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Publication Information

1 Collier Consumer Bankruptcy Practice Guide About the Author

About the Author

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Henry J. Sommer is Supervising Attorney at the *pro bono* Consumer Bankruptcy Assistance Project in Philadelphia. He has litigated many major cases involving bankruptcy, consumer law, civil rights and other issues. Previously, he was the head of the Consumer Law Project at Community Legal Services in Philadelphia, where he worked for over 21 years. Mr. Sommer has also served as a Lecturer-in-Law at the University of Pennsylvania Law School.

Mr. Sommer received his A.B. degree from Harvard College, *magna cum laude* and his J. D. degree from Harvard Law School, *cum laude*. Together with Alan N. Resnick, Mr. Sommer serves as Editor-in-Chief of *Collier on Bankruptcy, 15th Edition Revised* and the entire line of Collier bankruptcy publications. He is the author of *Collier Consumer Bankruptcy Practice Guide* (Matthew Bender) and co-author of *Collier Family Law and the Bankruptcy Code* (Matthew Bender). In addition, he is a contributing author and editorial board member for *Collier on Bankruptcy, 15th Edition Revised*. He is also a contributing author to *Collier Bankruptcy Manual, Third Edition Revised* (Matthew Bender), *Collier Bankruptcy Practice Guide*, and the Matthew Bender treatise on *Debtor-Creditor Law*.

Mr. Sommer is the former President of the National Association of Consumer Bankruptcy Attorneys (NACBA), a former member of the Federal Judicial Conference Advisory Committee on Bankruptcy Rules (appointed by the Chief Justice of the Supreme Court), and former Chairman of the Eastern District of Pennsylvania Bankruptcy Conference. He is also a member of the National Bankruptcy Conference, a Fellow of the American College of Bankruptcy, a member of the American Law Institute, and a former member of the Federal Reserve Board Consumer Advisory Council. He has been asked to testify many times before the House and Senate Judiciary Committees on bankruptcy and consumer law issues. He has served on the faculty of numerous continuing legal education programs including those presented by the Federal Judicial Center, NYU School of Law, the National Conference of Bankruptcy Judges, the Southeastern Bankruptcy Law Institute, the Executive Office of U.S. Trustees, ALI-ABA, the ABA Family Law Section, and the Pennsylvania Bar Institute. Mr. Sommer was the first recipient of the National Consumer Law Center's Vern Countryman Consumer Law Award.



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What's New

1 Collier Consumer Bankruptcy Practice Guide Scope

Scope

HIGHLIGHTS

Release 12A December 2009

Updates and Revisions

Release 12A (December 2009) contains case updates and revisions to thirty-one chapters.

Time Computation Changes

Release 12A is fully updated to account for the time computation amendments to the Federal Rules of Bankruptcy Procedure.

Time Computation Changes.

The Federal Rules of Bankruptcy Procedure, as well as the Federal Rules of Appellate, Civil Procedure, and Criminal Procedure, will be amended effective December 1, 2009, to adopt a new method of computing time under the rules. *Bankruptcy Rule 9006(a)* implements that change in the Bankruptcy Rules. Most notably, the rule will no longer exclude intermediate Saturdays, Sundays, or holidays for periods that are less than 8 days. Of course, if a period ends on a Saturday, Sunday or holiday, the period is extended to the next day that is not a Saturday, Sunday or holiday. In addition to the amendments to *Rule 9006(a)* establishing a new method for computing time, the rules are being amended to make the deadlines under the rules multiples of seven days for most periods that are fewer than 30 days. Release 12A is fully updated to account for these changes.

Updated Case Law.

New cases covered in this release include: *In re Cushing*, 401 B.R. 528 (B.A.P. 1st Cir. 2009) (returns must be filed by the deadline in section 1308, which may be extended in certain circumstances, even if they are not yet due under tax law); *In re Thongta*, 401 B.R. 363 (Bankr. E.D. Wis. 2009) (creditor of nondebtor spouse violated stay by docketing tort judgment against her because judgment created lien on community property); *Matter of Kuehn*, 563 F.3d 289 (7th Cir. 2009) (withholding transcript violated stay and discharge injunction); *Thompson v. GMAC, LLC*, 566 F.3d 699 (7th Cir.

Ill. 2009) (refusal to return car that was repossessed prepetition is violation of stay); *In re Sheridan, 2009 Bankr. LEXIS 552* (Bankr. D. Idaho Mar. 12, 2009) (Mortgage Electronic Registration Systems (MERS) failed to show standing to bring motion); *In re Van Ness, 399 B.R. 900 (Bankr. E.D. Cal. 2009)* (court denied creditor's request for bans on filing of future bankruptcy cases by other persons, bans on automatic stays in future cases, and authorization for sheriff to ignore a future bankruptcy case when conducting an eviction); *In re Lewis, 406 B.R. 518 (E.D. Mich. 2009)* (right to payments from Ford buyout program that gave debtor option of educational benefits or cash payout could be exempted under § 522(d)(11)(E)); and *In re Dutkiewicz, 2009 Bankr. LEXIS 1695* (B.A.P. 6th Cir. July 6, 2009) (at a minimum, trustee must announce meeting is being held open).

Recommended Publication. Available weekly via email or monthly in print, the *COLLIER BANKRUPTCY CASE UPDATE* provides thorough and concise summaries of bankruptcy decisions from all federal courts. It is the ideal tool for practitioners to stay current on the evolving law and is a perfect companion to the *Collier Consumer Bankruptcy Practice Guide*. Each issue arranges cases by Code section or Bankruptcy Rule and differentiates between pre- and post-BAPCPA cases. The monthly print version includes indices listing cases alphabetically and by deciding judge. In addition, the weekly e-mail version contains helpful links between the circuit listings and the case summaries as well as Web links to the full text opinions on lexis.com. To order the *Case Update*, visit the online bookstore, at <http://bookstore.lexis.com/catalog>, or call 800.533.1637. To receive a complimentary four-week subscription to the weekly *Case Update*, contact Kent Hanson, at kent.hanson@lexisnexis.com.

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CHAPTER 1 Overview of Chapter 7 Bankruptcy

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§ 1.syn Synopsis to Chapter 1: Overview of Chapter 7 Bankruptcy

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P 1.02 Commencement of a Chapter 7 Case

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CHAPTER 1 Overview of Chapter 7 Bankruptcy

1-1 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

In order to provide a brief overview of a chapter 7 consumer bankruptcy, the chapter provides a review of the basic steps involved in a chapter 7 case from commencement to closing of the case.



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CHAPTER 1 Overview of Chapter 7 Bankruptcy

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P 1.01 Introduction

Chapter 7, colloquially known as "straight bankruptcy," is the "operative" chapter of the Bankruptcy Code that governs liquidation cases. Liquidation is a form of relief afforded by the bankruptcy laws which involves the collection, liquidation and distribution of the nonexempt property of the debtor and, if the debtor is an individual, culminates in the discharge of the debtor. Chapter 7 is the chapter most frequently chosen by individual debtors. For most debtors it offers a speedy and relatively inexpensive fresh financial start.

The basic purposes of chapter 7 are to provide this fresh start to the debtor and to equitably distribute any nonexempt property to the debtor's creditors. Every step in the chapter 7 process is directed to one or both of these ends.



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CHAPTER 1 Overview of Chapter 7 Bankruptcy

1-1 Collier Consumer Bankruptcy Practice Guide P 1.02

P 1.02 Commencement of a Chapter 7 Case

A chapter 7 case is commenced by a petition, which may be filed voluntarily by a debtor or a husband and wife jointly,ⁿ¹ or may be filed by creditors seeking an involuntary bankruptcy case.ⁿ² The petition must be accompanied by the filing fee of \$299,ⁿ³ an application to pay the fee in installments or, an application to waive the filing fee.ⁿ⁴ The debtor must file with a voluntary petition a list of creditors, codebtors and parties to executory contracts and unexpired leases, sometimes known as the "mailing matrix," giving the address of each such entity.^{n4a} A debtor filing a voluntary petition must also submit, with the petition, a verified statement of the debtor's social security number and any other tax identification number or a statement that the debtor has no such number.ⁿ⁵ A case also may be converted to chapter 7 from chapter 11, chapter 12, or chapter 13.ⁿ⁶

MORE INFORMATION

For a detailed discussion of the procedure for the commencement of a case, including the payment of filing fees in installments, *see* chapter 6 *infra*. The procedure for waiver of filing fees is discussed in chapter 32 *infra*. Conversion of cases is examined in chapter 24 *infra*.

Eligibility for chapter 7 is governed by section 109(a) and (b)ⁿ⁷ of the Bankruptcy Code. Eligibility may also be limited by section 109(g), which bars a new petition within 180 days after dismissal of a prior case in certain circumstances,ⁿ⁸ⁿ⁹ and section 109(h), which with limited exceptions requires a debtor to receive a briefing and assistance with budget analysis from an approved nonprofit organization within the 180 days preceding filing. The filing of a voluntary petition constitutes an "order for relief" under chapter 7, which sets the chapter 7 process in motion.ⁿ¹⁰ (In an involuntary case, the court enters an order for relief if the involuntary petition is not controverted or if the debtor is found after a trial to meet the criteria for involuntary relief).ⁿ¹¹

A debtor may commence a bankruptcy case in any federal judicial district in which the domicile, residence, principal place of business or principal assets of the debtor have been located for 180 days prior to the petition, or for a longer portion of that 180 days than any other district.ⁿ¹² The language of the statute referring to the district meeting the test for "the longer portion of such one-hundred-and-eighty-day period" suggests that only one district can satisfy the requirement for residence.ⁿ¹³ However, there may be more than one venue that fits the statute's description, for example, if the debtor's residence and principal place of business or assets have been in two different districts for 180 days. If a person does not reside in the United States, that person still may file a bankruptcy petition if the person has

assets in the United States.ⁿ¹⁴

Occasionally, debtors file in an incorrect venue, either inadvertently or intentionally, especially if that venue is more convenient or offers some other advantage. Incorrect venue does not deprive the bankruptcy court of jurisdiction over the case. However, the court may dismiss or transfer the case to a proper venue if a party so requests by motion.ⁿ¹⁵ Sanctions may also be assessed against an attorney who knowingly files in an improper venue.ⁿ¹⁶ The court may also transfer a case to a different venue in the interest of justice or for the convenience of the parties.ⁿ¹⁷

The filing of a petition brings about the creation of the bankruptcy estate. *Section 541 of the Bankruptcy Code* defines the property of the estate.ⁿ¹⁸ After the order for relief, an interim trustee is appointed by the United States trustee to administer the case.ⁿ¹⁹ In the vast majority of Chapter 7 cases, the interim trustee becomes the permanent trustee.

MORE INFORMATION

Chapter 7 *infra* provides a detailed discussion of appointment of the trustee.

The filing of the petition also usually effectuates the automatic stay of *section 362(a) of the Bankruptcy Code*, protecting the debtor and the estate from most creditor actions. In addition, any entity holding property of the estate that the trustee may use, sell, or lease, or that the debtor may exempt, must immediately deliver that property to the trustee.ⁿ²⁰

MORE INFORMATION

For detailed discussion of the protections of the automatic stay and cases in which it does not arise see chapter 8 *infra*. See chapter 11 *infra* for discussion of turnover of property to the estate.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. §§ 301 and 302.*

(n2)Footnote 2. *11 U.S.C. § 303. See 2 Collier on Bankruptcy*, ch. 303 (Matthew Bender); *1 Collier Bankruptcy Manual*, ch. 303 (Matthew Bender). Involuntary petitions are extremely rare in consumer bankruptcy cases.

(n3)Footnote 3. This fee actually consists of a filing fee of \$245 required by *28 U.S.C. § 1930(a)*, and supplemental fees of \$39 for noticing and \$15 for trustee compensation that are imposed pursuant to *28 U.S.C. § 1930(b)*.

(n4)Footnote 4. *28 U.S.C. 1930(f).*

(n5)Footnote 4a. *Fed. R. Bankr. P. 1007(a)(1).*

(n6)Footnote 5. *Fed. R. Bankr. P. 1007(f).* The Statement should conform to Official Form 21.

(n7)Footnote 6. *11 U.S.C. §§ 1112(a), (b), 1207(a), 1307(a), (c).*

(n8)Footnote 7. *See 2 Collier on Bankruptcy*, P 109.02 (Matthew Bender); *1 Collier Bankruptcy Manual*, P 109.02 (Matthew Bender).

(n9)Footnote 8. *See 2 Collier on Bankruptcy*, P 109.08 (Matthew Bender); *1 Collier Bankruptcy Manual*, P 109.08 (Matthew Bender).

(n10)Footnote 9. [Reserved]

(n11)Footnote 10. 11 U.S.C. § 301.

(n12)Footnote 11. 11 U.S.C. § 303(h).

(n13)Footnote 12. 28 U.S.C. § 1408.

(n14)Footnote 13. *In re Handel*, 253 B.R. 308 (B.A.P. 1st Cir. 2000) .

(n15)Footnote 14. *See, e.g., Bank of America, N.T. & S.A. v. World of English, N.V.*, 23 B.R. 1015, 1019-23 (N.D. Ga. 1982) (bank account in United States); *In re McTague*, 198 B.R. 428 (Bankr. W.D.N.Y. 1996) (resident of Canada with \$194 bank account).

(n16)Footnote 15. *In re Handel*, 253 B.R. 308 (B.A.P. 1st Cir. 2000) .

(n17)Footnote 16. *Thompson v. Greenwood*, 507 F.3d 416 (6th Cir. 2007); *In re Pannell*, 253 B.R. 216 (S.D. Ohio 2000) .

(n18)Footnote 17. 28 U.S.C. § 1412.

(n19)Footnote 18. *See* 5 Collier on Bankruptcy, ch. 541 (Matthew Bender).

(n20)Footnote 19. 11 U.S.C. § 701. *See* 6 Collier on Bankruptcy, ch. 701 (Matthew Bender).

(n21)Footnote 20. 11 U.S.C. § 542.



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CHAPTER 1 Overview of Chapter 7 Bankruptcy

1-1 Collier Consumer Bankruptcy Practice Guide P 1.03

P 1.03 Initial Steps in Administration of a Chapter 7 Case

The debtor is required to file schedules and a statement of financial affairs either with the petition or within a short time after the case is commenced, giving all parties necessary information about the debtor's circumstances.ⁿ¹ Additionally, the 2005 amendments to the Bankruptcy Code,ⁿ² require debtors, in most cases, to file a statement of current monthly income with pertinent means test calculations,ⁿ³ a certificate regarding notice under section 342(b),ⁿ⁴ records of payment from employment,ⁿ⁵ a statement of monthly net income,ⁿ⁶ a statement of anticipated increase in income or expenditures,ⁿ⁷ and a certificate from the nonprofit budget and credit counseling agency that provided a briefing to the debtor describing the services the debtor received and a copy of a debt management plan, if such a plan was developed.ⁿ⁸ An individual debtor is permitted to claim certain property of the estate as exempt pursuant to section 522(b).ⁿ⁹ An individual debtor with secured consumer debts or personal property leases must also file a statement of intention with respect to such leases and the property securing those debts,ⁿ¹⁰ and the debtor's attorney must in every case file a disclosure of attorney's fees paid or promised.ⁿ¹¹

MORE INFORMATION

Chapter 6 *infra* provides a detailed step-by-step description of how to prepare forms used in a typical bankruptcy case. Chapter 13 *infra* outlines how to claim and object to exemptions. Chapter 5 *infra* examines attorney's fees.

Within 21 days after the petition is filed, the court sends notice of the case to all creditors, along with notice of the meeting of creditors under section 341(a), and notice of the deadline for objections to the debtor's discharge, objections to the exemptions claimed by the debtor, or complaints to determine the dischargeability of certain types of debts.^{n11a} If it appears that there are significant assets that will be distributed to creditors, the notice also informs creditors of the deadline for filing proofs of claim. Otherwise, it states that creditors should not file proofs of claim unless they receive a later notice to do so. The notice sent to creditors contains the debtor's full social security number. However, in order to somewhat protect the debtor's private information, the copy of the notice filed with the court does not.ⁿ¹²

FORMS

For sample notices of commencement of case see Official Form 9, *reprinted in Collier Consumer Bankruptcy Forms*, § CS10.32 (Matthew Bender).

The creditors' meeting under section 341(a) normally takes place within 40 to 60 days after the petition is filed and is conducted by the interim trustee or the United States trustee. Section 521(e), added in 2005,ⁿ¹³ provides that at least 7 days prior to the meeting of creditors the debtor must provide the trustee, and any creditor so requesting, with a copy of the most recent year's federal tax return (or a transcript of the return). The debtor must ordinarily bring to the creditors' meeting evidence of current income, statements from deposit accounts covering the petition date, and evidence of the debtor's identity and social security number. At the meeting, creditors and the trustee have the opportunity to examine the debtor. In addition, increasingly, personnel from the United States trustee's office have been appearing at meetings of creditors to propound questions in addition to those of the case trustee. The trustee is also required to assure that the debtor is aware of the consequences of a bankruptcy discharge, the effect of reaffirming a debt and certain other information. Creditors also may elect a trustee.ⁿ¹⁴ If the creditors do not elect a trustee, the interim trustee becomes the permanent trustee.ⁿ¹⁵ If there are assets in the estate to be liquidated or legal proceedings that are appropriate, the trustee may employ professionals if necessary to perform the trustee's duties, such as attorneys or auctioneers.ⁿ¹⁶

MORE INFORMATION

The meeting of creditors is discussed further in chapter 16 *infra*.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. 521(a)(1), formerly § 521(1), as redesignated and amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *Fed. R. Bankr. P. 1007*.

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. Official Form 22A. An individual debtor whose debts are primarily business debts, or who is a disabled veteran, a reservist, or a National Guard member as described in 11 U.S.C. § 707(b)(2)(D), must file Official Form 22A, but need only check the box indicating such status and sign the form because the means test does not apply to such debtors.

(n4)Footnote 4. 11 U.S.C. 521(a)(1)(B)(iii). This certification is included in Official Form 1, the voluntary petition.

(n5)Footnote 5. 11 U.S.C. 521(a)(1)(B)(iv).

(n6)Footnote 6. 11 U.S.C. 521(a)(1)(B)(v). This statement is included in Official Form 6, Schedule J.

(n7)Footnote 7. 11 U.S.C. 521(a)(1)(B)(vi). Official Form 6, Schedules I and J provide spaces for debtors to state this information.

(n8)Footnote 8. 11 U.S.C. 521(b). The certificate and debt management plan, if any, are to be attached to Exhibit D of the voluntary petition unless the debtor states on that exhibit a valid reason why it cannot be attached.

(n9)Footnote 9. 11 U.S.C. § 522(b).

(n10)Footnote 10. 11 U.S.C. 521(a)(2), formerly § 521(2), as redesignated and amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. *Fed. R. Bankr. P. 2016(b)*.

(n12)Footnote 11a. Like all notices, this notice is emailed, rather than mailed, to attorneys who are enrolled in the courts electronic filing system.

(n13)Footnote 12. *Fed. R. Bankr. P. 2002(a)(1)*. See 2003 Advisory Committee Note to *Bankruptcy Rule 2002*.

(n14)Footnote 13. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n15)Footnote 14. *11 U.S.C. § 702.*

(n16)Footnote 15. *11 U.S.C. § 703(d).*

(n17)Footnote 16. *11 U.S.C. § 327.*



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CHAPTER 1 Overview of Chapter 7 Bankruptcy

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P 1.04 Other Common Events in Consumer Chapter 7 Cases

What happens after the meeting of creditors depends to some extent on whether there are assets in the bankruptcy estate which are neither exempt nor encumbered, and are thus available for the unsecured creditors.

In all cases, unless some party successfully objects, the debtor retains property claimed as exempt.ⁿ¹ The trustee generally abandons other property in which there is only a small amount of nonexempt equity. When the property is abandoned, the trustee in effect disclaims interest in it, and ownership status reverts to whatever it was prior to the bankruptcy.ⁿ² Various other proceedings may sometimes take place, such as motions to avoid liens on exempt property.

MORE INFORMATION

Chapter 13 *infra* outlines how to claim and object to exemptions. Chapter 28 *infra* discusses abandonment of property. Chapter 18 *infra* reviews lien avoidance motions.

In cases in which there is property securing a debt,ⁿ³ and the debtor has filed a statement of intentionⁿ⁴ to redeem the property,ⁿ⁵ surrender it, or reaffirm the debt,ⁿ⁶ that intention must be performed.ⁿ⁷ Section 521, as amended in 2005,ⁿ⁸ requires the debtor to perform within 30 days after the first date set for the meeting of creditors, but the court may extend that deadline for cause if the debtor so requests before it expires.ⁿ⁹ The 2005 amendments to the Bankruptcy Codeⁿ¹⁰ also permit relief from the automatic stay pursuant to section 362(h) if the debtor fails to timely file a statement of intention or take timely action to carry out the stated intention. However, the debtor's substantive rights in relation to the creditor are not affected by the debtor's failure to meet the prescribed deadlines.ⁿ¹¹ The debtor may also choose to reaffirm any other debt.

MORE INFORMATION

For further discussion of the statement of intention *see* chapter 6 *infra*. For discussion of redemption and reaffirmation *see* chapters 25 and 27 *infra*, respectively.

A creditor may also file a proceeding during this period challenging the debtor's right to a dischargeⁿ¹² or the dischargeability of a particular debt.ⁿ¹³ The debtor may also file a proceeding seeking a determination that a particular debt is dischargeable.ⁿ¹⁴

MORE INFORMATION

For further discussion of the dischargeability of debts and the discharge of debtors *see* chapters 26 and 29 *infra*, respectively.

In cases in which property remains in the estate, it is normally administered by the trustee, except when the property has little value. In such cases, called "nominal asset cases," the property is usually abandoned, either through inaction by the trustee or at the debtor's request¹⁵ on the grounds that it would not provide any meaningful distribution to creditors after the costs of administration were paid.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 522(l). *Taylor v. Freeland and Kronz*, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280, 26 C.B.C.2d 487 (1992) .

(n2)Footnote 2. 11 U.S.C. § 554.

(n3)Footnote 3. "Debt" is defined at 11 U.S.C. § 101(12).

(n4)Footnote 4. The statement of intention is required by 11 U.S.C. § 521(a)(2), formerly § 521(2), as redesignated and amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. Redemption is provided for in 11 U.S.C. § 722.

(n6)Footnote 6. Reaffirmation of debts is permitted in some circumstances by 11 U.S.C. § 524(c).

(n7)Footnote 7. 11 U.S.C. § 521(a)(2)(B), formerly § 521(2)(B), as redesignated and amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 8. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 9. 11 U.S.C. § 521(a)(2)(B), formerly § 521(2)(B), as redesignated and amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n10)Footnote 10. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. *See* 11 U.S.C. 362(h); 11 U.S.C. 521(a)(2)(C).

(n12)Footnote 12. 11 U.S.C. § 727.

(n13)Footnote 13. 11 U.S.C. § 523.

(n14)Footnote 14. 11 U.S.C. § 523.

(n15)Footnote 15. 11 U.S.C. § 554(b). *See* ch. 28 *infra* for further discussion of abandonment of property.



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CHAPTER 1 Overview of Chapter 7 Bankruptcy

1-1 Collier Consumer Bankruptcy Practice Guide P 1.05

P 1.05 Liquidation and Distribution of Estate Property

If there is a significant amount of nonexempt property in the estate, the trustee must take possession of that property and convert it to cash, normally by public or private sale. The trustee also has the power to recover property for the estate through the avoidance of various types of transfers from the debtor or from the estate.ⁿ¹

MORE INFORMATION

For further discussion of the avoiding powers of the trustee *see* chapter 17 *infra*.

In addition, the trustee receives and reviews the proofs of claim filed by creditors.ⁿ² If the trustee believes a proof of claim is improper, the trustee must object to the claim if a purpose would be served by doing so. If no party objects to a proof of claim, it is deemed allowed.ⁿ³

MORE INFORMATION

For further discussion of claims *see* chapter 19 *infra*.

Once the property of the estate has been liquidated, it is distributed to creditors in accordance with the distribution scheme set forth in the Code.ⁿ⁴ Secured creditors are paid in satisfaction of their liens on property that has been liquidated to the extent of their interests in such property.ⁿ⁵ Unsecured creditors and administrative claimants are then paid in the order set forth in section 507(a), except to the extent that an entity that granted postpetition credit or that was harmed by a failure to provide adequate protection has been granted a higher priority by the court.ⁿ⁶

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. §§ 544-553, 724(a).*

(n2)Footnote 2. *11 U.S.C. 704(a)(5)*, formerly § 704(5), as redesignated and amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *11 U.S.C. § 502(a).*

(n4)Footnote 4. *11 U.S.C. § 726. See 6 Collier on Bankruptcy, ch. 726 (Matthew Bender).*

(n5)Footnote 5. *11 U.S.C. 506(a)*, formerly § 506(a), as redesignated and amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. *11 U.S.C. § 507*. See 4 Collier on Bankruptcy, ch. 507 (Matthew Bender).



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CHAPTER 1 Overview of Chapter 7 Bankruptcy

1-1 Collier Consumer Bankruptcy Practice Guide P 1.06

P 1.06 Discharge of Debtor

To be eligible for a discharge, an individual debtor must take, with very limited exceptions, a personal financial management course from an approved provider.ⁿ¹ The course may be taken at any time after the petition but a certificate evidencing completion of the course must be filed by 45 days after the first date set for the meeting of creditors,^{n1a} unless the court enlarges that time limit under *Federal Rule of Bankruptcy Procedure 9006(b)*. If the debtor is an individual, the court enters an order of discharge shortly after the deadline for objections to discharge has passed, unless an objection to discharge has been sustained by the court.^{n1b} The discharge eliminates the debtor's personal liability for all debts not excepted from discharge by section 523. It also serves as an injunction against efforts to collect such debts,ⁿ² unless the debtor has reaffirmed a debt pursuant to section 524(c),(d) and (k).

If the debtor desires to enter into a reaffirmation agreement, and was not represented by counsel in negotiating the agreement, the court must hold a discharge hearing to advise the debtor of the consequences of the agreement and decide whether to approve the agreement.ⁿ³ The court may, in its discretion, hold discharge hearings in other cases, such as when the agreement is presumed under section 524(m) to impose an undue hardship and is subject to disapproval by the court. After the discharge is entered, the court sends notice of the discharge to the debtor and all creditors.ⁿ⁴

MORE INFORMATION

The exceptions to discharge are discussed in chapter 26 *infra* and the procedure for obtaining a discharge is discussed in chapter 29 *infra*.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 727(a)(11).

(n2)Footnote 1a. *Fed. R. Bankr. P. 1007(c)*.

(n3)Footnote 1b. 11 U.S.C. § 727.

(n4)Footnote 2. 11 U.S.C. § 524(a).

(n5)Footnote 3. 11 U.S.C. § 524(d).

(n6)Footnote 4. *Fed. R. Bankr. P. 4004(a)*.



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CHAPTER 1 Overview of Chapter 7 Bankruptcy

1-1 Collier Consumer Bankruptcy Practice Guide P 1.07

P 1.07 Closing of Case

After notice of the discharge is mailed, unless there are assets to be administered, the case is promptly closed by the court.ⁿ¹ If there are nonexempt assets that the trustee plans to administer, the case is closed only after the distribution of those assets is complete and the trustee has filed a report with the court to that effect.ⁿ²

Once the case is closed, if any further proceedings become necessary it is usually necessary to file a motion to reopen the case.ⁿ³

MORE INFORMATION

The procedure for reopening a case is covered in chapter 31 *infra* .

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 350(a)*.

(n2)Footnote 2. *11 U.S.C. § 704(a)(9)*, formerly § 704(9), as redesignated by Pub. L. 109-8, effective with respect to cases file on or after October 17, 2005.

(n3)Footnote 3. *11 U.S.C. § 350(b)*.



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CHAPTER 2 Overview of Chapter 13 Bankruptcy

1-2 Collier Consumer Bankruptcy Practice Guide 2.syn

§ 2.syn Synopsis to Chapter 2: Overview of Chapter 13 Bankruptcy

P 2.01 Introduction

P 2.02 Commencement of a Chapter 13 Case

P 2.03 Initial Steps in Administration of a Chapter 13 Case

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CHAPTER 2 Overview of Chapter 13 Bankruptcy

1-2 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

In order to provide a brief overview of a chapter 13 bankruptcy, the chapter provides a review of the basic steps involved in a chapter 13 case from commencement to closing of the case.



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CHAPTER 2 Overview of Chapter 13 Bankruptcy

1-2 Collier Consumer Bankruptcy Practice Guide P 2.01

P 2.01 Introduction

Chapter 13 of the Bankruptcy Code gives the debtor the opportunity to adjust his or her financial affairs without having to liquidate current assets. Rather than being designed to pay debts out of those assets, a chapter 13 case usually involves payment of debts out of future income (although the debtor may also decide on some payment out of current assets). The debtor is allowed to keep and use all property, whether exempt or not, and to pay some or all debts according to a plan approved by the court. At the completion of this plan (or, in some cases, earlier) the debtor receives a discharge which, with several significant exceptions, is similar to the discharge received in a chapter 7 case.

Chapter 13 is most frequently chosen by debtors who must use its provisions to deal with mortgage arrearages or other secured debts, and by debtors who have nonexempt property that they wish to retain. However, there are a variety of other reasons for choosing chapter 13, including simply the desire to repay some or all debts. The basic purposes of chapter 13, like those of chapter 7, are to provide a fresh financial start to the debtor and to distribute payments equitably to the debtor's creditors.

MORE INFORMATION

See chapter 4 *infra* for discussion of choosing the appropriate chapter under which to file.



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CHAPTER 2 Overview of Chapter 13 Bankruptcy

1-2 Collier Consumer Bankruptcy Practice Guide P 2.02

P 2.02 Commencement of a Chapter 13 Case

A chapter 13 case is commenced by a petition, which may be filed voluntarily by a debtor or a husband and wife jointly.ⁿ¹ Chapter 13 is a purely voluntary chapter so creditors may not file an involuntary chapter 13 petition.ⁿ² The petition must be accompanied by the filing fee of \$274ⁿ³ or an application to pay the fee in installments.ⁿ⁴ The debtor must file with a voluntary petition a list of creditors, codebtors and parties to executory contracts and unexpired leases, sometimes known as the "mailing matrix," giving the address of each such entity.^{n4a} A debtor filing a voluntary petition must also submit, with the petition, a verified statement of the debtor's social security number and any other tax identification number or a statement that the debtor has no such number.ⁿ⁵ A case also may be converted to chapter 13 from chapter 7, chapter 11, or chapter 12.^{n5a}

MORE INFORMATION

For a detailed discussion of the procedure for the commencement of a case, including the payment of filing fees in installments, *see* chapter 6 *infra*. The procedure for waiver of filing fees is discussed in chapter 32 *infra*. Conversion of cases is examined in chapter 24 *infra* .

Eligibility for chapter 13 is governed by section 109(a), (e), and (h) ofⁿ⁶ the Bankruptcy Code. Section 109(e) requires that a chapter 13 debtor must be an individual with regular income or such an individual and his or her spouse.ⁿ⁷ It also makes chapter 13 unavailable to debtors with debts above certain specified limits.ⁿ⁸ Section 109(h), which was added in 2005,ⁿ⁹ with limited exceptions, requires a debtor to receive a briefing and assistance with budget analysis from an approved nonprofit organization within the 180 days preceding filing. Eligibility may also be limited by section 109(g), which bars a new petition within 180 days after dismissal of a prior case in certain circumstances.ⁿ¹⁰ The filing of a voluntary petition constitutes an "order for relief" under chapter 13, which sets the chapter 13 process in motion.ⁿ¹¹ The venue rules for a chapter 13 case are the same as for a chapter 7 case.ⁿ¹²

The filing of a petition brings about the creation of the bankruptcy estate. *Section 541 of the Bankruptcy Code* defines the property of the estate at the outset of the case.ⁿ¹³ However, in chapter 13 property of the estate also includes income and property acquired after the case is filed.ⁿ¹⁴

After the order for relief, a trustee is appointed by the United States trustee to administer the case.ⁿ¹⁵ Typically, the trustee is a standing trustee who administers all or a sizable percentage of the chapter 13 cases in the judicial district.

MORE INFORMATION

Chapter 7 *infra* provides a detailed discussion of appointment of the trustee.

The filing of the petition also normally effectuates the automatic stay of *section 362(a) of the Bankruptcy Code*, protecting the debtor and the estate from most creditor actions. This stay is supplemented in chapter 13 by a codebtor stay, which protects codebtors of the debtor from creditor action in most cases. In addition, any entity holding property of the estate that the trustee may use, sell, or lease, or that the debtor may exempt, must immediately deliver that property to the trustee.ⁿ¹⁶ Because the debtor has a right to possession of all property of the estate,ⁿ¹⁷ the trustee must then deliver such property to the debtor.

MORE INFORMATION

For detailed discussion of the protections of the automatic stay and codebtor stay *see* chapter 8 *infra* and chapter 9 *infra*, respectively. *See* chapter 11 *infra* for discussion of turnover of property to the estate.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 301, as amended by Pub. L. No. 109-8 (2005); 11 U.S.C. § 302.

(n2)Footnote 2. *Cf.* 11 U.S.C. § 303. *See* 2 Collier on Bankruptcy, ch. 303 (Matthew Bender).

(n3)Footnote 3. This fee actually consists of a filing fee of \$235 required by 28 U.S.C. § 1930(a), and a supplemental fee of \$39 for sending notices pursuant to 28 U.S.C. § 1930(b).

(n4)Footnote 4. 28 U.S.C. § 1930(a), (b).

(n5)Footnote 4a. *Fed. R. Bankr. P. 1007(a)(1)*.

(n6)Footnote 5. *Fed. R. Bankr. P. 1007(f)*. The Statement should conform to Official Form 21.

(n7)Footnote 5a. The Supreme Court has held that the right of a debtor to convert from chapter 7 to chapter 13 is not absolute, and can be denied for bad faith. *Marrama v. Citizens Bank*, 127 S. Ct. 1105, 166 L. Ed. 2d 956 (2007). The court held that in the rare situation when a case would be subject to immediate dismissal or conversion back to chapter 7 under section 1307(a) for bad faith, a bankruptcy court may deny a conversion to chapter 13.

(n8)Footnote 6. *See* 2 Collier on Bankruptcy, P 109.02,. 06 (Matthew Bender).

(n9)Footnote 7. *See* 11 U.S.C. § 101 for definition of "individual with regular income."

(n10)Footnote 8. 11 U.S.C. § 109(e). *See* 2 Collier on Bankruptcy, P 109.06[2] (Matthew Bender).

(n11)Footnote 9. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n12)Footnote 10. *See* 2 Collier on Bankruptcy, P 109.08 (Matthew Bender).

(n13)Footnote 11. 11 U.S.C. § 301.

(n14)Footnote 12. *See* P 1.02 *supra*.

(n15)Footnote 13. *See* 5 Collier on Bankruptcy, ch. 541 (Matthew Bender).

(n16)Footnote 14. 11 U.S.C. § 1306(a). *See* 8 Collier on Bankruptcy, P 1306.02 (Matthew Bender).

(n17)Footnote 15. *11 U.S.C. § 1302. See 8 Collier on Bankruptcy, ch. 1302 (Matthew Bender).*

(n18)Footnote 16. *11 U.S.C. § 542.*

(n19)Footnote 17. *11 U.S.C. § 1306(b).*



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CHAPTER 2 Overview of Chapter 13 Bankruptcy

1-2 Collier Consumer Bankruptcy Practice Guide P 2.03

P 2.03 Initial Steps in Administration of a Chapter 13 Case

The debtor is required to file schedules and a statement of financial affairs either with the petition or within a short time after the case is commenced, giving all parties necessary information about the debtor's circumstances.ⁿ¹ If the schedules are not filed with the petition, a list of creditors' names and addresses, sometimes referred to as a "mailing matrix," must be filed with the petition.ⁿ² Additionally, the 2005 amendments to the Bankruptcy Code,ⁿ³ require debtors, in most cases, to file a statement of current monthly income, commitment period and, if required, calculation of disposable income,^{n3a} a certificate regarding notice under section 342(b),ⁿ⁴ records of payment from employment,ⁿ⁵ a statement of monthly net income,ⁿ⁶ a statement of anticipated increase in income or expenditures,ⁿ⁷ and a certificate from the nonprofit budget and credit counseling agency that provided a briefing to the debtor describing the services the debtor received and a copy of any debt management plan.ⁿ⁸ An individual debtor is permitted to claim certain property of the estate as exempt pursuant to section 522(b).ⁿ⁹ The debtor's attorney must in every case file a disclosure of attorney's fees paid or promised.ⁿ¹⁰

MORE INFORMATION

Chapter 6 *infra* provides a detailed step--by--step description of how to prepare forms used in a typical bankruptcy case. Chapter 13 *infra* outlines how to claim and object to exemptions. Chapter 5 *infra* examines attorney's fees.

In addition to these documents, the debtor must file a chapter 13 plan either with the petition or within 14 days after the petition is filed, unless that time period is extended by the court.ⁿ¹¹ The chapter 13 plan sets forth the payments the debtor intends to make to creditors during the case. The debtor is given great leeway in formulating the plan subject to only a few requirements. The most important of the provisions usually required, which are discussed in greater detail elsewhere in this guiden¹² are listed below:

- all claims given priority by section 507, with one very limited exception, must be paid in full unless the creditor agrees otherwise;ⁿ¹³
- the present valuen¹⁴ of payments on unsecured claims must be at least equal to what would be paid in a chapter 7 liquidation;ⁿ¹⁵

- with respect to each allowed secured claim provided for by the plan, either (1) the holder of the claim accepts the plan, (2) The plan provides that the holder of an allowed secured claim retain its lien until the earlier of the payment of the underlying debt determined by nonbankruptcy law or a discharge,ⁿ¹⁶ or (3) the debtor surrenders the property securing the claim to the creditor;ⁿ¹⁷ and
- if a party in interest objects to the plan, the plan must either commit all of the debtor's disposable income for the applicable commitment period or pay unsecured claims in full.ⁿ¹⁸

The plan may be modified by the debtor prior to confirmation as a matter of course.

Within 21 days after the petition is filed, the court sends notice of the case to all creditors, along with notice of the meeting of creditors under *section 341(a) of the Bankruptcy Code*, notice of the deadline for objections to the exemptions claimed by the debtor, notice of the deadline for filing proofs of claim, and notice of the date of the confirmation hearing.^{n18a} The notice sent to creditors contains the debtor's full social security number. However, in order to somewhat protect the debtor's private information, the copy of the notice filed with the court does not.ⁿ¹⁹

FORMS

For a sample form see Official Form 91, *reprinted in Collier Consumer Bankruptcy Forms, Form CS10.32-5* (Matthew Bender).

Under the 2005 amendments to the Bankruptcy Code, chapter 13 debtors must comply with two new obligations with respect to tax returns. First, at least 7 days before the section 341(a) meeting, the debtor must provide to the trustee and, in some cases, to creditors copies of the debtor's federal income tax return, or a transcript thereof, for the most recent tax year ending before the commencement of the case and for which the debtor filed a return.ⁿ²⁰ Second, by the day before the section 341(a) meeting, a chapter 13 debtor must file with appropriate taxing authorities all tax returns that the debtor was required to file for all taxable periods ending in the four years before the petition.ⁿ²¹ If the debtor was not required to file a return, or has filed all required returns, no additional return need be filed.

The creditors' meeting under section 341(a) normally takes place within 40 to 60 days after the petition is filed and is conducted by the standing trustee or the United States trustee. The debtor must ordinarily bring to the creditors' meeting evidence of current income, statements from deposit accounts covering the petition date, and evidence of the debtor's identity and social security number. At the meeting, creditors and the trustee have the opportunity to examine the debtor.

Both before and after the meeting of creditors, until the normal deadline of 90 days after the date initially set for the meeting,ⁿ²² creditors file proofs of claim with the court for prepetition debts. Occasionally, claims for postpetition debts are also filed, either during this period or later in the case.

MORE INFORMATION

The meeting of creditors is discussed further in chapter 16 *infra*. Chapter 19 examines the process for filing and objecting to proofs of claims.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. 521(a)(1)*, formerly § 521(1), as amended and redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005; *Fed. R. Bankr. P. 1007*.

(n2)Footnote 2. *Fed. R. Bankr. P. 1007(a)*.

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 3a. Official Form 22C.

(n5)Footnote 4. *11 U.S.C. 521(a)(1)(B)(iii)*. This certification is included in Official Form 1, the voluntary petition.

(n6)Footnote 5. *11 U.S.C. 521(a)(1)(B)(iv)*

(n7)Footnote 6. *11 U.S.C. 521(a)(1)(B)(v)*. This statement is included in Official Form 6, Schedule J.

(n8)Footnote 7. *11 U.S.C. 521(a)(1)(B)(vi)*. Official Form 6, Schedules I and J provide spaces for debtors to state this information.

(n9)Footnote 8. *11 U.S.C. 521(b)*. The certificate and debt management plan, if any, are to be attached to Exhibit D of the voluntary petition unless the debtor states on that exhibit a valid reason why it cannot be attached.

(n10)Footnote 9. *11 U.S.C. § 522(b)*.

(n11)Footnote 10. *Fed. R. Bankr. P. 2016(b)*.

(n12)Footnote 11. *Fed. R. Bankr. P. 3015(b)*.

(n13)Footnote 12. *See ch. 14 infra*.

(n14)Footnote 13. *11 U.S.C. § 1322(a)(2); 11 U.S.C. 1322(a)(4)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n15)Footnote 14. The concept of present value arises from the language "value as of the effective date of the plan" in *11 U.S.C. § 1325(a)(4)*. Basically, it envisions a total of payments which equals the amount creditors would receive in a liquidation case plus interest over the term of the plan. *See discussion in ch. 14 infra*.

(n16)Footnote 15. *11 U.S.C. § 1325(a)(4)*.

(n17)Footnote 16. *11 U.S.C. § 1325(a)(5)(B)*, as enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. This section also requires that the plan provide for lien retention in the event of dismissal or conversion and certain plan distributions.

(n18)Footnote 17. *11 U.S.C. § 1325(a)(5)* as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n19)Footnote 18. *11 U.S.C. § 1325(b)* as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n20)Footnote 18a. Like all notices, this notice is emailed, rather than mailed, to attorneys who are enrolled in the courts electronic filing system.

(n21)Footnote 19. *Fed. R. Bankr. P. 2002(a)(1)*. *See* 2003 Advisory Committee Note to *Bankruptcy Rule 2002*.

(n22)Footnote 20. *11 U.S.C. § 521(e)(2)* enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n23)Footnote 21. *11 U.S.C. § 1308(a)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. The returns must be filed by the deadline in section 1308, which may be extended under certain circumstances, even if they are not yet due under tax law. *In re Cushing*, 401 B.R. 528 (B.A.P. 1st Cir. 2009).

(n24)Footnote 22. *Fed. R. Bankr. P. 3002(c)*. There is a somewhat longer deadline for certain governmental claims

stated in the rule, section 502(b)(9) and *Fed. R. Bankr. P. 3002(c)*.



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CHAPTER 2 Overview of Chapter 13 Bankruptcy

1-2 Collier Consumer Bankruptcy Practice Guide P 2.04

P 2.04 Confirmation and Implementation of the Chapter 13 Plan

Unless the court orders otherwise, the debtor must begin making payments under the chapter 13 plan within 30 days after the plan is filed or order for relief, whichever is earlier.ⁿ¹ Very often, these payments are effectuated through a wage deduction order signed by the court and sent to the debtor's employer, who then remits the payments directly to the trustee.ⁿ² Additionally, unless the court orders otherwise, within the same 30-day period the debtor must begin making post-petition, scheduled lease payments directly to the lessor under a lease for personal property, and the debtor must provide adequate protection payments directly to any creditor holding an allowed claim secured by a purchase money security interest in personal property.ⁿ³

A confirmation hearing must be held in every case.ⁿ⁴ At the hearing, which will typically be held between 20 days and 45 days after the conclusion of the section 341(a) meeting of creditors,ⁿ⁵ the court considers any objections to confirmation filed by the trustee or creditors. Typically, if there is no objection, the plan is confirmed.

MORE INFORMATION

For a more detailed discussion of confirmation of plans *see* chapter 20 *infra*.

The effect of confirmation is to bind the debtor and all creditors of the debtor to the terms of the plan.ⁿ⁶ Normally, the trustee then begins payments to creditors who have filed claims under the plan. Confirmation also reverts title to all property of the estate in the debtor, free and clear of any creditor's claim, except as otherwise provided in the plan.ⁿ⁷ Completion of all payments set forth in the confirmed plan is necessary for a "full compliance" chapter 13 discharge. In very limited circumstances, the court may revoke an order of confirmation, if a party in interest can show that the confirmation order was procured by fraud.ⁿ⁸

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 1326(a)(1), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. 11 U.S.C. § 1325(c). *See* ch. 7 *infra*.

(n3)Footnote 3. 11 U.S.C § 1326(B), (C), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. In some districts courts have ordered that the payments be made through the trustee, in

order to ease the accounting issues that direct payments cause for the trustees; in those districts a portion of the pre-confirmation payments to the trustee will be paid before confirmation to creditors entitled to adequate protection payments.

(n4)Footnote 4. *11 U.S.C. § 1324.*

(n5)Footnote 5. *11 U.S.C. § 1324*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. *11 U.S.C. § 1327(a)*. See *In re Szostek*, 886 F.2d 1405, 21 C.B.C.2d 889 (3d Cir. 1989) (discussing the effects of confirmation).

(n7)Footnote 7. *11 U.S.C. § 1327(c)*.

(n8)Footnote 8. *11 U.S.C. § 1330(a)*. See 8 Collier on Bankruptcy, ch. 1330 (Matthew Bender); 3 Collier Bankruptcy Manual, ch. 1330 (Matthew Bender). Even if the order of confirmation is revoked, the debtor should generally have an opportunity to propose a modified plan. *11 U.S.C. § 1330(b)*.



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CHAPTER 2 Overview of Chapter 13 Bankruptcy

1-2 Collier Consumer Bankruptcy Practice Guide P 2.05

P 2.05 Other Common Events in Chapter 13 Cases

A variety of other proceedings may occur during a chapter 13 case, either before or after confirmation of the plan. The debtor or trustee may object to a proof of claim filed by a creditor. A creditor may move for relief from the automatic stay or, less often, from the codebtor stay. The trustee or a creditor may move to dismiss the case, usually because the debtor has defaulted in payments required by the plan. Other proceedings may sometimes also take place, such as motions to avoid liens on exempt property, objections to exemptions, or complaints to determine the dischargeability of particular debts.

MORE INFORMATION

Chapter 19 *infra* provides a detailed discussion of objections to claims. Dischargeability of debts is discussed in chapter 26 *infra*. Chapter 10 *infra* examines motions for relief from the stay. Chapter 23 *infra* outlines dismissal of cases. Chapter 18 *infra* discusses lien avoidance motions and chapter 13 *infra* provides a detailed discussion of exemptions.



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CHAPTER 2 Overview of Chapter 13 Bankruptcy

1-2 Collier Consumer Bankruptcy Practice Guide P 2.06

P 2.06 Modification of Plan After Confirmation

For various reasons, the debtor may wish to modify the plan that was originally submitted. After confirmation, the plan may be modified by the debtor unless, after notice and a hearing, the modification is disapproved.ⁿ¹ Although there is no requirement that a debtor establish good cause for modification,ⁿ² the plan as modified must, of course, meet the requirements of the Code.ⁿ³

One of the most common reasons for modification is to cure postpetition mortgage defaults.ⁿ⁴ The debtor may also wish to provide for postpetition transactions that arise from an unforeseen emergency or change in the debtor's circumstances. Postpetition claims may generally be provided for in the initial plan, but subsequently will be disallowed if the claimant knew or should have known that the trustee's prior approval of the debtor's incurring the obligation was practicable and was not obtained.ⁿ⁵ Postpetition obligations may also be incurred with the trustee's permission and paid outside the plan.ⁿ⁶ Unless a postpetition claim is allowed and provided for by the plan, it survives the chapter 13 discharge at the end of the case.

The holder of an unsecured claim or the trustee may also move for modification of the plan.ⁿ⁷ The principal reason for such a motion would be a change in the debtor's income or expenses that would enable the debtor to make larger payments for the remainder of the plan. Normally, a modification of the plan at a creditor's request should not be granted without a hearing unless the debtor consents.

MORE INFORMATION

For a detailed discussion of postconfirmation modification see chapter 22 *infra* and chapter 14 for discussion of motions to increase plan payments.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 1329, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *Fed. R. Bankr. P. 3015(g)*.

(n2)Footnote 2. See 8 *Collier on Bankruptcy*, P 1329.02 (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1329.02 (Matthew Bender).

(n3)Footnote 3. 11 U.S.C. § 1329(b), (c), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases

filed on or after October 17, 2005.

(n4)Footnote 4. *In re Hogle*, 12 F.3d 1008 (11th Cir. 1994) (debtor could modify plan to cure postconfirmation default).

(n5)Footnote 5. 11 U.S.C. § 1305.

(n6)Footnote 6. Payments outside the plan are not made through the trustee. See discussion in ch. 14 *infra*.

(n7)Footnote 7. 11 U.S.C. § 1329(a), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 2 Overview of Chapter 13 Bankruptcy

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P 2.07 Options in the Event of Failure to Complete the Plan

In some cases, usually due to loss of income, the debtor is unable to complete the plan as proposed. In such situations four options are available, each of which has somewhat different consequences.

[1] Hardship Discharge

The Code provides for a hardship discharge if the debtor's problems are caused by circumstances for which the debtor is not justly accountable.ⁿ¹ Such circumstances may include the debtor's death or a serious deterioration of the debtor's financial circumstances.ⁿ² A hardship discharge may be granted at any time after confirmation, provided that unsecured creditors have received as much as they would have received in a chapter 7 liquidation.ⁿ³ Thus, there need not have been the full payment of priority claims normally required in a chapter 13 case.

To be eligible for a hardship discharge, an individual debtor must take, with very limited exceptions, a personal financial management course from an approved provider and file a certificate showing the completion of the course no later than the filing of the motion for a hardship discharge.^{n3a} And, if the debtor has claimed a state homestead exemption in excess of \$136,875, the debtor must file a statement about whether any proceeding that could implicate the exemption limit in section 522(q) is pending.^{n3b} A hardship discharge may be granted only if modification of the plan is not practicable.ⁿ⁴ Thus, the Code seems to prefer modification whenever possible.

MORE INFORMATION

Chapter 29 *infra* discusses the hardship discharge in more detail.

[2] Modification of the Plan

It is often possible to modify the plan, under the provisions discussed above,ⁿ⁵ to accommodate new problems as they arise. The payments under the plan may be reduced, or even terminated, if the plan, as modified, still complies with the requirements of chapter 13.

The advantages of modification are that the broader "full compliance" discharge of chapter 13 is preserved, and the hardship discharge tests need not be met. Normally, however, the priority claims and allowed secured claims provided for in the plan must still be paid, and if they cannot be paid modification may be impracticable.

MORE INFORMATION

Chapter 22 *infra* discusses modification in more detail.

[3] Conversion to Chapter 7

The debtor has an absolute right to convert a case to chapter 7,ⁿ⁶ without any showing of hardship, and in most cases such a conversion provides the same relief as the hardship discharge. The Bankruptcy Rules provide that the debtor need only file a notice of conversion, and that no court order is necessary to effect the conversion.ⁿ⁷

After conversion, if there is nonexempt property in the estate, that property is liquidated regardless of what the unsecured creditors have already received under the plan (at least to the extent necessary to pay all creditors in full). Therefore, in cases in which the debtor has nonexempt assets and can meet the requirements, a hardship discharge is often preferable to conversion.

On the other hand, an advantage of conversion is that it allows postpetition debts arising before conversion to be treated as if they arose prepetition.ⁿ⁸ These debts may thus be discharged if they are dischargeable under chapter 7.ⁿ⁹ This may make conversion an attractive option if the debtor has significant unsecured postpetition debts.

The debtor may wish to convert if the reasons for the initial choice of chapter 13 no longer apply. For example, the debtor may have chosen chapter 13 to protect property, such as an automobile, from repossession.ⁿ¹⁰ If that property is later destroyed or is no longer of value to the debtor, chapter 13 may no longer be necessary. There are also some situations in which, because of the scope of relief available in chapter 11 or 12, conversion to those chapters may be an alternative to remaining in chapter 13.ⁿ¹¹

Conversion may also be advantageous when the debtor is unable to complete his or her plan or unable to certify payment of certain domestic support obligations, and is ineligible for a hardship discharge, yet wishes to obtain a discharge of unsecured debts or to preserve the effect of lien avoidance or other orders obtained under chapter 13.ⁿ¹² If a case is voluntarily or involuntarily dismissed, rather than converted, liens avoided in the bankruptcy are reinstated.ⁿ¹³

Conversion to chapter 7 can be ordered against the debtor's will upon request of a party in interest, "for cause" or for failure to file tax returns as required by section 1308. "For cause" may include, but is not limited to unreasonable delay to the prejudice of creditors, failure to file a timely plan, failure to commence plan payments, failure to pay certain domestic support obligations, denial of confirmation along with denial of time to file a modified plan, a material default by the debtor in performance of a plan, revocation of confirmation, or termination of a plan according to its own terms.ⁿ¹⁴ However, if the debtor is a farmer, the Code provides that the court may not convert the case to chapter 7 unless the debtor so requests.ⁿ¹⁵

MORE INFORMATION

Chapter 24 *infra* discusses conversions in more detail.

[4] Dismissal

Occasionally, dismissal may be preferable to any of the other options. The debtor may at any time obtain dismissal as of right unless the case was previously converted from another chapter.ⁿ¹⁶ This route may be particularly attractive if it appears that the case may be converted to chapter 7 against the debtor's will and if the debtor has nonexempt property that he or she does not wish to see liquidated.

A dismissal places the debtor and the creditors where they were before the case began. Unless the court orders

otherwise, a dismissal vacates most bankruptcy orders and returns the parties as much as possible to the status quo prior to the petition.ⁿ¹⁷ The trustee should return to the debtor any funds that he or she is still holding.ⁿ¹⁸ In some cases, this may be preferable to all of the other alternatives discussed above, leaving the debtor to deal with creditors as if no bankruptcy had occurred. Obviously, to the extent that creditors have been paid before the case is dismissed, the debtor is entitled to the benefit of these payments. Some debts may have been completely paid, or partially paid to an extent sufficient for the debtor to work out an agreement directly with the creditor on the balance due.

Dismissal, like conversion, can also be ordered against the debtor's will, upon the request of any party in interest, "for cause" or for failure to file tax returns required by section 1308. In addition to the reasons that might justify conversion such as failure to make plan payments or lack of eligibility for chapter 13, the court may also dismiss the case for failure to pay required fees and charges or for failure to file required documents.ⁿ¹⁹

MORE INFORMATION

Chapter 23 *infra* examines provisions for dismissal of cases in greater detail.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 1328(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. See 8 Collier on Bankruptcy, P 1328.03 (Matthew Bender). See also Fed. R. Bankr. P. 1016.

(n3)Footnote 3. 11 U.S.C. § 1328(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Again, the present value as of the effective date of the plan is the relevant figure. See P 2.03 n.8 *supra*.

(n4)Footnote 3a. 11 U.S.C. § 1328(g); Fed. R. Bankr. P. 1007(c).

(n5)Footnote 3b. Fed. R. Bankr. P. 1007(b)(8).

(n6)Footnote 4. 11 U.S.C. § 1328(b)(3).

(n7)Footnote 5. See P 2.06 *supra*.

(n8)Footnote 6. 11 U.S.C. § 1307(a).

(n9)Footnote 7. Fed. R. Bankr. P. 1017(d).

(n10)Footnote 8. 11 U.S.C. § 348(d). See 3 Collier on Bankruptcy, P 348.05[3] (Matthew Bender).

(n11)Footnote 9. See ch. 14 *infra*.

(n12)Footnote 10. See generally ch. 14 *infra* for a discussion of the use of chapter 13 in dealing with secured creditors.

(n13)Footnote 11. 11 U.S.C. § 1307(d). For example, when the chapter 13 debt limits make dismissal unexpectedly likely under § 109(e), conversion to chapter 11 remains possible. *Rudd v. Laughlin*, 866 F.2d 1040 (8th Cir. 1989) ; *In re Wenberg*, 94 B.R. 631 (B.A.P. 9th Cir. 1988) .

(n14)Footnote 12. 11 U.S.C. § 348(f)(1)(B).

(n15)Footnote 13. 11 U.S.C. § 349. See *In re Sadler*, 935 F.2d 918, 24 C.B.C.2d 2017 (7th Cir. 1991) .

(n16)Footnote 14. *11 U.S.C. § 1307(c)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n17)Footnote 15. *11 U.S.C. 1307(f)*, formerly 1307(e), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. This is in accord with the general bar against involuntary bankruptcies involving farmers. *See 11 U.S.C. § 303(a)*.

(n18)Footnote 16. *11 U.S.C. § 1307(b)*.

(n19)Footnote 17. *11 U.S.C. § 349(b)*.

(n20)Footnote 18. *In re Nash*, 765 F.2d 1410, 13 C.B.C.2d 209 (9th Cir. 1985) .

(n21)Footnote 19. *11 U.S.C. § 1307(c)(2), (9), (10)*.



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CHAPTER 2 Overview of Chapter 13 Bankruptcy

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P 2.08 Discharge of Debtor

Upon completion of all payments under the plan, the court enters a "full compliance" discharge.ⁿ¹ To be eligible for a discharge, an individual debtor must take, with very limited exceptions, a personal financial management course from an approved provider and file a certificate showing the completion of the course no later than the date of the last plan payment, unless the court enlarges that time pursuant to *Federal Rule of Bankruptcy Procedure 9006(b)*.^{n1a} If the debtor is required to pay a domestic support obligation,^{n1b} the debtor must also certify that all payments due on the obligation, except for payments excused by the plan, have been made.^{n1c} And, if the debtor has claimed a state homestead exemption in excess of \$136,875, the debtor must file a statement about whether any proceeding that could implicate the exemption limit in section 522(q) is pending.^{n1d}

The discharge eliminates the debtor's personal liability for all debts provided for in the plan not excepted from the discharge by *1328(a) of the Bankruptcy Code*. In the case of a hardship discharge, the discharge eliminates all debts not excepted by section 1328(b). The discharge also serves as an injunction against efforts to collect such debts,ⁿ² unless the debtor has reaffirmed a debt pursuant to the procedures in section 524(c), (d) and (k).

If the debtor desires to enter into a reaffirmation agreement, and was not represented by counsel in negotiating the agreement, the court must hold a discharge hearing to advise the debtor of the consequences of the agreement and decide whether to approve the agreement.ⁿ³ The court may, in its discretion, hold discharge hearings in other cases, such as when the agreement is presumed under section 524(m) to impose an undue hardship and is subject to disapproval by the court.. After the discharge is entered, the court sends notice of the discharge to the debtor and all creditors.ⁿ⁴

MORE INFORMATION

The exceptions to discharge are discussed in chapter 26 *infra* and the procedure for obtaining a discharge is discussed in chapter 29 *infra*.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 1308*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 1a. *11 U.S.C. § 1328(g); Fed. R. Bankr. P. 1007(c)*.

(n3)Footnote 1b. "Domestic support obligation" is defined in *11 U.S.C. § 101*.

(n4)Footnote 1c. *11 U.S.C. § 1328(a)*.

(n5)Footnote 1d. *Fed. R. Bankr. P. 1007(b)(8)*.

(n6)Footnote 2. *11 U.S.C. § 524(a)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n7)Footnote 3. *11 U.S.C. § 524(d)*.

(n8)Footnote 4. *Fed. R. Bankr. P. 4004(a)*.



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P 2.09 Closing of Case

After notice of the discharge is mailed and the trustee has filed a final report of distributions in the case, the case is promptly closed by the court.ⁿ¹ Once the case is closed, if any further proceedings become necessary it is usually necessary to file a motion to reopen the case.ⁿ²

MORE INFORMATION

The procedure for reopening a case is covered in chapter 31 *infra* .

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 350(a).

(n2)Footnote 2. 11 U.S.C. § 350(b).



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CHAPTER 3 Interviewing the Debtor and Investigating the Facts

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CHAPTER 3 Interviewing the Debtor and Investigating the Facts

1-3 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter provides tips on interviewing the debtor to insure the acquisition of complete information. The chapter highlights the types of information that are frequently overlooked in the handling of bankruptcy cases and provides useful sources for seeking information. Finally, the chapter emphasizes the need for the client to understand the importance of providing complete and accurate information.



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CHAPTER 3 Interviewing the Debtor and Investigating the Facts

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P 3.01 The Importance of Getting All the Facts

Before a bankruptcy case can be filed, it is necessary that a decision be made that bankruptcy is, in fact, the best vehicle for dealing with the problems facing a particular client. Indeed, most of the legal analysis that occurs in a typical consumer bankruptcy case involves comparing bankruptcy with other possible avenues of relief.

An absolutely necessary prerequisite to such consideration, just as in most other legal analysis of real world problems, is knowledge of all the relevant facts. Although it may sometimes be possible to rule out bankruptcy based upon knowledge of only a few facts (*e.g.*, that the client does not wish to lose certain property that cannot be saved in bankruptcy), it is never possible to recommend bankruptcy safely without a thorough knowledge of the facts. Without such knowledge, unknown property (such as the right to a tax refund) may be lost in bankruptcy, major debts may turn out to be nondischargeable or unaffected because of security interests, the debtor may be ineligible to receive a discharge or the benefit of the automatic stay because of a prior case, or undervalued property might be determined to be nonexempt and lost.

Of equal importance is the fact that, without complete information, an attorney may not be able to utilize fully the bankruptcy for the debtor's maximum benefit. Substantial hardship may be caused, for example, if a creditor is not notified of the automatic stay before the debtor's car is repossessed because no one checked to see if the debtor was behind in payments to that secured creditor. The debtor's right to avoid or modify a lien may be lost because the existence of the lien is not discovered in the fact-gathering stage of the case. Moreover, debts not listed in the bankruptcy papers might survive a discharge;ⁿ¹ even if they are discovered during the pendency of the case and can be included, they may lead to additional fees for the debtor and more work for the debtor's attorney.ⁿ²

MORE INFORMATION

Chapter 26 *infra* provides a detailed discussion of dischargeability of unscheduled debts.

Finally, much of the information which should be sought early is necessary in any case for proper completion of the bankruptcy forms. It makes sense, then, to obtain this information before, rather than after, there is a commitment to pursue a bankruptcy instead of other possible strategies.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 523(a)(3); 11 U.S.C. 1328(a)(2)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. The fee currently set by the Administrative Office of the Courts for an amendment adding a creditor is \$26.00. It may be waived upon application to the court in cases of indigent debtors. *See* ch. 32 *infra* for discussion of filing documents *in forma pauperis*.



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CHAPTER 3 Interviewing the Debtor and Investigating the Facts

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P 3.02 Interviewing the Debtor

The steps necessary to assure complete information will vary somewhat from case to case. For example, if no real estate is involved, a title search might not be necessary. If a client has clearly kept organized and complete records, counsel may often rely upon them with little risk.

[1] Questions that Will Provide an Overview of the Case

Normally, the first step is an interview with the client. In addition to the establishment of a relationship, this interview will usually serve to quickly identify most cases in which bankruptcy is not appropriate. Regardless of whether the possibility of a bankruptcy is first broached by a client who believes it is necessary or an attorney whose initial reaction to the case leads in that direction, a few questions will usually reveal the most likely impediments to a successful bankruptcy.

These initial questions should be asked early to get an overview of the client's problems:

- What types of debt are causing the most trouble?
- How were the debts incurred and are they secured?
- What significant assets does the client have?
- How much income does the debtor have available which is not committed to unavoidable expenses?
- How imminent is creditor action which may limit the client's options?

The answers to these general questions (which, of course, must be put in terms the client understands) will reveal not only the likelihood of relief in a bankruptcy but also many other dimensions of the client's problems: their causes, their scope, whether they are likely to continue or recur, and whether other solutions seem obviously preferable. They can lead naturally into a broad discussion of the problems most troubling to the client.

[2] Filling in the Complete Picture

Once bankruptcy is being seriously considered, and has perhaps tentatively been decided upon, much more information is necessary. Only after all of this information is gathered can bankruptcy finally be recommended. Section 707(b)(4)(C), added in 2005, requires an attorney to perform a reasonable investigation into the circumstances giving rise to the petition.ⁿ¹ While it is not clear that this language goes beyond what is already required by *Rule 9011*, at a minimum it serves as a reminder that knowledge of all the relevant facts is essential prior to filing. Again, the principal source of information is usually the client, but methods of tapping this source may vary.

Many bankruptcy specialists have clients do much of the information-assembling on their own, through use of a detailed questionnaire phrased in easily understandable terms. Practitioners using questionnaires cite two principal advantages. First, they save time, and encourage the client to gather much information prior to a detailed interview. Second, use of a form questionnaire, even if it is completed by the attorney or by the attorney's staff, ensures a complete interview and minimizes the possibility of any later misunderstanding (or malpractice claim) concerning whether the client was asked a particular question.

FORMS

For a sample questionnaire see *Collier Consumer Bankruptcy Forms, Form CS4.02-1* (Matthew Bender).

Whether or not a questionnaire is used, it is important to conduct a careful interview to assure the completeness and accuracy of the data obtained. Even the simplest written questions may not be understood by some clients, and clients may be confused about the purpose of others. They may fail to list debts they wish to pay, or property they do not consider "really" theirs.

PRACTICE NOTE

The oral and written questions to clients should always be supplemented and checked by obtaining every shred of documentation the client possesses regarding his or her financial situation. Tax returns, recent pay stubs and bank statements will usually provide greater detail and specificity than the debtor's memory. Consumer debtors may not realize that security interests have been taken in their property; they may also be unaware of defenses and counterclaims available to them. In addition, the documents will usually provide precise information on the amounts due and the addresses of creditors.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 3 Interviewing the Debtor and Investigating the Facts

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P 3.03 Frequently Missed Information

Certain types of information, in particular, are frequently overlooked in the handling of bankruptcy cases, especially by practitioners who rely exclusively on the questions in the official forms as their interview guide. Given the broad definitions of property and claims in the Code, the forms by themselves are not adequate as a means of inquiring into nontraditional types of assets and debts.

Some of the most commonly missed items in the cases of consumer debtors are listed below. Regardless of the method used to elicit information from a client, inquiry should always be made into the following matters.

[1] Assets of the Client

Among the types of property clients often forget in reporting their assets are long-dormant accounts with savings institutions, such as banks and credit unions. Especially in the case of the latter, the client may not have access to a share balance (deposit) that was required to secure a loan. Nonetheless, such a balance belongs to the client and may become important to the case. Similarly, pledged goods, such as those in the hands of pawnbrokers, are often not considered by clients to be "their own." In all of these cases, as much property as possible should be withdrawn from the hands of others prior to bankruptcy. Not only can this property be converted to exempt assets, if necessary, but the return of the property will avoid later difficulties caused by reluctance of the holding party to relinquish it after the bankruptcy.ⁿ¹

MORE INFORMATION

See chapter 4 infra for discussion of such "exemption planning." Goods constituting security for a debt should not be transferred, since doing so may risk objections under 11 U.S.C. § 727(a)(2) or 11 U.S.C. § 523(a)(6). *See generally* chapters 26 and 29 *infra*.

Other types of property that clients may not recognize include entitlement to tax refunds or credits, rights to alimony or support arrearages or marital property settlements, rights to inheritance or life insurance proceeds from someone who has recently died or may soon pass away, security deposits given to landlords or utilities, accrued vacation pay, future commissions from sales positions, salary or pension rights, legal claims against third parties, leasehold interests which are of value, shares in housing, shopping, agricultural or other cooperatives, the right to collect money owed to the debtor, property such as a joint bank account that is nominally in the client's name but not considered by the client to be

his or her property, interests in education savings such as section 529 plans and education IRA's for children or other relatives,^{n1a} and entitlements to government grants such as energy assistance grants. Knowing about causes of action that the debtor either has asserted or may assert in the future is particularly important, because if they are not listed in the bankruptcy case, the debtor may be barred from later asserting them by judicial estoppel.ⁿ²

PRACTICE NOTE

It is crucial to know about all of these interests, both to ensure that they will not be lost and to take full advantage of them. Depending on the circumstances, a bankruptcy petition might be postponed until a tax refund is received or vacation pay or other entitlements are exhausted.ⁿ³

It is also important to know about property the debtor might soon acquire. Not only might such property be available to solve some of the debtor's financial problems, but in addition it could be lost in a bankruptcy case if it could not be exempted. If the debtor acquires a right to property within 180 days after filing a bankruptcy case, by way of a marital property settlement, inheritance, or from life insurance proceeds, such property becomes property of the bankruptcy estate.ⁿ⁴

Lastly, insurance interests are often overlooked. Clients may have life insurance with a cash value or credit insurance that can be terminated and "cashed in" at the time of bankruptcy.ⁿ⁵ On the other hand, whether clients have fire or automobile insurance may be an important factor in providing "adequate protection"ⁿ⁶ to creditors who might otherwise be entitled to possession of their security. Local practice usually determines the extent to which the trustee or court will inquire into such nontraditional assets, but there is no excuse for the debtor's counsel being less than fully informed and prepared for all possible problems that might arise.

[2] Liabilities of the Client

Naturally, the opportunity for discharge of debts in bankruptcy should be used to its fullest, and every conceivable liability should be searched out and considered in weighing the advantages of a petition. Clients do not always realize that they have certain types of debts, especially if payment has not been demanded for them. Just as a legal claim may be a form of property, so too may it give rise to a liability if the client is the potential defendant. The terms of a lease or land installment sales contract may be important, especially if it is possible to modify them in a chapter 13 case,ⁿ⁷ or if an unfair lease or rent-to-own contract is found.ⁿ⁸ Debts of others for whom clients have cosigned are not usually considered by clients as their own liabilities. Similarly, clients are rarely aware of possible deficiencies remaining after property is repossessed in satisfaction of secured debts, or after vacating a rental property, voluntarily or involuntarily, before the expiration of a lease.

MORE INFORMATION

Chapter 15 *infra* outlines tenants' rights in chapter 13 cases and executory contracts and also gives a general discussion of leases in bankruptcy. Chapters 14 and 25 *infra* provide a discussion of rent-to-own contracts.

Clients also may not be aware that a debt is or may be a secured debt. Some clients may have co-signed on debts incurred by others and offered their own property as collateral. This is particularly common for elderly homeowners who have tried to help their adult children. Other clients may not realize that second mortgages have been taken on their homes, and few understand that a judgment resulting from a lawsuit or a divorce settlement may constitute a lien on their real property.

In addition, several major retailers regularly claim to have security interests in property purchased with their credit cards. Other creditors, usually credit unions, claim to have security interests in debtors' automobiles, due to

cross-collateral clauses in car loan documents, purporting to make the vehicle collateral for all other debts owed to the creditor. Finance companies often take nonpurchase-money security interests in household goods. Although these creditors often have trouble documenting their security interests, and nonpurchase-money security interests in many household items usually can be avoided under *Code section 522(f)(1)(B)*,ⁿ⁹ it is important to be aware of whether such interests exist in counseling the debtor about bankruptcy strategy.

MORE INFORMATION

Motions to avoid nonpossessory nonpurchase-money security interests are discussed in chapter 18 *infra*. Chapter 27 *infra* outlines strategies with respect to creditors that claim purchase-money credit card security interests in household goods.

In many states an individual is automatically liable for necessities provided by a third party to that individual's dependents, or for welfare payments provided; few clients are aware of such liabilities. Divorce related debts, such as money owed on a property settlement, division of marital liabilities, or alimony and child support may also be overlooked.ⁿ¹⁰ Utility bills paid regularly may be omitted by a client because they are not perceived as comparable to a loan or other long-term debt, or because the client is current on a payment agreement to cure a long-term arrearage. A client may not think it necessary to mention that a driver's license was revoked because of an old tort judgment or fines which may be dischargeable.ⁿ¹¹ Likewise, if public benefit overpayments are being deducted from current benefits, a client may feel that fact has little to do with bankruptcy and fail to list such overpayments as debts. A debtor who has been involved in running a business may not realize that sales or payroll taxes which the business failed to pay may become the debtor's liability. Often, when debtors have been paid as independent contractors, rather than as employees, they are unaware of their tax obligations with respect to that income.

PRACTICE NOTE

Special care must also be taken to inquire into debts likely to be treated differently in bankruptcy. Unpaid taxes must be carefully analyzed to determine their dischargeability and priority status.ⁿ¹² Are there large liabilities for student loans, support, or alimony?ⁿ¹³ Has there been recent, improvident use of credit cards, in excess of the credit limits imposed?ⁿ¹⁴ Clients should be advised, at the same time, of the likely loss of their credit cards due to a bankruptcy, at least if they are in default on those accounts.ⁿ¹⁵

Finally, many debtors ask that certain debts be omitted from their bankruptcy papers because of embarrassment about notifying particular creditors, or because of a continuing intent to repay. The answer to this request must always be that every existing liability has to be listed (including personal debts to family members and friends). The debtor's signature on the schedules is a certification under penalty of perjury that the information provided is complete and accurate. Upon learning this, some debtors may instead choose to pay off a particular debt prior to filing so that there is no liability to be listed, although they should be advised of the ramifications if a creditor receives an avoidable preference.ⁿ¹⁶

[3] Determining debtors expenses is particularly problematic in many cases for two reasons.

First, most debtors do not keep very good records of their expenses and may have only a vague idea of what they are spending for food, clothing, transportation and other necessities that do not involve a monthly bill. The expenses they list in many cases seem to be a good deal less than their incomes, yet it is clear that they are not saving money. In such cases, it is often effective to ask the debtors where they are depositing the surplus income each month in order to bring home the reality that they are spending more than they have stated.

Second, most debtors are so financially strapped by the time they come in for bankruptcy advice that they are skimping on many necessities and other reasonable expenses, often spending nothing on them. For example, debtors often defer home maintenance when they are short of funds, so their homes may need painting or even repairs to plumbing or electrical systems. Similarly, many debtors do not receive regular dental care or medical checkups, especially if they have no health insurance.

Especially for debtors with higher incomes, it is important to fully explore not only what the debtor is spending but also the needs that are not being met so that Schedules I and J of Official Form 6, the debtor's statements of income and expenses, do not show a large surplus that does not accurately reflect the debtor's true expenses. Generally, expenses that total approximately the amount allowed by the chapter 7 means test should be considered a presumptively reasonable standard of living. In particular, Congress has made very clear, through the enactment of section 1329(a)(4), that debtors have a right to maintain or obtain health insurance for themselves and their families.

Thus, in reviewing debtors expenses, it is important to look not only at current expenses but also at unmet needs to determine a reasonable budget for going forward. In some cases, the simple fact is that debtors incomes are insufficient to meet all reasonable needs and the budget may show a net monthly deficit. But in others, where debtors have more middle-class income levels, debtors should be sure to list all of their reasonable expenses. Expenses that are often overlooked or underestimated include:

- health insurance--debtors who do not have adequate insurance should consider obtaining it prior to filing the bankruptcy case.
- uninsured medical expenses--these often include co-pays and deductibles, glasses, contact lenses and fluid, nonprescription drugs and vitamins, and checkups.
- dental care--many debtors need dental work which they have deferred because they cannot afford it.
- eye care--regular vision checkups and glasses or contact lenses are not covered by most insurance plans.
- child care--debtors may have been imposing on family members out of necessity, and can consider whether their children would be better off in day care.
- home maintenance--an amount should be budgeted for home maintenance, including both unexpected repairs or replacement of old systems and appliances, and tasks such as painting and roof repairs that may occur only once every four or five years, as well as lawn care, snow removal, and other necessary services a debtor cannot perform him or herself.
- school expenses and childrens activities--children have expenses for a variety of school activities, school lunches, and sometimes uniforms, at most schools; other activities, such as music lessons, scouting expenses, or sports fees, should be allowed if reasonable.
- automobile maintenance--debtors with no immediate repair needs often ignore the fact that maintenance of an older car usually exceeds \$1000 per year. Even with a newer car, oil changes and other maintenance add up to a significant amount annually.
- alarm service--in many urban areas, a burglar alarm is considered a reasonable expense.
- pest control--in some areas this is a necessity.

- personal care--haircuts and the like, especially for a family with children, add up to a considerable amount each month.
- baby supplies--diapers and clothes for a small child constitute a large monthly expense.
- summer camp for children--this would usually be considered a reasonable expense, especially for working parents.
- cigarettes--for debtors who are addicted to smoking, most courts have allowed this considerable expense as reasonable.
- charitable donations--the Code clearly allows for debtors to make reasonable religious or charitable donations, which they may have been unable to make before the bankruptcy petition due to financial stress.
- tax return preparation fees--courts will generally allow debtors to pay reasonable amounts for tax return preparation.
- pet expenses--reasonable expenses for pets, including food and occasional visits to a veterinarian, should be listed. However, debtors should be sure to list the pets as assets on Schedule B.
- bank charges--ATM fees and other bank charges, such as monthly account fees, are often forgotten.
- holiday and birthday gifts for family members--few judges would begrudge debtors the ability to give modestly priced presents to their children.
- work expenses--debtors may have to pay for uniforms or tools, or for parking at work, and there may be reasons debtors must purchase meals at work.
- annual auto and registration and license expenses--these expenses are sometimes considerable, and are often forgotten because they are paid only once a year.
- life insurance--if debtors have any dependents and do not have life insurance, the purchase of a reasonable amount of term insurance would be considered appropriate.

[4] Other Aspects of Financial Affairs

Finally, careful inquiry must be made into other areas of the client's affairs which are likely to generate issues if a bankruptcy case is filed. For example:

- Can the client terminate payroll deductions being made, such as to a credit union? If so, that step usually prevents later complications of trying to recover money deducted after a bankruptcy is filed. It also increases the client's available income. Similarly, are there electronic fund transfers and preauthorized payments to creditors that the client can stop?
- Has the client made any prebankruptcy transfer or disposition of property which could cause problems?¹⁷
- Does the client remember giving a financial statement to any creditor which was not completely true?¹⁸

- Has there been recent excessive or unusual use of a credit card?n19
- Are there any criminal prosecutions pending related to bad checks, theft of utility service, conversion of collateral, or other liabilities on debts?n20
- Does the debtor own or possess any property that is hazardous or alleged to be hazardous, giving rise to potential liabilities or a diminution in the property's value?n21

FOOTNOTES:

(n1)Footnote 1. See ch. 11 *infra* for discussion of banks freezing debtors' accounts after a bankruptcy case is filed and for discussion of the duty to turn over property of the debtor after filing. A few banks have adopted policies of freezing all debtor accounts, at least until a trustee relinquishes the estates rights in the account. Such policies are questionable at best. Compare *In re Jimenez*, 335 B.R. 450 (Bankr. D.N.M. 2005) , with *In re Calvin*, 329 B.R. 589, 601 (Bankr. S.D. Tex. 2005) . However, if there is any possibility a depository institution may have such a policy, funds should be withdrawn prior to the filing of the petition. Similarly, it is best to avoid, if possible, filing a case when there are outstanding checks drawn on the debtors account, to avoid arguments that the funds in the account are property of the estate, at least if such funds could not be exempted. See *In re Pyatt*, 486 F.3d 423 (8th Cir. 2007) (rejecting holdings of some other courts that debtor had to turn over such funds after payees on checks had already cashed them).

(n2)Footnote 1a. Most interests in education savings accounts are excluded from the bankruptcy estate by 11 U.S.C. § 541(b)(6) & (7). However, a "record" of the debtor's interest in such accounts must be filed with the court. 11 U.S.C. § 521(c); *Fed. R. Bankr. P. 1007(b)(1)(F)*. It is not clear whether listing an interest in an account on Schedule B of Official Form 6 is sufficient for this purpose.

(n3)Footnote 2. See P6.07[1][b], n.7a for examples of cases dealing with this issue.

(n4)Footnote 3. Greater detail concerning the appropriate timing of a bankruptcy filing is contained in ch. 4 *infra* .

(n5)Footnote 4. 11 U.S.C. § 541(a)(5). See 5 *Collier on Bankruptcy*, P 541.16 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 541.17 (Matthew Bender).

(n6)Footnote 5. See ch. 15 *infra* for the possibilities of rejecting executory contracts for credit insurance.

(n7)Footnote 6. Creditors are entitled to "adequate protection" of their interests in collateral as a condition of maintaining the automatic stay. See ch. 8 *infra*.

(n8)Footnote 7. See ch. 15 *infra* for a discussion of tenants' rights in chapter 13 cases and executory contracts.

(n9)Footnote 8. See chs. 14, 25 *infra* for discussion of rent-to-own contracts and ch. 15 *infra* for a general discussion of leases in bankruptcy.

(n10)Footnote 9. 11 U.S.C. § 522(f)(1)(B), (4), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See ch. 18 *infra* for discussion of debtor's avoidance powers.

(n11)Footnote 10. For a comprehensive discussion of marital debts in bankruptcy see Sommer and McGarity, *Collier Family Law and the Bankruptcy Code* (Matthew Bender).

(n12)Footnote 11. See ch. 30 *infra* for discussion of restoring drivers' licenses through bankruptcy.

(n13)Footnote 12. See ch. 26 *infra*.

(n14)Footnote 13. These debts are all, to some extent, nondischargeable in chapter 7 and chapter 13 and are usually priority claims. *11 U.S.C. §§ 507(a)(1), 523(a)(5), 523(a)(8), 1328(a)(2)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See ch. 26 infra*.

(n15)Footnote 14. This may cause problems if the creditor claims the debts were incurred under false pretenses and that they are nondischargeable. *11 U.S.C. § 523(a)(2)*. *See ch. 26 infra*.

(n16)Footnote 15. *See ch. 16 infra* for discussion of the practice of requiring debtors to give up their credit cards.

(n17)Footnote 16. *See ch. 17 infra*.

