CARC is not a governmental unit. Thus, while the claims are recognized as liens under Maierhoffer, in CARC's hands the claims are not entitled to priority under the Bankruptcy Code. See note 18 of December 3, 1999, Memorandum Opinion. In the Court of Appeals' decision in Pollice v. National Tax Funding, L.P., 225 F.3d 379 (3d Cir. 2000), the court stated that the liens assigned to NTF were not considered any less tax claims by virtue of their assignment to National Tax. This holding is consistent with Maierhoffer v. GLS Capital, Inc., where the court found that tax liens are assignable as a matter of law under the Municipal Claims and Tax Liens Act." 225 B.R. at 409. The definition of a "tax" was not crucial to the Court of Appeals' decision. It is important for purposes of priority status under the Bankruptcy

Code. CARC's claims are based on the fact that Debtors owed governmental taxing authorities a tax. The Pennsylvania Constitution prohibits the General Assembly from delegating to private entities the power to levy taxes or perform municipal functions. See PA. CONST. art. III, E, §31. The Bankruptcy Code gives priority to claims of governmental units. 11 U.S.C. §507(a)(8). CARC holds claims but it is not a governmental unit. Thus, even if the obligations held by CARC are taxes, they are not entitled to priority. Likewise, CARC is not a municipality and once the City's claims were transferred to CARC, for it to have a secured claim for bankruptcy purposes, CARC was required to perfect its interest as a private entity, not as a municipality.

Relying on Shropshire, Woodliff, & Co. v. Bush, 204 U.S. 186, 27 S.Ct. 178 (1907), CARC argues that priority status attaches to the debt and not to the creditor and concludes that its claims are entitled to §507(a)(8) priority. Shropshire, however, did not involve analysis of §507(a)(8) and is inapposite to this case. In Shropshire as well as in In re Missionary Baptist Foundation of America, Inc., 667 F.2d 1244 (5th Cir. 1982), a creditor which had cashed the debtor's employees' wage checks was held to be an assignee of the employees' priority claims with the same priority as the employee wage earners. Section 507(a)(3) provides priority to claims for wages, salaries, or commissions "to the extent of \$4,300 for each individual or corporation, ... earned within 90

days before the ... filing of the petition ...." (Emphasis added.) This language indicates that the §507(a)(3) priority attaches to the claim itself; i.e., to the \$4,300 earned within the 90 days prepetition. Thus, under §507(a)(3), whoever holds the wage claim holds a priority claim and will be paid accordingly.

In contrast, however, §507(a)(8) provides for priority to "claims of governmental units".<sup>3</sup> That is, it applies to claims asserted by a particular entity, not to claims of a particular type. Thus, Shropshire and Missionary Baptist are inapplicable in this case and the claims are entitled to priority only if held by a governmental unit. CARC is not a governmental unit.<sup>4</sup>

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<sup>3</sup>Section 507(a)(8) further restricts the priority to claims of governmental units "only to the extent that such claims are for ... a property tax assessed before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition". 11 U.S.C. §507(a)(8)(B). Thus, not all taxes have a priority, even in the hands of a governmental unit.

<sup>4</sup>The Pennsylvania Constitution provides, in relevant part:

The General Assembly shall not delegate to any special commission, private corporation or association, any power to make, supervise or interfere with any municipal improvement, money, property or effects, whether held in trust or otherwise, or to levy taxes or perform any municipal function whatever....

PA. CONST. art. III, E, §31.

CARC itself acknowledged at the hearing on this motion that it did not acquire every right the City had when it was the creditor. For example, CARC does not have the right to shut off Debtors' water supply for failure to pay the charges nor is it entitled to any immunity the City would enjoy.

The Motion to Amend on this ground is denied.

3. Whether CARC's Claim for Penalties Should be Allowed

Because CARC's underlying claims are not entitled to priority, neither are its penalty claims. CARC argues that its penalty claims should at least be allowed as general unsecured claims. The December 3, 1999, Memorandum Opinion provided that

To the extent CARC's prepetition claims encompass prepetition debt which includes a maximum of ten percent interest accrued to the date of filing of the bankruptcy CARC has an allowed claim. Any interest in excess of ten percent, including any penalty charge which, as to the City, was not in compensation for actual pecuniary loss, 11 U.S.C. §507(a)(8)(G), or which creates an effective interest rate in excess of ten percent, is disallowed.