(n18)Footnote 17. These transfers may be preferences or fraudulent transfers avoidable by the trustee or may give rise to an objection to discharge. *See ch. 4 infra*.

(n19)Footnote 18. This may be grounds for a claim that the debt is nondischargeable under *11 U.S.C. § 523(a)(2)*. *See ch. 26 infra*.

(n20)Footnote 19. This can give rise to claims under *11 U.S.C. § 523(a)(2)(A)* for fraud. Particular attention should be paid to the presumption of fraud based on prepetition purchases of luxury items within 90 days of filing a bankruptcy or use of a credit card for cash advances within 70 days of filing. *11 U.S.C. § 523(a)(2)(C)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See ch. 26 infra*.

(n21)Footnote 20. *See chs. 12, 26 infra*.

(n22)Footnote 21. If the debtor owns or possesses property that poses or is alleged to pose a threat of imminent and identifiable harm to public health or safety, that fact must also be disclosed in Exhibit C to the bankruptcy petition.



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CHAPTER 3 Interviewing the Debtor and Investigating the Facts

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P 3.04 Other Sources of Information

Depending upon the complexity of a client's debt situation, and the completeness of the information obtained from the client, it may be necessary to seek further information elsewhere.

[1] Contacts with Creditors

One source that should not be overlooked is the creditor to whom a debt is or may be owed. Especially if they think it may be to their benefit, as in a chapter 13 case, creditors are usually quick to respond to inquiries regarding the balance due and the security interests they have. And the same letter which requests this information can also serve notice upon the creditor that it must henceforth communicate only with the attorney and not the client.

FORMS

For forms informing creditors of representation of debtor *see* Collier Consumer Bankruptcy Forms, § CS 4.21 (Matthew Bender).

[2] Credit Reports

In addition, a credit report, which can be used to check or supplement previous information, should normally be obtained by the client at no cost or for a small fee. There are three major credit reporting agencies that may be contacted. If credit has been denied based upon a credit report within the past sixty days, a free copy of that report must be offered by the credit reporting agency. In addition, each consumer is entitled to one free copy of a credit report from each reporting agency through a centralized source authorized by the Federal Trade Commission. To order a free report over the internet go to www.annualcreditreport.com. Free annual credit reports may also be obtained by calling 877-322-8228 or mailing a completed Annual Credit Report Request Form (available at www.ftc.gov/credit) to

Annual Credit Report Request Service
P.O. Box 105281
Atlanta, GA 30348-5281

Alternatively, credit reports may be obtained directly from any or all of the three national reporting companies. Most

agencies will impose a small charge, usually under \$10, for a basic credit report. Credit reports may be obtained online from all three companies for a similar fee. It may be wise to obtain a credit report, if the debtor has not done so, while the debtor is in the attorney's office.

[a] Experian (Formerly TRW)

A credit report may be obtained from Experian online at www.experian.com.

A report may also be requested by telephone at (888)-397-3742 or by mail, by sending a request to:

Experian
P.O. Box 2104
Allen, TX 75013

The written request signed by the debtor must include the debtor's full name, date of birth, current and previous addresses for the past two years (with zip codes), two proofs of current address (such as a copy of a billing statement or driver's license), and social security number. The applicable fee must also be included with the request.

[b] Equifax

A credit report may be obtained from Equifax online at www.equifax.com.

A report may also be requested by telephone at (800) 685-1111 or by mail, by sending a request to:

Equifax Information Services, LLC
Disclosure Department
P.O. Box 740241
Atlanta, GA 30374

The written request signed by the debtor must include the debtor's full name, date of birth, current and previous addresses for the past five years, social security number, and phone number. The applicable fee must also be included with the request.

[c] Trans Union

A credit report may be obtained from Trans Union online at www.transunion.com.

A report may also be requested by telephone at (800) 888-4213 or by mail, by sending a request to:

Trans Union, LLC
P.O. Box 1000
Chester, PA 19022

The written request signed by the debtor must provide the full name of the debtor, current address, other addresses for the past two years, social security number, date of birth, current employer, and phone number. The applicable fee must also be included with the request.

[3] Title Searches and Appraisals

For debtors who own real estate, past appraisals, lien or title searches, or previous years' tax returns may be necessary or helpful. Moreover, debtors may be unaware that some of their debts are secured by mortgages, municipal liens or judgment liens. A lien search may also indicate other liens which the debtor does not remember or know about, and which may be avoided or otherwise dealt with in the bankruptcy.

MORE INFORMATION

For a discussion of ways to deal with secured creditors, *see* chs. 14, 18 and 25 *infra*.

The value of the debtor's home is often an important issue in a bankruptcy case. If the value of property is of significant importance, a current formal or informal appraisal may be required to get a full picture of the case. Information on valuation of real estate also can be obtained from web sites such as www.domania.com , www.homevaluehunt.com, www.homegain.com , www.zillow.com , www.eppraisal.com, www.bankofamerica.cyberhomes.com, and www.realtor.com . In addition, many realtors' websites list recent sales in the neighborhoods they cover.

PRACTICE NOTE

In a few districts, aggressive trustees have been known to use their section 544 "strong arm" powers to avoid unperfected security interests in property such as automobiles,ⁿ¹ creating equity in the property which the debtor cannot exempt and thereby causing the loss of the property to the debtor. The better view is that in such cases the trustee simply steps into the shoes of the lienholder and has no greater rights. However, if such a lien has not been perfected, the debtor may want to consider different strategies, perhaps through filing a chapter 13 case.

[4] Obtaining Tax Information

For clients with significant tax debts, it is critical to know a variety of dates and amounts before decisions about bankruptcy strategy can be made. In some cases, waiting a few days, weeks, or months before filing can save the debtor thousands of dollars if the delay brings the debtor past a time period during which taxes are entitled to priority status or are nondischargeable. Besides timing, other issues of strategy may turn on whether and when tax liens were obtained. A federal tax return or transcript thereof, as well as recent pay stubs will be needed in any event once the case is filed.^{n1a}

MORE INFORMATION

Chapter 26 *infra* provides a discussion of priority and nondischargeable taxes.

PRACTICE NOTE

Therefore, in analyzing tax debts, it is important to have all the facts, including precise dates, so that the relevant time periods can be calculated accurately. For federal income taxes, the best way to ensure this is to obtain a transcript from the Internal Revenue Service. Two types of transcripts are available, an MFTRA-X, which is fairly easily deciphered, and a more detailed MFT-30, which must be decoded. The former, unfortunately, omits information that may be important, such as whether a return listed was a substitute return not filed by the debtor, which may not constitute a filed return for the purpose of triggering the relevant time periods.

The MFTRA-X can be obtained from the local IRS service center or disclosure office. A letter requesting it should include an IRS form power of attorney signed by the debtor. The debtor can also obtain this transcript in person at the local IRS field office. In an emergency, the IRS will sometimes give some information over the phone and send a transcript more quickly if the debtor's counsel calls the Tax Practitioner Hotline, 866-860-4259 and immediately faxes a power of attorney. The MFT-30 takes longer to obtain, usually about two weeks. In complicated cases, a Freedom of Information Act Request can be sent to the appropriate IRS disclosure office, requesting the debtor's entire file, including the MFT-30, collection file, notices of deficiency, and records of assessments. However, obtaining these records can take several months.

Similar information should be obtained with respect to state and local taxes. Obviously, the necessary procedures vary in the different jurisdictions.

[5] Court Records

If there are questions about previous bankruptcy cases filed by the debtor, such as the case number, date filed, date of any prior dismissal, or number of earlier cases, information on prior bankruptcy filings may be obtained from the bankruptcy court. Normally, this information is available electronically, through the PACER system or another automated system.ⁿ² In addition, a national database of bankruptcy filings is available through LexisNexis. Prior bankruptcy filings within the previous ten years should also appear on a clients credit report. Because it is now so easy to electronically check on prior filings, it is a good idea to have some verification of the debtors prior bankruptcy cases, or lack of them, in every case.

[6] Industry Valuation Guides

If valuation of an automobile is an issue, the average wholesale and retail values for most models can be obtained from industry guides, such as the Kelley Blue Book (www.kbb.com) and the NADA Used Car Guide (www.nadaguides.com). Other online resources include www.edmunds.com, www.autopricing.com, and www.carprices.com. UCC filing information often may be obtained through LexisNexis.

FOOTNOTES:

(n1)Footnote 1. See ch. 17 *infra* for discussion of the "strong arm" powers.

(n2)Footnote 1a. See ch. 6 *infra* for discussion of requirements that these documents be filed or provided to the trustee.

(n3)Footnote 2. Access to the PACER system, administered by the courts, is available on the Internet at www.pacer.psc.uscourts.gov.



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CHAPTER 3 Interviewing the Debtor and Investigating the Facts

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P 3.05 Convincing Clients of the Need for Full and Accurate Information

No matter what method is used to inquire into the client's situation, it is crucial that the client understand the importance of providing every detail requested. A lack of trust or other feeling on the part of a client that something should be concealed must be dispelled.

Usually, the best way to do this is to paint a vivid picture of the worst consequences which can result from less than full disclosure, while at the same time emphasizing the confidentiality of the attorney-client relationship. It should be made clear that property not listed as exempt may be lost and that debts not reported may not be discharged. It should also be pointed out that there is often a filing fee for amending the papers, that bankruptcy cases may be audited,ⁿ¹ and (in a non-threatening manner, of course) that by giving incomplete or false information under oath on the bankruptcy forms the debtor risks not only losing the bankruptcy discharge but also criminal prosecution.

More than anything else, though, it should be emphasized that representation in the client's case may suffer if counsel has less than the whole story and that the real loser if this happens will be the client. Once they understand this reality, most clients realize the importance of a real effort on their part to help develop the facts of the case.

FOOTNOTES:

(n1)Footnote 1. Audits of selected cases are provided for in Section 603(a) of Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2006.



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CHAPTER 4 Counseling the Debtor About Bankruptcy Options

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§ 4.syn Synopsis to Chapter 4: Counseling the Debtor About Bankruptcy Options

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P 4.02 Explaining the Options to Clients

P 4.03 Methods of Explaining Bankruptcy

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[c] Debtor Barred from Receiving Chapter 7 Discharge

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[e] Possibly Lower Payments on Taxes or Domestic Support Obligations

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 - [e] Delay to Avoid Tax Dischargeability and Priority Problems
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CHAPTER 4 Counseling the Debtor About Bankruptcy Options

1-4 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

After discussing the importance and methods of explaining bankruptcy to the client, this chapter details the factors that weigh in favor and against filing for bankruptcy. These include the scope of the discharge, protection afforded by the automatic stay, litigation advantages, loss of property, effect on credit and reputation, and the cost of filing a bankruptcy petition. Next, once the decision to file has been made, the chapter describes the considerations and alternatives that should be explored in choosing the type of bankruptcy case that offers the greatest advantage to the client. The chapter then explains the advantages and disadvantages of joint petitions filed by spouses. Finally, the chapter reviews the considerations of timing the filing of the petition as well as steps, such as exemption planning, that could improve the debtor's position before a bankruptcy case is filed.



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P 4.01 Introduction

Whether, how, and when to file a bankruptcy petition are probably the most important decisions made in a bankruptcy case. Like most questions of legal strategy, it is rarely simple. It involves the interplay of a number of factors. Many of these are unique to each client; others turn on state law, custom or practice in a community, or the provisions of the Bankruptcy Code.



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P 4.02 Explaining the Options to Clients

Naturally, it is important early on to explain to clients the options being considered, and what they would entail. In cases in which bankruptcy is a serious possibility, the general principles and procedures involved should be discussed. Often, it is necessary to dispel some of the common myths about bankruptcy, e.g., that debtors will lose all of their property, or that the law prohibits the acquisition of property or credit after bankruptcy.

FORMS

A debtor's attorney must certify that the debtor has received an explanation of the relief available under the different chapters of the Code. The required certification is incorporated into the bankruptcy petition form. *See Collier Consumer Bankruptcy Forms, Form CS10.03-1* (Matthew Bender). The 2005 amendments added 11 U.S.C. § 527, which mandates various other disclosures (some of which are inaccuraten1) that must be made by "debt relief agencies" as defined in 11 U.S.C § 101(12A) in a way that may include attorneys. *See Collier Consumer Bankruptcy Forms, Forms CS4.03-3, CS4.03-4* (Matthew Bender).

In many cases, it is also crucial to deal with the perceived stigma of bankruptcy. The moral overtones of not paying one's debts (which, of course, are constantly reinforced by those to whom debts are owed) are frequently forgotten by those who deal with such problems on a daily basis. The idea of bankruptcy, which represents a declaration of sorts that a debtor does not intend to pay, may be difficult for clients to accept at first, especially if they have been continually and sincerely insisting to creditors that they do intend to make good on their obligations.

For these clients, some counseling is especially helpful. They should be reminded that bankruptcy is their right under the law, provided for in the Constitution, intended to provide a fresh start for those in precisely their situation, and that big corporations, like Texaco, Macy's, T.W.A. and Penn Central, and famous people, such as Jerry Lewis, Mickey Rooney, Tammy Wynette and even former Treasury Secretary John Connally, have used this right. It might help to point out that the "stigma" of bankruptcy is largely a creation of creditors who have every reason to make bankruptcy appear unattractive, and that bankruptcies are not generally publicized in newspapers or elsewhere, although they are a matter of public record. Some clients might find comfort in the fact that the Bible itself provides for periodic release from debts:

At the end of every seven years thou shalt make a release. And this is the manner of the release:

every creditor shall release that which he has lent unto his neighbor and his brother; because the Lord's release hath been proclaimed.^{n1a}

Lastly, the alternatives to bankruptcy must be explained. What are the likely results of doing nothing? Are there other ways to defend against the largest and most troublesome debts? What would be the consequences of waiting until later before filing a bankruptcy petition?

FOOTNOTES:

(n1)Footnote 1. For example, the disclosures state that the trustee is a court official and that the debtor must always pay a filing fee.

(n2)Footnote 1a. Deut. 15:1-2.



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P 4.03 Methods of Explaining Bankruptcy

Certainly the most common method of explaining these subjects is through a face-to-face discussion during the client interview. Not surprisingly, many bankruptcy specialists have found that doing this job can be both time-consuming and repetitive. For that reason, some have chosen to give most of this general information in written form and to supplement that information in the interview. Clients seeking further information may also be referred to books about bankruptcy for lay readers, which are available in most public libraries. They may also be able to access a wealth of information on the Internet at sites like www.uscourts.gov/library/bankbasic.pdf, www.bankruptcybooks.com, which contains a text entitled "How to Rebuild Your Credit," or www.abiworld.org, but they should be cautioned that the Internet can also be a source of misinformation.ⁿ¹

FORMS

For an example of a client education brochure see *Collier Consumer Bankruptcy Forms, Form CS4.03-1* (Matthew Bender).

FOOTNOTES:

(n1)Footnote 1. For example, the site www.bankruptcy.com contains creditor propaganda attempting to discourage consumers from filing bankruptcy cases.



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P 4.04 To File a Bankruptcy Case or Not to File? Factors to be Considered

[1] Factors that Suggest Bankruptcy Is Advisable

Before a client can make an intelligent decision on a course of action, the advantages of bankruptcy applicable to that client's case, and the disadvantages, if any, must be considered and explained. Although a single factor in the decision may ultimately be of overriding importance, all of these factors must be considered before a decision can be made.

[a] Discharge of Most Debts

The principal goal of most bankruptcies is to achieve the discharge of most unsecured debts. Bankruptcy is a relatively quick and easy way to end the creditor harassment (though, of course, there are other ways to curtail this),ⁿ¹ hardship, anxiety and marital stress normally associated with debt overload.

MORE INFORMATION

Debts that are not discharged are discussed at chapter 26 *infra*.

PRACTICE NOTE

If the client has a large amount of debt that can be discharged in a bankruptcy case, this factor suggests that a chapter 7 or chapter 13 case would be beneficial. The greater the dischargeable debt in proportion to the client's ability to pay, the more beneficial the case would be.

[b] Protection of Property and Income from Unsecured Creditors

Bankruptcy is often the only sure way to protect a debtor's property from execution by unsecured creditors. Bankruptcy may provide total protection for a home, car, or other vital property. The amount of property debtors are allowed to protect from creditors through use of exemptions in bankruptcy is, in many states, far greater than the amount they can protect in state law execution processes.

MORE INFORMATION

The federal and state exemption laws are discussed in chapter 13 *infra*.

Even where state exemptions from execution are similar to or better than the federal bankruptcy exemptions or where the federal exemptions are not available, bankruptcy allows the debtor to avoid having to assert the exemptions repeatedly in response to the execution attempts of different creditors. Once a bankruptcy case is filed, an unsecured creditor holding a dischargeable claim, including a dischargeable tax claim, is ordinarily stayed from ever obtaining a lien on the debtor's property, even a lien that, had it been obtained prior to bankruptcy, could not have been eliminated by the bankruptcy.

Normally bankruptcy also serves to prevent any garnishment of wages or other income after the petition is filed. This, in turn, may protect a client's job if the client's employer does not favor multiple wage garnishments.ⁿ² Even recoupment of social security or other public benefit overpayments should be preventable by a timely bankruptcy petition.

MORE INFORMATION

Chapter 26 *infra* discusses the discharge of debts arising out of public benefits programs.

PRACTICE NOTE

This factor requires a weighing of the likelihood of unsecured creditors seeking to execute on the debtor's income or property. In some cases such execution may already have begun and is the reason the debtor has sought counsel. In others, this weighing may be based on counsel's knowledge and experience with the particular creditors to whom the client owes money. The actuality or likelihood of a creditor executing on the client's property weighs in favor of filing a bankruptcy case. The more essential the property to the client, the more bankruptcy may be beneficial. In addition, counsel must consider the likelihood that any execution could be prevented without a bankruptcy filing, as well as the difficulty and expense of taking the steps necessary to do so.

[c] Ability to Eliminate or Modify Secured Debts

Under the Code, bankruptcy gives debtors mechanisms to deal with most secured creditors. Many types of liens may be eliminated or reduced, either because they impair exemptions,ⁿ³ or because they are in reality undersecured.ⁿ⁴ In a chapter 13 case, payments on most other secured debts can be lowered,ⁿ⁵ and a reasonable time can be gained to cure any defaulted secured debt.ⁿ⁶ Often, one or more of these aspects of bankruptcy will make it possible for a client to keep a home, car, or other essential property that would otherwise be lost.

PRACTICE NOTE

Consideration of this factor requires the examination of a client's secured debts. To the extent that liens can be removed and the underlying debts discharged, bankruptcy is obviously beneficial, with the benefit increasing to the extent that the debtor would have had difficulty paying the secured debts. If a reduction or extension of payments, or time to cure a default, would permit a client to keep property that might otherwise be lost, that too is a very significant benefit of filing a case. The more essential the property, of course, the greater is the benefit.

[d] Automatic Stay

Sometimes, the most valuable feature of a bankruptcy is the automatic stay, gained instantaneously in most cases upon the filing of a petition. The stay forces an abrupt halt of creditor actions against the debtor, including most repossessions, garnishments or attachments, utility shut-offs, foreclosures, and, in many cases, evictions. Many of these collection actions can afterwards be permanently stopped.ⁿ⁷ The stay is also an effective way (though, again, hardly the

only way) to end creditor collection efforts, with contempt, or money damages, and attorney's fees as available remedies for violations of the stay.ⁿ⁸ In chapter 13, a bankruptcy also creates a codebtor stay, which may stay actions against the debtor's friends or relatives. Beyond all this, the stay gives the debtor a breathing spell, a chance to sort things out, through the additional time gained to solve problems.

PRACTICE NOTE

If the debtor is faced with imminent action by a creditor that would be stayed by a bankruptcy case, the benefits of the stay will be a definite factor in favor of filing. The weight to be given to this factor depends on the detriment that would occur if the action is not stayed. It also depends on the likelihood of being able to prevent the action in some other way, and the expense and difficulty of doing so.

MORE INFORMATION

Chapter 8 *infra* provides a discussion of the automatic stay and chapter 10 *infra* outlines the remedies for violation of the stay. Chapter 9 *infra* examines the chapter 13 codebtor stay.

[e] Protection from Nonmonetary Consequences of Nonpayment of Debt

Sometimes the threat to a debtor is not loss of property but rather the loss of some privilege or license. Bankruptcy may be the only possible way for a client to keep or regain a driver's license subject to revocation because of an unpaid accident judgment.ⁿ⁹ This, in turn, may mean employment and income for the client's family.

Bankruptcy may, in some cases, literally mean freedom for a debtor who might otherwise be incarcerated for failure to pay support obligations,ⁿ¹⁰ or as a result of contempt proceeding involving some other debt.ⁿ¹¹

PRACTICE NOTE

To the extent such threats to the debtor's freedom or livelihood are serious possibilities, and bankruptcy offers a feasible way of eliminating the threat, it should be considered very seriously. On the other hand, there may be cases involving child support, for example, in which bankruptcy offers little help because the debt is not dischargeable and the debtor cannot propose a feasible plan to pay it. Again, the likelihood and expense of preventing the threatened action outside of bankruptcy must be weighed against the advantages and disadvantages of a bankruptcy case.

[f] Elimination of Future Interest and Penalties on Nondischargeable Tax Debts

Even for taxes that cannot be discharged, a chapter 13 case may save the debtor thousands of dollars in interest and penalties. In some situations, no postpetition interest need be paid on unsecured tax claims paid through a chapter 13 plan, even if they are priority claims.ⁿ¹²

PRACTICE NOTE

For debtors with large tax delinquencies, these savings may strongly suggest that a chapter 13 case would be beneficial. The larger the savings, the more beneficial the case would be. However, counsel must also consider the debtor's likelihood of proposing a feasible plan. If such a plan cannot be proposed, that may mean that the debtor simply cannot afford to pay the taxes. If the debtor has little property that can be reached by the taxing authority, it may be preferable to try to negotiate payments the debtor can afford outside of bankruptcy.

[g] Protection Against Discrimination

The Code also protects the debtor from many types of discriminatory action by governmental units and private employers on the basis of unpaid debts discharged in bankruptcy.ⁿ¹³ If a client is facing adverse action, such as denial of a license or denial of a student loan, based upon the nonpayment of a dischargeable debt, bankruptcy may well provide a practical solution.

In addition, private parties are not permitted to take action intended to coerce payment of discharged debts.ⁿ¹⁴ Thus, if a particular creditor denies services or in some other way tries to coerce payment of a dischargeable debt, these actions can be halted by a bankruptcy case, through which the debt will be discharged. However, in most instances, a creditor that is not a public utility or a governmental unit cannot be compelled to do business with a debtor after bankruptcy if the creditor can show that its actions are motivated by financial responsibility criteria or other considerations not involving an attempt to coerce payment of a discharged debt.

PRACTICE NOTE

The advisability of bankruptcy will depend in part on how severely the denial or threatened denial affects the debtor. And, as always, the feasibility of nonbankruptcy alternatives must also be weighed. For example, under federal student loan regulations, a client may have the option of making a payment agreement and obtaining a new student loan after six months of payments under the agreement. The client may also prefer the option of refinancing the student loan under available arrangements in which the payments are determined based on the debtor's income.ⁿ¹⁵

MORE INFORMATION

Discrimination protections are discussed further in chapter 30 *infra*.

[h] Litigation Advantages Resulting from a Bankruptcy Filing

An important factor to consider in certain cases is the opportunity to litigate disputes with creditors in a federal court, which has at least initial jurisdiction over such disputes after a case has been filed.ⁿ¹⁶ In some places the bankruptcy court may provide a far more sympathetic forum than the local state court, and it may be far more familiar with the applicable law. It may also offer procedural advantages, such as greater discovery rightsⁿ¹⁷ or the ability to serve distant defendants.ⁿ¹⁸ Other rights, such as statutes of limitationsⁿ¹⁹ or sovereign immunity,ⁿ²⁰ may also be affected to the client's advantage.

PRACTICE NOTE

For example, there may be issues of whether a distant defendant with which there is a substantial dispute is amenable to suit in the debtor's jurisdiction outside of bankruptcy and this issue would not be present in bankruptcy litigation. Similarly, since there is a general abrogation of federal sovereign immunity in bankruptcy for most purposes, the bankruptcy court may be a good place to litigate federal tax disputes. The same advantage may often be present in disputes with state governments, at least if the government files a proof of claim. And if there is a dispute arising under consumer protection statutes the bankruptcy court is more likely than many state courts to consider carefully the interpretation and purposes of such statutes.

In cases in which this consideration is present, the advantages (or in occasional cases disadvantages) of litigating a dispute in the bankruptcy court must be weighed against the alternative litigation possibilities. In addition to the possible benefits described above, there may be issues of expense and delay to be considered. In a particular case, depending on the circumstances, a bankruptcy filing may increase or decrease litigation expenses and may either speed up or delay ultimate resolution of the dispute. Of

course, if the debt is dischargeable, a bankruptcy case may totally eliminate the need to litigate the dispute.

[2] Factors that Suggest Bankruptcy Is Not Advisable

Despite all of the possible advantages that bankruptcy may provide, there are many valid reasons for choosing not to file a petition. Some of these concern problems in the cases of particular clients, and others relate simply to the fact that bankruptcy is not the only means to address a client's legal problems and may not be necessary.

[a] Loss of Property in Bankruptcy

One consequence of a chapter 7 bankruptcy may be the loss of nonexempt property (or its value in cash). For most consumer clients this is not a problem because consumer debtors rarely have any nonexempt property. Except in those few states that not only have low exemptions but also have opted out of the federal exemptions, the amount of property a debtor is allowed to keep is relatively generous; only debtors with equity substantially over \$21,000²¹ per debtor in a home, \$3,225²² in a car, or \$10,775²³ in household goods and certain other property are likely to have any problems under the federal exemptions. Many states have more generous exemptions. Even when a debtor has nonexempt property, a chapter 13 bankruptcy often presents a viable alternative through which debtors may retain all of their possessions.

MORE INFORMATION

Chapter 13 *infra* provides a discussion of states' rights to opt out of the federal exemptions and examines the interplay of the dollar limits among the federal exemption provisions.

Thus, if a debtor has nonexempt property, consideration must be given to several issues. First, is the nonexempt property likely to be liquidated in a chapter 7? Most trustees are not interested in small amounts of property (less than \$1,000-\$3,000 worth), especially if there will be expenses involved in liquidating the property. And if there are significant expenses involved in obtaining the property, such as the costs of litigating a cause of action belonging to the debtor, trustees may abandon property worth even more.

In some cases, a client may be able to dispose of assets that are not exempt and acquire assets of similar value that are exempt. Such exemption planning may solve the problem of excess assets if there is an ability to exchange assets in this manner and the time in which to do it. Such planning is discussed below.²⁴

In other cases, if the value of the nonexempt property is not too high, a chapter 7 debtor may be able to repurchase some or all of the property from the trustee with postpetition income or a postpetition loan from friends or family. Trustees will usually cooperate in such a sale, which facilitates their job of converting the property to cash. Alternatively, if the debtor can afford the payments that would be required in a chapter 13 plan, the debtor could file a chapter 13 case, in which some or all of the nonexempt property could be retained, provided that its value, plus interest, was paid to unsecured creditors. Occasionally, even if the debtor does stand to lose some property, the advantages of filing a bankruptcy case may still outweigh those of any available alternative.

MORE INFORMATION

For discussion of the "best interests of creditors test" under 11 U.S.C. § 1325(a)(4) see P 14.05[1] *infra*.

[b] Effect on Credit and Reputation

Invariably, a bankruptcy will be part of a debtor's credit history for as long as the law allows, *i.e.*, 10 years under the Fair Credit Reporting Act.²⁵ The effect this will have on future credit is less predictable, but it is an understandable

concern for many clients.

There is no definite response to this concern. However, clients should be reminded that if they have substantial debts, and especially if they are in default, their credit histories are already poor. In the eyes of some creditors, a bankruptcy that wipes the slate clean will be an improvement.^{n25a} Not only will the potential customer be free of other financial obligations, but he or she will also be unable to obtain a chapter 7 discharge, in most cases,ⁿ²⁶ for another eight years. For these reasons, some creditors have been known to actively solicit recent bankruptcy debtors. Indeed, with the loosening of credit standards until recently, many debtors received unsolicited offers of credit soon after their bankruptcy cases are over.

In any case, the available research on the subject is inconclusive. It is fair to say that each credit decision turns on the bias of the individual creditor and that most creditors look more to a potential customer's current income situation, and its stability, than anything else. Most creditors have chosen not to exclude automatically all of the millions of people who have filed a bankruptcy case, especially if a few years have passed since the filing. Indeed, as credit standards have loosened in recent years, bankruptcy debtors have regularly been offered new credit, even while they are still in bankruptcy, though often on fairly unfavorable terms. And clients should also be reminded that they always have the option of voluntarily paying a favored creditor with whom they wish to maintain a line of credit, either before the bankruptcy (though preferences of over \$600 within 90 days should be avoided if possible)ⁿ²⁷ or afterward. It is often possible for a client to pay off a low balance on at least one credit card before bankruptcy, so that the creditor need not be listed on the schedules. In most such cases, the creditor will then permit continued use of the credit card after bankruptcy. In addition, many credit grantors now offer to continue giving credit to debtors who reaffirm their debts.

MORE INFORMATION

Chapter 27 *infra* examines reaffirmation agreements in further detail.

As discussed earlier, the effect of a bankruptcy on a client's reputation in the community is almost always imperceptible. However, in a small town, especially if debts are owed to local people, the stigma of bankruptcy cannot be entirely discounted. The potential harm can only be evaluated locally, on a case-by-case basis, and weighed against the advantages that bankruptcy has to offer. Again, the possibility of voluntarily paying selected debts should not be overlooked if that would ameliorate the problem.

Thus, the effect of a bankruptcy on the debtor's credit and reputation is normally a minor factor in the decision regarding whether to file a case. However, the issue must be explored to ensure that the case is not one of those few exceptions in which the issue is significant.

[c] Possible Discrimination after Bankruptcy

Closely related to the problem of reputation is that of discrimination against debtors who have filed bankruptcy cases. To a large extent, the Bankruptcy Code alleviates this problem.

[i] Available Protections

Under the Code, governmental unitsⁿ²⁸ generally may not discriminate on the basis of a bankruptcy filingⁿ²⁹ or the nonpayment of a discharged debt.ⁿ³⁰ Thus, a housing authority or student loan agency cannot deny benefits to a client based upon the filing of a bankruptcy case or a previously discharged debt. Similarly, utilities may not deny service based upon a bankruptcy or discharged debts.ⁿ³¹ Nor may any private employer discriminate with respect to employment or terminate employment based upon bankruptcy or debts discharged in bankruptcy.ⁿ³² Clients can be assured that the law protects them in this regard and that they will be able to enforce their rights in court, if necessary.

PRACTICE NOTE

However, the distinction between discrimination based upon bankruptcy or debts discharged in bankruptcy and discrimination based upon future financial responsibility or ability should be carefully explained. The legislative history of the Code makes clear that it is not prohibited discrimination to take into account such factors as financial responsibility and ability to repay, if this is done with all people and not just those who have filed bankruptcy cases.ⁿ³³ Thus, a client should be told that even creditors who are precluded from discrimination based on bankruptcy may refuse new credit or other services if the refusal is properly based on other considerations. Of course, as with any discrimination issue, questions may also arise about whether a creditor's articulated reason for refusing credit or services is a pretext for bankruptcy discrimination.

The law regarding discrimination by other private entities, such as creditors who provide essential services, is not as clear. It should be pointed out that this type of discrimination is extremely rare, especially in more urban areas where many providers of goods and services are available to a client. It would be most likely to occur in a small town, where only one merchant offered a particular product or service. In that case, at least if it could be shown that later discrimination was an attempt to coerce payment of a debt, the client would also have a remedy, since *section 524(a) of the Bankruptcy Code* prohibits acts to coerce payment of a discharged debt.ⁿ³⁴

Again, the situation can best be assessed locally, on a case-by-case basis. Normally, discrimination against debtors who have filed bankruptcy cases is not a problem, but if a practitioner is in doubt, the chapter 13 standing trustee or a more experienced bankruptcy attorney may be consulted.

[ii] Medical Debts

Medical debts to doctors or hospitals with whom a patient would like to have a continuing relationship are often a source of concern. Particularly in small communities where there may be few health care providers, clients may worry that a discharge will leave them with few options for future care.

One response is that, if the client cannot pay the debts anyway, the doctor or hospital involved may have little concern about a bankruptcy discharge. Often a frank discussion with a sympathetic doctor about inability to pay will allay any concern about future refusal to provide service.

PRACTICE NOTE

A second option is for the debtor to make voluntary payments after the bankruptcy.ⁿ³⁵ In extreme cases, even reaffirmation of a particular debt may be appropriate.ⁿ³⁶ Before taking such drastic action, however, the debtor should be reminded that the ethical obligations of doctors and hospitals should preclude their refusal to provide service to patients who are in extreme need. Moreover, even the most recalcitrant doctor will generally provide care if cash payments or medical coverage is offered, and many hospitals have a legal obligation under state or federal law to provide free medical care to those who are unable to pay.ⁿ³⁷

In summary, there is no completely satisfactory answer to questions about future health care because a doctor has no legally enforceable obligation to provide care to a debtor who has discharged prior medical debts. However, the problem should rarely affect access to needed care.

[d] Clients' Feelings of Moral Obligation

Another factor militating against bankruptcy may be the client's personal feelings on the subject. This difficult subject, which is generally outside a lawyer's training, must be discussed carefully and with understanding. Remember, it is not

easy for clients suddenly to decide to seemingly discard the values that may have guided them since childhood.

Usually, it is best to remind the client of other values that must also be considered. Besides the fact that bankruptcy is a right guaranteed by law and provided for in the Constitutionⁿ³⁸ and even the Bible,ⁿ³⁹ a client should consider the hardship bankruptcy may avoid for his or her family. It may be the only way to provide the family with food, clothing, and shelter in hard times. Very often, clients decide that the moral obligation to provide for loved ones outweighs the obligation to pay their creditors.

It may also be possible to explore chapter 13 with clients who wish to pay some or all of their debts. In some cases, a chapter 13 bankruptcy may provide a viable mechanism for repaying creditors as well as solving other problems, if the debtor has sufficient income. Lastly, clients should be reminded that filing a bankruptcy case does not prevent them from voluntarily paying their debts at a later time if they wish.ⁿ⁴⁰ This realization, too, provides comfort to those who cannot come to terms with the idea of turning their backs on their creditors forever.

[e] Cost of Filing a Bankruptcy Petition

Besides any attorney's fee, which depending upon the case and jurisdiction, can vary from a few hundred dollars to a few thousand dollars,ⁿ⁴¹ bankruptcy carries an out-of-pocket cost for the filing fees, normally \$299 in a chapter 7 case and \$274 in a chapter 13 case.ⁿ⁴² Occasionally, other fees may raise this figure somewhat. And, in a chapter 13 case, the trustee is usually entitled to a fee of up to 10% of the payments made through the plan.ⁿ⁴³ Debtors must also pay the costs of a consumer credit counseling briefing and a personal financial management education course, usually totaling \$70 to \$100, unless those costs are waived due to inability to pay.^{n43a} Also, in some cases, various utilities may require security deposits to ensure future service.ⁿ⁴⁴

These costs, like those less tangible, must be weighed in deciding whether to file a bankruptcy case. Occasionally, litigation can be reasonably anticipated in a bankruptcy case that will mean substantial attorney's fees for the debtor, which could be a significant factor in deciding whether to file the case. Usually, however, assuming the debtor has some way to pay the expenses of a bankruptcy case, the other factors discussed in this chapter are considerably more important and the net financial result will far outweigh the out-of-pocket costs of the case.

[f] Is Bankruptcy Necessary?

The question of cost leads back to a more basic issue. In some states, there are debtors who are totally judgment-proof at the time they seek advice. Legally, creditors can do virtually nothing to obtain money or property from these clients, although collection calls and letters can cause a real emotional toll.

In such cases, several other factors must be considered. Is the client likely to fall further into debt? For some clients the answer is no; their debts arose before they lost a job because of layoff, disability or retirement. For many, though, there is a prospect of medical bills, or other continuing financial problems that will result in greater debt. For most, there is also a slight possibility of a motor vehicle accident or other incident creating a large liability.

Some debtors have only a few debts and have strong defenses to each. For those debtors, the best avenue might be either litigation or settlement outside of bankruptcy court. This decision may also depend on whether resources are available to make the alternative of vigorous litigation a possibility.

In all of these cases, a client should be advised to bear in mind that the same relief available in bankruptcy now will almost always be available later,ⁿ⁴⁵ but that filing a bankruptcy case now may impair the right to file another one in years to come.ⁿ⁴⁶ Thus, unless a judgment-proof debtor expects to soon acquire nonexempt property, he or she may wish to wait.

Ultimately, the client must make a choice. Do the advantages of bankruptcy outweigh the disadvantages? Will bankruptcy in some way have a positive effect on that client's life? Obviously, for many consumer clients who face real threats that bankruptcy can eliminate, the answer is yes. But even those clients who are not in danger of sustaining a tangible loss may value the peace of mind that comes from having their burden of debt lifted. Whether they arise from the hope of someday making it out of a life of poverty, or simply from the anxiety of constantly feeling pressure to pay what is owed, these feelings should not be discounted. Thus, the decision of an informed client as to whether to file a bankruptcy petition should almost always be respected.ⁿ⁴⁷

[g] Case in Which Bankruptcy Offers No Help or Is Unavailable

Finally, there are some cases in which bankruptcy is the wrong tool to use and in which none of the advantages listed above will be realized.

[i] Debtors Who Cannot Afford to Pay Secured Debts

One such situation is that of the debtor whose most troublesome debts are fully secured by security interests or other liens that cannot be eliminated or modified through bankruptcy, and who does not have sufficient income to remedy a default even with all of the help bankruptcy provides. Unless there is some special advantage to litigating in bankruptcy court, bankruptcy will not solve the basic problems this debtor faces. At most, it may discharge the debtor's personal liability for the debts and gain the advantage of the automatic stay for a month or more. Although in some cases this could be worthwhile, in many it will not ultimately benefit the client.

MORE INFORMATION

Chapter 8 *infra* examines the automatic stay in more detail.

The problem of clients in these predicaments is often that their current expenses (including payments on secured debts) exceed their income. Since bankruptcy (except for chapter 13's ability to stretch out or reduce certain types of short-term debts) basically deals with assets and liabilities, it does not directly address this problem in most cases.

[ii] Cases in which Bankruptcy May Hasten the Loss of Property

The opposite situation can also sometimes cause problems. If a debtor has substantial and valuable unencumbered property that cannot be exempted, a premature bankruptcy will generally hasten loss of the property rather than prevent it. Because unsecured creditors would have to obtain judgment liens or levies on the debtor's property under state law, execution outside bankruptcy may be quite slow. In many cases a creditor will never execute. On the other hand, liquidation of nonexempt property generally occurs relatively quickly in the bankruptcy process. And, since unsecured creditors are entitled to the present value of nonexempt property in chapter 13, a case under that chapter could be quite costly. In this situation, the best option is probably to advise the client to wait at least until execution on the property appears imminent, unless the client can afford the necessary chapter 13 case.

[iii] Property Held in Trust

Another potentially difficult situation arises when a client holds property in trust for children or other relatives. Because a trust may not file a bankruptcy petition, it may be difficult to gain the protection of bankruptcy for such property. However, in some cases relief may be possible if the beneficiaries of the trust file cases on their own behalf, which could protect their beneficial interests in the property. Alternatively, a trustee's bare legal title may be sufficient to invoke the automatic stay while a creditor secured by the property in question is paid through the trustee's chapter 13 plan.ⁿ⁴⁸

[iv] Impediments Caused by Prior Bankruptcy Cases

Some clients may be barred from filing a bankruptcy case altogether for some period of time. If a client was the debtor in a bankruptcy dismissed in the previous 180 days, and that dismissal was (1) for willful failure to abide by court orders or to appear in court in proper prosecution of the case or (2) a voluntary dismissal following a request for relief from the automatic stay of section 362, then that client is not eligible to be a debtor until 180 days after the dismissal.ⁿ⁴⁹ Occasionally, a court has entered, or a client has agreed to, an order that bars the client from filing a new case for some specified period of time or that purports to limit the client's protection under the automatic stay. Such an order or agreement may sometimes be reconsidered, or challenged in a later case, but otherwise it may be a significant hurdle. In addition, a recent dismissal of a bankruptcy case may make it difficult to maintain or, in some cases, even to obtain, the automatic stay.^{n49a}

In other cases, the automatic stay might not apply by reason of a prior case under the Bankruptcy Code or a court order in a prior case.ⁿ⁵⁰ The automatic stay is not effective upon filing or limited in a cases filed by a debtor who has had a prior case or cases dismissed within the year. Also excepted from the stay are certain actions to enforce a security interest in real property in connection with serial filings. If the primary purpose for filing is to obtain the benefits of the automatic stay and one of these exceptions applies, debtors need to take affirmative action to have the stay imposed or consider other alternatives to bankruptcy.

Lastly, some clients may stand to gain little from a chapter 7 bankruptcy because they cannot receive a discharge due to a prior bankruptcy.ⁿ⁵¹ However, a chapter 13 case may still be available to provide significant relief. Even though a chapter 13 discharge is not available if the debtor received a chapter 7 discharge in a case filed during the preceding four years, there may be occasions in which a debtor will find it advantageous to file a chapter 13 case even if a discharge is not available. For example, a debtor may seek to cure a default through a plan or to obtain protection of the bankruptcy court and the automatic stay while paying debts in an orderly fashion through a plan.ⁿ⁵²

In any event, if a client has filed prior bankruptcy cases in the recent past, the situation must be examined carefully to determine whether a new case is likely to fail for the same reasons that the prior cases failed. Debtors' attorneys should not become participants in their clients efforts to abuse the bankruptcy process by filing repeated cases that have no chance of success.

FOOTNOTES:

(n1)Footnote 1. Harassment by collection agencies and by certain attorneys acting as debt collectors is regulated by the Fair Debt Collection Practices Act, 15 U.S.C. § 1692. Actions of creditors may violate state tort law on the grounds of intentional infliction of emotional distress or invasion of privacy, as well as state statutes dealing with unfair and deceptive practices.

(n2)Footnote 2. Garnishments are limited by the Consumer Credit Protection Act, 15 U.S.C. § 1674, as is the employer's right to discharge employees due to garnishment. The laws of many states further restrict the extent to which wages may be garnished.

(n3)Footnote 3. See P 18.03 and P 18.04 *infra* for discussion of liens which impair exemptions.

(n4)Footnote 4. See ch. 14 *infra* for discussion of liens which can be modified because they are undersecured.

(n5)Footnote 5. See P 14.09 *infra* for discussion of the right to modify secured claims in chapter 13 cases.

(n6)Footnote 6. See P 14.09 *infra* for discussion of the right to cure defaults within a reasonable time in chapter 13 cases.

(n7)Footnote 7. The automatic stay is not normally limited prior to the end of the case except in certain circumstances. 11 U.S.C. § 362(c), (d), (f), as amended and enacted by Pub. L. No. 109-8 (2005), effective in cases

commenced on or after October 17, 2005. If the debt is discharged during the case, 11 U.S.C. § 524(a) prevents any act to collect it after the case is over, though some liens may survive bankruptcy.

(n8)Footnote 8. 11 U.S.C. § 362(k), formerly § 362(h), as amended and redesignated by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n9)Footnote 9. Normally, such revocation cannot be continued after discharge of the judgment. *Perez v. Campbell*, 402 U.S. 637, 91 S. Ct. 1704, 29 L. Ed. 2d 233 (1971) . See P 30.05[1] *infra*.

(n10)Footnote 10. Dischargeability of these obligations is discussed in ch. 26 *infra*. See also Sommer and McGarity, Collier Family Law and the Bankruptcy Code (Matthew Bender).

(n11)Footnote 11. See, e.g., *Juidice v. Vail*, 430 U.S. 327, 97 S. Ct. 1211, 51 L. Ed. 2d 376 (1977) . Such proceedings would usually be automatically stayed by a bankruptcy case. In addition, the bankruptcy court or district court probably could exercise habeas corpus powers to end a debt-related incarceration.

(n12)Footnote 12. See P 14.07 *infra*.

(n13)Footnote 13. 11 U.S.C. § 525, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n14)Footnote 14. 11 U.S.C. § 524(a), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. See P 29.10 *infra*.

(n15)Footnote 15. 34 C.F.R. § 682.200; 34 C.F.R. § 685.215.

(n16)Footnote 16. 28 U.S.C. § 1334(a), (b), (d), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. See ch. 32 *infra*.

(n17)Footnote 17. Basically, the Rules of Bankruptcy Procedure incorporate the liberal federal discovery rules. *Fed. R. Bankr. P.* 7026-7037, 9014. See ch. 32 *infra*.

(n18)Footnote 18. The venue provisions of 28 U.S.C. § 1408 essentially provide for nationwide service of process in most proceedings.

(n19)Footnote 19. See 11 U.S.C. § 108.

(n20)Footnote 20. See 11 U.S.C. § 106. See 2 Collier on Bankruptcy, ch. 106 (Matthew Bender); 1 Collier Bankruptcy Manual, ch. 106 (Matthew Bender).

(n21)Footnote 21. Pursuant to 11 U.S.C. § 104(b), the federal homestead and "wild card" exemptions comprising this amount are subject to periodic adjustment and were raised from \$18,450 to \$20,200 for the homestead exemption and from \$975 to \$1075 for the "wild card" exemption, effective April 1, 2007. For cases commenced before April 1, 2004, the total exemption amount in effect per debtor in a home is \$19,375, based upon the \$17,425 homestead and \$975 "wild card" exemptions. The adjustment is made every three years beginning on April 1, 1998. See 2 Collier on Bankruptcy, P 104.03 (Matthew Bender); 1 Collier Bankruptcy Manual, P 104.03 (Matthew Bender).

(n22)Footnote 22. Pursuant to 11 U.S.C. § 104(b), this amount is subject to periodic adjustment and was raised from \$2,950 to \$3,225, effective in cases commenced on or after April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$2,775. The adjustment is made every three years beginning on April 1, 1998. See 2 Collier on Bankruptcy, P 104.03 (Matthew Bender); 1 Collier Bankruptcy Manual, P 104.03 (Matthew Bender).

(n23)Footnote 23. Pursuant to 11 U.S.C. § 104(b), this amount is subject to periodic adjustment and was raised

from \$9,850 to \$10,775, effective in cases commenced on or after April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$9,300. The adjustment is made every three years beginning on April 1, 1998. *See* 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n24)Footnote 24. *See* P 4.07[1][b] *infra*.

(n25)Footnote 25. 15 U.S.C. § 1681c(a)(1).

(n26)Footnote 25a. *See* Aleksandra Todorova, *Declaring Bankruptcy Can Improve Your Credit Score*, Jan. 22, 2007, available at <http://www.smartmoney.com/debt/advice/index.cfm?story=boostscore>.

(n27)Footnote 26. 11 U.S.C. § 727(a)(8), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005; 11 U.S.C. § 727(a)(9) *See* 6 *Collier on Bankruptcy*, P 727.11 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.11 (Matthew Bender).

(n28)Footnote 27. 11 U.S.C. § 547. *See* 5 *Collier on Bankruptcy*, ch. 547 (Matthew Bender); 2 *Collier Bankruptcy Manual*, ch. 547 (Matthew Bender). While there is nothing illegal or immoral about a debtor making a preferential transfer before bankruptcy, the trustee may avoid many such transfers if he or she chooses. Therefore, if the property to be transferred can be claimed as exempt in the bankruptcy, the debtor may be advised to transfer it after the bankruptcy to eliminate the risk of avoidance of the transfer by the trustee.

(n29)Footnote 28. The term "governmental unit" is defined in 11 U.S.C. § 101. *See* 2 *Collier on Bankruptcy*, ch. 101 (Matthew Bender); 1 *Collier Bankruptcy Manual*, ch. 101 (Matthew Bender).

(n30)Footnote 29. 11 U.S.C. § 525(a). *See* ch. 12 *infra*; 4 *Collier on Bankruptcy*, P 525.02 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 525.02 (Matthew Bender).

(n31)Footnote 30. 11 U.S.C. § 525(c), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005, specifically prohibits such discrimination in student loan programs.

(n32)Footnote 31. 11 U.S.C. § 366, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. However, utilities may be able to demand adequate assurance of future payments. *See* ch. 12 *infra*; 3 *Collier on Bankruptcy*, P 366.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 366.03 (Matthew Bender).

(n33)Footnote 32. 11 U.S.C. § 525(b). *See* 4 *Collier on Bankruptcy*, P 525.04 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 525.03 (Matthew Bender).

(n34)Footnote 33. H.R. Rep. No. 595, 95th Cong., 1st Sess. 81 (1977), *reprinted in* Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender).

(n35)Footnote 34. 11 U.S.C. § 524(a)(2). *See* P 29.10 *infra*. 4 *Collier on Bankruptcy*, P 524.02[2][b] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 524.02[2][b] (Matthew Bender).

(n36)Footnote 35. 11 U.S.C. § 524(f).

(n37)Footnote 36. 11 U.S.C. § 524(c), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. However, reaffirmation may not always be possible even if the debtor desires it. *See* ch. 27 *infra*.

(n38)Footnote 37. For example, the Hill-Burton uncompensated care assurance requirements apply to hospitals which have received federal funds. *See* 42 C.F.R. § 124.501 *et seq.* Hospitals are also limited in turning away patients with medical emergencies by the Emergency Medical Treatment and Women in Active Labor Act, 42 U.S.C. § 1395dd,

and may have other obligations to serve the community due to their charitable status.

(n39)Footnote 38. *U.S. Const. art. I, § 8* provides that Congress has the power to establish uniform bankruptcy laws.

(n40)Footnote 39. *See Deut. 15:1-2.*

(n41)Footnote 40. *11 U.S.C. § 524(f).*

(n42)Footnote 41. *See ch. 5 infra.*

(n43)Footnote 42. The filing fee for each chapter under *28 U.S.C. § 1930(a)* is \$245 for chapter 7 and \$235 for chapter 13. Under *28 U.S.C. § 1930(b)*, the Federal Judicial Conference decided to assess an additional noticing fee of \$39 in connection with all chapter filings under title 11 and has mandated a \$15 fee for chapter 7 debtors to pay compensation to chapter 7 trustees. In chapter 7, the filing fee, noticing fee and trustee fee may be waived, in appropriate circumstances, or paid in installments. In chapter 13, the noticing fee (and other fees assessed pursuant to section 1930(b)) should be waivable for indigent debtors. The filing fee in chapter 13 is not waivable, but may be paid in installments. *See ch. 32 infra; Collier Consumer Bankruptcy Forms, Form CS10.02-3 (Matthew Bender)* for an Application to Waive Administrative Fees.

(n44)Footnote 43. However, debts paid outside the plan in a chapter 13 case may not be subject to the percentage fee and, to the extent the plan pays unsecured creditors, the percentage fee is borne by these creditors. *See ch. 14 infra* for discussion of chapter 13 plans.

(n45)Footnote 43a. *See chs. 6 and 29 infra* for discussion of the prepetition credit counseling and postpetition credit education requirements.

(n46)Footnote 44. *11 U.S.C. § 366(b).* *See ch. 12 infra.*

(n47)Footnote 45. A warning, however, should be added, that if the client's situation changes greatly, or if the law changes, *e.g.*, the state opts out of the federal exemptions, bankruptcy may not be as attractive in the future.

(n48)Footnote 46. *11 U.S.C. §§ 727(a)(8), (9), 1328(f).* *See 6 Collier on Bankruptcy, P 727.11 (Matthew Bender), 2 Collier Bankruptcy Manual, P 727.11 (Matthew Bender)* for a discussion of the bar to future chapter 7 cases.

(n49)Footnote 47. This is not to suggest that an attorney is obligated to represent the client in the course of action chosen.

(n50)Footnote 48. *See In re Foster, 19 B.R. 28 (Bankr. E.D. Pa. 1982).*

(n51)Footnote 49. *11 U.S.C. § 109(g).* *See 2 Collier on Bankruptcy, P 109.08 (Matthew Bender); 1 Collier Bankruptcy Manual, P 109.08 (Matthew Bender).*

(n52)Footnote 49a. *11 U.S.C. § 362(c)(3), (4)* curtails automatic stay protection when a prior case was dismissed within the year before a new petition. *See ch. 8, infra.*

(n53)Footnote 50. *See P 8.03[4][c] infra.*

(n54)Footnote 51. Section 727(a)(8) bars a chapter 7 debtor from receiving a discharge if the debtor has previously been granted a discharge under chapter 7 in a case commenced within 8 years before the filing of the petition. Section 727(a)(9) bars a chapter 7 debtor from receiving a discharge if the debtor has previously been granted a discharge under chapter 13 within the 6 years prior to filing the petition unless the exceptions in 727(a)(9)(A) or (B) apply.

(n55)Footnote 52. *See* 8 *Collier on Bankruptcy*, P 1300.40[4] (Matthew Bender).



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CHAPTER 4 Counseling the Debtor About Bankruptcy Options

1-4 Collier Consumer Bankruptcy Practice Guide P 4.05

P 4.05 Choosing the Type of Bankruptcy Case

Bound up with the decision of whether to file a bankruptcy case is the question of which type of bankruptcy offers the greatest benefit to a client. Although this decision normally may be changed at least once by converting the case after it is filed, it is nonetheless of obvious importance to ultimately settle upon the chapter offering the greatest advantages for a client.

[1] Considerations Favoring Chapter 7

For many consumer debtors, "straight bankruptcy," provided for in chapter 7 *of the Code*, has traditionally been the remedy chosen. There are a number of reasons why chapter 7 usually meets the needs of the low-income debtor in particular.

[a] Discharge of Debts without Loss of Property or Income

First, one of the main factors leading to a chapter 13 case, namely the desire to protect nonexempt property, is rarely present. A low-income debtor in most states will rarely have any nonexempt property. Nor will he or she be likely to have any excess income, over and above that necessary for living expenses, with which to pay unsecured creditors through a chapter 13 plan.ⁿ¹

Thus, unless a chapter 13 petition is necessary for some specific reason, such as those discussed below, many consumer debtors will not desire it. They can obtain a quick and easy fresh start in life through a chapter 7 case which will discharge most of their debts. Even if the debtor has one or two secured creditors who must be dealt with, a chapter 13 plan may not be necessary. Debtors can handle some secured creditors as well, or better, in a chapter 7 case, by utilizing the devices for reducing or eliminating their liens that are available in that type of case,ⁿ² or by dealing with their claims outside the bankruptcy court. Sometimes, the fact that discharged debts no longer need to be paid enables the debtor to remain or become current on those secured debts that remain after a chapter 7 case.

MORE INFORMATION

Discussion of lien avoidance and modification of secured creditors' rights can be found in chapters 18 and 14, respectively.

[b] Debtors Who Are Ineligible for Chapter 13

A small number of consumer debtors have a different problem. The amounts of their debts exceed the limitations for eligibility to file a chapter 13 case. If a debtor's secured noncontingent liquidated debts exceed \$1,010,650, or unsecured noncontingent liquidated debts exceed \$336,900,ⁿ³ the Code denies that debtor access to chapter 13.ⁿ⁴ Since these limits are not doubled for a husband and wife filing together, the debt limits may sometimes dictate that only one spouse, or each spouse separately, file a chapter 13 case if the individual spouse's debts alone are within the statutory limits. Alternatively, they may choose to file a chapter 11 case.ⁿ⁵

PRACTICE NOTE

An important factor to remember is that a subsequent chapter 13 case may be filed at any time after a chapter 7 case.ⁿ⁶ Thus, if a chapter 13 case is not necessary at the time the debtor wants to file, it may still be filed later if circumstances change, and at that point, because of the prior chapter 7 case, the debtor may no longer be above the chapter 13 debt limits. The option to file a chapter 13 case is not lost by filing a chapter 7 case. However, a chapter 13 discharge will not be available if the debtor received a discharge in a chapter 7 case filed during the preceding four years.

A debtor may also be ineligible if the debtor does not have "regular income", as required by section 109(e). It should be remembered, though, that regular income is defined broadly to include income other than wages, such as alimony, public assistance or pensions.ⁿ⁷ Most courts even permit an agreement of a spouse or other relative to make contributions toward the debtor's expenses to constitute regular income.ⁿ⁸

[2] Reasons for Filing a Chapter 13 Case**[a] Tools for Dealing with Secured Creditors**

Probably the most common reason for filing a chapter 13 case on behalf of a consumer client is the presence of one or more secured creditors who cannot be satisfactorily handled in any other way. One frequent example is a bank or finance company that is about to repossess a client's car. Few legal steps prevent repossession as quickly and effectivelyⁿ⁹ as a chapter 13 petition and plan, which can also usually lower the monthly payments and perhaps the balance due.ⁿ¹⁰ Similarly, a chapter 13 case can be used to halt a mortgage foreclosure, giving the client time to cure a default and, in some cases,ⁿ¹¹ a chance to lower the payments or principal due. Even if there is no hope of the debtor curing a mortgage default, a chapter 13 case may give the debtor the opportunity to sell his or her home for its fair market value and thereby avoid the loss of equity that could occur in a foreclosure sale, which typically will occur at a price well below the market value of the home.

[b] Protection of Nonexempt Property

As mentioned above, other reasons to file a chapter 13 case spring from deficiencies in the relief available under chapter 7. If the debtor does have nonexempt property, it is protected in chapter 13, though its present value must usually be paid to unsecured creditors over the course of the plan.ⁿ¹² Unless the debtor is unable to make these payments, or would prefer to surrender the property, chapter 13 is usually preferable when there is a significant amount of nonexempt property.

[c] Debtor Barred from Receiving Chapter 7 Discharge

If the debtor has obtained a chapter 7 discharge in a case filed within the previous eight years or in a chapter 13 case filed within the previous six years, the only real bankruptcy option in most cases is chapter 13.ⁿ¹³ These time bars cannot be evaded by filing a chapter 13 case within the applicable eight or six year period and then converting the case to chapter 7 after the relevant time bar has run.ⁿ¹⁴ In addition, most of the possible objections to a chapter 7 discharge,

such as fraudulent transfer, concealment of property, or inability to explain loss of assets, may not be raised in a chapter 13 case. Thus, a debtor who anticipates a possible denial of discharge in chapter 7 may decide to file a chapter 13 case instead.ⁿ¹⁵

PRACTICE NOTE

However, there may be rare instances when a debtor will wish to file a chapter 7 case even if a discharge cannot be obtained. When a chapter 13 case is impossible for some reason, exempt property may nevertheless be protected in a chapter 7 case even if a discharge is not available.ⁿ¹⁶ Section 727(a)(8) and (9) prohibit another chapter 7 discharge within the aforementioned time periods. Those subsections do not bar the filing of another chapter 7 case, in which exemptions would still be available. For at least a few debtors, that may be the best alternative since they would receive the temporary benefit of the automatic stay and their exempt property would thereby be protected from creditors despite the lack of a discharge.

Similarly, a debtor may be advised to avoid chapter 7 if it appears likely that a chapter 7 case would be challenged as an "abuse" under *section 707(b) of the Code* because the debtor would be deemed to be able to make payments on unsecured debts above the thresholds specified in that section. Such a debtor might consider filing a chapter 13 case or simply adjusting his or her budget in order to pay debts outside of bankruptcy.

PRACTICE NOTE

Section 707(b) was substantially amended in 2005 to create a bright line test to determine whether the debtor is deemed to have the ability to pay some of his or her debtors in a chapter 13. Through a complex set of calculations, known as the means test formula, the debtor can determine prior to filing whether a presumption of abuse will arise.

MORE INFORMATION

Motions under section 707(b) are discussed in chapter 23 *infra*.

[d] Broader Chapter 13 Discharge

Another feature of chapter 13 that may sometimes be important is the broader discharge it provides. Some debts that are not dischargeable in chapter 7 may be discharged in chapter 13. These include:

- some taxes;ⁿ¹⁷
- willful and malicious torts causing injury to property or not yet reduced to a judgment or restitution award;ⁿ¹⁸
- debts with respect to which a previous bankruptcy discharge was denied or waived;
- marital property settlement debts that are not in the nature of support;
- certain homeowner association and condominium fees.

Discharge of these debts is barred by *section 523(a) of the Bankruptcy Code* in a chapter 7 case.ⁿ¹⁹

PRACTICE NOTE

A decision to file under chapter 13 sometimes depends on how likely it is that these questions will arise. Some debts are dischargeable in chapter 7 unless the creditor affirmatively files a complaint seeking a declaration of their nondischargeability.ⁿ²⁰ When an objection to discharge or dischargeability is not predictable, it may be preferable to commence a chapter 7 case and later convert to chapter 13, if necessary.

[e] Possibly Lower Payments on Taxes or Domestic Support Obligations

Even for the nondischargeable debts, such as domestic support obligations or taxes that must be paid in a chapter 13 case because they are priority debts,ⁿ²¹ a chapter 13 plan may still benefit the debtor by allowing him or her to stretch out the payments over a longer period than would otherwise be possible and usually avoid interest and penalties.

This advantage of chapter 13 is most significant in cases of debtors with large tax debts. Often some of these taxes will not have to be paid in chapter 13 because they are not secured or priority debts. However, even if all of a tax debt has to be paid, no penalties will be added and, except to the extent the debt is secured, no interest will normally accrue during the repayment period. The only exception to this rule would be the case in which there is nonexempt property that would have been sufficient to permit full payment of the tax debt in a chapter 7 case, in which case interest could be required under the best interests of creditors test.ⁿ²²

Of course, the debtor must have the ability to make the payments for such a plan to succeed. If a debtor cannot pay all priority debts, with very limited exceptions, the plan will not be confirmed without the agreement of the priority creditors who would not be paid in full.ⁿ²³ Indeed, even if a debtor needs to file a chapter 13 case for other reasons, the debtor's inability to pay large priority debts in full may make chapter 13 unavailable.

[f] Debtors Who Wish to Pay Unsecured Debts Under Court Supervision and Protection

Another reason to file a chapter 13 case is to help a client who does want to pay his or her debts but needs the protection of the bankruptcy court and, perhaps, the "discipline" of a chapter 13 plan. Chapter 13 usually offers this client, in addition, an end to finance charges and late charges on unsecured claims, and possibly less detriment (where there is any) to the debtor's credit history and reputation. However, such a client should be reminded that most of these advantages are available without a chapter 13 case; he or she may pay all or part of any debt voluntarily after a chapter 7 case, without the deadlines and extra costs of a chapter 13 plan.

[g] Ability to Defer All or Part of Attorney's Fee

Occasionally, the filing of a chapter 13 case is required because a client cannot afford to pay his or her bankruptcy attorney's fee except by installments as part of a chapter 13 plan. Attorneys should be careful not to abuse this device; the bankruptcy courts and United States trustees are giving greater scrutiny to chapter 13 cases that seem to have been filed primarily so that the debtor's attorney could "use the chapter 13 trustee as his collection agent."ⁿ²⁴

MORE INFORMATION

Chapter 5 *infra* provides further discussion of payment of attorney's fees through the chapter 13 plan.

[h] Cases in which There Is Uncertainty About Wisdom of a Bankruptcy Case

Finally, if there is significant doubt as to whether any bankruptcy is the right solution, but for some reason the debtor must file a petition before that doubt is finally resolved, chapter 13 usually offers a safer course than chapter 7. The debtor may voluntarily dismiss a case commenced under chapter 13 at any time as a matter of right.ⁿ²⁵ The same is not true of a case commenced under chapter 7 (or later converted to a chapter 7). In a chapter 7 case, dismissal may occur only with leave of the court, and may be refused if it appears to prejudice the rights of creditors. Voluntary dismissal of

a chapter 7 case is sometimes denied.

MORE INFORMATION

Dismissal of cases is discussed in chapter 23 *infra*.

[3] Use of Chapter 11 by Consumer Debtors

In *Toibb v. Radloff*,ⁿ²⁶ the Supreme Court held that individual debtors may file under the reorganization provisions of chapter 11 of the Bankruptcy Code. While even a cursory review of the chapter 11 process is beyond the scope of this practice guide, there may be rare occasions when a consumer may have no feasible bankruptcy remedy other than a chapter 11 case. For the great majority of consumer debtors, chapter 11 is not the right choice. Most of the relief available in chapter 11 is available for individuals in chapter 13 at a much lower cost in time and money.

However, a limited number of debtors might choose chapter 11 over chapter 13 in the following situations:

- The debtor wishes to modify a mortgage which is not protected from modification by section 1124(b)(5) and cannot pay the present value of the creditor's allowed secured claim within the five year maximum term of a chapter 13 plan.^{n26.1}
- The debtor is ineligible to file under chapter 13 because of noncontingent, liquidated, secured debt in excess of \$1,010,650 or noncontingent, liquidated, unsecured debt in excess of \$336,900,ⁿ²⁷ but must try to deal with secured debts or the existence of nonexempt property through a plan;ⁿ²⁸
- The absence of a limit on reducing claims secured by motor vehicles purchased within 910 days before bankruptcy or other property purchased within a year before bankruptcy will save the debtor a very substantial amount of money;
- The debtor cannot pay priority tax claims within the five-year period permitted under chapter 13, but could do so within the time permitted under chapter 11;ⁿ²⁹

In addition, some practitioners find that, without a chapter 13 trustee scrutinizing the debtor's plan, a high income debtor is allowed more leeway in plan provisions and living expenses than would be likely in chapter 13.

Chapter 11 cases tend to be expensiveⁿ³⁰ and complicated. Unlike a chapter 13 case, a chapter 11 case may not be dismissed as of right;ⁿ³¹ a plan may ultimately be proposed by creditors rather than the debtor over the debtor's objection;ⁿ³² creditors generally must vote on the plan;ⁿ³³ there is no codebtor stay;ⁿ³⁴ and the same exceptions to discharge found in chapter 7 apply.ⁿ³⁵ For this reason, it is advisable to perform a thorough review to make certain that chapter 11 is necessary. It also may be helpful to obtain expert assistance or consult the *Collier Bankruptcy Practice Guide*, which covers chapter 11 in some detail.

FOOTNOTES:

(n1)Footnote 1. One requirement of chapter 13 is that all priority claims, with very limited exceptions, must be paid in full. 11 U.S.C. § 1322(a), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n2)Footnote 2. 11 U.S.C. §§ 506, 522, 722, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n3)Footnote 3. Pursuant to 11 U.S.C. § 104(b), these amounts are subject to periodic adjustment and were raised from \$922,975 to \$1,010,650 for secured noncontingent liquidated debts and from \$307,675 to \$336,900 for unsecured

noncontingent liquidated debts, effective in cases commenced on or after April 1, 2007. For cases commenced before April 1, 2004, the amounts in effect are \$871,550 and \$290,525, respectively. *See 2 Collier on Bankruptcy, P 104.03* (Matthew Bender); *1 Collier Bankruptcy Manual, P 104.03* (Matthew Bender).

(n4)Footnote 4. *11 U.S.C. § 109(e)*. *See 2 Collier on Bankruptcy, P 109.06* (Matthew Bender), *1 Collier Bankruptcy Manual, P 109.06* (Matthew Bender) for more detailed discussion.

(n5)Footnote 5. *See P 4.05[3] infra*.

(n6)Footnote 6. *See Johnson v. Home State Bank, 501 U.S. 78, 111 S. Ct. 2150, 115 L. Ed. 2d 66, 24 C.B.C.2d 1171 (1991)*. However, it is not clear that a chapter 13 case may be filed while a chapter 7 case is still pending. Normally, conversion would be appropriate in those circumstances. *But see In re Saylor, 869 F.2d 1434 (11th Cir. 1989)* (chapter 13 case may be filed while chapter 7 case still pending if debtor has received discharge and only lack of trustee's administrative acts delays closing of case).

(n7)Footnote 7. *See Collier Bankruptcy Manual § 109.06* (Matthew Bender).

(n8)Footnote 8. *See Collier Bankruptcy Manual § 109.06* (Matthew Bender).

(n9)Footnote 9. The repossession is prohibited upon filing by the automatic stay provided for in *11 U.S.C. § 362*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. *See ch. 8 infra*.

(n10)Footnote 10. However, if the value of the collateral is quite low, the debtor could choose to redeem the property in a chapter 7 case, which would also stay a repossession. *11 U.S.C. § 722*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. *See ch. 25 infra*.

(n11)Footnote 11. A claim for which there is a security interest in the debtor's principal residence may only be modified by a chapter 13 plan in certain circumstances. *11 U.S.C. § 1322(b)(2)*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. *See P 14.09 infra*.

(n12)Footnote 12. *11 U.S.C. § 1325(a)(4)*. *See 8 Collier on Bankruptcy, P 1325.05* (Matthew Bender); *3 Collier Bankruptcy Manual, P 1325.05* (Matthew Bender).

(n13)Footnote 13. *11 U.S.C. § 727(a)(8), (9)*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n14)Footnote 14. *In re Burrell, 148 B.R. 820 (Bankr. E.D. Va. 1992)*.

(n15)Footnote 15. However, a court may well consider outrageous behavior to be violative of the "good faith" requirement of *11 U.S.C. § 1325(a)(3)*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. *See P 14.06 infra*.

(n16)Footnote 16. *11 U.S.C. § 522(c)*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n17)Footnote 17. The kinds of taxes that are nondischargeable in chapter 13 have been greatly expanded by the 2005 Act. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. However, some taxes that are nondischargeable in chapter 7 remain dischargeable in chapter 13.

(n18)Footnote 18. The 2005 amendments to the Code expanded the categories of debts not subject to discharge in a chapter 13 to include debts for restitution or damages awarded for willful or malicious injury or death. *11 U.S.C. § 1329(a)(4)*, enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. However, unlike section 523(a)(6), injuries to property are not included and thus remain dischargeable in a chapter 13.

(n19)Footnote 19. *See* ch. 26 *infra*.

(n20)Footnote 20. 11 U.S.C. § 523(c) specifies these types of debts.

(n21)Footnote 21. 11 U.S.C. § 1322(a)(2). Section 1322(a)(4), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005, permits less than full payment of priority domestic support obligations assigned to a governmental unit if the plan commits all of debtor's projected disposable income for a 5-year period.

(n22)Footnote 22. 11 U.S.C. § 1325(a)(4). *See* P 14.05[1] *infra*.

(n23)Footnote 23. 11 U.S.C. § 1322(a)(2). *See* P 14.03[2] *infra*.

(n24)Footnote 24. *See, e.g., In re San Miguel*, 40 B.R. 481 (Bankr. D. Colo. 1984) .

(n25)Footnote 25. 11 U.S.C. § 1307(b). *See In re Barbieri*, 199 F.3d 616 (2d Cir. 1999) . *See also In re Nash*, 765 F.2d 1410, 13 C.B.C.2d 209 (9th Cir. 1985) ;

(n26)Footnote 26. 501 U.S. 157, 111 S. Ct. 2197, 115 L.Ed. 2d 145, 24 C.B.C.2d 1179 (1991) .

(n27)Footnote 26.1. For discussion of mortgages that can be modified, *see* P 14.09[5] *infra*.

(n28)Footnote 27. Pursuant to 11 U.S.C. § 104(b), these amounts are subject to periodic adjustment and were raised from \$922,975 to \$1,010,650 for secured noncontingent liquidated debts and from \$307,675 to \$336,900 for unsecured noncontingent liquidated debts, effective in cases commenced on or after April 1, 2007. For cases commenced before April 1, 2004, the amounts in effect are \$871,700 and \$290,525, respectively. The adjustment is made every three years beginning on April 1, 1998. *See 2 Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n29)Footnote 28. 11 U.S.C. § 109(e). *See 2 Collier on Bankruptcy*, P 109.06 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 109.06 (Matthew Bender).

(n30)Footnote 29. *Compare* 11 U.S.C. § 1322(a)(2) and (c) with 11 U.S.C. § 1129(a)(9)(C), which permits six years after the date of assessment. This situation would be very rare. In chapter 11 present value payments on the priority tax debts would be required.

(n31)Footnote 30. The filing fee for chapter 11 is currently \$1039. 28 U.S.C. § 1930(a)(3), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. In addition, fees to the United States trustee of at least \$250 per quarter is required until the case is closed, converted, or dismissed. 28 U.S.C. § 1930(a)(6). There are also other costs, including those of preparing and mailing disclosure statements and ballots for creditor voting.

(n32)Footnote 31. *Compare* 11 U.S.C. § 1112 with 11 U.S.C. § 1307.

(n33)Footnote 32. 11 U.S.C. § 1121.

(n34)Footnote 33. 11 U.S.C. §§ 1125, 1129.

(n35)Footnote 34. *Compare* 11 U.S.C. § 1301. *See* ch. 9 *infra*.

(n36)Footnote 35. 11 U.S.C. § 523(a), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.



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CHAPTER 4 Counseling the Debtor About Bankruptcy Options

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P 4.06 Should Both Spouses File?

[1] Advantages of a Joint Case

In cases in which both a husband and wife are represented, an additional question presents itself--whether both spouses should file, or only one of them. The answer to this question is that it is usually preferable for both to file. The cost is usually about the same for a joint case as for an individual case and can provide both spouses the advantages of a bankruptcy discharge. Most often, many debts are jointly owed; a spouse who does not file thus remains liable as a codebtor and may continue to be pursued by creditors. Although such pursuit may cease during a chapter 13 case due to the codebtor stay,ⁿ¹ it would be renewed afterwards to the extent the debt was not paid during the case.

MORE INFORMATION

The codebtor stay is discussed in chapter 9 *infra*.

When a joint bankruptcy case is filed, the debtors file joint schedules, statements and other papers, reducing the amount of work necessary as compared to the filing of two separate cases. However, the filing of a joint bankruptcy does not automatically consolidate the cases of the two debtors; such consolidation, which would consolidate the bankruptcy estates of the debtors, must be ordered by the court.ⁿ² This issue is significant primarily in cases in which one spouse has nonexempt property that will be distributed (or much more nonexempt property than the other spouse) and some or all of the debts are not joint debts. In such cases, the creditors of the spouse with more nonexempt property have an interest in opposing consolidation so they do not have to share that spouse's nonexempt property with creditors of the other spouse.ⁿ³

PLANNING NOTE

The decision to file jointly, if appropriate, must be made at the outset of the case. Numerous courts have held that a spouse cannot be added to an existing bankruptcy petition after it is filed.ⁿ⁴ If an existing debtor's spouse seeks to file shortly after the initial spouse's petition, the best option might be a separate filing under the same chapter and a request for joint administration of the two cases.ⁿ⁵

[2] Reasons for Not Filing a Joint Case

There are several exceptions to the general rule that both spouses should file. The most obvious is the situation in which one spouse does not wish to participate. After an explanation of the disadvantages of such a course of action to that spouse, most of the advantages of bankruptcy can still be obtained by filing a petition on behalf of the willing spouse.

[a] Circumstances of One Spouse Pose Obstacles to Successful Case

A second exception is the case in which one spouse is barred from filing by a prior bankruptcy or, if the case proposed is a chapter 7 case, by some likely objection to discharge or an allegation of "abuse" under section 707(b). In such a case, that spouse would probably obtain little advantage from joining in the bankruptcy case.

Similarly, if a chapter 13 case is advisable, some debt of the non-filing spouse, *e.g.*, a very large priority debt that must be paid,ⁿ⁶ or a debt above the chapter 13 debt limitations, might make a viable joint case impossible. In that situation, the only way the spouse without the disqualifying debt can obtain chapter 13 relief is to file a case that is not a joint case.

[b] Protection of Property

Probably the most important case in which it is necessary to deviate from the general rule is the situation in which filing for only one spouse would protect property. Sometimes, this may mean not filing for a spouse with nonexempt property. However, creditors can then usually continue to proceed against that property unless they are prevented from doing so by the chapter 13 codebtor stay.

The more likely reason is the presence of substantial amounts of entireties property or other jointly owned property in excess of the federal exemption levels, which under state law are not reachable by a creditor of only one spouse. In such cases, if only one spouse files, and the state, rather than federal, exemptions are chosen, all of that spouse's interest in such property may be exemptible, at least as to creditors of only the filing spouse.ⁿ⁷ Then, after the bankruptcy, those creditorsⁿ⁸ will be unable to reach the joint property, even if it subsequently passes to the former bankruptcy debtor, because their claims will have been discharged.ⁿ⁹ The advantages of one spouse filing in such situations, then, may be substantial.

[c] Community Property Considerations

Finally, it is necessary to remember the effects of the bankruptcy on community debts and community property in community property states. Although the considerations involved will vary with the different community property laws, most community property generally becomes a part of the estate, and most community claims usually are discharged with respect to any community property, including community property acquired after the bankruptcy, even if only one spouse files.ⁿ¹⁰ Thus, most or all of a spouse's property and debts may be affected by the bankruptcy regardless of whether he or she joins in the petition. This factor may bring either advantages (discharge) or disadvantages (loss of property) to a nonfiling spouse, and should be considered carefully.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 1301.

(n2)Footnote 2. 11 U.S.C. § 302(b).

(n3)Footnote 3. See *In re Reider*, 31 F.3d 1102, 31 C.B.C.2d 1409 (11th Cir. 1994) (substantive consolidation is abuse of discretion in case in which creditor can show it will thereby inequitably receive lesser share of assets because it relied on credit of one spouse).

(n4)Footnote 4. See, *e.g.*, *In re Morgan*, 96 B.R. 615 (Bankr. N.D. W. Va. 1989) ; *In re Kirkus*, 97 B.R. 675 (Bankr. N.D. Ga. 1987) .

(n5)Footnote 5. *Fed. R. Bankr. P. 1015(b)*.

(n6)Footnote 6. *11 U.S.C. § 1322(a)(2)*.

(n7)Footnote 7. *11 U.S.C. § 522(b)(2)(B)*, redesignated § 522(b)(3)(B) by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. *But see Sumy v. Schlossberg*, 777 F.2d 921, 13 C.B.C.2d 1213 (4th Cir. 1985) ; *Matter of Grosslight*, 757 F.2d 773, 12 C.B.C.2d 525 (6th Cir. 1985) ; *Napotnik v. Equibank*, 679 F.2d 316 (3d Cir. 1982) (limiting the exemption possible under *11 U.S.C. § 522(b)(2)(B)*). A few courts have held that even in a joint case, the entireties exemption may be claimed with respect to non-joint creditors. For discussion of the joint property exemption, see *P 13.05[2] infra*.

(n8)Footnote 8. An exception is the secured creditor whose rights were not impaired by the bankruptcy.

(n9)Footnote 9. In a few jurisdictions, courts have also ruled that even when there are joint creditors, a bankruptcy filed by one spouse who chooses the exemption for entireties property can protect the entireties property from their claims. See *P 13.05[2] infra*.

(n10)Footnote 10. *11 U.S.C. § 524(a)(3)*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005; *11 U.S.C. § 541(a)(2)*.



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 4 Counseling the Debtor About Bankruptcy Options

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P 4.07 Considerations of Timing and Events Prior to Filing

A final factor to be considered in deciding on a course of action is the timing of the petition. Even after the debtor decides that a bankruptcy should be filed, in many cases it is advisable to wait before filing.

Of course, in some cases, a debtor has no choice but to file immediately. Prompt action may be necessary to forestall a repossession, eviction, execution sale or utility shut-off. It may also be the only way to stay a state court proceeding and avoid the unnecessary work and trouble connected with it.

Another occasional reason for a quick bankruptcy is an expectation of soon acquiring nonexempt property. This expectation would have to be something less than an entitlement, since the latter would probably be property of the estate under *Code section 541*. With the exception of a few specified types of property acquired within 180 days after a bankruptcy petition is filed, after-acquired property does not usually become part of the estate after filing.ⁿ¹

In all of these cases, a bankruptcy can be filed almost instantaneously, if necessary, under the current rules. However, the debtor must, with rare exceptions, receive a credit counseling briefing from an approved nonprofit budget and counseling agency within the 180 days before the bankruptcy is filed.^{n1a}

MORE INFORMATION

Chapter 6 *infra* discusses emergency filing procedures.

[1] The Effects of Prebankruptcy Transfers or Other Actions

One of the prime reasons for a delay before filing stems from the possible effects, both negative and positive, of prebankruptcy transfers. Some transfers already made may dictate a delay in filing, and it may be advisable to take time to make others before filing in order to gain maximum advantage from the case.

[a] Fraudulent Acts, Conveyances and Preferences

Several types of acts fall into the class of transfers that dictate delays; some of these may affect a discharge in chapter 7 proceedings. If the debtor, with intent to hinder, delay or defraud creditors, has transferred, removed, destroyed, mutilated or concealed his or her property within one year before the filing of a petition, a successful objection to a

chapter 7 discharge may be brought.ⁿ² This definition may include the transfer of specific property subject to a security interest in favor of a creditor, but only if the requisite intent existed.

PLANNING NOTE

If it seems likely that such an objection will be raised, it may be prudent to delay filing a chapter 7 case, if possible, until a year has passed since that act. Even after that year, a trustee may still seek to recover a fraudulent transfer, and a secured creditor may still raise a claim of willful and malicious conversion of the collateral, but only to seek an exception to the discharge of that particular creditor's claim in a chapter 7 case.ⁿ³

Usually less serious are two other types of transfers. These are preferences and those types of fraudulent conveyances made without actual intent to defraud creditors. The worst possible result of these transfers is a reversal of the transfer by the bankruptcy trustee.ⁿ⁴ Briefly, an avoidable preference in an individual bankruptcy is a transfer of property worth more than \$600 from an insolvent debtor to a creditor on account of an antecedent debt, that allows that creditor to receive more than it would otherwise receive in a chapter 7 liquidation case, made within ninety days before filing (or one year before filing if the creditor is an insider).ⁿ⁵ Thus, large payments to some creditors before bankruptcy may be set aside by the trustee if they were made within the stated time periods.

PLANNING NOTE

If the client cares, as he or she may if the payment was made to a friend or relative, it may be better to delay filing until after the applicable preference period has passed. However, it should be stressed that there is nothing improper or illegal about making a preferential payment. The only possible negative consequence is avoidance of the transfer by the trustee.

A fraudulent transfer may also be set aside by the trustee. Basically, the trustee's power extends to such a conveyance is a transfer or obligation made within two years before filing, either (1) for the purpose of hindering, defrauding, or delaying creditors, or (2) for which the debtor did not receive reasonably equivalent value at a time that the debtor was insolvent or was about to incur debts beyond his or her ability to pay.ⁿ⁶ In addition, a transfer that could be set aside under a state fraudulent transfer statute can usually be set aside by the trustee at any time within the period allowed by that statute (usually longer than two years).ⁿ⁷ Again, this may be of no concern to the debtor, but if it is, it may be advisable to wait, if possible, before filing.

On the other hand, some preferences and fraudulent transfers may be set aside by the debtor within the same time periods allowed the trustee. Generally, if the transfer was involuntary, the debtor did not conceal the property, and the debtor could have exempted the property involved, then the debtor may set aside the transfer.ⁿ⁸ Thus, if the debtor plans to make use of this power, it may be crucial to file the petition *before* the time period has run.

MORE INFORMATION

For further discussion of the trustee's avoiding powers *see* chapter 17 *infra* and for discussion of the debtor's avoiding powers *see* chapter 18 *infra*.

Finally, *section 523(a)(2)(C) of the Code* creates a rebuttable presumption that consumer debts aggregating more than \$550ⁿ⁹ owed to a single creditor for "luxury goods and services" obtained within 90 days before a bankruptcy case was filed or cash advances aggregating more than \$825 obtained within 70 days of filing were fraudulently incurred.

PLANNING NOTE

If the debtor plans to file a chapter 7 case and has recently incurred that type of debt, it is usually better,

if possible, to wait until the relevant time period has passed so that, if a dischargeability proceeding is filed, the debtor will not have to rebut this presumption and would have a better chance of recovering attorney's fees from an unsuccessful creditor plaintiff.

[b] Exemption Planning

There are also steps a debtor can sometimes take to improve his or her legal position before the filing. Some of these come under the general rubric of exemption planning. Basically, exemption planning means arranging the debtor's affairs so that a maximum amount of property can be claimed under the exemption provisions, and a minimum amount is lost to creditors in the bankruptcy. It is much akin to tax planning, which is the way people arrange their affairs to take maximum advantage of the tax laws. In the opinion of most commentators, it is perfectly legal under present law, at least if not done to excess.ⁿ¹⁰

WARNING

However, some courts have held that transfers designed to maximize exemptions are fraudulent even under the Code. Clients must be advised that there is a risk that the transfers will be avoided, and that there is even a risk to their discharge. Most of these cases have involved state exemption law, large amounts of money, and conduct intended to conceal the transfers.ⁿ¹¹

A number of steps can be taken to take advantage of the exemption provisions. For example, some states require the debtor to file a homestead deed in order to claim the state homestead exemption. Assets that are not exempt, such as cash above the amounts allowed, can be spent on food, household goods and clothing (each item must be worth less than \$525),ⁿ¹² life insurance, or other items in categories in which the debtor has unused exemptions (assuming the federal exemptions or similar state exemptions are available). If there is nonexempt equity in a debtor's home, the possibility of obtaining a second mortgage (again using the money to purchase exempt assets) should be weighed against loss of that equity (or against paying that amount in a chapter 13 case).ⁿ¹³ All of these steps are nothing more than a rearrangement of a debtor's assets. Unless there is established case law in a jurisdiction finding them not permissible, these steps should be relatively free from risk.ⁿ¹⁴

It is also important to remember property owed to the debtor. Tax refunds due are always considered part of the estate and are often claimed by the trustee if they are not exempt.ⁿ¹⁵ Thus, if the refund due is greater than the debtor's unused exemptions, it may be better to wait until it arrives and spend it on exempt assets before filing the bankruptcy petition. In some areas, exemption planning may even come down to waiting until the debtor's payday to file, since careful trustees may seek out any nonexempt wages or vacation pay owed the debtor for the previous few days if such sums cannot be exempted.ⁿ¹⁶ If no unused exemptions remain, prepaid rent could also pose a problem; in a few areas trustees and judges may consider the remaining portion of a month's prepaid rent, as well as any security deposits to landlords or utilities, to be assets.ⁿ¹⁷ Arrangements for a temporary refund may be worked out if no money is presently owed to the utility companies. Similarly, trustees have occasionally even been known to claim bank deposits as assets because checks that have been written have not yet cleared by the date of filing. Local practice regarding these types of property varies greatly and should be investigated. In most areas, trustees do not inquire into these small amounts due the debtor. And, of course, if the debtor has significant unused exemptions to cover these amounts, there is no cause for concern.

A debtor may also take steps to ensure that no new nonexempt property comes into the bankruptcy estate after filing. Such property could come into the estate, for example, if the debtor receives or becomes entitled to acquire it by bequest, devise, or inheritance, as a result of a marital property settlement or divorce decree, or as a beneficiary of a life insurance policy or death benefit plan. If the situation warrants, it may be advisable to change temporarily the will or insurance policy giving rise to a possible entitlement, and to arrange marital settlements accordingly. Since most of these steps involve the acts of persons other than the debtor (i.e., the testator or owner of an insurance policy), there is

little likelihood that they could adversely affect the debtor's case.ⁿ¹⁸

WARNING

Exemption planning should be distinguished from a process by which debtors transfer property completely out of their estate. It is not permissible, for example, for a debtor to give valuable property to a spouse or other relative shortly before bankruptcy, without return of fair consideration, in order to keep it from coming into the bankruptcy estate. Such conduct may be considered an effort to defraud the estate and may give rise to a challenge to discharge, avoidance of the transfer as fraudulent or even, in serious cases, to criminal prosecution.ⁿ¹⁹ However, a fair trade of property for consideration should be allowed.ⁿ²⁰

[2] Other Reasons for Delaying a Petition

[a] Anticipation of Further Debt

It is sometimes said that a bankruptcy should not be filed until a client's debt load has peaked. If the client anticipates further unavoidable liabilities, such as medical bills, the bankruptcy should, if possible, be delayed until after these are incurred. The object of this, of course, is to gain maximum benefit from the discharge.

However, this delay must be carefully distinguished from another type of behavior--that of obtaining goods or services under false pretenses with no intent of paying for them. Debts incurred in this manner may be declared nondischargeable in a chapter 7 case.ⁿ²¹ Fortunately, the line between these two courses of action is not as difficult to draw as it might at first seem. In general, the courts have found nondischargeable only the most obvious examples of debts incurred with no intent to pay, e.g., prebankruptcy vacation trip and credit card shopping spree debts.ⁿ²² Expenses for medical bills and other necessities are rarely challenged.

[b] Paying Favored Creditors

Clients may wish to delay a bankruptcy until after they have paid creditors whose claims they do not want to see discharged--for example, friends or the grantors of credit cards they hope to keep. As noted above, such payments, if over \$600 and within the applicable preference period, could be set aside by the bankruptcy trustee. Thus, if a client wants to pursue this course of action, and ensure that the creditor gets to keep the payment, the petition must be delayed until after the preference period has run.ⁿ²³

PRACTICE NOTE

In most cases, it is preferable not to delay a bankruptcy for this purpose, but rather to pay the creditor after the petition is filed, using either exempt assets or postpetition income. There is no impediment to this course of action in a chapter 7 case and usually it will not be questioned in a chapter 13 case.ⁿ²⁴

[c] Delay of a Petition as a Strategy to Forestall Harm to Clients

There will be occasions when, for purposes of litigation strategy, a bankruptcy petition should be delayed. For example, a client defending against a mortgage foreclosure may also desire a bankruptcy. By waiting to file the petition until delay of the foreclosure is no longer possible in state court litigation, a good advocate can take advantage of the automatic stay arising from the bankruptcy to gain additional time during which the client may remain in his or her residence. This same strategy can apply in cases where the debtor faces eviction rather than foreclosure. However, the 2005 amendments to the Bankruptcy Code limit the applicability of the automatic stay if a lessor has obtained a judgment for possession prior to the debtor's bankruptcy filing.ⁿ²⁵ Thus, in cases where an eviction action is proceeding in state court, a bankruptcy petition should be filed prior to an entry of judgment for possession. Whether a

debtor is facing eviction or foreclosure, the additional time can be invaluable to a client who may later be able to settle the housing problem, either outside the bankruptcy or in a chapter 13 case. At the least, the client will have more time to find another place to live. There is certainly nothing unethical about timing a legitimate and necessary bankruptcy to obtain the maximum advantage for the client. Of course, filing a bankruptcy petition solely for the purpose of delay is quite a different matter and would likely be found unethical,ⁿ²⁶ or cause for sanctions against the debtor, the debtor's counsel, or both.ⁿ²⁷

[d] Delay to Avoid Credit Card Dischargeability Issues

There is a ninety day period during which there is a presumption of nondischargeability of certain debts for "luxury goods or services," and a seventy day period in which the presumption arises for cash advances on credit cards.ⁿ²⁸ Waiting out this period does not guarantee dischargeability. However, absence of the presumption may make creditor challenges to dischargeability much less likely.

MORE INFORMATION

The credit card fraud presumption is discussed in chapter 26 *infra*.

[e] Delay to Avoid Tax Dischargeability and Priority Problems

The dischargeability of certain taxes and their possible treatment as priority debts (which must be paid in full in chapter 13 cases) will depend on various time periods having passed. Investigation concerning the exact date of expiration of these time periods is essential if discharging taxes is an objective of the case.ⁿ²⁹ Many debtors have been disappointed by an attorney's miscalculation of the relevant dates, which can be complicated by tolling periods and special tax rules.

Delay until the date of expiration of the periods is appropriate if there will not be other harmful consequences in the interim. If delay creates other risks, those risks must be weighed against the benefit of discharging the taxes involved. On the other hand, if the debtor has not filed tax returns for past tax years, it may be advantageous for the debtor to file the missed tax returns and file a bankruptcy petition more quickly so the taxes are priority debts. If the debtor then files a chapter 13 case, the debtor can pay the priority tax debts before paying other unsecured creditors, thereby devoting more of the debtor's disposable income to paying debts that would otherwise be nondischargeable.

MORE INFORMATION

Tax dischargeability is discussed in chapter 26 *infra*.

[f] Delay to Avoid Statutory Time Bars on Repeat Bankruptcy Filings

The Bankruptcy Code contains a 180 day time bar which may apply if a debtor wants to file a second case after a prior case has been dismissed.ⁿ³⁰ Not all cases filed within the 180 day limit are barred. However, some complicated issues arise under the language of the statute so that litigation on whether a particular case is permitted is fairly common. When a question about the debtor's refiling could be raised, it may be good practice to delay filing a new petition until 180 days from a prior dismissal in order to avoid the potential for involuntary dismissal.

[g] Delay to Obtain More Favorable Treatment of Certain Secured Debts in Chapter 13

The 2005 amendments added a new provision to chapter 13 that may impair the debtor's right to "cramdown" with respect to certain debts secured by purchase money security interests in personal property.ⁿ³¹ The provision applies if a motor vehicle was purchased for the debtor's personal use within the 910 days before the bankruptcy petition or if other property was purchased within one year before the petition. If the debtor is filing a chapter 13 case in which the debtor can benefit from the bifurcation of such secured claims to reduce the amount that must be paid to a secured creditor, it

may be important to wait until the requisite time period has run.

[h] Timing the Petition to Avoid a Presumption of Abuse in Chapter 7 or to Lower Disposable Income in Chapter 13

The means test and new method of calculating disposable income for chapter 13 cases added yet another timing issue that must be considered in some cases. The debtor's "current monthly income" upon which both the chapter 7 means test and chapter 13 disposable income are based is an average of the debtor's income (with certain exclusions and additions) over the six calendar months preceding the petition.ⁿ³² If the debtor's income has increased during that period, the current monthly income will become higher each month after the increase because the calculation will include more months at the higher income level. If the debtor's income has decreased during that period, the current monthly income will become lower if the debtor delays the petition.

In most chapter 7 cases, the timing may not make a difference because the debtor will be below the applicable median income threshold that brings the means test into play, even at the higher income level. However, in some cases, delaying or expediting the petition may drop the debtor below that threshold, or may change the result of the means test calculation so that a presumption of abuse does not arise. Other factors that might change in the near future, such as expenses permitted under the means test or the debtor's household size for purposes of the means test, must also be taken into account in deciding when to file the case.

In chapter 13 cases, the current monthly income is the basis for calculating the debtor's payments to unsecured creditors in every case. Although some debtors may have insufficient funds to pay unsecured creditors even at the higher income level, for many debtors an increase in current monthly income will lead to higher required payments in the chapter 13 plan, unless their expenses have also increased commensurately. If the debtor's current monthly income changes from above to below the applicable median income level stated in section 1325(a)(4) or vice versa, the "applicable commitment period" determining total payments to unsecured creditors also is changed, from 60 to 36 months or vice versa. Thus, careful planning of the timing of a chapter 13 petition may make a significant difference in the amount a debtor is required to pay.

[i] Timing the Petition to Avoid Automatic Stay Limitations

The dismissal of prior bankruptcy cases within one year before a new petition may result in early termination of the automatic stay with respect to the debtor or, in some cases, prevent the stay from taking effect.ⁿ³³ Delaying the bankruptcy filing beyond the one year period may ensure the debtor gains the full protection of the automatic stay and eliminates the need to file a motion for extension or imposition of the stay in the new case.

[j] Less Common Reasons for Delaying a Petition

The situations described above are the most common scenarios in which the timing of the bankruptcy case can work to the debtor's advantage or disadvantage. They are not the only ones. For example, if debtors have recently placed substantial amounts in education savings accounts, the amounts excluded from the bankruptcy estate under section 541(b)(5) and (b)(6) may be affected by a delay in filing. A quickly rising real estate market may dictate filing a bankruptcy case sooner rather than later so the debtor's home equity does not increase to an amount that cannot be exempted. Ultimately, only a thorough knowledge of all of the Code provisions that may be relevant to a particular debtor, especially those containing time periods, can ensure the optimal timing of a petition.

The 2005 amendments made it much more likely that exemptions will have to be considered in deciding when to file a bankruptcy case. The time period in which a debtor must be domiciled in the debtor's current state in order to claim that state's exemptions was extended from 90 days or less to two years.ⁿ³⁴ If a debtor's state of domicile has changed in the two years before bankruptcy, the prior domicile's laws will usually govern. Depending on how favorable each state's

exemption laws are for the debtor, this change may dictate filing a case quickly, before the two year period runs, to take advantage of the prior state's laws, or waiting so that the laws of the current domicile will govern.

In addition, the 2005 amendments added limitations on homestead exemptions in states that permit large or unlimited homestead exemptions. If the debtor acquired the homestead property within 1215 days before a bankruptcy, except to the extent the debtor uses the proceeds of another home in the same state, the homestead exemption is limited to \$136,875.ⁿ³⁵ In such cases, it may be advantageous to wait, if possible, until the 1215 day period has run.

FOOTNOTES:

(n1)Footnote 1. Certain property acquired within 180 days of filing does become a part of the estate, *e.g.*, property acquired by inheritance or marital property settlement. *11 U.S.C. § 541(a)(5)*. In addition after-acquired property becomes part of the estate in a chapter 13 case. *11 U.S.C. § 1306*.

(n2)Footnote 1a. *11 U.S.C. § 109(h)*. See ch.6 *infra*.

(n3)Footnote 2. *11 U.S.C. § 727(a)(2)*. See ch. 29 *infra*.

(n4)Footnote 3. *11 U.S.C. § 523(a)(6)*. See ch. 26 *infra*. The trustee may also still be able to avoid a fraudulent conveyance under *11 U.S.C. § 544* or *§ 548*. See ch. 17 *infra*.

(n5)Footnote 4. *11 U.S.C. §§ 544, 547, 548*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n6)Footnote 5. *11 U.S.C. § 547*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. The terms "transfer," "insider," and "insolvent," are all defined in *11 U.S.C. § 101*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. In most districts, a trustee will not pursue a preference avoidance unless the transfer is substantially more than \$600.

(n7)Footnote 6. *11 U.S.C. § 548*, as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. Additionally, the 2005 amendments to the Code permit that trustee to avoid certain transfers of the debtor's interest in property to a self-settled trust, or similar device, that was made within 10 years before the date of filing the petition. If the debtor has made such transfer it may simply be impractical to "wait out" the 10-year time period before filing.

(n8)Footnote 7. *11 U.S.C. § 544*.

(n9)Footnote 8. *11 U.S.C. § 522(h)*.

(n10)Footnote 9. Pursuant to *11 U.S.C. § 104(b)*, this amount is subject to periodic adjustment every three years beginning on April 1, 1998. However, the 2005 Act, specifically reduced these amounts for cases filed on or after October 17, 2005. The amount was adjusted, as of April 1, 2007, from \$500 to \$550. For cases commenced between April 1, 2004 and October 16, 2005 the dollar amount in effect for both "luxury items" and cash advances is \$1,225. See *2 Collier on Bankruptcy, P 104.03* (Matthew Bender); *1 Collier Bankruptcy Manual, P 104.03* (Matthew Bender).

(n11)Footnote 10. H.R. Rep. No. 595, 95th Cong., 1st Sess. 361 (1977), *reprinted in*, Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender), states that this practice is not fraudulent with respect to creditors, and permits the debtor to make full use of the exemptions to which he or she is entitled under law. See *Coughlin v. Cataldo (In re Cataldo)*, 224 B.R. 426, 429 (B.A.P. 9th Cir. 1998) . However, *11 U.S.C. § 522(o)*, added in 2005, provides that a homestead exemption shall be reduced to the extent its value is attributable to property that a debtor disposed of within 10 years prior to the bankruptcy with the intent to hinder, delay, or defraud a creditor. It is unclear whether this more specific direction from Congress will take the place of prior judicially fashioned rules in this area.

(n12)Footnote 11. See 6 *Collier on Bankruptcy*, P 727.02[3][g] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.02[3][f] (Matthew Bender).

(n13)Footnote 12. 11 U.S.C. § 522(d)(3). Pursuant to 11 U.S.C. § 104(b), this amount is subject to periodic adjustment and was raised from \$475 to \$525, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$450. The adjustment is made every three years beginning April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n14)Footnote 13. See P 4.05[2][b] *supra*.

(n15)Footnote 14. In the unlikely event a court finds the property nonexempt because of such actions, the debtor will still be able to save it through payment of its value in a chapter 13 plan, or perhaps by voluntary dismissal of the case. Therefore, if there is doubt about whether a transfer might be considered fraudulent, a chapter 13 case should be seriously considered from the outset. See n.9 *supra*.

(n16)Footnote 15. *United States v. Michaels*, 840 F.2d 901 (11th Cir. 1988) (IRS permitted to recoup tax refunds paid to debtors since they should have been paid to chapter 7 trustee).

(n17)Footnote 16. See, e.g., *Matter of Sexton*, 140 B.R. 742 (Bankr. S.D. Iowa 1992) ; *In re Meade*, 84 B.R. 106 (Bankr. S.D. Ohio 1988) (wages earned by debtor but not yet paid on date of petition were property of the estate). In many states, most or all of a debtor's accrued wages are exempt from garnishment, and wages are also protected from garnishment by the Consumer Credit Protection Act. 15 U.S.C. §§ 1671-1677. Such exemptions may also be applicable if the state and federal nonbankruptcy exemption scheme is utilized by the debtor in a bankruptcy case. See *In re Maidman*, 141 B.R. 571 (Bankr. S.D.N.Y. 1992) . See generally ch. 13 *infra*. Some states also have specific exemptions for accrued wages applicable to bankruptcy cases.

(n18)Footnote 17. But prepaid rent should be exemptible under the broad wording of *Code section 522(d)(1)*, the federal homestead exemption, which permit exemptions of an interest in property used as a residence, or a similar state exemption. If a homestead exemption is available for prepaid rent, the debtor may use nonexemptible cash to pay future rent and claim that asset as an exempt homestead interest. See *Sticka v. Casserino (In re Casserino)*, 379 F.3d 1069 (9th Cir. 2004) (prepaid rent exemptible under Oregon homestead exemption).

(n19)Footnote 18. But see *In re Green*, 986 F.2d 145 (6th Cir. 1993) (in unusual situation of debtor who, having a contractual right to receive property under a will, agreed to give up that right, the exercise of a power of appointment to terminate the debtor's rights under a will was found to be a fraudulent transfer).

(n20)Footnote 19. 11 U.S.C. § 727(a)(2); 18 U.S.C. § 152. See P 29.04 *infra*.

(n21)Footnote 20. See *Matter of Armstrong*, 931 F.2d 1233 (8th Cir. 1991) (transfer of home to father found proper when father paid fair consideration).

(n22)Footnote 21. See P 26.07 *infra*.

(n23)Footnote 22. See P 26.07 *infra*.

(n24)Footnote 23. See P 17.05 *infra* for discussion of preferences

(n25)Footnote 24. However, paying more to one creditor than to another while a chapter 13 case is pending, even outside the plan, could be considered evidence that the debtor can afford to pay more under the disposable income test. See PP 14.05, .08 *infra*.

(n26)Footnote 25. 11 U.S.C. § 362(b)(22), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n27)Footnote 26. See Rule of Professional Conduct 3.1; *Fed. R. Bankr. P. 9011(b)*.

(n28)Footnote 27. *Cinema Service Corp. v. Edbee Corp.*, 774 F.2d 584, 13 C.B.C.2d 1032 (3d Cir. 1985) .

(n29)Footnote 28. 11 U.S.C. § 523(a)(2)(C), amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n30)Footnote 29. In some cases, if the debtor has not filed an income tax return for a particular year, the debtor must file a return to start the running of the time period for dischargeability. See 11 U.S.C. § 523(a)(1)(B).

(n31)Footnote 30. 11 U.S.C. § 109(g). See 2 *Collier on Bankruptcy P 109.08* (Matthew Bender); 1 *Collier Bankruptcy Manual, P 109.08* (Matthew Bender).

(n32)Footnote 31. Language added at the end of 11 U.S.C. § 1325(a) makes § 506 inapplicable to these debts for purposes of § 1325(a)(5). See ch. 14 *infra* for discussion of the right to cramdown and the limitations on that right.

(n33)Footnote 32. 11 U.S.C. § 101(10A). See chs. 14 and 23, *infra*, for discussion of current monthly income, the chapter 7 means test, and chapter 13 disposable income.

(N34)Footnote 33. 11 U.S.C. § 362(c)(3), (4). See ch. 8, *infra*.

(n35)Footnote 34. 11 U.S.C. § 522(b)(3).

(n36)Footnote 35. 11 U.S.C. § 522(p).



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CHAPTER 5 Considerations for Attorneys--Duties and Compensation

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CHAPTER 5 Considerations for Attorneys--Duties and Compensation

1-5 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the duties and compensation of debtor's counsel in bankruptcy cases. The chapter begins with a discussion of the duties of bankruptcy attorneys under new provisions that classify them as "debt relief agencies." The chapter discusses restrictions on and duties of debt relief agencies as well as liability for failing to adhere to the requirements for such agencies. The chapter also reviews advertising rules for debt relief agencies. Then, the chapter turns to various certifications that attorneys are required to make in chapter 7 bankruptcy cases. Next, the chapter considers fee arrangements and means of compensation for debtor's counsel. There is an examination of the requirement for a disclosure statement and the requirements of *Federal Rule of Bankruptcy Procedure 2017*. The chapter also outlines the procedure involved in seeking a judicial examination of the compensation paid or promised to a debtor's attorney. Finally, the chapter reviews the various Bankruptcy Code provisions and statutory sources of attorney's fees in bankruptcy cases.



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CHAPTER 5 Considerations for Attorneys--Duties and Compensation

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P 5.01 Attorneys as Debt Relief Agencies

The 2005 amendments to the Bankruptcy Code¹ enacted a series of new requirements for "debt relief agencies." All attorneys who represent debtors in bankruptcy cases may be subject to the provisions related to debt relief agencies.^{n1a} In addition, due to poor drafting, these provisions may also apply to many attorneys who rarely, or never, represent consumer bankruptcy debtors.

The new provisions, which are set forth in sections 526, 527, and 528, impose certain restrictions on the conduct of debt relief agencies; conduct which for the most part was considered improper prior to the new legislation. In addition, certain disclosures are mandated and retainer agreement requirements are specified. Noncompliant retainer agreements may be declared void and unenforceable. Further, negligent or intentional failure of a debt relief agency to comply with certain requirements could result in monetary liability. Finally, the provisions contain new requirements for the advertising of bankruptcy services directed to the general public.

[1] Definition of Debt Relief Agency

A "debt relief agency" is defined as any person who provides bankruptcy assistance to an assisted person in return for compensation or who is a bankruptcy petition preparer as defined in section 110.ⁿ² Under new definitions in section 101, an "assisted person" is any person whose debts are primarily consumer debts and whose nonexempt property is worth less than \$150,000.ⁿ³ This description encompasses the vast majority of the population, because there is no requirement that an assisted person be a bankruptcy debtor. "Bankruptcy assistance" is then defined as goods or services sold or otherwise provided to an "assisted person" with the purpose of providing advice, document preparation, or representation in a bankruptcy case or proceeding, regardless of the chapter.ⁿ⁴ Again, the advice or representation need not be in connection with a case in which the assisted person is a debtor, nor need it be in connection with a consumer bankruptcy case. However, section 526(d) provides that nothing in the debt relief agency provisions shall limit or curtail the authority or ability of states to enforce the qualifications for the practice of law. For this reason, some courts have held that attorneys are not bound by the debt relief agency provisions.^{n4a}

As a result of the sweeping definition, debt relief agencies may include attorneys who represent individual landlords or other mom and pop businesses that owe primarily consumer debts, as well as those who represent consumer creditors, or nondebtor spouses who are creditors in title 11 cases. Because "person" is defined to include partnerships and corporations,ⁿ⁵ presumably the entire law firm would be a debt relief agency. However, because "debt relief agency"

excludes officers, employees, directors or agents of debt relief agencies or petition preparers, attorneys employed by a firm, by the attorney's own professional corporation (of which he is an officer), or by any entity providing bankruptcy assistance is not a "debt relief agency," though the employer may be.ⁿ⁶

[2] Restrictions and Duties

[a] Restrictions

The restrictions placed on debt relief agencies, for the most part, prohibit practices that are already considered improper, such as failing to perform services as promised, and making untrue or misleading statements or advising clients to make statements that the agency should know are untrue or misleading.ⁿ⁷ Section 526 also prohibits debt relief agencies from misrepresenting the services to be provided or the benefits or risks of bankruptcy, or advising an assisted person to incur more debt in contemplation of filing a bankruptcy case or in order to pay bankruptcy fees to an attorney or petition preparer.ⁿ⁸

[b] Disclosures

Section 527, added in 2005,ⁿ⁹ sets forth a series of disclosures required to be made by debt relief agencies to all assisted persons being provided bankruptcy assistance.

[i] Notice Required by § 342(b)(1)

The assisted person must be given the written notice required under section 342(b)(1).ⁿ¹⁰ This notice should describe the types of bankruptcy relief available to consumer debtors and detail the types of services available from consumer credit counseling agencies.ⁿ¹¹

FORMS

A form has been promulgated by the Administrative office of United States Courts for the purpose of section 342(b) disclosures. *See Collier Consumer Bankruptcy Forms.*

[ii] Information Not Covered by § 342(b)(1) Notice

To the extent not covered by the section 342(b)(1) notice, and within three days of when the agency first offers to provide bankruptcy assistance services to an assisted person a clear and conspicuous notice containing various other pieces of information must also be provided.ⁿ¹² First, the notice must advise the assisted person that the information the person is required to provide under the Bankruptcy Code must be complete, accurate and truthful.ⁿ¹³ Second, the notice must advise the assisted person that all assets and liabilities must be completely and accurately disclosed in the documents filed to commence a bankruptcy case.ⁿ¹⁴ Additionally, the replacement value of each asset pursuant to section 506 must be stated where requested,ⁿ¹⁵ after reasonable inquiry.ⁿ¹⁶ Third, section 527(a)(2)(C) provides that the notice must advise the assisted person that amounts stated in relation to current monthly income, the means-testing formula, and disposable income (in a chapter 13 case) are to be provided only after "reasonable inquiry." Finally, the notice must advise the assisted person that information provided by that person during their case may be audited and that failure to provide information can result in dismissal or other sanctions, including criminal sanctions.ⁿ¹⁷

[iii] Statement Related to Bankruptcy Assistance Services

A debt relief agency must also provide the assisted person a statement about "bankruptcy assistance services."ⁿ¹⁸ The required statement, which must be given verbatim, or in substantially similar language, relates generally to representation of an assisted person by an attorney or bankruptcy petition preparer, including the need for a written contract between the respective parties. The information also covers selected aspects of the bankruptcy process and it

advises an assisted person about the types of services that person might need in a bankruptcy case.

This notice is particularly troublesome because the information required may be misleading, or even incorrect. For example, the notice is required to state, "You will have to pay a filing fee to the bankruptcy court." This is not always true because the fee may be waived by the court, or no fee may be charged for a particular proceeding.ⁿ¹⁹ The notice must also state, "The following information helps you understand what must be done in a routine bankruptcy case to help you evaluate how much service you need."ⁿ²⁰ But in fact, the statement gives no information that would help someone to evaluate how much service is needed. Finally, it proceeds to "inform" the assisted person that "you can get help in some localities from a bankruptcy petition preparer who is not an attorney,"ⁿ²¹ a statement that implies petition preparers are competent to help bankruptcy debtors and may promote the unauthorized practice of law by petition preparers.

[iv] How to Provide Information Required Under § 521

Certain debt relief agencies are required to give clear and conspicuous written notice to an assisted person giving "reasonably sufficient information" on how to provide information required under section 521.ⁿ²² Section 521 dictates the general duties of a debtor under the Bankruptcy Code. However, section 521 also requires information subject to unsettled questions of law such as how to determine current monthly income, how to do means test calculations, how to determine disposable income in chapter 13, how to list creditors, how to determine the amount owed and the proper address for the creditor, and how to determine what property is exempt and value exempt property at replacement value as defined in section 506, which has nothing to do with valuing property for exemption purposes. Such information plainly constitutes legal advice, and as a result may render the section inapplicable to any entity that the section appears to regulate.

Section 527(c), by its terms, does not apply to attorneys who provide the relevant information themselves after inquiry for the purpose of completing required documents in a bankruptcy case. Additionally, the section expressly provides that a debt relief agency may give such information only to the extent permitted by nonbankruptcy law. Nonbankruptcy law restricts the ability of petition preparers to give legal advice which would clearly be necessary to satisfy the conditions of section 527(c). As a result, the section may simply have no practical effect.

[c] Retainer Agreement Requirements

Section 528(a)(1), enacted in 2005,ⁿ²³ requires a debt relief agency to execute a written contract with the assisted person that explains clearly and conspicuously the services that the agency will provide to the assisted person, the fees or charges for those services, and the payment terms. This retainer must be executed not later than 5 business days after the first day on which the agency provides any bankruptcy assistance services, but before the filing of the assisted person's petition under the Bankruptcy Code. Section 528(a)(2) mandates that the debt relief agency give the assisted person a copy of the fully executed and completed retainer. Since no time requirement is specified in section 528(a)(2), presumably, the copy of the executed retainer should be provided within a reasonable time.

It is unclear what should be done in cases in which the assisted person is unwilling or unable to sign a written contract within the required time frame. It would probably be sufficient for the debt relief agency to sign and tender the contract to the assisted person. And, presumably the duty to provide a copy under section 528(a)(2) would be inapplicable if the assisted person did not execute the contract.

It is important to note that telephonic or electronic messages that contain general information to the public would probably not constitute "bankruptcy assistance" under section 101(4A) because they are not provided "in a case or proceeding on behalf of another."ⁿ²⁴ However, such messages would be governed by the requirements related to advertising.ⁿ²⁵

[3] Liability of Debt Relief Agencies

[a] Retainer Void and Unenforceable

Section 526(c)(1) renders a contract for bankruptcy assistance between a debt relief agency and an assisted person void if the contract is not in compliance with the material requirements of sections 526, 527 and 528. Section 526(c)(1) also provides that such a contract may not be enforced by any federal or state court or by any other person, other than the assisted person.ⁿ²⁶

[b] Monetary Liability

Section 526(c)(2) authorizes courts to award to an assisted person: 1) the amount of any fees or charges that the debt relief agency received in connection with providing bankruptcy assistance to the assisted person, 2) actual damages, and 3) reasonable attorneys' fees and costs if the agency is found, after notice and a hearing, to have committed any of the acts or omissions listed in section 526(c)(2)(A), (B) or (C). Liability under section 526(c)(2) requires a showing of negligence or intentional conduct.

Section 526(c)(2)(A) imposes liability on a debt relief agency if the agency intentionally or negligently fails to comply with any provision of section 526, 527 or 528. Section 526(c)(2)(B) imposes liability on a debt relief agency if it provides bankruptcy assistance to an assisted person in a case or proceeding under the Bankruptcy Code that is dismissed or converted to a case under another chapter of the Code becauseⁿ²⁷ of the agency's intentional or negligent failure to file any required document. Section 526(c)(2)(C) imposes liability on a debt relief agency if it intentionally or negligently disregards the applicable material requirements of the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure. The terms "material requirements" is not defined anywhere in the Code. Thus, the scope of the term and the scope of the liability provisions will be determined by future judicial decisions.

[c] Intentional Violations

Section 526(c)(5) provides that if a court finds that a person intentionally violated section 526 or engaged in a clear and persistent pattern or practice of violating the section, the court may enjoin the violation or impose an appropriate civil penalty against the violator. The court can take this action on its own motion or on the motion of the United States trustee or the debtor. This section applies notwithstanding any other provision of federal law and is in addition to any other remedy under federal or state law.

[4] Advertising Requirements

The 2005 amendments to the Bankruptcy Codeⁿ²⁸ added several provisions dealing with the advertising of debt relief agencies. Advertising is defined to include "general media, seminars, mailings, telephonic or electronic messages" but only if directed to the general public.ⁿ²⁹ All such advertising of bankruptcy assistance services or of the benefits of bankruptcy must contain the statement: "We are a debt relief agency. We help people file for relief under the Bankruptcy Code," or a substantially similar statement.ⁿ³⁰ The statement must be clear and conspicuous. This advertising requirement is also specifically applicable to any advertisement offering assistance with respect to credit defaults, mortgage foreclosures, or evictions.ⁿ³¹

Section 528(b)(1) enumerates what descriptions and statements are included in the term, "advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public." These include descriptions of bankruptcy assistance in connection with a chapter 13 plan, irrespective of whether or not chapter 13 is specifically mentioned, and statements such as "federally supervised repayment plan," "federal debt restructuring help," or other similar statements that could lead a reasonable consumer to believe that debt counseling was being offered even when the services were designed to provide a chapter 13 plan or other form of bankruptcy relief under the Code. Presumably, the list is not exclusive of the kinds of statements that might fall within the meaning of the term.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 1a. Courts have differed about whether attorneys are included within the definition of debt relief agency. *See P 5.01* infra.

(n3)Footnote 2. *11 U.S.C. § 101(12A)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 3. *11 U.S.C. § 101(3)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 4. *11 U.S.C. § 101(4A)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 4a. *Compare Milavetz, Gallop & Milavetz v. United States*, 355 B.R. 758 (D. Minn. 2006) , *rev'd in part, Milavetz, Gallop & Milavetz, P.A. v. United States*, 541 F.3d 785 (8th Cir. 2008) (holding attorneys are debt relief agencies); *cert. granted*, 129 S. Ct. 2769; 174 L. Ed. 2d 269 (2009) ; *In re Attorneys At Law & Debt Relief Agencies*, 332 B.R. 66 (Bankr. S.D. Ga. 2005) , *appeal dismissed by In re Attys. at Law & Debt Relief Agencies*, 353 B.R. 318 (S.D. Ga. 2006) . *But see Milavetz, Gallop & Milavetz, P.A. v. United States*, 541 F.3d 785 (8th Cir. Minn. 2008) (holding attorneys are debt relief agencies), *cert. granted*, 129 S. Ct. 2769; 174 L. Ed. 2d 269 (2009); *Hersh v. United States*, 553 F.3d 743 (5th Cir. 2008) .

(n7)Footnote 5. *11 U.S.C. § 101(41)*.

(n8)Footnote 6. *11 U.S.C. § 101(12A)(A)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 7. *11 U.S.C. § 526(a)(1), (2)*, added by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n10)Footnote 8. *11 U.S.C. § 526(a)(3), (a)(4)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. The restriction on such lawful and proper advice infringes on the *First Amendment* rights of attorneys and their clients. *U.S. CONST. amend. I, Milavetz, Gallop & Milavetz, P.A. v. United States*, 541 F.3d 785 (8th Cir. Minn. 2008) (holding attorneys are debt relief agencies), *cert. granted*, 129 S. Ct. 2769; 174 L. Ed. 2d 269 (2009). *But see Hersh v. United States*, 553 F.3d 743 (5th Cir. 2008) . *See New York State Bar Ass'n v. Reno*, 999 F. Supp. 710 (N.D.N.Y. 1998) .

(n11)Footnote 9. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n12)Footnote 10. *11 U.S.C. § 527(a)(1)*. Confusingly, section 527(a)(1), only mentions a portion of the notice required under section 342(b)(1), omitting the portion required by section 342(b)(2). This disclosure is essentially duplicative as the clerk of the court is required to provide the notice specified in section 342(b). *See 11 U.S.C. § 342(b)*.

(n13)Footnote 11. *11 U.S. C. § 342(b)(1)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n14)Footnote 12. *11 U.S.C. § 526(a)(1)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n15)Footnote 13. *11 U.S.C. § 527(a)(2)(A)*.

(n16)Footnote 14. *11 U.S.C. § 527(a)(2)(B)*.

(n17)Footnote 15. Neither the petition, which is filed to commence the case, nor the schedules request a statement of replacement value. Therefore, it is unclear how the assisted person would be under an obligation to provide replacement value in the documents filed to commence a case.

(n18)Footnote 16. *11 U.S.C. § 527(a)(2)(B)*. Section 506 only defines replacement value for personal property acquired for personal, family, or household use. For other types of assets replacement value will vary depending on the circumstances and applicable sections of the Code.

(n19)Footnote 17. *11 U.S.C. § 527(a)(2)(D)*.

(n20)Footnote 18. *11 U.S.C. § 527(b)*.

(n21)Footnote 19. *11 U.S.C. § 527(b)*.

(n22)Footnote 20. *Id.*

(n23)Footnote 21. *Id.*

(n24)Footnote 22. *11 U.S.C. § 527(c)*.

(n25)Footnote 23. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n26)Footnote 24. *See 11 U.S.C. § 101(4A)*.

(n27)Footnote 25. *See P 5.01[4] infra*.

(n28)Footnote 26. It is unclear how the assisted person can enforce the void contract.

(n29)Footnote 27. Liability under section 526(c)(2)(B) will require the movant to demonstrate causation between the act or omission of the debt relief agency and the dismissal or conversion of the case.

(n30)Footnote 28. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n31)Footnote 29. *11 U.S.C. § 528(a)(3)*.

(n32)Footnote 30. *11 U.S.C. § 528(a)(4)*.

(n33)Footnote 31. *11 U.S.C. § 528(a)(4)*.



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CHAPTER 5 Considerations for Attorneys--Duties and Compensation

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P 5.02 Attorney Certifications

Section 707(b), as amended in 2005, provides for certification of all petitions, pleadings, motions and schedules in chapter 7 cases.

[1] Certification of Petitions, Pleadings and Motions

Section 707(b)(4)(C), added in 2005,ⁿ¹ provides that the signature of an attorney on a petition, pleading, or written motion is a certification that the attorney has performed a reasonable investigation into the circumstances giving rise to petition, pleading, or written motion; determined that it is well grounded in fact; and determined that it is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and determined that it does not constitute an "abuse" under paragraph 707(b)(1). This provision applies to all attorneys, not just those representing debtors, and is applicable to all motions and pleadings filed in chapter 7 cases.ⁿ² For example, it would apply to frivolous motions for relief from the automatic stay filed in chapter 7 cases, and would require a reasonable investigation by the attorney of amounts asserted in such motions. The language of this provision is quite similar to the former language of *Rule 9011* and it is not clear that it adds anything to current *Rule 9011*.

[2] Certification of Schedules

Section 707(b)(4)(D) provides that the signature of attorney for the debtor on the petition also certifies that attorney has no knowledge, after an inquiry, that the schedules are incorrect. The statute requires an inquiry, which should be no greater than for other pleadings. A violation occurs only when an attorney has actual knowledge, not just a belief or suspicion, that the schedules are inaccurate.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. *11 U.S.C. § 103(b)*.



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CHAPTER 5 Considerations for Attorneys--Duties and Compensation

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P 5.03 Fee Arrangements with Clients

As in any other matter, it is very important for the attorney and client to discuss and have a clear understanding of fee arrangements as early as possible. Generally, consumer debtors' bankruptcy attorneys charge a basic fee, with additional charges for services beyond those covered by the basic fee. Precisely what services are included in the basic fee and those which require additional charges must be made clear.

Next, the best method of payment must be determined. Unlike most clients of private practitioners, bankruptcy clients are always facing serious financial problems. They may have great difficulty in paying even modest fees. These difficulties require counsel to consider alternatives to the typical fee arrangements, where some amount is paid in advance while the remainder is billed as services are performed. Often, with the increase in bankruptcy costs and fees, a debtor will have to save money for several months to afford the attorney's fee, paying installments to the attorney, before the case is filed. This is made somewhat easier if the debtor can be advised that certain debts the debtor has been struggling to pay, but that will be discharged, need not be paid. Debtors also rely on gifts from family members or borrow money from retirement accounts or home equity lines of credit to raise funds for the fee. In some jurisdictions, it is common for attorneys to take an assignment of the debtor's expected tax refund for all or part of the fee.ⁿ¹

In chapter 13 cases, as well as in occasional chapter 7 cases, there is the possibility for payment of attorney's fees through the court's administration of the bankruptcy. Typically, the court's administration of the bankruptcy will mean the payment of fees as a priority claim through the debtor's chapter 13 plan, which provides one solution for the debtor unable to pay all or even part of the fee in advance.

[1] Discuss Fee Arrangements at Initial Client Interview

Normally, a discussion of the fee arrangement will occur at the first interview with the debtor. Many attorneys have preprinted retainer agreements and/or brochures, which can be given to clients at this initial consultation. These agreements and/or brochures spell out exactly what services are covered by the attorney's basic fee, and what charges will be made for additional services, should they prove necessary. Naturally, these written materials and all fee arrangements should be consistent with any previous representations or advertisements.

FORMS

For sample forms pertaining to the retainer agreement *see Collier Consumer Bankruptcy Forms*, §

CS4.11 (Matthew Bender).

[2] The Basic Fee

Many attorneys, as well as courts in their review of counsel's compensation, begin the process of setting fees by deciding upon a reasonable basic fee for those services necessary in every bankruptcy case.

[a] Services Customarily Covered by the Basic Fee

In most forms of retainer agreements the debtor's attorney agrees to provide a limited number of "basic services" including:

[i] Initial Consultation and Advice

The initial consultation and advice to a debtor would concern:

- alternatives to bankruptcy;
- consequences of bankruptcy;
- whether to file at all;
- whether to file under chapter 7 or 13;
- the timing of the filing;
- the election of federal over state exemptions in jurisdictions where the federal exemptions are available under section 522;
- the reaffirmation of car loans and similar secured obligations under section 524(c);
- the redemption of items of collateral under section 722 (in a chapter 7 case);
- the avoidance of judicial liens and nonpossessory, nonpurchasemoney security interests in household goods under section 522(f); and
- the abandonment of burdensome assets under section 554.

[ii] Preparation of Initial Papers

Preparation of the initial papers may include:

- the petition;
- a list of creditors;
- schedules of assets and liabilities, and current income and expenditures;
- statement of monthly net income, statement of current monthly income, and, if applicable, means test calculations;

- a statement of financial affairs;
- a statement of debtor's intentions about retention or surrender of assets, exemptions, redemptions, and reaffirmations; and
- the chapter 13 plan (in a chapter 13 case), including preconfirmation modifications of the plan.

Any factual investigation necessary for the preparation of the initial papers may also be included.

[iii] Submission of Other Documents

Several other documents are required to be submitted to the court at the commencement of the case or within a specified period of time after the petition has been filed. These documents may include:

- certification by a credit counseling agency;
- payment advices for the 60-day period prior to filing;
- tax returns;²³
- record of interest in education IRA or section 529 tuition savings program; and
- annual statements of income and expenditures (chapter 13 only).

Any investigation necessary for the preparation and submission of such documents may also be included.

[iv] Attendance at Meetings and Hearings

Preparation for and attendance at mandatory meetings and hearings may include:

- the meeting of creditors;
- chapter 13 confirmation hearing (in a chapter 13 case); and
- discharge hearing (where a discharge hearing is required).

[v] Ancillary Minor and Routine Tasks and Advice

Any ancillary minor or routine tasks and advice to the debtor throughout the course of the case may include:

- advice by phone and letter;
- dealing with creditor inquiries;
- letters to creditors when necessary to halt collection attempts; and
- amendments to schedules.

Most bankruptcy courts do not permit an attorney to "unbundle" these basic services and provide, for example, only the preparation of the papers initially filed.^{3a} Many courts also require that an attorney who files a case may not withdraw

from the case without court permission.^{n3b}

[b] Amounts Typically Charged

Because of the 2005 amendments to the Bankruptcy Code,ⁿ⁴ the basic fee for a chapter 7 case has increased substantially due to increased paperwork requirements and has ranged from \$1,000 to \$2,000, with many courts setting an informal limit between \$1,500 and \$2,500.ⁿ⁵ Fees in a typical chapter 13 case generally ranged from \$2,000 to \$4,000, and in more complicated case could go up to \$5,000 or more. To some extent the amount of increase in chapter 13 fees may depend on whether there are regular requests for annual budget statements and tax returns.

For attorneys in doubt about the appropriate amount in a particular locale, it is usually a good idea to visit the clerk's office and review the fee disclosure statements which have been filed and approved in recent cases. Often, a discussion of the question with a trustee or attorney more experienced in bankruptcy can also prove helpful.

[c] Incremental Increases for Business Cases, Joint Cases or Anticipated Complications

Some attorneys and courts consider it appropriate to add a small increment to the basic fee in joint cases or where other complications make the case more difficult than average to prepare. The filing of a chapter 7 petition by an individual who has substantial business assets and liabilities complicates the matter of determining the proper amount of a retainer payment.

In some instances, the individual may have operated a business as a sole proprietor: the owner of the classic "Mom and Pop" corner grocery or convenience store, service station, restaurant, dry cleaner, repair shop, or retail clothing store. For purposes of this discussion, these may be called "proprietary chapter 7 cases." They generally justify a larger retainer payment than in a consumer case. In many instances, the preparation of the schedules and the statement of affairs is difficult because the books and records were not kept in any semblance of order. The debtor's counsel may have to spend a fair amount of time directing the bookkeeper or accountant in straightening out the books and records. Occasionally, the office of debtor's counsel will have to carry out these tasks because there is simply no one else able to do so. The debtor cannot expect to escape this problem (or pay to rectify it) merely by filing the petition and expecting the trustee or the trustee's accountants to reconstruct the books and records of the debtor's business.

In addition, the debtor's counsel in a proprietary chapter 7 case may have to represent the debtor on matters relating to the debtor's exemptions, taxes, exceptions or objections to discharge, and similar bankruptcy matters. In light of these factors that are unique to proprietary cases, the retainer payment amount may readily reach the same level as the amount appropriate in a chapter 7 business case filed by a corporation or partnership.

[d] Basic Fee as Guideline to Enable Prompt Approval of Fees Without the Need for Detailed Review of Actual Work Performed

The basic fee is not cast in stone and serves more as a guideline for the convenience and efficiency of the court and counsel, permitting prompt approval of fees without a detailed review of the work done. Since fees in bankruptcy cases are to be awarded on the same basis as fees in other cases, counsel is entitled to request more than the court's normal fee, even in a routine case, under the "lodestar method." The "lodestar method" provides for compensation at a reasonable hourly rate for time reasonably expended.ⁿ⁶ However, counsel seeking to deviate from the basic fee will undoubtedly have a substantial burden in convincing the court that their rates and hours are reasonable when other attorneys in the district routinely perform the same services at a lower cost.

[3] Fees For Supplemental Services

Two types of services in addition to the basic services must be planned for in the initial retainer agreement between the debtor and the debtor's attorney: additional predictable services, and unexpected complications.

[a] Set Fee for Additional Predictable Routine Services

It is usually possible to predict other services which will be necessary, such as filing of a homestead deed, once the facts of a debtor's case are known. The fees for such services, assuming they will proceed routinely, should also be set in advance. In some cases, an agreement for a percentage contingency fee may be appropriate, but no such agreement may override the court's duty to determine whether fees are reasonable. If the agreement produces a claim in excess of the reasonable value of services rendered, that excess portion of the claim will be disallowed.ⁿ⁷

[b] Establish Hourly Rate for Complications

Lastly, the attorney and client should agree upon an arrangement for fees, usually at an hourly rate prevalent in the community and commensurate with the attorney's experience and billing rate for other matters, should complications arise. Such complications might include defending against a motion for relief from the automatic stay,ⁿ⁸ a dischargeability complaint,ⁿ⁹ or an objection to discharge.ⁿ¹⁰

[c] Debtor's Attorney Generally Held Obligated to Continue Representation Although Retainer Agreement Fails to Provide for Payment of Attorney's Fees for Supplemental Services

A substantial problem arises when the retainer agreement is limited to defined basic services and there is no provision for additional services. For example, if a complaint for a determination of nondischargeability is filed against the debtor, can the debtor's counsel ethically decline the representation? Is it sufficient for counsel to point out to the debtor that the retainer agreement explicitly limited the services to be performed? The short answer to both questions is usually "No." Most courts take the position that the debtor's counsel agreed to represent the debtor in the "case" and that the "case" includes representation of the debtor in all contested matters and adversary proceedings.ⁿ¹¹ In other words, a limitation under the retainer agreement will not be deemed effective by many courts.

The attorney's inability to be paid for additional services will not be sufficient by itself to support an application to withdraw. Some courts will be very skeptical of an application to withdraw based on an alleged refusal of the debtor to cooperate with the debtor's counsel. The suspicion will be that the debtor's inability or refusal to pay supplemental fees is the real explanation.

If services beyond the scope of the basic fee are required and the debtor's attorney withdraws from representation because the debtor could not pay for these services, the debtor's counsel runs a risk of having to turn over the retainer to the debtor or, worse still, being reported by the court to the state bar grievance or disciplinary board.

[4] Informing Debtor of Filing Fees and Other Costs Likely to Be Incurred

In every case the debtor should be advised of all costs likely to be incurred, including the necessary filing fees, as well as possible costs for title searches and appraisals. Costs that are certain to occur are usually collected by counsel at the outset of the case.

[5] Method of Payment of Attorney's Fees**[a] Payment in Advance of Filing**

Particularly in chapter 7 cases, an attorney will usually want to be paid all or most of the fee in advance of the filing. The Supreme Court has generally approved this method of payment.ⁿ¹² Collection of the fee after filing will prove difficult since the attorney's fee is a dischargeable debt and collection efforts are subject to the automatic stay. Attorneys in a few jurisdictions have attempted to offer "no money down" chapter 7 cases, arguing that their fees in the bankruptcy cases were not dischargeable and could be collected postpetition. These arguments have generally, and properly, been rejected.ⁿ¹³ Prepetition attorneys' fees agreements are dischargeable in bankruptcy. The exceptions to discharge, found

in section 523(a), do not include attorneys' fees for preparing and filing a bankruptcy petition.ⁿ¹⁴

Although a few courts have held otherwise, fees paid in advance as a prepetition retainer for postpetition services that the attorney commits to provide also should not be deemed property of the bankruptcy estate. The attorney's fee should be deemed earned when the attorney contracts to provide future services in exchange for it.ⁿ¹⁵ Alternatively, at a minimum, it should be deemed subject to a possessory attorney's lien that survives the bankruptcy.ⁿ¹⁶

[b] Postpetition Fees Paid from Postpetition Earnings

The debtor's attorney may be compensated for postpetition services from the debtor's postpetition earnings. The debtor's attorney may find it advisable to enter into two separate fee agreements: an agreement to be fully paid prepetition, and an hourly postpetition agreement, executed postpetition, to be paid from the debtor's postpetition assets.

[c] Payment in Ways Other than Cash Payment from Debtor

Payment of the attorney's fee may be made by a third party such as a friend or relative. The debtor may also give the attorney a security interest in property or transfer property outright to the attorney.

WARNING

However, the potential for later problems in enforcing the security or establishing the fair value of transferred property may make such arrangements inadvisable. They also create the possibility of a conflict of interest between the attorney and the debtor or the estate.

[d] Payment From Debtor's Estate

The remaining method by which an attorney may be compensated is through payment from the debtor's estate. This arrangement is common in chapter 13 cases. Although possible in certain circumstances, this method of payment is rarely used in chapter 7 cases. All attorney's fees paid from estate property must be approved in advance.

MORE INFORMATION

For a discussion of payment of fees from the bankruptcy estate *see* chapter 21 *infra*.

[i] Chapter 7 Case

Payment of attorney fees from property of the estate is feasible in a chapter 7 case filed by a consumer only if the debtor has sufficient nonexempt property to pay all priority administrative expenses in full. Since debtors, if they receive good advice, will normally protect their nonexempt property by converting it to exempt property or filing a chapter 13 petition, this method of payment in consumer chapter 7 cases is extremely rare.

MORE INFORMATION

For a discussion of the considerations and alternatives in choosing the type of bankruptcy case that offers the greatest advantage to the debtor *see* chapter 4 *supra*.

An additional potential problem for a chapter 7 debtor's attorney seeking to be paid from the estate is an amendment to section 330(a) made by the Bankruptcy Reform Act of 1994. The reference to "the debtor's attorney" as one of the persons who could be paid professional fees was omitted from the section, which was substantially rewritten. Probably, this omission was a technical drafting error, since no legislative history indicates that a change was intended.ⁿ¹⁷ However, the Supreme Court has held that, unless a debtor's attorney is appointed to represent the estate in some matter,

the bankruptcy court is not authorized to award fees to the debtor's attorney under section 330.ⁿ¹⁸ Fortunately, section 330(a)(4)(B) makes clear that the court can award fees to debtors' attorneys in chapters 12 and 13 cases.

[ii] Chapter 13 Case

One important feature of chapter 13 not usually present in consumer chapter 7 cases is the possibility of paying the debtor's attorney from the property of the estate. The opportunity for the debtor to pay all or part of the fee in installments is often the only way a financially strapped client can pay the fee at all. And the fact that the attorney has some assurance, though hardly a complete guarantee, that the fee can be paid in this manner makes him or her more comfortable about taking the client's case without advance payment of all or most of the fee.

Normally the attorney for the debtor classifies his or her fee among the administrative expenses entitled to priority under section 507(a)(2). Not only does this mean that the fee must be paid in full for a chapter 13 discharge under section 1328(a), but it also usually means the fee will be paid before most other creditors receive payment.ⁿ¹⁹ Fees may have to be paid concurrently with adequate protection payments to certain secured creditors and payments on leases under section 1326(a)(1).^{n19a} In addition, there are issues concerning whether the language in section 1325(a)(5)(B)(iii)(I) dictating that holders of allowed secured claims be paid in "equal monthly installments" requires those installments to begin before the debtor's attorney has been paid in full. The better view is that it does not require this and secured creditors may recognize that if they must share initial payments with attorney's fees, their "equal monthly payments" will be smaller and it will take longer for them to be paid the full amount due to them under the plan.^{n19b} In addition, if fees have been approved, they may be paid by the trustee pursuant to section 1326(a)(2) even if the case is dismissed before confirmation.ⁿ²⁰ However, by local rule in some districts attorney's fees are customarily paid *pro rata* with other disbursements to assure the attorney's continued interest in the success of the plan.ⁿ²¹ Of course, deferring of counsel fees until later in the plan increases the risk that the fees will not be paid in full, and courts that require counsel to defer fees must recognize that it will result in higher fees being charged due to that risk.

MORE INFORMATION

The payment of priority claims through chapter 13 plans is examined in chapter 14 *infra* .

FOOTNOTES:

(n1)Footnote 1. *See In re Carson*, 374 B.R. 247 (B.A.P. 10th Cir. 2007) . *But see Wagers v. Lentz & Clark, P.A. (In re Wagers)*, 514 F.3d 1021 (10th Cir. 2007) . The *Wagers* case was unusual in involving an extremely large refund and a fee that was not clearly earned on receipt.

(n2)Footnote 2. Some tax returns are provided to trustee, and are not submitted to the court. Additionally, the debtor may provide transcripts in lieu of returns.

(n3)Footnote 3. [Reserved]

(n4)Footnote 3a. *See Hale v. United States Tr.*, 509 F.3d 1139 (9th Cir. 2007) (attorney sanctioned for providing only preparation of documents, where debtors did not understand limitations on services and attorney refused to say which services he personally preformed).

(n5)Footnote 3b. *In re Bulen*, 375 B.R. 858 (Bankr. D. Minn. 2007) (it was improper for fee agreement to state that attorney would withdraw if she was not paid because local rule required attorney to handle entire case unless court gave permission for attorney to withdraw).

(n6)Footnote 4. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n7)Footnote 5. *See*, Government Accountability Office, Report No. GAO-08-697, Dollar Costs Associated with

the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (2008), *available at* <http://www.gao.gov/new.items/d08697.pdf>. (detailing study of increased attorney's fees); *Matter of Geraci*, 138 F.3d 314, 39 C.B.C.2d 764 (7th Cir.), *cert. denied*, 119 S. Ct. 63 (1998) (presumptive \$800 fee for no asset chapter 7 case not abuse of discretion).

(n8)Footnote 6. *In re Boddy*, 950 F.2d 334 (6th Cir. 1991) (use of \$650 "normal and customary" fee for bankruptcy case, rather than lodestar method, was abuse of discretion). *See generally* 3 *Collier on Bankruptcy*, P 330.04 (Matthew Bender).

(n9)Footnote 7. *In re Yermakov*, 718 F.2d 1465, 9 C.B.C.2d 699 (9th Cir. 1983) .

(n10)Footnote 8. *See* ch. 10 *infra*.

(n11)Footnote 9. *See* ch. 26 *infra*.

(n12)Footnote 10. *See* ch. 29 *infra*.

(n13)Footnote 11. *Cf. In re Woodcock*, 100 B.R. 520 (Bankr. E.D. Cal. 1989) (appearance in the case held not to extend to adversary proceedings).

(n14)Footnote 12. *Lamie v. United States Tr.*, 540 U.S. 526, 124 S. Ct. 1023, 1032, 157 L. Ed. 2d 1024, 1036 (2004) .

(n15)Footnote 13. *Rittenhouse v. Eisen*, 404 F.3d 395 (6th Cir. 2005) ; *In re Bethea*, 352 F.3d 1125 (7th Cir. 2003) ; *In re Biggar*, 110 F.3d 685 (9th Cir. 1997) ; *In re Symes*, 174 B.R. 114 (Bankr. D. Ariz. 1994) . *But see In re Hines*, 147 F.3d 1185 (9th Cir. 1998) (attorney can collect fees after petition is filed for postpetition services because such fees are postpetition debts); *In re Mills*, 40 C.B.C.2d 684, 170 B.R. 404 (Bankr. D. Ariz. 1994) .

(n16)Footnote 14. [Reserved]

(n17)Footnote 15. *See Barron v. Countryman*, 432 F.3d 590 (5th Cir. 2005) (retainers collected by chapter 13 attorney before petition was filed were earned upon receipt under attorneys retainer agreement and state law and did not have to be escrowed or approved by bankruptcy court because they were not property of the estate). *Ryan v. Butera*, *Beausang*, *Cohen & Brennan*, 193 F.3d 210 (3d Cir. 1999) (advance retainer was nonrefundable under state law and became property of attorney when paid); *In re Jones*, 42 C.B.C.2d 705, 236 B.R. 38 (D. Colo. 1999) (reasonable attorney's fees received prior to petition for services to be performed postpetition were not property of the estate); *Indian Motorcycle Associates III Ltd. Partnership v. Massachusetts Housing Finance Agency*, 66 F.3d 1246, 1254-55 (1st Cir. 1995) .

(n18)Footnote 16. *In re Century Cleaning Services*, 39 C.B.C.2d 129, 215 B.R. 18 (B.A.P. 9th Cir. 1997) , *aff'd on other grounds*, 195 F.3d 1053, 43 C.B.C.2d 59 (9th Cir. 1999) ; *Rajala v. Hodes* (*In re Hodes*), 289 B.R. 5 (D. Kan. 2003) (debtors' counsel had valid retaining liens against retainers paid prepetition for postpetition services). *See also In re Carson*, 374 B.R. 247 (B.A.P. 10th Cir. 2007) (attorney permitted to take assignment of prepetition tax refund and refund is then excluded from estate).

(n19)Footnote 17. Compare *In re Top Grade Sausage, Inc.*, 227 F.3d 123 (3d Cir. 2000) (chapter 7 debtor's attorney may be compensated from estate funds); *In re Century Cleaning Services*, 195 F.3d 1053, 43 C.B.C.2d 59 (9th Cir. 1998) (drafting error should not prevent fees) with *In re Pro-Snax Distribs.*, 157 F.3d 414, 40 C.B.C.2d 1218 (5th Cir. 1998) (no fees permitted by language of statute).

(n20)Footnote 18. *Lamie v. United States Tr.*, 540 U.S. 526, 124 S. Ct. 1023, 1032, 157 L. Ed. 2d 1024, 1036 (2004) .

(n21)Footnote 19. *11 U.S.C. § 1322(a)(2); In re Shorb*, 21 C.B.C.2d 274, 101 B.R. 185 (B.A.P. 9th Cir. 1989) (fees must be paid prior to or concurrently with other claims and cannot be deferred to six months after commencement of payments to unsecured claims).

(n22)Footnote 19a. *See* ch. 9 *supra* for discussion of such payments.

(n23)Footnote 19b. *See* ch. 11 *supra* for discussion of the "equal monthly payments" language.

(n24)Footnote 20. *In re Lampman*, 276 B.R. 182 (Bankr. W.D. Tex. 2002) (attorney's fees may be paid by trustee in dismissed chapter 13 case, but only if fees are allowed by court upon application with notice to debtor and trustee); *In re Oliver*, 40 C.B.C.2d 725, 222 B.R. 272 (Bankr. E.D. Va. 1998) .

(n25)Footnote 21. *See In re Lanigan*, 101 B.R. 530 (Bankr. N.D. Ill. 1986) (bankruptcy court had authority to order payment of fees over life of plan).



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 5 Considerations for Attorneys--Duties and Compensation

1-5 Collier Consumer Bankruptcy Practice Guide P 5.04

P 5.04 Disclosure and Review of Bankruptcy Attorney's Fees

One aspect of attorney's fees in bankruptcy that is somewhat unusual is the close court supervision of fees charged. In addition, monitoring and, where appropriate, commenting upon attorney's fees applications is one of the primary duties of the United States trustee's office. This supervision of attorney's fees in bankruptcy arises mainly from an unfortunate history of abuse and overreaching by the bankruptcy bar.

The purpose of the monitoring is twofold. First, it was designed to prevent bankruptcies in which there are significant assets from becoming impracticable and wasteful of time and money for the lawyers involved. Second, the scrutiny of fees paid by the debtor is based upon a recognition that bankruptcy clients are particularly vulnerable to attorney overreaching. Court oversight now prevents much of that overreaching. To assist the courts in their supervisory role, every attorney for a debtor is required to furnish a disclosure statement providing the details of any compensation and fee-sharing agreement. Furthermore, procedures are in place that allow certain parties to request a court review of any compensation agreement with the debtor's attorney for a determination of its reasonableness.

[1] Disclosure Statement Required

Both the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure have strict requirements for disclosure of all fees. Together, section 329(a) and *Rule 2016(b)* require the disclosure of the amount and source of any compensation and the details of any fee-sharing arrangement.

[a] Compensation

Section 329(a) requires any attorney representing a debtor in a bankruptcy case, or in connection with a bankruptcy case, to file a statement:

- of the amount of all compensation paid or agreed to be paid in connection with services rendered within one year prior to filing, or to be rendered, which are related to the bankruptcy; and
- the source of all such compensation.ⁿ¹

The statute requires disclosure of sums already paid, as well as money to be paid prospectively. It is improper to list only money which is paid by or expected from the estate or the debtor. Fees for services not rendered directly in the

bankruptcy case but related to the case must also be disclosed.ⁿ² The disclosure of fees must be filed even if the attorney has charged only for advice or preparation of papers and has not appeared in the bankruptcy case.ⁿ³ The statement must be filed whether or not the debtor's counsel files or intends to file an application for compensation or reimbursement of expenses under section 330 or 331.

[b] Fee-Sharing

Bankruptcy Rule 2016(b) requires that the disclosure statement must also state whether the attorney has shared or agreed to share such compensation with any other person, and the particulars of any such sharing arrangement, except where the sharing is with another attorney in the same firm.ⁿ⁴ The only proper statement on this matter that can be included in the disclosure of compensation statement is a denial of any agreement to share compensation except with other members or regular associates of the attorney's law firm, at least if the compensation is from property of the estate. The Rules make clear that any sharing, in the form of referral or forwarding fees, with attorneys who have not performed real service to earn their portion of the fee shall not be allowed, and can be the basis for the denial of fees for all attorneys involved in the transaction.ⁿ⁵ Similar sorts of fees to nonattorneys are also improper, and must be disclosed to the court, with respect to prebankruptcy fees at least, in response to question 9 in the Statement of Financial Affairs.

MORE INFORMATION

The Statement of Financial Affairs is examined in more detail in chapter 6 *infra* .

In most states, the sharing of compensation arising from the referral of cases is permitted under, but is subject to, the provisions of the canons of ethics adopted by the legislature or, by delegation, by the state Supreme Court.ⁿ⁶ To the contrary and as a matter of superseding federal law, Congress has prohibited the payment of any referral fees by a debtor's counsel. The only exception is for fees paid to a bona fide public service attorney referral program, of the type operated by bar associations.^{n6a} *Rule 2016(b)* acts as a policing mechanism to enforce the prohibition against fee splitting. If the debtor's counsel has agreed to pay a referral fee and fails to disclose that agreement, and that agreement is later discovered and brought to the attention of the court, the debtor's counsel may be disqualified from any further representation of the debtor in the bankruptcy case, ordered to disgorge the entire retainer, and denied all further compensation.ⁿ⁷

[c] Statement of Services Rendered and Expenses Incurred

Where compensation is sought from the estate, including payment through the chapter 13 plan, *Rule 2016(a) of the Federal Rules of Bankruptcy Procedure* requires an attorney to provide a detailed statement of the services rendered and expenses incurred to justify the amount requested. Although *Rule 2016(b)* does not require that such a listing be included in the disclosure statement, it is a good idea to furnish a similar listing in the statement, even in those cases in which the attorney is paid directly by the debtor. Not only will the description of services support the amount of fees requested, it will also make clear to the court what services have not been included, so that there can be no later question as to whether the attorney's fee included particular activities. Indeed, it is usually advisable to include in the statement a specific disclosure of the hourly rate or other arrangements which have been made for such additional services as might become necessary.

FORMS

For a sample of a disclosure of compensation by the attorney for the debtor see *Collier Consumer Bankruptcy Forms, Form CS5.02-2* (Matthew Bender).

Where fees are to be paid from property of the estate, payment must be requested by application. However, the application process varies from one jurisdiction to another. Some jurisdictions will allow a disclosure statement that

sufficiently details the services rendered combined with a provision in a chapter 13 plan to substitute for the usual fee application process.

[d] Procedure for Filing

Federal Rule of Bankruptcy Procedure 2016(b) implements section 329(a). *Rule 2016(b)* requires the statement of compensation and feesharing to be filed within 14 days after a voluntary petition is filed or at such other time as the court may direct. In addition it must be transmitted to the United States trustee. The failure to file this form may jeopardize an attorney's right to receive any fees at all.

[e] Supplemental Disclosure Statement

Rule 2016(b) requires a supplemental disclosure statement to be filed with the court and transmitted to the United States Trustee within 14 days after any payment or agreement regarding payment not previously disclosed. The supplemental statement should generally conform to the same standards as the original disclosures.

FORMS

For a sample of a disclosure of an agreement for supplemental services see *Collier Consumer Bankruptcy Forms, Form CS5.03-1* (Matthew Bender).

[2] Bankruptcy Court Review of Fee Disclosures

The whole point of *section 329(a) of the Bankruptcy Code* and *Rule 2016(b) of the Federal Rules of Bankruptcy Procedure*, requiring disclosure of any fee agreement, is apparent from section 329(b) and *Rule 2017*. The object of section 329(b) is to guard against and to impose sanctions on a debtor's attorney who takes advantage of a desperate debtor by charging excessive fees. Section 329(b) authorizes the court to cancel any agreement or to order the return of any payment when the compensation paid or agreed to be paid to the debtor's counsel exceeds the "reasonable value" of legal services when, under section 329(a), *inter alia* such payment or applicable agreement was made in the year before filing of the petition. *Rule 2017* provides for a determination by the court whether any fees paid or property transferred by the debtor to an attorney for services rendered or to be rendered is "excessive." That matter may be heard on motion by the United States trustee, or on the court's own motion,ⁿ⁹ or if the fees were paid or property transferred before the petition date, then on motion by any party in interest.

[a] Transactions with Debtor's Attorney Subject to Review by Bankruptcy Court; Rule 2017

All fees paid by the debtor related to the bankruptcy case are subject to review.ⁿ¹⁰ Any payments exceeding the reasonable value of services rendered may be ordered returned to either the debtor or the estate, whichever is appropriate.ⁿ¹¹ The provisions of *Bankruptcy Rule 2017* are divided into two parts based on when the transaction between the debtor and debtor's attorney occurred.

[i] Payments Before Order for Relief

Rule 2017(a) provides for the examination of transfers or payments by a debtor to the attorney prior to the entry of the order for relief.ⁿ¹² The rule covers any transfer or payment, whether direct or indirect. The transfer or payment must be in contemplation of the commencement of a bankruptcy case to be subject to review under the Rule. What is meant by "in contemplation of" the filing of a petition is something more than mere consciousness of insolvency. It means that the debtor, in making the transfer, is influenced by the imminence of bankruptcy. Even services devoted to the prevention of bankruptcy, such as to effect a settlement, may be rendered in contemplation of bankruptcy and are, therefore, subject to re-examination.ⁿ¹³ The best test is whether the ensuing bankruptcy was reasonably predictable at the time the payment or transfer to the attorney was made.

[ii] Payment or Transfer After Order for Relief

Under *Rule 2017(b)* the court may review a payment or transfer or an agreement to pay or transfer to an attorney by the debtor after the entry of an order for relief in a bankruptcy case. Since a transfer or payment must occur after the entry of the order for relief in order to fall within *Rule 2017(b)*, there is no need to limit the payments or transfers to be reviewed to those made (or promised) in contemplation of bankruptcy. However, as the last clause of *Rule 2017(b)* indicates, the services of the attorney must be related to the bankruptcy case in some way.ⁿ¹⁴

[iii] Payment or Transfer Made by Third Party

While *Rule 2017* permits on its face examination of a transfer or payment (or an agreement for payment or transfer) by the debtor, *section 329 of the Bankruptcy Code* is not so limited. Therefore, courts have held that a payment or transfer by a third party is subject to examination pursuant to *Rule 2017*, notwithstanding the wording of the Rule.ⁿ¹⁵

[b] Nature of Review

One aspect of reviewing fees simply involves the question of whether the fees charged are reasonable in relation to the services involved. The second aspect of fees with which courts concern themselves is that of preventing the abuse of the bankruptcy process by attorneys at the expense of debtors or creditors.

[i] Review For Reasonableness

The Bankruptcy Court must review all fees or arrangements between the debtor and the debtor's attorney to determine whether the fees charged in each case are reasonable for the services actually provided. What is reasonable is, of course, a question of fact to be determined by the particular circumstances in each case.ⁿ¹⁶ Bankruptcy courts have broad discretion in determining appropriate levels of compensation.ⁿ¹⁷

The general test to be applied by the court in determining the reasonableness of the fee arrangements under *Rule 2017* is the same as the test applied in review of an application for compensation pursuant to *Rule 2016* and *section 330 of the Bankruptcy Code*.ⁿ¹⁸

In practice, courts have established rates to serve as guidelines to expedite the review process. Most judges have a range of rates which they consider fair for the basic services involved in a consumer bankruptcy case and will not perform a detailed review if the attorney's fee falls within that range.ⁿ¹⁹ Information as to what this range is should be easy to obtain through a review of fees approved in other cases filed at the clerk's office. Many judges also have let it be known what they feel is equitable for an uncontested adversary proceeding or other routine tasks. In some jurisdictions a local rule may fix the standards for reasonableness of compensation in certain types of cases (*e.g.*, consumer liquidations).

Different courts also have a variety of rules regarding such issues as whether fees are allowed for travel time, which costs are compensable, and the rates that will be permitted for costs such as photocopying.

Counsel for debtors should not be afraid, however, to charge more than the basic fee when the work reasonably required in a case warrants a larger fee which the client agrees to pay.ⁿ²⁰ The "basic fee" (sometimes called the "no-look fee") utilized by many courts is only a guideline set for the convenience of the court and counsel. Bankruptcy litigation can be lengthy and complex, and the legislative history of the Bankruptcy Code makes clear that Congress intended bankruptcy attorneys to be compensated at the same level as other attorneys in the community handling nonbankruptcy matters of similar difficulty.ⁿ²¹

Previous case lawⁿ²² holding that bankruptcy cases are governed by a special "spirit of economy" which dictated lower fees was expressly disapproved when the Bankruptcy Code was enacted.ⁿ²³ The policy of the Code is to encourage

quality representation in bankruptcy by allowing fees which will attract competent practitioners.

[ii] Review to Prevent Abuses of the Bankruptcy Process

The second aspect of fees with which courts concern themselves is that of preventing the abuse of the bankruptcy process by attorneys at the expense of debtors or creditors. In pursuit of this goal, bankruptcy judges have granted relief under *section 329 of the Bankruptcy Code* and *Rule 2017* citing any number of factors including:

- the incompetence of the attorney in the performance of services;
- whether any benefit was derived from the services;
- whether the services rendered were compensable;
- whether the attorney engaged in unethical conduct;
- whether the attorney deceptively advertised fees; and
- whether the attorney failed to accurately disclose the fees charged.

Much of this conduct would also make a retainer agreement void and unenforceable under section 526 and potentially subject the attorney to monetary liability.ⁿ²⁴

[3] Policing Conduct of Nonattorneys

Finally, section 329 has been used to police the fees and conduct of nonattorneys who provide debtors with "advice" or "services" in connection with bankruptcy cases, which are then often filed *pro se*. Either upon motion by the United States trustee, or upon request of disgruntled "clients," *section 329 of the Bankruptcy Code* can be an effective weapons against the unauthorized practice of law and abusive practices of these "clinics," "debt counselors," "typing services" and other entities, that prey on the misfortunes of financially troubled debtors.

However, the enactment of *section 110 of the Bankruptcy Code* in 1994 shifted most of the focus on fees paid to nonattorney petition preparers to that section rather than to section 329.ⁿ²⁵

FOOTNOTES:

(n1)Footnote 1. See 3 *Collier on Bankruptcy*, P 329.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 329.03 (Matthew Bender).

(n2)Footnote 2. *In re Zepecki*, 277 F.3d 1041 (8th Cir. 2002) (services in connection with prepetition sale of property); *In re Campbell*, 259 B.R. 615 (Bankr. N.D. Ohio 2001) (fees for services in connection with refinancing to complete chapter 13 plan).

(n3)Footnote 3. *In re Kisseberth*, 273 F.3d 714 (6th Cir. 2001) (disgorgement of fees when disclosure requirements not met); *In re Basham*, 208 B.R. 926 (B.A.P. 9th Cir. 1997) (attorney who prepared papers for debtors who filed "pro per" but did not file fee disclosure, and who charged excessive fees for services rendered, required to disgorge all fees).

(n4)Footnote 4. See 9 *Collier on Bankruptcy*, P 2016.15 (Matthew Bender).

(n5)Footnote 5. Advisory Committee Note to *Fed. R. Bankr. P. 2016*; See *In re Wright*, 290 B.R. 145 (Bankr. C.D. Cal. 2003) (discussing rules for disclosure of payments to "appearance attorney" who attends creditors meeting or

hearing); *In re Greer*, 271 B.R. 426 (Bankr. D. Mass. 2002) (improper to pay another attorney \$50 to represent debtors at creditors meeting; listing of attorney on letterhead and paying attorney's malpractice insurance did not make attorney part of firm); *In re Palladino*, 267 B.R. 825 (Bankr. N.D. Ill. 2001) (denying fees for attorneys who were not part of firm hired by debtor and not directly hired by debtor).

(n6)Footnote 6. See Model Code of Professional Responsibility, DR 2-107(A).

(n7)Footnote 6a. 11 U.S.C. § 504(c).

(n8)Footnote 7. See *In re Arlan's Dep't Stores, Inc.*, 615 F.2d 925 (2d Cir. 1979) ; See also *In re Matis*, 73 B.R. 228 (Bankr. N.D.N.Y. 1987) .

(n9)Footnote 8. See, e.g., *In re Coones Ranch, Inc.*, 7 F.3d 740, 29 C.B.C.2d 1625 (8th Cir. 1993) .

(n10)Footnote 9. *In re Busy Beaver Bldg. Centers, Inc.*, 19 F.3d 833, 30 C.B.C.2d 1264 (3d Cir. 1994) .

(n11)Footnote 10. *In re Walters*, 868 F.2d 665, 22 C.B.C.2d 263 (4th Cir. 1989) (court had power to review fees paid by debtors from exempt property in state court suits against creditor). Cf. *Matter of Hargis*, 895 F.2d 1025 (5th Cir. 1990) (court had no authority to order disgorgement of fees paid for services not related to bankruptcy case).

(n12)Footnote 11. 11 U.S.C. § 329(b). *In re Lee*, 884 F.2d 897 (5th Cir. 1989) (court ordered return of fees attorney collected under contingent fee agreement to the extent they exceeded reasonable hourly rate). See 3 *Collier on Bankruptcy*, P 329.04 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 329.04 (Matthew Bender).

(n13)Footnote 12. See 9 *Collier on Bankruptcy*, P 2017.09 (Matthew Bender).

(n14)Footnote 13. See 3 *Collier on Bankruptcy*, P 329.03[1][d] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 329.03[1][c] (Matthew Bender).

(n15)Footnote 14. See 9 *Collier on Bankruptcy*, P 2017.08 (Matthew Bender).

(n16)Footnote 15. See 3 *Collier on Bankruptcy*, P 329.04[2][b] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 329.04[2][b] (Matthew Bender).

(n17)Footnote 16. See 3 *Collier on Bankruptcy*, P 330.04 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 330.04 (Matthew Bender).

(n18)Footnote 17. See, e.g., *Matter of Lawler*, 807 F.2d 1207 (5th Cir. 1987) .

(n19)Footnote 18. See, e.g., *Matter of Lee*, 884 F.2d 897, 899 (5th Cir. 1989) .

(n20)Footnote 19. See P 5.01[2][b] *supra*.

(n21)Footnote 20. See generally, See *In re Eliapo*, 468 F.3d 592 (9th Cir. 2006) (attorney who had applied for "no look" fee did not show extraordinary circumstances justifying additional fees for normal case preparation tasks, but was awarded fees for other additional work; attorney should have been granted opportunity for a hearing on disputed fees); *In re Cahill*, 428 F.3d 536 (5th Cir. 2005) (case did not involve sufficient amount of work to deviate from standard fee). *Matter of Lawler*, 807 F.2d 1207 (5th Cir. 1987) ; *In re Powerine Oil Co.*, 71 B.R. 767 (B.A.P. 9th Cir. 1986) .

(n22)Footnote 21. 124 Cong. Rec. H11091-22 (daily ed. Sept. 28, 1978) (Statement of Rep. Don Edwards), reprinted in Vol. D *Collier on Bankruptcy*, App. Pt. 4(f)(i) (Matthew Bender); H.R. Rep. No. 595, 95th Cong., 1st Sess. 329-30 (1977), reprinted in Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender). *In re Boddy*, 950 F.2d 334 (6th Cir. 1991) (use of \$650 "normal and customary" fee for bankruptcy case, rather than lodestar method, was

abuse of discretion); *Grant v. George Schumann Tire & Battery Co.*, 908 F.2d 874, 23 C.B.C.2d 708 (11th Cir. 1990) (bankruptcy attorney fees should be calculated by lodestar method and should be no less and no more than fees received for comparable nonbankruptcy work).

(n23)Footnote 22. See, e.g., *In re Beverly Crest Convalescent Hospital, Inc.*, 548 F.2d 817 (9th Cir. 1977) ; *In re Paramount Merrick, Inc.*, 252 F.2d 482, 485 (2d Cir. 1958) .

(n24)Footnote 23. 124 Cong. Rec. H11091-92 (daily ed. Sept. 28, 1978) (Statement of Rep. Don Edwards), reprinted in Vol. D Collier on Bankruptcy, App. Pt. 4(f)(i) (Matthew Bender); H.R. Rep. No. 595, 95th Cong., 1st Sess. 329-30 (1977), reprinted in Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n25)Footnote 24. 11 U.S.C. 526(c), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n26)Footnote 25. See 2 Collier on Bankruptcy, ch. 110 (Matthew Bender); 1 Collier Bankruptcy Manual, ch. 110 (Matthew Bender).



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CHAPTER 5 Considerations for Attorneys--Duties and Compensation

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P 5.05 Procedure for Judicial Examination of Compensation

Although *section 329 of the Bankruptcy Code* provides that compensation paid or promised to a debtor's attorney will be subjected to court examination, no procedure for making such an examination is provided by the section. The procedures for such judicial examination are set forth in *Federal Rule of Bankruptcy Procedure 2017*.ⁿ¹ In addition, *Bankruptcy Rule 9014* applies to contested matters, including any such matters arising under *Bankruptcy Rule 2017*, and it is generally designed to insure that the requisites of due process are afforded to parties involved in a dispute arising out of a case under the Bankruptcy Code.