Memorandum Opinion of December 3, 1999, at 25. The disallowance of CARC's penalty charges was based upon the District Court's opinion in Pollice v. National Tax Funding, L.P., 59 F. Supp.2d 474 (W.D.Pa. 1999). The District Court found that CARC had combined interest and penalty for an effective interest rate in excess of the statutory maximum. The court disallowed the excess.

On August 29, 2000, the Court of Appeals for the Third Circuit affirmed the District Court and held that under Pennsylvania law, interest on the tax, water, and sewer charges cannot exceed ten percent. Pollice v. National Tax Funding, L.P., 225 F.3d 379, 391-92 (3d Cir. 2000). The court held that even the City could not provide for a rate that would exceed

ten percent.<sup>5</sup> Id. In light of the opinion of the Court of Appeals, I hold that, to the extent CARC's claims include interest and/or penalty charges in excess of ten percent in total, they must be disallowed.<sup>6</sup> To the extent they are equal to or less than ten percent, they are allowed as general unsecured claims. To the extent that the December 3, 1999, Memorandum Opinion could be construed as allowing any part of the claims under §507(a)(8), the Memorandum Opinion is clarified to reflect that the allowance and disallowance of the claims are as general unsecured claims pursuant to §502.

Further, regarding post-purchase penalties, we note that §7203 of title 53 of the Pennsylvania statutes provides that  
any municipality or township of this

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<sup>5</sup>The City passed an ordinance allowing a 12 percent annual rate of interest on unpaid property taxes plus a one-half percent monthly penalty. It also allowed a 12 percent annual rate of interest on unpaid sewer charges plus a one-time five percent penalty. Additionally, a Pittsburgh Water and Sewer Authority resolution imposed interest and penalty charges at the rate of one-half percent per month on unpaid water and sewer charges. See Pollice, 229 F.3d at 386.

<sup>6</sup>In some instances, CARC claims only six percent interest on delinquent water claims. The six percent is clearly less than ten percent and, therefore, is allowed as claimed. However, as the Court of Appeals noted, there appears to be no actual difference in CARC's use of the monthly "interest" or "penalty" charges. In the Court of Appeals, [National Tax] argued that the penalty is to punish the delinquent party for noncompliance with the law whereas interest is compensation for the lost time value of money. 225 F.3d at 392. The court found this distinction "artificial" and concluded that the municipality should not be permitted to avoid the ten percent statutory limit on interest by labeling a portion of the monthly charge as "penalty" instead of "interest." Id.

Commonwealth shall have the right to impose a penalty, not exceeding five per centum, for failure to pay any municipal assessment which remains unpaid for ninety days after the assessment shall have been levied. Such penalty shall be added to the assessment and included in the amount for which the municipal lien is filed for such unpaid assessment.

53 P.S. § 7203 (emphasis added). CARC is not a municipality or township and has no statutory right to assess penalties going forward from and after the date of its purchase. The City cannot, by contract, assign to CARC, a private entity, a right of assessment provided by the legislature only to governmental units. Otherwise, a state constitutional violation would result. PA. CONST. art. 3, §31. The Court of Appeals in Pollice pointed out that under the Home Rule charter even the City itself cannot take action which exceeds the powers granted it by statute. Therefore, the court concluded, under 53 P.S. §7143, the City's total interest charges could not exceed ten percent. The court held that the home rule municipality's authority to set rates of taxation did not include the authority to set interest and penalty rates on delinquent taxes. 225 F.3d at 390, 391.

As I stated in my Memorandum Opinion of December 3, 1999, CARC admitted that it charged interest in this case on the same basis it did in Pollice. Memorandum Opinion of December 3, 1999, at 27. Accordingly, CARC's allowed claims cannot include

penalties or interest which exceed ten percent.<sup>7</sup> Moreover, in bankruptcy cases, penalties are allowed priority status (a) only when owed to governmental units, (b) only to the extent they are imposed in connection with a tax under 11 U.S.C. §507(a)(8), and then (c) only to the extent the penalty is in compensation for actual pecuniary loss. CARC fails to meet the first test so it cannot satisfy all three of the necessary elements and its penalty claims are not entitled to priority status.