MORE INFORMATION

The procedure used in contested matters is outlined in chapter 32 *infra* .

[1] Request for Examination

Generally the payment, or agreement to pay, should be examined prior to the closing of the estate. However, a closed estate may be reopened for the purpose of making a motion to recover excessive compensation paid by a debtor for services rendered in conjunction with the case *if* the payments were concealed and not revealed by the disclosure statement required to be filed. Such procedure would be especially warranted if the size of the payment is substantial.

Proceedings for the examination of the amount paid are to be brought in the court having jurisdiction of the estate and not elsewhere.

[2] Parties Who May Seek Judicial Examination

[a] United States Trustee

Rule 2017 of the Federal Rules of Bankruptcy Procedure permits the United States trustee to seek examination of any transaction, whether it occurred before or after the commencement of the case.

[b] The Court Itself

The court may also, *sua sponte*, examine any transfer of money or property or any fee arrangement. The court's ability

to do so is facilitated by the disclosures required under *Rule 2016(b)* and *section 329(a) of the Bankruptcy Code*.

[c] Any Party In Interest

Rule 2017(a) allows any party in interest to seek examination of a payment or transfer made prior to the commencement of the case. However, there is no similar provision under *Rule 2017(b)* for initiation of an examination by any party in interest of a payment or transfer made after the filing of the petition. This is so because in a chapter 7 case, payments from property obtained (or earned) postpetition by an individual debtor are of no concern to creditors generally since such payments will not affect the estate.ⁿ² Compensation paid to an attorney after the commencement of the case from the estate will be scrutinized under *Rule 2016*.ⁿ³

[3] Examination Most Often Occurs After a Request by Trustee

Although *Rule 2017* provides that the examination may be made upon the court's own motion,ⁿ⁴ it most often occurs after a request by the trustee or the United States trustee. In many districts the court specifically requires the trustee to make a recommendation as to whether an attorney's fee should be approved, and it has been held that this is part of the United States trustee's function of supervising the administration of bankruptcy cases.ⁿ⁵ According to the Executive Office for the United States trustees, the monitoring of debtors' attorneys' fees is an important part of the United States trustee's job.

[4] Notice and Hearing in Review of Fees

A request for a review of fees under *Rule 2017* initiates a contested matter, and is therefore governed by *Rule 9014 of the Federal Rules of Bankruptcy Procedure* which requires that relief under *Rule 2017* be requested by motion on notice. Reasonable notice and an opportunity for hearing are required pursuant to *Bankruptcy Rule 9014*.ⁿ⁶ The term "notice and a hearing" in the Bankruptcy Rules has the same meaning as "notice and a hearing" in *section 102(1) of the Bankruptcy Code*.

MORE INFORMATION

The procedures used in contested matters are outlined in chapter 32 *infra*.

Although the debtor's attorney is entitled to a hearing, the trustee's motion may be heard on affidavits or orally.ⁿ⁷ If the attorney desires to introduce oral testimony, this should be indicated at the hearing and any right thereto is waived by failure to object to the motion being heard on affidavits only.ⁿ⁸

The debtor's attorney must carry the burden of proof on the issue of the reasonableness of fees.ⁿ⁹ Depending on local practice requirements, the debtor's attorney may offer proof of the reasonableness of fees by offering testimony at the hearing, filing an answer to the motion, or both.

[5] Court May Order the Return of Any Unreasonable Fee Under Section 329

Under *section 329 of the Bankruptcy Code*, the court may either cancel the agreement or order the return of a payment, to the extent excessive, to either the estate or to the entity that made the payment. Payment to the estate will be ordered if the property transferred would have been property of the estate or was to be paid by or on behalf of the debtor under a chapter 13 plan. Thus, the relief granted on the motion for examination may be a money judgment for the amount which is found to be excessive and unreasonable or, if the consideration received by the attorney was in the form of a transfer of property or by way of a lien on the property of the debtor, the judgment will be in the form of a decree declaring the transfer or the lien null and void.

The usual remedy for overpayment under *section 329(b)* is merely a reduction of the payment to a "reasonable" amount.

When a court with proper jurisdiction orders restoration of the payment, a failure to obey is civil contempt of court.ⁿ¹⁰ An attorney not complying with the order to refund the transfer, or rescind the agreement is, therefore, subject to imprisonment. The attorney cannot be imprisoned, however, if it is shown that the attorney cannot comply with the order. The attorney must categorically and in detail swear to the extent of the present resources of all kinds and show what became of the money taken in order to purge the contempt.ⁿ¹¹

[6] Making a Record on Fee Issues

Regardless of the way the fee request comes to the court's attention, the matter must be given the same type of careful consideration required by the Rules for any other type of proceeding. A final (as opposed to interim) order on fees is a final appealable order.ⁿ¹² In cases likely to be appealed, all parties must be careful that there is evidence in the record to support their positions. Although written findings of fact are not necessary in the typical fee request, they are important where a substantial issue is likely to arise. If the bankruptcy court does not make such findings, it should be specifically requested to do so, in order to create an adequate record for appellate review.ⁿ¹³

Where the record evidences the hours reasonably spent and the bankruptcy court gives no specific reason for reducing fees below the amount requested, an appellate court may reverse the reduction of fees as an abuse of discretion.ⁿ¹⁴

FOOTNOTES:

(n1)Footnote 1. *See 9 Collier on Bankruptcy, P 2017.10* (Matthew Bender).

(n2)Footnote 2. *See 11 U.S.C. § 541.*

(n3)Footnote 3. *Rule 2016* governs compensation from property of the estate. Property of the estate includes earnings during a pending chapter 12 or 13 case. *See 11 U.S.C. §§ 1207(a)(2), 1306(a)(2).*

(n4)Footnote 4. *See In re Busy Beaver Bldg. Centers, Inc., 19 F.3d 833, 30 C.B.C.2d 1264 (3rd Cir. 1994)* (bankruptcy court has power to review fees *sua sponte* even if neither U.S. trustee nor any other party objects to fees).

(n5)Footnote 5. *In re Pierce, 809 F.2d 1356 (8th Cir. 1987).*

(n6)Footnote 6. *Rule 9014* requires service of process in accordance with *Rule 7004*.

(n7)Footnote 7. *See, In re Eliapo, 468 F.3d 592 (9th Cir. 2006)* (attorney should have been granted opportunity for a hearing on disputed fees); *In re Pfleghaar, 215 B.R. 394 (B.A.P. 8th Cir. 1997)* (attorney entitled to evidentiary hearing before bankruptcy court denied his fee application).

(n8)Footnote 8. *In re Falk, 30 F.2d 607 (2d Cir. 1929).*

(n9)Footnote 9. *In the Matter of Olen, 5 C.B.C.2d 944, 15 B.R. 750 (Bankr. E.D. Mich. 1981).*

(n10)Footnote 10. *Slattery v. Dillon, 17 F.2d 347 (9th Cir. 1936).*

(n11)Footnote 11. *In re Byrd Coal Co., 83 F.2d 256 (2d Cir. 1936).*

(n12)Footnote 12. *See In re Spillane, 884 F.2d 642 (1st Cir. 1989).* *Cf. In re Boddy, 950 F.2d 334 (6th Cir. 1991)* (interim award became final when it no longer could be modified by the court); *In re Dahlquist, 751 F.2d 295 (8th Cir. 1985)* (interim award became final when bankruptcy case was dismissed).

(n13)Footnote 13. *In re Botelho, 3 C.B.C.2d 739, 8 B.R. 305 (Bankr. 1st Cir. 1981).* *See also In re Clark, 223 F.3d 859 (8th Cir. 2000)* (appellant attorney did not provide reviewing court transcript or other record that supported his contentions); *In re Boddy, 950 F.2d 334 (6th Cir. 1991)* (case remanded where court had not discussed how award was

calculated under lodestar method).

(n14)Footnote 14. *In re Paster*, 119 B.R. 468 (E.D. Pa. 1990) (under "lodestar" method applicable in circuit to bankruptcy fees, where court did not specifically take issue with number of hours reasonably spent and rate was not excessive, reduction of fees was abuse of discretion).



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CHAPTER 5 Considerations for Attorneys--Duties and Compensation

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P 5.06 Other Sources of Attorney's Fees in Bankruptcy Cases

The opposing party is one final source of attorney's fees often overlooked by many bankruptcy practitioners. Most practitioners are aware of the Bankruptcy Code provisions providing for attorney's fees to prevailing debtors in certain circumstances, such as proceedings to enforce the automatic stay, certain dischargeability complaints, and involuntary bankruptcy petitions. But they are often less knowledgeable about the myriad of other federal and state statutes which provide for attorney's fees to prevailing parties. Altogether there are nearly 100 such federal statutes, and many more state statutes. Among the more important of such statutes are the Civil Rights Attorney's Fee Awards Act, the Truth In Lending Act, and the Equal Access to Justice Act. However, it should be noted that the 1994 Amendments placed limitations on the amount of attorney's fees awarded against governmental units.ⁿ¹

[1] Bankruptcy Code Provisions Providing For Awards of Attorney Fees to Prevailing Debtors

[a] Enforcing the Automatic Stay

Section 362(k) of the Bankruptcy Code provides that any individual injured by a willful violation of the automatic stay will be awarded actual damages including attorney fees. However, punitive damages may be precluded if a creditor acts with a good faith belief that the stay has been terminated under section 362(h)ⁿ² and no monetary penalties may be imposed against a creditor who has not received effective notice of the stay.ⁿ³ A willful violation is one committed knowingly; no malice need be shown.ⁿ⁴ Even if a violation begins innocently, refusal to rectify it after notice of the case renders it willful.ⁿ⁵ Similarly, a willful violation occurs when a creditor fails to act affirmatively to prevent an action prohibited by the stay, *e.g.*, by failing to prevent the sheriff from selling property postpetition at a sheriff's sale.ⁿ⁶

MORE INFORMATION

For a discussion of enforcing the automatic stay *see* chapter 8 *infra*.

[b] Defending Against Fraud-Based Dischargeability Complaints

When a fraud-based dischargeability complaint is brought under *section 523(a)(2) of the Bankruptcy Code*, the debtor that successfully defends against the complaint may be entitled to an award of attorney fees from the creditor. Section 523(d) requires the creditor to pay attorney fees to the debtor if the latter prevails and the creditor's complaint was not "substantially justified." The purpose of this provision is to prevent a creditor from bringing a questionable case to

exploit the fact that the debtor must pay a lawyer to assert a meritorious defense to a dischargeability complaint; thus, whenever a creditor does not have significant evidence to support its claim, the creditor should be obliged to pay the debtor's attorney. Otherwise, the debtor will have lost money even when the case is won.

MORE INFORMATION

For a detailed discussion of procedures and strategies in dischargeability cases see chapter 26 *infra*.

The fees should be awarded for all hours reasonably expended on the litigation including appellate representation. The fact that the case was dismissed or dropped by the creditor short of a final judgment after full trial on the merits will not excuse liability for attorney fees.

[c] Defending Against Involuntary Bankruptcy Petitions

Bringing an involuntary bankruptcy can be very risky for the petitioning creditor(s). Under *section 303(i) of the Bankruptcy Code*, if the petition is not successful (and the court may dismiss⁷ the case or abstain⁸ from hearing the case), the court is authorized to award to the debtor not only attorney's fees and costs, but also compensatory and punitive damages.⁹

[2] Other Statutory Sources of Attorney Fee Awards

[a] The Civil Rights Attorney's Fees Awards Act of 1976

The Civil Rights Attorney's Fees Awards Act of 1976, section 1988 of title 42, is the most important of the myriad of state and federal statutes which provide for attorney's fees to prevailing parties. Despite its title, there are strong arguments that this law applies in every action brought under the Bankruptcy Code against state and local entities or officials.

Under these arguments, the Civil Rights Attorney's Fees Awards Act of 1976 prescribes fee awards in every action under section 1983 of title 42, which in turn is applicable to every denial of federal statutory rights under color of law. The leading case on the subject is *Maine v. Thiboutot*,¹⁰ in which the Supreme Court held that the denial of rights granted by a federal statute, in that instance the Social Security Act, gave rise to a cause of action under section 1983. There, the court held that section 1983 should be interpreted literally: the civil rights statute could be used to enforce any right created by the Constitution or laws of the United States, regardless of whether the right had a constitutional or civil rights character.¹¹

Since the Bankruptcy Code is a federal statute, the *Thiboutot* holding should be clearly applicable. Thus, any denial, under color of law, of rights granted by the Bankruptcy Code creates a cause of action under section 1983 of title 42.¹² If the plaintiff in such a case is successful, attorney's fees should be awarded under the Civil Rights Attorneys Fee's Awards Act.¹³

The ramifications of these principles are broad. In every case where a debtor seeks to enforce bankruptcy rights (arising out of any section of the Bankruptcy Code) against a county-run or municipal utility, or a state or local governmental entity, attorney's fees should be available. For example, those claims may rely upon the following provisions:

- section 525(a), prohibiting discrimination by governmental units against debtors who have filed bankruptcy cases;
- section 362, providing for the automatic stay;
- section 366, dealing with utility service; or

- section 524, dealing with the protections of discharge.

Many of these claims give rise to fee awards under the Code or under contempt theories, so arguments under section 1988 will not be necessary.

Damages and fees may also be sought under sections 1983 and 1988 from private parties acting under color of law in concert with government officials.ⁿ¹⁴ Although debtors' advocates can often receive fee awards under other theories, the possibilities for receipt of significant fees under the Civil Rights Acts should not be ignored. However, requests for fees may now be met with the argument that they must be limited to the rates set forth in section 2412(D)(2)(A) of title 28 due to the operation of *section 106(a)(3) of the Bankruptcy Code*.ⁿ¹⁵

[b] Consumer Protection Statutes

Also common, but all too often neglected, are opportunities in bankruptcy cases to bring actions under various consumer protection statutes providing for attorney's fees. A thorough familiarity with debtors' rights under these statutes can mean substantial, additional fees for bankruptcy attorneys, not to mention important benefits for their clients.

[i] Truth In Lending Act

On the federal level, the most important of these statutes is the Truth in Lending Act.ⁿ¹⁶ Section 130(a) of the Act,ⁿ¹⁷ which is applicable to every consumer credit transaction, provides for mandatory attorney's fees to successful consumer litigants. In view of the fact that the typical consumer debtor has entered into numerous transactions subject to the Act, an attorney handling a substantial number of bankruptcies is quite likely to find many potential Truth in Lending cases in his or her files.

[ii] Other Federal Consumer Protection Statutes

Other federal consumer protection statutes providing for attorney's fees include:

- the Magnuson-Moss Warranty Act;ⁿ¹⁸
- the Fair Debt Collection Practices Act;ⁿ¹⁹
- the Equal Credit Opportunity Act;ⁿ²⁰ and
- the Fair Credit Reporting Act.ⁿ²¹

[iii] State Consumer Protection Laws

Many state laws have similar provisions. These include usury statutes, laws prohibiting unfair and deceptive practices, and laws regulating collection practices or landlord-tenant relationships. A number of states require that if creditors' contracts contain a clause giving them a right to fees if they prevail in litigation with the debtor then that the obligation be reciprocal.ⁿ²²

Bankruptcy practitioners should become familiar with all such statutes which touch so frequently upon their clients' lives. In most cases, prepetition claims under these statutes may be reserved by the debtor as exempt property and then pursued by the debtor in the bankruptcy forum or elsewhere. Indeed, if they are not listed in the bankruptcy schedules, the defendant may argue that the debtor is barred from asserting them by judicial estoppel. Even if the debtor cannot exempt such claims, the trustee in a chapter 7 case will rarely have either the interest or expertise to pursue them and

will abandon them back to the debtor. In chapter 13 cases, since the debtor retains control over all property of the estate,ⁿ²³ there is no reason why such claims may not be immediately pursued if the debtor wishes.

[c] The Equal Access to Justice Act

In litigation against the federal government, an additional potential source of attorney's fees is the Equal Access to Justice Act, section 2412 of title 28. This Act provides, *inter alia*, for attorney's fees where the federal government takes a position, before or during litigation, that is not "substantially justified."ⁿ²⁴ The Supreme Court has held that more than good faith is necessary for the government to meet this test; the requirementⁿ²⁵ is for a position that is "justified in substance or in the main," "having a reasonable basis both in law and in fact." Similar fee provisions apply to litigation with the Internal Revenue Service.ⁿ²⁶

However, the Act provides that fees normally must be awarded at the relatively low rate of \$125 per hour. This rate may be adjustable, though, at least for inflation since the statute's enactment, so that it is now significantly higher.ⁿ²⁷ Obviously, despite the lack of prevailing market rates, the possibility of recovering fees in litigation against federal agencies can benefit both attorneys and their clients when fees are otherwise unavailable. It has already been utilized in the bankruptcy courts,ⁿ²⁸ and in view of the intransigent positions frequently taken by the federal government in bankruptcy cases, it is likely to be applied often.

[d] Other Statutes

Finally, it must be remembered that almost any type of action relating to the debtor's affairs may be brought under the expanded jurisdiction of the bankruptcy forum.ⁿ²⁹ It is possible that any one of the wide array of other state and federal fee-shifting statutes could be applicable in a particular case. Even a summary discussion of these statutes is beyond the scope of this guide, and the topic of fee awards has been well-covered elsewhere.ⁿ³⁰ Although the courts have differed upon the question of how these fees should be determined, all agree that they must be premised upon fair hourly rates which will serve the statutes' purpose of attracting attorneys to such cases.

FOOTNOTES:

(n1)Footnote 1. *See 2 Collier on Bankruptcy, P 106.04[1]* (Matthew Bender).

(n2)Footnote 2. *See 11 U.S.C. § 362(k)(2)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *See 11 U.S.C. § 342(g)(2)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. *See In re Ketelsen*, 880 F.2d 990 (8th Cir. 1989) ; *In re Bloom*, 875 F.2d 224 (9th Cir. 1989) .

(n5)Footnote 5. *In re Stephen W. Grosse, P.C.*, 84 B.R. 377 (Bankr. E.D. Pa. 1988) , *aff'd*, 96 B.R. 29 (E.D. Pa. 1989) , *aff'd mem.*, 879 F.2d 857 , *cert. denied sub nom.*, *Jakobowski v. Dubin*, 493 U.S. 976, 110 S. Ct. 501, 107 L. Ed. 2d 504 (1989) .

(n6)Footnote 6. *Matter of Sams*, 106 B.R. 485 (Bankr. S.D. Ohio 1989) .

(n7)Footnote 7. *11 U.S.C. § 707(a)*.

(n8)Footnote 8. *11 U.S.C. § 305(a)*.

(n9)Footnote 9. *11 U.S.C. § 303(i)*. *See In re Reid*, 854 F.2d 156 (7th Cir. 1988) .

(n10)Footnote 10. *448 U.S. 1*, 100 S. Ct. 2502, 65 L. Ed. 2d 555 (1980) .

(n11)Footnote 11. *Maine v. Thiboutot*, 448 U.S. 1, 8, 100 S. Ct. 2502, 2506, 65 L. Ed. 2d 555, 562 (1980) . But cf. *Middlesex County Sewerage Authority v. National Sea Clammers Assoc.*, 453 U.S. 1, 101 S. Ct. 2615, 69 L. Ed. 2d 435 (1981) in which this holding was somewhat modified as to some statutes.

(n12)Footnote 12. *Almand v. Benton County, Arkansas*, 145 B.R. 608 (W.D. Ark. 1992) (cause of action under section 1983 for violations of automatic stay).

(n13)Footnote 13. *In re Watts*, 93 B.R. 350 (E.D. Pa. 1988) , rev'd on other grounds, 876 F.2d 1090 (3d Cir. 1989) ; *Higgins v. Philadelphia Gas Works*, 54 B.R. 928 (E.D. Pa. 1985) ; *In re Gibbs*, 12 B.R. 737 (Bankr. D. Conn. 1981) .

(n14)Footnote 14. *Almand v. Benton County, Arkansas*, 145 B.R. 608 (W.D. Ark. 1992) (cause of action under section 1983 for violations of automatic stay against parties who participated in wrongful execution).

(n15)Footnote 15. See 2 *Collier on Bankruptcy*, P 106.04[1] (Matthew Bender).

(n16)Footnote 16. 15 U.S.C. §§ 1601-1677. See generally 1 Debtor-Creditor Law ch. 2 (Matthew Bender).

(n17)Footnote 17. 15 U.S.C. § 1640(a).

(n18)Footnote 18. 15 U.S.C. §§ 2301-2312. See generally 5 Forms and Procedures Under the *Uniform Commercial Code*, Article 2 Pt. 2A (Matthew Bender).

(n19)Footnote 19. 15 U.S.C. §§ 1692-1692o. See generally 1 Debtor-Creditor Law ch. 4 (Matthew Bender).

(n20)Footnote 20. 15 U.S.C. §§ 1691-1691f. See generally 1 Debtor-Creditor Law ch. 4A (Matthew Bender).

(n21)Footnote 21. 15 U.S.C. §§ 1681-1681t. See generally 1 Debtor-Creditor Law ch. 7 (Matthew Bender).

(n22)Footnote 22. See, *In re Martinez*, 416 F.3d 1286 (11th Cir. 2005) (debtor awarded fees for successful dischargeability defense under Florida reciprocal fees statute). *In re Nealy*, 139 B.R. 48 (D. D.C. 1992) (awarding fees incurred in dischargeability proceeding based on contract clause that provided that creditor would pay debtor's fees if debtor prevailed in collection litigation). But see *In re Johnson*, 756 F.2d 738, 12 C.B.C.2d 573 (9th Cir. 1985) (California statute providing for attorney's fees to prevailing party in any action or a contract which contains an attorney's fee clause not applicable to motion for relief from automatic stay).

(n23)Footnote 23. 11 U.S.C. § 1306(b).

(n24)Footnote 24. 28 U.S.C. § 2412(d). See *Dougherty v. Lehman*, 711 F.2d 555 (3d Cir. 1983) .

(n25)Footnote 25. *Pierce v. Underwood*, 487 U.S. 552, 563-564, 108 S. Ct. 2541, 2549, 101 L. Ed. 2d 490, 504 (1988) .

(n26)Footnote 26. 26 U.S.C. § 7430. *In re Chambers*, 140 B.R. 233 (N.D. Ill. 1992) (bankruptcy court was "court of the United States" that could award fees under section 7430 of title 26); But see *In re Grewe*, 4 F.3d 299 (4th Cir. 1993) , cert. denied, 114 S. Ct. 1056 (1994) (fees under section 7430 of title 26 denied because debtors did not exhaust administrative remedies); *In re Graham*, 981 F.2d 1135, 28 C.B.C.2d 78 (10th Cir. 1992) (fees could not be awarded under section 7430 of title 26 if government's position was not substantially unjustified *ab initio*); *In re Brickell Inv. Corp.*, 922 F.2d 696, 24 C.B.C.2d 731 (11th Cir. 1991) (bankruptcy court not a "court of the United States" for purposes of awarding fees under *Internal Revenue Code* section 7430, section 7430 of title 26; however, party may seek fees under this section by following procedures for non-core proceedings to obtain judgment of the district court).

(n27)Footnote 27. 28 U.S.C. § 2412(d)(2)(A).

(n28)Footnote 28. *O'Connor v. United States Dep't of Energy*, 942 F.2d 771, 25 C.B.C.2d 539 (10th Cir. 1991) (bankruptcy court had jurisdiction to award fees under Equal Access to Justice Act). *But see In re Davis*, 899 F.2d 1136, 23 C.B.C.2d 555 (11th Cir. 1990) (bankruptcy court did not have jurisdiction to award fees under Equal Access to Justice Act, and fee award could only be entered by district court upon recommended findings of fact and conclusions of law supplied by bankruptcy court).

(n29)Footnote 29. See 1 Collier on Bankruptcy, ch. 3 (Matthew Bender) for a discussion of bankruptcy court jurisdiction.

(n30)Footnote 30. Collier Bankruptcy Compensation Guide (Matthew Bender); Derfner and Wolf, Court Awarded Attorney Fees (Matthew Bender).



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CHAPTER 6 Commencement of the Case

1-6 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter provides a detailed step-by-step description of how to prepare and file the forms used in a typical bankruptcy case. It discusses the petition which commences the case, the statements and schedules the debtor is required to file, and other miscellaneous forms that must sometimes be filed at the beginning of a chapter 7 or chapter 13 bankruptcy case. The chapter 13 plan, which is also often filed at the outset of the case, is discussed in chapter 14 *infra*.



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CHAPTER 6 Commencement of the Case

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P 6.01 General Principles

Preparing a bankruptcy case is mostly a matter of gathering documents and filling in the blanks on a standard set of forms. As with any legal document, an important goal is to convey information as clearly and completely as possible. If necessary, the preparer should not hesitate to supplement the answers given with notes indicated by asterisks or otherwise. It is reassuring to remember that mistakes made in completing the forms may ordinarily be corrected later without great difficulty by amendment.ⁿ¹

FORMS

For examples of completed forms used in the commencement of a case see *Collier Consumer Bankruptcy Forms*, Part CS10 (Matthew Bender).

In answering the various questions posed in the Official Forms, it is important to have a general understanding of the purpose of those questions. The overall purpose is to give the court, the trustee, and the creditors a full and accurate picture of the debtor's case. Knowing the reason for a question enables the debtor's attorney to ensure that the question is answered in a way that provides the necessary information.

Knowing the purpose of a question is also important in presenting the client's case in the best possible truthful light. For example, in questions of property valuation, estimates on the low side of a possible range of values (often forced sale value) are usually used to maximize the amount of property that can be claimed within the dollar limits of the exemptions allowed. Similarly, it is often important to give a low estimate of the amount of a claim against the debtor, taking into account all possible defenses and setoffs, if it may not be fully eliminated by the discharge. However, these general rules cannot be applied in every case. In some instances it may be advantageous to give a higher estimate of the value of an encumbrance on a piece of property if the strategy is ultimately to have the trustee decide to abandon the property because it has no equity available for creditors. In others, property should be given a higher estimated value to preclude a creditor that is likely to seek relief from the stay from arguing that the debtor has admitted to having no equity in the property.

MORE INFORMATION

Chapter 13 *infra* provides a detailed discussion of the claim of exemptions. Chapter 28 *infra* examines

abandonment. Chapter 10 *infra* outlines the grounds for relief from the automatic stay.

In every case it should be borne in mind that the trustee and creditors will have an opportunity (of which they may or may not make good use) to examine the client concerning the information given.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 1009. See P 6.02 infra* for discussion of amendment procedures.



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CHAPTER 6 Commencement of the Case

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P 6.02 Mechanics of Form Preparation

[1] In General

Some bankruptcy practitioners who do not handle large numbers of cases make use of bankruptcy forms printed by various commercial suppliers. These forms are usually available from sellers of legal stationery for about eight to fifteen dollars a set. Those handling more substantial numbers of bankruptcy cases generally use computer programs, which prepare all the necessary documents. *Collier Topform* is an example of such a program. In almost judicial districts, electronic filing of bankruptcy forms is required or permitted. Electronic filing can be a great convenience, especially for offices located at some distance from the courthouse. Eventually, it is expected that all districts will permit electronic filing, so it is important to find a program, such as *Collier Topform*, that is compatible with the standards for electronic filing set by the bankruptcy courts. For offices which do not have a computer program, photocopying of blank Official Forms is another alternative. (Unlike commercial form sets, the Official Forms are government-produced documents and hence not copyrighted.)

FORMS

The Official Forms are reproduced in *Collier Consumer Bankruptcy Forms*, Part CS10 (Matthew Bender).

The Advisory Committee Note to *Federal Rule of Bankruptcy Procedure 9009* states that the forms used should substantially comply with the Official Forms. The Introduction and General Instructions for the Official Forms state that a form will be in substantial compliance if it contains the complete substance of the information required by the Official Forms. This means, for example, that typefaces can be changed and that the instructions in the forms can be deleted. Of course, when necessary, continuation sheets may be attached to provide complete information.

The instructions also state that courts may not reject forms because they are presented in novel or unfamiliar formats. The only requirements other than complete substantive information are that the forms be printed on one side only, with two prepunched holes at the top of the document and an adequate top margin so that the caption and text are not obscured. In many localities, the requirement of prepunched holes is waived.

In filling out the forms, it is important to check boxes which state "none," if "none" is the appropriate answer. Additionally, if the answer to a question is "none" or "not applicable" it is necessary to so indicate. However, where

multiple choices are contained in the Official Form, it is acceptable to file a form which contains only the choice selected.

It is also acceptable, especially in emergency situations, to file legible handwritten forms or to indicate that required information is the most complete available and that it will be supplemented by amendment or otherwise.ⁿ¹

All of the official bankruptcy forms include spaces for the information which must be provided by nonattorney bankruptcy petition preparers under *Bankruptcy Code section 110*. The failure to provide this information will lead to serious sanctions against a petition preparer.ⁿ²

[2] Electronic Document Filing

All bankruptcy courts now require or permit documents to be filed electronically, including the petition that commences the case.ⁿ³ All courts also make possible electronic access over the Internet to the full text of all filed documents.

The rules and mechanisms for electronic filing vary somewhat from court to court, so local rules must be consulted. Generally, courts require documents to be filed in Adobe Acrobat's PDF format, and attorneys who file documents must provide a credit card to which any filing fees or access fees may be charged.

Electronic filing of documents enables attorneys in bankruptcy cases to save time and money, avoiding trips to the courthouse, messenger fees, and copying fees. The system enables emergency filings and, often, instant notice of and access to documents filed by other parties to a case. Documents may be filed at any time of the day or night.

The Collier TopForm Bankruptcy Filing Program is capable of filing documents electronically and is compatible with the equipment in every district.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 1009* allows amendments to be made as a matter of course, at any time before the case is closed. *See P 6.11 infra*.

(n2)Footnote 2. *11 U.S.C. § 110*. *See 2 Collier on Bankruptcy*, ch. 110 (Matthew Bender).

(n3)Footnote 3. Electronic filing is authorized by *Fed. R. Bankr. P. 5005(a)(2)*, in courts that have, by local rules, established procedures consistent with Judicial Conference standards. Information on courts' progress in moving to electronic filing is available from the local courts' web sites, accessible through www.uscourts.gov, or from the PACER web site at <http://pacer.psc.uscourts.gov>.



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CHAPTER 6 Commencement of the Case

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P 6.03 Papers Necessary at the Outset of a Bankruptcy Case

[1] Papers Which Must Be Filed at the Time Case Is Commenced

It is sometimes necessary to file a bankruptcy immediately in order to utilize the automatic stay to stop some possibly imminent harm, such as a foreclosure sale or repossession, from befalling a client. In such cases, it is often impossible to gather the necessary information and prepare all of the required papers before the bankruptcy case has to be filed.

MORE INFORMATION

Chapter 8 *infra* provides a detailed discussion of automatic stay.

Fortunately, the Bankruptcy Rules contemplate this problem. A debtor may commence a case by filing only:

- the three-page bankruptcy petition,ⁿ¹ which is the pleading that actually seeks relief from the court; and
- a list of the debtor's creditors, codebtors, and parties to executory contracts or unexpired leases, providing and their addresses.ⁿ²

Local rules dictate the required number of copies of these forms when they are not filed electronically.

The debtor must also submit to the clerk with the petition a verified statement of the debtor's social security number and any other tax identification number, or a statement that the debtor has no such number.^{n2a} This document is not "filed" with the court, so it does not become a part of the case file available to the general public.

The filing must be accompanied by the filing fee, an application to pay the fee in installments,ⁿ³ and, if possible, an application for waiver of a portion of the fees,^{n3a} or, if appropriate, an application for waiver of the chapter 7 filing fee.ⁿ⁴ The current fee for commencing a chapter 7 case is \$299 and for commencing a chapter 13 case is \$274.

FORMS

For a form used in applying to pay the filing fee in installments (Official Form 3A) and a form used in

applying for a waiver of the chapter 7 filing fee (Official Form 3B) *see Collier Consumer Bankruptcy Forms, Forms CS10.02-2, CS10.02-3* (Matthew Bender).

After these few documents are filed, the Rules require that the remainder of the initial bankruptcy forms and documents, *i.e.*, the statements, schedules, payment advices, credit counseling certificate, disclosure of attorney's fees and, in chapter 13, the plan, be filed within 14 days.ⁿ⁵ The court may further extend the deadline for all of the forms upon motion, for cause shown, on notice to the trustee and United States trustee.ⁿ⁶

If the remaining required forms are not filed, the case is usually dismissed. However, it cannot be assumed that the case will always be dismissed.^{n6a} A chapter 13 case may be converted to chapter 7.ⁿ⁷ And, if creditors or the trustee object to dismissal of a chapter 7 case, the court may allow the case to proceed.

[2] Papers Which Must Be Filed Either with the Petition or Shortly Thereafter

Normally, a consumer bankruptcy case is started by filing several documents along with the petition. In each case, the debtor must file:

- a statement of financial affairs;
- schedules listing assets, liabilities and other information;
- statement of current monthly income and means test calculation or disposable income calculation; and
- a disclosure of attorney's fees paid or promised.ⁿ⁸

In a *chapter 7* case in which there are consumer debts secured by the debtor's property, the debtor must also file:

- a statement of intention with respect to property securing debts and personal property subject to an unexpired lease.ⁿ⁹

In a *chapter 13* case, the debtor must also file:

- a chapter 13 plan.

MORE INFORMATION

Chapter 13 plans are discussed extensively in chapter 14 *infra* .

Several other forms and documents are required.^{n9a} These include:

- certification from a credit counseling agency;
- records of payments from employment; and
- certain tax recordsⁿ¹⁰
- record of interests in education savings accounts

Additionally, notice of any interests in an education IRA, as required by section 541(b)(5), should now be filed as part

of schedule B.

Local rules may also require one or two other papers. One form commonly mandated is a form summarizing the plan in a chapter 13 case.

The Federal Rules of Bankruptcy Procedure do not state the number of copies of the statements and schedules to be filed, leaving that matter to local rules.ⁿ¹¹ The Rules require only one copy of the chapter 13 plan and fee disclosure statement,ⁿ¹² though local rules may impose additional requirements.

If paper forms are filed, with the possible exception of documents required by local rule, all of the forms usually may be filed in a single package. Many courts require two holes to be punched at the top of the forms when the documents are not filed electronically. Local practices regarding these procedures vary and should be checked. In any event, the clerk is not permitted to reject the filing of any paper because it is not presented in proper form.ⁿ¹³ However, the court may thereafter require that a defective filing be corrected and dismiss the case (after notice and a hearing) if it is not.

FOOTNOTES:

(n1)Footnote 1. *See P 6.05 infra*.

(n2)Footnote 2. Many courts require this list to be in a specified form, sometimes known as the "mailing matrix," for the creation of mailing labels or for optical scanning or require a separate matrix. Local rules and practice should be checked.

(n3)Footnote 2a. *Fed. R. Bankr. P. 1007(f)*. The Statement should conform to Official Form 21.

(n4)Footnote 3. *See 9 Collier on Bankruptcy, P 1006.03*.

(n5)Footnote 3a. Certain filing fees are waived, but only in very limited circumstances. *See 9 Collier on Bankruptcy, P 1006.04* (Matthew Bender).

(n6)Footnote 4. *See 28 U.S.C. 1930(f)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n7)Footnote 5. *Fed. R. Bankr. P. 1007(c), 3015*. The statement of intentions with regard to property securing consumer debts has a somewhat different deadline. *See P 6.09 infra*.

(n8)Footnote 6. *Fed. R. Bankr. P. 1007(c), 3015*.

(n9)Footnote 6a. *11 U.S.C. § 521(i)* provides for "automatic" dismissal if various forms are not filed within 45 days of the petition. Courts have struggled with what this means. *See § 23.02[2][b] infra*. Most courts provide the debtor with some notice that the papers filed are incomplete prior to this deadline, giving the debtor the chance to correct the deficiency.

(n10)Footnote 7. *11 U.S.C. § 1307(c)*. *See ch. 24 infra*.

(n11)Footnote 8. *Fed. R. Bankr. P. 1007(b)*. *See ch. 5 supra*.

(n12)Footnote 9. *See P 6.09 infra*.

(n13)Footnote 9a. *See P 6.12 infra*.

(n14)Footnote 10. Some tax records must be submitted directly to the court, some are provided to the trustee, and others must be submitted to the appropriate taxing authority. *See 11 U.S.C. § 521(e)(2), (f); 11 U.S.C. § 1308*.

(n15)Footnote 11. The former rules specifying the number of copies required were abrogated by the 1987 amendments to the rules.

(n16)Footnote 12. *Fed. R. Bankr. P. 3015*, 2016.

(n17)Footnote 13. *Fed. R. Bankr. P. 5005(a)*.



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CHAPTER 6 Commencement of the Case

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P 6.04 Timing the Filing of Multiple Cases

Attorneys filing several bankruptcies during a short time period may wish to check with the clerk of the bankruptcy court as to how the date of filing affects the dates of later proceedings, such as the section 341 meeting of creditors. Especially where the court is located at some distance from the office, it is obviously a more efficient use of resources to have more than one meeting scheduled for a single date.

PRACTICE NOTE

This often can be accomplished by filing several bankruptcy cases simultaneously. Even if the cases cannot be filed together, however, it is worthwhile to check with the court, the trustee, or the United States trustee on the possibility of having several cases scheduled for meetings on the same day. (This must be done promptly, since the notice of the meeting of creditors is usually sent out shortly after the case is filed.)



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P 6.05 The Bankruptcy Petition (Official Form 1)

[1] In General

The actual bankruptcy petition, which is the pleading that officially commences a case, is a three-page form with boxes for information to be filled in as appropriate and an attached Exhibit D.ⁿ¹ Its content is prescribed by the Official Forms.^{n1a}

FORMS

For the form for voluntary petitions see *Collier Consumer Bankruptcy Forms, Form CS10.02-1* (Matthew Bender).

The petition must include all names, including fictitious or trade names, the debtor has used over the previous eight years, and the last four digits of debtor's social security number. In a similar vein, the petition requests basic information about the chapter chosen by the debtor, the type of case being filed (individual, joint, partnership, corporate or otherwise), the number of creditors and the debtor's assets and liabilities, bankruptcy cases filed by the same debtor within the prior eight years, and pending relatedⁿ² cases. This information is requested because a discharge in a prior case could bar a discharge in the present case.ⁿ³ Additionally, dismissal of the prior case within 180 days of the present case may render the debtor ineligible for relief.ⁿ⁴ If there is a pending related case, the new bankruptcy case will usually be assigned to the judge who is handling the related case.

The debtor must certify in Exhibit D to the petition whether he or she has received counseling from an approved budget and credit counseling agency within the 180-day period preceding the filing of the petition or whether the debtor is requesting a waiver of such requirement. The petition also requests certain information to establish that the debtor(s) meet the basic venueⁿ⁵ and jurisdictional prerequisites for the chapter selected. Debtors who reside as tenants in residential property must also provide certain information if their landlord has obtained a judgment for possession of the property against them.

The petition in every consumer chapter 7 case must also contain an averment by the debtor that he or she is aware of and understands the choice available between relief under chapter 7, chapter 11, chapter 12, and chapter 13 *of the Code*. This averment is contained in the box in which the debtor signs the petition. In addition, to reinforce the importance of an informed choice between chapters, every consumer chapter 7 bankruptcy petition must contain a separately signed

declaration by the debtor's attorney that he or she has explained the relief available under chapters 7, 11, 12 and 13 and delivered to the debtor the notice required by section 342(b) (Exhibit B). Thus, the attorney for a consumer chapter 7 debtor must sign the petition in two places.

Finally, every debtor must indicate, by checking a box, whether he or she owns or possesses property that poses or has been alleged to pose an imminent threat of identifiable harm to public health or safety. For debtors who do own such property, the possible harms must be identified on Exhibit C to the petition, to notify the trustee who might be responsible for the property and other parties who might have a need to know.

The petition must be filed with the clerk of the bankruptcy court, who transmits a copy to the United States trustee.ⁿ⁶ Except for occasional problems concerning venue, whether a particular debtor is eligible for the relief requested because of a prior case, or whether the debtor is eligible for chapter 13, the petition itself rarely gives rise to an issue in a case. Even with respect to the last of these issues, the court normally refers to the schedules rather than the petition in deciding the issue.

PLANNING NOTE

However, if a debtor wishes to take a particular litigation position during the case, the debtor should be careful not to complete the petition in a manner inconsistent with that position. Thus, if the debtor plans to argue that his or her debts are not primarily consumer debts for purposes of a possible dismissal motion under section 707(b),ⁿ⁷ the debtor should not indicate that the nature of debts is "nonbusiness/consumer" and should not sign the declaration for debtors who have primarily consumer debts.

[2] Petition for an Infant or Incompetent Person

Section 109 of the Code, setting eligibility requirements for bankruptcy debtors, in no way disqualifies an infant or an incompetent person from being a debtor. Infants, though they generally may not enter into binding contracts, may need relief, for example, if property that they own is threatened with foreclosure or the consequences of the acts of others. Under section 102, a claim against an infant's property is deemed a claim against the infant if the infant files a bankruptcy case.ⁿ⁸ A person who is incompetent could face similar problems. Alternatively, such a person may have incurred debt prior to becoming incompetent or because someone took advantage of the person's diminished capacities.

Federal Rule of Bankruptcy Procedure 1004.1 provides a procedure for filing a case on behalf of an infant or incompetent person. If a representative exists under nonbankruptcy law, that person has the authority to file for an infant or incompetent person. The Rule does not define representative, but gives as examples a general guardian, committee, conservator, or similar fiduciary. If no representative exists, then the petition may be filed on behalf of an infant or incompetent person by a next friend. The rule thus appears to prohibit such a filing by a next friend if a representative does exist.

Because the rule is permissive, it does not answer the question of whether someone for whom a legal representative has been appointed may file a petition without the participation of the representative.ⁿ⁹

Rule 1004.1 also requires the court to appoint a guardian ad litem for an infant or incompetent person who is not otherwise represented or to make such other orders as proper for the protection of the infant or incompetent person. Normally, if the petition is properly filed by a next friend, that person can continue to proceed on behalf of the debtor.

FOOTNOTES:

(n1)Footnote 1. Exhibit A pertains to certain business cases, so is not included in individual cases. Exhibit B is included in the three-page Petition, and Exhibit C is attached only if the debtor has potentially hazardous property.

Exhibits B and C are discussed below.

(n2)Footnote 1a. Official Form 1.

(n3)Footnote 2. A case is defined as related if filed by a spouse, partner or affiliate of the debtor.

(n4)Footnote 3. *11 U.S.C. § 727(a)(8), (9). See 6 Collier on Bankruptcy, P 727.11 (Matthew Bender); 2 Collier Bankruptcy Manual, P 727.11 (Matthew Bender).*

(n5)Footnote 4. *11 U.S.C. § 109(g). See 2 Collier on Bankruptcy, P 109.08 (Matthew Bender); 1 Collier Bankruptcy Manual, P 109.08 (Matthew Bender).*

(n6)Footnote 5. *See 1 Collier on Bankruptcy, P 4.01 (Matthew Bender), 1 Collier Bankruptcy Manual, P 4.01 (Matthew Bender) for discussion of proper venue for cases under 28 U.S.C. § 1408(1). Venue problems occur most often with debtors who have recently moved or who are employed in a judicial district other than that in which they reside.*

(n7)Footnote 6. *Fed. R. Bankr. P. 1002.*

(n8)Footnote 7. *See ch. 23 infra.*

(n9)Footnote 8. *11 U.S.C. § 102(2).*

(n10)Footnote 9. *See, e.g., In re Woods, 248 B.R. 322 (Bankr. W.D. Tenn. 2000) (petition dismissed because it was not authorized by debtor's conservator).*



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P 6.06 Notice from the Clerk of Chapters Under Which Relief Is Available

Section 342(b) of the Code requires the clerk of the bankruptcy court to give each consumer debtor a notice indicating each chapter under which such individual may proceed, prior to the filing of the petition.ⁿ¹ When this requirement was first added, some clerks had required the debtor to file a form acknowledgment of notice from the clerk regarding the types of relief available to satisfy the dictates of section 342(b). Under the 2005 amendments, the debtor's attorney must certify on the petition that the notice has been given to the debtor, so in effect the debtor's attorney must give the notice.^{n1a} This certification is part of Exhibit B in Official Form 1, the bankruptcy petition.

Based upon these provisions, the debtor's attorney should deliver the notice to the debtor and sign the certification to comply with section 521(a)(1)(B)(iii).ⁿ² The Administrative Office of United States Courts has promulgated a form of notice, so it is safest simply to use this form.ⁿ³

FORMS

See Collier Consumer Bankruptcy Forms, Form CS10.04-1 (Matthew Bender).

FOOTNOTES:

(n1)Footnote 1. *See 3 Collier on Bankruptcy, P 342.03 (Matthew Bender); 1 Collier Bankruptcy Manual, P 342.03 (Matthew Bender).*

(n2)Footnote 1a. *11 U.S.C. § 521(a)(1)(B)(iii)*, enacted by Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005; Official Form 1.

(n3)Footnote 2. To the extent not covered by the section 342(b)(1) notice, and within three days of first providing bankruptcy assistance to the debtor, section 527(a)(2) requires a debt relief agency to also provide a notice to the debtor containing various other disclosures about the bankruptcy process. *See ch. 15, infra*. Attorneys may want to provide the notices required by these sections to the debtor at the same time. *See 1 Collier Consumer Bankruptcy Forms, Form CS4.03-4 (Matthew Bender).*

(n4)Footnote 3. The form is reprinted in *1 Collier Consumer Bankruptcy Forms, Form CS4.03-2 (Matthew Bender).*



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 6 Commencement of the Case

1-6 Collier Consumer Bankruptcy Practice Guide P 6.07

P 6.07 The Bankruptcy Schedules (Official Form 6)

Each individual debtor who files a bankruptcy case, under any chapter, must submit schedules A through J (Official Form 6). The main purpose of these schedules is to give an exact picture of the debtor's assets, liabilities, and budget, as of the date of filing, in a uniform manner that facilitates administration of the case. This section describes generally how the schedules are to be completed, but local rules may impose additional requirements, such as a requirement to alphabetize creditors.

FORMS

For forms of schedules see *Collier Consumer Bankruptcy Forms, Form CS10.42-1* (Matthew Bender).

[1] Schedules A, B and C: The Debtor's Property

[a] Schedule A: Real Property

Schedule A is the list of the debtor's real property. In this schedule the debtor must list all legal, equitable and future interests in real property. As with all the schedules, if the debtor has no such interests, the debtor should state "none." Leasehold interests must be listed separately in Schedule G.ⁿ¹ If the debtor's interest in a particular property is other than a full possessory interest in fee simple (as in the case, for example, of a life estate or the beneficial interest in property held in trust), a careful description of the debtor's actual interest should be provided. Similarly, if there are limits on the debtor's access to the property (as, for example, in some divorce agreements), the nature of the limitation should be described.^{n1a} It is more important to list accurately the nature of the interest, than to fit it to the available space. Footnotes or supplemental pages should be supplied when necessary.

If the debtor is married, the schedule must indicate whether the property is owned by the husband, the wife, jointly, or as community property, regardless of whether the petition is filed jointly. If the property is owned jointly, whether or not by spouses, the box describing the nature of the debtor's interest should so indicate and an appropriate adjustment reflecting the extent of the debtor's ownership interest should be made to the value.

PRACTICE NOTE

The value of the property interest should also be given without deduction for any secured debts, such as

mortgages, which are listed in the last column and described more fully in Schedule D. As noted earlier,ⁿ² value should be listed as the amount most helpful to the debtor's case that can truthfully be given. Usually, if the property is to be claimed as exempt or if it may be worth less than the amount of any liens affecting it, the best valuation will be on the low side of the possible range. If the value of a debtor's equity might exceed the exemption amount, it may be appropriate to give a value that takes into account liquidation costs a trustee would incur, such as a broker's commission, trustee's fees, trustee's professionals' fees, transfer taxes, and the interest and escrow portions of the mortgage payments that would not be made while the house is awaiting sale. The deduction of such items should be noted on the schedules to avoid any confusion. If the property is likely to be the subject of a motion for relief from stay, a higher choice may be preferable.

Sometimes, there may be uncertainty as to how to estimate the value of one spouse's undivided and unalienable interest in certain types of joint property which cannot be sold without the consent of both spouses. In such cases, since the trustee may have a right to partition the property,ⁿ³ it is probably best to indicate the value of a one-half ownership as one half the total value of the property, but with a note explaining that the debtor could not sell his or her share for that amount. The same approach is appropriate for other interests in jointly held property where the joint owner is not a debtor. Similarly, if the debtor has a life estate or other non-fee simple interest in the property, the value assigned should account for the limited nature of the interest.

Lastly, courts vary regarding the specificity they demand in the description of real property. Usually, the address and a brief description is sufficient. Courts in some districts, however, may require a full legal description including the metes and bounds from the deed.

[b] Schedule B: Personal Property

Schedule B is a list of the debtor's personal property. Schedule B should contain a list of all of the debtor's interests in personal property together with a description and the location of the property. In addition to tangible possessions, all other types of interests should be set out in this schedule, including causes of action, eligibility for government grants such as energy assistance, security deposits with landlords or utilities, support or alimony owed to the debtor, earned income tax credits, retroactive social security awards, etc.ⁿ⁴ Property the debtor is purchasing under a rent-to-own agreement should also be listed if the debtor wants to treat the rent-to-own agreement as a credit sale rather than an executory contract.ⁿ⁵

WARNING

Because of the potential consequences of failing to list property in the schedules, it is always better to be over-inclusive, rather than under-inclusive. Failure to give a description which at least puts the trustee on notice of the likely value of the property (and of the wisdom of further inquiry) may be cause for denying an exemption of property not properly disclosed.ⁿ⁶ Similarly, an exemption or even the debtor's discharge may be denied if the debtor conceals assets.ⁿ⁷ And debtors who are entitled to tax refunds should be sure to list that entitlement on Schedule B. If the refund cannot be claimed as fully exempt and it is not practical to delay the case until after it is received, the debtor should be instructed not to spend the refund, because the trustee may demand it.^{n7a} Also, failure to schedule property that is not exempted will preclude that property from being deemed abandoned at the close of the case pursuant to *section 554(c) of the Bankruptcy Code* and, with respect to a debtor's cause of action, may give a defendant the defense of judicial estoppel.^{n7b} In egregious cases, failing to list assets may even lead to criminal prosecution. However, the debtor may sometimes rectify the failure to schedule an asset by reopening the bankruptcy case and amending the schedules.ⁿ⁸

Although the categories of property set out in Schedule B are quite detailed, it is not critical to list each piece of property in the right category as long as it is listed somewhere. Note that the instructions also require that an "x" be placed in any category for which the debtor has no property and that, for married debtors, the property be listed as that of the husband, or wife, or as joint or community property.

Further, there is considerable variation among courts as to the degree of specificity they require in descriptions of property. In view of the small values involved, some might allow low-income debtors to group property broadly in categories such as "used clothing" or "assorted household goods, each item worth under \$525."^{n8a} Others require much more specific lists. One frequently used compromise is to list major appliances and furniture, with the latter designated more or less by room, *e.g.*, "2 bedroom sets," "kitchen set," etc. It is normally a good idea also to include a catchall of "miscellaneous household goods" to cover all of the other items with values too small to warrant individual listings.

One type of property that should be listed particularly carefully is a deposit account in a bank or brokerage company. The debtor is ordinarily required to provide the trustee at the creditors meeting a copy of a statement including the amount on deposit on the petition date.^{n8b} Therefore, it is prudent to obtain the balance on the petition date before filing the schedules so that the schedules will not differ from the bank statement. If this cannot be done, it is probably a good idea to include the highest estimate of the amount in the account that can truthfully be given, since no one is likely to complain if the debtor overstates assets.^{n8c}

As for valuation, there is quite a bit of leeway. The purpose of valuation on Schedule B primarily relates to exemptions, and therefore, the fair market value standard should be used.^{n8d} Fair market value usually will take into account the proposed method of liquidation by distress sale, without deduction for liens or exemptions.ⁿ⁹ A good way to convey this concept to clients is to ask them for the "tag sale" or "garage sale" value of specific items. In completing this schedule, it is important to bear in mind the very low sale value of most used furniture and appliances. Because of this low value, the trustee will have little interest in the personal property of consumer clients, except perhaps for a few large items.

Some categories of property present more tricky problems of valuation. The value of a cause of action, for example, should be discounted for the contingency of success and ultimate collectability. These considerations should be explained by a short note. Sometimes a similar note can explicate a seemingly low valuation on other property. For example, a relatively new car given a low value might be described as "inoperable, 120,000 miles" if those were the facts. In every case, of course, the trustee and creditors will have an opportunity to demand more detail later. Amendments to the schedule are also possible.ⁿ¹⁰ Therefore, the consequences of an innocently imperfect description of assets are not grave.

Alternatively, if the value of property is truly unknown, it is often best to simply state the value as "unknown," leaving it to the trustee and creditors to assess the value on their own. This treatment of a cause of action has the advantage of ensuring that the debtor will not be accused of undervaluing it, and has been deemed sufficient by the Supreme Court.^{n10a}

As with real estate, it is important to describe accurately the nature of the debtor's interest if it is other than a full ownership interest in fee simple. A legal or beneficial interest in a trust, for example, should be explained with as much detail as possible. Similarly, in a divorce scenario, a non-filing spouse's interest in property under a state law equitable distribution provision should be described. Footnotes to the schedule or supplemental pages should be filed if necessary to provide full and complete information. Some care is also required in valuing property in which the debtor holds an unusual interest. Legal restrictions on use or access to property can lower its value.

One other question which sometimes arises in connection with Schedule B is how to treat property in which the debtor has an interest, but which does not become property of the bankruptcy estate. An example of this kind of property is the debtor's interest in certain ERISA qualified pensions.ⁿ¹¹ Because Schedule B is a list of all the debtor's property

interests and not just those that come into the estate, the best practice is to list the debtor's interest with a notation that it is excluded from the estate, together with a statutory reference. In the case of a pension and most other non-estate property, the appropriate reference will be to section 541(c)(2) or the appropriate section of 541(b). Often the claim that property is not part of the estate should be coupled with an exemption claim, raised in the alternative in Schedule C.

There may also be some doubt as to whether to list claims to future income entitlements, such as social security. Although the most cautious course is probably to list such rights, in many places the practice is not to do so.

[c] Schedule C: Property Claimed as Exempt

Schedule C is the debtor's list of property claimed as exempt. Normally, it is permissible to incorporate by reference much of the listing in Schedules A and B in order to avoid repetition. However, any cross reference should be to specific items listed since a general claim of exemption for "assets of the petitioner" probably does not satisfy the requirements of the statute.ⁿ¹² As always, though, local practice should be checked.

Schedule C must, first of all, state whether the debtor is utilizing the state exemptions or the federal bankruptcy exemptions. (Often, there is no choice because the state has opted out of the latter). Since a detailed explanation of the claiming of exemptions follows in a later chapter,ⁿ¹³ only a few other points need be made here regarding completion of this schedule.

Obviously, the goal in completing this schedule is to exempt as much as possible, preferably all of the client's property. If all property cannot be exempted, the debtor should consider exemption planning prior to filing the petition.^{n13a}

The items listed in Schedule C should be checked against Schedules A and B to be sure nothing has been inadvertently omitted. For each item, the specific applicable exemption statute should be listed. Most often, the value given in Schedule C for the exemption equals the value given in Schedules A and B, except that lien amounts can and should be deducted. If the federal exemptions are available (and under some state statutes), property which would not normally appear to be exempt may be exempted under the "wild card" exemption.ⁿ¹⁴ When exemptions contain monetary limits, two or more different exemptions that are applicable to the same property can be combined. Therefore, it should be fairly rare to completely omit any property interest from Schedule C unless it is an interest which the trustee is unlikely to liquidate.

PRACTICE NOTE

Another strategy that is effective, if the debtor has a relatively small amount of property that cannot be exempted, is to claim exemptions in a manner that will discourage the trustee from liquidating any particular item. For example, if the debtor has five valuable household items and a car, with a total value of \$2,400 over the amount that can be exempted, the debtor may exempt all but \$400 in value of each item, assuming the exemptions afford that flexibility, either through a wild card exemption or a total exemption amount for a variety of personal property items. The trustee would then be less likely to liquidate these items than if one item worth \$2,400 was not exempted.

Similarly, if not all property can be exempted, it is better to leave as nonexempt the property which the trustee is least likely to liquidate, such as a cause of action which would involve litigation expenses, or all or part of a joint interest in real estate. For example, if a debtor, using the federal exemptions, has an interest in real estate worth \$20,200 and \$3,975 in cash or other liquid assets, the debtor might exempt only \$17,200 worth of the real property interest, using the remainder of the exemption for the liquid assets under the wild card provisions of section 522(d)(5).^{n14a} Although a trustee probably would demand the nonexempt cash from the debtor, it is unlikely that the trustee would invest the time and expense necessary to liquidate a \$3,000 interest in real estate.

It is also important to exempt property as to which the right of redemption is to be exercised. Otherwise, unless the property is sure to be abandoned, the right to redeem may be jeopardized. Similarly, if property is subject to liens or transfers avoidable under section 522, the property should be claimed as exempt before the avoiding powers are exercised.ⁿ¹⁵

MORE INFORMATION

Discussion of the right to redeem and lien avoidance appears in chapters 25 and 18 *infra*, respectively.

PRACTICE NOTE

In cases of property with a value that is not readily determinable it may be necessary, in light of several recent cases, to specify that the debtor is exempting the debtor's entire interest in the property listed. Some courts have held, erroneously, that listing an item and an amount means only that the debtor has reserved that amount out of the item's total value as exempt.ⁿ¹⁶ While in most cases a fair reading of the other schedules listing that same amount as the total value of the debtor's interest in the property makes clear that the debtor indeed does intend to claim as exempt the total value of his or her interest, it may be safest to specify this fact on Schedule C itself. This should be done by stating explicitly "the debtor exempts the full amount of the estate's interest in this property," since even an exemption of "all" or "100%" may lead to questions about whether the debtor means "all of the exemption" or "all of the property."ⁿ¹⁷

It should be remembered, that Schedule C (and all the debtor's schedules) may be amended as of right at any time before the close of the case so that mistakes and oversights are easily corrected.ⁿ¹⁸ The amended schedules are then subject to objection for the time period provided in the rules.ⁿ¹⁹

[2] Schedules D, E and F: Information About Creditors

Schedules D, E and F divide all of the client's liabilities into three categories: those to secured creditors, those to unsecured creditors entitled to priority, and those to unsecured creditors without priority.

WARNING

In filling out these schedules, it is of critical importance to list the correct name and address of the creditor. If this is not done and, consequently, the creditor fails to receive notice, the dischargeability of a debt may be affected.ⁿ²⁰ For government creditors, the correct address can sometimes be obtained from a registry which the bankruptcy court clerk is required to keep.^{n20a} If a governmental unit has filed a request for listing in the registry of a particular address, use of that address ensures that no question of an incorrect address will later arise. Similarly, clerks may also make available notices of address filed by other creditors pursuant to section 342(f). Also, if the debtor knows that a person to be included on a list of creditors or in the schedules is an infant or incompetent person, the debtor should include, in addition, the name, address, and legal relationship of any person who would be served with process in an adversary proceeding brought against the infant or incompetent person in accordance with *Bankruptcy Rule 7004(b)(2)*.^{n20b} Normally, this would be the parent or guardian of the infant or incompetent person.

The other information, regarding the account number,^{n20c} the amount of debt, the date incurred, whether there are codebtors and the consideration for the claim is usually less crucial but, of course, should be answered as accurately as possible. When accurate information is unavailable, the debtor's best estimate is usually sufficient as long as it is made

in good faith. In most consumer cases, the amount listed in the schedules has little relevance, because if assets are available, they are paid according to the creditor's proof of claim rather than according to the debtor's schedules.ⁿ²¹

For joint petitions only, the debtor must list whether the debt is owed by the husband, the wife, or as a joint or community debt. The schedule should note the existence of a co-obligor (other than a spouse with whom the debtor has filed jointly) by a check in the appropriate box labeled "codebtor" and by providing the necessary information about the codebtor in Schedule H.ⁿ²²

Debtors must also indicate whether any claim is predominantly dischargeable under sections 523(a)(8)--related to student loans, 523(a)(15)--related to marital property settlements, and 523(a)(18) related to retirement fund loans. The designations are intended for statistical purposes only and are not considered an admission of the debtor concerning the dischargeability of the debt. However, if there is a chance that the amount of a debt will continue to be relevant after the bankruptcy (as with secured or nondischargeable debts), the schedules should not contain an admission of a debt larger than the debtor will later maintain to be due.

If the debt is contingent, unliquidated, or in dispute, that should be noted in the appropriate place. Whether a debt is contingent or unliquidated may be important if the debtor has large debts that make him or her ineligible for chapter 13.^{n22a} A debt is usually considered contingent if payment is not yet due and will not become due unless a particular event occurs in the future. An example of a contingent debt is a guarantor's obligation to pay a debt only if the principal obligor does not pay. A debt is unliquidated when the debtor has a legal obligation to pay some amount of money, but the amount has not yet been fixed. An example of an unliquidated debt is an auto accident claim for which the debtor acknowledges liability, but with respect to which the amount of the liability has not yet been fixed. By listing such debts and having them discharged, the debtor can often avoid having to fight over the details concerning the validity or amount of the debt.

PRACTICE NOTE

It is always wise to check the column which lists a debt as disputed if there is any doubt about the validity of the debt or the amount the creditor claims due. For example, a debtor who has been contacted by an entity that claims to have purchased a debt should mark any debt to such entity as disputed unless the debtor has been provided proof of the purchase. Noting the debt as disputed should prevent a later claim by the creditor that the schedules constitute an admission by the debtor of the validity or extent of the creditor's claim.

Since debts that are not listed are sometimes not discharged, it is of obvious importance to list every conceivable claim against the client so that the discharge may be used to maximum advantage. As discussed above in a previous chapter, this may necessitate prompting the client to remember various types and categories of frequently overlooked debts.ⁿ²³ It may also dictate scheduling debts listed on the client's credit report, even if the client does not remember them, with the notation that they are disputed.

[a] Schedule D: Secured Debts

Schedule D lists all secured creditors. This schedule should include all creditors that hold liens, even if they are undersecured, and even if their liens can later be avoided by the debtor or trustee.ⁿ²⁴ Creditors holding security deposits also should be listed here, as well as creditors holding less noticeable types of security interests, such as those in the refunds of credit insurance. Similarly, banks and other savings institutions with a right of setoff against the debtor's accounts should be considered secured for the amounts in such accounts. (But normally, with good planning, all money will be withdrawn prior to bankruptcy and therefore these creditors will be unsecured.)ⁿ²⁵ Again, if the debtor intends to treat a rent-to-own contract as a credit sale of property subject to a security interest, the rent-to-own debt

should be included in this schedule.ⁿ²⁶ There is a box in the Official Form for the debtor to check if there are no secured creditors at all.

If the debtor disputes whether a claim is secured, it should be listed in Schedule D, along with the fact that the security interest is disputed. Again, as with all of the forms, the goal should be clarity in depicting the client's affairs. As long as this is achieved, even errors as to placement in the proper schedule will not be of great importance.

PRACTICE NOTE

Although there is no place on the form to list the amount of arrears owed on a long-term secured debt such as a mortgage, it may be a good idea to include that information if the debtor has filed chapter 13 and intends to cure those arrears. This may help eliminate confusion about the nature of the debtor's plan.

Finally, some care should be taken in Schedule D to identify undersecured creditors, particularly in chapter 13, and to list the amount of the unsecured portion in the appropriate box. This may help in a later attempt to determine the creditor's allowed secured claim.ⁿ²⁷

[b] Schedule E: Priority Debts

Schedule E lists the different categories of debt that may have priority under the Code. The Official Form has boxes that should be checked to designate the types of priority debt or to note that the debtor has no priority obligations.

In order to complete this schedule, the practitioner must first determine which claims, if any, fall into the priority categories set out in *section 507 of the Bankruptcy Code*.ⁿ²⁸ If the creditor has a lien, the debt should be placed in Schedule D whether or not the creditor would otherwise be entitled to a priority, since section 507(a), which defines types of priority debts is applicable only to unsecured claims. (If there is neither a lien nor an applicable priority, the debt belongs in Schedule F as unsecured, non-priority). In some cases, only part of a debt will be entitled to priority status. With respect to each priority debt, the amount entitled to the priority should be listed separately in the appropriate column on the schedule, and the amount not entitled to priority should also be listed in the appropriate column on Schedule E, rather than on Schedule F.

PRACTICE NOTE

The most common type of priority debt owed by consumer clients is taxes. It should be noted, however, that not all tax claims are entitled to priority, and only those which are both at least partially priority claims and unsecured should be listed in Schedule E. This is especially important because priority tax claims must be paid in full in chapter 13 and they are nondischargeable in chapter 7.^{n28a} In a chapter 7 case, if there are assets in the estate, it is important to make sure that such nondischargeable tax debts are listed as priority claims and a proof of claim is filed for them so that they will be paid first. However, if there are no assets, and if there is any doubt as to priority status, the taxes should be listed in Schedule F (unless secured by a lien) so as not to make any admission as to nondischargeability.

Other types of priority debts sometimes found in consumer cases are those for domestic support obligation arrears, drunk-driving debts, wages or consumer deposits, which sometimes exist if the client had a small business, and certain debts incurred through drunk driving. There may be issues regarding whether a debt owed is a domestic support obligation and thus a priority debt, or in the nature of a property settlement and therefore not entitled to priority. A debtor in a chapter 13 case, depending upon the circumstances, may wish to argue that a debt is not a domestic support obligation debt, but is rather a property settlement which is a dischargeable general unsecured claim.ⁿ²⁹ Alternatively, the debtor may wish to argue that the debt is a domestic support obligation so that it will be accorded priority treatment and be paid first. The treatment of the debt in the debtor's schedules should be consistent with the strategy desired.

Since wages and consumer deposit claims are normally dischargeable, there need be no hesitation about listing any such possible priority claims on Schedule E in chapter 7 cases. In chapter 13, however, more care should be exercised because an admission of priority status will carry a requirement that the particular debt be paid in full under the debtor's plan.ⁿ³⁰

[c] Schedule F: General Unsecured Debts

All of the client's remaining debts are included on Schedule F. The general principles stated above apply here with equal force, and all possible claims should be listed. Often forgotten are the contingent subrogation claims which may be available to codebtors who later pay off a claim, including those on mortgages guaranteed by the Veterans Administration or Federal Housing Administration and those on guaranteed student loans. Though such persons are often unlikely to pursue the client, or even know they have a right to do so, it is good practice to list them as creditors as well, with an indication that the debt is not a separate one to be added to the total amount owed.ⁿ³¹ If this is done, codebtors will be given notice of the case, and any possible claims they have will be extinguished.

Another frequently overlooked category of debt is a continuing obligation to pay prorated amounts on a prepetition contract for services. If the contract calls for deferment of a lump sum balance due at the outset of the agreement, such as with many condominium assessments, those debts may be dischargeable in chapter 13.ⁿ³²

Courts vary on the specificity required in completing the section of the form detailing the consideration for the debt and the date the debt was incurred. In the case of credit card debts, courts will usually accept a general description such as "credit card" or "miscellaneous purchases" made on "various dates."

MORE INFORMATION

Dischargeability of condominium assessments is now addressed by *11 U.S.C. § 523(a)(16)* and is discussed in ch. 26 *infra*.

PRACTICE NOTE

Finally, even though the Official Form is not formatted to easily input an obligation that is owed to two separate creditors, it is a good idea to include both creditors in the schedule. Probably the easiest way to do this is to enter the creditors' names separately in the same box, or in two boxes with a notation that it is the same debt so that it does not affect the total. This approach is also useful with respect to an obligation assigned to another entity or to a collection agency for purposes of collection. Including both the original creditor and the collection agency or assignee in both the schedule and the mailing matrix (to assure that they both get notice of the case) ensures that any claim of either of them is discharged and neither can claim that postpetition collection attempts were due to lack of notice.

[3] Schedule G: Unexpired Leases and Executory Contracts

Schedule G, the schedule of unexpired leases and executory contracts is required in all cases. It is designed primarily to put the trustee on notice of leases or other executory contracts which might be assumed or rejected because of their potential benefit or cost to the estate.ⁿ³³ Although the issues which might be raised by the schedule are rarely of great importance in consumer cases, the schedule is not difficult to complete.

An executory contract is broadly defined as one for which significant aspects of performance remain due on both sides. An unexpired lease is one that has not yet terminated by its terms. If, as is common, the debtor has no unexpired leases or executory contracts, the debtor should check the box marked "none."

MORE INFORMATION

Chapter 15 *infra* closely examines the Code's treatment of unexpired leases and executory contracts.

For most consumer debtors, a residential lease will be the only entry on this form. These should probably be listed even if the lease is only a month-to-month oral agreement. Occasionally, the debtor may have an automobile lease or an ongoing employment contract or a pending sale agreement for goods or real estate. These should be listed as well.

In those cases which include unexpired leases or other executory contracts, the listing must include a statement of the debtor's interest. The other party to the contract may also be listed as a creditor in the applicable schedule (usually Schedule F, since there is unlikely to be a security interest or priority), particularly if there is a default on the contract. All entities listed on Schedule G must also be listed on the list of creditors filed at the outset of the case to ensure notice of the bankruptcy to them.

One other issue that may occasionally arise is how to treat a "rent-to-own" contract for consumer goods. For the reasons discussed in a later chapter, there is a significant advantage and considerable precedent for treating these contracts as security agreements rather than executory contracts.ⁿ³⁴ Consequently, the rent-to-own obligation should generally be listed in Schedule D as a secured debt.

[4] Schedule H: Codebtors

The debtor's codebtors, other than a spouse in a joint case, should be listed in Schedule H. The instructions for the Official Form provide that, in community property states, a married debtor not filing a joint case should always report the name and address of the nondebtor spouse, together with any other names used by the nondebtor spouse within the previous eight years. As discussed above, codebtors may also be listed as creditors in Schedule F due to any potential subrogation claims that could arise if the codebtors later pay off the obligation. However, even if they are not listed in that schedule, their claims are ordinarily discharged if they receive notice of the case and, in most cases, even if they do not.

MORE INFORMATION

Chapter 26 *infra* gives a detailed discussion of when lack of scheduling or notice can affect dischargeability.

[5] Schedules I and J: Income and Expenses

The last two parts of Official Form 6 are schedules I and J which require a complete disclosure of the debtor's income and expenses. Prior to the 2005 amendments to the Bankruptcy Code,ⁿ³⁵ these schedules were used to help determine "substantial abuse" in a chapter 7 case, and in chapter 13 cases allowed the trustee and interested creditors to determine whether the debtor's plan was feasible and satisfied the "ability to pay" (also known as "disposable income") test. However, the statement of current monthly income and means test calculation or disposable income calculation, discussed later in this chapter, will be the more relevant document in many of these circumstances. In chapter 13 cases, the schedules may be used to apply the "disposable income test" in cases where the debtor's disposable income is not determined under section 1325(b)(3) and to determine whether the plan is feasible under section 1325(a)(6).

[a] Schedule I: Income

Schedule I must include income for both spouses in a joint case. It must also include income for both spouses when one spouse files a case under any chapter of Title 11 individually, unless the spouses are separated. Income contributions to the debtor by persons not married to the debtor should generally be listed separately in the schedule as "other monthly income." This is of particular importance in chapter 13 cases in which the income contributions are necessary to meet

the regular income eligibility requirement or to make the plan feasible.ⁿ³⁶

When income from a business or farm is included, a detailed statement of the business revenues must be attached. When expected income is not likely to be received, such as alimony or support payments that have not historically been paid, this circumstance should be noted to present a realistic picture. Although food stamps and certain other public benefits are not treated as income for many purposes, they should nevertheless be considered income for the purpose of the bankruptcy filing. The existence of food stamps in Schedule I, for example, will be offset by the debtor's food expense in Schedule J, and may explain what otherwise appears to be an unrealistic budget.

Schedule I also requires information about the dependents. However, the schedule was amended in 2003 so that it no longer requires the debtor to list the names of minor children or other dependents and asks only their relationship.

Because the form requires information about anticipated increases or decreases in income in the year following the filing of the schedule, any significant non-speculative expected changes should be listed. For example, if unemployment benefits are due to terminate during the first year of the case, the date of termination should be given.

[b] Schedule J: Expenses

Schedule J requires information about the expenses of the debtor and the debtor's family. A box is provided in the Official Form to be checked by spouses who have filed a joint case but keep separate households. Such debtors are instructed to file separate schedules of expenditures, with the second schedule labeled "spouse." When household expenses are paid by persons whose income or contributions are not included in Schedule I, it is best to list the expense as zero with an appropriate note about how it is paid.

When there are regular expenses from operation of a farm or business, a detailed statement of those expenses must be attached. For chapter 13 cases, it is necessary to work out the debtor's plan before finishing the expense schedule, since the debtor must list on that schedule the amount to be paid into the plan. Schedule J also asks debtors to describe any anticipated increase or decrease in expenditures anticipated within the year following the filing of the schedule.

In listing the debtor's income and expenses, particularly the latter, the purposes of the forms should be kept in mind. A good faith effort to be accurate is always required, but budgets are flexible and budgeting for the future is an inexact science. Many debtors have only the vaguest idea of what they spend for various items. Moreover, their recent expenditures on things like home maintenance, clothing and health care may well have been less than the amounts really necessary, because the debtors were using their income to make debt payments. The debtor's expenses usually can be estimated, within the limits of realistic planning, in a way that presents the case in a favorable light.

PRACTICE NOTE

A catchall category, such as "miscellaneous expenses" can be added to reflect the various items not specifically listed, and other categories, such as the substantial expenses for haircuts in a large family may also need to be added. However, this is rarely likely to be a problem; the overwhelming majority of debtors filing chapter 7 bankruptcies have barely enough income to meet the most basic family expenses. Indeed, there is no requirement that a chapter 7 debtor show a positive cash flow. It is therefore quite common for chapter 7 debtors to schedule expenses substantially greater than income.

In chapter 13, the debtor's income and expenses must support the debtor's position that sufficient disposable income is available to fund the proposed plan. If, for example, the debtor's income is only barely sufficient to fund the necessary payments required under chapter 13, some care may be necessary to use the lowest possible reasonable estimates of the debtor's expenses so that the plan will not appear

infeasible. In other cases, it will be to the debtor's advantage to minimize disposable income which would otherwise be paid to unsecured creditors.ⁿ³⁷ In that event, the maximum good faith estimate of anticipated necessary expenses should be used.

It is not uncommon for debtors to estimate poorly their expenditures on items such as food, clothes, and transportation. Counsel should make every effort to get an appropriate good faith estimate that supports the debtor's goals for a chapter 13 case. Ideally, the budget will show the sum of the debtor's expenses and payments under the plan to be just a bit less than his or her income. Items frequently overlooked on the expense side are child care costs including diapers, home maintenance costs, and irregular expenses such as schoolbooks and auto maintenance.^{n37a} Because the income and expense information requested are estimates of future income and expenses, there is some latitude to go back to the debtor to obtain good faith estimates consistent with the debtor's objectives. Generally, expenses that do not exceed those permitted by the chapter 7 means test will not be questioned as unreasonable.^{n37b}

[6] Declaration Concerning Debtor's Schedules

The Official Form schedules include a separate "declaration" page. This contains the debtor's oath under penalty of perjury that the debtor has read the schedules and that they are true and correct to the best of his or her knowledge, information and belief. Joint debtors must each sign the declaration page.

The meeting with the debtor to review the schedules is another opportunity to explain the bankruptcy process as well as the purposes of the information contained in the schedules and also double check the balances in deposit accounts. It is a good idea to allow the debtor as much time as the debtor needs to read over all the schedules and statements. A practitioner can then spend some time with the debtor to explain the meeting of creditors and anything else concerning anticipated future progress of the case.

[7] The Summary of Schedules

Accompanying the schedules is a form summarizing debts, property, income and expenses. The form is self-explanatory. After the summary is filled out, it is usually inserted at the front of the schedules for filing, or elsewhere if required by local practice.

FOOTNOTES:

(n1)Footnote 1. *See P 6.07[3] infra.*

(n2)Footnote 1a. The Internal Revenue Service produces a table for valuation of life estates in Publication 1459, available at www.irs.gov.

(n3)Footnote 2. *See P 6.01 supra.*

(n4)Footnote 3. *11 U.S.C. § 363(h). See 3 Collier on Bankruptcy, P 363.08 (Matthew Bender); 1 Collier Bankruptcy Manual, P 363.08 (Matthew Bender). See also Sommer and McGarity, Collier Family Law and the Bankruptcy Code, P 2.06[3] (Matthew Bender).*

(n5)Footnote 4. A review of some of the less common types of property interests which may come into the debtor's estate is provided in ch. 3 *supra*.

(n6)Footnote 5. *See ch. 15 infra.*

(n7)Footnote 6. *Payne v. Wood, 775 F.2d 202, 13 C.B.C.2d 1047 (7th Cir. 1985), cert. denied, 475 U.S. 1085, 106 S. Ct. 1466, 89 L. Ed. 2d 722 (1986) (holding that debtors could not exempt insurance proceeds received after destruction of certain property not fairly disclosed in schedules).*

(n8)Footnote 7. *Matter of Yonikus*, 996 F.2d 866, 29 C.B.C.2d 114 (7th Cir. 1993) (contingent right to receive workers' compensation in the future not disclosed in schedules could not be exempted where court found intentional and bad faith concealment of asset). See P 29.05 *infra* for discussion of objections to discharge.

(n9)Footnote 7a. See *In re Bailey*, 380 B.R. 486 (B.A.P. 6th Cir. 2008) (trustee could demand tax refund from debtor even though debtor no longer had money); P 29.04 *infra* discussing possible denial of discharge to debtors who fail to obey orders to turn over tax refunds.

(n10)Footnote 7b. See *Vreugdenhill v. Navistar Int'l Transport Corp.*, 950 F.2d 524 (8th Cir. 1991) ; *Matter of Shondel*, 950 F.2d 1301, 26 C.B.C.2d 193 (7th Cir. 1991) (debtor's failure to list liability policy as an asset justified reopening bankruptcy case for benefit of tort liability claimant); *Krank v. Utica Mutual Ins. Co.*, 109 B.R. 668 (E.D. Pa. 1990) , *aff'd*, 908 F.2d 962 (3d Cir. 1990) (once cause of action becomes property of the estate, debtor may not bring suit unless that property is abandoned by the trustee). See also *In re Coastal Plains, Inc.*, 179 F.3d 197 (5th Cir. 1999) (debtor precluded by judicial estoppel from bringing unscheduled cause of action).

(n11)Footnote 8. *Lopez v. Specialty Restaurants Corp.* (*In re Lopez*), 283 B.R. 22 (B.A.P. 9th Cir. 2002) (debtor should have been permitted to reopen and amend to schedule cause of action because, even if claim had been intentionally concealed, asset could be administered to benefit creditors); *In re Dewberry*, 266 B.R. 916 (Bankr. S.D. Ga. 2001) .

(n12)Footnote 8a. Pursuant to 11 U.S.C. § 104(b), this amount is subject to periodic adjustment and was raised from \$475 to \$525, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$450. The adjustment is made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n13)Footnote 8b. *Fed. R. Bankr. P. 4002(b)(2)(B)*.

(n14)Footnote 8c. See *In re Pyatt*, 486 F.3d 423 (8th Cir. 2007) (rejecting holdings of some other courts that debtor had to turn over such funds after payees on checks had already cashed them), for the types of issues that can arise when debtor did not take into account outstanding uncashed checks drawn on a bank account.

(n15)Footnote 8d. The "replacement value" standard dictated in section 506 is relevant only for determining allowed secured claims and will usually be addressed in the claims process or confirmation process.

(n16)Footnote 9. Security interests and exemptions should be listed separately in Schedule D and C, respectively.

(n17)Footnote 10. *Fed. R. Bankr. P. 1009*. See P 6.11 *infra*.

(n18)Footnote 10a. *Taylor v. Freeland & Kronz*, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280, 26 C.B.C.2d 487 (1992) (cause of action described but valued as "unknown" was sufficient to put trustee on notice of the exemption).

(n19)Footnote 11. See 5 *Collier on Bankruptcy*, P 541.07[1] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 541.07[1] (Matthew Bender).

(n20)Footnote 12. *In re Andermahr*, 8 C.B.C.2d 1316, 30 B.R. 532 (B.A.P. 9th Cir. 1983) .

(n21)Footnote 13. See ch. 13 *infra*.

(n22)Footnote 13a. See P 4.07[1][b] *supra*.

(n23)Footnote 14. 11 U.S.C. § 522(d)(5). See ch. 13 *infra*.

(n24)Footnote 14a. See P 13.04[6] *infra*.

(n25)Footnote 15. Since § 522(h) allows avoidance of liens on property "which the debtor could have exempted," it may not be necessary to list the property as exempt before the lien is avoided under that section. However, since § 522(f) contains different wording, it is safer as a general practice to claim the debtor's interest in the property as exempt, with an explanatory note about planned lien avoidance if appropriate.

(n26)Footnote 16. *E.g., In re Hyman*, 967 F.2d 1316 (9th Cir. 1992) .

(n27)Footnote 17. *See In re Mercer*, 53 F.3d 1, 33 C.B.C.2d 841 (1st Cir. 1995) , *cert. denied*, 517 U.S. 1103, 116 S. Ct. 1317, 134 L. Ed. 2d 471 (1996) (claim of "100%" found to mean "100% of the available exemption").

(n28)Footnote 18. *Fed. R. Bankr. P. 1009*.

(n29)Footnote 19. *Fed. R. Bankr. P. 4003(b)* allows objections within 30 days after amendment. *See ch. 13 infra*.

(n30)Footnote 20. 11 U.S.C. § 523(a)(3). *See ch. 26 infra*. Although section 523(a)(3) is not applicable to chapter 13 cases where the debtor completes a plan, the claim of an unlisted creditor without actual notice of the case is probably also not discharged because the claim is not provided for under the plan. *See 11 U.S.C. § 1328(a)*.

(n31)Footnote 20a. *See Fed. R. Bankr. P. 5003(e)*.

(n32)Footnote 20b. *Fed. R. Bankr. P. 1007(m)*.

(n33)Footnote 20c. In 2003, Schedules D, E, and F were amended to give the debtor the option of listing only the last four digits of creditor account numbers.

(n34)Footnote 21. There may occasionally be an issue under 11 U.S.C. § 109(e) concerning debt limits for eligibility for chapter 13 to which such estimates are relevant. *See 2 Collier on Bankruptcy, P 109.06[2]* (Matthew Bender); *1 Collier Bankruptcy Manual, P 109.06[2]* (Matthew Bender). There also may be issues which arise under section 707(b) or section 1325(a)(3), (4), or (b) concerning whether the debts are primarily consumer debts, the debtor's purposes in filing, good faith or the amount which must be paid to unsecured creditors under a chapter 13 plan. At most, the amounts listed in schedule D are evidence of the debtor's belief about what such creditors are owed at the outset of the case. They should not be conclusive proof of the amount of the debt even against the debtor.

(n35)Footnote 22. *See P 6.07[4] infra*.

(n36)Footnote 22a. *See 2 Collier on Bankruptcy, P 109.06[2]* (Matthew Bender) for discussion of chapter 13 debt limits.

(n37)Footnote 23. *See ch. 3 supra*.

(n38)Footnote 24. *See chs. 17-18 infra*.

(n39)Footnote 25. *See 4.07 supra* .

(n40)Footnote 26. *See P 15.02[3] infra*.

(n41)Footnote 27. *See ch. 19 infra*.

(n42)Footnote 28. *See 4 Collier on Bankruptcy, PP 507.04-.11* (Matthew Bender).

(n43)Footnote 28a. Many taxes are also nondischargeable in chapter 13. 11 U.S.C. § 1328(a)(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Priority claims (other than for trust fund taxes) for which nonfraudulent returns are filed continue to be dischargeable. However, they must be paid

in full; they will only be discharged without full payment if the taxing authority fails to file a claim. Additionally, these claims can be paid off without interest. However, interest continues to run on nondischargeable claims

(n44)Footnote 29. Both domestic support obligation debts and marital property settlement debts are nondischargeable in chapter 7.

(n45)Footnote 30. *11 U.S.C. § 1322(a)(2)*.

(n46)Footnote 31. Though government guarantors of mortgages rarely pursue a debtor after foreclosure, the failure to discharge the personal liability to the Veteran's Administration for example may leave a debtor ineligible for a new veteran's mortgage. If the debt is discharged, the VA may not discriminate based on previous nonpayment. *11 U.S.C. § 525(a)*. See ch. 30 *infra*.

(n47)Footnote 32. See *In re Rosteck*, 899 F.2d 694 (7th Cir. 1990) (condominium assessments falling due postpetition on a prepetition contract are dischargeable).

(n48)Footnote 33. See ch. 15 *infra*.

(n49)Footnote 34. See ch. 15 *infra*.

(n50)Footnote 35. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n51)Footnote 36. See ch. 14 *infra* and 2 *Collier on Bankruptcy*, P 109.06[1] (Matthew Bender).

(n52)Footnote 37. See ch. 14 *infra*.

(n53)Footnote 37a. A discussion of frequently overlooked expenses can be found at P 3.03[3] *supra* .

(n54)Footnote 37b. See 23.02[3][b] *infra* for discussion of expenses permitted by the means test.



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CHAPTER 6 Commencement of the Case

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P 6.08 The Statement of Financial Affairs (Official Form 7)

The statement of financial affairs (Official Form 7) is also required in both chapter 7 and chapter 13 cases. Every question must be answered, but the form is simple to fill out. Each question has a box labeled "none" which should be checked if that is the appropriate response to a given question.

FORMS

See Collier Consumer Bankruptcy Forms, Form CS10.43-1 (Matthew Bender) for a sample Statement of Financial Affairs (Official Form 7).

Spouses filing a joint petition may file a single statement. In cases under chapter 12 or 13, married debtors must provide information for both spouses whether or not a joint petition is filed, unless the spouses are separated and a joint petition is not filed. Debtors engaged in business must provide the requested information for all unincorporated businesses as well as for their personal affairs.

Questions 1 to 18 must be answered by every debtor, but questions 19 to 25 are required only for debtors who have been engaged in business¹ within the six years preceding bankruptcy.

[1] Income History: Questions 1 and 2

The first two questions on the statement of financial affairs address the debtor's income history. The information to be included in response to question 1 covers the current calendar year and the two preceding calendar years, while the information sought in question 2 covers the two year period prior to the date of the bankruptcy case filing. Obviously, the income reported in these questions may be quite different from the expected future income included in Schedule I. The income figures provided should be in terms of gross income, not take-home pay.

WARNING

Although income is usually not relevant to a chapter 7 case, which deals primarily with assets and liabilities, a statement of high income or one which does not fit in with other information provided may prompt further investigation. It may also trigger an inquiry by the United States trustee or the court as to

whether the filing of a chapter 7 case is an "abuse" of that chapter.

MORE INFORMATION

The "substantial abuse" test is further discussed in chapter 23 *infra*.

[2] Transfers or Losses of Property: Questions 3 to 10

The next eight questions concern recent transfers or losses of property by the debtor. Using the responses to these questions, the trustee can sometimes avoid transfers or seek proceeds due the debtor. Since debtors themselves may exercise avoiding powers, especially with respect to executions on their property, accurate information here is important to protect these rights. Lastly, the answers to these questions could point out possible impediments to discharge, such as transfers to hinder or defraud creditors.ⁿ²

MORE INFORMATION

Chapter 17 *infra* provides a discussion of trustees' avoiding powers and chapter 18 *infra* reviews a debtor's avoiding powers. The grounds for objection to discharge are found in chapter 29 *infra*.

The first part of question three requests information about loans and other debts on which more than \$600 was repaid within the 90 days prior to the bankruptcy. The first part also asks the debtor to indicate with an asterisk any payments made on account of a domestic support obligation or paid as part of an alternative repayment schedule under a plan by an approved budget and credit counseling agency. The second part of the question pertains only to non-consumer debtors. The third part deals with payments of any amount made to or for the benefit of creditors who were "insiders" within the year prior to the bankruptcy regardless of the amount. "Insider" is defined as it is in *Code section 101*. It includes relatives and certain business relations of the debtor. "Relative" is also defined in section 101 and includes an "individual related by affinity or consanguinity within the third degree by the common law, or individual in a step or adoptive relationship within such third degree."ⁿ³

The trustee may be able to recover these payments as preferences.ⁿ⁴ Again, in most cases, the trustee will not be interested in pursuing small amounts of money, even if they are somewhat above the \$600 threshold, especially if they are not easily collectible. Local practice varies as to the specificity required in answering this question. In some places it may be sufficient to state that "monthly 'payments'" or "several payments" of a particular amount were made to some or all creditors if the aggregate to any single creditor is under \$1000 or so. If the trustee is interested, he or she may then inquire further. Even though they are not normally avoidable as preferences, payments of over \$600 to secured creditors, such as mortgagees and car lenders, must also be listed in response to this question.

Question four seeks information about all lawsuits and administrative proceedings involving the debtor which are pending or were terminated within the previous year. It also seeks the details of any execution, seizure, or garnishment in the previous year. Such transfers may be preferences or fraudulent transfers.ⁿ⁵ The information required is minimal; the debtor need only provide the caption, case number, nature of proceeding, court and status of the case.

Such information may help uncover creditor actions which can be set aside by the trustee or debtor. It also may lead to a further source of information about the debtor's affairs. In addition, property seized or levied upon may still belong to the debtor and may come into the estate if it has not been sold. The question also recognizes that lawsuits brought by the debtor may, in fact, be assets of the debtor that can benefit the estate. When such claims of the debtor are listed, they should also be included in Schedule B as property of the debtor and in Schedule C as exempt, if possible.

Question five requests information about repossessions, foreclosures, deeds in lieu of foreclosure, and returns of property. Such prepetition transfers of property may also give the trustee an opportunity to recover property for the

estate.

Question six concerning assignments and receiverships is rarely applicable to consumer cases, since those mechanisms normally concern business insolvencies in the few situations when they are still used. Like the preceding questions, this question is intended to identify property that might be recovered by the trustee and the custodians of such property.

Question seven seeks information about large gifts or charitable contributions in the year before bankruptcy. Because gifts, by definition, are without consideration, the trustee reviews the answer to this question to determine whether property may be recovered for the estate as a fraudulent transfer.ⁿ⁶ The debtor need not list ordinary and usual gifts to family members (such as birthday or holiday gifts) if they total less than \$200 per recipient. Similarly, charitable contributions aggregating \$100 or less to a single recipient need not be listed. Generally, charitable contributions are protected from trustee avoidance proceedings,^{n6a} and if the debtor's budget and, if applicable, Form 22 calculations, assert ongoing charitable or religious contributions the answer to this question should be consistent with the debtor's assertions on those forms.

Question eight, seeking information as to gambling, theft, or fire losses, is designed to explain lost assets. It is also sometimes used to smoke out dishonest debtors who use this section to account for the sudden disappearance of large amounts of property. In some cases, this question will help the trustee discover the availability of a claim to insurance proceeds which might substitute for the lost property.

Question nine seeks disclosure of payments made for debt counseling or bankruptcy within one year before the case by or on behalf of the debtor. In addition to payments made to third party debt counselors and prior attorneys, payments made in connection with the debtor's existing case to the debtor's attorney and the provider of the required prepetition credit counseling briefing should be included. Payments made by persons other than the debtor must also be disclosed. The question's purpose is to assist in court supervision of attorney's fees paid to debtors' counsel and occasionally to turn up exploitative debt counseling or other bankruptcy related scams.

The next question, number ten, again looks for transfers which can be set aside, including fraudulent transfers.ⁿ⁷ Any transfers that were not in the ordinary course of the business or financial affairs of the debtor (such as payments for normal household expenses) and that are not listed elsewhere in the statement should be listed in response to question ten. It is important to remember that the granting of a security interest is a transfer within the meaning of this question,ⁿ⁸ as is any payment to any entity not listed in answering the previous questions. Also included are involuntary transfers other than repossessions and returns.

[3] Other Information Which Must Be Supplied: Questions 11 to 18

Questions 11 and 12 concerning closed financial accounts and safe deposit boxes are designed to determine if the debtor has hidden or transferred any assets that could potentially benefit the estate. The answers to these questions, in some cases, are also used to trace the debtor's assets. Closed financial accounts must be listed, whether they were in the debtor's name or for the benefit of the debtor. They may include bank accounts, certificates of deposit, credit union accounts, pension funds, brokerage accounts, and other types of financial accounts. Safe deposit boxes must be listed only if they contained cash, securities, or other valuables within the year prior to the bankruptcy. In some jurisdictions, trustees will routinely request additional information about the contents of safe deposit boxes or statements from the closed accounts.

Question 13 requests information about setoffs by a bank or any other entity within the 90 days preceding the case, again because the trustee or debtor may have the option to recover the setoff.ⁿ⁹ Debtors who have had setoffs against their accounts during that period must list the name and address of the creditor, the date of the setoff, and the amount of the setoff.

Question 14 deals with property held by the client but belonging to another person. Especially if large amounts of such property exist, or if the property seems to encompass things that most people would own themselves, such as household goods or clothing, the trustee might inquire into this further. Property held in trust for another or in a Uniform Transfer to Minors Act account should also be listed here.

Question number 15 requests prior addresses of the debtor within the previous three years. The answer to this question sometimes provides a clue to the trustee or a suspicious creditor of additional interests of the debtor in real estate or a way to begin an investigation of potential hidden assets.

Question 16 requests information concerning spouses and former spouses, but only for debtors who have lived in community property states in the previous eight years. Such debtors must list the name of the debtor's spouse or any former spouse who resided with the debtor in a community property state. This information is necessary because the community property provisions of the Bankruptcy Code often will cause a debtor's bankruptcy case to affect the property and debts of a spouse or former spouse in a community property state, even if the spouse or former spouse has not joined in the bankruptcy case.

Question 17 seeks information concerning potential environmental liabilities of the debtor. Although few consumer debtors have such liabilities, any debtor who has received a notice that he or she may have an environmental violation, or who is subject to a judicial or administrative proceeding under an environmental law, must provide information in response to this question.

Question 18 is intended to identify debtors who have been in business in the previous six years. Every debtor must either answer the question or check the box marked "None". If the debtor has been in business, information identifying the business must be provided and questions 19-25 must be answered.

[4] Debtors Engaged in Business: Questions 19-25

Questions 19-25 are applicable only to debtors who have owned or operated businesses, including family farms, partnerships and sole proprietorships, within the six years prior to the case. Information must be provided about the business, the business books and records, inventories, present and former business partners, officers, directors, and shareholders, as well as withdrawals or distributions made to insiders.

The questions generally concern the location of books, records and inventory from the debtor's business. Questions 21 through 23 are applicable only to corporations and partnerships.

[5] Signature of Debtor

The debtor's statement of financial affairs, like the schedules, must be signed by the debtor or debtors under penalty of perjury. For almost all consumer debtors, the responses to the questions in the statement of financial affairs are routine. It is likely that the trustee will engage in little more than a cursory review of the statement and it will have little impact on the case. Obviously, though, thorough answers are appropriate, because any attempt to obfuscate is only likely to lead to problems and perhaps a claim that the debtor is seeking to hide assets. To the extent that the debtor intends to seek to recover exempt property from creditors, the answers in the statement should be consistent with the debtor's theory for that recovery.ⁿ¹⁰

FOOTNOTES:

(n1)Footnote 1. Being "in business" is defined for the purposes of Official Form 7 in the Official Form. It includes debtors who are officers, directors, managing executives or persons in control of a corporation; partners other than limited partners; sole proprietors or self-employed. Family farmers are included.

(n2)Footnote 2. *11 U.S.C. § 727(a)(2)*.

(n3)Footnote 3. *See* 2 Collier on Bankruptcy, ch. 101 (Matthew Bender).

(n4)Footnote 4. *See* ch. 17 *infra* for discussion of avoiding powers.

(n5)Footnote 5. *11 U.S.C. §§ 547, 548. See* ch. 17 *infra*.

(n6)Footnote 6. *See* ch. 17 *infra* concerning fraudulent transfers.

(n7)Footnote 6a. *11 U.S.C. §§ 544(b)(2) and 548(a)(2). See* PP 17.03 and 17.06, *infra*.

(n8)Footnote 7. *11 U.S.C. § 544; 11 U.S.C. § 548*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See* ch. 17 *infra*.

(n9)Footnote 8. *11 U.S.C. § 101. See* 2 Collier on Bankruptcy, ch. 101 (Matthew Bender); 1 Collier Bankruptcy Manual, ch. 101 (Matthew Bender).

(n10)Footnote 9. *11 U.S.C. § 553. See* ch. 17 *infra*.

(n11)Footnote 9a. *11 U.S.C. §§ 524(a)(3); 541(a)(2). See* P 29.10[4] *infra*; Collier on Bankruptcy PP 524.02[3], 541.13 (Matthew Bender); 2 Collier Bankruptcy Manual PP 524.02[3], 541.14 (Matthew Bender).

(n12)Footnote 10. *See* ch. 18 *infra*.



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CHAPTER 6 Commencement of the Case

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P 6.09 Statement of Current Monthly Income and Means Test Calculation (Chapter 7 Cases)

A statement of current monthly income and means test calculation must be completed by every individual chapter 7 debtor, whether or not filing jointly. Joint debtors are permitted to combine their information in one statement. The form statement, Official Form 22A, is divided into seven different parts. Parts II and III are used to determine whether the debtor must perform the means test calculation which is found in Parts IV-VI. Part VII is the verification of the form, which requires the debtor's signature. In addition, a box at the top of the first page of the form requires the debtor to indicate whether a presumption of abuse under section 707(b) arises or not. The vast majority of debtors will only need to complete Parts II, III and VII.

MORE INFORMATION

See chapter 23 for more information on the means test and the presumption of abuse.

Part I pertains to disabled veterans for whom the means test of section 707(b) does not apply. Qualified disabled veterans should check the box in Part I, sign the verification in Part VII, and check the "presumption does not arise box" at the top of the first page. Under a 2008 amendment to section 707(b)(4)(D), certain reservists and National Guard members may also check a box to be exempted from means testing. Similarly, debtors whose debts are not primarily consumer debts follow the same procedure.

Part II is the calculation of current monthly income for the purposes of determining whether the mean test applies. The first portion of this section seeks certain information regarding marital and filing status. This information is then used to determine whether both the debtor's income and that of the debtor's spouse must be reported.ⁿ¹ The second portion of Part II asks the debtor to report average income for the six months prior to the month of filing for a variety of categories. These amounts are then totaled to provide the debtor's current monthly income.

Part III considers whether the safe harbor exclusion from the means test in 707(b)(7) applies. First, the debtor is required to determine an annualized current monthly income by multiplying the total from Part II by 12. Next, the applicable state median income must be determined.ⁿ² A comparison of the annualized currently monthly income and the applicable state median income will determine if the debtor must complete the means test. If the annualized figure is less than the applicable state median income, then the safe harbor provisions of section 707(b)(7) apply and the debtor is not required to complete the means test. Instead the debtor can skip to the verification in Part VII, sign the form, and

check the box on the first page indicating that the presumption does not apply.

If the annualized figure is greater than the applicable state median income the debtor must perform the means test, which begins in Part IV. That section determines current monthly income for purposes of 707(b)(2). The calculation deducts from the previous total current monthly income in Part II any of the debtor's spouse's income that is not regularly contributed to household expenses.

Part V identifies all the various deductions from the current monthly income for purposes of the means test. These deductions include certain expenses specified in the collection of standards of the IRS--Subpart A, other expenses allowed by section 707(b)-Subpart B,ⁿ³ and payments for secured or priority debts and hypothetical administrative expenses in a chapter 13 case - Subpart C. Subpart D totals all the permitted deductions.

Part VI is the determination of whether a presumption of abuse arises. Monthly disposable income is calculated in this part and multiplied by 12 to determine the debtor's "60-month disposable income." If this figure is less than \$6,575ⁿ⁴ the presumption of abuse does not apply. If the figure is greater than \$10,950 the presumption of abuse does apply. If the debtor's 60-month disposable income is in between \$6,575 and \$10,950 then the debtor must perform an additional calculation to determine whether the debtor's 60-month disposable income is at least 25% of the debtor's nonpriority unsecured debt. If it is, the presumption of abuse arises.

If the presumption of abuse arises, the debtor must indicate so in the box at the top of the first page. The debtor will want to inform the trustee and United States Trustee about any special circumstances that might rebut the presumption. Such special circumstances could be simply a reduction in the debtor's income below the current monthly income figure, or additional expenses, such as the moving expenses, security deposit, and other costs that would be incurred if the debtor moved to a lower rent apartment. There are many other possibilities, such as high commuting costs, the increased price of gas, security costs in dangerous neighborhoods, or the cost of infant formula and diapers. Indeed, any legitimate expense that is out of the ordinary for an average family, or that may have increased since the IRS guidelines were calculated, could be considered.

FOOTNOTES:

(n1)Footnote 1. The official form deviates significantly from the language of the statute in determining the amount of income from a nondebtor spouse to be included for purposes of calculating current monthly income. The form directs that all of a non-debtor spouse's income be included unless the debtor is legally separated or living apart from the non-debtor spouse. However, the plain language of the statute only requires (other than in a joint case) a non-debtor spouse's income be included in the calculation to the extent that it is contributed to household expenses.

(n2)Footnote 2. The Bureau of the Census has begun reporting the relevant median income numbers for each state every year. The applicable median income figures and Internal Revenue expense allowances may be found on the United States Trustee web site: www.usdoj.gov/ust.

(n3)Footnote 3. The official form deviates from the language in the statute by identifying only certain categories of other necessary expenses. According to both the legislative history and the IRS standards themselves, other necessary expenses is a nonexclusive category of expenses necessary for family health and welfare or production of income. See H.R. Rep. No. 109-31, at 14, n.66.

(n4)Footnote 4. The applicable numbers are adjusted every three years for inflation pursuant to 11 U.S.C. § 107. Prior to April 1, 2007, the figures were \$6,000 and \$10,000.



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P 6.10 Statement of Current Monthly Income and Disposable Income Calculation (Chapter 13)

A statement of current monthly income and disposable income calculation must be completed by every individual chapter 13 debtor, whether or not filing jointly. Joint debtors are permitted to combine their information in one statement. The form statement, Official Form 22C, must be completed in addition to Schedules I and J. The form contains five separate parts. Part I is a calculation of the debtor's current monthly income. In Part II, the debtor determines whether his or her disposable income must be calculated under section 1325(b)(3). If applicable, Parts III and IV determine debtor's disposable income under section 1325(b)(3). And, Part V is the verification of the form, which requires the debtor's signature. In addition, a box at the top of the first page of the form requires the debtor to indicate whether disposable income is determined under section 1325(b)(3) or not.

MORE INFORMATION

See chapter 14 for more information on the disposable income test.ⁿ¹

Part I is the calculation of current monthly income. The first portion of this section seeks certain information regarding marital and filing status. This information is then used to determine whether both the debtor's income and that of the debtor's spouse must be reported. The second portion of Part II asks the debtor to report average income for the six months prior to the month of filing for a variety of categories. These amounts are then totaled to provide the debtor's current monthly income.

Part II is the calculation of the applicable commitment period under section 1325(b)(4). The form permits the debtor to exclude the income of the debtor's spouse if the case is not a joint case, because by definition in section 101(10)(A), only a debtor can have current monthly income. If the current monthly income is above the applicable median family income for the state, the applicable commitment period is five years.

Part III is used to determine whether the disposable income test of section 1325(b)(3) is applicable. First, the debtor is required to determine an annualized current monthly income by multiplying the total from Part I by 12. Next, the applicable state median income must be determined.ⁿ² If the annualized figure is less than the applicable state median income, then disposable income will not be determined in accordance with section 1325(b)(3). If the annualized figure is greater than the applicable state median income, the debtor will need to continue on to Part III and IV to determine his or her disposable income under section 1325(b)(3).

Part IV identifies all the various deductions from the current monthly income for purposes of the disposable income test.ⁿ³ These deductions include certain expenses specified in the collection of standards of the IRS--Subpart A, other expenses allowed by section 707(b)-Subpart B,^{n3a} and payments for secured or priority debts and administrative expenses for the chapter 13 case - Subpart C. Subpart D totals all the permitted deductions.

Part V is the calculates the debtor's disposable income under section 1325(b)(2) by subtracting support income, qualified retirement deductions, and the deductions allowed in Part IV from the debtor's currently monthly income established in Part I. This amount is presumably the monthly amount that the debtor is able to pay over the applicable commitment period into a chapter 13 plan.ⁿ⁴

FOOTNOTES:

(n1)Footnote 1. The form deviates from the statute by not allowing the debtor to count uncategorized Other Necessary Expenses in the calculation

(n2)Footnote 2. The Bureau of the Census has begun reporting the relevant median income numbers for each state every year.

(n3)Footnote 3. The deductions are based on the deductions allowed under section 707(b)(2). *See P 23.02[3][b][iv] infra.*

(n4)Footnote 3a. The official form deviates from the language in the statute by identifying only certain categories of other necessary expenses. According to both the legislative history and the IRS standards themselves, other necessary expenses is a nonexclusive category of expenses necessary for family health and welfare or production of income. *See H.R. Rep. No. 109-31, at 14, n.66.*

(n5)Footnote 4. Of course, this presumption is seriously flawed as the debtor's disposable monthly income is predicated on the debtor's average income for the six months prior to filing rather than the debtor's projected income over the life of the plan.



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CHAPTER 6 Commencement of the Case

1-6 Collier Consumer Bankruptcy Practice Guide P 6.11

P 6.11 Statement of Intention with Regard to Secured Debts and Unexpired Personal Property/Leases (Official Form 8)

A statement of intention is required in any chapter 7 cases in which there is a "debt" ⁿ¹ secured by property or personal property subject to an unexpired lease. With respect to personal property subject to an unexpired lease, the form asks whether such lease will be assumed or whether the leased property will be surrendered. In addition, this document must state certain intentions of the debtor, as of the date of its filing, with regard to any property, real or personal, that serves as collateral for a "debt." ⁿ² The statement must be filed within thirty days after the debtor files a petition under chapter 7, or on or before the date of the section 341 meeting of creditors, whichever is earlier, unless the court, for cause, extends the deadline for filing. ⁿ³ As a practical matter, it is normally filed with the statement of affairs and schedules in a chapter 7 case.

The Federal Rules of Bankruptcy Procedure provide that the statement of intention must be prepared as prescribed by Official Form 8. That form requires a listing of all property subject to security interests securing consumer debts, and the names of the creditors holding liens on the property. The rules also require that the statement be served on the trustee and each creditor named in the statement on or before the date the statement is filed. Official Form 8 has also been amended to provide a section for personal property subject to an unexpired lease and an options labeled "Property will be surrendered" or "Lease to be assumed pursuant to 11 U.S.C. § 362(h)(1)(A)."

FORMS

For a form of a chapter 7 individual debtor's statement of intention see *Collier Consumer Bankruptcy Forms, Form CS10.44-1* (Matthew Bender).

It is important to note what this form does and does not require. It requires only that the debtor state (1) whether the property will be surrendered or retained, (2) whether it will be claimed as exempt, (3) whether the debtor intends to redeem the property, and (4) whether the debtor intends to reaffirm the debt secured by the property. ⁿ⁴

If the property is to be retained, the Official Form for this purpose offers the debtor the option of indicating an intention, if applicable, to: (1) claim the property as exempt, (2) redeem pursuant to section 722, or (3) reaffirm pursuant to section 524(c). A debtor may choose to claim the debtor's interest as exempt, even if it is only a possessory interest with no monetary value and retain the property subject to the creditor's security interest and state law rights, whatever they

may be.ⁿ⁵ If the debtor's intention is to surrender the property, there is no requirement to deliver it or to execute a deed to effectuate the surrender, since the Code provision was not designed to provide a substitute for normal state law proceedings to enforce a creditor's rights to collateral.^{n5a}

There is also nothing in section 521 stating that a debtor may not change his or her intentions. Like other statements and schedules, this statement may be amended at any time before the time period for performance of the intention expires.ⁿ⁶ Failure to file the statement of intention with respect to covered property within the required time or failure to timely take action as specified in the statement may result in termination of the automatic stay with respect to that property.

In most chapter 7 cases, completion of the statement of intention is quite simple. Generally, chapter 7 debtors retain all of their property, since they claim their interests in all of it as exempt. (If there is significant nonexempt property the debtor usually chooses chapter 13 rather than chapter 7.)ⁿ⁷ The fact that the property is encumbered by a secured creditor's lien does not prevent the debtor from claiming his or her interest, subject to the lien, as exempt. In many cases the lien may be partially or totally avoidable in bankruptcy. Few debtors reaffirm their debts or redeem more than one or two items under section 722.

MORE INFORMATION

Chapter 18 *infra* discusses avoiding liens; chapter 27 *infra* examines reaffirmation; and chapter 25 *infra* discusses redemption.

In any case, the function of the statement of intention is simply one of notice. It is intended to meet creditors' complaints at congressional hearings that they could not get necessary information from debtors' attorneys and were not permitted to contact pro se debtors at all. Except in those courts that have held that the form requires a debtor to either reaffirm, redeem or surrender the collateral, it should impose little burden on debtors, since it changes none of their substantive rights.ⁿ⁸

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 521(a)(2)(A), formerly § 521(2)(A), as amended and redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. This statement is no longer limited to consumer debts.

(n2)Footnote 2. Consumer debt is defined at 11 U.S.C. § 101. See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender); 1 Collier Bankruptcy Manual, ch. 101 (Matthew Bender).

(n3)Footnote 3. 11 U.S.C. § 521(a)(2)(A), formerly § 521(2)(A), as amended and redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. *Fed. R. Bankr. P. 1007(b)(2)*.

(n5)Footnote 5. See *In re Parker*, 139 F.3d 668 (9th Cir. 1998), cert. denied 119 S. Ct. 592 (1998); *Lowry Federal Credit Union v. West*, 882 F.2d 1543 (10th Cir. 1989) (Code does not limit debtor to choice between redemption or reaffirmation); *Homeowners Funding Corp. of America v. Belanger*, 128 B.R. 142 (E.D.N.C. 1990), aff'd, 962 F.2d 345, 26 C.B.C.2d 1429 (4th Cir. 1992); 4 Collier on Bankruptcy, P 521.10[2] (Matthew Bender); 2 Collier Bankruptcy Manual, P 521.08[2] (Matthew Bender). But see *In re Burr*, 160 F.3d 843, 41 C.B.C.2d 42 (1st Cir. 1998).

(n6)Footnote 5a. *In re Theobald*, 218 B.R. 133 (B.A.P. 10th Cir. 1998).

(n7)Footnote 6. *Fed. R. Bankr. P. 1009(b)*. See P 6.11 *infra*.

(n8)Footnote 7. *See* ch. 4 *supra*.

(n9)Footnote 8. 11 U.S.C. § 521(a)(2)(C). *See* 4 *Collier on Bankruptcy*, P 521.10[5] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 521.08[5] (Matthew Bender) for discussion of the conflicting case law under this provision.



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P 6.12 Other Forms and Documents

Aside from the papers already described, there are several other forms and documents which need to be filed. These generally require much less work to prepare.

[1] Application to Waive Filing Fees or Pay in Installments (Official Forms 3A & 3B)

If the filing fee is not paid in full at the time of filing, the debtor must file an application to pay in installments or, if appropriate, an application for waiver of the chapter 7 filing fee. In a chapter 13 case, an application to pay the fee in installments may also be accompanied by an application for waiver of a portion of the filing fees.ⁿ¹

"Filing fee" for purposes of paying in installments or waiver includes any fee payable on commencement of the case, including fees imposed pursuant to section 1930(b) of title 28 by the Federal Judicial Conference. Usually, only one copy of the application and proposed order need be filed.

In a chapter 7 case, the court may waive the entire filing fee if the individual's income is less than 150% of the applicable income official poverty line and if the debtor is unable to pay the filing fee in installments.ⁿ² The form for this application is provided in Official Form 3B. That form requires information regarding the debtor's family size, income, expenses and assets. Designated schedules may be attached in lieu of filling in certain portions of the application. In addition the application requests information regarding prior filings and payments to attorneys or non-attorneys for services in connection with the case. The form also contains a proposed order that permits the court to waive the fees or order the fees paid in installments.

MORE INFORMATION

Chapter 32 *infra* closely examines *in forma pauperis* applications in bankruptcy cases.

If the debtor does not qualify for a waiver of the filing fees, the debtor may file an application to pay them in installments. The form for this application is provided in Official Form 3A, which was revised in 2005; it is a fill-in-the-blanks format. The form also contains a proposed order. This application requires that the debtor state that it will not make any additional (future) payments to an attorney for bankruptcy fees until the filing fee payment is completed. Application to pay the fee in installments is normally granted as a matter of course.^{n2a}

MORE INFORMATION

For a form to apply to pay the filing fee in installments or waive the following fee see *Collier Consumer Bankruptcy Forms, Forms CS10.02-2, CS10.02-4* (Matthew Bender).

[2] Motion for Extension of Time to File Required Documents

If the schedules, statements, or plan cannot be filed within 14 days of the petition, a motion for additional time must be filed or the case may be dismissed.ⁿ³ Failure to file schedules on time without an extension of time could lead to dismissal of the case. It could also lead to a loss of substantive rights, such as the right to claim exemptions, even if the case is not dismissed.ⁿ⁴ A simple form for a motion for an extension of time can easily be prepared for repeated use. Such an application should show cause for the extension and be served on the trustee, if any, and the United States trustee.ⁿ⁵ Most courts routinely grant a two to three week extension of time if requested before the papers are due. Some courts require proposed orders to be attached to these papers and local practice should be checked.

FORMS

For samples of motions for extension of time see *Collier Consumer Bankruptcy Forms, § CS10.40* (Matthew Bender).

[3] Certification from Credit Counseling Agency

Section 521(b), added by the 2005 amendments to the Bankruptcy Code,ⁿ⁶ requires an individual debtor to file with the court a certificate from an approved nonprofit budget and credit counseling agency that the debtor received the briefing required by section 109(h) and, if a debt repayment plan was developed through the counseling, a copy of that plan. The statute states no time period within which the credit counseling certificate must be filed. *Rule 1007(c)* specifies that the certification of credit counseling must be filed within 14 days of the entry of the order for relief.

[4] Records of Payments from Employment

Section 521(a)(1)(B)(iv), added in 2005,ⁿ⁷ requires that the debtor file with the court copies of all "payment advices" or other evidence of payment received within 60 days before the petition from any employer of the debtor.ⁿ⁸ Few debtors retain these documents, so an attorney will often have additional work involved in contacting the employer to obtain a statement which can be evidence of payment. The rules require that these documents be filed within 14 days of the petition unless an extension of time is granted by the court, and that all but the last four numbers of social security numbers be redacted from these documents.^{n8a}

If such records are not filed within 45 days after the petition, the case may be dismissed automatically.ⁿ⁹ However, this consequence may be avoided if the debtor obtains an order from the court excusing performance. Thus, when all payment advices or other evidence of payment for the past 60 days are not readily available, the debtor should file a motion to excuse the filing of some or all of them. Alternatively, filing less than all the payment advices may provide sufficient information if the first and last pay periods within the 60 days are included and year to date information appears on them.^{n9a}

[5] Records of Interests in Education Savings Accounts

Section 521(c), added in 2005,ⁿ¹⁰ requires that the debtor file a "record" of any interest of the debtor in an Education IRA or tuition savings program under *section 529(b)(1) of the Internal Revenue Code*.ⁿ¹¹ Schedule B, as amended, provides a space for the debtor to list any interest in any educational savings plan. Listing any such interests and timely filing Schedule B may satisfy the requirements of this section, although *Bankruptcy Rule 1007(b)(1)(F)* appears to require a separate document.^{n11a}

[6] Tax Records

In addition to filing documents with the court, the debtor must provide additional tax records to the trustee and sometimes to creditors under section 521(e)(2)(A), added by the 2005 amendments to the Bankruptcy Code.ⁿ¹² At least 7 days before the section 341 meeting, the debtor must provide to the trustee a copy of the federal income tax return required under applicable law for the most recent tax year ending immediately before the commencement of case and for which a federal income tax return was filed, or a tax transcript of such return. At the same time as the return or transcript is provided to the trustee, it must be provided to any creditor that timely requests it.ⁿ¹³ If the debtor fails to provide a required return or transcript to the trustee or to a creditor that timely requests it, the case must be dismissed, unless the debtor shows that failure is due to circumstances beyond debtor's control.ⁿ¹⁴

Additionally, section 521(f), also added in 2005,ⁿ¹⁵ requires the debtor, if the court, the United States trustee, or any part in interest requests, to file certain tax returns, or transcripts thereof, with the court, as well as amendments of those returns.ⁿ¹⁶ Lastly, section 315(c) of the 2005 Act requires the Director of the Administrative Office of the United States Courts to establish procedures for safeguarding the confidentiality of tax information required to be provided by the debtor by October 17, 2005. The procedures "shall include restrictions on creditor access to tax information that is required to be provided...".ⁿ¹⁷ The Director of the Administrative Office has adopted an Interim Guidance which generally requires a creditor to file a motion to obtain a copy of tax information filed with the court.ⁿ¹⁸

[7] Forms Required by Local Rules or Practice

Finally, local practice may require particular procedures for electronic filing, other papers, and may dictate the size of the paper to be used, whether backers are needed, and so forth. Practitioners should consult local rules or the clerk's office for these and any other requirements.

FOOTNOTES:

(n1)Footnote 1. The fee in a chapter 13 case consists of a filing fee of \$150 required by 28 U.S.C. § 1930(a), and a supplemental fee of \$39 for sending notices pursuant to 28 U.S.C. § 1930(b). The \$150 filing fee is not waivable. However, a court may waive fees assessed pursuant to 1930(b) in chapter 13 cases.

(n2)Footnote 2. 11 U.S.C. 1930(f), as enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 2a. *Fed. R. Bankr. P. 1006(b)*. In a few districts, contrary to the express language of the rule, courts require part of the filing fee to be paid when a petition is filed with an application to pay the fee in installments.

(n4)Footnote 3. *See Fed. R. Bankr. P. 1007(c)*.

(n5)Footnote 4. *See Petit v. Fessenden*, 80 F.3d 29, 35 C.B.C.2d 968 (1st Cir. 1996) (exemptions disallowed).

(n6)Footnote 5. *Fed. R. Bankr. P. 1007(c)*.

(n7)Footnote 6. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 7. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 8. 11 U.S.C. § 521(a)(1)(B)(iv).

(n10)Footnote 8a. *Fed. R. Bankr. P. 1007(b)(1)(E)*.

(n11)Footnote 9. 11 U.S.C. § 521(i)(1).

(n12)Footnote 9a. *In re Tay-Kwamya*, 367 B.R. 422 (Bankr. S.D.N.Y. 2007) (cumulative information on pay stubs provided by debtor was sufficient).

(n13)Footnote 10. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n14)Footnote 11. 11 U.S.C. §§ 521(c).

(n15)Footnote 11a. *Fed. R. Bankr. P. 1007(b)(1)(F)*.

(n16)Footnote 12. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n17)Footnote 13. 11 U.S.C. § 521(e)(2)(A)(ii).

(n18)Footnote 14. 11 U.S.C. § 521(e)(2)(B),(C).

(n19)Footnote 15. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n20)Footnote 16. 11 U.S.C. § 521(f)(1)-(3)

(n21)Footnote 17. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n22)Footnote 18. The Interim Guidance may be found at <http://www.uscourts.gov/bankruptcycourts/resources.html>.



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P 6.13 Amendments to Petition, Schedules or Statements

When an amendment to the petition, a schedule or a statement is necessary, whether due to inadvertence, mistake, or an unexpected change in circumstances, the procedure is quite simple. Under the Federal Rules of Bankruptcy Procedure the debtor may amend these initial papers as a matter of course at any time before the case is closed.ⁿ¹ The procedure requires the filing of an amended document verified by the debtor. The amended document should be filed with the same number of copies as the original document, and signed or verified in the same manner as the document being amended.ⁿ²

FORMS

For a sample form for the amendment of schedules see *Collier Consumer Bankruptcy Forms, Form CS10.45-2* (Matthew Bender).

The rules also provide that "[t]he debtor shall give notice of the amendment to the trustee and to any entity affected thereby."ⁿ³ Principally, this notice is meant for creditors added by amendment so that they may protect their rights (although other creditors may be affected as well). Notice to a creditor added by amendment must include the debtor's full social security number (although any copy filed with the court should include only the last 4 digits) as well as the debtor's name and address.

WARNING

In certain cases, listing a creditor only by the late filing of an amendment could prejudice the right to discharge a debt.ⁿ⁴ Therefore, the debtor's counsel should make sure that the creditor receives notice of the amendment and a copy of the notice of the meeting of creditors as soon as possible. Because the court will send out notices when a creditor is added, there is a \$26 fee for filing such an amendment. However, this fee can be waived upon application to the court for good cause.ⁿ⁵ For all other amendments, there is no fee.

Moreover, adding a creditor to the schedules may not be sufficient to bring about the discharge of the creditor's claim in a chapter 13 case if the deadline for filing proofs of claims has already passed, because a chapter 13 case discharges only those claims provided for in the plan.ⁿ⁶ If the debtor's plan is worded in such a way that a tardily filed claim is provided for, the debtor may be able to file a claim on behalf of

the creditor under Federal Rule of Bankruptcy Procedure 3004 or seek an extension of time to file such a claim.ⁿ⁷ If the debtor or the creditor files a late proof of claim and no party objects that the claim is tardy, the claim is allowed.ⁿ⁸

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 1009.*

(n2)Footnote 2. *Fed. R. Bankr. P. 1008.*

(n3)Footnote 3. *Fed. R. Bankr. P. 1009.*

(n4)Footnote 4. *See 11 U.S.C. § 523(a)(3).* For further discussion of this issue, *see* ch. 26 *infra*.

(n5)Footnote 5. Judicial Conference Bankruptcy Court Miscellaneous Fee Schedule, Item 4, *reprinted in* 1 Collier on Bankruptcy, Ch. App. 9 (Matthew Bender).

(n6)Footnote 6. *11 U.S.C. § 1328(a).*

(n7)Footnote 7. *In re Moore*, 247 B.R. 677 (Bankr. W.D. Mich. 2000) .

(n8)Footnote 8. *11 U.S.C. § 502(a).*



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CHAPTER 6 Commencement of the Case

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P 6.14 Procedure for Signing, Verification, and Filing

Once all of the forms are prepared and reviewed, they must be signed by the attorney of record and the debtor(s), as well as verified by the debtor(s). In appropriate circumstances, a petition may be signed and filed by another on behalf of a debtor pursuant to a power of attorney.ⁿ¹

The attorney normally signs two documents--the petition (including a separate signature on Exhibit B to the petition in chapter 7 cases involving primarily consumer debts) and the disclosure of attorney's fees. Those signatures, like any other signatures on pleadings, constitute certifications that the documents meet the requirements of section 707(b)(4) and *Federal Rule of Bankruptcy Procedure 9011*, the bankruptcy counterpart to *Federal Rule of Civil Procedure 11*. Additionally, the attorney's signature on the petition certifies that the attorney has no knowledge, after an inquiry, that the schedules are incorrect. By submitting the papers that he or she does not sign, the attorney also becomes subject to the requirements of *Rule 9011* with respect to those papers. The debtor signs the petition and statement of intentions, and verifies the schedules, statement of social security number, statement of financial affairs, and statement of current monthly income. Either the attorney or the debtor may sign the chapter 13 plan. Under federal law, a notarized signature to a verification is not necessary if the signer certifies its truth under penalty of perjury.ⁿ²

Every document prepared by a nonattorney bankruptcy petition preparer, as defined by *section 110 of the Code* must contain the signature and printed name and address of the preparer.ⁿ³ If the preparer is not an individual, an officer, principal, partner or other responsible party must sign the document and provide his or her name and address.^{n3a} The document must also contain the social security number of the preparer and the printed names and social security numbers of all other individuals who prepared or assisted in preparation of the document. If a preparer is not an individual, an officer, principal, partner or other responsible party must provide his or her social security number.^{n3b} Separate certifications by each person who prepared the document must be attached.ⁿ⁴ The failure to comply with these requirements will render the violators subject to serious sanctions.ⁿ⁵

PRACTICE NOTE

It is always an important to have a client carefully review the documents before signing. This serves as a final check on their correctness, and also prevents any later misunderstanding in which the client might claim that the forms were not properly prepared.

Once the papers have been signed and verified, they are ready for filing. With the filing of the complete set of documents, or just the petition, statement of social security member, and list of creditors (with an application to pay the filing fee in installments, if necessary), the bankruptcy case is officially commenced.

FOOTNOTES:

(n1)Footnote 1. *In re Ballard*, 15 B.C.D. 1328 (Bankr. N.D. Cal. 1987) .

(n2)Footnote 2. 28 U.S.C. § 1746 provides that an unsworn declaration "under penalty of perjury" shall have the same force and effect as a sworn statement.

(n3)Footnote 3. 11 U.S.C. § 110(b), (c), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Spaces for this information have been added to each official bankruptcy form in which it is likely to be required.

(n4)Footnote 3a. 11 U.S.C. § 110(b)(1), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 3b. 11 U.S.C. § 110(c)(2)(B), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 4. 11 U.S.C. § 110(c)(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See also* the Official Bankruptcy Forms.

(n7)Footnote 5. 11 U.S.C. § 110(i), (j), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005; 18 U.S.C. § 156.



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CHAPTER 7 Appointment of Trustee and Trustee's Duties

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§ 7.syn Synopsis to Chapter 7: Appointment of Trustee and Trustee's Duties

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CHAPTER 7 Appointment of Trustee and Trustee's Duties

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Scope

SCOPE NOTE

This chapter discusses the appointment of a trustee in a consumer chapter 7 or chapter 13 case, and the trustee's duties, from the perspective of debtors and creditors. It also covers the possibility of the election of a trustee in chapter 7. It includes discussion of the routine tasks performed by trustees in all or most cases.



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CHAPTER 7 Appointment of Trustee and Trustee's Duties

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P 7.01 Appointment of Trustee in Chapter 7

In each chapter 7 case, an interim trustee is appointed immediately after the order for relief.ⁿ¹ The appointment is made by the United States trustee from a panel of private trustees maintained by the Office of the United States trustee. In districts in which there is no United States trustee² the appointment is made by the court, acting through its Bankruptcy Administrator, from a similar panel. In either case, the trustee must be a "disinterested person" as defined by *Code section 101*.ⁿ³

In the vast majority of chapter 7 cases, creditors do not utilize the opportunity to elect a trustee that is provided by section 702ⁿ⁴ and the interim trustee becomes the permanent trustee pursuant to section 702(d).

As a practical matter, the debtor and creditors usually receive notice of the appointment when they receive the notice of the meeting of creditors, which lists the trustee's name and address.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 701. See 6 Collier on Bankruptcy, ch. 701 (Matthew Bender).*

(n2)Footnote 2. There is no United States trustee in judicial districts in Alabama and North Carolina. *See Pub. L. No. 101-650, reprinted in Vol. F Collier on Bankruptcy, App. Pt. 42(b)(1)(D) (Matthew Bender), amending Pub. L. No. 99-554 § 302(d), reprinted in Vol. E Collier on Bankruptcy, App. Pt. 7(a) (Matthew Bender).*

(n3)Footnote 3. *See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender) for discussion of the definition of "disinterested person."*

(n4)Footnote 4. *See P 7.02 infra.*



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CHAPTER 7 Appointment of Trustee and Trustee's Duties

1-7 Collier Consumer Bankruptcy Practice Guide P 7.02

P 7.02 Election of Trustee in Chapter 7

PRACTICE NOTE

Creditors who hold unsecured proofs of claim that are undisputed, fixed and liquidated may elect a trustee to replace the interim trustee. Although this rarely occurs, it may be a good strategy for creditors in cases in which creditors believe that someone who they elect is more willing or able to pursue assets of the debtor, through avoidance actions, aggressive investigation or otherwise.

A trustee may be elected at the meeting of creditors if he or she receives the votes of creditors holding at least 20 percent in amount of the unsecured claims of creditors permitted to vote *and* receives the votes of creditors holding a majority in amount of claims that actually do vote.ⁿ¹ In order to vote by proxy on behalf of a creditor, an attorney or other representative of the creditor must present a power of attorney.ⁿ²

FORMS

For forms of general powers of attorney (Official Form 11A) and special powers of attorney (Official Form 11B) see *Collier Consumer Bankruptcy Forms, Form CS23.12-1* and *Form CS23.12-2* (Matthew Bender), respectively.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 702(c)*. The 20 percent test must also be met to request an election. *11 U.S.C. § 702(b)*. See 6 *Collier on Bankruptcy, P 702.06* (Matthew Bender).

(n2)Footnote 2. *Fed. R. Bankr. P. 9010(c)*.



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CHAPTER 7 Appointment of Trustee and Trustee's Duties

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P 7.03 Appointment of Trustee in Chapter 13

In chapter 13 cases, the trustee is usually a standing chapter 13 trustee appointed by the United States trustee to handle all of the chapter 13 cases in a district, or some specified portion of the cases, such as those assigned to particular judges.ⁿ¹ In districts in which there is no United States trustee,ⁿ² the appointment is made by the court.

If there is no standing trustee in the district, or if for some reason the standing trustee cannot serve, a disinterested person may be appointed as trustee for the particular chapter 13 case.ⁿ³ Alternatively, the United States trustee may serve as trustee.ⁿ⁴

FOOTNOTES:

(n1)Footnote 1. 28 U.S.C. § 586(b). See 8 *Collier on Bankruptcy*, P 1302.04 (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1302 (Matthew Bender).

(n2)Footnote 2. There is no United States trustee in judicial districts in Alabama and North Carolina. See Pub. L. No. 101-650, *reprinted in* Vol. F *Collier on Bankruptcy*, App. Pt. 42(b)(I)(D) (Matthew Bender), amending Pub. L. No. 99-554 § 302(d), *reprinted in* Vol. E *Collier on Bankruptcy*, App. Pt. 7(a) (Matthew Bender).

(n3)Footnote 3. 11 U.S.C. § 1302(a). See 8 *Collier on Bankruptcy*, P 1302.02 (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1302 (Matthew Bender).

(n4)Footnote 4. 11 U.S.C. § 1302(a). See 8 *Collier on Bankruptcy*, P 1302.02[1] (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1302 (Matthew Bender).



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CHAPTER 7 Appointment of Trustee and Trustee's Duties

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P 7.04 Duties of Chapter 7 Trustee

The chapter 7 trustee has the duty to administer the chapter 7 case and to represent the interests of unsecured creditors in the case. In the course of doing so, the trustee first investigates the assets of the estate, an investigation that typically includes conducting the meeting of creditors and interrogating the debtor at that meeting. In addition, section 704(a)(10), added by the 2005 amendments to the Bankruptcy Code,ⁿ¹ requires the trustee to provide certain notices in cases in which there is a claim with respect to the debtor for a domestic support obligation.ⁿ²

If there are assets of the estate that are neither exempt nor abandoned the trustee must collect that property from the debtor or any other entity holding the property, convert it into cash, usually by sale of the property, and be accountable for that property. The trustee must normally give 21 days notice of intent to sell the property. Any party, including the debtor, may object within specified time limits to the proposed sale, which may be a private sale or a sale by public auction.ⁿ³ If an asset is partially exempt, the debtor's exemption should be paid in cash from the proceeds prior to distribution of any proceeds to creditors. If appropriate, the trustee may object to the debtor's claim that particular property is exempt. However, trustees are discouraged from liquidating nominal amounts of nonexempt property that are insufficient to produce a significant distribution to unsecured creditors.ⁿ⁴

MORE INFORMATION

Chapter 13 *infra* provides a detailed discussion of exemptions.

The gathering of estate property may also include filing lawsuits, including proceedings to exercise the trustee's power to avoid preferences, fraudulent transfers, and other avoidable transfers of property of the debtor.

MORE INFORMATION

Avoiding powers of the trustee are discussed in greater detail in chapter 17 *infra*.

Once the estate's property has been liquidated, the trustee must preserve the assets and then distribute them to creditors. To do so, the trustee is required to review the proofs of claim that are filed and object to those that are improper, unless the objection would serve no purpose.ⁿ⁵ The trustee must then make distributions to creditors whose claims are proper, in the order specified in the Code.

In order enhance the ability of child support claimants and state child support enforcement agencies to assert their claims in the bankruptcy process and after bankruptcy, the chapter 7 trustee is now required to provide certain notices in cases in which there is a claim with respect to the debtor for a domestic support obligation.ⁿ⁶ Under section 704(c)(1)(A) the trustee must provide to the holder of a domestic support obligation claim written notice that the claimant is entitled to use the services of the state child support enforcement agency to obtain assistance in collecting support in bankruptcy and afterwards.ⁿ⁷ The trustee must also provide written notice to the state child support enforcement agency of the existence of the claim against the debtor, and include in the notice the name, address and telephone number of the holder of the claim.ⁿ⁸ The trustee is required to send another notice to the domestic support obligee and to the state child support enforcement agency at the time the debtor is granted a discharge.ⁿ⁹ This notice is to inform its recipients of the granting of the discharge, the last known address of the debtor, the last known address of the debtor's employer, and the name of each creditor that holds a claim that is not discharged under section 523(a)(2),(4) or (14A) or that it was reaffirmed.ⁿ¹⁰

The trustee, as administrator and representative of creditors, must furnish information to parties in interest.ⁿ¹¹ The trustee also has the duty to ensure that the debtor carries out intentions stated in the statement of intention with respect to secured debts,ⁿ¹² and to object to the debtor's discharge if advisable.ⁿ¹³ Lastly, the trustee must report to the court and the United States trustee on the administration of the case.ⁿ¹⁴

Of course, in the vast majority of consumer chapter 7 cases, there are no nonexempt assets or other assets to liquidate. In those cases, the trustee conducts the meeting of creditors, investigates the debtor's assets, right to a discharge, and exemptions, sends required notices related to domestic support obligations, if applicable, and ensures that the statement of intention provisions are followed. The trustee then files a report stating that no assets have been found and, once the deadline for objections to discharge has passed and the debtor receives a discharge, the case is closed.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. "Domestic support obligation" is defined in 11 U.S.C. § 101, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005; *see* ch.101 *supra*.

(n3)Footnote 3. *Fed. R. Bankr. P. 6004*.

(n4)Footnote 4. *In re Kusler*, 40 C.B.C.2d 794, 224 B.R. 180 (Bankr. N.D. Okla. 1998) (criticizing trustee for selling encumbered property which would not realize significant dividends for creditors). *See* 6 *Collier on Bankruptcy*, P 704.02[1] (Matthew Bender).

(n5)Footnote 5. 11 U.S.C. § 704(a)(5), formerly § 704(5), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See* 6 *Collier on Bankruptcy*, P 704.09 (Matthew Bender).

(n6)Footnote 6. 11 U.S.C. § 704(a)(10), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n7)Footnote 7. 11 U.S.C. § 704(c)(1)(A), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 8. 11 U.S.C. § 704(c)(1)(B), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 9. 11 U.S.C. § 704(c)(1)(C), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n10)Footnote 10. 11 U.S.C. § 704(c)(1)(C)(i)-(iv), enacted by Pub. L. No. 109-8 (2005), effective with respect to

cases filed on or after October 17, 2005.

(n11)Footnote 11. *11 U.S.C. § 704(a)(7)*, formerly § 704(7), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See 6 Collier on Bankruptcy, P 704.11* (Matthew Bender).

(n12)Footnote 12. *11 U.S.C. § 704(a)(3)*, formerly § 704(3), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See 6 Collier on Bankruptcy, P 704.07* (Matthew Bender).

(n13)Footnote 13. *11 U.S.C. § 704(a)(6)*, formerly § 704(6), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See 6 Collier on Bankruptcy, P 704.10* (Matthew Bender).

(n14)Footnote 14. *11 U.S.C. § 704(a)(9)*, formerly § 704(9), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See 6 Collier on Bankruptcy, P 704.13* (Matthew Bender).



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CHAPTER 7 Appointment of Trustee and Trustee's Duties

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P 7.05 Duties of the Chapter 13 Trustee

The chapter 13 trustee has many of the same duties as the chapter 7 trustee, including accounting for property received, investigating the financial affairs of the debtor, examining and objecting to proofs of claim, opposing the debtor's discharge if appropriate, sending required notices related to domestic support obligations, if applicable, furnishing information to parties in interest, and reporting on the administration of the case.ⁿ¹

In addition, the chapter 13 trustee also has a number of other duties, stemming from the trustee's responsibility to administer the chapter 13 plan of the debtor. These include appearing and being heard at the confirmation hearing and at any hearing regarding valuation of property subject to a lien or plan modification.ⁿ² The duties also include advising the debtor on matters other than legal matters,ⁿ³ assisting the debtor in performance under the plan,ⁿ⁴ and ensuring the debtor makes payments under the plan.ⁿ⁵

PRACTICE NOTE

As the initial recipient of most or all of the debtor's payments under the plan, the trustee monitors those payments. Typically, if there is a significant delinquency, the trustee moves to dismiss the case.ⁿ⁶ In some districts, the trustee may also offer services to the debtor, such as debtor education, or even the sale of automobile insurance to debtors.

As with a chapter 7 trustee, a chapter 13 trustee is now required to provide certain notices in cases in which there is a claim with respect to the debtor for a domestic support obligation.ⁿ⁷ Under section 1302(d)(1)(A) the trustee must provide to the holder of a domestic support obligation claim written notice that the claimant is entitled to use the services of the state child support enforcement agency to obtain assistance in collecting support in bankruptcy and afterwards.ⁿ⁸ The trustee must also provide written notice to the state child support enforcement agency of the existence of the claim against the debtor, and include in the notice the name, address and telephone number of the holder of the claim.ⁿ⁹ The trustee is required to send another notice to the domestic support obligee and to the state child support enforcement agency at the time the debtor is granted a discharge.ⁿ¹⁰ This notice is to inform its recipients of the granting of the discharge, the last known address of the debtor, the last known address of the debtor's employer, and the name of each creditor that holds a claim that is not discharged under section 523(a)(2),(4) or (14A) or that was reaffirmed.ⁿ¹¹

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 1302(b)(1)*. See 8 *Collier on Bankruptcy*, P 1302.03[1] (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1302 (Matthew Bender).

(n2)Footnote 2. *11 U.S.C. § 1302(b)(2)*. See 8 *Collier on Bankruptcy*, P 1302.03[1][k], [l] (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1302 (Matthew Bender).

(n3)Footnote 3. *11 U.S.C. § 1302(b)(4)*. See 8 *Collier on Bankruptcy*, P 1302.03[1][i] (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1302 (Matthew Bender).

(n4)Footnote 4. *11 U.S.C. § 1302(b)(4)*. See 8 *Collier on Bankruptcy*, P 1302.03[1][j] (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1302 (Matthew Bender).

(n5)Footnote 5. *11 U.S.C. § 1302(b)(5)*. See 8 *Collier on Bankruptcy*, P 1302.03[1][m] (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1302 (Matthew Bender).

(n6)Footnote 6. See ch. 23 *infra*.

(n7)Footnote 7. Section 1302(b)(6), added by the 2005 amendments to the Bankruptcy Code. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(N8)Footnote 8. *11 U.S.C. § 1302(d)(1)(A)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 9. *11 U.S.C. § 1302(d)(1)(B)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n10)Footnote 10. *11 U.S.C. § 1302(d)(1)(C)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. *11 U.S.C. § 1302(d)(1)(C)(i)-(iv)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 7 Appointment of Trustee and Trustee's Duties

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P 7.06 Chapter 13 Wage Payover Order

It is extremely common for debtors to request an order from the court that their employers pay a portion of their wages directly to the chapter 13 trustee as their chapter 13 plan payments. Such orders facilitate the smooth operation of a chapter 13 case, ensuring payments at least as long as the debtor maintains employment.

WARNING

For this reason, although the order should normally be voluntary on the part of the debtor, some trustees strongly pressure the debtor to agree to such orders. If a trustee routinely requests such orders in every case, it may be necessary for counsel to advise the trustee if the debtor does not want the order entered, or to oppose the trustee's motion for an order. The court may view the willingness to agree to an order as assurance of the debtor's seriousness, especially if the debtor has been delinquent on plan payments in the past. Indeed, in such circumstances the order may be entered without the debtor's consent.

Similar orders may be entered against other entities that provide income to the debtor.ⁿ¹ However, other federal statutes limit the ability of the court to enter orders against the Social Security Administration and probably against entities such as the Veterans Administration and pension funds.ⁿ²

The procedure for obtaining a wage payover order is usually very simple. Typically it involves a form motion for the order, that may be filed either by the debtor or the trustee and is quickly acted upon, without a hearing, by the court. Although the statute specifically authorizes such orders only after confirmation of a plan,ⁿ³ they are routinely obtained at the outset of the case.

FORMS

For sample forms for obtaining a payover order see *Collier Consumer Bankruptcy Forms*, § CS23.34 (Matthew Bender).

PRACTICE NOTE

In some cases, confusion arises because the debtor is required to commence payments within 30 days after the plan is filed,ⁿ⁴ but the court and employer do not process the order by that time. The debtor,

believing that the employer payments will meet the plan obligations, may fall a payment or two behind and face difficulty catching up. Therefore, a debtor should be advised that, if the employer does not begin deducting plan payments from paychecks by thirty days after the plan is filed, the debtor must make payments directly to the trustee until such deductions begin.

Occasionally, employers are recalcitrant in complying with the order to pay the debtor's income directly to the trustee. Normally, the trustee should take steps, including a motion for contempt, necessary to assure compliance. Employers are prohibited from discriminating against debtor employees based on the order by *Code section 525(b)*.ⁿ⁵ A few employers have attempted to assess charges against debtors for administering wage deductions for the trustee. In such cases, the debtor or trustee should obtain an order prohibiting such deductions as discriminatory, at least if other deductions are made without charge by the employer.ⁿ⁶

Of course, since the chapter 13 case is entirely voluntary, the debtor always has the right to terminate a wage deduction by dismissing the case, at least if the case has not been converted from another chapter.ⁿ⁷ The debtor may also file a motion to end the wage deduction order at any time.

FOOTNOTES:

(n1)Footnote 1. *See 8 Collier on Bankruptcy, P 1325.09[4]* (Matthew Bender).

(n2)Footnote 2. *See 8 Collier on Bankruptcy, P 1325.09[4]* (Matthew Bender).

(n3)Footnote 3. *11 U.S.C. § 1325(c)*.

(n4)Footnote 4. *11 U.S.C. § 1326(a)(1)*.

(n5)Footnote 5. *See ch. 30 infra*.

(n6)Footnote 6. *See, e.g., In re Santoro, 208 B.R. 645 (E.D. Va. 1997)* (administrative fee charged by U.S. Postal Service was improper because § 1325(c) payroll deduction was not a garnishment on which fee could be charged pursuant to 5 U.S.C. § 520a.) *But see Black v. United States Postal Serv. (In re Heath), 115 F.3d 521 (7th Cir. 1997)* (bankruptcy court did not have jurisdiction to consider challenge to \$50 fee charged by U.S. Postal Service for complying with wage order).

(n7)Footnote 7. *11 U.S.C. § 1307(b)*.



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CHAPTER 7 Appointment of Trustee and Trustee's Duties

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P 7.07 Duties of U.S. Trustee, or Bankruptcy Administrator

The 2005 amendments added a new subsection (b) to section 704 which sets forth new duties of the United States trustee, or Bankruptcy Administrator, if any,ⁿ¹ in cases of all individual debtors.ⁿ² These duties pertain to the determination of whether a chapter 7 case is an abuse as defined by section 707(b) and, in particular, the presumption of abuse under section 707(b)(2).ⁿ³ Section 704(b) concerns duties of the United States trustee or Bankruptcy Administrator, if any, rather than the trustee. It requires the United States trustee or Bankruptcy Administrator to review the debtor's filings and file with the court a statement as to whether the case would be presumed to be an abuse under section 707(b), which the court is then to provide to all creditors.ⁿ⁴ It also requires, if the United States trustee or Bankruptcy Administrator determines there is a presumption of abuse in the case of a debtor above the applicable median income threshold, that, within 30 days after the first statement either a motion to dismiss or convert the case under section 707(b) or a second statement setting forth why such a motion is not appropriate be filed.ⁿ⁵

FOOTNOTES:

(n1)Footnote 1. The Bankruptcy Administrator performs most of the duties of a United States trustee in cases filed in Alabama and North Carolina, where the United States trustee program is not operational. References to the United States trustee in this chapter shall be deemed to include the Bankruptcy Administrators in those states.

(n2)Footnote 2. *11 U.S.C. § 704(b)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *See ch. 6 infra.*

(n4)Footnote 4. *11 U.S.C. § 704(b)(1)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See 11 U.S.C. § 707(b)(2)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. *11 U.S.C. § 704(b)(2)*.



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CHAPTER 8 Enforcing the Automatic Stay

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CHAPTER 8 Enforcing the Automatic Stay

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Scope

SCOPE NOTE

This chapter discusses the protections of the automatic stay in bankruptcy cases provided by *section 362(a) of the Bankruptcy Code*. After reviewing the purpose and duration of the stay, the chapter focuses on the scope of the automatic stay and the broad range of activities against the debtor and the debtor's property that are prohibited by the stay. The exceptions to the stay that are significant in consumer bankruptcy cases and notice procedures for giving notice of the stay are also discussed. Finally, the chapter covers the remedies for violations and procedure for enforcing the stay. Other chapters in this guide cover the related issues of the codebtor stay in chapter 13 (chapter 9), how a creditor may obtain relief from an automatic stay (chapter 10), and the automatic protections against adverse actions by those who provide utility services to the debtor (chapter 12).



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CHAPTER 8 Enforcing the Automatic Stay

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P 8.01 Purpose of the Automatic Stay

The automatic stay is an instrument of awesome breadth and power, which is obtained by almost every debtor who files a bankruptcy petition. Few other legal steps that may be taken on behalf of a consumer can bring about relief so simply, so effectively, and so dramatically.

Indeed, the certainty of obtaining such relief is often a prime factor in the decision to file a case. In some situations, there may be no other remedy as effective, and usually none is as simple. For clients who have come to an attorney's office at the last possible minute before some serious adverse action, the automatic stay may provide the only practical solution. And for other clients, for whom all other legal steps have failed, it may provide one last way of at least postponing a crisis while the debtor seeks relief in the bankruptcy court.

The basic purpose of the automatic stay is to protect the debtor and the debtor's property. As stated in the House Report on the Bankruptcy Code:

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization, or simply to be relieved of the financial pressures that drove him into bankruptcy.ⁿ¹

Functionally, the stay also freezes the debtor's assets as of the date of filing, preventing individual creditors from picking away at them for their own benefit and to the detriment of the ultimate goals of the bankruptcy. In chapter 7 liquidation cases, this guarantees the protection of the debtor's property or equity therein, both so it can be exempted to provide a fresh start and so nonexempt property can be fairly distributed to creditors. In chapter 13, the stay ensures protection of property that may be necessary not only for the debtor's fresh start but also for the success of the debtor's plan.

Along with other provisions governing property of the estate, the stay permits the bankruptcy court to deal with all aspects of the debtor's situation in an orderly manner. It generally prevents, at least until such time as the bankruptcy court allows, other courts and parties from interfering with or complicating the bankruptcy process. Virtually all activity concerning the debtor and the debtor's property thus comes into a single forum to be handled in accordance with the (usually) overriding purposes of the bankruptcy.

Although the reach of the automatic stay is broad, it is not unlimited. Some actions that would otherwise fall within the scope of the stay are excepted from the stay by the Bankruptcy Code.ⁿ² These exceptions are typically based on particular policy objective, for example, a need to be able to enforce criminal penalties or collect payments for domestic support obligations. Even when actions are excepted from the stay, a court generally has the power to enjoin or limit such actions.ⁿ³

FOOTNOTES:

(n1)Footnote 1. H.R. Rep. No. 595, 95th Cong., 1st Sess. 340 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. (4)(d)(i) (Matthew Bender). *See In re Ionosphere Clubs, Inc.*, 922 F.2d 984 (2d Cir. 1990) (breathing spell from creditors is a principal purpose of automatic stay).

(n2)Footnote 2. *See P 8.03[4] infra.*

(n3)Footnote 3. *See P 8.03[5].*



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CHAPTER 8 Enforcing the Automatic Stay

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P 8.02 Duration of the Stay

The duration of the automatic stay can vary significantly depending upon the circumstances. Commonly, the stay lasts for the duration of the case, a matter of three to six months or longer in a chapter 7 and up to five years in a chapter 13. However, it may be terminated sooner by operation of law (e.g., if the debtor does not file a timely statement of intention in a chapter 7 casen1 or if the case is filed within one year after dismissal of a prior casen2 or by order of the court if circumstances require. As a practical matter, the stay usually is not ended or modified by the court in much less than 30 days. If two or more cases under any chapter were dismissed during the year prior to filing, the automatic stay does not go into effect except to the extent the court so orders.n3

Technically, the statuten4 provides that the stay continues until the following dates:

To the extent the stay is based upon provisions barring an act against property of the estate the earlier of:

- the date such property is no longer property of the estate (usually the date property is abandoned, or the date it is deemed abandoned at the close of the case under *section 554(c) of the Bankruptcy Code*);
- the date on which the stay is terminated by operation of law, order of the court, or by inaction of the court upon a request for relief from the stay.

To the extent the stay is against any other act, the earliest of the following:

- the date the case is closed;
- the date the case is dismissed;
- the date a discharge is granted or denied;
- the date on which the stay is terminated by order of the court or operation of law.n5

- the date such property is no longer property of the estate (usually the date property is abandoned, or the date it is deemed abandoned at the close of the case under *section 554(c) of the Bankruptcy Code*);
- the date on which the stay is terminated by operation of law, order of the court, or by inaction of the court upon a request for relief from the stay.
- the date the case is closed;
- the date the case is dismissed;
- the date a discharge is granted or denied;
- the date on which the stay is terminated by order of the court or operation of law.ⁿ⁵

Practically, however, the benefits of the stay may last a good deal longer. A lazy or inefficient opponent may not pay attention to when the bankruptcy ends, and thus may not reinstate actions promptly (assuming there remains an action to reinstate after the stay is terminated). While the court notifies all parties that the stay is in effect, usually as part of the notice of the meeting of creditors, and debtor's counsel may also give a notice of the stay,ⁿ⁶ in most circumstances there is no specific notice that the stay is terminated at the end of the case. In the interim a creditor may give up on or simply forget the course of action originally planned. In either case, much additional time may pass, sometimes years, to the benefit of the debtor. Indeed, a statute of limitations, which is extended, if necessary, until 30 days after termination of the stay,ⁿ⁷ may run before any action is taken.

FORMS

For examples of notices see Official Form 9, *reprinted in Collier Consumer Bankruptcy Forms*, § CS10.32 (Matthew Bender).

PRACTICE NOTE

If a case is dismissed, and a new filing is appropriate, a new automatic stay comes into effect. However, counsel should take care that the subsequent filing is in good faith and not barred by the 180 day limit of *section 109(g) of the Bankruptcy Code*.ⁿ⁸ In addition, if the new case is commenced within one year of a prior dismissal, the stay may be limited by section 362(c)(3). If there were two prior dismissals in a year, the stay does not come into effect without a court order.^{n8a} If relief from the stay is granted or the stay is terminated during a case, conversion of the case to another chapter does not create a new stay.ⁿ⁹

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 362(h), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n2)Footnote 2. 11 U.S.C. § 362(c)(3), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n3)Footnote 3. See P 8.03[4][c][ii] *infra*.

(n4)Footnote 4. 11 U.S.C. § 362(c)-(f), (h), (l), (m), as amended and enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. See 3 *Collier on Bankruptcy*, P 362.06 (Matthew Bender).

(n5)Footnote 5. Under *Fed. R. Bankr. P. 4001(a)(3)*, the stay remains in effect for 14 days after entry of the order granting relief, unless the court orders otherwise. *But see In re Duran*, 483 F.3d 653 (10[th] Cir. 2007) (§ 362(e) takes precedence over *Fed. R. Bankr. P. 4003(a)(3)* so creditor did not have to wait after order granting stay relief when time period in § 362(e) ended earlier).

(n6)Footnote 5. [Reserved]

(n7)Footnote 6. *See P 8.04[1] infra.*

(n8)Footnote 7. 11 U.S.C. § 108(c). *See, e.g., Valley Transit Mix of Ruidoso, Inc. v. Miller*, 928 F.2d 354 (10th Cir. 1991) .

(n9)Footnote 8. *See 2 Collier on Bankruptcy, P 109.08* (Matthew Bender).

(n10)Footnote 8a. *See P 8.03[4][c][ii] infra.*

(n11)Footnote 9. *In re State Airlines, Inc.*, 873 F.2d 264 (11th Cir. 1989) .



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 8 Enforcing the Automatic Stay

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P 8.03 Scope of the Automatic Stay

The acts prohibited by the automatic stay are set out in a series of overlapping statutory provisions.ⁿ¹ Together, those provisions prohibit a broad range of activities directed against the debtor and the debtor's property.

[1] Legal Proceedings

The stay bars "the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case ...or to recover a claim against the debtor that arose before the commencement of the case ...".ⁿ² Thus, almost all forms of civil legal actions are brought to an abrupt halt.ⁿ³ The only exceptions to this provision are actions that do not arise out of circumstances existing prior to the case and do not pertain to a claim that existed prior to the case and those specifically carved out by other parts of section 362, as discussed below. However, many of those actions may still be barred by a different provision of section 362(a).

[a] Types of Proceedings that Are Stayed

Among the many types of legal proceedings affected by the automatic stay are attachments, garnishmentsⁿ⁴ and executions, most evictions,ⁿ⁵ and some family-related court proceedings. A proceeding against the debtor commenced in the federal district court or court of appeals is stayed, notwithstanding the fact that they are "higher" courts than the bankruptcy court.ⁿ⁶ Even proceedings in which the debtor is sued solely in a fiduciary capacity, and proceedings based on admittedly nondischargeable debtsⁿ⁷ are prohibited unless an exception to the stay applies or the court grants relief from the stay. Also enjoined in most cases are most administrative proceedings such as those to revoke drivers' licenses,ⁿ⁸ to intercept tax refunds,ⁿ⁹ to determine and collect overpayments of public benefits, as well as arbitrations and other less formal proceedings. Appeals of all proceedings against the debtor are also stayed.ⁿ¹⁰

[b] Effect of Stay on Pending Legal Proceedings

No further steps may be taken against the debtor or the debtor's property in any stayed proceedings without the permission of the bankruptcy court.ⁿ¹¹ Ongoing discovery must also be discontinued. Similarly, civil contempt proceedings for alleged discovery order violations are stayed. Counsel bringing an action against the debtor has a duty to take action to halt a nonbankruptcy court's actions.ⁿ¹² However, the provision pertaining to legal proceedings is subject to several exceptions, discussed below.ⁿ¹³

[c] Legal Proceedings Initiated by the Debtor

It is important to note that 11 U.S.C. § 362 bars only actions against the debtor, not those brought by the debtor.ⁿ¹⁴ The debtor's actions may be continued after commencement of the case, although the trustee may acquire an interest in the action and a party may be able to remove the action to the bankruptcy court.ⁿ¹⁵ Occasionally, it is not clear whether an action is against the debtor or brought by the debtor, *e.g.*, in a case where a debtor's counterclaim predominates or where a defendant/debtor has filed an appeal. The answer to this question turns on whether the action was brought initially by or against the debtor.ⁿ¹⁶ When the original action was brought against the debtor, the action is stayed, even if the debtor would prefer that it go forward.ⁿ¹⁷

It is also quite clear that, except as provided in the codebtor stay provisions,ⁿ¹⁸ the stay does not affect acts against codebtors.ⁿ¹⁹ However, a creditor cannot pursue community property or entireties property owned jointly by the debtor and a codebtor, even if acquired after the bankruptcy, because section 362(a)(1) prohibits any legal action to recover a prepetition claim against the debtor and a "claim against the debtor" includes a claim against the debtor's property.ⁿ²⁰

MORE INFORMATION

For further discussion of the codebtor stay in chapter 13 see chapter 9 *infra*.

[2] Acts Directed at the Debtor's Property

Several provisions protect, in various ways, the property owned by the debtor at the time of filing. They also protect community property that is brought into the estate under section 541(a)(2).^{n20a} They generally prohibit:

- the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under title 11;ⁿ²¹
- any act to obtain possession of property of the estate or property from the estate or to exercise control over property of the estate;ⁿ²²
- any act to create, perfect, or enforce any lien against property of the estate;ⁿ²³ and
- any act to create, perfect, or enforce any lien to the extent that such lien secures a claim that arose before the commencement of the case under title 11.ⁿ²⁴

These provisions have slightly different effects depending upon whether a judgment or a lien is involved. A judgment obtained prior to filing cannot be enforced against either the debtor or property of the estate. This includes most injunctive as well as monetary judgments.ⁿ²⁵ And because legal proceedings are also stayed as to prepetition claims, only a judgment which arose solely out of postpetition claims can be enforced against the debtor without violation of the stay.ⁿ²⁶

PRACTICE NOTE

However, judgments on postpetition claims cannot be enforced against property of the estate. The provisions prohibiting acts to obtain possession or to utilize liens against property of the estate apply regardless of when the claim arose, as property of the estate is essentially frozen, to be administered only by the bankruptcy court. In a chapter 13 case, this can be very important because, generally, all property the debtor acquires during the entire time the case is pending becomes property of the estate.ⁿ²⁷ Although there is some debate regarding whether this protection continues after confirmation of the plan with respect to property that reverts in the debtor, it is clear that the stay continues to protect all property

if the plan or order confirming the plan postpones such revesting until the end of the case.ⁿ²⁸

The prohibition of acts to obtain possession also applies to property not owned by, but in possession of, the estate, such as leased property, even if the lease was terminated prior to the case.ⁿ²⁹ And it applies to any other property in which the debtor has any interest,ⁿ³⁰ to intangible property rights as well as to tangible property.ⁿ³¹

The stay also generally prevents any action to create, perfect or enforce a lien against property of the estate.ⁿ³² Although this provision prevents renewal or extension of most expiring liens while the stay is in effect,ⁿ³³ another provision of the Code effectively extends an existing lien until at least 30 days after the stay expires if renewal or extension of the lien is stayed.ⁿ³⁴

Finally, these provisions generally prevent the creation, perfection or enforcement of any lien against the debtor's property even if it is not property of the estate, *e.g.* most property acquired after the filing of the bankruptcy case or property abandoned in a chapter 7 case, if the lien secures a prepetition claim.ⁿ³⁵ Thus, repossessions and sales of repossessed property are clearly enjoined. If relief from the stay is subsequently granted to allow the sale of estate property to go forward, the creditor may be required to re-advertise and provide new notice of the sale to all interested parties including the debtor.

PRACTICE NOTE

The applicability of the stay to acts against property of the estate often turns on difficult questions about whether the debtor had a property interest at the time the case was filed.ⁿ³⁶ Generally, however, even a very limited interest brings the stay into effect. For example, probate proceedings concerning an estate from which the debtor may inherit property are stayed.ⁿ³⁷ The stay may halt even evictions, foreclosures or other transactions that are nearly complete, depending upon the state law as to the debtor's interest.ⁿ³⁸

In particular, the relationship of the stay to rights of redemption under state law has been the subject of frequent litigation. Here, too, the applicable state law may be critical, especially if the creditor must take some further action, such as obtaining a deed, after the redemption period runs.ⁿ³⁹ Where a creditor need take no affirmative act to assert its rights after the redemption period, the debtor's only protection may come from *section 108 of the Code*, which extends a redemption period to sixty days after the petition is filed if it would otherwise have expired earlier.ⁿ⁴⁰ It is unclear whether this period can be further extended under the broad powers granted to the bankruptcy court under section 105.ⁿ⁴¹ However, even if the right of redemption expires, the creditor must seek relief from the stay to file an action against the debtor for possession of the property.ⁿ⁴²

[3] Other Acts Prohibited by the Stay

The automatic stay also generally prohibits:

- any [other] act to collect, assess or recover a claim against the debtor that arose before the commencement of the case;ⁿ⁴³
- the setoff of any debt owing to the debtor that arose before the commencement of the case against any claim against the debtor;ⁿ⁴⁴ and
- the commencement or continuation of a proceeding before the United States Tax Court concerning Tax liability of the debtor for a taxable period ending before the date of the order for relief.ⁿ⁴⁵

These provisions round out the stay's protections. Unless permitted by a statutory exception to the stay, creditors, may

not engage in any collection activity, nor in any other acts to try to force the debtor to pay a prepetition claim. This prohibition encompasses all types of collection attempts: by mail, by phone, in person or through third parties. As noted earlier, the word "claim" is broadly defined to include not only rights to payment, regardless of whether they are liquidated, contingent, matured, disputed, or secured, but also many rights to equitable remedies.ⁿ⁴⁶

Administrative recoupments of public benefits, *i.e.* social security or welfare, based upon a claim of overpayment or fraud, are not allowed.ⁿ⁴⁷

If a collection motivation is shown, the withholding of a student's transcript or other benefits normally provided to nondebtors is also prohibited.ⁿ⁴⁸ Similarly, creditors may not exercise a right of setoff against the debtor's property, such as bank accounts, without violating the stay, nor may they garnish the debtor's wages, or collect their debts from property of the debtor, such as energy assistance payments, that comes into their hands.ⁿ⁴⁹ The reporting of a debt to a credit bureau is a violation of the stay if done with the intent to coerce a debtor into paying a prepetition debt.ⁿ⁵⁰ Even the acceptance of some payroll deductions authorized by the debtor before the bankruptcy on payments for a prepetition debt constitutes an act to collect that debt and thus a violation of the stay.ⁿ⁵¹

The interception of tax refunds to pay student loans or other debts being collected by the government, other than certain prepetition tax liabilities or domestic support obligations, is another example of an act that is stayed. Although it is sometimes not easy to determine the date the intercept actually occurred, if it occurred after the bankruptcy case was filed it is normally possible to have the intercepted funds returned to the debtor without litigation by contacting the student loan agency that received the funds.

PLANNING NOTE

However, the Supreme Court has held that a "freeze" on a debtor's bank account, by a bank to which the debtor owes money, does not constitute a setoff prohibited by the stay.ⁿ⁵² Usually, the best way to prevent such a freeze from occurring is to ensure that the debtor has no money deposited, at the time the bankruptcy petition is filed, with any institution that is a creditor. When possible, the debtor should also try to make sure that all checks written on such accounts have cleared prior to the petition date. If that cannot be done, the debtor may want to consider withdrawing all funds from the account, advising the payees on the undeposited checks not to deposit those checks, and paying the payees with cash, money orders, or replacement checks drawn on a different account.