The Motion to Amend on this ground is granted in part and the December 3, 1999, Memorandum Opinion is clarified consistent herewith. In the December 3 Memorandum Opinion penalties were disallowed. In light of Pollice the motion to reconsider is granted to the extent that prepetition penalties that were purchased are allowed as part of CARC's claim to the extent that the penalties and the interest charged combined do

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<sup>7</sup>Although 53 P.S. §7203 permits a municipality to impose a maximum five percent penalty for failure to pay municipal assessments within ninety days after the assessment has been made, CARC does not rely on this provision in support of its claim. The evidence in the case before me was that "the interest rate and penalty rate charged by the City of Pittsburgh is 1.5 percent compounded per month . . . which would be the exact same thing that Capital Asset charges on those accounts." Exhibit 6 to Appendix, Docket #69, at 15, Deposition of Dwayne D. Woodruff, Regional Vice President and Director of Operations for the Pittsburgh affiliate office of CARC. The 1.5 percent compound interest rate is what the Court of Appeals disapproved in Pollice. Even if penalties would, in theory, be allowed as part of CARC's claims, the penalties would be general unsecured claims inasmuch as CARC does not assert that penalties were imposed to compensate for actual pecuniary loss, 11 U.S.C. §507(a)(8)(G), but rather to punish the delinquent taxpayer. Pollice, 225 F.3d at 392.

not exceed ten percent.

4. Whether CARC is Entitled to Use the City of Pittsburgh's Treasurer's Sale and Tax Collection Act Procedures to Sell Debtors' Property.

CARC argues that I should not have considered whether it is entitled to use the sale procedures under the Treasurer's Sale and Tax Collection Act because the Debtors are members of the plaintiff class in Houck et al. v. Capital Asset Research Corp., et al., No. 98-850 (W.D. Pa.). That case was partially settled to include an agreement by class plaintiffs that CARC was authorized to use the City Treasurer's sale procedures.

The response brief of Debtors Meyers and Ervin asserts that they were not part of the class subject to the Houck settlement because the class members included only those whose homes had been scheduled for a tax or Treasurer's sale "or regarding which Capital Assets [sic] holds or will hold municipal claims, such that tax or Treasurer's sales are threatened." Brief of Debtors Meyers and Ervin in Opposition to CARC's Motion to Amend December 3, 1999, Order of Court at 12. Even though CARC holds claims against them, no Treasurer's sale was then or is now imminent. Thus, the issue with respect to CARC's use of the City's Treasurer's sale procedures is not ripe for decision with respect to the cases before me. The Motion to Amend on this ground will be granted and the portion of the December 3, 1999, Memorandum Opinion addressing the Treasurer's sale procedures will be vacated.

CARC's Motion to Amend the December 3, 1999, orders

requests, in the alternative, an evidentiary hearing. However, an evidentiary hearing is not needed inasmuch as there are no material facts in dispute.

Conclusion

CARC's Motion to Amend is granted in part so as to clarify the December 3, 1999, Memorandum Opinion regarding allowance of claims and granted regarding the Treasurer's sale issues in accordance with this Memorandum Opinion. With respect to all other issues, the Motion to Amend is denied and I confirm my rulings stated in the December 3, 1999, Memorandum Opinion.

An appropriate order will be entered.

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/S/  
Judith K. Fitzgerald  
Chief Bankruptcy Judge

DATED: January 18, 2001

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**ORDER**

**AND NOW**, to-wit, this 18<sup>th</sup> day of **January, 2001**, it is **ORDERED** that the Motion Under Bankruptcy Rules 9023 and 9024 to Amend the Orders of this Court Dated December 3, 1999, or, in the Alternative, for an Evidentiary Hearing is **GRANTED in part** and **DENIED in part**.

The Motion is **GRANTED** and CARC holds allowed unsecured claims which may include a prepetition interest and penalty component that does not exceed a total of ten percent.

It is **FURTHER ORDERED** that CARC shall review its proofs of claim and within 30 days hereof file any amendments needed to clarify the nature of each claim as a tax or municipal charge, the property as to which the claim arose, the principal owed for each year prepetition, the rate of interest (not to exceed a total rate of ten percent), the total amount of interest owed prepetition, the penalty amount and rate which, when added to the interest rate, shall not exceed ten percent in total, and an identification of the tax lien register and/or judgment and locality indices wherein the original lien and the assignments were recorded and the dates thereof. **CARC shall include this information in all proofs of claim henceforth.**



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