Although the Supreme Court held that a temporary freeze on a debtor's bank account while a bank seeks relief from the stay in order to exercise a right of setoff is permissible, a more permanent freeze should be considered differently. If a creditor does not promptly seek relief from the stay in order to setoff its debt, the court's decision should not be considered applicable.ⁿ⁵³ Moreover, cases prohibiting a setoff or freeze in contravention of a confirmed plan providing for different treatment of the creditor's claim remain good law.ⁿ⁵⁴ In addition, there is no right to setoff prepetition debts against postpetition deposits in a bank account.ⁿ⁵⁵

Historically, the Internal Revenue Service (IRS) had been one of the most frequent adversaries in litigation regarding these issues. In several instances, the IRS was held in contempt for setting off tax refunds without getting relief from the stay.ⁿ⁵⁶ While section 362(b)(26), enacted in 2005,ⁿ⁵⁷ now permits the IRS to setoff tax refunds for prepetition tax periods against prepetition tax debts, it is clear that without relief from the automatic stay, the IRS may not setoff prepetition tax liability with tax refunds for post-petition tax periods. Further, chapter 13 plans may prohibit setoffs after confirmation of the plan. In any case, it is clear that there is no right to setoff if the tax debt is a prebankruptcy debt and the right to a refund is a postbankruptcy debt; the IRS would have no justification for freezing the debtor's funds in that situation.ⁿ⁵⁸

[4] Exceptions to the Automatic Stay

The breadth of the automatic stay is narrowed by twenty-eight exceptions listed in section 362(b) and the limitations imposed by sections 362(c)(3), (4) and 362(h). Some of these exceptions prevent the application of the stay in certain circumstances, while others limit the duration of the stay. Several of the exceptions have little bearing in consumer cases (such as those concerning commodity futures or HUD foreclosures on multiple-family dwellings). Some, though, are occasionally significant.

[a] Criminal Proceedings

The stay does not automatically prohibit commencement or continuation of criminal proceedings.ⁿ⁵⁹ Thus, a criminal case based upon a bad check can continue without violation of the stay.ⁿ⁶⁰ This exception, however, does not necessarily protect a private creditor who instigates such proceedings in an attempt to collect a debt.ⁿ⁶¹ This exception also does not include the collection of a monetary liability imposed as part of a probation program or as restitution in a criminal case.ⁿ⁶² However, it is less clear whether a court could, under the guise of continuing a criminal case, substitute jail time for unpaid restitution as an element of the punishment for the crime. The Supreme Court did not fully resolve this issue in the *Davenport* case, but implied that restitution orders may not be enforced during bankruptcy at all and at least some courts have so held.ⁿ⁶³ However, if the debtor does not pay according to the restitution order and then fails either to pay the order during the case or to obtain a discharge of the debt,ⁿ⁶⁴ the consequences may be severe.

It is unclear whether contempt proceedings are stayed. The answer may turn on the distinction between civil and criminal contempt. When the contempt proceeding is intended to coerce payment of a debt, as opposed to upholding the dignity of the court, the stay almost certainly applies.ⁿ⁶⁵

[b] Proceedings Concerning Domestic Support Obligations

The 2005 amendments to the Bankruptcy Codeⁿ⁶⁶ expanded the type of actions with respect to domestic support obligationsⁿ⁶⁷ which are excepted from the automatic stay. Specifically, the stay does not apply to the commencement or continuation of civil actions or proceedings to establish paternity, or to establish or modify an order for a domestic support obligation, or that concern child custody or visitation, domestic violence, or the dissolution of a marriage, except to the extent that the dissolution proceeding seeks to determine the division of estate property.ⁿ⁶⁸ Also, excepted from the stay are various methods of domestic support obligation enforcement; (1) the withholding, suspension, or restriction under state law of a driver's license, a professional or occupational license, or a recreational license, as specified in section,ⁿ⁶⁹ (2) the reporting of overdue support owed by a parent to any consumer reporting agency,ⁿ⁷⁰ (3) the interception of a tax refund,ⁿ⁷¹ and (4) the enforcement of a medical obligation.ⁿ⁷²

Section 362(b)(2)(C), enacted in 2005,ⁿ⁷³ provides an exception to the stay with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute. This amendment primarily affects chapter 13 cases. The property of the estate for chapter 13 purposes includes the debtor's post-petition earnings until the case is closed, which may be a number of years after the commencement of the case.ⁿ⁷⁴ Section 362(b)(2)(C) excepts from the stay withholding of such income whether or not the property of the estate reverts in the debtor upon confirmation under section 1327.ⁿ⁷⁵

Section 362(b)(2)(B) continues to except from the automatic stay the collection of a domestic support obligation from property that is not property of the estate. Thus, in a chapter 7 case, postpetition income can be collected and retained by an obligee for this purpose, but property of the estate cannot (at least until it has gone out of the estate because it is exempt or abandoned).ⁿ⁷⁶ By contrast, in chapter 13 cases, actions against property acquired by the debtor post-petition which become property of the estate are stayed (except as provided in 362(b)(2)(C)).

[c] Exceptions Arising by Reason of or From a Prior Case

In some situations, the automatic stay might not apply by reason of a prior case under the Bankruptcy Code or a court order in a prior case. For example, the automatic stay is limited in a case filed by a debtor who has had a prior case dismissed within the year before the petition.ⁿ⁷⁷ Additionally, the stay does not become effective upon filing in a case filed by a debtor who has had two or more prior cases dismissed within the year.ⁿ⁷⁸ The 2005 amendments to the Bankruptcy Codeⁿ⁷⁹ also except in connection with some serial filings certain actions to enforce a security interest in real property.ⁿ⁸⁰

[i] Prior Dismissed Case Within Year of Filing

Section 362(c)(3) limits the duration of the automatic stay in a case filed by a debtor who has had a prior case dismissed within the year before the petition.ⁿ⁸¹ Because the provision applies to each debtor individually, the expiration or inapplicability of the stay with respect to a debtor does not apply to a joint debtor who has not filed a prior case.^{n81a} If the debtor has had a prior single or joint case dismissed within the preceding one-year period, the automatic stay provided under § 362(a) expires with respect to the debtor 30 days after the filing of the petition unless it is extended by the court. However, most courts have held, based on the language of section 362(c)(3) and (4), that the stay continues with respect to property of the estate.^{n81b}

Section 362(c)(3)(B) provides that upon motion of a party in interest, and after notice and hearing before the 30 days expires, the court may continue the automatic stay as to some or all creditors. For a continuation of the stay, the movant must demonstrate that the case was filed in good faith as to the creditors to be stayed. Based on the language requiring a hearing within 30 days, the moving party should ensure that a hearing on the motion is scheduled within that period. However, if the motion is unopposed and the allegations of the motion are deemed admitted, many courts will grant such a motion without a hearing.

A case is presumptively not filed in good faith if:

- more than one case under chapter 7, 11 or 13 filed by or against the debtor was pending within the preceding one-year period;
- the prior case was dismissed within the preceding one-year period after the debtor failed to (a) file or amend without substantial excuseⁿ⁸² the petition or any required documents, (b) provide adequate protection ordered by the court, or (c) perform the terms of a confirmed plan; or
- there has not been a substantial change in the debtor's circumstances or is not some other reason that the case will be successfully concluded with a discharge; or
- with respect to a creditor who sought relief in a prior case, if such request was still pending when the case was dismissed or was resolved by termination, conditioning or limiting the stay.ⁿ⁸³

The presumption created by section 362(c)(3)(C), however, does not apply if the prior case is dismissed because the debtor has entered into a debt repayment plan.ⁿ⁸⁴

PRACTICE NOTE

Any party in interest may seek order confirming that the automatic stay has been terminated under section 362(c).ⁿ⁸⁵ This may be a prudent action for creditors who are uncertain of whether the stay is effective based on the provisions of sections 362(c)(3) or 362(c)(4). A mistaken belief that the automatic stay is not in effect does not eliminate liability for stay violations.

[ii] Two or More Dismissed Cases Within Year of Filing

Section 362(c)(4) prevents the automatic stay from taking effect in a case filed by a debtor who has had two or more prior cases dismissed within the year.ⁿ⁸⁶ Because the provision applies to each debtor individually, the expiration or inapplicability of the stay with respect to a debtor does not apply to a joint debtor who has not filed a prior case.^{n86a} However, upon motion of a party in interest filed within 30 days after the filing of the later case, and after notice and hearing, the court may order the automatic stay to take effect as to any or all creditors, subject to conditions or limitations that the court may impose.ⁿ⁸⁷ For a continuation of the stay, the movant must demonstrate that the case was filed in good faith as to the creditors to be stayed. The motion may have to be filed on an emergency basis with shortened notice period due to imminent impending creditor actions. If, for some reason, a motion is not filed within this time period, the court has the equitable power under section 105 to order an injunction that is the equivalent of the automatic stay, at least prospectively.^{n87a} Alternatively, the terms of a confirmed chapter 13 plan can provide equivalent relief.

As under section 362(c)(3), a presumption that a case was not filed in good faith may arise under this subsection, subject to rebuttal by clear and convincing evidence to the contrary. Section 362(c)(4)(D) lists the criteria under which the presumption arises, and these criteria are similar to those set out in section 362(c)(3)(C).ⁿ⁸⁸

[iii] In Rem Orders

Section 362(b)(20), enacted in 2005,ⁿ⁸⁹ creates an exception for the enforcement of a lien against or security interest in real property following the entry of an order under section 362(d)(4) in a prior bankruptcy case prohibiting the application of the automatic stay as to that property. Section 362(d)(4) provides that upon the request of a creditor whose claim is secured by an interest in real property, and after notice and hearing, the court may grant relief from the stay with respect to an act against the property if the court finds that the filing of the petition was part of a scheme to delay, hinder, and defraud creditors that involved either (1) the transfer of all or part ownership of or interest in the property without the consent of the secured creditor or court approval; or (2) multiple bankruptcy filings affecting the property. Unless relief from such order is granted in a subsequent case, it remains effective for two years after the date of entry.ⁿ⁹⁰

MORE INFORMATION

Chapter 10 *infra* examines relief from the automatic stay.

[iv] Filing by Ineligible Debtor or in Violation of Court Order

Section 362(b)(21), also enacted in 2005,ⁿ⁹¹ renders the stay inapplicable to enforcement of a lien on or security interest in real property if the debtor files a new petition during a period when the debtor is ineligible for relief under § 109(g) or filed the case in violation of a prior court order limiting new bankruptcy case filings. In a joint case, this provision would apply only if both debtors are ineligible under section 109(g) or subject to the prior court order.ⁿ⁹²

PRACTICE NOTE

Creditors relying on this exception to the stay based on § 109(g) run the risk of violating the stay if the debtor prevails in a dispute about whether he or she is eligible for relief. A mistaken belief that the automatic stay does not apply by virtue of section 362(b)(21) does not vitiate the willfulness of the action.

[d] Exception Related to Residential Property Evictions

The 2005 amendments to the Bankruptcy Code,ⁿ⁹³ enacted two new provisions which except from the stay certain

actions to recover possession of residential real property. Section 362(b)(22) applies to cases in which the lessor has obtained a prepetition judgment for possession of leased residential property, and section 362(b)(23) concerns eviction proceedings based on the endangerment of such property or the illegal use of controlled substances on such property.

[i] Prepetition Judgment for Possession

Section 362(b)(22) provides that the automatic stay under section 362(a)(3) does not apply if the lessor has obtained a judgment for possession prior to the filing of the bankruptcy.ⁿ⁹⁴ However, under section 362(l), enacted in 2005,ⁿ⁹⁵ the debtor may obtain an automatic stay for 30 days from the date the petition is filed, if the debtor files and serves on the lessor a certification under penalty of perjury that (1) the debtor has a right to cure the monetary default under nonbankruptcy law, and (2) the debtor, or an adult dependent of the debtor, has deposited with the clerk of the bankruptcy court all rent that would become due during the 30-day period after the filing of the petition. Thus, the filing of a certification with the petition by the debtor negates the effect of section 362(b)(22), at least for a period of 30 days. The debtor may obtain a stay under section 362(a)(3) beyond the 30 days after the petition if the debtor files, within 30 days after the petition, a further certification under section 362(l)(2) that the monetary default upon which eviction is being sought has been completely cured.

The lessor may file and serve on the debtor an objection to any certification filed under section 362(l)(1) (1) or (l)(2).ⁿ⁹⁶ If an objection is filed, the court must hold a hearing within 10 days to determine if the certification is true.ⁿ⁹⁷

If a judgment for possession has been obtained for a property in which the debtor resides has been obtained before the bankruptcy case is filed, the debtor must indicate on the bankruptcy petition that such a judgment has been obtained, and state the name and address of the lessor on the petition or any certification.ⁿ⁹⁸ If no certification is filed with the petition, the clerk must "immediately" serve on the debtor and the lessor a certified copy of the docket indicating the lack of a certification and the applicability of section 362(b)(22).ⁿ⁹⁹ If the debtor files a certification with the petition and makes the required deposit with the clerk, the clerk is to promptly transmit the deposit to the lessor.ⁿ¹⁰⁰

[ii] Endangerment of Property or Illegal Drug Use

Section 362(b)(23), added by the 2005 amendment to the Bankruptcy Code,ⁿ¹⁰¹ provides that the automatic stay under section 362(a)(3).ⁿ¹⁰² This stay exception applies only if the lessor files with the bankruptcy court and serves on the debtor a certification under penalty of perjury that such an eviction has been commenced or that the debtor has within 30 days before the certification either endangered the property or illegally used or allowed to be used controlled substances at the property.ⁿ¹⁰³

Section 362(m)(1) provides that this stay exception applies 15 days after the lessor files and serves the certification described in section 362(b)(23).ⁿ¹⁰⁴ If the debtor files and serves on the lessor an objection challenging the truth or legal sufficiency of the lessor's certification, the stay exception under section 362(b)(23) does not apply unless the court orders otherwise at a hearing held within 10 days after the filing of the objection.ⁿ¹⁰⁵ At the hearing, the debtor may demonstrate that the situation which gave rise to the lessor's certification of alleged property endangerment or illegal drug use either did not exist or has been remedied.ⁿ¹⁰⁶ If the court rules against the debtor, or if no objection to lessor's certification is filed, the clerk must "immediately" serve a certified copy of the docket indicating failure to object or court's order on the lessor and debtor.ⁿ¹⁰⁷

PRACTICE NOTE

Under section 362(b)(23), the bankruptcy court may be called upon to conduct contested hearings and make findings of fact regarding issues left to state courts by granting relief from stay under section 362(d). State courts, which routinely hear such matters, may present a better forum for raising issues

related to endangerment of property or illegal drug use. In those circumstances, lessors may prefer to file a stay relief motion rather than submit a certification despite the possible advantage of the expedited stay termination under section 362(b)(23).

[e] Setoff of Income Tax Refunds

Section 362(b)(26), enacted in 2005,ⁿ¹⁰⁸ permits taxing authorities to setoff tax refunds for prepetition tax periods against prepetition tax debts. Both the tax refund and the tax liability must relate to a taxable period that ended before the date of the order for relief. Alternatively, if there is a pending action to determine tax liability, a taxing authority may hold a refund pending the outcome of the action. However, on motion by the trustee and after notice and hearing, the court may order turnover of the refund, but only if the taxing authority is granted adequate protection.

[f] Personal Property Stay Termination

Section 362(h), added by the 2005 Act,ⁿ¹⁰⁹ terminates the automatic stay with respect to personal property, and renders that property no longer property of the estate, if the debtor fails to timely file a statement of intention under section 521(a)(2). The stay may also be terminated if the debtor fails to indicate on the statement an intention to surrender the property, to redeem the property or enter into a reaffirmation agreement with respect to the underlying claim.ⁿ¹¹⁰ Additionally, section 362(h)(1)(B) provides that the stay under section 362(a) is terminated if the debtor does not take timely the actionⁿ¹¹¹ specified in the statement of intention, unless the statement specifies an intention to reaffirm the debt on the original contract terms and the creditor refuses to agree to such reaffirmation.

It appears that if a debtor is willing to reaffirm any part of a debt secured by the property, perhaps equal to the value of the property, the debtor may state an intention to reaffirm and avoid termination of the stay for failing to state an intention to reaffirm. The exception to section 362(h)(1)(B) applies when the debtor's statement of intention specifies an intention to reaffirm on the original contract terms and the creditor refuses. However, the language in 362(h)(1)(A) does not limit compliance to reaffirmation agreements based on the original contract terms. Thus, a timely action to enter into a reaffirmation agreement, as stated in debtor's statement of intention, irrespective of whether it is based on the original contract terms, should be sufficient to avoid the termination of the stay under 362(h)(1)(B).

Significantly, section 362(h) does not create substantive rights. It only removes the stay as an impediment to actions that are otherwise permitted. Because the language of section 521(a)(2) was not significantly changed, and because many courts had held that a debtor has the right to retain collateral if the underlying debt payments were kept current after the case when the automatic stay had terminated, it is not at all clear that a creditor is given the right to repossess property from a debtor who is current in payments, even when section 362(h) is effective.

[g] Other Exceptions

Certain acts to perfect or continue perfection of security interests in property, mainly U.C.C. filings which relate back to their creation, are also permitted,ⁿ¹¹² as are proceedings and enforcement of some non-money judgments pursuant to governmental regulatory powers.ⁿ¹¹³ Courts have disagreed regarding whether some or all criminal or noncriminal forfeiture proceedings come within the latter exception.ⁿ¹¹⁴ Even when there is a regulatory action, courts look carefully to determine whether the real goal of the proceeding is to collect money from the debtor.ⁿ¹¹⁵

Another exception to the automatic stay allows negotiation of checks which were delivered prepetition.ⁿ¹¹⁶ Yet another permits taxing authorities to conduct an audit to determine tax liability, issue a notice of deficiency, make a demand for tax returns, and make an assessment for any tax along with a notice and demand for payment.ⁿ¹¹⁷ And yet another permits the attachment of property tax liens that arise automatically when those taxes are not paid.ⁿ¹¹⁸ Similarly, there is an exception to the stay which permits the creation of postpetition statutory liens for property taxes or special assessments on real property.ⁿ¹¹⁹ Still other exceptions to the stay exist, but they are rarely applicable in

consumer bankruptcy cases.ⁿ¹²⁰

Under the 2005 amendments to the Bankruptcy Code, the stay also does not apply to transfers not avoidable under sections 544 and 549,ⁿ¹²¹ does not prohibit the exclusion of the debtor from participating in federal health care programs,ⁿ¹²² and does not stay certain wage withholding and collection on certain retirement fund loans.ⁿ¹²³

Finally, it is clear that proceedings and actions pursued by the debtor against others are not stayed.ⁿ¹²⁴ Although this may occasionally become complicated when there are claims and counterclaims in one action or multiple parties, the distinction can and should be made; the debtor's action should be permitted to proceed.ⁿ¹²⁵

[5] Nonautomatic Stays

None of the inclusions or exceptions to the automatic stay in any way limits the general injunctive power of the court, under *section 105(a) of the Code*, to stay other actions.ⁿ¹²⁶ Thus, if the automatic stay is found to be not applicable to a criminal proceeding based upon a bad check, the court may nonetheless be persuaded that the purpose of the action is really to collect the liability and thus to circumvent the bankruptcy. Some bankruptcy courts have held that when restitution is a likely result, the prosecution of criminal actions can be enjoined.ⁿ¹²⁷ However, several appellate decisions have not looked favorably on such injunctions, holding them violative of the principles of federal-state court comity.ⁿ¹²⁸ One possible alternative method is an injunction that prevents a creditor from receiving or profiting from any restitution order.ⁿ¹²⁹ If such orders against creditors became a predictable response to the initiation of bad check prosecutions for collection purposes, such prosecutions would soon be few in number.

Similarly, the action of a private employer in discharging an employee,ⁿ¹³⁰ or of some other entity which would affect the debtor's income or expenses, might well be enjoined under section 105 if such an injunction is necessary for success of a chapter 13 plan. An injunction in such cases is not automatic upon filing; it must be specifically sought. A court may also occasionally be persuaded that an injunction against a creditor collecting from a nondebtor third party is necessary for the success of the plan.ⁿ¹³¹

Furthermore, the court may use its powers under section 105 to reinstate the automatic stay if it has previously been terminated.ⁿ¹³² Thus, if the stay was allowed to terminate through inadvertence, or if a substantial change in circumstances has occurred since a court order lifting the stay, the court may renew all or some of its protections. An order granting relief from the stay may also be superseded by the provisions of a confirmed chapter 13 plan, at least if the creditor has had fair notice that the plan proposes to alter the order.ⁿ¹³³

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 362(a)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. *11 U.S.C. 362(a)(1)*.

(n3)Footnote 3. *11 U.S.C. § 362(a)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *Sunshine Development Inc. v. F.D.I.C.*, 33 F.3d 106 (1st Cir. 1994) (FDIC is not exempt from stay when acting as receiver or conservator since it is not exercising regulatory powers excepted by *11 U.S.C. § 362(b)(4)*); *In re Colonial Realty Co.*, 980 F.2d 125, 28 C.B.C.2d 28 (2d Cir. 1992) (provisions of Federal Deposit Insurance Act giving FDIC rights superior to a bankruptcy trustee did not make automatic stay provisions inapplicable to FDIC).

(n4)Footnote 4. *See In re Roberts*, 175 B.R. 339 (B.A.P. 9th Cir. 1994) (state franchise tax board violated stay by continuing to accept payments from debtor's employer pursuant to prepetition garnishment).

(n5)Footnote 5. *In re Smith Corset Shops Inc.*, 696 F.2d 971, 976, 7 C.B.C.2d 1009, 1014 (1st Cir. 1982) .

(n6)Footnote 6. *See Constitution Bank v. Tubbs*, 68 F.3d 685 (3d Cir. 1995) (district court judgment was void, and therefore court of appeals had no jurisdiction, when it was entered in violation of stay, even though district court purported to enter judgment *nunc pro tunc* to date prior to bankruptcy filing).

(n7)Footnote 7. *See In re Merchant*, 958 F.2d 738, 28 C.B.C.2d 1290 (6th Cir. 1992) (actions to collect nondischargeable student loan violate stay). *Arneson v. Farmers Ins. Exch.* (*In re Arneson*), 282 B.R. 883 (B.A.P. 9th Cir. 2002) . *But see Palm v. Cady* (*In re Cady*), 315 F.3d 1121 (9th Cir. 2003) (creditor that obtains judgment of nondischargeability may proceed against property of the debtor, but not property of the estate); *In re Embry*, 10 F.3d 401, 30 C.B.C.2d 435 (6th Cir. 1993) (once creditor obtained determination that debt was nondischargeable in chapter 7 case due to false pretenses, creditor could proceed against property that was not property of the estate without violating the automatic stay). Note, however, that exempted property is protected during and after the case. 11 U.S.C. § 522(c).

(n8)Footnote 8. *In re Duke*, 31 C.B.C.2d 24, 167 B.R. 324 (Bankr. D.R.I. 1994) (stay prohibited state from suspending debtor's driver's license for failure to pay judgment.)

(n9)Footnote 9. *In re Herron*, 177 B.R. 866 (Bankr. N.D. Ohio 1995) (student loan creditor's failure to act to reverse postpetition tax refund intercept after notice of bankruptcy was willful stay violation.) *But see* 11 U.S.C. §§ 362(b)(2)(F), 362(b)(26).

(n10)Footnote 10. *See, e.g., Raymark Indus. v. Lai*, 973 F.2d 1125 (3d Cir. 1992) (appeal stayed even though debtor had posted deposit to stay execution prepetition); *Sheldon v. Munford, Inc.*, 902 F.2d 7, 23 C.B.C.2d 1163 (7th Cir. 1990) (appeal stayed even where appellant-debtor had filed supersedeas bond).

(n11)Footnote 11. *Ellis v. Consolidated Diesel Elec. Corp.*, 894 F.2d 371 (10th Cir. 1990) (dismissal of case against debtor violates stay). *See also In re Knightsbridge Dev. Co.*, 884 F.2d 145 (4th Cir. 1989) (postpetition entry of arbitration award violates stay where arbitrators had not completed their deliberations before the petition was filed); *In re Tampa Chain Co.*, 835 F.2d 54 (2d Cir. 1987) (appeal of defendant in adversary proceeding cannot be dismissed after that defendant became debtor in his own bankruptcy case). *But see Taylor v. Slick*, 178 F.3d 698, 41 C.B.C.2d 1785 (3d Cir. 1999) , *cert. denied*, 528 U.S. 1079, 120 S. Ct. 797 (2000) (postponement of foreclosure sale to new date does not violate stay); *In re Peters*, 101 F.3d 618 (9th Cir. 1996) (erroneously holding that the action of continuing a foreclosure sale was permitted because it merely preserved the status quo). *Compare In re Derringer*, 375 B.R. 903 (B.A.P. 10th Cir. 2007) (filing and serving notice of foreclosure was more than mere postponement or continuance of sale so it violated stay).

(n12)Footnote 12. *Eskanos & Adler, P.C. v. Leetien*, 309 F.3d 1210 (9th Cir. 2002) (failure to dismiss or stay pending collection action against debtor was willful violation of stay). *In re Scroggin*, 364 B.R. 772 (B.A.P. 10th Cir. 2007) (creditor willfully violated stay when it waited 12 weeks before it sent release of wage garnishment to employer).

(n13)Footnote 13. *See* P 8.03[4] *infra*.

(n14)Footnote 14. *Matter of U.S. Abatement Corp.*, 39 F.3d 563, 32 C.B.C.2d 769 (5th Cir. 1994) (creditor's motion with respect to debtor's counterclaim did not violate stay because counterclaim was not claim against the debtor); *Koolik v. Markowitz*, 40 F.3d 567 (2d Cir. 1994) (debtor's appeal of judgment on counterclaim against debtor was stayed because counterclaim was an action or proceeding against debtor); *Brown v. Armstrong*, 949 F.2d 1007 (8th Cir. 1991) (automatic stay does not apply to the debtor's action against the Farmers Home Administration).

(n15)Footnote 15. *See* 1 *Collier on Bankruptcy*, P 3.07 (Matthew Bender), 1 *Collier Bankruptcy Manual*, P 3.07 (Matthew Bender) for discussion of removal of proceedings to bankruptcy court.

(n16)Footnote 16. *Delpit v. C.I.R.*, 18 F.3d 768, 30 C.B.C.2d 1745 (9th Cir. 1994) (appeal from Tax Court proceeding was stayed because it was continuation of what was originally an administrative proceeding to collect taxes from the debtor); *Nielsen v. Price*, 17 F.3d 1276 (10th Cir. 1994) (stay did not apply to appeal in adversary proceeding

initiated by debtors in prior bankruptcy); *Alpern v. Lieb*, 11 F.3d 689 (7th Cir. 1993) (appeal from dismissal of suit originally filed by debtor was not stayed); *Farley v. Henson*, 2 F.3d 273, 29 C.B.C.2d 702 (8th Cir. 1993) (debtor's appeal in action brought against debtor was stayed). *But see Mason v. Oklahoma Turnpike Authority*, 115 F.3d 1442 (10th Cir. 1997) (Code did not prevent debtor's appeal in action originally brought against debtor but did stay plaintiff's cross appeal).

(n17)Footnote 17. *See Borman v. Raymark Indus., Inc.*, 946 F.2d 1031, 25 C.B.C.2d 1169 (3d Cir. 1991) (debtor's appeal of judgment against it is stayed).

(n18)Footnote 18. 11 U.S.C. § 1201, 1301.

(n19)Footnote 19. *Credit Alliance Corp. v. Williams*, 851 F.2d 119 (4th Cir. 1988); *Wedgeworth v. Fibreboard Corp.*, 706 F.2d 541, 8 C.B.C.2d 1119 (5th Cir. 1983).

(n20)Footnote 20. 11 U.S.C. § 102(2). *See In re Passmore*, 29 C.B.C.2d 523, 156 B.R. 595 (Bankr. E.D. Wis. 1993) (creditor could not attach postpetition wages of debtor's spouse, as they were community property in which debtor had an undivided interest). *See generally* Sommer and McGarity, Collier Family Law and the Bankruptcy Code, ch. 4 (Matthew Bender) for discussion of community property issues in bankruptcy.

(n21)Footnote 20a. *See In re Thongta*, 401 B.R. 363 (Bankr. E.D. Wis. 2009) (creditor of nondebtor spouse violated stay by docketing tort judgment against her because judgment created lien on community property); *In re Passmore*, 156 B.R. 595 (Bankr. E.D. Wis. 1993) (creditor could not attach postpetition wages of debtor's spouse, as they were community property in which debtor had an undivided interest), *supra*.

(n22)Footnote 21. 11 U.S.C. § 362(a)(2). *See 3 Collier on Bankruptcy*, P 362.03[4] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.03[2] (Matthew Bender).

(n23)Footnote 22. 11 U.S.C. § 362(a)(3). *See 3 Collier on Bankruptcy*, P 362.03[5] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.03[3] (Matthew Bender).

(n24)Footnote 23. 11 U.S.C. § 362(a)(4). *See 3 Collier on Bankruptcy*, P 362.03[6] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.03[4] (Matthew Bender).

(n25)Footnote 24. 11 U.S.C. § 362(a)(5). *See 3 Collier on Bankruptcy*, P 362.03[7] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.03[5] (Matthew Bender).

(n26)Footnote 25. Certain judgments obtained by governmental units to enforce police or regulatory powers may be enforced. 11 U.S.C. § 362(b)(4). Additionally, enforcement of a prepetition judgment for possession with respect to a residential real property lease is not stayed. 11 U.S.C. 362(b)(22), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005, except if the debtor has a right to cure the default and deposits the next month's rent with the court. *See P 8.03[4] infra*.

(n27)Footnote 26. *See Taylor v. First Fed. Sav. & Loan Ass'n of Monessen*, 843 F.2d 153 (3d Cir. 1988); *In re Petruccelli*, 22 C.B.C.2d 1519, 113 B.R. 5 (Bankr. S.D. Cal. 1990).

(n28)Footnote 27. 11 U.S.C. § 1306(a). *Security Bank of Marshalltown, Iowa v. Neiman*, 1 F.3d 687 (8th Cir. 1993) (property acquired by chapter 13 debtor during case continues to be property of the estate protected by the stay after it vests in the debtor upon confirmation).

(n29)Footnote 28. 11 U.S.C. § 1327(b) provides that confirmation vests estate property in the debtor only if the plan does not provide otherwise. This will extend the protection of the stay. *See In re Lambright*, 125 B.R. 733 (Bankr. N.D. Tex. 1991); *In re Petruccelli*, 22 C.B.C.2d 1519, 113 B.R. 5 (Bankr. S.D. Cal. 1990); *In re Denn*, 10 C.B.C.2d

279, 37 B.R. 33 (Bankr. D. Minn. 1983) .

(n30)Footnote 29. *In re Atlantic Business & Community Corp.*, 901 F.2d 325 (3d Cir. 1990) (mere possessory interest in property triggers stay); *In re 48th St. Steakhouse*, 835 F.2d 427, 17 C.B.C.2d 1415 (2d Cir. 1987) , cert. denied, 485 U.S. 1035 (1988) (same). But see 11 U.S.C. § 362(b)(22), discussed below.

(n31)Footnote 30. *Missouri v. U.S. Bankruptcy Court*, 647 F.2d 768, 4 C.B.C.2d 306 (8th Cir. 1981) , cert. denied, 454 U.S. 1162 (1982) . See also *Borman v. Raymark Indus., Inc.* 946 F.2d 1031 (3d Cir. 1991) (section 362(a)(3) protects property of the estate even if it is not in the debtor's possession).

(n32)Footnote 31. *Tringali v. Hathaway Machinery Co.*, 796 F.2d 553, 15 C.B.C.2d 273 (1st Cir. 1986) (debtor's interest in a liability insurance policy is property subject to the automatic stay); *In re Minoco Group of Companies, Ltd.*, 799 F.2d 517, 15 C.B.C.2d 1277 (9th Cir. 1986) (prepaid policy may not be canceled by the issuing company without relief from the stay). Cf. *Hazen First State Bank v. Speight*, 888 F.2d 574 (8th Cir. 1989) (stay does not prevent contract from expiring by its own terms).

(n33)Footnote 32. But see *Mann v. Chase Manhattan Mortg. Corp.*, 316 F.3d 1 (1st Cir. 2003) (adding charges to debtor's mortgage account in company's internal bookkeeping, absent any overt attempt to collect the fees, did not violate automatic stay); *Beeler v. Jewell (In re Stanton)*, 303 F.3d 939 (9th Cir. 2002) (increase in lien on debtors' home due to new advances on loan to corporation that debtors had guaranteed did not violate stay).

(n34)Footnote 33. A 1994 amendment to 11 U.S.C. § 362(b)(3) permits acts to maintain or continue perfection of a lien in certain limited circumstances.

(n35)Footnote 34. See 11 U.S.C. § 108(c); *In re Hunters Run Ltd. Partnership*, 875 F.2d 1425, 21 C.B.C.2d 491 (9th Cir. 1989) ; *In re Morton*, 866 F.2d 561, 20 C.B.C.2d 465 (2d Cir. 1989) .

(n36)Footnote 35. *In re Brooks*, 871 F.2d 89 (9th Cir. 1989) (creditor cannot re-record deed after bankruptcy to perfect interest in debtor's property by changing incorrect property description).

(n37)Footnote 36. See *United States v. Pelullo*, 178 F.3d 196 (3d Cir. 1999) (debtor had no interest in assets which had been divested by a criminal forfeiture order prior to bankruptcy petition).

(n38)Footnote 37. *In re Molitor*, 183 B.R. 547 (Bankr. E.D. Ark. 1995) (probate proceedings that occurred without relief from the stay were void; stay protected trustee's right to be involved in distribution of probate estate).

(n39)Footnote 38. See, e.g., *In re 48th St. Steakhouse*, 835 F.2d 427, 17 C.B.C.2d 1415 (2d Cir. 1987) , cert. denied, 485 U.S. 1035 (1988) (notice of lease termination to debtor's sublessor violated stay).

(n40)Footnote 39. See *Fish Market Nominee Corp. v. Pelofsky*, 72 F.3d 4 (1st Cir. 1995) (stay prevented state court order terminating debtor's right of redemption during bankruptcy case).

(n41)Footnote 40. 11 U.S.C. § 108; *Matter of Tynan*, 773 F.2d 177, 13 C.B.C.2d 655 (7th Cir. 1985) ; *Johnson v. First Nat'l Bank of Montevideo*, 719 F.2d 270, 9 C.B.C.2d 579 (8th Cir. 1983) , cert. denied, 465 U.S. 1012 (1984) (automatic transfer of property under Minnesota law would not violate stay). See 2 *Collier on Bankruptcy*, P 108.03[2] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 108.03[2] (Matthew Bender).

(n42)Footnote 41. Compare *Johnson v. First Nat'l Bank of Montevideo*, 719 F.2d 270, 9 C.B.C.2d 579 (8th Cir. 1983) , cert. denied, 465 U.S. 1012 (1984) with *Bank of Ravenswood v. Patzold*, 27 B.R. 542 (N.D. Ill. 1982) .

(n43)Footnote 42. 11 U.S.C. § 362(a)(3).

(n44)Footnote 43. 11 U.S.C. § 362(a)(6). See 3 *Collier on Bankruptcy*, P 362.03[8] (Matthew Bender); 1 *Collier*

Bankruptcy Manual, P 362.03[6] (Matthew Bender).

(n45)Footnote 44. 11 U.S.C. § 362(a)(7). See 3 *Collier on Bankruptcy*, P 362.03[9] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.03[7] (Matthew Bender). But see *Matter of Holford*, 896 F.2d 176, 22 C.B.C.2d 1097 (5th Cir. 1990) (certain recoupments allowed if they arise from the same transaction).

(n46)Footnote 45. 11 U.S.C. § 362(a)(8), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. See 3 *Collier on Bankruptcy*, P 362.03[10] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.03[8] (Matthew Bender). But see *Cheng v. Comm. I.R.S.*, 938 F.2d 141 (9th Cir. 1991) (automatic stay does not apply to appeal of tax court proceeding).

(n47)Footnote 46. 11 U.S.C. § 101(5). See 2 *Collier on Bankruptcy*, ch. 101 (Matthew Bender); 1 *Collier Bankruptcy Manual*, ch. 101 (Matthew Bender).

(n48)Footnote 47. *Lee v. Schweiker*, 739 F.2d 870, 11 C.B.C.2d 834 (3d Cir. 1984). See also *In re Malinowski*, 156 F.3d 131, 40 C.B.C.2d 1054 (2d Cir. 1998) (state agency could not reduce debtor's unemployment benefits to repay overpayment on prior claim; reduction was setoff and not recoupment because two unemployment claims covered separate periods and were not same transaction). However, some types of "recoupment" may be allowed, if previous payments to a debtor reduce or eliminate any entitlement to future benefits and are not otherwise considered as collectible debts. *Matter of Kosadnar*, 157 F.3d 1011 (5th Cir. 1998) (employer could reduce debtor's paychecks to recoup prior advances that were overpayments to debtor); *In re Mullen*, 696 F.2d 470, 7 C.B.C.2d 1074 (6th Cir. 1983) (military readjustment allowance not considered a debt).

(n49)Footnote 48. *Matter of Kuehn*, 563 F.3d 289 (7th Cir. 2009) (withholding transcript violated stay and discharge injunction); *In re Merchant*, 958 F.2d 738, 28 C.B.C.2d 1290 (6th Cir. 1992) (although student loan debt found nondischargeable, school's refusal to release transcript violates stay); *In re Gustafson*, 934 F.2d 216, 24 C.B.C.2d 1937 (9th Cir. 1991) (refusal to release transcript violates stay, but state university held immune from money damages).

(n50)Footnote 49. *In re Morris*, 45 B.R. 350 (E.D. Pa. 1984). But see 11 U.S.C. § 362(b)(26).

(n51)Footnote 50. *In re Singley*, 41 C.B.C.2d 1623, 233 B.R. 170 (Bankr. S.D. Ga. 1999), reconsideration denied, 236 B.R. 105 (Bankr. S.D. Ga. 1999). But see 11 U.S.C. § 362(b)(2)(E).

(n52)Footnote 51. *Matter of Hellums*, 772 F.2d 379, 13 C.B.C.2d 572 (7th Cir. 1985). Section 362(b)(2)(C) and (b)(19), both enacted in 2005, specifically exclude from the stay withholding from income for domestic support obligations and payments on retirement fund loans. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. Other types of payroll deductions, even if authorized by the debtor, are not excluded from the reach of the automatic stay.

(n53)Footnote 52. *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 116 S. Ct. 286, 33 C.B.C.2d 869 (1995). Notwithstanding the Supreme Court's decision, any freeze or setoff for credit card debts or overdrafts on consumer lines of credit is usually prohibited by nonbankruptcy law. 15 U.S.C. § 1666h(a).

(n54)Footnote 53. *In re Holden*, 217 B.R. 161 (D. Vt. 1997) (I.R.S. could not permanently hold debtors' refund to coerce payment of much smaller debt already addressed in debtors' chapter 13 plan); *Town of Hempstead Emp. Fed. Cred. Union v. Wicks*, 39 C.B.C.2d 506, 215 B.R. 316 (Bankr. E.D.N.Y. 1997) (four month administrative freeze without filing of motion for relief from automatic stay violated stay).

(n55)Footnote 54. *In re Continental Airlines*, 134 F.3d 536, 39 C.B.C.2d 391 (3d Cir. 1998) (reaffirming principles in earlier chapter 13 decision prohibiting IRS setoff after confirmation of plan providing for payment of tax debt through plan).

(n56)Footnote 55. *In re Schwartz*, 38 C.B.C.2d 1555, 213 B.R. 695 (Bankr. S.D. Ohio 1997) .

(n57)Footnote 56. *In re Price*, 103 B.R. 989 (Bankr. N.D. Ill. 1989) , *aff'd*, 42 F.3d 1068 (7th Cir. 1994) (that notice was sent out inadvertently by IRS computer is no defense). *See also United States ex rel. IRS v. Norton*, 717 F.2d 767, 9 C.B.C.2d 336 (3d Cir. 1983) (IRS may not offset money due to debtors against prepetition claim which was provided for in confirmed chapter 13 plan; section 362 also bars such setoff before confirmation).

(n58)Footnote 57. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n59)Footnote 58. The right to setoff applies to mutual debts only. *See* 5 *Collier on Bankruptcy*, P 553.03[3] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 553.02[3] (Matthew Bender).

(n60)Footnote 59. 11 U.S.C. § 362(b)(1). *In re Gruntz*, 202 F.3d 1074 (9th Cir. 2000) (en banc) (criminal child support proceeding was not stayed). *See* 3 *Collier on Bankruptcy*, P 362.05[1] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.05[1] (Matthew Bender).

(n61)Footnote 60. However such a case may be enjoined by the court under 11 U.S.C. § 105. *See* 3 *Collier on Bankruptcy*, P 362.05[1][a] (Matthew Bender).

(n62)Footnote 61. *In re Brown*, 213 B.R. 317 (W.D. Ky. 1997) (creditor violated stay and discharge injunction by filing criminal complaint to collect debt).

(n63)Footnote 62. *Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 110 S. Ct. 2126, 109 L. Ed. 2d 588, 22 C.B.C.2d 1067 (1990) .

(n64)Footnote 63. *See, e.g., In re Walters*, 219 B.R. 520 (Bankr. W.D. Ark. 1998) (municipality violated stay by arresting debtor to coerce payment of restitution debt).

(n65)Footnote 64. Many criminal restitution orders are nondischargeable in chapter 7. Restitution of certain criminal fines and some civil restitution awards are nondischargeable in chapter 13. *See* ch. 26 *infra*.

(n66)Footnote 65. *Goodman v. Albany Realty Co.* (*In re Goodman*), 277 B.R. 839 (Bankr. M.D. Ga. 2001) (arrest warrant arising out of contempt proceeding to coerce compliance with discovery was not part of a criminal proceeding and was stayed; creditor had duty to ensure that warrant was not enforced after bankruptcy filed); *Matter of Foster*, 100 B.R. 174 (Bankr. D. Del. 1989) (contempt proceeding against debtor for failing to pay a judgment is stayed). *See generally* Sommer & McGarity, *Collier Family Law and the Bankruptcy Code*, P 5.03[3][iii] (Matthew Bender).

(n67)Footnote 66. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n68)Footnote 67. Domestic support obligation is defined in 11 U.S.C. § 101(14A), added by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n69)Footnote 68. 11 U.S.C. § 362(b)(2)(A).

(n70)Footnote 69. 11 U.S.C. 362(b)(2)(D); 42 U.S.C. § 666(a)(16).

(n71)Footnote 70. 11 U.S.C. 362(b)(2)(E); 42 U.S.C. § 666(a)(7).

(n72)Footnote 71. 11 U.S.C. § 362(b)(2)(F); 11 U.S.C. §§ 664 and 666(a)(3).

(n73)Footnote 72. 11 U.S.C. § 362(b)(2)(G); 42 U.S.C. §§ 601, *et. seq.*

(n74)Footnote 73. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n75)Footnote 74. See 11 U.S.C. § 1306(a).

(n76)Footnote 75. 11 U.S.C. § 1327. This amendment effectively overrules cases in which the property of the estate did not revert in the debtor upon confirmation, and accordingly courts held that former section 362(b)(2)(B) was not applicable.

(n77)Footnote 76. 11 U.S.C. § 522(c)(1) allows exempt property to be pursued for these debts.

(n78)Footnote 77. See P 8.03[4][c][i] *infra*.

(n79)Footnote 78. See P 8.03[4][c][ii] *infra*.

(n80)Footnote 79. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n81)Footnote 80. See P 8.03[4][c][iii], [iv] *infra*.

(n82)Footnote 81. 11 U.S.C. § 362(c)(3), added by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. This stay limitation does not apply in a case brought by a family farmer under chapter 12. Nor, does it apply in a case filed under chapter 11 or 13 following the dismissal of a prior chapter 7 case under section 707(b).

(n83)Footnote 81a. *In re Parker*, 336 B.R. 678 (Bankr. S.D.N.Y. 2006) .

(n84)Footnote 81b. *In re Jumpp*, 356 B.R. 789 (B.A.P. 1st Cir. 2006) ; *In re Murray*, 350 B.R. 408 (Bankr. S.D. Ohio 2006) .

(n85)Footnote 82. The mere inadvertence or negligence on the part of the debtor shall not be a substantial excuse, unless the dismissal was caused by the negligence of the debtor's attorney. 11 U.S.C. § 362(c)(3)(C)(i)(II)(aa)

(n86)Footnote 83. 362(c)(3)(C)(ii), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n87)Footnote 84. Section 362(i), enacted in 2005, provides that if a case filed under chapter 7, 11, or 13 is dismissed due to the creation of a debt repayment plan, any subsequent case shall not be presumed to have been filed by the debtor with a lack of good faith. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n88)Footnote 85. 11 U.S.C. § 362(j).

(n89)Footnote 86. 11 U.S.C. § 362(c)(4), added by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. Although the text of the section is unclear, presumably the stay limitation does not apply in a case filed under a chapter other than chapter 7 following the dismissal of a prior chapter 7 case under section 707(b).

(n90)Footnote 86a. *In re Parker*, 336 B.R. 678 (Bankr. S.D.N.Y. 2006) .

(n91)Footnote 87. 11 U.S.C. § 362(c)(4)(B).

(n92)Footnote 87a. See P 8.03[5] *infra*.

(n93)Footnote 88. See P 8.03[4][c][i] *supra*.

(n94)Footnote 89. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n95)Footnote 90. 11 U.S.C. § 362(d)(4), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or

after October 17, 2005.

(n96)Footnote 91. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n97)Footnote 92. Section 362(b)(21) should be compared with the refiling provision in section 362(c)(3), which expressly states that the provision is applicable in a single or joint case filed by an individual debtor.

(n98)Footnote 93. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n99)Footnote 94. Because this exception only applies to the stay under section 362(a)(3), the lessor may not proceed with actions to recover on a money judgment without first obtaining relief from the stay provided under section 362(a)(6). Additionally, this exception will not apply if further judicial proceedings, which are stayed under section 362(a)(1), are necessary. A judgment that debtor has appealed and that is subject to a trial de novo is not a judgment for purposes of this subsection. *In re Alberts*, 381 B.R. 171 (Bankr. W.D. Pa. 2007) .

(n100)Footnote 95. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n101)Footnote 96. 11 U.S.C. 362(l)(3).

(n102)Footnote 97. *Id.*

(n103)Footnote 98. 11 U.S.C. 362(l)(5)(A).

(n104)Footnote 99. 11 U.S.C. 362(l)(4)(B).

(n105)Footnote 100. 11 U.S.C. 362(l)(5)(D).

(n106)Footnote 101. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n107)Footnote 102. Because this exception only applies to the stay under section 362(a)(3) the lessor may not proceed under this section with an eviction or other action that seeks to recover on a claim against the debtor that arose prepetition, such as a claim for damages to the rental property, without first obtaining relief from the stay provided under section 362(a)(6).

(n108)Footnote 103. 11 U.S.C. 362(b)(23).

(n109)Footnote 104. Unlike other provisions of section 362(b) that create an exception to the stay upon the filing of the petition, section 362(b)(23) does not prevent the automatic stay provided under section 362(a)(3) from taking effect immediately upon the filing of the debtor's petition.

(n110)Footnote 105. 11 U.S.C. § 362(m)(2).

(n111)Footnote 106. 11 U.S.C. § 362(m)(2)(C).

(n112)Footnote 107. 11 U.S.C. § 362(m)(2)(D).

(n113)Footnote 108. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n114)Footnote 109. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n115)Footnote 110. See 11 U.S.C. §§ 365(p), 524(c).

(n116)Footnote 111. Initiation of a redemption action should be sufficient to meet the timely action requirement since nothing in the Code sets a deadline for the debtor's redemption of property and, as a practical matter, it may be

difficult to obtain a hearing on a contested valuation within the time specified.

(n117)Footnote 112. 11 U.S.C. § 362(b)(3). See *Equibank N.A. v. Wheeling Pittsburgh Steel*, 884 F.2d 80 (3d Cir. 1989); *In re Yobe Elec., Inc.*, 728 F.2d 207 (3d Cir. 1984) (filing of mechanics lien permitted where, under state law, it related back to date materials installed); *In re Boggan*, 251 B.R. 95 (B.A.P. 9th Cir. 2000) (mechanic did not have to turn over debtor's car, held pursuant to mechanic's lien, because maintaining possession of car was necessary to preserve existence of lien). See 3 *Collier on Bankruptcy*, P 362.05[4] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.05[3] (Matthew Bender).

(n118)Footnote 113. 11 U.S.C. § 362(b)(4), as amended by the Omnibus Consolidated Emergency Supplemental Appropriations Act, 1999, Pub. L. No. 105-277 (1998), reprinted in Vol. F *Collier on Bankruptcy*, App. Pt. 41(o)(iv) (Matthew Bender 15th Ed. Revised). *Alpern v. Lieb*, 11 F.3d 689 (7th Cir. 1993) (a proceeding to impose Rule 11 sanctions on debtor was exempt from stay as an exercise of police or regulatory powers). See also *Federal Reserve Board v. MCorp*, 502 U.S. 32, 112 S. Ct. 459, 116 L. Ed. 2d 358, 25 C.B.C.2d 849 (1991) (Federal Reserve Board administrative action to enforce banking regulation is within exception to the stay); *In re Wade*, 948 F.2d 1122, 25 C.B.C.2d 1287 (9th Cir. 1991) (state bar's disciplinary action against attorney may proceed under the police power exception to the automatic stay); 3 *Collier on Bankruptcy*, P 362.05[5] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.05[4] (Matthew Bender).

(n119)Footnote 114. Compare *In re James*, 940 F.2d 46, 25 C.B.C.2d 471 (3d Cir. 1991) (state forfeiture action involving alleged proceeds of criminal activity comes within police power exception) with *In re Thomas*, 179 B.R. 523 (Bankr. E.D. Tenn. 1995) (postpetition noncriminal forfeiture proceeding that could not have been brought prepetition was stayed) and *In re Goff*, 159 B.R. 33 (Bankr. N.D. Okla. 1993) (civil forfeiture action that had no remedial purpose and was intended to make money was not within exception).

(n120)Footnote 115. See *Ohio v. Kovacs*, 469 U.S. 274, 105 S. Ct. 705, 83 L. Ed. 2d 649, 11 C.B.C.2d 1067 (1985); *In re Dunbar*, 245 F.3d 1058 (9th Cir. 2001) (agency's revocation of license for failure to pay restitution violated stay); *NLRB v. Continental Hagen Corp.*, 932 F.2d 828 (8th Cir. 1991) (NLRB order may be enforced by Court of Appeals except that back pay award must be enforced in bankruptcy proceedings).

(n121)Footnote 116. 11 U.S.C. § 362(b)(11). See *In re Roete*, 936 F.2d 963, 25 C.B.C.2d 177 (7th Cir. 1991); 3 *Collier on Bankruptcy*, P 362.05[11] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.05[11] (Matthew Bender).

(n122)Footnote 117. 11 U.S.C. § 362(b)(9). However, no lien may attach as a result of an assessment unless the tax is a debt of the debtor that will not be discharged in the case and the property or its proceeds are transferred out of the estate to, or otherwise revested in, the debtor. *Id.* See 3 *Collier on Bankruptcy*, P 362.05[9] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.05[8] (Matthew Bender).

(n123)Footnote 118. 11 U.S.C. § 362(b)(18), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. See 3 *Collier on Bankruptcy*, P 362.05[17] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.05[16] (Matthew Bender).

(n124)Footnote 119. 11 U.S.C. § 362(b)(18), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n125)Footnote 120. See 11 U.S.C. § 362(b); 3 *Collier on Bankruptcy*, P 362.05 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.05 (Matthew Bender).

(n126)Footnote 121. 11 U.S.C. § 362(b)(24). It is important to note that this exception does not apply to involuntary transfers, because § 549(c) only applies to a purchaser and "purchaser" is defined in § 101 as the transferee of a voluntary transfer.

(n127)Footnote 122. 11 U.S.C. § 362(b)(28).

(n128)Footnote 123. 11 U.S.C. § 362(b)(19).

(n129)Footnote 124. *In re Berry Estates, Inc.*, 812 F.2d 67 (2d Cir. 1987) , cert. denied, 484 U.S. 819 (1987) .

(n130)Footnote 125. See notes in P 8.03[1][c] *supra* .

(n131)Footnote 126. See 2 *Collier on Bankruptcy*, P 105.02-. 03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 105.02-. 03 (Matthew Bender). However, the Anti-Injunction Act of the Internal Revenue Code may limit the court's power. See *In re American Bicycle Ass'n*, 895 F.2d 1277 (9th Cir. 1990) (Anti-Injunction Act precludes a bankruptcy court from enjoining IRS levy of non-debtor attorney's receipts under a chapter 13 plan).

(n132)Footnote 127. *In re James*, 2 C.B.C.2d 322, 10 B.R. 2 (Bankr. W.D.N.C. 1980) (criminal case based upon alleged worthless checks enjoined because it would frustrate bankruptcy process). See *Howard v. Allard*, 122 B.R. 696 (W.D. Ky. 1991) (preliminary injunction may issue against county attorney preventing prosecution of bad faith bad check charges).

(n133)Footnote 128. E.g., *In re Fussell*, 928 F.2d 712, 24 C.B.C.2d 1695 (5th Cir. 1991) , cert. denied, 502 U.S. 1107 (1992) (refusal to enjoin criminal prosecution for "hindering enforcement of security interest" as bad faith attempt to collect dischargeable debt); *In re Heincy*, 858 F.2d 548, 20 C.B.C.2d 5 (9th Cir. 1988) (court should not enjoin collection of restitution without examining other remedies available to allow restitution payments in the context of chapter 13 plan).

(n134)Footnote 129. See *In re Redenbaugh*, 10 C.B.C.2d 323, 37 B.R. 383 (Bankr. C.D. Ill. 1984) ; *In re Holder*, 26 B.R. 789 (Bankr. M.D. Tenn. 1982) ; *In re Lawson*, 22 B.R. 100 (Bankr. S.D. Ohio 1982) . See also *In re Bicro Corp.*, 105 B.R. 255 (Bankr. M.D. Pa. 1989) (creditor enjoined from participating in criminal proceeding against debtor where central purpose of creditor's participation was to procure payment on a debt).

(n135)Footnote 130. A discharge or other employment discrimination based upon the bankruptcy or a prepetition debt is specifically prohibited. 11 U.S.C. § 525(b). See ch. 30 *infra*.

(n136)Footnote 131. See *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 26 C.B.C.2d 1413 (2d Cir. 1992) . See 2 *Collier on Bankruptcy*, P 105.03[1] (Matthew Bender).

(n137)Footnote 132. *Matter of Martin Exploration Co.*, 731 F.2d 1210 (5th Cir. 1984) ; 9 *Collier on Bankruptcy*, P 4001.03 (Matthew Bender).

(n138)Footnote 133. See 8 *Collier on Bankruptcy*, ch. 1327 (Matthew Bender); 3 *Collier Bankruptcy Manual*, 1327 (Matthew Bender).



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CHAPTER 8 Enforcing the Automatic Stay

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P 8.04 Notice of the Automatic Stay

[1] Necessity for Debtor Giving Notice in Some Cases

Creditors are notified officially of the automatic stay in the notice of the meeting of creditors.ⁿ¹ Unfortunately, from the debtor's perspective, this notice is not always adequate for several reasons. First, although some larger creditors receive prompt notice electronically, the notice is not mailed until weeks after the petition is filed. Second, when it is mailed, it goes only to creditors listed in the schedules or statement. Landlords or other entities to whom no debts are owed are not included in these lists. Moreover, although the notice has been revised to make it more clear, some unsophisticated creditors that receive it may not understand which actions are prohibited.

FORMS

For examples of letters to creditors advising them of the stay and notices of commencement of case see *Collier Consumer Bankruptcy Forms*, §§ CS6.15 and CS10.32 (Matthew Bender).

PRACTICE NOTE

The only solution to this problem is for the debtor's advocate to give additional notice of the stay, at least as to creditors and others who might violate the stay without prompt, clear notice. This notice should be sent by certified mail, return receipt requested, immediately after the petition is filed.ⁿ² If time is a critical factor, a telephone call or fax preceding the mailed notification may be appropriate. Such notice, whether by phone, email, fax or mail, should be effective under section 342, which does not establish any particular requirements for such notices to creditors unless a creditor has requested use of a specific address in that particular case under section 342(e).ⁿ³

Copies of the notice should be sent to both the party stayed and the party's attorney, so no excuse of communication problems is possible. If the debtor's wages are being garnished, notice should be given immediately to the employer, the attaching officer, and the creditor's attorney. In the case of the Internal Revenue Service, to suspend or forestall collection actions such as a wage levy or tax refund intercept, notice should be given to the Revenue Officer on the case as well as to the IRS Special Procedures Staff in the District Office collection branch for the relevant jurisdiction. Lastly, if appropriate, the notice can advise that the debtor will seek to have violators of the stay held in contempt and held liable for unfair practices, with damages and attorney's fees assessed against them.

[2] Creditor's Response to Notice of Stay**WARNING**

If a creditor has been given notice of the automatic stay or a bankruptcy filing, even informally, it is important for the creditor to check court records prior to taking any action to collect its debt. Since creditors are considered to be on notice of the stay if they learn of it from any source, failing to carefully check the status of the case may create a risk of sanctions for violating the stay.^{n3a}

If the stay has been inadvertently violated by a creditor, it is best to make arrangements with the debtor to restore the status quo that existed prior to the violation. Failure to do so once the creditor has notice of the stay may also lead to sanctions.ⁿ⁴ If any doubt exists about the applicability of the stay, the creditor should seek a determination on that issue from the bankruptcy court. A request for such a determination can be combined with a motion for relief from the stayⁿ⁵ and, if appropriate, a motion for abstention from hearing certain issues.

Creditors should be aware that even indirect attempts to collect a debt are prohibited by the stay. For example, conditioning future services or business relations on payment of prepetition debts has been held to be an act to collect a debt.ⁿ⁶

However, a creditor may still be able to collect its debt from other parties. Except in chapters 12 and 13, in which there is a codebtor stay,ⁿ⁷ the automatic stay does not protect codebtors, partners, guarantors or sureties who have not themselves filed bankruptcy cases. It may also be possible, in some cases, to proceed against the debtor's insurer. However, unless there is clear authority in the applicable jurisdiction that it is not necessary to do so, the safest course is to seek relief from the stay before pursuing insurance proceeds.

A creditor whose claim arises after the bankruptcy petition is filed should bear in mind that the stay does not prohibit the collection of postpetition debts, provided that there is no attempt to collect them from property of the bankruptcy estate. In many consumer cases, the debtor will have little if any property that is not property of the estate, except perhaps postpetition wages. However, in chapter 12 and chapter 13 cases, even property acquired after the petition is filed is property of the estate.ⁿ⁸

FOOTNOTES:

(n1)Footnote 1. Official Form No. 9.

(n2)Footnote 2. *See In re Calder*, 907 F.2d 953, 23 C.B.C.2d 677 (10th Cir. 1990) (failure to provide notice together with debtor's continued litigation activity in the stayed action equitably precludes the debtor from later claiming the protection of the automatic stay with regard to that action).

(n3)Footnote 3. *See 11 U.S.C. § 342(g)*, added by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. The debtor's notice can be much more specific than the official notice, tailored to the action the recipient is likely to take.

(n4)Footnote 3a. *In re Johnson*, 501 F.3d 1163 (10th Cir. 2007) (car dealer had duty to investigate if it had doubts).

(n5)Footnote 4. *See P 8.05 infra*.

(n6)Footnote 5. *See ch. 10 infra*.

(n7)Footnote 6. *See P 8.03[3] supra*.

(n8)Footnote 7. *See* ch. 9 *infra*.

(n9)Footnote 8. *11 U.S.C. § 1306(a)*. *See* 8 *Collier on Bankruptcy*, P 1306.02 (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1306.02 (Matthew Bender).



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CHAPTER 8 Enforcing the Automatic Stay

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P 8.05 Enforcing the Stay

[1] Voidness of Actions in Violation of Stay

It has long been held that actions taken in violation of the stay are void.ⁿ¹ Any actions taken after the bankruptcy filing, including foreclosure sales, repossessions and judgments, are without effect.ⁿ² This is true whether or not the violator acted with knowledge of the stay, though there are limited exceptions to this general rule.ⁿ³

Courts have the power to undo violations of the stay by injunction, by avoiding postpetition transfers under *Code section 549*,ⁿ⁴ and, if appropriate, by ordering other statutory and equitable remedies as discussed below. Numerous courts have held, for example, that postpetition credit union deductions or repossessed automobiles must be returned.ⁿ⁵

[2] Damage Remedy

The Bankruptcy Code contains a specific cause of action against a creditor who causes injury to an individual by a willful violation of the section 362 stay.ⁿ⁶ A willful violation is one committed knowingly; no malice need be shown.ⁿ⁷ Even when a violation begins innocently, refusal to rectify it after notice of the case renders it willful.ⁿ⁸ Similarly, a willful violation occurs when a creditor fails to act affirmatively to prevent an action prohibited by the stay, *e.g.*, by failing to prevent the sheriff from selling the debtor's property at a postpetition sheriff's sale.ⁿ⁹ In such cases, section 362(k)(1) provides for actual damages, costs and attorney's fees as well as punitive damages, if appropriate.ⁿ¹⁰ Actual damages may include recovery of money received by the creditor in violation of the stay and, if property is repossessed or retained by a creditor in violation of the stay, loss of use damages. Similarly, lost wages are recoverable for time the debtor had to spend remedying the violation or was otherwise unable to go to work.ⁿ¹¹ Emotional distress damages are also available.ⁿ¹² If the court finds a willful violation of the stay, the debtor is entitled to all reasonable attorney's fees and costs; the court does not have discretion to award less.ⁿ¹³

An issue in some cases is whether the creditor has received actual notice. For damages to be available, the debtor must prove notice of the stay to the party enjoined.ⁿ¹⁴ For example, a telephone call or fax to a creditor or its counsel, notifying them of the automatic stay should provide sufficient notice.ⁿ¹⁵ However, proof issues may arise if the notice is not in writing. Similarly, if the filing occurs at the last minute to prevent a foreclosure sale, repossession, or utility termination, it may be a good idea to tell the client to inform the creditor or the creditor's agent directly, at the location of the threatened action. Even posting a copy of the petition on property that is likely to be repossessed should be sufficient notice to the creditor and the repossessing agent.

Several amendments to the Bankruptcy Code made in 2005ⁿ¹⁶ limit the relief available under section 362(k)(1). Section 362(k)(2) was added as a companion provision to section 362(h), which provides for the termination of the stay as to personal property based on the debtor's failure to take certain action related to the statement on intention under section 521(a)(2).ⁿ¹⁷ If a violation of the stay is based on an action taken by an entity in the good faith belief that the stay had been terminated as to the debtor under section 362(h), section 362(k)(2) provides that the recovery under section 362(k)(1) shall be limited to actual damages, which, by the terms of section 362(k)(1), may include costs and attorney's fees.ⁿ¹⁸

In addition, section 342(g)(2), added in 2005,ⁿ¹⁹ provides that a "monetary penalty" may not be imposed on a creditor under section 362(k) for violation of the stay unless the conduct that is the basis for the violation occurs after the creditor has received effective notice as provided under § 342 of the order for relief. Since actual damages are typically viewed as compensatory in nature, and generally do not serve as a penalty, this provision appears to preclude only the recovery of punitive damages under section 362(k)(1). Moreover, section 342(g)(2) does not apply if the remedy sought for a violation of the stay is contempt of court.

Moreover, under section 342(g)(1), if a creditor has established reasonable procedures to deliver notices to a responsible person or department, then notice is not considered effective notice "brought to the attention of such creditor" until it reaches that person or department. This provision will provide fertile ground for discovery into a creditor's "reasonable procedures," including whether the creditor has given an address to the Bankruptcy Noticing Center for notices, whether it uses BANKO (an on-line service that notifies creditors of bankruptcy filings)^{n19a} to check on filings, whether the creditor receives notices of case events electronically, and what mechanisms are in place to transmit timely notices to appropriate departments. If a debtor gives reasonable notice, a creditor should have procedures that transmit it almost instantly. It is hard to imagine how a creditor that does not have a procedure for immediate transmission of notices received by its attorneys, collection staff, repossession agents, and collection agents could be deemed to have reasonable procedures.^{n19b} And presumably, by negative implication, if such reasonable procedures do not exist, any actual notice given to a creditor should be deemed brought to the creditor's attention. So, in the end, any reasonable notice should be sufficient to be effective notice for purposes of section 342(g). This conclusion is buttressed by *Bankruptcy Rule 2002(g)(5)*, which provides that a creditor may treat a notice as not having been brought to its attention only if, prior to issuance of the notice, the creditor has filed a statement that designates the name and address of the person or organizational subdivision responsible for receiving notices under the Code and that describes the procedures established by the creditor to cause such notices to be delivered to that person or subdivision. Needless to say, very few, if any, creditors have filed such statements.

An action for damages based on violation of the automatic stay survives the dismissal of the underlying bankruptcy case and the bankruptcy court has continuing jurisdiction to decide it.^{n19c}

[3] Contempt Remedies

In addition to remedies under section 362(k), the debtor has remedies for violation of the automatic stay as contempt of a court order. It is quite clear that a violation of the stay's prohibitions constitutes contempt of court.ⁿ²⁰ The legislative history of section 362(k) formerly 362(h), makes clear that, in passing that section, Congress was granting an additional remedy to debtors beyond those already in existence.ⁿ²¹ Neither remedy may be available, however, if it was unclear whether an act was barred by the stay.ⁿ²²

WARNING

Contempt sanctions generally can be imposed regardless of whether the violation is in willful disregard of the stay.ⁿ²³ So long as the enjoined party has notice of the stay, it is responsible for the consequences. The duty is on creditors, especially those regularly involved with bankruptcy cases, to establish

procedures that ensure compliance with the stay, in order that bankruptcy cases proceed smoothly.ⁿ²⁴ Indeed, if either a creditor or its collection agent has knowledge of the case, the creditor may be held in contempt for any postpetition collection attempts by its agent.ⁿ²⁵ Additionally, reliance in good faith on the advice of an attorney that actions are not barred by the stay is no defense.ⁿ²⁶ Nor is "computer error" a valid defense.ⁿ²⁷

The sanctions that may be imposed for contempt are similar to those available under section 362(k) except that punitive damages are not available.ⁿ²⁸ They may include fines and attorneys' fees, in appropriate cases, against both the violator and any attorneys who advised such violations.ⁿ²⁹ Many courts have held that damages for contempt may also be awarded.ⁿ³⁰ But, in any event, the bankruptcy court has exclusive jurisdiction over sanctions for violation of the automatic stay itself.ⁿ³¹

[4] Unfair Trade Practices and Other State or Federal Law Remedies

Note also that the same actions which can be penalized as violations of the automatic stay might also be unfair trade practices under state law or violations of federal debt collection protections.ⁿ³² In some cases it may be a good idea to seek this remedy in the alternative because of the availability of enhanced damages. Relief under other theories, such as abuse of process and negligence should also be considered.ⁿ³³

[5] Remedies Against Governmental Creditors

Another issue which unfortunately often arises concerns the remedies available against government entities for violations of the stay. If the stay is violated through state action as defined for purposes of the civil rights laws, remedies under 42 U.S.C. § 1983 may be available against the officials who violate the stay under color of law. A violation of section 362 is a denial of rights secured by federal law.ⁿ³⁴ If such an action were successful, then attorneys' fees would also be proper under the Civil Rights Attorney's Fees Award Act, 42 U.S.C. § 1988.ⁿ³⁵

In light of Supreme Court cases taking a narrow view of the Bankruptcy Code's original provisions regarding waiver of sovereign immunity, there had been some doubt about whether damages are available against state and federal governmental entities for violating the automatic stay. Such issues should no longer arise with respect to the federal government because the 1994 amendments to the Code specifically abrogated sovereign immunity with respect to section 362.ⁿ³⁶ In addition, the Supreme Court has held that states are generally subject to the bankruptcy laws protections of debtors and their property notwithstanding the *Eleventh Amendment*.ⁿ³⁷

Several courts have held that when the government violates the stay in attempting to collect a tax claim, the debtor's claim for damages and attorney's fees under section 362(k)ⁿ³⁸ arises out of the same transaction or occurrence as the government's claim, so that sovereign immunity is waived.ⁿ³⁹ At least if the state government has filed a claim in the bankruptcy case, the state should be deemed to have submitted itself to the bankruptcy court's jurisdiction.ⁿ⁴⁰

Even if remedies are limited under section 362(k) based on the *Eleventh Amendment*, contempt remedies should remain available.ⁿ⁴¹ However, punitive damages may not be authorized.ⁿ⁴²

[6] Procedure for Enforcing the Stay

One further issue entails the best procedure to remedy a violation of the stay. Although several courts have held that relief under former section 362(h), amended and redesignated as section 362(k) in 2005,ⁿ⁴³ is available by motion,ⁿ⁴⁴ it may be preferable to proceed by complaint pursuant to the adversary proceeding rules, especially if injunctive relief or a contempt remedy is sought.ⁿ⁴⁵ This will eliminate any potential issues about the due process rights of the defending party. In many, if not all cases, careful practice requires seeking statutory remedies together with relief for contempt in the alternative.

FORMS

For sample forms and commentary relating to maintaining and enforcing the automatic stay see *Collier Consumer Bankruptcy Forms*, § CS6.21-. 32 (Matthew Bender).

Expeditious action to protect the debtor's rights is generally advisable, especially if damages may be mitigated, but a remedy is available even after the bankruptcy case is terminated.ⁿ⁴⁶ Moving quickly in the bankruptcy court to remedy the violation is particularly important if the stay violation involves proceedings in a state court. It is almost always better to seek enforcement of the stay in the bankruptcy court, which is usually more familiar with and sympathetic to the stay than a state court, than to allow the state court to rule on whether the stay applies. Although the Ninth Circuit has held that the bankruptcy court can find such a state court ruling to be erroneous and, therefore, void as a violation of the stay,ⁿ⁴⁷ other courts have ruled otherwise and refused to overturn a state court's decision.ⁿ⁴⁸ In some instances, if relief is sought after the bankruptcy case has been closed, the case may need to be reopened pursuant to *Code section 350(b)*.

MORE INFORMATION

For a fuller discussion of reopening a case see chapter 31 *infra*.

Discovery in an action for sanctions may be useful to learn whether the creditor's violation of the stay was caused by the creditor's failure to have proper procedures to act on notice of a bankruptcy filing. At trial, it is important to have specific evidence of actual damages including, if applicable, evidence of medical problems or emotional distress much akin to the evidence that would be presented in a tort action.

FOOTNOTES:

(n1)Footnote 1. *Kalb v. Feuerstein*, 308 U.S. 433, 60 S. Ct. 343, 84 L. Ed. 370 (1940) . See, e.g., *In re Knightsbridge Dev. Co.*, 884 F.2d 145 (4th Cir. 1989) (arbitration award entered in violation of stay is void); *In re Louisiana Ship Management Inc.*, 761 F.2d 1025 (5th Cir. 1985) ; *In re Posner*, 700 F.2d 1243 (9th Cir. 1983) . See also 3 *Collier on Bankruptcy*, P 362.11[1] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.11[1] (Matthew Bender).

(n2)Footnote 2. E.g., *40235 Wash. St. Corp. v. Lusardi*, 329 F.3d 1076 (9th Cir. 2003) (tax foreclosure auction in violation of stay was void even though bankruptcy case later dismissed); *In re 48th Street Steakhouse*, 835 F.2d 427, 17 C.B.C.2d 1415 (2d Cir. 1987) , cert. denied, 485 U.S. 1035 (1988) ; *In re Ward*, 837 F.2d 124, 18 C.B.C.2d 133 (3d Cir. 1988) (foreclosure sale occurring in violation of the stay is void). See also *Easley v. Pettibone Michigan Corp.*, 990 F.2d 905, 28 C.B.C.2d 1002 (6th Cir. 1993) (actions in violation of stay are voidable and shall be voided absent limited equitable circumstances).

(n3)Footnote 3. E.g., *In re Smith*, 876 F.2d 524 (6th Cir. 1989) (postpetition sale of repossessed car is void even though bank had no notice of stay; debtor found not to have remained "stealthily silent"); *Zestee Foods, Inc. v. Phillips Foods Corp.*, 536 F.2d 334 (10th Cir. 1976) .

(n4)Footnote 4. See ch. 17 *infra*.

(n5)Footnote 5. *Thompson v. GMAC, LLC*, 566 F.3d 699 (7th Cir. Ill. 2009) (refusal to return car that was repossessed prepetition is violation of stay); *In re Knaus*, 889 F.2d 773 (8th Cir. 1989) (property seized in violation of the stay must be returned; failure to return it constitutes an actionable violation of the stay); *In re Smith*, 876 F.2d 524 (6th Cir. 1989) (postpetition sale of repossessed car is void); *Matter of Hellums*, 772 F.2d 379, 13 C.B.C.2d 572 (7th Cir. 1985) (postpetition payroll deductions must be returned).

(n6)Footnote 6. See *Pettitt v. Baker*, 876 F.2d 456 (5th Cir. 1989) . See also 3 *Collier on Bankruptcy*, P 362.11[3] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 362.11[3] (Matthew Bender). In 1998 Congress enacted 26 U.S.C.

§ 7433(e), which provides a damage remedy against the United States for willful stay violations by I.R.S. in situations not covered by § 362(h). This new provision will primarily benefit nonindividual debtors, since damages for willful violations with respect to individuals are available under § 362(h). The new provision, specifically 26 U.S.C. § 7433(e)(2)(B), also contains some confusing language which provides that administrative and litigation "costs," even in an action under § 362(h), may only be awarded under 26 U.S.C. § 7430, which may mean that exhaustion of administrative remedies is required to recover such costs. Although IRS regulations define these costs to include "legal fees," *Treas. Reg. 301.7433-1(b)*, this provision mentioning only "costs" should not be read to limit the right to "attorney's fees" under section 362(h). Alternatively, the language could be read to simply limit the hourly rate for attorney's fees to that found in § 7430.

(n7)Footnote 7. Compare 11 U.S.C. § 523(a)(6), referring to willful and malicious acts. See *In re Lansdale Family Restaurants, Inc.*, 977 F.2d 826 (3d Cir. 1992) (willfulness does not require an intent to violate the stay, it requires only that acts which violate the stay be intentional acts); *In re Bloom*, 875 F.2d 224 (9th Cir. 1989) .

(n8)Footnote 8. *In re Carrigg*, 216 B.R. 303 (B.A.P. 1st Cir. 1998) (creditor's failure to return repossessed vehicle after notice of case sanctioned as willful violation of stay even though creditor had not had notice of case when vehicle was repossessed); *In re Abrams*, 25 C.B.C.2d 15, 127 B.R. 239 (B.A.P. 9th Cir. 1991) (retention of repossessed automobile after receiving notice of the stay is willful); *In re Stephen W. Grosse, P.C.*, 84 B.R. 377 (Bankr. E.D. Pa. 1988) , *aff'd*, 96 B.R. 29 (E.D. Pa. 1989) , *aff'd mem.*, 879 F.2d 857 , sub nom., *Jakobowski v. Dubin*, 493 U.S. 976 (1989) . *In re Mims*, 38 C.B.C.2d 538, 209 B.R. 746 (Bankr. M.D. Fla. 1997) (creditor had duty to dismiss garnishment proceeding after bankruptcy petition filed).

(n9)Footnote 9. *Matter of Sams*, 106 B.R. 485 (Bankr. S.D. Ohio 1989) .

(n10)Footnote 10. 11 U.S.C. § 362(k), formerly § 362(h), as amended and redesignated by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. See, e.g., *In re Bloom*, 875 F.2d 224 (9th Cir. 1989) (punitive damages upheld on appeal where creditor continued to violate stay after being warned by debtor's attorney that his conduct violated the stay).

(n11)Footnote 11. See *Eskanos & Adler, P.C. v. Roman (In re Roman)*, 283 B.R. 1 (B.A.P. 9th Cir. 2002) (injury can be as minimal as costs expended in going to an attorney's office).

(n12)Footnote 12. *Fleet Mortgage Group, Inc. v. Kaneb*, 196 F.3d 265 (1st Cir. 1999) ; *In re Holden*, 226 B.R. 809 (D. Vt. 1998) ; *In re Flynn*, 185 B.R. 89 (S.D. Ga. 1995) . But see *In re Aiello*, 239 F.3d 876 (7th Cir. 2001) (no recovery for "purely emotional injury" when there were no other damages).

(n13)Footnote 13. *In re Stainton*, 139 B.R. 232 (B.A.P. 9th Cir. 1992) .

(n14)Footnote 14. See *Price v. Rochford*, 947 F.2d 829 (7th Cir. 1991) (commencing lawsuits without notice of the stay is not actionable under section 362(h)).

(n15)Footnote 15. Such notice, whether by phone or fax should be effective under section 342, which does not establish any particular requirements for notices to creditors unless a creditor has requested use of a specific address in that particular case under section 342(e). See 11 U.S.C. § 342(g), added by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n16)Footnote 16. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n17)Footnote 17. See P 6.09 *supra*.

(n18)Footnote 18. Actual damages may include attorneys fees and costs, emotional distress damages, lost wages, and loss of use damages (for repossessed property).

(n19)Footnote 19. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n20)Footnote 19a. Information on BANKO is available at www.banko.com.

(n21)Footnote 19b. *In re Harvey*, 388 B.R. 440, 447 (Bankr. D. Me. 2008) (creditor whose procedure was to discard correspondence sent to billing address did not have reasonable procedures).

(n22)Footnote 19c. *In re Johnson*, 390 B.R. 414, 419 (B.A.P. 10th Cir. 2008) ; *In re Williams*, 323 B.R. 691 (B.A.P. 9th Cir. 2005) .

(n23)Footnote 20. 11 U.S.C. § 362(k), formerly § 362(h), as amended and redesignated by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. *In re Pace*, 67 F.3d 187 (9th Cir. 1995) ; In the *Matter of Carter*, 691 F.2d 390, 7 C.B.C.2d 683 (8th Cir. 1982) ; *Fidelity Mortgage Investors v. Camelia Builders*, 550 F.2d 47 (2d Cir. 1976) , cert. denied, 429 U.S. 1093 (1977) . Contempt proceedings in bankruptcy cases are governed by *Fed. R. Bankr. P. 9020*.

(n24)Footnote 21. 130 Cong. Rec. H1942 (daily ed. Mar. 26, 1984) (remarks of Rep. Rodino). *See also In re Skinner*, 917 F.2d 444 (10th Cir. 1990) .

(n25)Footnote 22. *United States ex rel. IRS v. Norton*, 717 F.2d 767, 9 C.B.C.2d 336 (3d Cir. 1983) .

(n26)Footnote 23. *McComb v. Jacksonville Paper Co.*, 336 U.S. 187, 191, 69 S. Ct. 497, 93 L. Ed. 599, 604 (1949) ; *Perry v. O'Donnell*, 759 F.2d 702 (9th Cir. 1985) ; *Vuitton et Fils S.A. v. Carousel Handbags*, 592 F.2d 126 (2d Cir. 1979) . *See also In re Skinner*, 90 B.R. 470 (D. Utah 1988) (actions not willful where creditor received notice of stay, but did not read it; nonetheless creditor could be held in civil contempt).

(n27)Footnote 24. *In re Price*, 103 B.R. 989 (Bankr. N.D. Ill. 1989) (IRS threat to levy against debtor violates stay even though notice was generated by computer; IRS had no procedures in place to prevent notices from being sent out in violation of the stay).

(n28)Footnote 25. *In re Fowler*, 16 B.R. 596 (Bankr. S.D. Ohio 1981) (agent's knowledge imputed to creditor).

(n29)Footnote 26. *In re Taylor*, 884 F.2d 478 (9th Cir. 1989) .

(n30)Footnote 27. *Associated Credit Servs. v. Campion* (*In re Campion*), 294 B.R. 313 (B.A.P. 9th Cir. 2003) (failure of debt collector's computer to match debtor's name with name in its database did not render violation non-willful); *In re Rijos*, 263 B.R. 382 (B.A.P. 1st Cir. 2001) ; *In re Chateaugay Corp.*, 112 B.R. 526 (S.D.N.Y. 1990) .

(n31)Footnote 28. *See Knupfer v. Lindblade* (*In re Dyer*), 322 F.3d 1178 (9th Cir. 2003) (although attorney's fees may be awarded and mild non-compensatory fines may be necessary under some circumstances, serious punitive penalties are not available for civil contempt).

(n32)Footnote 29. *Hubbard v. Fleet Mortgage Co.*, 810 F.2d 778 (8th Cir. 1987) (upholding imposition of \$7,649 fine, plus attorney's fees, plus cancellation of mortgage); *Borg-Warner Acceptance Corp. v. Hall*, 685 F.2d 1306, 7 C.B.C.2d 209 (11th Cir. 1982) . *See also In re Stephen W. Grosse, P.C.*, 84 B.R. 377 (Bankr. E.D. Pa. 1988) , *aff'd*, 96 B.R. 29 (E.D. Pa. 1989) , *aff'd mem.*, 879 F.2d 857 , sub nom., *Jakobowski v. Dubin*, 493 U.S. 976 (1989) (sanctions against attorney upheld).

(n33)Footnote 30. *In re Zartun*, 8 C.B.C.2d 1103, 30 B.R. 543 (Bankr. 9th Cir. 1983) . *See also In re Ketelsen*, 880 F.2d 990 (8th Cir. 1989) (no damages proved in case where FmHA seized the debtor's tax refund in violation of the stay; however attorney's fees awarded).

(n34)Footnote 31. *Halas v. Platek*, 239 B.R. 784 (N.D. Ill. 1999) (because state court had no jurisdiction to

sanction stay violations, prior state proceeding could not be *res judicata* on issue of whether sanctions for such violations were proper).

(n35)Footnote 32. See *Randolph v. IMBS, Inc.*, 368 F.3d 726 (7th Cir. 2004) (claim under FDCPA is not preempted by Bankruptcy Code provisions providing other remedies for stay violations). *Greenwood Trust Co. v. Smith*, 212 B.R. 599 (B.A.P. 8th Cir. 1997) (creditor's direct communication seeking reaffirmation of debt with debtor represented by attorney violated state consumer credit laws); *In re Aponte*, 82 B.R. 738 (Bankr. E.D. Pa. 1988) . But see *Eastern Equip. & Servs. Corp. v. Factory Point Nat'l Bank*, 236 F.3d 117 (2d Cir. 2001) (actions based upon stay violations must be brought in bankruptcy court and state law tort claims for same acts were preempted by federal law).

(n36)Footnote 33. See *Vahlsing v. Commercial Union Ins. Co.*, 928 F.2d 486 (1st Cir. 1991) .

(n37)Footnote 34. See *Maine v. Thiboutot*, 448 U.S. 1, 100 S. Ct. 2502, 65 L. Ed. 2d 555 (1980) .

(n38)Footnote 35. *Maine v. Thiboutot*, 448 U.S. 1, 100 S. Ct. 2502, 65 L. Ed. 2d 555 (1980) . See ch. 5 *supra*.

(n39)Footnote 36. 11 U.S.C. § 106(a). However, punitive damages may not be awarded under this provision, and there are limitations on attorney's fees, at least against the federal government.

(n40)Footnote 37. *Central Virginia Community College v. Katz*, 126 S.Ct. 990 (2006) .

(n41)Footnote 38. 11 U.S.C. § 362(k), formerly § 362(h), as amended and redesignated by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n42)Footnote 39. *In re Lile*, 161 B.R. 788 (S.D. Tex. 1993) ; *Taborski v. IRS*, 141 B.R. 959 (N.D. Ill. 1992) .

(n43)Footnote 40. 11 U.S.C. § 106(b).

(n44)Footnote 41. See *Small Business Admin. v. Rinehart*, 887 F.2d 165, 21 C.B.C.2d 917 (8th Cir. 1989) (affirming award of actual damages, costs and attorneys fees); *In re Colon*, 23 C.B.C.2d 1202, 114 B.R. 890 (Bankr. E.D. Pa. 1990) (*Eleventh Amendment* bars damages under section 362 but not under court's contempt power).

(n45)Footnote 42. See *Small Business Admin. v. Rinehart*, 887 F.2d 165, 21 C.B.C.2d 917 (8th Cir. 1989) .

(n46)Footnote 43. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n47)Footnote 44. *Fed. R. Bankr. P. 9014*. See *In re Rijos*, 263 B.R. 382 (B.A.P. 1st Cir. 2001) ; *In re Karsh Travel, Inc.*, 102 B.R. 778, 780-781 (N.D. Cal. 1989) ; *In re Zumbrun*, 88 B.R. 250 (B.A.P. 9th Cir. 1988) .

(n48)Footnote 45. *Fed. R. Bankr. P. 7001 et seq.* .

(n49)Footnote 46. *Price v. Rochford*, 947 F.2d 829 (7th Cir. 1991) ; *In re Davis*, 32 C.B.C.2d 1940, 177 B.R. 907 (Bankr. 9th Cir. 1995) .

(n50)Footnote 47. *In re Gruntz*, 202 F.3d 1074, 43 C.B.C.2d 921 (9th Cir. 2000) (en banc). See also *In re Dunbar*, 245 F.3d 1058 (9th Cir. 2001) (administrative agency ruling).

(n51)Footnote 48. *E.g.*, *In re Singleton*, 41 C.B.C.2d 802, 230 B.R. 533 (B.A.P. 6th Cir. 1999) .



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CHAPTER 9 The Codebtor Stay in Chapter 13

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§ 9.syn Synopsis to Chapter 9: The Codebtor Stay in Chapter 13

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CHAPTER 9 The Codebtor Stay in Chapter 13

1-9 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

In chapter 13 cases, in addition to the section 362 automatic stay, another stay also goes into effect upon the filing of the chapter 13 petition. This stay prohibits any act or civil legal action to collect all or part of a consumer debt of the debtor from any codebtor.

This chapter discusses the scope of the codebtor stay, notice of the stay and enforcement of the stay. Relief from the codebtor stay is discussed in chapter 10 of this guide.



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CHAPTER 9 The Codebtor Stay in Chapter 13

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P 9.01 Purpose of the Codebtor Stay

Congress found the chapter 13 codebtor stay to be necessary because in many instances under the old Chapter XIII of the Bankruptcy Act codebtors, who were usually relatives or friends, were pursued by creditors as soon as a debtor filed a case, leading ultimately to the failure of the Chapter XIII plan.ⁿ¹ The codebtor stay is designed to ensure that creditors do not pursue codebtors during a chapter 13 case, so those codebtors do not then put pressure on the debtor to pay the pursuing creditor instead of making chapter 13 plan payments.

The codebtor stay has become increasingly important with the enactment of the 2005 amendments to the Code.ⁿ² Many actions a creditor may be permitted to take because of new exceptions and limitations to the automatic stay of section 362 may nonetheless be barred in chapter 13 as against a codebtor.

FOOTNOTES:

(n1)Footnote 1. H.R. Rep. No. 595, 95th Cong., 1st Sess. 122 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005.



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CHAPTER 9 The Codebtor Stay in Chapter 13

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P 9.02 Scope of the Codebtor Stay

The codebtor stay generally protects all codebtors of the debtor, who are normally relatives or friends of the debtor. In some cases the availability of the codebtor stay may make it unnecessary for a debtor's spouse, or some other relative who has cosigned or guaranteed a debt, to file a bankruptcy case, since that relative will receive the protection of the stay on debts that will ultimately be paid through the debtor's plan. The codebtor need not be personally liable on the debt; it is sufficient that the codebtor put up security for the obligation.ⁿ¹

One problem which arises, not infrequently, is the reporting of a bankruptcy on the credit report of a codebtor, even though the codebtor has not filed a bankruptcy case. Although creditors have argued that such a report accurately reflects that the particular debt is being paid in a bankruptcy plan, the report may be actionable if it inaccurately appears from the report that the codebtor has filed a bankruptcy case. Even if the report is accurate, it may be a violation of the codebtor stay if it is made with the intent to coerce payment by the codebtor.ⁿ²

PRACTICE NOTE

There are several limitations upon this stay, however. It applies only to "consumer debts."^{n2a} This term probably does not include a tax debt.ⁿ³ It also may not include tort liability.ⁿ⁴ In addition, the codebtor stay does not apply to codebtors who became obligated in the ordinary course of their business.ⁿ⁵ The stay ends automatically if a chapter 13 case is closed, dismissed, or converted to a chapter other than chapter 12.

In several situations, the stay is effective as of the filing of the case, but may be lifted or modified by the court upon motion of a creditor or other party in interest. Relief from the codebtor stay is discussed elsewhere in this volume.ⁿ⁶

FOOTNOTES:

(n1)Footnote 1. *In re Harris*, 203 B.R. 46 (Bankr. E.D. Va. 1994) (conveyance of jointly held property to foreclosure sale purchaser violated codebtor stay even though nondebtor spouse's personal liability on joint mortgage had been discharged in prior bankruptcy case).

(n2)Footnote 2. *In re Singley*, 41 C.B.C.2d 1623, 233 B.R. 170 (Bankr. S.D. Ga. 1999) , *reconsideration denied*, 236 B.R. 105 (Bankr. S.D. Ga. 1999) ; *In re Sommersdorf*, 139 B.R. 700 (Bankr. S.D. Ohio 1992) (bank's actions in placing notation of debt charge-off on codebtor's credit report violated stay).

(n3)Footnote 2a. "Consumer debt" is defined at *11 U.S.C. § 101(8)*. See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender); 1 Collier Bankruptcy Manual, ch. 101 (Matthew Bender).

(n4)Footnote 3. See *IRS v. Westberry*, 215 F.3d 589 (6th Cir. 2000) .

(n5)Footnote 4. *In re Alvarez*, 57 B.R. 65 (Bankr. S.D. Fla. 1985) .

(n6)Footnote 5. *11 U.S.C. § 1301(a)(1)*.

(n7)Footnote 6. See ch. 10 *infra*.



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CHAPTER 9 The Codebtor Stay in Chapter 13

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P 9.03 Notice of the Codebtor Stay

PRACTICE NOTE

As in the case of the section 362 stay, notice of the codebtor stay is given, in general language, as part of the notice of the meeting of creditors. Because this notice is general and because it is not sent immediately after filing of the case, it is sometimes necessary for the debtor's counsel to give notice of the codebtor stay to particular creditors to prevent any action against the codebtor by them.

FORMS

For forms of notice of commencement of case under chapter 13 of the Bankruptcy Code, meeting of creditors, and fixing of dates *see* Official Form 9I in *Collier Consumer Bankruptcy Forms, Form CS10.32-5* (Matthew Bender).

Such notice can be given by mail, phone or fax. The issues regarding notice of the codebtor stay are identical to those regarding notice of the section 362 stay.ⁿ¹

FOOTNOTES:

(n1)Footnote 1. *See P 8.04 supra.*



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CHAPTER 9 The Codebtor Stay in Chapter 13

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P 9.04 Enforcing the Codebtor Stay

The codebtor stay may be enforced in many of the same ways as the automatic stay under section 362.ⁿ¹ Thus, an action in violation of the stay should be held void, injunctive relief should be available to remedy violations, and violators held in contempt of court may be ordered to pay damages and attorney's fees.

PRACTICE NOTE

However, section 362(k), the Code's specific damage remedy for violations of the section 362 stay, is not available for violations of the section 1301 codebtor stay. Thus, unless a different theory may be advanced, it may be difficult to obtain punitive damages for violations of the codebtor stay.

FOOTNOTES:

(n1)Footnote 1. *See P 8.05 supra.*



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

1-10 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter begins with a discussion of the purpose for granting relief from the automatic stay. An examination of the grounds for relief follows, specifically, relief for cause and relief when the debtor has no equity in the property and the property is not necessary for an effective reorganization. The chapter then considers whether relief from the stay is available to lessors. Next, the chapter reviews several issues important in relief proceedings, including burden of proof, alternative forms of relief, remedies for failure of adequate protection, and factors to consider when determining property valuation.

The chapter then proceeds to discuss the time deadlines and procedures for seeking relief from the stay, including strategies for parties filing motions seeking relief and for debtors who oppose such motions. Also, the chapter reviews procedure for obtaining court approval when the debtor and one or more nondebtors provide for relief from the automatic stay by agreement or stipulation. In addition, the chapter discusses discovery procedures, the requirements for ex parte relief, as well as relief from the codebtor stay. Finally, the chapter examines the options available to a party who is unsuccessful in either filing a motion seeking relief or opposing such a motion.



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.01 Purpose for Granting Relief from the Stay

While the scope of the stay is broad and the sanctions to enforce it are powerful, the duration of its protections may be short-lived. A common creditor response to the bankruptcy petition is to file a proceeding seeking relief from the automatic stay. The court may grant relief, upon motion of a party, terminating, annulling,ⁿ¹ modifying, or conditioning the stay. Only the bankruptcy court has the power to grant relief from the automatic stay.ⁿ²

Upon a motion for relief, the automatic stay may be lifted or modified to the extent that there is no legitimate reason for the stay to continue. Broadly speaking, the stay may be lifted when the debtor does not legitimately need the protection of the stay, or when continuation of the stay would unduly harm a legitimate interest of a secured creditor or other interested nondebtor.

The purposes behind permitting relief from the automatic stay are derived from the purposes behind the stay itself. The first goal of the automatic stay is to provide the debtor with breathing space--all collection efforts and foreclosure actions are stopped. Its second goal is to maintain the status quo while the debtor's estate is reorganized or liquidated--it protects the general interest of all the parties to the case by preventing individual creditors or other third parties from taking property from the debtor or from interfering in any other way with the reorganization or liquidation. However, in some cases creditors and other nondebtors, as well as the debtor, are entitled to protection. Protection for creditors and other nondebtors is provided by 362(d), which offers relief from the stay in certain circumstances.

The two basic legal grounds for relief from the stay reflect the two basic purposes for granting relief. Section 362(d)(2) provides that relief from the stay is available (1) for "cause," which includes a lack of adequate protection, and (2) when the debtor has no equity in the property and the property is not necessary for an effective reorganization. In addition, section 362(d)(4), added in 2005,ⁿ³ allows for *in rem* relief from stay under certain circumstances.

[1] Relief for Cause

The first ground, "cause," authorizes relief from the stay when an injured nondebtor can show some compelling reason for relief. This basis for relief focuses on the unwarranted harm that the stay is imposing on the nondebtor. Most often, cause consists of lack of adequate protection for an interest in property. As part of its right to the maintenance of the status quo, a nondebtor is entitled to adequate protection of the value of its collateral during the delay on foreclosure imposed by the automatic stay. If the collateral is depreciating in value, the nondebtor is entitled to relief from the stay

unless the debtor can provide a means of adequately protecting the value of the collateral, or unless the debtor proves that the nondebtor is already adequately protected.

As is suggested by the nature of the harm redressed under this ground for relief, this ground for relief is typically pleaded by secured creditors and, occasionally, lessors and others whose property interests would otherwise be tied up and lose value over the course of a long chapter 13 case. Usually, chapter 7 cases are wrapped up more quickly and collateral is typically not tied up long enough for lack of adequate protection to be a realistic issue. Therefore, motions for relief on this ground in chapter 7 cases are rare.

The automatic stay puts a stop to lawsuits against the debtor. Sometimes there is no bankruptcy-related reason not to let these suits go forward. The suit might be nearing completion and it might be best to get it out of the way. Or it might involve specialized issues best adjudicated by the nonbankruptcy court. This general category permits relief from the stay in such circumstances. This category may also be used to provide relief when the bankruptcy case itself was filed in bad faith--by a debtor using bankruptcy to buy time when there is no real hope of a successful chapter 13 plan.

PRACTICE NOTE

Relief from the stay is seldom sought or granted in chapter 7 cases. However, when relief is granted, usually sought under the general "cause" category of section 362(d)(1), it is often to permit the conclusion of an almost completed lawsuit or to permit the nonbankruptcy case to be heard in the more appropriate nonbankruptcy forum.

[2] Relief When there Is No Equity and Property Not Necessary for Reorganization

The second ground for relief from the stay, that the debtor has no equity in the property and the property is not necessary for an effective reorganization, recognizes that when property has no remaining value to a bankruptcy estate, a nondebtor with an interest in the property should be able to proceed against the property free of the constraints of the stay. If the debtor has no equity that could enhance the estate, and if the property is unnecessary for a reorganization, there is simply no legitimate need to prevent the nondebtor from proceeding, and the nondebtor may therefore obtain relief from the stay.

[3] Grounds for Relief Available Independently of One Another

A nondebtor may seek relief from the stay under *either* sections 362(d)(1) or 362(d)(2). It is not necessary to prove the elements of both. Even if a debtor does have equity in the property and the property is necessary for a reorganization, the debtor will have to provide adequate protection of the nondebtor's deteriorating interest if the debtor wants to keep the property. And even if the debtor offers adequate protection of a nondebtor's interest and there is no other cause for granting relief from the stay, a nondebtor is entitled to relief from the stay if the debtor has no equity in the property and the property is not necessary for an effective reorganization.

[4] Parties Eligible for Relief from the Stay

Most courts agree that anyone whose property, contract right, or legal claim against the debtor is or may be adversely affected by the stay may move for relief. Relief motions are commonly brought by:

- secured creditors, including mortgagees;
- co-owners, consignors, and other property holders;
- holders of a right of set-off;

- lessors;
- persons with other property, contract, family law, or tort claims against the debtor.

A creditor seeking relief from the stay must make sure it can document the fact that it is the holder of the underlying debt. As the selling and securitization of mortgages has become commonplace, it has become harder for mortgage holders and servicers to keep track of which party holds the mortgage. Bankruptcy courts have become increasingly aware of such issues and have more frequently denied motions for relief from stay based upon lack of standing.^{n3a}

[5] *In Rem* Relief

Creditors with claims secured by real property may seek *in rem* stay relief under section 362(d)(4) in certain limited circumstances. This section addresses conduct that could be indicative of an abusive filing in relation to a real property foreclosure and could affect the rights of a future debtor who was not even involved in the case in which *in rem* relief was sought. To obtain *in rem* relief from the automatic stay, the court must find that the petition was part of a scheme to delay, hinder, and defraud creditors and that the scheme involved (1) the transfer of all or part ownership of or interest in the property without the consent of the secured creditor or court approval; or (2) multiple bankruptcy filings affecting the property.ⁿ⁴

If the court enters an *in rem* order and the order is recorded in compliance with state laws for recording liens or interests in property the stay does not apply with respect to the property in a later case filed within two years after the date of the order. However, a debtor may move in a subsequent case for relief from an *in rem* order based upon changed circumstances or for good cause shown.

FOOTNOTES:

(n1)Footnote 1. *In re Soares*, 107 F.3d 969, 37 C.B.C.2d 1281 (1st Cir. 1997) (annulment should not be granted to validate foreclosure when mortgagee knew of bankruptcy and failed to inform state court); *Franklin v. Office of Thrift Supervision*, 31 F.3d 1020 (10th Cir. 1994) (power to annul stay should rarely be used, probably only in cases of claimants who were honestly ignorant of stay); *In re Siciliano*, 13 F.3d 748, 30 C.B.C.2d 667 (3d Cir. 1994) (court had authority to annul stay in proper circumstances).

(n2)Footnote 2. *In re Gruntz*, 202 F.3d 1074, 43 C.B.C.2d 921 (9th Cir. 2000) (*en banc*).

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n4)Footnote 3a. *E.g.*, *In re Sheridan*, 2009 Bankr. LEXIS 552 (Bankr. D. Idaho Mar. 12, 2009) (Mortgage Electronic Registration Systems (MERS) failed to show standing to bring motion); *In re Fitch*, 2009 Bankr. LEXIS 1375 (Bankr. N.D. Ohio May 28, 2009) (MERS was never in chain of title for mortgage note and had no standing); *In re Maisel*, 378 B.R. 19 (Bankr. D. Mass. 2007) (assignee who filed motion before mortgage was assigned to it did not have standing). *See also In re Foreclosure Cases*, 521 F. Supp. 2d 650 (N.D. Ohio 2007) .

(n5)Footnote 4. 11 U.S.C. § 362(d)(4), added by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.02 Relief for Cause

When continuation of the stay would harm a legitimate interest of the nondebtor, *section 362(d)(1) of the Bankruptcy Code* permits relief for "cause," which usually consists of a lack of adequate protection for the property of a nondebtor.ⁿ¹ However, relief under section 362(d)(1) may also be granted for other reasons.

[1] Lack of Adequate Protection as Cause for Relief

A nondebtor with a lien or other interest in estate property is entitled to assurance that its interest will not decline in value over the course of the case. This assurance is provided by the nondebtor's right to require either the lifting or modification of the stay or the provision of adequate protection for its interest.

[2] Types of Adequate Protection

Although the term "adequate protection" refers to a single concept, the term is used in two slightly different contexts. The law says that the nondebtor is entitled to adequate protection of its property interest. If the nondebtor moves for relief on the basis of lack of adequate protection, the debtor might respond in either of two ways. First, the debtor might assert that the nondebtor does not in fact lack adequate protection; the nondebtor might already be adequately protected by the fact that its debt is substantially oversecured. Second, the debtor might assert that even though the value of the collateral is deteriorating, the debtor's offer of cash or some form of additional security will adequately protect the nondebtor from loss.

Whether adequate protection has been provided is a question of fact to be decided by the bankruptcy court.ⁿ²

[3] Preexisting Adequate Protection: The Equity Cushion

If the collateral is worth much more than the creditor's claim, the creditor's interest might not be adversely affected by a moderate decline in the value of the collateral or increase in the debt.ⁿ³ The amount by which the value of the collateral exceeds the amount of the claim is sometimes called the "equity cushion." For example, suppose a creditor has a \$100,000 claim secured by a home worth \$150,000. If the home were to decline in value by \$10,000 the creditor would still be able to recover its full claim out of the collateral. If the equity cushion is large enough, the cushion itself may constitute adequate protection of the creditor's interest in the collateral.

[a] How Much of a Cushion is Enough?

The answer to this question depends primarily on three factors: how rapidly the property is deteriorating in value, the extent to which there is protection in addition to the equity cushion, and the stage of the case (*i.e.*, for how long will protection be needed?). Under *section 506(b) of the Bankruptcy Code*, an "oversecured" creditor--a creditor with an equity cushion--is entitled to accrue interest against the excess value, plus any costs and fees provided for in the security agreement. Thus, over time the creditor's claim may increase if no payments are being made on the claim. Even if the collateral were not declining in value, the creditor's claim might eventually exceed the value of the collateral. It seems clear from the statute that the equity cushion the creditor is entitled to have is not necessarily the amount originally bargained for in the transaction, but rather can be considerably less. The purpose of the provision is to allow the court to decide what is adequate to protect the creditor's interest, even if the creditor once had better than adequate protection.ⁿ⁴

Courts have disagreed about whether the equity cushion (or other form of adequate protection) must be large enough to protect accruing interest as well as principal. Some courts have held that as long as there is enough value in the property to provide the creditor with the amount that it would have received from a foreclosure sale, the cushion offers adequate protection. These courts recognize that *under* secured creditors are not entitled to recover interest or fees, and they suggest that once the collateral runs out of value to provide for accruing interest and fees, there is no right to further recovery. Thus, according to these courts, the only assurance offered to the creditor at this point is that the principal amount can be recovered.

Other courts have found that the cushion must be adequate to protect the oversecured creditor's right to accruing interest, costs, and fees as well as the right to principal. These courts note that the Bankruptcy Code explicitly provides an oversecured creditor with the right to these accruals, and they suggest that the automatic stay should not operate to deprive the creditor of this. In *United Savings Association of Texas v. Timbers of Inwood Forest Associates*,ⁿ⁵ the Supreme Court decided that the interest to be protected does not include any opportunity cost resulting from the delay imposed by the stay, that undersecured creditors are not entitled to recover interest, fees, and costs, and that the interest to be protected is the value of the creditor's interest in the collateral.

COMMENTARY

In view of the *Timbers* decision, the better rule is that adequate protection should *not* cover the oversecured creditor's right to interest, costs, and fees. In other words, adequate protection should protect only against declines in the value of the collateral that would deprive the creditor of the amount that it would have received at a foreclosure sale held immediately. Thus, to the extent that the collateral discussed above threatened to decline in value to less than \$100,000, the equity cushion would be inadequate. But an equity cushion would not be considered inadequate solely because of an increase in the size of the creditor's claim resulting from the operation of section 506(b) accruals.

[b] Effect of Junior Interests on the Equity Cushion and Adequate Protection

If more than one creditor has rights in the collateral, the senior creditor might have a cushion even if the debtor has no equity in the collateral.

ILLUSTRATION

For example, suppose Creditor 1 has a \$100,000 claim secured by a home valued at \$150,000. Creditor 1 would have a \$50,000 equity cushion. Suppose, however, that Creditor 2 had a \$75,000 junior claim secured by the same property. The debtor would have no equity in the home, because the liens exceed the value of the property. Nevertheless, because Creditor 1 is the senior creditor, it would be entitled to full satisfaction of its claim before Creditor 2 could receive any recovery. Therefore, Creditor 1 has an equity

cushion even though the debtor has no equity in the collateral.ⁿ⁶

[c] Undersecured Creditors Not Entitled to Postpetition Interest

In *United Savings Association of Texas v. Timbers of Inwood Forest Associates*,ⁿ⁷ the Supreme Court held that undersecured creditors were not entitled to compensation under section 362(d)(1) for delay in foreclosing on collateral caused by the automatic stay. The Court reasoned that to require the payment of interest to the holders of undersecured claims would be inconsistent with the wording and purpose of sections 506(b), which expressly authorizes the accrual of interest for oversecured creditors, section 552(b), which generally limits the types of security interests that can attach postpetition, and section 362(d)(2), which authorizes relief from the stay for undersecured creditors, but only when the debtor has no equity in the property and the property is unnecessary for an effective reorganization. The Court held that, in the absence of express statutory authority, an undersecured creditor could not recover postpetition interest.

[4] Adequate Protection Provided by the Debtor Under Section 361

If the debtor cannot prove that the nondebtor's interest is already adequately protected, relief may be granted unless the debtor affirmatively provides adequate protection. *Bankruptcy Code section 361* does not define adequate protection, but gives three examples of adequate protection: (1) periodic payments; (2) additional or replacement liens; and (3) other relief offering the "indubitable equivalent" of the interest in the property. In each case, the object is to assure the nondebtor that the total value of its interest in the property will not decrease during the period in which the stay prevents the nondebtor from enforcing its rights.

[a] Adequate Protection Through Periodic Cash Payments

One way of protecting a nondebtor's interest in property is to provide the nondebtor with periodic payments equal to the predicted decline in the value of the property.ⁿ⁸ This method is frequently useful in the foreclosure or repossession context, because the debtor will often have little or no equity in the property at issue. The Code allows the debtor to propose a plan in a chapter 13 case that, in effect, cures or pays off the debt on a car or home at a rate that keeps up with any possible depreciation. As long as the debtor makes the plan payments, the creditor is adequately protected within the meaning of the Code. Sometimes a debtor is required to make cash payments to provide adequate protection before confirmation of the plan. Specifically, section 1326(a)(1)(C), enacted in 2005,ⁿ⁹ requires a chapter 13 debtor to make adequate protection payments directly to a creditor holding an allowed claim secured by personal property to the extent it is "attributable to the purchase of such property by the debtor for that portion of the obligation that becomes due after the order for relief." The debtor may also be required to make adequate protection payments in other circumstances. In such cases, plan payments may be reduced by the amount of the payment made directly to the secured creditor and any payments must be credited towards amounts to be paid under Section 1325(a)(5)(B) to satisfy the allowed secured claim once the plan is confirmed.ⁿ¹⁰

[b] Adequate Protection by Additional or Replacement Liens

Another way for the debtor to make up for lost value might be to offer the creditor a lien on additional property, or to replace its lien on the particular piece of property with a lien on other property of greater or more consistent value.ⁿ¹¹ Of course, the value of the creditor's new or additional lien should not exceed the value of the creditor's original lien. Otherwise, the creditor might be unfairly enriched at the expense of unsecured creditors who would otherwise have shared in that excess value.

WARNING

For example, if the debtor owns two cars and only one is encumbered, a lien on the second may be offered to the secured creditor as adequate protection. Of course, the risk in doing so is that the creditor will then have a security interest in both automobiles rather than just one. If payments cannot be made,

the debtor might lose both. For this reason, the strategy is advisable only in the most extreme cases.

[c] Adequate Protection by Offering the Nondebtor the "Indubitable Equivalent" of the Nondebtor's Interest

The nondebtor may also be protected by being given the "indubitable equivalent" of its interest in the property. This "indubitable equivalent" category gives the parties and the court considerable flexibility in protecting the nondebtor's interest. Nevertheless, this flexibility should not be abused; the nondebtor must be provided with reasonable assurance that it will be protected against declines in the value of its interest in the collateral.

[i] Administrative Priority Is Not the "Indubitable Equivalent."

Although the "indubitable equivalent" standard is intentionally broad and flexible, section 361 expressly excludes one conceivable protection device: the granting of an administrative priority under section 503(b)(1).¹² Such "protection" was commonly provided under the old Bankruptcy Act but proved to be inadequate in actual practice. (However, if any sort of adequate protection provided under section 362(d)(1) proves to be inadequate, the Code does provide the injured nondebtor with the compensatory remedy of a *superpriority* under section 507(b).)¹³

[ii] Types of Protection that May be Provided

In an appropriate case, adequate protection may require payments to superior lien holders or to government tax authorities. Physical as well as fiscal protection might be required. The debtor might be required to keep the property in good repair in the face of potential damage from weather or the normal wear and tear of daily use. The nondebtor's entitlement to adequate protection is often the basis for requiring the debtor to maintain adequate fire and casualty insurance protection. A chapter 13 debtor is specifically required to provide proof of such insurance to creditors whose claims are secured by personal property and to personal property lessors by section 1326(a)(4). The courts are divided on the issue of whether mortgage insurance adequately protects the interests of a mortgagee (at least if the insurer is not also moving for relief from the stay.)¹⁴

Junior lienholders may try to protect their position by requesting that payments on senior liens be made or at least that the payments be brought current. Protection may sometimes be provided by third party guarantees, if relatives or friends of the debtor are willing to give such assistance.

[5] Ways in Which the Adequate Protection Issue Under 362(d)(1) Can Arise

The adequate protection issue can be resolved through a number of procedural devices:

- the nondebtor can move to terminate the stay; the debtor can respond with proof that the nondebtor is already adequately protected by an equity cushion or other means;
- the nondebtor can move to terminate the stay; the debtor can respond with an offer of adequate protection;
- the nondebtor can propose to have the stay conditioned upon the provision of what the nondebtor believes will be adequate protection; the debtor can deny that adequate protection is needed, or can offer a lesser form of protection, or can acquiesce to the nondebtor's demand;
- the nondebtor can move to have the stay conditioned upon fulfillment of certain adequate protection conditions on or by a certain date;
- the parties can agree to one or another form of adequate protection arrangement, usually after a

motion for relief is filed, with or without a so-called "drop-dead" provision to terminate the stay upon the debtor's default. Often such agreements provide for notice of default and opportunity to cure before the stay is terminated.

[6] Cause Other than Lack of Adequate Protection

Relief for cause other than lack of adequate protection is a catchall category that encompasses a variety of situations. It is usually granted in one of two sets of circumstances: (1) when there is good reason to let a nonbankruptcy lawsuit begin or proceed; and (2) when the debtor's bankruptcy filing has no chance of success.

[a] Relief to Permit a Nonbankruptcy Lawsuit to Proceed

There are essentially two rationales for suspending the stay to permit a nonbankruptcy lawsuit to proceed. The first involves overall considerations of judicial economy or fairness to the parties. The second involves the idea that the dispute should be heard in a nonbankruptcy court because of that court's special expertise in the subject matter of the dispute.¹⁵ In actual practice, relief is not commonly granted on either of these grounds, because lifting the stay would often create as much disruption and unfairness as it would eliminate, and because there are in fact relatively few areas where bankruptcy courts believe themselves so lacking in expertise that they would find it preferable to allow the dispute to be heard elsewhere.

In determining whether there is cause for granting relief from the stay for reasons of fairness and judicial economy, a court must balance the hardship or prejudice that the debtor or estate might suffer from the granting of relief with the hardship or prejudice to the nondebtor caused by continuation of the stay. If the nonbankruptcy lawsuit was nearing completion when the petition was filed and its continuation would not disrupt the bankruptcy process or the debtor's rehabilitation efforts, the stay might be lifted in the interests of efficiency and fairness to the parties.

ILLUSTRATION

In *In re Fernstrom Storage and Van Co.*,¹⁶ for example, the court granted relief from the stay to a creditor who was seeking a judgment against the debtor solely to enable the creditor to recover from the debtor's insurer. The court found that permitting the action to proceed would not impair the debtor's reorganization, because the insurer was the real party in interest, while allowing the stay to continue would impose considerable expense and hardship on the creditor, particularly since the litigation had already proceeded almost to trial.¹⁷

The stay may also be lifted because the debtor is being sued in a fiduciary capacity, or because the issues are irrelevant or only marginally relevant to the concerns of the bankruptcy case, as in certain disputes arising from the debtor's postpetition activities.¹⁸ And even though the suit may involve issues irrelevant to the bankruptcy case, the bankruptcy court is still likely to base its decision on a balancing of interests. The stay is intended to protect the debtor and the estate against the expense and emotional drain of collection efforts and other actions, and to protect any reorganization or rehabilitation effort. If the lawsuit for which relief is sought will entail expense and burden to the debtor, a court should require a very strong reason before granting relief on grounds of cause. At the same time, when the burden to the debtor and the estate is slight, weaker cause may be sufficient to justify relief.

[b] Relief Because the Dispute Requires a Specialized Forum

The bankruptcy court will also consider whether the issues involved are state law issues for which the expertise of the bankruptcy court is unnecessary. The courts may also consider whether the issues involved might be so intertwined with state law as to require the intervention of a state court. For example, in *In re Robbins*,¹⁹ the court affirmed a bankruptcy court's decision to grant relief from the stay to permit an equitable distribution dispute to proceed in state court, finding that such disputes represent "cases in which state courts have a special expertise and for which federal

courts owe significant deference." Courts have also considered whether it would be more efficient to permit a matter to proceed in a nonbankruptcy forum than to burden the bankruptcy court with hearing a matter that may not involve application of bankruptcy law.

[c] Failure to Make Postpetition Mortgage Payments

One other type of cause averred in a number of cases is the failure of a debtor to make current payments on a mortgage or other secured obligation. Generally, if the creditor's interest is adequately protected, the stay should not be lifted solely for this reason.ⁿ²⁰ Obviously, a creditor's refusal to accept payments or inaccuracies in crediting payments also should preclude it from obtaining relief under this theory.ⁿ²¹ In many cases, due to their lack of proper accounting for payments and their imposition of illegal charges, mortgage companies bring motions for relief from the stay when the debtor is not in default or when they cannot prove the debtor is in default. Courts have properly sanctioned creditors who bring such motions.^{n21a}

Another common response is to modify the plan to include a cure of the postpetition default.ⁿ²² However, if the failure to pay is prolonged or the collateral is depreciating, and there is no prospect for cure, a court may decide that there is no purpose in maintaining the stay.ⁿ²³ Often, in chapter 12 or chapter 13 cases, the court articulates the reason for relief from stay as "failure to comply with the plan."ⁿ²⁴

On the other hand, if the debtor is in compliance with a confirmed plan, the grounds for a creditor to obtain relief from the stay are extremely limited. Courts have generally held that confirmation of the plan is *res judicata* on issues such as adequate protection and that a creditor is bound by the terms of the plan.ⁿ²⁵ Even if the creditor's motion would have been granted prior to plan confirmation, the creditor is usually deemed to have waived its rights by not raising them in opposition to confirmation of a plan that did not protect them.ⁿ²⁶

[d] Relief When Debtor's Case Has No Chance of Success

Some courts have held that relief from the stay may be granted when the debtor's case clearly has no chance of success. These decisions are often premised on the conclusion that the debtor has filed the case in bad faith or the filing is abusive. Most often, they occur when a debtor has filed several previous cases and nothing has changed since then to make a successful plan more likely in the current case.

The 2005 amendments to the Bankruptcy Code set forth specific rules limiting the automatic stay in repeat filings. In a case filed by a debtor who has had a prior case dismissed within the year, section 362(c)(3) limits the duration of the automatic stay, with respect to the debtor but not with respect to property of the estate,^{n26a} to 30 days after the filing of the petition.ⁿ²⁷ The court may continue the stay, after notice and hearing, beyond 30 days upon motion of any party in interest. In a case filed by a debtor who has had two or more prior cases dismissed within the year, section 362(c)(4) prevents the automatic stay from taking effect upon filing of the petition.ⁿ²⁸ Upon motion of any party in interest filed within 30 days after the filing, the court may order, after notice and hearing, the automatic stay to take effect as to any or all creditors. Under either section 362(c)(3) or 362(c)(4), the movant must demonstrate that the case was filed in good faith as to the creditors to be stayed. This will typically require the movant to overcome a presumption of bad faith as provided in each section.ⁿ²⁹

In addition, *Code section 109(g)* provides statutory guidelines which explicitly articulate the standard for determining when repeat filings are not permissible. That section renders ineligible for relief under the Code any individual who within the previous 180 days has (1) suffered dismissal of a case for *willful* failure to abide by orders of court or to appear before the court or (2) requested and obtained *voluntary* dismissal "following" the filing of a request for relief from the section 362 stay. If a debtor is ineligible for relief under section 109(g), the automatic stay does not prevent any act to enforce a lien against real property.^{n29a}

A companion provision in section 349(a) provides that, except as provided in section 109(g), the dismissal of a case, whether voluntary or involuntary, does not prejudice the debtor with regard to the filing of a subsequent petition. These provisions strongly suggest that a court does not have authority to enjoin debtors from filing future cases or to dismiss repeat filings except under the terms specified in the statute.ⁿ³⁰

COMMENTARY

These provisions were intended to be carefully targeted only at the type of repetitive filing in which there is rarely a justification for the new bankruptcy. Their precise language should be strictly construed, with careful attention paid to the statute's distinction between voluntary and involuntary dismissal. Thus, an involuntary dismissal following a request for relief from the stay does not bar a new case (unless it was for willful failure to abide by court orders or to appear). And a voluntary dismissal may be willful, but it does not bar a second filing unless it follows a request for relief from the stay.

[7] Relief From the Stay May Be Limited or Conditional

In some cases, the bankruptcy court may grant limited or conditional relief. For example, the relief order will often allow the debtor one more chance to comply with a plan or modified plan and provide for relief if the debtor does not comply in the future. In some cases, the court may allow a case in a nonbankruptcy forum to go as far as judgment, but might require bankruptcy court approval before the judgment could be enforced.

FOOTNOTES:

(n1)Footnote 1. *See generally* 3 *Collier on Bankruptcy*, P 362.07[3] (Matthew Bender).

(n2)Footnote 2. *In re O'Connor*, 808 F.2d 1393 (10th Cir. 1987) .

(n3)Footnote 3. *See* 3 *Collier on Bankruptcy*, P 362.07[3][d][i] (Matthew Bender).

(n4)Footnote 4. *See In re Ahlers*, 794 F.2d 388, 15 C.B.C.2d 111 (8th Cir. 1986) , *rev'd on other grounds*, 485 U.S. 197, 108 S. Ct. 963, 99 L. Ed. 2d 169, 18 C.B.C.2d 262 (1988) (considering the extent to which a creditor is entitled to adequate protection for potential delays associated with foreclosure).

(n5)Footnote 5. 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740, 17 C.B.C.2d 1368 (1988) .

(n6)Footnote 6. *Nantucket Investors II v. California Fed. Bank (In re Indian Palms Assocs.)*, 61 F.3d 197 (3d Cir. 1995) ; *In re Mellor*, 734 F.2d 1396, 10 C.B.C.2d 1353 (9th Cir. 1984) .

(n7)Footnote 7. 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740, 17 C.B.C.2d 1368 (1988) .

(n8)Footnote 8. *See* 3 *Collier on Bankruptcy*, P 361.03[2] (Matthew Bender).

(n9)Footnote 9. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n10)Footnote 10. [Reserved]

(n11)Footnote 11. *See* 3 *Collier on Bankruptcy*, P 361.03[3] (Matthew Bender).

(n12)Footnote 12. *See* 3 *Collier on Bankruptcy*, P 361.03[4][a] (Matthew Bender).

(n13)Footnote 13. *See* 4 *Collier on Bankruptcy*, P 507.12[1] (Matthew Bender).

(n14)Footnote 14. *Compare In re Roane*, 3 C.B.C.2d 747, 8 B.R. 997 (Bankr. E.D. Pa. 1981) , *aff'd*, 14 B.R. 542 (E.D. Pa. 1981) with *In re Britton*, 9 B.R. 245 (Bankr. E.D. Pa. 1981) .

(n15)Footnote 15. *See, e.g., In re Roberge*, 95 F.3d 42 (4th Cir. 1996) (court granted relief to allow determination of vested equitable distribution rights of debtor's spouse in state court).

(n16)Footnote 16. 938 F.2d 731 (7th Cir. 1991) .

(n17)Footnote 17. *See also In re Holtkamp*, 669 F.2d 505, 5 C.B.C.2d 1412 (7th Cir. 1982) (personal injury action allowed to go forward where insurer assumed full financial responsibility).

(n18)Footnote 18. H.R. Rep. No. 95-595, 95th Cong. 1st Sess. 343-44 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender). *See also* Sommer and McGarity, Collier Family Law and the Bankruptcy Code, ch. 5 (Matthew Bender).

(n19)Footnote 19. 964 F.2d 342 (4th Cir. 1992) .

(n20)Footnote 20. *See, e.g., In re Nichols*, 440 F.3d 850 (6th Cir. 2006) ; *Household Fin. Corp. v. Adams*, 8 C.B.C.2d 843, 27 B.R. 582 (D. Del. 1983) ; *In re Mathews*, 208 B.R. 506 (Bankr. N.D. Ill. 1997) (stay relief inappropriate after debtor missed two postpetition mortgage payments, especially given an \$8,000 equity cushion).

(n21)Footnote 21. *In re Alvarez*, 101 B.R. 176 (B.A.P. 9th Cir. 1989) .

(n22)Footnote 21a. *In re Fagan*, 376 B.R. 81 (Bankr. S.D.N.Y. 2007) (\$10,000 plus attorney's fees awarded to debtor when creditor's own records showed debtor was not in default).

(n23)Footnote 22. *See* ch. 22 *infra*.

(n24)Footnote 23. *E.g., In re Wieseler*, 934 F.2d 965 (8th Cir. 1991) .

(n25)Footnote 24. *E.g., Reinbold v. Dewey Cty. Bank*, 942 F.2d 1304 (8th Cir. 1991) , *cert. denied*, 503 U.S. 946, 112 S. Ct. 1499, 117 L. Ed. 2d 639 (1992) .

(n26)Footnote 25. *E.g. In re Wellman*, 322 B.R. 298 (B.A.P. 6th Cir. 2004) ; *Chevy Chase Bank v. Locke*, 227 B.R. 68 (E.D. Va. 1998) . *See* § 20.05 *infra*.

(n27)Footnote 26. *E.g. Chevy Chase Bank v. Locke*, 227 B.R. 68 (E.D. Va. 1998) . *See* § 20.05 *infra*. *See also* *Carvalho v. Fannie Mae (In re Carvalho)*, 335 F.3d 45 (1st Cir. 2003) (order granting relief from stay did not eliminate the plan's bifurcation of creditor's claim into secured and unsecured claims).

(n28)Footnote 26a. *In re Harris*, 342 B.R. 274 (Bankr. N.D. Ohio 2006) ; *In re Jones*, 339 B.R. 360 (Bankr. E.D.N.C. 2006) (both cases noting contrasting language of § 362(a)(4) that precludes application of stay entirely unless imposed by court).

(n29)Footnote 27. 11 U.S.C. § 362(c)(3), added by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n30)Footnote 28. 11 U.S.C. § 362(c)(4), added by Pub. L. No. 109-8 (2005) effective in cases commenced on or after October 17, 2005.).

(n31)Footnote 29. *See* P 8.03[c][i], [ii] *supra*.

(n32)Footnote 29a. 11 U.S.C. § 362(b)(21), enacted by Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005.

(n33)Footnote 30. *See In re Frieouf*, 938 F.2d 1099, 25 C.B.C.2d 481 (10th Cir. 1991) , *cert. denied*, 502 U.S.

1091, 112 S. Ct. 1161, 117 L. Ed. 2d 408 (1992) (court may not enjoin filings by a debtor beyond the statutory 180 day limit but may enjoin discharge of debts listed in prior dismissed case for a three-year period). *But see In re Casse*, 198 F.3d 327 (2d Cir. 1999) (court has power to enjoin future filings for period longer than 180 days); *In re Tomlin*, 105 F.3d 933, 37 C.B.C.2d 654 (4th Cir. 1997) (interpreting bankruptcy court order dismissing case "with prejudice" as one imposing a bar to refiling within 180 days).



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.03 Relief When the Debtor Has No Legitimate Need for the Property

Relief from the stay of acts against property is available under section 362(d)(2) when (1) the debtor has no equity in the property and (2) the property is not necessary for an effective reorganization.ⁿ¹ Without equity that the debtor can exempt or the trustee can sell, or need for the property in order to have a successful case, there is no reason to block the nondebtor from enforcing its rights.

[1] Lack of Equity in the Property

If the debtor does have equity in the property, he or she, or the trustee, is entitled to realize on that equity and control the disposition of the property, subject to the nondebtor's right to adequate protection under section 362(d)(1). Resolution of the equity issue often depends on the value of the property.ⁿ²

"Equity" for purposes of section 362(d)(2) generally means net equity in the particular property subject to the motion--*all* claims against the property and the costs of foreclosure are subtracted from its value. Unlike the equity cushion analysis used to evaluate whether excess value is available to satisfy a senior secured claim against the property, in which junior liens are not considered because they do not affect the senior creditor's recovery, the equity analysis for purposes of section 362(d)(2) considers *all* of the liens against the property and compares the total amount of the liens to the value of the property. Only when the value of the property exceeds *all* of the liens on the property does the debtor have equity in the property for purposes of section 362(d)(2). This is consistent with the underlying purpose of the provision, which is to determine whether the estate can derive any value from the property. If the total liens exceed the value of the property, there is no excess value for the estate. However, out of concern for the interests of junior lienholders, some courts have refused to subtract the value of liens junior to that of the moving creditor when calculating whether the debtor has equity in the property for purposes of section 362(d)(2).

The stay should not be lifted if it protects some interest in property that the debtor may exempt under section 522, because allowing a creditor to proceed outside the bankruptcy court could jeopardize the exemption and thus the debtor's fresh start. Similarly, if there is equity in property that is not exempt, the Code usually prefers that it be disposed of in the normal bankruptcy liquidation process or, in a chapter 13 case, that the debtor have the opportunity to preserve that equity through a chapter 13 plan.

[2] Property Not Necessary for an Effective Reorganization

Even a debtor who has no equity in the property can resist relief under section 362(d)(2) if the debtor can prove that the property is necessary for an effective reorganization. Proof that a reorganization is likely to succeed is often a key element of the debtor's case; if the debtor cannot reorganize, the property cannot be considered "necessary."

In setting this test, the Bankruptcy Code tries to protect debtors' chances of reorganizing by assuring them that they can retain and use essential property subject to security interests even when they have no equity in the property. For example, a chapter 13 debtor is unlikely to be able to complete a plan if the debtor's car necessary to drive to work is repossessed, or if the debtor must incur moving expenses due to foreclosure on his or her home.

Moreover, even if the property is functionally necessary for the success of the debtor's plan, relief from the stay will not be denied unless the debtor can show that there is a chance of a successful plan. If the debtor has no chance of success, the debtor does not in fact need the property, because what the debtor would need it for will not exist. In *United Savings Association of Texas v. Timbers of Inwood Forest Associates*,ⁿ³ the Supreme Court recognized this by suggesting that relief from the stay may be appropriate unless a successful reorganization is in prospect. The Court stated: What this ['necessary to an effective reorganization' standard] requires is not merely a showing that if there is conceivably to be an effective reorganization, this property will be needed for it; but that the property is essential for an effective reorganization *that is in prospect*. This means, as many lower courts, including the en banc court in this case, have properly said, that there must be 'a reasonable possibility of a successful reorganization within a reasonable time.' The Court also noted that the burden of establishing that the collateral is necessary for a reorganization is on the debtor resisting relief from the stay, not on the creditor.

[3] Applicability of Test to Individual Cases Under Chapters 12, 13 and 7

Businesses "reorganize;" individuals do not. Consequently, courts have taken a variety of positions on how or even if section 362(d)(2), with its "necessary to an effective reorganization" requirement, should apply in individual rehabilitation cases or under chapter 7.

[a] Chapter 12 and 13 Cases

A few courts have taken the position that section 362(d)(2) does apply in chapter 12 and 13 cases, but because "reorganization" is a meaningless concept in relation to a natural person, property can never be "necessary" under chapters 12 and 13. Under this view, nondebtors may obtain stay relief under section 362(d)(2) for all property in which the debtor has no equity.

This view of section 362(d)(2) struck other courts as so excessive in its empowerment of creditors and so inconsistent with chapter 13's debtor protection policies that those courts adopted the directly opposite view, that section 362(d)(2) should be off-limits to chapter 13 creditors. Thus, some courts have taken the position that section 362(d)(2) does not apply at all in chapter 12 and 13 cases, because section 362(d)(2) uses the word "reorganization" and reorganizations do not exist outside of commercial chapter 11 cases. Under this view, section 362(d)(2) is simply not available to chapter 12 or 13 nondebtors as a basis for relief.

This view of section 362(d)(2) can be criticized as excessively favorable to debtors--for no compelling reason, it deprives creditors of access to property that the debtor does not need. It is also arguably inconsistent with section 103, which can be read as expressing Congressional intent to make section 362(d)(2) applicable to cases under chapters 12 and 13.

The better view, adopted by most courts, is that section 362(d)(2) is available under chapters 12 and 13, and that a debtor may keep property in which it has no equity if the property is necessary to the success of the debtor's debt adjustment plan.ⁿ⁴ Property may be necessary, for example, if loss of the property would so interfere with the debtor's existence that the debtor would be unable to perform under a plan. For example, the loss of a house that could not

readily be replaced might interfere with a debtor's job performance. The loss of a car needed for commuting to work might be similarly devastating. "Necessary," under this view, would mean whatever is necessary for the continuation of a lifestyle consistent with the debtor's employment needs.

[b] Chapter 7 Cases

Relief from the stay is typically not as important an issue under chapter 7 as it is under other chapters of the Code, because chapter 7 cases are usually wrapped up relatively quickly and the nondebtor's property is usually not tied up for long. However, as under chapters 12 and 13, courts have taken a variety of positions on how and if section 362(d)(2) applies under chapter 7.

Some courts have held that section 362(d)(2) does apply under chapter 7, but because there will be no reorganization, the creditor can retrieve its property merely by proving lack of equity. Note that some courts have taken a similar position with regard to chapters 11 and 12. Other courts have held section 362(d)(2) does not apply at all under chapter 7.

[4] Proof of Necessity for Reorganization

In chapter 13 cases, the debtor's testimony is usually sufficient to prove the necessity of assets for a reorganization. If the property is a house in which the debtor lives, the burdens and expense of a forced move, along with higher housing costs, can easily be shown to have enough disruptive potential to cause failure of a chapter 13 plan. Similarly, if the property in question is an automobile necessary for transportation to work or other important family business, it is not difficult to prove the deleterious effects on a plan that would be caused by its loss.

As for "luxury" items, such as entertainment equipment or a second car not needed for work, the test is somewhat more difficult. When it can be shown that saving the property is a prime motivation for the plan, and that its loss will cause the debtor to give up on the plan, it should be possible to argue that this property, too, is necessary for an effective reorganization.ⁿ⁵ Of course, all of these possibilities are based upon the assumption that an effective reorganization or plan can otherwise be accomplished. If it cannot, then logically the property cannot possibly be necessary for an effective reorganization.

FOOTNOTES:

(n1)Footnote 1. *See 3 Collier on Bankruptcy, P 362.07[4]* (Matthew Bender).

(n2)Footnote 2. *See P 10.10 infra.*

(n3)Footnote 3. *484 U.S. 365, 375-76, 108 S. Ct. 626, 632-633, 98 L. Ed. 2d 740, 750-751, 17 C.B.C.2d 1368, 1374 (1988).*

(n4)Footnote 4. *See 3 Collier on Bankruptcy, P 362.07[4][b][i]* (Matthew Bender).

(n5)Footnote 5. *Grundy Nat'l Bank v. Stiltner, 58 B.R. 593 (W.D. Va. 1986)* (where debtor's primary purpose in filing bankruptcy is to save a home, an "irrebuttable presumption" is created that the home is necessary to effective reorganization).



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.04 When Is Relief from the Stay Available to Lessors?

[1] Personal Property Leases in Chapter 7

Section 362(h), added in 2005,ⁿ¹ provides for the termination of the stay in chapter 7 cases with respect to personal property subject to an unexpired lease if the debtor fails to timely file a statement of intention under section 521(a)(2), fails to actually state an intention to surrender or assume the lease, or fails to timely take action as specified.ⁿ² Significantly, section 362(h) does not create substantive rights. It only removes the stay as an impediment to actions that are otherwise permitted. Because the language of section 521(a)(2) was not significantly changed, and because many courts had held that a debtor has the right to retain collateral if the underlying debt payments were kept current after the case when the automatic stay had terminated, it is not at all clear that a creditor is given the right to repossess property from a debtor who is current in payments, even when section 362(h) is effective.

PRACTICE NOTE

The meaning of taking timely action to carry out the debtor's stated intention may not always be clear. For example, full performance of the debtor's stated intention to assume a lease within the time permitted under section 521(a)(2) may be complicated by the different set of time periods in section 365 for actions to be taken by the trustee, debtor and the lessor. Because of the consequences of stay termination, particularly when done automatically without a stay relief proceeding, courts may be reluctant to construe the phrase "take timely the action" to require complete performance of the stated option within the time specified. It may be prudent for a lessee of personal property to request an order confirming the stay termination or seek stay relief under section 362(d) if there is any doubt about whether the stay is in force.

[2] Personal Property Leases in Chapter 13

Section 365(p)(3), enacted in 2005,ⁿ³ provides that in a chapter 13 case, a lease for personal property is deemed rejected if not assumed by the debtor as of the conclusion of the hearing on confirmation. If the lease is rejected, the automatic stay and, if applicable, the codebtor stay are terminated with respect to the property subject to the lease.

Chapter 13 debtors are also required to make scheduled lease payments to personal property lessors for the portion of the obligation that becomes due after the order for relief.ⁿ⁴ Such payments are then deducted from the payments due to

the trustee. The remedy for failure to make current lease payments is likely to be relief from the automatic stay. However, unlike the provisions of section 362(h), relief is not automatic. Therefore, a lessor will still have to file a motion for relief from the stay if payments have not been made, and the court may well allow a debtor to cure a default in payments.

[3] Real Property Leases

With respect to leases for real property, the question remains as to whether relief from stay is available during the potentially long time period when the debtor is deciding whether to assume or reject the unexpired lease. The 2005 amendments to the Bankruptcy Code,ⁿ⁵ created two new provisions which except from the stay certain actions to recover possession of residential real estate property: (1) cases in which lessor has obtained a prepetition judgment for possession of leased residential property, and (2) eviction proceedings based on the endangerment of such property or the illegal use of controlled substances on such property.ⁿ⁶ However, even if neither of these provisions is applicable, there is nothing in the Code that explicitly precludes relief and the issue is likely to turn on whether there is adequate protection for the lessor's interest. If relief from stay cannot be obtained, the lessor in any case may move for an order to compel the debtor or trustee to assume or reject the lease within a stated time period.

Other special problems arise under the stay provisions in cases involving residential leases. While it may be quite possible for a debtor to give a lessor adequate protection, perhaps in the form of a security deposit, it is usually difficult to argue that the debtor has equity in the leased premises unless the debtor has a long-term lease at a rate below current market values, or receives other benefits from remaining in possession, such as the special rights available in public housing or in a rent-control jurisdiction. Also, as to the property's necessity for an effective reorganization, it is usually somewhat harder to argue that moving to other leased premises is as great a hardship as losing a home owned by the debtor, because the lease usually guarantees only a short term of residency in any case. (Again, if rent control laws include eviction controls, stronger arguments can be made).ⁿ⁷

MORE INFORMATION

Chapter 15 *infra* provides a more extensive discussion of the assumption and rejection of leases.

The greatest problems of persuasion arise because the debtor, by means of the stay, could, in effect, extend a lease beyond the term to which he or she was otherwise entitled, and in some cases retain possession of property in which he or she otherwise had no rights whatsoever still in existence.

There are several reasons why the stay should be continued as to a leased property, even if the tenancy has ended or will soon end. These arguments are most convincing in cases in which the lessor has adequate protection and the continuation of the stay is necessary to an effective reorganization. The stay's provisions are meant to allow use by the debtor of property, such as collateral which would otherwise be repossessed, including property which the debtor does not technically "own."

Moreover, as long as adequate protection is provided, there is no economic harm to the lessor, compared to what could otherwise be realized by renting the property. The substitution of money for the right of possession is in accord with a long line of cases holding that residential rental real estate is a fungible consumer good and not a unique interest for which money is no substitute.ⁿ⁸ This is an especially compelling argument in the bankruptcy court, which as a court of equity must consider the "balance of hurt." When a lessor cannot show any real harm resulting from the stay, and protests only the continued occupancy by people to whom he or she does not choose to rent, the bankruptcy court should not feel compelled to lift the stay preventing eviction of the debtors.

For the same reasons, the fact that there is no lease for the debtors to assume is also not in itself cause for the stay to be lifted. Section 362 need not be read as limited by section 365, because the latter has other purposes. In a business case,

for example, a long-term lease may be a valuable asset and the right to assume the lease may mean continued occupancy at below-market rents or the ability to assign the lease in exchange for a large cash payment. This is not likely to be so in a consumer case. If there is not an assumable lease, continued occupancy may still be allowed, but only with adequate protection, *e.g.*, rent payments at the market rate the lessor could otherwise receive.

Lessors sometimes argue that the automatic rejection of a lease by a chapter 7 trustee under *Code section 365(d)(1)*, which occurs in virtually every case involving a tenant, terminates the lease. This argument is incorrect, since the rejection simply abandons the lease back to the debtor.ⁿ⁹ Therefore, rejection of a residential lease by the debtor under section 365 does not necessarily mean that the lessee may not continue in possession if the lessee continues to pay rent. It only means that the court must consider the lease in light of bankruptcy law provisions such as the right to adequate protection.

These arguments were significantly strengthened by the 1984 amendments to the Code, which for the first time recognized the differences between residential and nonresidential leases. Section 365(c)(3) prohibits the assumption of a lease terminated prior to a bankruptcy only in the case of a nonresidential lease. Section 365(d)(4)ⁿ¹⁰ provides that property be immediately surrendered to a lessor after rejection only if the lease is a nonresidential lease. Section 362(b)(10) makes clear that the stay applies even when a residential lease has expired, by excepting from the stay only nonresidential leases which have expired. Additionally, the two new exceptions to the stay for eviction actionsⁿ¹¹ create a negative implication that without a judgment for possession or endangerment to the property, the nonexistence of a valid lease alone is insufficient to permit relief from stay.

COMMENTARY

The obvious implication of these provisions pertaining to nonresidential leases is that residential tenants are not bound by them, and may be allowed to remain in a property even when a lease has been rejected or terminated.ⁿ¹² They make clear that, absent a judgment for possession or endangerment to the property, when a lessor is adequately protected and the debtor continues to pay rent, nothing in the Code requires granting the lessor relief from the automatic stay and imposing the hardships of eviction on a bankruptcy debtor.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n2)Footnote 2. Section 365(p)(2) permits the debtor to assume a personal property lease with the lessor's consent, and lessor's consent may be conditioned on the cure of any outstanding default of the contract. *See* § 6.09, *supra*.

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. 11 U.S.C. § 1326(a)(1)(B), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n5)Footnote 5. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n6)Footnote 6. 11 U.S.C. § 362(b)(22), (b)(23), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n7)Footnote 7. *See Matter of Gibbs*, 4 C.B.C.2d 161, 9 B.R. 758 (Bankr. D. Conn. 1981) , later proceeding 12 B.R. 737 (Bankr. D. Conn. 1981) .

(n8)Footnote 8. *See Javins v. First Nat'l Realty Corp.*, (1970), 428 F.2d 1071 (warranty of habitability implied through comparison of leased housing with other consumer goods); *Centex Homes Corp. v. Boag*, 128 N.J. Super. 385,

320 A.2d 194 (Ch. Ct. 1974) . (specific performance of sales agreement denied because realty not unique); Case Note, 48 Temple L.Q. 847 (1974).

(n9)Footnote 9. See § 15.04[4] *infra*.

(n10)Footnote 10. 11 U.S.C. § 365(d)(4), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n11)Footnote 11. 11 U.S.C. § 362(b)(22), (b)(23), enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n12)Footnote 12. *But see Matter of Williams*, 144 F.3d 544 (7th Cir. 1998) (bankruptcy court did not abuse discretion in granting relief from stay for lessor to continue eviction proceedings in which state court could better assess debtor's defenses); *Robinson v. Chicago Housing Authority*, 54 F.3d 316, 33 C.B.C.2d 603 (7th Cir. 1995) (relief from stay appropriate if lease terminated and the debtor has no way to revive lease under state law).



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P 10.05 *In Rem* Relief

Section 362(d)(4), enacted in 2005,ⁿ¹ permits creditors with claims secured by real property to seek *in rem* stay relief under section 362(d)(4) in certain limited circumstances. To obtain *in rem* relief from the automatic stay, the court must find that the petition was part of a scheme to delay, hinder, and defraud creditors and that the scheme involved (1) the transfer of all or part ownership of or interest in the property without the consent of the secured creditor or court approval; or (2) multiple bankruptcy filings affecting the property. By requiring that the scheme to hinder, delay and defraud a creditorⁿ² must involve either an unauthorized transfer of the property or multiple bankruptcy filings affecting the property, section 362(d)(4) addresses conduct indicative of abusive filing in relation to a real property foreclosure. For example, a court may find that the transfer of a fractional interest of property to a bankruptcy debtor by a property owner facing foreclosure, done for the purpose of gaining the automatic stay, was part of a scheme to hinder, delay and defraud a foreclosing creditor. However, an innocent transfer of the property, such as the court ordered transfer of a former spouse's property interest to the debtor as part of a domestic court proceeding, should not by itself form the basis for an *in rem* order under section 362(d)(20). Similarly, the filing of multiple bankruptcy cases in a row by the debtor or others holding an interest in the property for the purpose of delaying a foreclosure could be part of the requisite scheme. But a single case, or even several cases filed over an extended period of time or which do not all affect the property, may fail to support the findings required for the entry of an *in rem* order.

If the court enters an *in rem* order and the order is recorded in compliance with state laws for recording liens or interests in property the stay does not apply with respect to the property in a later case filed within two years after the date of the order. The *in rem* order, by its nature, is also applicable to a purchaser of the property. However, such purchasers should have record notice that the property is subject to such an order. Section 362(d)(4) provides that the debtor (or presumably purchaser) may move in a subsequent case for relief from an *in rem* order based upon changed circumstances or for good cause shown.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. Courts may look to case law construing the "hinder, delay or defraud a creditor" language found in § 727(a)(2) for guidance in applying § 362(d)(4). However, the difference in wording, namely the use of "and" instead of "or," along with different ordering of the words, suggests that Congress required all three elements to be present, including fraud, before invoking the drastic provisions of section 362(d)(4). See *In re Gould*, 348 B.R. 78, 80 (Bankr.

D. Mass. 2006) (use of "and" in section 362(d)(4) must be deliberate "since Congress clearly knew how to use the disjunctive form when it wishes to do so"); *In re Abdul Muhaimin*, 343 B.R. 159 (Bankr. D. Md. 2006) (creditor satisfied burden of proving scheme to hinder, but failed to prove fraud).



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P 10.06 Burden of Proof and Burden of Going Forward

On all issues under section 362(d)(1) and 362(d)(4) and on all section 362(d)(2) issues, except the debtor's lack of equity in the property, the ultimate burden of proof is on the debtor. But even though the ultimate burden is on the debtor, the person moving for relief has the burden of going forward with some evidence with regard to the issues raised by its motion.

[1] Nondebtor Proves Lack of Equity; Debtor Has Burden of Proof on Other Issues

The burden of proof in relief from stay motions is established by section 362(g). Section 362(g) puts the burden of showing lack of equity in the property on the person seeking relief (*i.e.*, the nondebtor), while the burden for all other issues is on the party opposing relief (typically, the debtor).ⁿ¹ Consequently, although the party seeking relief from the stay under section 362(d)(2) must show that the value of the property is less than the debt secured by it, the debtor must show that the property is necessary for an effective reorganization. In this regard, the debtor has the burden of showing both (1) functional necessity and (2) the likelihood of a successful reorganization.

[2] Nondebtor Has Burden of Going Forward

Section 362(g) speaks of burden of proof--the ultimate burden of persuasion. However, courts have held that the person moving for relief has the burden of going forward with some evidence to support its motion, even when the ultimate burden of persuasion falls on the debtor.ⁿ² This approach makes intuitive sense.

A creditor's failure to carry this burden of going forward to show grounds for relief should result in a decision for the debtor.ⁿ³ In many cases, due to their lack of proper accounting for payments and their imposition of illegal charges, mortgage companies bring motions for relief from the stay when the debtor is not in default or when they cannot prove that the debtor is in default.ⁿ⁴ Courts have properly sanctioned creditors who bring such motions.ⁿ⁵ Courts have also sanctioned the common practice of filing relief from stay motions in chapter 7 cases, apparently with the purpose of running up attorney's fees, when there is no showing of cause for relief from the stay because the stay is already likely to expire imminently with the closing of the case.ⁿ⁶

PRACTICE NOTE

A party seeking relief from the stay should have to present some justification for its request. Once it has

done so, the debtor must present evidence to show that the request should not be granted and, under section 362(g), the debtor has the burden of persuading the court that the preponderance of the evidence is in its favor on all issues other than the debtor's equity in the property. On the issue of the debtor's lack of equity, the movant would have the burden *both* of initially presenting evidence and of ultimately persuading the court that the debtor has no equity in the property.

FOOTNOTES:

(n1)Footnote 1. See 3 *Collier on Bankruptcy*, P 362.10 (Matthew Bender). 1 *Collier Bankruptcy Manual*, ch. 362 (Matthew Bender).

(n2)Footnote 2. *In re Sonnox Indus., Inc.*, 907 F.2d 1280, 23 C.B.C.2d 132 (2d Cir. 1990) ; *In re Anthem Cmtys./RBG, LLC*, 267 B.R. 867 (Bankr. D. Colo. 2001) (*sua sponte* denial of relief to creditor that failed to meet initial burden of going forward).

(n3)Footnote 3. *In re Anthem Communities/RBG, L.L.C.*, 267 B.R. 867 (Bankr. D. Colo. 2001) (court denied relief *sua sponte* to creditor who failed to meet initial burden of production); see, e.g., *In re Sonnox Indus., Inc.*, 907 F.2d 1280 (2d Cir. 1990) .

(n4)Footnote 4. E.g., *In re Vargas*, 396 B.R. 511 (Bankr. C.D. Cal. 2008) (low level clerk who simply compared declaration to computer screen was not competent to testify to anything relating to stay motion).

(n5)Footnote 5. *In re Haque*, 395 B.R. 799 (Bankr. S.D. Fla. 2008) (attorney fined total of \$95,130.45 for filing 45 false affidavits); *In re Fagan*, 376 B.R. 81 (Bankr. S.D.N.Y. 2007) (\$10,000 plus attorney fees awarded to debtor when creditor's own records showed debtor was not in default).

(n6)Footnote 6. *In re Cabrera-Mejia*, 402 B.R. 335 (Bankr. C.D. Cal. 2008) (law firm fined \$21,000).



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.07 Forms of Relief Available

The court can lift the stay completely or, when appropriate, it can modify, condition, or annul it. Although equitable principles cannot override a clear statutory entitlement to relief, they can affect the form of relief granted as well as whether the court will find general "cause" for relief under section 362(d)(1).

[1] Broad Judicial Discretion: Alternatives to Lifting the Stay

The court has considerable discretion in fashioning the form of relief. Section 362(d) indicates that the stay may not only be terminated, but may also be modified or conditioned or annulled. Thus, relief may be either partial or complete, and an action may be permitted to proceed (1) as if there were no bankruptcy, (2) in a limited fashion, or (3) only in certain circumstances.ⁿ¹

ILLUSTRATION

For example, recognizing that state foreclosure proceedings may take a long time, a bankruptcy court might permit the mortgagee to proceed with a foreclosure proceeding up to the point of sale, but not to actually hold the sale. This would enable the nondebtor party to avoid unnecessary delay in its foreclosure while protecting the debtor's interest over the course of the case. Similarly, a secured creditor that wanted to protect its rights but did not have grounds for completely lifting the stay might in some instances move for lesser relief, for example, to modify the stay by permitting the mailing of a default notice.

In section 362(d)(1) situations, where adequate protection is in question, the continuation of the stay is commonly conditioned upon the debtor's continued compliance with the terms of an adequate protection agreement or with adequate protection conditions directly imposed by the court itself in response to the nondebtor's motion for relief. For example, the automatic stay might automatically terminate if the debtor failed to make the required periodic cash payments.

The ability of a court to annul the stay suggests that stay relief may, in a proper case, be granted retroactively, validating actions taken by a party that was unaware of the stay. Although courts have stated that retroactive relief should be granted sparingly, most courts recognize that when a party has innocently violated the stay and would have been entitled to relief if it had known to apply for it, there is little reason to void the action and require the party to repeat the

action after stay relief is granted. Thus, for example, in *In re Siciliano*,ⁿ² the court held that the bankruptcy court could grant relief retroactively to a mortgagee who had previously obtained relief from the stay and who had the property sold while unaware that the debtor had commenced a second chapter 13 case (which triggered a new stay). Retroactive relief would validate the foreclosure sale, which otherwise would have been void as a violation of the second stay. The court observed that use of the word "annulling" in section 362(d) "indicates a legislative intent to apply certain types of relief retroactively and validate proceedings that would otherwise be void ab initio." Annulment may also be appropriate to prevent any contempt punishment of a nondebtor party that committed some technical violation of the stay while it was unaware of it, particularly when the party could easily have obtained relief if it had known that it was necessary to move for it.

PRACTICE NOTE

The ability of the court to fashion relief may be helpful either to a debtor opposing relief or a creditor seeking relief. The debtor can argue that less than complete relief from the stay is needed and that the creditor would be protected by conditioning the stay on certain performance by the debtor in the future. A creditor who is unlikely to obtain full relief can salvage at least some benefit from a stay motion by obtaining partial relief, such as conditioning or modification of the stay.

[2] Effect of Equitable Principles on Stay Relief

The bankruptcy court is a court of equity. Consequently, it should be cognizant of equitable principles when considering motions for stay relief. But equitable principles should not override a clear statutory mandate. Thus, if the court finds that the debtor has no equity in property and that the property is not necessary for an effective reorganization, the court must grant stay relief regardless of the equities of the matter.

Equitable principles can affect stay relief in two ways. First, the court has discretion in fashioning the form of relief to be granted. For example, relief need not involve giving the creditor unfettered discretion to foreclose. In a proper case, a court may condition its relief or offer a more limited remedy if equitable principles so dictate. Second, the court has considerable discretion in construing the grounds for relief from the stay. A finding of general "cause" under section 362(d)(1) requires the court to balance the equities of the debtor and the party seeking relief. The application of equitable principles may influence the court's finding of the existence or non-existence of cause for granting relief from the stay.

FOOTNOTES:

(n1)Footnote 1. *See 3 Collier on Bankruptcy, P 362.07[1]* (Matthew Bender).

(n2)Footnote 2. *13 F.3d 748, 751, 30 C.B.C.2d 667, 671-672 (3d Cir. 1994)* .



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P 10.08 Remedy for Failure of Adequate Protection

If the adequate protection given to a party under section 362(d)(1) later proves to have been inadequate, the party will be entitled to a compensatory superpriority claim under section 507(b). This compensatory superpriority claim provides a measure of fallback protection to nondebtors who were given ineffective adequate protection under section 362(d)(1) or under section 363 or section 364. The superpriority claim will be senior to all other claims, except for claims arising from postpetition financing that are given an even higher priority under section 364(c)(1).

Some commentators believe that court approval of an adequate protection arrangement is a precondition to the availability of a superpriority remedy under section 507(b). But the statute itself is silent, and some courts, without discussing the issue, have honored section 507(b) claims based on failure of adequate protection provided under unapproved private stipulations. The court in *In re Blehm Land & Cattle Co.*ⁿ¹ adopted what may be the best approach. While it rejected the argument that prior court approval of the adequate protection stipulation was a precondition to the availability of a superpriority remedy under section 507(b), the court held that an unapproved stipulation should be reviewed by the court when considering the section 507(b) claim. If the unapproved stipulation was equitably arrived at and did not provide excessive protection, the superpriority claim should be honored.

PRACTICE NOTE

Even under the relatively liberal view taken by the court in the *Blehm* case, however, the nondebtor's chance of being eligible for a superpriority remedy is improved if the nondebtor obtains adequate protection either through a motion or through an agreement that is properly served on other creditors and is approved by the court. Therefore, the safest practice is to obtain court approval.

Of course, in many chapter 13 cases, once relief from the stay is granted the plan fails and the case is dismissed. Only if the debtor continues payments under the plan, or if the case is converted to a chapter 7 case involving distributions to creditors, is the superpriority likely to be of much benefit to the creditor that obtained it.

FOOTNOTES:

(n1)Footnote 1. *859 F.2d 137, 19 C.B.C.2d 933 (10th Cir. 1988)* .



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P 10.09 Factors for Nondebtors to Consider Before Moving for Relief

Before moving for relief, the nondebtor must consider whether relief is actually needed, whether filing a motion might do more harm than good, and when is the best time to file the motion.

[1] Is Relief Actually Needed?

The nondebtor might consider the following in deciding whether relief is needed at all:

- Does the property seem to be valuable and disposable enough to warrant the trouble and expense of going after it, after accounting for the probable costs of moving for relief and the risks of not succeeding? A creditor with a junior undersecured lien, for example, might realize little or nothing upon disposition of the property.
- Is the stay likely to expire in the near future because the case will be closed, in which case there is no need to expend the time and money necessary to seek relief?
- The nondebtor might not need or be entitled to relief under section 362(d)(1) if its interest is already adequately protected.
- Is the debtor meeting its payments and other obligations?
- Is the property declining in value rapidly enough to threaten the nondebtor's interest?
- Does the debtor really want to keep the property or the protections of the stay? The nondebtor might not have to move for relief if the debtor does not need the stay enough to be willing to contest the nondebtor's demands. The debtor may be willing to stipulate to a termination of the stay in such cases, or to permit ancillary litigation like family law proceedings to go forward because the bankruptcy was filed to deal with other problems.

[2] Would a Relief Motion Expose the Nondebtor to Unacceptable Risks?

Filing a relief motion might call attention to weaknesses in the nondebtor's own position. The nondebtor's underlying

claim might be vulnerable to a counterattack. For example, some leases could be considered a disguised but improperly perfected security interest. And there might be defenses or counterclaims to the creditor's claim that the debtor might never have raised if the only consequence of these defenses or counterclaims would have been a different distribution among various creditors.

[3] Would a Stipulation Actually Be as Good as a Successful Motion?

A debtor in a weak position might agree to a "drop-dead" stipulation under which the stay will be lifted automatically if the debtor does not meet certain conditions by a certain date. It may be obvious to the nondebtor that the conditions will not be met, and the nondebtor will then get the relief it wants--perhaps not as soon as it would have preferred, but at less cost.

[4] When Is the Best Time to Move for Relief?

The *general* rule is that the nondebtor should move for relief as soon as there are legal grounds that would justify relief. This judgment involves a balancing of the need to protect the creditor's interest from deterioration and the desire to look reasonable. Courts are not friendly to stay motions brought after a minor default that the debtor can probably cure. Generally in a mortgage foreclosure situation, creditors often wait until there is a default of several months before moving for relief. During this time it is wise to give notice to the debtor's counsel that a motion will be filed if the default is not cured.

The amount of time that a creditor should wait depends in part on the strength of its case. The court is less likely to grant relief if the debtor has substantial equity in the property or has a sympathetic case in other respects. On the other hand, if the debtor has filed several prior bankruptcy cases, the court is likely to be more sympathetic to the creditor who seeks relief after a less serious default.

One advantage of waiting before filing a motion in a chapter 13 case is that the trustee may move to dismiss the case, which ends the stay without the necessity of the creditor expending time and money. However, if no motion for relief has been filed, the debtor may also voluntarily dismiss and file a new case without running afoul of the refiling limitations of *Code section 109(g)*.ⁿ¹ However, in such circumstances the provisions of section 362(c)(3) and (c)(4) may apply, and, as a result, the stay in subsequent cases filed by the debtor may not become effective upon filing or it may be limited in duration.

FOOTNOTES:

(n1)Footnote 1. *See 2 Collier on Bankruptcy, P 109.08* (Matthew Bender).



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P 10.10 Strategies for Defending Against Motions for Relief from the Stay

A debtor's strategy for responding to a motion for relief from the stay varies, of course, depending on the situation. In some cases, if the motion seeks only the ability to continue ancillary litigation, such as family court proceedings, or proceedings aimed at collecting from the debtor's insurer, the debtor may not want to oppose relief.

In other cases, in which a creditor seeks to foreclose on the debtor's home and the case was designed to save that home, aggressive defense of the motion may be called for. This may mean not only responding to the motion, but engaging in expedited discovery due to the short time frames for stay relief hearings.ⁿ¹

One issue is whether the party bringing the motion even has a right to do so. As the selling and securitization of mortgages has become commonplace, it has become harder for mortgage holders and servicers to keep track of which party holds the mortgage. Bankruptcy courts have become increasingly aware of such issues and have more frequently denied motions for relief from stay based upon lack of standing.^{n1a}

Discovery may be particularly important to demonstrate that the motion for relief from the stay is frivolous. It has become increasingly common for mortgage servicing companies to make errors in crediting bankruptcy debtors' payments and to file motions for relief from the stay when a debtor is current in postpetition payments. In such cases, sanctions against the moving party may be warranted.ⁿ² Defending against the motion also may mean asserting that defenses and counterclaims exist that defeat the creditor's claim. It may mean hiring an appraiser to testify to the value of property.ⁿ³ It means preparing direct and cross examination for a hearing before the court on any issues of fact.

However, most motions for relief from the stay are settled. If both debtor's counsel and creditor's counsel are experienced in the court where the motion is filed, they are likely to know the likely result of a hearing. If that result will be to give the debtor a chance to catch up on a delinquency if one exists, or to modify the plan to provide for a postpetition delinquency, the parties both save time and expense by stipulating to that relief. Obviously, it is to the debtor's advantage to seek terms that are as easy to meet as possible and, assuming the creditor has no real desire to foreclose on a debtor who is able to catch up on payments, this may be in the creditor's interest as well.

PRACTICE NOTE

Debtor's counsel should also seek a grace period for any late payments, during which debtor's counsel is

given notice of the default, and a process whereby the creditor's counsel has to certify a default to the court after that grace period, with notice to debtor's counsel, in order to obtain relief. Such procedures are very helpful in catching the frequent accounting errors of mortgage companies and debtor misunderstandings of their obligations that sometimes lead to allegations of default.

FOOTNOTES:

(n1)Footnote 1. *See PP 10.12 and 10.16 infra* .

(n2)Footnote 1a. *E.g., In re Sheridan, 2009 Bankr. LEXIS 552* (Bankr. D. Idaho Mar. 12, 2009) (Mortgage Electronic Registration Systems (MERS) failed to show standing to bring motion); *In re Fitch, 2009 Bankr. LEXIS 1375* (Bankr. N.D. Ohio May 28, 2009) (MERS was never in chain of title for mortgage note and had no standing); *In re Maisel, 378 B.R. 19* (Bankr. D. Mass. 2007) (assignee who filed motion before mortgage was assigned to it did not have standing). *See also In re Foreclosure Cases, 521 F. Supp. 2d 650* (N.D. Ohio 2007) .

(n3)Footnote 2. *See In re Gorshtein, 285 B.R. 118* (Bankr. S.D.N.Y. 2002) ; *In re Kilgore, 253 B.R. 179* (Bankr. D.S.C. 2000) .

(n4)Footnote 3. *See P 10.10 infra*.



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P 10.11 Valuation of Property in Section 362(d) Relief Motions

Property valuation is often the key factual issue in section 362(d) motions. Each side must prepare its valuation case by considering the nature of the property, its own resources and its adversary's, and the potentially problematic interrelationship between valuation for section 362(d) purposes and valuation for other purposes over the course of the case.

Section 506(a) was amended in 2005ⁿ¹ to specify that value of personal property is determined based on replacement value of the property without deducting costs of sale or marketing.ⁿ² For property acquired for personal, family or household purposes, the determination of replacement value must take account of the age and condition of the property at the time of valuation. Additionally, the date on which the personal property should be valued is the date of the motion for relief, unless the personal property is not for personal, family or household purposes in which case the date of valuation is the date of the petition. In most cases, despite the clarification as to the appropriate valuation standard, there is still likely to be a range of value that can be attributed to the personal property (though such range will be narrower than under the previous version of the Code).

The valuation of real property is commonly based on an appraisal or a broker's price opinion. These valuations can vary significantly depending on the evaluator's access to the property and the method used to determine value (i.e., reproduction cost, income approach, comparable sales). In the event, the property was recently purchased, the purchase price adjusted for any clear changes in condition may suffice. The date of valuation for real property for purposes of relief from stay should be the date of the motion for relief.

Generally, once a motion for relief has been filed, it is in the debtor's interest that a high value be placed on the property to show that equity exists and that the creditor is adequately protected.ⁿ³ Conversely, creditors seeking to demonstrate that there is not equity in the property will generally favor a low value for the property.

WARNING

Counsel for debtors and creditor should be careful to assess what impact a high or low valuation may have on other proceedings in the case. Although a valuation determination under section 362(d) is not technically binding for other purposes over the course of the case, as a practical matter, an inconsistent argument may be hard to sustain. For example, the same value used in the automatic stay proceeding

might be the value used to redeem the property from a lien under section 722 or to satisfy an allowed secured claim under section 1325(a)(5).

MORE INFORMATION

Chapters 14 and 25 *infra* examine sections 1325(a)(5) and 722 and the valuation approaches they have engendered.

[1] Methods of Proving Value

Local procedural rules and customs may be relevant to how valuation issues and other issues are decided. Relief from stay motions may be heard in a very informal way; in some cases in some districts, motions are decided on the basis of affidavits and very little else. Evidentiary standards may be relaxed to the point where hearsay documents such as tax assessments may be considered, or the valuation opinions of lay witnesses may be admitted.

[a] Debtor's Testimony

In some cases, at least with respect to the debtor's case, the debtor's testimony may be sufficient. If property was recently purchased at arms-length, the price may be a good indication of value. The debtor should usually testify to the basis for her opinion, such as asking prices, industry price guides on the Internet, or discussions with possible brokers or dealers. The debtor may also have knowledge (supplemented by certified copies of deeds or other sale documents presented in evidence) of recent sale prices of similar properties. Neighbors or friends may be able to offer testimony about the value of their properties. Generally, a landowner's testimony as to the value of his or her land is admissible without further qualification.ⁿ⁴ In the case of a life estate or remainder interest, the debtor can cite Internal Revenue Service tables.^{n4.1}

[b] Use of Appraisers

More common is the use of experts in property appraisal. Their expertise, of course, allows them to render opinions regarding the value of property. In most places real estate appraisers are available to testify; in larger cities they may be employed full time in that profession, while in other areas they are usually real estate brokers. In either case, paying their fees may be a real hardship for some clients. In cases in which appraisers are necessary, however, this relatively small investment may save thousands of dollars for a client.

Where real estate is concerned, an experienced appraiser should, if possible, be recruited, preferably from the American Institute of Real Estate Appraisers. Often, the appraiser will offer a split fee, with one price for the written report (which may be sufficient to settle the case) and another price for court testimony.

The appropriate appraisal method must be determined. The three recognized methods are (1) reproduction cost (how much it would cost to replace the structures); (2) the income approach (an estimate of value based on expected income stream); and (3) comparable sales (how much similar properties have been sold for recently). The comparable sales method is considered the best method whenever the facts of the case permit its application and is almost always used in cases involving residential real estate.

[2] Proving Valuation of Real Estate

The nondebtor's examination typically goes through three phases. First, the appraiser is qualified as an expert. Second, the witness is taken through his or her investigation, the way in which "highest and best use" was determined, and his or her opinion as to value. Finally, the appraisal report is identified and offered as evidence.

Unless there is a compelling reason not to do so, debtors usually stipulate as to the credentials of the nondebtor's appraiser; courts tend to be impatient with unfounded disputes on this point. When the appraiser's findings are based on comparable sales, the debtor may question on cross-examination whether the "comparables" really are comparable. When the appraiser's findings are based on replacement cost, the accuracy of the estimates may be questioned. In almost any kind of case, the debtor is on the lookout for calculation errors in the appraiser's testimony and report, and uses its own appraiser (if any) as a source of questions to bring out any other apparent errors or fallacies.

If the debtor can afford an expert appraiser, it presents its case in the same way the nondebtor presented its case. If the debtor cannot afford a fully accredited expert, the debtor may testify about the value of the property.

The nondebtor's counsel then cross-examines the debtor's appraiser or the debtor. Difficulties in cross-examining the debtor's appraiser here commonly result from the fact that the two sides are so obviously mismatched. In some cases, the nondebtor's appraiser may not have had access to the interior of the property or may be unaware of defects in the property known only to the owner.

[3] Valuation of Other Property

For appraisals of property other than real estate, obtaining an expert may be difficult. In cases involving motor vehicles or mobile homes, standard industry guides may be acceptable as evidence, and in many areas, auctioneers are willing and able to testify to the value of consumer goods. When property such as an automobile is worth less than the standard value for that model based on, for example, mechanical problems, testimony of a mechanic or used car dealer may be necessary.

[4] Requests for Admissions

One way to ease the problem of proof, and in some cases shift the costs, is to engage in pretrial discovery on issues of value. If a request for an admission of value is denied by an opposing party and that value is later proved, the party denying the request can be required to pay for the costs of proof on that issue, including attorney's fees.⁵ Thus, it may be possible to obtain a written appraisal inexpensively and request that its authenticity and correctness be admitted, or even to simply request that a specific valuation be admitted. If the valuation is not admitted, then the cost of successful testimony can usually be shifted.

FORMS

For a sample debtor's request for admission see *Collier Consumer Bankruptcy Forms, Form CS6.02-6* (Matthew Bender).

Similarly, if there may be a problem of admissibility, a request for admissions can demand that an opponent admit or deny the accuracy of sources such as the NADA used car guides, and the fact that they are regularly used as indicators of "replacement" value. Especially given the costs and expenses of proving disputed issues at trial, a request for admissions can result in a stipulated value which meets the party's needs and, on occasion, to withdrawal or settlement of a motion.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. This standard replaces the wholesale or liquidation value standards that some courts had adopted prior to the 2005 amendments.

(n3)Footnote 3. *But see In re George Ruggiere Chrysler-Plymouth*, 727 F.2d 1017, 10 C.B.C.2d 220 (11th Cir. 1984) (corporate debtor successfully argued for lower value where it wished to remit that amount to creditor to provide

adequate protection).

(n4)Footnote 4. *Joe T. Dehmer Distribs. Inc. v. Temple*, 826 F.2d 1463 (5th Cir. 1987) ; *United States v. 3698. 63 Acres of Land*, 416 F.2d 65, 67 (8th Cir. 1969) ; *United States v. Sowards*, 370 F.2d 87 (10th Cir. 1966) .

(n5)Footnote 4.1. Such tables are available at <http://www.irs.gov/pub/irs-pdf/p1459.pdf>.

(n6)Footnote 5. *Fed. R. Bankr. P. 7037* incorporating *Fed. R. Civ. P. 37(c)*. *In re Sweeten*, 56 B.R. 675 (Bankr. E.D. Pa. 1986) .



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P 10.12 Alternatives to Section 362(d) Relief Motions

The Bankruptcy Code provides more than one vehicle for protecting collateral and other nondebtor rights. In some circumstances these other vehicles may offer better protection than that available under section 362(d).

[1] Section 365(d)(2) Protection for Executory Contracts and Unexpired Leases

If the interest to be protected is an "executory contract" or an unexpired lease, the nondebtor may move under section 365(d)(2) for an order requiring the debtor to assume (and cure defaults) or reject (and be liable for damages) within a fixed period of time.

MORE INFORMATION

Chapter 15 *infra* examines the assumption or rejection of executory contracts and unexpired leases.

[2] Dismissal or Conversion of the Case

The nondebtor may be able to move for dismissal or conversion, if a presumption of abuse arises under section 707(b) or if it can be established that the case otherwise was filed in bad faith.ⁿ¹ In many instances, however, a motion under section 362(d)(1) alleging bad faith or 362(d)(4) seeking *in rem* relief may provide more effective relief.

Outright dismissal of the case may permit the debtor to file again and obtain the benefit of a new automatic stay, subject to the limitations of 362(c)(3) and (c)(4). By contrast, voluntary dismissal after the filing of a motion for relief from stay operates as a bar to refiling for 180 days under section 109(g). Conversion of a case from chapter 13 to chapter 7 may prevent the option of refiling for the debtor and also make available nonexempt assets for creditors if such assets exist.

MORE INFORMATION

For a complete review of the dismissal of a case and conversion *see* chapters 23 and 24 *infra*, respectively.

[3] Objection to Confirmation of Chapter 13 Plan

The confirmation hearing in a chapter 13 case will normally occur between 20 and 45 days after the conclusion of the meeting of creditors. If the debtor's plan cannot be confirmed, and cannot be modified in a manner that makes it confirmable, the case is normally dismissed and the stay thus terminated.

In some courts, the fact that the debtor has not made preconfirmation payments to creditors or the trustee is taken as very strong evidence that the plan should not be confirmed. Therefore, in that situation, it may be easier to file an objection to confirmation than to show grounds for relief from the stay.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 707(b)(3)*, enacted by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005. However, this option will not be available if the debtor's income is less than the applicable state median income. *11 U.S.C. § 707(b)(6), (b)(7)*.



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P 10.13 Time Deadlines in Relief from Stay Proceedings

In stay relief proceedings, there are prescribed deadlines for preliminary and final hearings, the scheduling and noticing of hearings, the debtor's response, the notice of ex parte relief, and the filing of a notice of appeal.

[1] Strict Time Limits for Stay Litigation Involving Stays of Acts Against Property of the Estate

In providing for relief from the automatic stay, Congress sought an expedited procedure that would assure that a party seeking relief could receive a timely hearing and determination of its right to relief. Section 362(e) establishes specific time periods within which the bankruptcy court must act in response to a motion for relief from the automatic stay of any act against property of the debtor's estate. The stay automatically terminates if the court fails to adhere to any of the deadlines.

[a] Initial 30-Day Time Limit for Action on Motion for Relief from Stay

Section 362(e)(1) provides that upon the filing of a relief motion, at least a preliminary hearing must be held and concluded within 30 days of the filing of the motion; if that hearing is not held and concluded, the stay automatically terminates. The parties and the court have the option to hold a final, rather than a preliminary, hearing at the outset; this final hearing would have to be concluded and the order entered within 30 days of the request for relief to avoid the automatic termination of the stay. Most courts agree that this first 30-day time period begins to run from the date that the motion is filed with the bankruptcy court.

After the preliminary hearing, the court may order the stay continued pending the conclusion of a final hearing only if the court finds that there is a reasonable likelihood that the debtor will ultimately prevail in defeating the motion after a full evidentiary hearing. The preliminary hearing may be informal when the two-hearing process is adopted. At the very least, there must be an opportunity for the moving party to be heard,ⁿ¹ although it is possible that no evidence will be received and the court will decide this issue based upon the arguments of the parties.

WARNING

However, it may be dangerous to assume that no evidence will be taken at the preliminary hearing. If the court declines to extend the stay, the debtor may feel compelled to request that the hearing be a final hearing at which all evidence on the issue is taken. Otherwise, the stay may be ended and debtor might

not be in a position to appeal the court's ruling.

[b] Additional 30-day Time Limit for Conclusion of Final Hearing

If the hearing held within 30 days of the request for relief is deemed a preliminary hearing, a final hearing must be held and concluded not later than 30 days after the conclusion of the preliminary hearing. If the final hearing is not held within the extended 30-day period, the stay will terminate automatically.

[c] Time Limit for Final Decision

Prior to the 2005 amendments, no time period had been set forth in the Code within which a decision had to be rendered on a stay relief motion. Section 362(e)(2), added in 2005,ⁿ² now provides that in a chapter 7, 11 or 13 case, the stay shall terminate 60 days after the request for relief unless a final decision is rendered during the 60-day period. However, the stay will not terminate if the 60-day period is extended by agreement of all parties in interest or is extended by the court for a specific period of time that the court finds is required for good cause, as described in findings of the court.

PRACTICE NOTE

However, it is noteworthy that this deadline runs from the conclusion of the preliminary hearing. If the court keeps that hearing open, and at the same time finds that there is a reasonable likelihood that the debtor will prevail, the time period does not begin to run.

[d] Time Periods May Be Extended

These time limits prescribed by section 362(e)(1) and 362(e)(2) are not binding on a court in all situations; they may be waived by a party seeking relief, either explicitly or implicitly, or extended by order of the court in compelling circumstances. The 30-day time periods and 60-day time period may be extended with the consent of the parties in interest. Consent need not be explicitly given. For example, creditors have been held to have waived the 30-day deadline by filing detailed discovery requests to which responses were due after the deadline, or by agreeing to adjourn the hearing on the motion for relief beyond the 30-day period.ⁿ³ In addition, parties may be pressured into agreeing to a postponement; few litigants can refuse a judge's strong suggestion that a hearing be continued.

The bankruptcy court also may extend for a specific period the 30-day time period if the extension is required by compelling circumstances and the 60-day time period if the extension is required for good cause. In practice the reasons for extension of any of the time periods are likely to be similar despite the difference in the language. For example, the bona fide illness of a party or the judge, or the occurrence of some other event beyond the parties' control, might be deemed sufficiently compelling or good cause to justify extending the 30-day time period.

[e] Stay Terminated When Time Limits Expired May Be Reinstated Under Section 105(a)

On the basis of the equitable powers available to it under section 105(a), the court may reinstate a stay that has terminated when the prescribed time limits have expired. Reimposition of the stay requires a showing of extraordinary circumstances that justify injunctive relief. The debtor has the burden of proving: (1) a substantial likelihood of success on the merits; (2) irreparable harm to the debtor if the stay is not reinstated; (3) that the harm to the debtor if injunctive relief is denied will outweigh the harm to the creditor; and (4) that granting injunctive relief will not harm the public.ⁿ⁴

[2] Scheduling of Hearing and Timing of Notice

Notice of the hearing must be served not later than seven days before the date on which the hearing is to take place.ⁿ⁵ Local rules usually provide detailed procedures for service of motions and scheduling of hearings. In many courts, no hearing will be scheduled unless a response to the motion or a request for a hearing is filed.

[3] Debtor's Response to Motion for Relief from Stay

While the Federal Rules of Bankruptcy Procedure provide that no response to a motion is required unless the court directs that one be filed, local rules often require a response to be filed. Such rules can constitute the court direction that an answer be filed.ⁿ⁶ If the debtor files a response, the response must be served on the movant not later than one day before the scheduled hearing. Again, local rules or a court order may set an earlier deadline.

[4] Ex Parte Relief

A special set of deadlines and requirements applies when relief is granted upon an ex parte motion.ⁿ⁷ If ex parte relief from the stay is granted, then counsel for the party seeking relief from the stay must immediately give to the trustee and to the debtor oral notice of the relief granted. In addition, counsel for the moving party must send copies of the order granting relief from the stay and the motion papers requesting the relief to the trustee, the debtor, and their counsel.ⁿ⁸

After a grant of ex parte relief from the stay, the trustee or debtor in possession may appear before the court and seek reinstatement of the stay on two days notice (or less if the court so orders) to the party who obtained relief from the stay.ⁿ⁹

[5] Stipulations or Agreements Relating to Relief from the Automatic Stay

An interested party that wishes to object to a proposed agreement for adequate protection, or a proposed agreement to modify or terminate a stay, must file its objection with 15 days from the date that the notice of the motion for approval of the agreement was mailed, unless the court sets a different time.ⁿ¹⁰

If a hearing on the motion for approval of the agreement is to be held, either because an objection to the agreement was filed or the court determined a hearing was appropriate, a minimum of five days' notice to the following parties is required: the party that objected, the parties to the agreement, those parties required to receive notice of the original motion, and any other parties as directed by the court.ⁿ¹¹

[6] 10-Day Time Period within Which Notice of Appeal Must Be Filed; Possible Extension

Any notice of appeal must be filed with the clerk within 14 days of entry of the decision being appealed.ⁿ¹² The bankruptcy judge may extend the time for filing the notice of appeal for a period of up to 21 days from the expiration of the original 14-day period. But a request to so extend the time period must be made before the original 14-day time period has expired.ⁿ¹³ Often, if the creditor has prevailed on the stay motion, it is necessary for the debtor to obtain a stay pending appeal to prevent some immediate creditor action that would be disastrous for the debtor's case and moot any appeal. Unless the court orders otherwise, an order granting relief from the stay is not effective for 14 days, in order to permit time for a party to seek a stay pending appeal.ⁿ¹⁴ Creditors may seek an order eliminating this 14-day period as a matter of course, but a debtor should argue that only special circumstances justify a change from the normal rules.

MORE INFORMATION

For an extensive examination of appeals see chapter 33 *infra*.

[7] Computation of Prescribed Time Periods

In computing any prescribed time period the day of the act, event, or default from which the time period begins to run is not included. However, the last day of the time period is included in the computation unless it is a Saturday, Sunday or legal holiday, or a day on which the clerk's office is inaccessible (e.g., because of severe weather conditions), in which case the time period runs until the end of the next day which is not such a day as those listed above.ⁿ¹⁵

In certain circumstances a prescribed time period may be either enlarged or reduced. For cause shown the court may, in its discretion, with or without motion or notice, order the time period enlarged if the court's action is taken before the initially prescribed period expires.ⁿ¹⁶ Even after the initial time period has expired, the court may, on motion and in its discretion, permit an act to be done when the act had not been timely done due to excusable neglect.ⁿ¹⁷

For cause shown the court may also, in its discretion and with or without motion or notice, order the period reduced.ⁿ¹⁸

FOOTNOTES:

(n1)Footnote 1. *In re Looney*, 823 F.2d 788 (4th Cir. 1987) .

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n3)Footnote 3. *See 3 Collier on Bankruptcy*, P 362.08[4] (Matthew Bender).

(n4)Footnote 4. *In re Wedgewood Realty Group, Ltd.*, 878 F.2d 693, 21 C.B.C.2d 203 (3d Cir. 1989) (stay can be reimposed on grounds similar to those which would warrant a preliminary injunction).

(n5)Footnote 5. *Fed. R. Bankr. P. 9006(d)*.

(n6)Footnote 6. *See Fed. R. Bankr. P. 9014*.

(n7)Footnote 7. *See P 10.17 infra*.

(n8)Footnote 8. *Fed. R. Bankr. P. 4001(a)(2)*. *See 9 Collier on Bankruptcy*, P 4001.04 (Matthew Bender).

(n9)Footnote 9. *Id.*.

(n10)Footnote 10. *Fed. R. Bankr. P. 4001(d)(2)*. *See P 10.15 infra*.

(n11)Footnote 11. *Fed. R. Bankr. P. 4001(d)(3)*.

(n12)Footnote 12. *Fed. R. Bankr. P. 8002(c)*.

(n13)Footnote 13. *Fed. R. Bankr. P. 8002(c)*.

(n14)Footnote 14. *Fed. R. Bankr. P. 4001(a)(3)*. *In re Derringer*, 375 B.R. 903 (B.A.P. 10th Cir. 2007) (mailing and filing foreclosure notice within appeal day period violated stay). *In re Banks*, 253 B.R. 25 (Bankr. E.D. Mich. 2000) (damages awarded against creditor who proceeded to evict debtor before expiration of appeal period from order granting relief from stay). *But see In re Duran*, 483 F.3d 653 (10[th] Cir. 2007) (§ 362(e) takes precedence over *Fed. R. Bankr. P. 4003(a)(3)* so creditor did not have to wait after order granting stay relief when time period in § 362(e) ended earlier).

(n15)Footnote 15. *Fed. R. Bankr. P. 9006(a)*.

(n16)Footnote 16. *Fed. R. Bankr. P. 9006(b)(1)*. *See 10 Collier on Bankruptcy*, P 9006.06 (Matthew Bender).

(n17)Footnote 17. *Fed. R. Bankr. P. 9006(b)(1)*. *See 10 Collier on Bankruptcy*, P 9006.06 (Matthew Bender).

(n18)Footnote 18. *Fed. R. Bankr. P. 9006(c)*. *See 10 Collier on Bankruptcy*, P 9006.09 (Matthew Bender).



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.14 Nondebtor Procedure for Obtaining Relief from the Stay; Form Drafting, Filing, and Service

[1] Form Drafting

Relief from the stay usually requires the moving party to draft a motion, notice of motion and a proposed order for relief, each having specific requirements as to both form and content.

[a] Proceeding Must Be Commenced by Motion

A proceeding by a creditor to obtain relief from the automatic stay under section 362(d) is a contested matter and must be initiated by written motion.ⁿ¹ The creditor's request for relief from the stay may not be honored if it is filed as an adversary proceeding commenced by a complaint, or joined with any claim for relief that would require an adversary proceeding. At a minimum, since the time periods for responding to a complaint differ, a creditor commencing a stay relief proceeding by a complaint would likely be deemed to have waived the time requirements for that proceeding to be heard.ⁿ²

Motions for relief from the stay are governed by *Rule 9014*, which provides that many of the Rules under Part VII of the Federal Rules of Bankruptcy Procedure that govern adversary proceedings automatically apply in stay relief proceedings even though stay relief is considered a "contested matter" rather than an adversary proceeding, unless the court orders otherwise.

[b] Notice of Motion

Although court procedures for dealing with motions are typically governed by local rules and vary greatly, the motion for relief should be accompanied by a notice of the motion which informs the opposing parties of the steps which must be taken to oppose the motion and states the date of any scheduled hearing.

[c] Proposed Order

Most courts require the motion to be accompanied by a proposed order granting the requested relief in a form ready to be signed by the bankruptcy judge. In a few courts, this order is not submitted until after the court decides to grant relief. In either case, a signed order becomes effective when entered on the docket by the clerk.

[2] Contents of Forms**[a] Contents of Motion**

Although local rules and practices vary, certain information should be included in every motion for relief from the stay.

FORMS

For examples of motions for relief from the stay *see Collier Consumer Bankruptcy Forms, Forms 6.02-6.06* (Matthew Bender).

[i] Caption

The caption must contain the name of the court, the title of the case, the bankruptcy docket number, a brief description of the character of the paper (*i.e.*, a title such as [Name of Creditor]'s Motion for Relief from the Automatic Stay), and the chapter of the Bankruptcy Code under which the case is proceeding.

[ii] Statement of Jurisdiction and Controlling Authority

The motion should contain a brief statement providing the basis of the court's jurisdiction to hear the motion and the authority upon which the court will decide the motion. In addition to the relevant sections(s) of the Bankruptcy Code, this statement typically refers to those sections of the judicial code that grant jurisdiction over bankruptcy proceedings to the district courts and provide the district courts with the authority to refer matters to the bankruptcy judges. (*E.g.*, This Court has jurisdiction of this contested matter pursuant to 28 U.S.C. §§ 1334 and 157 and 11 U.S.C. § 362.)

[iii] Nature and Extent of Claim

The nature and extent of the nondebtor's claim should be set forth in the motion and appropriate supporting documents should be attached to the motion as exhibits, or a separate proof of claim may be filed and incorporated into the motion by reference.

[iv] Ground(s) for Relief

The creditor must state with particularity the grounds upon which the motion is based.ⁿ³ Some pleading of facts supporting one or more grounds for relief is required. It is generally advisable to plead a strong case for relief, showing why continuation of the stay will cause material harm to the creditor. The grounds upon which relief from the stay may be granted are discussed above.ⁿ⁴

WARNING

However, care should be taken to avoid taking positions that could prove harmful later in the case, such as asserting an artificially low value for the collateral at the outset of the case when the creditor will try to assert a high valuation at the time of confirmation.

[v] Relief Sought

The motion must set forth the relief sought.ⁿ⁵ The creditor can request that the stay be terminated, annulled, modified or conditioned.ⁿ⁶ Several of these forms of relief can also be sought in the alternative. But parties in stay litigation should not include in their motions requests for relief beyond the issue of whether, and to what extent, the stay remains in place.^{n6a}

[vi] Signature, Office Address and Telephone Number of Attorney of Record

The nondebtor's motion must be signedⁿ⁷ by at least one attorney of record, in that attorney's individual name, with that attorney's office address and direct telephone number.ⁿ⁸ If the motion is not signed, it will be stricken, unless it is promptly signed after the attorney whose signature is required is notified of the omission. However, only the original motion must be signed. Any copies served on other parties need not be signed, or may be photocopies of the original signed document. In either case, the copies should indicate by whom the original was signed because the copies must conform to the original.

Bankruptcy Rule 9011(b) provides that in signing the motion, the attorney certifies that the attorney has read the motion, and after reasonable inquiry, believes the motion is well grounded in fact and warranted by existing law or a good faith argument for a modification of existing law, and that the motion is not put forth for any improper purpose such as to delay or increase the cost of the litigation, or to harass. *Bankruptcy Rule 9011* places an affirmative duty on the attorney to investigate the facts and law prior to the signing and submission of a motion. If the motion is signed in violation of *Rule 9011*, the court, on its own or on motion of a party, must impose sanctions on the attorney who signed it, the party represented by the attorney, or both.

[vii] Verification of Motion Not Required

Motion papers seeking relief from the automatic stay under section 362(d) need not be verified.ⁿ⁹ However, some courts by local rule require supporting affidavits to be submitted with motions.

[b] Contents of Notice of Motion

Although the general form of the notice of motion is prescribed by Official Form 20A, its precise content is dictated by local rules and procedures for hearing motions. The notice must include the caption of the case as described above for the motion itself.ⁿ¹⁰ The notice of motion should be addressed to the debtor, the trustee, their respective counsel and any other parties required to receive notice by the Federal Rules of Bankruptcy Procedure.

The notice should contain a brief statement of the nature of the motion. It must also state whether a response is required, the type of response required, any deadline for the response, where the response should be filed, and upon whom the response must be served.

If a hearing has been scheduled, the notice must inform the recipient of the date and time scheduled for the hearing on the motion, and the complete street address of the location at which the hearing will take place. The date selected for the hearing on the motion must be such that the notice is served not later than five days before the hearing is to take place.ⁿ¹¹

[c] Contents of Proposed Order

The proposed order must contain the caption described above for the motion.ⁿ¹² It should begin with a recitation of the authority and basis for granting the relief requested. The statement should describe the basis and purpose of the underlying motion; state the date of any hearing held on the motion; declare that proper notice had been given to all required parties; and that the order is granted after due deliberation.

Example:

Upon the motion, dated March 1, 1999 of John Jones, the Creditor, for an Order, pursuant to *section 362(d) of title 11, United States Code*, lifting the automatic stay; and after the hearing on the motion held on March 27, 1999; and notice having been given to all required parties; and after due deliberation; on this -- day of --, 1999, it is Ordered ...

The order must obviously include a precise statement of the relief being granted. In the usual case the statement of relief

granted will restate the terms of the Wherefore Clause of the underlying motion, preceded by some variation of the phrase, "It is Ordered that." At the end of the order there must be designated a place where the Bankruptcy Judge will sign and date the order.

[3] Filing Motion and Payment of Filing Fee

The nondebtor must file one original motion with the clerk in the district where the bankruptcy case is pending.ⁿ¹³ It should be noted that the judge of that court may allow the motion to be filed with the judge rather than with the clerk.ⁿ¹⁴ Where service is not accomplished electronically, copies will be needed for service. Local rules may impose additional requirements with respect to filing, such as a cover sheet giving information about the motion or a certification of service.

PRACTICE NOTE

"Filing," within this context, means actual filing with the clerk. Therefore, mailing does not fulfill the filing requirement of *Bankruptcy Rule 5005(a)* until the clerk actually receives the document.ⁿ¹⁵

The Judicial Conference requires a fee of \$150 to be paid to the clerk upon the filing of motions seeking relief from the automatic stay provided under section 362(a).ⁿ¹⁶

[4] Service

[a] Service Required

Federal Rule of Bankruptcy Procedure 9014 provides that a motion for relief from the automatic stay under section 362(d) must be served in the same manner as that provided for service of a summons and complaint by *Rule 7004*. *Rule 7004* incorporates selected provisions of *Rule 4 of the Federal Rules of Civil Procedure*, but permits service by first class mail as an alternative to other methods provided in *Rule 4*.ⁿ¹⁷ Service on the debtor's counsel may be accomplished using any means authorized by *Federal Rule of Civil Procedure 5(b)*, which may include electronic service. As the moving party, the nondebtor is responsible for service with respect to a motion for relief from the stay.

[b] Parties upon Whom the Motion Must Be Served

Federal Rules of Bankruptcy Procedure 4001(a) and *9013* require that any motion for relief from the automatic stay under section 362(d) must be served on the debtor and on the trustee. Whenever service must be made upon a debtor represented by an attorney, the service must be made upon both the debtor and the debtor's attorney unless the court orders otherwise.ⁿ¹⁸ The court may direct that the motion be served on additional parties; for example, interested third parties such as junior lienholders or additional unsecured creditors.

[c] Actual Service Necessary to Establish Court's Jurisdiction Over Parties

Neither actual notice, nor simply naming the person in the caption of the motion is sufficient to meet the requirements of service under *Rule 7004*. Service may be made anywhere in the United States either personally, by any person not less than 18 years of age who is not a party, or by first class mail, or electronically (where permitted).

Personal service is made in basically the same manner as under the Federal Rules of Civil Procedure. But service is usually made by first class mail postage prepaid, if the party to be served is within the United States. However, insured depository institutions must be served by certified mail.ⁿ¹⁹ Service by mail is complete upon mailing; but, when service is by mail, the person served is entitled to three additional days in which to respond. No acknowledgment of service by mail is required. The manner of service by mail depends upon the status of the party to be served.

[i] Service by Mail upon an Individual Other than an Infant or Incompetent

Service by mail upon an individual other than an infant or incompetent is made by mailing a copy to the individual's dwelling home or usual place of abode, or to the individual's usual place of business.ⁿ²⁰

[ii] Service by Mail upon Corporation, Partnership, or an Unincorporated Association that Can Be Sued Under Its Common Name

Service by mail upon a corporation or a partnership, or upon an unincorporated association that can be sued under its common name, is made by mailing a copy to an officer, a managing or general agent, or any other agent authorized to receive process.ⁿ²¹

[iii] Service by Mail upon an Insured Depository Institution

Service by mail upon an Insured Depository Institution, *i.e.*, a bank or credit union, must be by certified mail addressed to an officer of the institution, unless the institution has appeared by its attorney, in which case the attorney must be served by first class mail, or unless the institution has waived in writing its entitlement to service by certified mail, or unless the court orders otherwise, upon an application served by certified mail.ⁿ²²

[iv] Service by Publication

If a party cannot be served either personally or by mail, then the court may order such party to be served by mail to the party's last known address and by at least one publication in the manner and form as directed by the court.ⁿ²³ Service by publication as permitted by *Rule 7004(c)* is restricted to those proceedings that affect rights in property that is in the custody of the court.

[v] Electronic Service

Rule 7004(g) specifically provides that service on the debtor's counsel may be accomplished using any means authorized by *Federal Rule of Civil Procedure 5(b)*, which may include electronic service. Courts increasingly employ electronic service for attorneys practicing before them. Local rules should be checked to determine the circumstances under which service may be made or received electronically.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 4001(a)*. See 9 *Collier on Bankruptcy*, P 4001.02[1] (Matthew Bender).

(n2)Footnote 2. See P 10.12 *supra*.

(n3)Footnote 3. *Fed. R. Bankr. P. 9013*.

(n4)Footnote 4. See PP 10.02-10.03 *supra* .

(n5)Footnote 5. *Fed. R. Bankr. P. 9013*.

(n6)Footnote 6. See P 10.06 *supra*.

(n7)Footnote 6a. See *In re Van Ness*, 399 B.R. 900 (Bankr. E.D. Cal. 2009) (court denied creditor's request for bans on filing of future bankruptcy cases by other persons, bans on automatic stays in future cases, and authorization for sheriff to ignore a future bankruptcy case when conducting an eviction).

(n8)Footnote 7. For electronic filings, local rules typically specify that the user's login and password required to submit the documents electronically serve as the user's signature. Local rules may also specify other requirements for

electronically submitted documents.

(n9)Footnote 8. *Fed. R. Bankr. P. 9011(a)*.

(n10)Footnote 9. *Fed. R. Bankr. P. 9011(e)*.

(n11)Footnote 10. *See P 10.13[2][a][i] supra*.

(n12)Footnote 11. *Fed. R. Bankr. P. 9006(d)*.

(n13)Footnote 12. *See P 10.13[2][a][i] supra*.

(n14)Footnote 13. *Fed. R. Bankr. P. 5005(a)*.

(n15)Footnote 14. *Fed. R. Bankr. P. 5005(a)*.

(n16)Footnote 15. *Chrysler Motors Corp. v. Schneiderman*, 940 F.2d 911, 25 C.B.C.2d 423 (3d Cir. 1991) .

(n17)Footnote 16. Judicial Conference Bankruptcy Court Miscellaneous Fee Schedule, Item 20, *reprinted in* 1 Collier on Bankruptcy, Ch. App. 9 (Matthew Bender).

(n18)Footnote 17. *See* ch. 32 *infra*. Transmission of a "Notice of Electronic Filing," or the like, may constitute service under local rules.

(n19)Footnote 18. *Fed. R. Bankr. P. 7004(g)*.

(n20)Footnote 19. *Fed. R. Bankr. P. 7004(h)*.

(n21)Footnote 20. *Fed. R. Bankr. P. 7004(b)(1)*.

(n22)Footnote 21. *Fed. R. Bankr. P. 7004(b)(3)*.

(n23)Footnote 22. *Fed. R. Bankr. P. 7004(h)*.

(n24)Footnote 23. *Fed. R. Bankr. P. 7004(c)*.



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.15 Debtor Procedure for Responding to Motion for Relief from Stay

[1] Debtor Response Not Required; Local Rules Vary

The debtor is not required by the Federal Rules of Bankruptcy Procedure to serve a response to the creditor's motion for relief from the stay unless the court directs otherwise. Such direction may be contained in local rules or practice that require a response. Some courts will grant the relief sought by the movant by default if a response is not filed, notwithstanding the applicability of *Federal Rule of Bankruptcy Procedure 7055*, which requires 7 days notice to the debtor of an application for a default judgment.ⁿ¹

[2] If Debtor Chooses to Respond

[a] Timing of Response

If the debtor chooses to respond, the response must be in writing and served on the creditor's counsel not later than one day before the hearing.ⁿ² Again, however, it is often the case that different timing of the response may be dictated by local rules or by court order.

[b] Raising Procedural Issues

In a proceeding for relief from the stay, joinder of the debtor and the trustee is almost always necessary. The former typically has possession of property, or will be the defendant in legal proceedings if the stay is lifted, and usually has a strong interest in continuation of the stay. The latter also has at least a possible interest in almost every case involving property. Indeed, because of the chapter 13 trustee's important role, the Code expressly provides that he or she appear and be heard at any hearing that concerns the value of property subject to a lien, a frequent issue in stay litigation.ⁿ³

PRACTICE NOTE

Thus, one of the first issues which can be raised is whether the court should dismiss the proceeding for lack of an indispensable party. A motion to dismiss on these grounds may be necessary when a motion for relief from the stay has been filed only against the trustee or only against the debtor.ⁿ⁴ In such a case, a good argument can be made that the proceeding must be dismissed so that the 30-day time limit will begin to run only when all of the proper parties have been notified and joined in the proceeding. Any

other result would allow a party seeking relief from the stay to sue only some of the necessary parties, and then to add others when the 30 days is about to run, giving those others inadequate time to prepare a defense.

Similarly, lack of proper service may be grounds for dismissal of the proceeding or at least postponement of the hearing. Creditors moving for the stay sometimes fail to serve both the debtor and the debtor's attorney, as required by *Federal Rule of Bankruptcy Procedure 7004(b)(9)*, which is applicable to stay motions by virtue of *Rule 9014*.

[c] Controvert Main Factual Bases for Relief

Of course, the debtor should, if possible, controvert the main factual bases for relief. However, the debtor should not controvert routine allegations, such as the amount of the debt, execution of the note, or the fact that the loan is secured, unless there are grounds for doing so. The debtor may also wish to set forth as part of the response the debtor's version of the situation, although this is not required.

[d] Defenses or Counterclaims

The debtor's response should include any defenses or counterclaims that would reduce or eliminate the creditor's right to proceed after the stay is lifted. For example, if a debtor claims that a lien does not exist because it was rescinded under the Truth in Lending Act, the stay should not be lifted to permit enforcement of that lien.ⁿ⁵ Or, if a debtor's defenses and counterclaims reduce the balance owing on an automobile loan to an amount that does not justify lifting of the stay, then evidence of those defenses should be allowed.

The purpose for raising defenses and counterclaims to the underlying claim is to influence the judge's decision on the motion itself, but not for the purpose of actually obtaining a final determination of those issues.

The party seeking relief from the stay may protest that the counterclaims have nothing to do with the stay litigation. However, the legislative history of the stay provision suggests otherwise. The House Report states that the hearing "will not be the appropriate time at which to bring in other issues, such as counterclaims against the creditor *on largely unrelated matters*. Those counterclaims are not to be handled in the summary fashion that the preliminary hearing under this provision will be."ⁿ⁶

Thus Congress apparently contemplated that counterclaims and defenses on related matters should be considered in stay litigation. The Rules foreclose the actual pleading of counterclaims in response to a motion, but they certainly do not preclude the debtor from raising the existence of defenses and counterclaims in defending against the motion. If the counterclaims and defenses are related to the creditor's claim, they can then be considered to the extent it is necessary to determine whether they are reasonably likely to be successful, as might be done in a preliminary injunction proceeding.ⁿ⁷

However, the final litigation of the issues raised is ordinarily deferred until later in the case.ⁿ⁸ The final resolution of counterclaims requires a separate adversary proceeding, initiated with a formal complaint. Normally, the debtor should begin the separate action on any counterclaim immediately; if it appears to have merit, the court may modify the stay pending the resolution of the debtor's counterclaim as necessary to protect the interests of both sides. If, on the other hand, the debtor's separate action does not appear to have merit, the court may decide to lift the stay altogether.

[3] Contents of Debtor's Response to Motion for Relief from Stay

Although the form of answer or response may be altered by local rules, certain elements are likely to be uniform.

[a] Caption

The caption is the same as that appearing on the motion for relief that the debtor is responding to, except that the description of the pleading should specifically refer to the motion it answers.ⁿ⁹

[b] Admissions and Denials

The admissions and denials give the parties the opportunity to define the issues of the case and deny those factual allegations that are not true. A general denial of those facts not admitted is acceptable. It is not clear whether specific paragraphs need to be admitted or denied, since *Federal Rule of Bankruptcy Procedure 7008*, which requires admission or denial of allegations, is not made applicable to contested matters by *Rule 9014*. However, local rules should be consulted as they may dictate more specific requirements for responses to relief from stay.

[c] Defenses and Counterclaims

The answer should raise any defenses and/or counterclaims that would either reduce or eliminate the creditor's right to relief from the stay. It should be kept in mind, however, that the bankruptcy court will only make a final determination as to whether or not the stay will be lifted. A final resolution of any counterclaims the debtor may put forward must come through a separate adversary proceeding initiated by a formal complaint.ⁿ¹⁰

[d] Relief Sought

The debtor must state the relief requested in the Wherefore Clause. Typically, the debtor will request that the motion for relief from the stay be denied, and such other relief as may be just.

[e] Signature, Office Address and Telephone Number of Attorney of Record

The debtor's answer must be signedⁿ¹¹ by at least one attorney of record, in that attorney's individual name, with that attorney's office address and direct telephone number.ⁿ¹² If the answer is not signed, it will be stricken, unless it is promptly signed after the attorney whose signature is required is notified of the omission. Only the original answer must be signed. Any copies served on other parties need not be signed, although the copies should indicate by whom the original was signed because the copies must be conformed to the original.

As with any pleading, *Rule 9011(b)* provides that in signing the answer, the attorney certifies that the attorney has read the answer, and after reasonable inquiry, believes the answer is well grounded in fact and warranted by existing law or a good faith argument for a modification of existing law, and that the motion is not put forth for any improper purpose such as to delay or increase the cost of the litigation, or to harass.

[f] Verification of Answer Not Required

The debtor's answer to a motion seeking relief from the automatic stay under section 362(d) need not be verified. However, a few courts require both motions and responses to motions to be accompanied by affidavits.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 7055* is made applicable by *Fed. R. Bankr. P. 9014*.

(n2)Footnote 2. *Fed. R. Bankr. P. 9006(d)*.

(n3)Footnote 3. *11 U.S.C. § 1302(b)(2)*.

(n4)Footnote 4. *See In re Di Bona*, 7 B.R. 798 (Bankr. E.D. Pa. 1980) (joinder of trustee ordered on grounds that he was indispensable party).

(n5)Footnote 5. *In re Gurst*, 75 B.R. 575 (Bankr. E.D. Pa. 1987) .

(n6)Footnote 6. H.R. Rep. No. 595, 95th Cong., 1st Sess. 344 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender). The Senate Report, S. Rep. No. 989, 95th Cong., 2d Sess. 55 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender) is somewhat more restrictive, but should not be considered meaningful because the Senate Bill did not include the expanded jurisdiction of the final statute.

(n7)Footnote 7. *Payment Plans, Inc. v. Strell*, 717 F.2d 25 (2d Cir. 1983) (fact that creditor's lien was unperfected considered in denying relief from stay); *In re Bialac*, 694 F.2d 625, 627 (9th Cir. 1982) (when debtor's defenses and counterclaims directly involve question of debtor's equity, they should be heard in stay proceeding).

(n8)Footnote 8. 3 *Collier on Bankruptcy*, P 362.08[6] (Matthew Bender), 1 *Collier Bankruptcy Manual*, P 362.08[6] (Matthew Bender) (*res judicata* determination on counterclaims should not be made when the court decides on relief from the stay, but they may be raised and considered by the court at that time). *See Grella v. Salem Five Cent Sav. Bank*, 42 F.3d 26 (1st Cir. 1994) (relief from stay determination did not have preclusive effect with respect to trustee's preference claim); *Estate Constr. Co. v. Miller & Smith Holding Co., Inc.*, 14 F.3d 213 (4th Cir. 1994) (failure to raise fraud claim at hearing on relief from stay did not preclude raising it in a later proceeding); *D-1 Enterprises, Inc. v. Commercial State Bank*, 864 F.2d 36 (5th Cir. 1989) (order granting relief from stay did not resolve debtor's lender liability claim against creditor).

(n9)Footnote 9. *See* P 10.13[2][a][i] *supra*.

(n10)Footnote 10. *See* P 10.14[2][d] *supra*.

(n11)Footnote 11. For districts that require or permit electronic filings, local rules typically specify that the user's login and password required to submit the documents electronically serve as the user's signature. Local rules may also specify other requirements for electronically submitted documents.

(n12)Footnote 12. *Fed. R. Bankr. P. 9011(a)*.



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.16 Procedure Governing Court Approval of Stipulations and Agreements Relating to Relief from Stay

Relief from the automatic stay may be provided for by agreement between the debtor and one or more nondebtors. Under *Bankruptcy Rule 4001(d)*, an agreement requires court approval, which is obtained by filing a motion that has been served and noticed on the parties designated by the Rule. A hearing is held if a party files an objection. But if the agreement is in settlement of an earlier motion for relief from the stay, as is usually the case, the court may approve the agreement without a new motion if the court finds that the relief motion provided reasonable notice of the terms of the agreement and of the opportunity for a hearing.

[1] Form Drafting

Court approval of stay relief agreements requires the parties to draft a motion and notice of motion.ⁿ¹

[a] Contents of Motion

The motion must contain a caption conforming to *Federal Rule of Bankruptcy Procedure 9004(b)*.ⁿ² Thus, the caption must include the name of the court, the title of the case, the bankruptcy docket number, a brief description of the character of the document, and the chapter of the Bankruptcy Code under which the case is proceeding.

The motion must contain a brief statement providing the basis of the court's jurisdiction to hear the motion and the authority upon which the court will decide the motion. In addition to the relevant sections(s) of the Bankruptcy Code, this statement typically refers to those sections of the judicial code that grant jurisdiction over bankruptcy proceedings to the district courts and provide the district courts with the authority to refer matters to the bankruptcy judges.

DRAFTING NOTE

The nature and extent of the claim should be set forth in the motion and appropriate supporting documents, including a copy of the agreement for which approval is sought, must be attached to the motion as exhibits, or a separate proof of claim may be filed and incorporated into the motion by reference.ⁿ³

The parties must state with particularity the grounds upon which the motion is based. Some pleading of facts is required. The motion must also set forth the relief sought, *i.e.*, it must request that the proposed

agreement for relief from the stay be approved by the court.

Finally, the motion must be signed by at least one attorney of record, in that attorney's individual name, with that attorney's office address and direct telephone number.ⁿ⁴ If the motion is not signed, it will be stricken, unless it is promptly signed after the attorney whose signature is required is notified of the omission. Only the original motion must be signed. Any copies served on other parties need not be signed, although the copies should indicate by whom the original was signed because the copies must conform to the original.

Motion papers seeking approval of an agreement relating to relief from the stay or the provision of adequate protection need not be verified.

[b] Contents of Notice of Motion

The notice of the motion must also conform to Official Form 20A and any local rule variations of that form. The notice should contain a brief statement of the purpose of the motion. The notice must inform the recipient of the time within which objections to the agreement must be filed and served on the debtor in possession or trustee. Normally, the time limit for such objections is 15 days from the date the notice is mailed; however, the parties may move for an enlargement or a reduction of the period for cause shown under *Rule 9006(b)* or *(c)*. The court may also fix a different time period for objections on its own initiative.ⁿ⁵

[2] Filing

The original motion must be filed with the clerk in the district where the bankruptcy case is pending. Local practice may vary according to local rules or court order. The movant, usually the nondebtor--although the rules allow either the debtor or a nondebtor to file--must file one original motion with the clerk in the district where the bankruptcy case is pending.ⁿ⁶ Local rules may impose additional requirements with respect to filing, such as a cover sheet or other papers.

[3] Service

The motion, notice of motion, proposed agreement, and any supporting documents must be served upon the parties designated by the Bankruptcy Rules and as may be directed by the court. *Rule 4001(d)(1)* requires only that any motion for approval of an agreement relating to relief from the automatic stay must be served, accompanied by a copy of the proposed agreement, on a creditors committee or designated creditors in a chapter 11 case. Thus, normally, in a chapter 7 or chapter 13 case, if the debtor and trustee are both parties to the motion, no notice to creditors is necessary. The court may direct that the motion and proposed agreement be served on additional parties including some or all of the creditors in chapter 7, 12 and 13 cases, where no creditors might otherwise receive notice or upon the United States trustee and the chapter 13 trustee, if not a party to the agreement.

Bankruptcy Rule 4001(d)(2) requires that notice of the motion be mailed to all parties upon whom the motion had to be served under *Rule 4001(d)(1)*.

Service may be made anywhere in the United States either personally, or by first class mail or electronically (where permitted). In certain exceptional circumstances, service may be accomplished through a combination of mailing and publication as directed by the court. Whenever service must be made upon a party represented by an attorney, the service must be made upon the attorney unless ordered otherwise by the court.ⁿ⁷ Service may be made by first class mail, postage prepaid, if the party to be served is within the United States, and normally is made in this manner. Service by mail is complete upon mailing; however, where service is by mail, the person served is entitled to three additional days in which to respond. No acknowledgment of service by mail is required.

If a party cannot be served either personally or by mail, then the court may order such party to be served by mail to the

party's last known address and by at least one publication in the manner and form as directed by the court.ⁿ⁸

[4] Objections to Proposed Agreement

Any interested party may enter an objection to the proposed agreement. A party that wishes to enter an objection to the proposed agreement relating to relief from the automatic stay must file a written objection within 15 days of the mailing of the notice, and serve it on the movant and debtor or trustee.ⁿ⁹ Although *Bankruptcy Rule 4001(d)(2)* states that any objection must be made within 15 days of the mailing of the notice of the motion requesting approval of the agreement, the court may fix a different time. Furthermore, the prescribed time period may be enlarged or reduced for cause under *Rule 9006*.

The court must hold a hearing if any objection to the proposed agreement is timely filed. If no objection is made, the court need not hold a hearing unless it determines that a hearing is necessary to protect the interests of all affected parties. The court may not hold a hearing on less than five days notice to the objector, the movant, and all the parties who were served with the motion. *Bankruptcy Rule 4001(d)(3)* makes it clear that no hearing may be conducted without the required notice. Therefore, ex parte hearings with respect to agreements relating to relief from the stay are prohibited. Unless there was a prior motion for relief served and noticed under the Rules, no such agreement may be approved without the filing and service of a motion, notice and time to object and if objections are filed, a hearing to consider those objections.

[5] Exception to Procedural Requirements Where Agreement Is in Settlement of a Prior Motion for Relief from Stay

If the agreement is in settlement of an earlier motion for relief from the stay, the court may approve the agreement without a new motion or new notice to the parties if the court determines that the earlier stay relief motion provided reasonable notice of the material terms of the proposed agreement and of the opportunity for a hearing.ⁿ¹⁰

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 4001(d)(1), (2)*. See 9 *Collier on Bankruptcy*, P 4001.07 (Matthew Bender).

(n2)Footnote 2. See PP 10.13[2][a][i], P 10.14[3][a] *supra* .

(n3)Footnote 3. *Fed. R. Bankr. P. 4001(d)(1)*, 9013.

(n4)Footnote 4. *Fed. R. Bankr. P. 9011(a)*.

(n5)Footnote 5. *Fed. R. Bankr. P. 4001(d)(2)*.

(n6)Footnote 6. *Fed. R. Bankr. P. 5005(a)*.

(n7)Footnote 7. *Fed. R. Bankr. P. 7005(b)*.

(n8)Footnote 8. *Fed. R. Bankr. P. 9008*.

(n9)Footnote 9. *Fed. R. Bankr. P. 4001(d)(2)*.

(n10)Footnote 10. *Fed. R. Bankr. P. 4001(d)(4)*.



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.17 Discovery Available to Both Parties in Relief from Stay Proceeding

A full range of discovery devices is available to both the movant and the debtor; however, the parties must be aware of the strict time constraints involved in relief from stay proceedings.

Part VII of the Federal Rules of Bankruptcy Procedure adopts or incorporates by reference each of the Federal Rules of Civil Procedure which relates to discovery.ⁿ¹ Although a motion seeking relief from the automatic stay is a contested matter, *Bankruptcy Rule 9014* makes all of the discovery rules of Part VII applicable, except for Rule 26(a)(1)-(3) and (f) (requiring certain pretrial disclosures and a discovery planning conference) and *Rule 7027* (concerning depositions before an adversary proceeding or pending appeal).

However, because of the strict time limits involved in a relief from stay proceeding, a party seeking discovery may find it necessary to obtain a court order for expedited discovery, or to obtain the consent of the other party to an extension of the 30-day or 60-day time period. A party who moves for relief from the stay should be aware that the strict time periods under section 362(e) may be inadvertently waived by filing detailed discovery requests to which responses are due after the deadline.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 7026-7037* (incorporating *F. R. Civ. P. 26-37*).



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CHAPTER 10 Motions for Relief from the Automatic Stay or Codebtor Stay

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P 10.18 Ex Parte Relief

Ex parte relief is available in extraordinary circumstances, but because there are alternative procedural devices involving informal notice and reduced response time, ex parte relief is rarely requested or granted.

Section 362(f) provides for relief from the stay upon the request of a party in interest, with or without a hearing "as is necessary to prevent irreparable damage to the interest of an entity in property, if such interest will suffer such damage before there is an opportunity for notice and a hearing under subsection (d) or (e) of this section."

Since notice in emergencies can be very informal, such as by a telephone call, relief is virtually never granted without some form of notice. Nonetheless, *Rule 4001(a)(2)* permits actions to be taken without notice under section 362(f). In the few cases in which this occurs, the Rule requires prompt oral notice to the debtor or trustee of the relief granted and the prompt mailing of the order, and permits the adverse party to appear and seek reinstatement of the stay on two days' notice, or less if the court so orders.ⁿ¹

[1] Procedural Requirements of Ex Parte Relief.

Federal Rule of Bankruptcy Procedure 4001(a)(2) provides that a court may grant ex parte relief from the automatic stay only if (1) the nondebtor can show with specific facts supported by affidavit or a verified motion that it will suffer irreparable harm before the debtor can be heard in opposition, and (2) the nondebtor's attorney certifies to the court in writing the efforts made to notify the debtor and why notice should not be required in the proceeding.

[2] Alternatives to Ex Parte Relief Available to Nondebtor.

Because of the courts' reluctance to grant ex parte relief, a nondebtor is more likely to be successful in requesting a shortened response time under *Federal Rule of Bankruptcy Procedure 9006(c)(1)*, which allows a court, for cause and in its discretion, to shorten the time period allowed for the debtor to respond. Other alternatives available to the nondebtor are requesting adequate protection under section 363(e) or seeking injunctive relief with a temporary restraining order pending a hearing.

FOOTNOTES:

(n1)Footnote 1. *See 9 Collier on Bankruptcy, P 4001.04* (Matthew Bender).



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P 10.19 Relief from the Codebtor Stay

The procedures for relief from the codebtor stay of *Code section 1301* are similar to those for relief from the automatic stay of section 362(a). However, there are some significant differences.

[1] Grounds for Relief

The codebtor stay may be lifted or modified in several situations by the court upon request of a creditor or other party in interest. Such a request may be grounded upon the fact that the chapter 13 debtor was really the cosigner, and the nonfiling individual received the consideration for the claim.ⁿ¹ However, the issue in such cases is not whether the cosigner is the primary obligor or secondary obligor; cosigners are protected if they are also liable, along with the debtor, on any debt which provided a benefit to the debtor.ⁿ²

Relief from the codebtor stay is also available upon a showing of irreparable harm to the creditor caused by the stay.ⁿ³

In addition, the codebtor stay will be lifted upon a creditor's motion to the extent that the proposed plan does not provide for full payment of the claim.ⁿ⁴ Thus, if a plan proposes to pay 10 percent of a claim, relief from the stay may be granted as to the remaining 90 percent. However, the codebtor is required to pay the amounts not paid under the plan only as they fall due, and not immediately, if there has been no prior acceleration of the debt.

PRACTICE NOTE

The fact that a creditor will be paid late does not by itself justify relief from the stay if payment will be made in full.ⁿ⁵ Less clear is what happens where unearned interest is involved. Normally, unearned interest is not considered part of an unsecured claim in chapter 13,ⁿ⁶ and not paid in a plan. Therefore, it should not be taken into account in deciding whether the "claim" is paid in full. However, some courts have held otherwise, stating that a codebtor may be pursued to the extent that postbankruptcy interest is not paid in the plan.ⁿ⁷

[2] Procedure

The procedure by which creditors may obtain relief from the codebtor stay is similar to that followed for relief from the section 362 automatic stay, except in a few respects. A creditor that files a motion for relief from the codebtor stay

based upon allegations that the plan will not pay its claim in full need not obtain a court order terminating the stay if that motion is not opposed. If the debtor or codebtor does not file a response to the motion and serve it upon the creditor within 20 days, the codebtor stay is terminated to the extent requested by the creditor.ⁿ⁸ It is important to note that this exception applies to only one of the grounds for relief from the codebtor stay (failure to propose payment in full), and it has no effect if a response to the creditor's motion is timely filed and served.

Also, the time limits set forth in section 362(e) for court determination of a motion for relief from the automatic stay affecting an act against property are not made applicable to the section 1301 codebtor stay.ⁿ⁹ Finally, the burden of proof should be on the party seeking relief from the codebtor stay to prove that the grounds for relief exist.ⁿ¹⁰

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 1301(c)(1)*. See 8 Collier on Bankruptcy, P 1301.03[2][a] (Matthew Bender).

(n2)Footnote 2. *In re Lemma*, 394 B.R. 315, 320 (Bankr. E.D.N.Y. 2008) (stay applies when both debtor and codebtor received consideration); *In re Zersen*, 189 B.R. 732 (Bankr. W.D. Wis. 1995) .

(n3)Footnote 3. *11 U.S.C. § 1301(c)(3)*. See 8 Collier on Bankruptcy, P 1301.03[2][c] (Matthew Bender).

(n4)Footnote 4. *11 U.S.C. § 1301(c)*. See 8 Collier on Bankruptcy, P 1327.03[2][b] (Matthew Bender).

(n5)Footnote 5. *Harris v. Fort Oglethorpe State Bank*, 721 F.2d 1052 (6th Cir. 1982) .

(n6)Footnote 6. *11 U.S.C. § 502(b)(2)*.

(n7)Footnote 7. See *Matter of Bradley*, 705 F.2d 1409 (5th Cir. 1983) (holding codebtors could be pursued for interest as it came due; debtor apparently did not argue that unearned interest was not part of the unsecured claim); *Southeastern Bank v. Brown*, 266 B.R. 900 (S.D. Ga. 2001) (codebtor can be pursued for postpetition interest, but debtor may prevent this by separately classifying creditor and paying debt in full, including interest, through the plan).

(n8)Footnote 8. *11 U.S.C. § 1301(d)*.

(n9)Footnote 9. *11 U.S.C. § 362(e)*.

(n10)Footnote 10. *In re Burton*, 4 B.R. 608 (Bankr. W.D. Va. 1980) . See 8 Collier on Bankruptcy, P 1301.03[1] (Matthew Bender). Compare *11 U.S.C. § 362(g)*.



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CHAPTER 10 Motions for Relief from the Automatic Stay or Debtor Stay

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P 10.20 Options Available to the Unsuccessful Party

There are a number of different options available by which an unsuccessful party may attempt to reverse its fortune, including:

- moving for an amendment of the findings of the court under *Bankruptcy Rule 7052*; or a new trial under *Bankruptcy Rule 9023*;
- appealing a final determination as of right, or an interlocutory decision by leave of the court; or
- filing a new motion.

[1] Motion to Amend Findings Under Bankruptcy Rule 7052

Federal Rule of Bankruptcy Procedure 7052, which is an incorporation by reference of *Federal Rule of Civil Procedure 52*, requires that in an adversary proceeding tried upon the facts the court must find the facts specially and state its conclusions of law separately. *Bankruptcy Rule 7052* is made applicable to contested matters by *Bankruptcy Rule 9014*. Therefore, a party unsuccessful in stay litigation can file a motion to amend the findings and the judgment under *Rule 7052*. While the court will almost never change its decision, an inconclusive decision may be sharpened considerably. For example, the court may be persuaded by the amended findings to impose a variety of conditions as suggested by the creditor to preserve the status quo, or the court may effectively put a limit on the debtor's time to reorganize.

Similarly, *Rule 9023* incorporates *Federal Rule of Civil Procedure 59*, which permits the court to reconsider its decision on any of several grounds stated in that rule.

Under *Federal Rule of Bankruptcy Procedure 8002(b)*, the filing of a motion to amend the findings and the judgment under *Bankruptcy Rule 7052* or a motion for a new trial under *Rule 9023* will extend the time for the creditor to file a notice of appeal until 14 days after the entry of the order disposing of the motion.

[2] Appeal

A party can appeal a final judgment, order or decree of a bankruptcy judge to a district court or bankruptcy appellate

panel. In addition, a party may appeal by leave of the court from any interlocutory judgment, order or decree of a bankruptcy judge as permitted by 28 U.S.C. 158(a).ⁿ¹ A party may appeal as of right any final decision of a bankruptcy court, and courts have generally held that an order granting or denying relief from a stay is a final order.

MORE INFORMATION

For further discussion of appeals *see* chapter 33 *infra*.

To exercise this right the party must file a notice of appeal with the clerk within 14 days of the date of the entry of the judgment, order, or decree appealed from.ⁿ² The form of the notice of appeal is dictated by Official Form 17. The bankruptcy judge may extend the time for filing the notice of appeal for a period of up to 21 days from the expiration of the original 14-day period. However, a request to so extend the time period must be made before the original 14-day time period has expired.

FORMS

For examples of forms used in filing the notice of appeal *see Collier Consumer Bankruptcy Forms*, § CS3.02 (Matthew Bender).

An unsuccessful debtor that is appealing from a decision in a relief from stay action should apply for a stay of the judgment pending the appeal.ⁿ³ If the debtor does not seek such a stay, the successful creditor may proceed with its planned actions outside the bankruptcy court and then argue that the debtor's appeal has become moot.ⁿ⁴ For this reason, *Rule 4001(a)(3)* provides that, unless the court orders otherwise, an order granting relief from an automatic stay is itself stayed until 14 days following the entry of the order, so that the losing party has time to seek a stay pending appeal before action is taken that would render the appeal moot or otherwise of no value.ⁿ⁵ Therefore, if a possible appeal is contemplated, a debtor should argue against any language in the court's order changing the normal 14 day delay of relief from the stay.

[3] File a New Motion for Relief from the Stay

If the nondebtor's motion is denied by a final order, there is no legal bar to filing a new motion asking for the same relief. However, as a practical matter, the nondebtor must meet the considerable burden in showing sufficiently changed circumstances.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 8001. See 9 Collier on Bankruptcy, P 8001.01* (Matthew Bender).

(n2)Footnote 2. *Fed. R. Bankr. P. 8002(c). See 9 Collier on Bankruptcy, P 8001.03* (Matthew Bender).

(n3)Footnote 3. *Fed. R. Bankr. P. 8005.*

(n4)Footnote 4. *In re National Mass Media Telecommunication Systems, Inc.*, 152 F.3d 1178 (9th Cir. 1998) (when foreclosed property was sold to nonparty, appeal from order granting relief from stay to permit foreclosure became moot).

(n5)Footnote 5. *Fed. R. Bankr. P. 4001(a)(3).*



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CHAPTER 11 Turnover of Property Held by Third Parties

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§ 11.syn Synopsis to Chapter 11: Turnover of Property Held by Third Parties

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CHAPTER 11 Turnover of Property Held by Third Parties

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Scope

SCOPE NOTE

This chapter first discusses when turnover of property is required. Next, the chapter reviews how a debtor or trustee can force turnover from entities that refuse to comply with the Bankruptcy Code. The chapter also outlines the basic steps involved in bringing a turnover proceeding, including an overview of the litigation process. Finally, the chapter reviews issues of possession that arise after turnover of property of the bankruptcy estate.



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CHAPTER 11 Turnover of Property Held by Third Parties

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P 11.01 When Turnover Is Required

The commencement of a bankruptcy case activates two automatic provisions relating to the debtor's property in addition to the automatic stay-- *sections 542 and 543 of the Bankruptcy Code*. These sections require turnover to the trustee of property in which the debtor has an interest. Both of these sections have similar provisions; section 543 applies to "custodians,"ⁿ¹ such as sheriffs or receivers legally appointed to take charge of the debtor's property, and section 542 applies to all other "entities."ⁿ²

[1] General Rules

Very simply, section 542 requires that any entity, other than a custodian, in possession, custody, or control of property that the trustee³ may use, sell, or lease, or that the debtor may exempt, must immediately deliver to the trustee such property or the value of such property, unless the property is of inconsequential value or benefit to the estate.ⁿ⁴ Its purpose is to assist in the gathering up of all property of the estate for the liquidation or reorganization that will take place in bankruptcy, as well as to effectuate the debtor's right to claim exemptions.

This general rule has few exceptions, stated in later subsections and not often applicable in consumer cases. Except for these, the rule normally applies to all property of the estate, because an individual debtor may usually choose to exempt any property of the estate,ⁿ⁵ *i.e.*, any property in which the debtor has any legal or equitable interest.ⁿ⁶ It applies no matter where the property is located and no matter how it was acquired by the entity in possession.ⁿ⁷ The rule also applies to recorded information, such as records subject to an attorney's lien.ⁿ⁸ Section 543 requires custodians to turn over "any property of the debtor transferred to" them, probably an even broader collection of property interests than that covered by section 542.ⁿ⁹

[2] Secured Parties in Possession

Unfortunately, due to poor drafting of the statute, a question arose as to whether an entity must surrender property in which the debtor's present interest does not include a possessory interest but only something less, such as a right of redemption, *e.g.*, an automobile validly repossessed just prior to the bankruptcy. Noting that only property of the estate can be used, sold, or leased under section 363, some courts concluded that the estate's property was only the right of redemption in such cases, and not the right of possession, so that turnover was not required.ⁿ¹⁰

This interpretation was unduly narrow, in that little would remain of section 542 if it were adopted. The principal

purpose of section 363 is to allow the trustee or chapter 13 debtor to continue to use, sell, or lease property that the creditor could otherwise repossess due to its security interest in the property. Indeed, even "cash collateral," such as bank deposits subject to a right of setoff by the bank, may be used if adequate protection is provided.ⁿ¹¹ Thus, it is evident that the debtor need not have a right to retain possession as of the commencement of the case in order to use, sell or lease property. For the same reason, if a debtor claims as exempt an equity interest in a repossessed vehicle, it is hard to see how that interest could be delivered except by return of the entire vehicle.

COMMENTARY

For chapter 11 cases, the Supreme Court has explicitly held that, at least when the debtor has more than bare legal title, turnover is required.ⁿ¹² Although the Court expressly declined to rule on the issue with respect to non-chapter 11 cases,ⁿ¹³ the logic employed in its decision also dictates turnover in chapter 13 cases in which property is necessary for the debtor's rehabilitationⁿ¹⁴ and perhaps in chapter 7 cases in which the right of redemption could be exercised.ⁿ¹⁵ Certainly, if the property has significant value that is not exempted by the debtor, a chapter 7 trustee will seek turnover to liquidate that value for the benefit of the creditors.ⁿ¹⁶

Thus, the turnover provisions should be very useful in regaining possession of repossessed automobiles, pledged goods,ⁿ¹⁷ goods subject to garagemen's, warehousemen's or artisans' liens, and any other property seized legally or illegally by a secured creditor prior to the bankruptcy.ⁿ¹⁸ A chapter 13 debtor may gain possession of the property, although the creditor's lien is preserved.

FOOTNOTES:

(n1)Footnote 1. "Custodian" is defined at 11 U.S.C. § 101. See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender).

(n2)Footnote 2. "Entity" is defined at 11 U.S.C. § 101. See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender).

(n3)Footnote 3. In a chapter 13 case the debtor exercises most of these trustee powers. See 8 Collier on Bankruptcy, chs. 1304 and 1306 (Matthew Bender).

(n4)Footnote 4. See generally 5 Collier on Bankruptcy, P 542.02 (Matthew Bender).

(n5)Footnote 5. See ch. 13 *infra* for a discussion of what property may be exempted.

(n6)Footnote 6. 11 U.S.C. § 541.

(n7)Footnote 7. But see *In re James*, 940 F.2d 46 (3d Cir. 1991) (court may not order turnover of currency confiscated as proceeds of drug transaction).

(n8)Footnote 8. 11 U.S.C. § 542(e). See 5 Collier on Bankruptcy, P 542.06 (Matthew Bender); 2 Collier Bankruptcy Manual, P 542.06 (Matthew Bender).

(n9)Footnote 9. See 5 Collier on Bankruptcy, P 543.03 (Matthew Bender); 2 Collier Bankruptcy Manual, P 543.03 (Matthew Bender).

(n10)Footnote 10. See, e.g., *In re Avery Health Center*, 8 B.R. 1016 (W.D.N.Y. 1981), overruled *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 103 S. Ct. 2309, 76 L. Ed. 2d 515, 8 C.B.C.2d 710 (1983).

(n11)Footnote 11. 11 U.S.C. § 363(c). *In re Brown*, 106 B.R. 546 (Bankr. N.D. Ill. 1989) (debtor entitled to turnover of bank account subject to IRS levy upon showing that IRS was being adequately protected). But see *Matter of Lyons*, 957 F.2d 444 (7th Cir. 1992) (trustee could not compel turnover of retirement funds, even though they were estate property, when debtor had no right to withdraw them or use them).

(n12)Footnote 12. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 103 S. Ct. 2309, 76 L. Ed. 2d 515, 8 C.B.C.2d 710 (1983) . See also *In re Challenge Air Int'l, Inc.*, 952 F.2d 384 (11th Cir. 1992) (third party required to turn over to chapter 11 debtor funds subject to IRS levy).

(n13)Footnote 13. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 208 n.17, 103 S. Ct. 2309, 2315 n.17, 76 L. Ed. 2d 515, 524 n.17, 8 C.B.C.2d 710, 717-718, n.17 (1983) .

(n14)Footnote 14. *In re Moffett*, 356 F.3d 518 (4th Cir. 2004) (repossession did not terminate debtor's interest under Virginia law and turnover required); *In re Rozier*, 376 F.3d 1323 (11th Cir. 2004) , relying upon answer to certified question, *Motors Acceptance Corp. v. Rozier*, 278 Ga. 52, 597 S.E.2d 367 (Ga. 2004) . But see *In re Lewis*, 137 F.3d 1280 (11th Cir. 1998) (erroneously holding that turnover not required because debtor has only right of redemption after repossession under Alabama law).

(n15)Footnote 15. See *In re Gerwer*, 898 F.2d 730 (9th Cir. 1990) (trustee may obtain turnover from secured party in possession in chapter 7 case).

(n16)Footnote 16. See 6 *Collier on Bankruptcy*, P 704.02 (Matthew Bender), 2 *Collier Bankruptcy Manual*, P 704.02 (Matthew Bender) for discussion of trustee's duty to liquidate estate.

(n17)Footnote 17. *In re Dunlap*, 143 B.R. 859 (Bankr. M.D. Tenn. 1992) (property in possession of pawnbroker must be turned over to chapter 13 debtors if debtors provide adequate protection).

(n18)Footnote 18. But see *In re Boggan*, 251 B.R. 95 (B.A.P. 9th Cir. 2000) (mechanic did not have to turn over debtor's car, held pursuant to mechanic's lien because maintaining possession of car was necessary to preserve existence of lien, and maintaining possession was therefore within exception to stay provided by section 363(a)(3)).



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CHAPTER 11 Turnover of Property Held by Third Parties

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P 11.02 Penalties for Failure to Comply with Turnover Requirements

A willful failure to turn over assets seized prepetition may constitute an actionable violation of the automatic stay.ⁿ¹ Additionally, failure to turn over property in a timely fashion may result in disallowance of a creditor's claim.ⁿ²

Similarly, even if property has been legally seized after the filing of the petition, there is a duty to turn it over if it is property of the estate.

FOOTNOTES:

(n1)Footnote 1. *In re Knaus*, 889 F.2d 773 (8th Cir. 1989) (refusal to turn over property lawfully seized prepetition after being given notice of the stay constitutes violation of the automatic stay remediable pursuant to § 362(h)); *In re Abrams*, 127 B.R. 239 (B.A.P. 9th Cir. 1991) (retention of repossessed automobile after receiving notice of the bankruptcy is a willful violation of the stay).

(n2)Footnote 2. 11 U.S.C. § 502(d). See *Matter of Davis*, 889 F.2d 658 (5th Cir. 1989) (IRS entitled to a reasonable time to turn over property before its claim is disallowed).



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P 11.03 Obtaining Possession through Demand or Negotiation

PLANNING NOTE

Theoretically, a party obligated to turn over property should do so immediately upon notice of the bankruptcy case. The first step that should be taken on behalf of the debtor or trustee is to give the creditor or other party in possession notice of the case, both formal and informal, in a manner similar to that used to give notice of the automatic stay.

Also, it is important to give notice of the case promptly to any holder of property not only to obtain a turnover, but to prevent the complications that could arise from a transfer to a third party by a holder without notice. It is clear that the holder incurs no special liability for such a transfer,ⁿ¹ and thereafter the property may not be recoverable. However, there are good arguments that the estate retains ownership of the property because rights were frozen as of the filing of the case.ⁿ²

FORMS

For forms of letters demanding turnover of property *Collier Consumer Bankruptcy Forms, Form CS24.02-1* (Matthew Bender).

In practice, many holders refuse to turn over property. Some simply do not believe that they are required to do so, because these provisions are not nearly as clear as those setting out the automatic stay. In such cases, there is no alternative but to obtain a court order for turnover, seeking immediate interlocutory relief if necessary.ⁿ³

Other holders refuse to turn over property on the grounds that they are entitled to adequate protection. Courts are divided as to whether a creditor can refuse turnover prior to receiving adequate protection.ⁿ⁴ In jurisdictions where courts have ruled that the turnover must occur regardless of adequate protection, the debtor should enforce that right. In jurisdictions in which courts have ruled that creditors may demand adequate protection, or if the issue has not been definitively resolved, it is best to negotiate such adequate protection, if possible, because as a practical matter the court may require it before issuing a turnover order. If the property sought is to be used, sold or leased, then the creditor with a lien on the property may demand that this be done only if adequate protection is provided.ⁿ⁵ As to any property that the secured party would otherwise have a right to repossess or sell, that party could respond to a debtor's turnover complaint, requesting termination of the automatic stay if adequate protection is not provided.

An agreement to turn over possession may be negotiated either before or after legal action has been instituted by the trustee. If the issue of adequate protection is raised and an understanding is reached providing for a payment to the third party or the assignment of a lien on other property, court approval should be obtained.ⁿ⁶ When the third party is a secured creditor and the negotiations result in an agreement to make periodic payments, it is to the advantage of the secured party that the payments be described in terms of adequate protection. A reference to the payments as a means of adequate protection could be significant if the creditor nevertheless later sustains a loss and seeks the superpriority allowed in such situations under section 507(b).

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 542(c)*.

(n2)Footnote 2. *See* discussion of *11 U.S.C. § 549* and *550* in ch. 17 *infra* as to voidability of postpetition transfers.

(n3)Footnote 3. *See P 11.04 infra*.

(n4)Footnote 4. *Compare In re Sharon*, 234 B.R. 676 (B.A.P. 6th Cir. 1999) ; *In re Berscheid*, 223 B.R. 579 (Bankr. D. Wyo. 1998) with *In re Nash*, 228 B.R. 669 (Bankr. N.D. Ill. 1999) .

(n5)Footnote 5. *11 U.S.C. § 363(e)*. *In re Brown*, 106 B.R. 546 (Bankr. N.D. Ill. 1989) (debtor entitled to turnover of bank account subject to IRS levy upon showing that IRS was being adequately protected). In chapter 13 cases, adequate protection will often consist of payments under the plan. *See P 10.02[1] supra*.

(n6)Footnote 6. *See* ch. 10 *supra*.



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P 11.04 Bringing a Turnover Proceeding

If the party with possession of property refuses to negotiate a turnover of the property, a proceeding to enforce the right to turnover is usually necessary. Such a proceeding comes within the scope of *Federal Rule of Bankruptcy Procedure 7001* and is, therefore, an adversary proceeding. All the provisions in Part VII of the Bankruptcy Rules apply, including those relating to formal pleadings, discovery procedures and trial.

[1] Pleadings

The pleadings in an adversary proceeding such as an action under section 542 are virtually the same as in district court civil litigation. Part VII of the Bankruptcy Rules governs adversary proceedings and sets forth the time periods within which each pleading must be filed. The complaint and answer are the minimum requirements, but a counterclaim may also be included by the defendant. Motion practice within the proceeding is substantially the same as in other civil litigation, which often is subject to local rules and customs.

[2] Complaint

After the jurisdictional allegations, the complaint under the federal system of notice pleading should only contain a simple and concise statement of the basis of the claim. The plaintiff should, of course, be identified as the debtor or trustee. The defendant should also be identified as the party in possession of property of the estate or as a party who was in possession of property of the estate at some time after the commencement of the proceeding. The property of the estate which is the subject matter of the action should be described briefly and how it became property of the estate should be stated. Generally this will mean that it was property of the debtor at the time the proceedings were instituted. The plaintiff should also allege that plaintiff can use, sell or lease the property as provided in section 363 or that the debtor may exempt the property.

PRACTICE NOTE

It is unnecessary to set forth, in addition, that plaintiff can meet the other conditions of section 363, as those conditions are more in the nature of affirmative defenses. In other words, it is unnecessary to allege that adequate protection can be provided. In a sense, such an allegation would be anticipating the defense of the third party in possession. Although the trustee has the burden of proof on the issue of adequate protection, that issue does not arise until the party in possession alleges an interest in the property and

requests the court to prohibit or condition the use, sale or lease of the property until adequate protection has been provided.

The prayer for relief should consist of a demand for judgment of possession or an order directing the defendant to turn over possession or, as an alternative, an order for an accounting for the property or its value. Because retaining property of the estate has been held to be a violation of the automatic stay, the prayer for relief should also demand any compensatory damages and attorney's fees, as well as punitive damages if appropriate.

FORMS

For forms of complaint by debtor seeking turnover of exempt property *see Collier Consumer Bankruptcy Forms, Form 24.03-1* (Matthew Bender).

[3] Interlocutory Relief

In some cases, it is important to obtain possession of property quickly because it is necessary to the debtor's production of income, such as a car required to get to work. These situations often require a request for preliminary relief by way of a temporary restraining order or preliminary injunction. The procedure for obtaining such relief is governed by adversary proceeding rules which incorporate the provisions of the Federal Rules of Civil Procedure dealing with the same issues.



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P 11.05 Response of Secured Creditor or Other Party in Possession

In many situations, especially once an adversary proceeding has been filed, the best response for the secured creditor is to turn over the property in question. There is often no valid defense to the debtor's or trustee's action and litigation may only result in wasted expense, additional damages for loss of use, and the risk of sanctions. Moreover, the secured creditor is often better off if the debtor can retain the property and complete a plan, paying all or most of the secured creditor's claim through the plan, than if the creditor forecloses on the property.

[1] Response to Complaint

The defendant may raise issues by the filing of motions before filing an answer to the complaint.ⁿ¹ For example, any question with respect to venue or transfer of the action to another district may be brought before the court by motion. The filing of a motion will extend the time to file an answer until the motion is disposed of. A motion to dismiss may also be used to test the sufficiency of the averments of the complaint although in notice pleading it is unusual to find a court dismissing a complaint on that ground.

DRAFTING NOTE

Defenses on the merits are raised by the filing of an answer. The usual rules of pleading applicable under Part VII of the Bankruptcy Rules will apply. Factual averments in the complaint should be admitted or denied and affirmative defenses set forth separately. Since it appears that a debtor or trustee is probably not required to allege an ability to provide adequate protection under section 363 as part of the cause of action, a third party defendant claiming an interest in the property of the estate should set forth that it is entitled to adequate protection if it intends to raise such defense. Although the burden of pleading and perhaps of going forward with the evidence on the issue of adequate protection rests upon the third party claiming an interest in the property of the estate, the Code clearly places the ultimate burden of proof upon the debtor or trustee.

[2] Seeking Relief from the Stay

PLANNING NOTE

In addition to the filing of an answer contesting the merits of a complaint to recover property, a third

party should consider whether to file a counterclaim or a motion for relief from the automatic stay of *section 362 of the Bankruptcy Code*. While it is true that relief from the automatic stay does not require an adversary proceeding, but may be obtained by motion, no sound reason exists why relief from the automatic stay may not be requested in a counterclaim in an adversary proceeding seeking to compel the turnover of property. However, since the timetable for deciding adversary proceedings is longer than that for contested matters, a party seeking relief from the stay by way of a counterclaim may be deemed to have waived the expedited scheduling guaranteed by *section 362(e) of the Bankruptcy Code*. Even if a separate motion for stay relief is filed, though, the parties may agree that all of the issues should be resolved in a single hearing.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 7012*. See 10 Collier on Bankruptcy, ch. 7012 (Matthew Bender).



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P 11.06 Litigation of the Turnover Proceeding

[1] Discovery

All the rules under Part VII of the Bankruptcy Rules with respect to discovery will apply equally to an action under section 542. This includes the use of depositions, interrogatories and requests for production of documents. In simple cases when the factual issues are not extensive, the practice in bankruptcy cases is to expedite the proceedings and usually discovery is not sought. When discovery is requested, the court may in its discretion limit its use. An early hearing may be more desirable and more practical.

However, in other cases discovery may be useful, especially with respect to issues of valuation and damages. In dealing with the question of adequate protection, the value of property will generally be important and both sides may find it necessary or appropriate to obtain appraisals and to use expert witnesses. The exchange of such evidence before trial may well expedite the final hearings and the use of discovery techniques in those cases will undoubtedly be permitted.

PRACTICE NOTE

With respect to damages, the plaintiff may wish to prove that the defendant regularly ignores turnover requests. Evidence to that effect strengthens a claim for punitive damages. On the other hand, the defendant may seek discovery regarding actual damages claimed by the plaintiff.

[2] Trial

When the property sought to be recovered by the trustee is not of substantial value, the court will probably schedule a prompt trial. A pretrial conference is often held to narrow the issues and perhaps even serve as a means of disposing of the case.

Ordinarily, in civil litigation, the plaintiff has the burden of proving all the elements of his cause of action as alleged in the complaint or in a counterclaim. Under sections 362 and 363 of the *Bankruptcy Code*, the burden of proof is assigned according to issues, regardless of which party raises them. For example, under section 362(g) in an action to terminate or modify the automatic stay the party seeking to continue the stay has the burden on all issues with the exception of the debtor's equity in property. Similarly, under section 363(p) the debtor or trustee has the burden of proof on the issue of adequate protection, but the party asserting an interest in property has the burden of proof on the issue of the validity,

priority, or extent of such interest.ⁿ¹ Normally, a debtor or trustee will also offer evidence of damages due to loss of use, including lost wages, alternative transportation or other expense, or simply the value of the use in terms of rental costs that would have to be incurred.

[3] Judgment

If the trial results in a finding against the plaintiff, the judgment is simply an order dismissing the complaint or denying the relief requested. If the plaintiff succeeds, then the judgment entered in his or her favor will be a direction to the defendant to turnover the property which is the subject of the complaint unless the property is no longer available and an accounting has been requested. In the latter event, the judgment will be for an accounting and may include a direction to the defendant to pay to the plaintiff the value of the property. It will be helpful for the plaintiff to submit to the court a written order or judgment in the form appropriate to the facts of the case.

Since continuing to exercise control over property of the estate is a violation of the automatic stay, as well as section 542,ⁿ² the judgment may include sanctions under section 362(k) or a contempt order, including damages and attorneys' fees.ⁿ³

DRAFTING NOTE

In any event, the form of the order should carefully describe the property to be returned so that there will be little dispute in the way the order is carried out. The judgment should also indicate the time within which the order is to be complied with if there is to be any delay. If the order is to be performed forthwith the judgment should so state. In some cases, a question may arise as to the expenses in removing the property from the premises of the third party and transferring it to those of the plaintiff. The payment of these expenses should be made a provision of the order or judgment.

[4] Enforcement of Judgment

If the third party does not respond to the judgment by returning the property or paying the amount awarded for its value if that is the form of the judgment, the enforcement of the judgment must be sought. Execution on a judgment entered in the bankruptcy court is, of course, available in the same manner that a judgment may be enforced in ordinary civil litigation. If the judgment is in the form of an order to make payment of a sum of money representing the value of the property, then the plaintiff may make use of the ordinary forms of execution, including a levy on or attachment of property of the defendant. But if the judgment is for the return of specific property in kind, then a failure to obey the judgment will justify the issuance of a writ of seizure. Execution by seizure would be similar to that available in the enforcement of a judgment in a replevin action.

The failure to obey the judgment in an action under section 542 will also support a contempt citation.

FOOTNOTES:

(n1)Footnote 1. Formerly 363(o), as redesignated by Pub. L. No. 109-8 (2005).

(n2)Footnote 2. *In re Hill*, 174 B.R. 949 (Bankr. S.D. Ohio 1994) .

(n3)Footnote 3. Formerly 362(h), as amended and redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See Thompson v. GMAC, LLC*, 566 F.3d 699 (7th Cir. 2009) (refusal to return car that was repossessed prepetition is violation of stay); *General Motors Acceptance Corp. v. Ryan*, 183 B.R. 288 (M.D. Fla. 1995) (retention of property was stay violation; creditor cannot wait until debtor files turnover complaint after receiving request for turnover); *In re Cordle*, 187 B.R. 1 (Bankr. N.D. Cal. 1995) (failure to turn over insurance proceeds violated stay and justified sanctions).



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P 11.07 Issues of Possession After Turnover

It must be noted that section 542 requires turnover of property to the trustee, and not to the debtor. Nowhere does the Bankruptcy Code clearly spell out the procedure that should be used to transfer such property to the debtor in cases in which it seems clear the debtor should have possession of it. Thus, for example, if property that the debtor may exempt in a chapter 7 case is turned over to the trustee, the trustee may not feel free to relinquish it immediately to the debtor before the exemptions are approved.

It seems fairly obvious that the intent of the Code is that debtors should have possession of exempt property during the case; they are not expected to relinquish their household goods pending approval of the exemptions claimed. In fact, the exemptions are approved automatically if there is no objection to them.ⁿ¹ Moreover, such goods are rarely of any use to the trustee who would incur needless expense in storing and preserving them. In view of all this, and the general purpose of the exemptions to allow the debtor to maintain a modest standard of living, there can be little doubt that property claimed as exempt should be immediately relinquished to the debtor by a trustee to whom it is turned over under section 542, at least absent a serious dispute about the exemption claim.

PLANNING NOTE

Until this issue is definitively resolved, however, it is best to avoid having to litigate it. As much exempt property as possible should be in the debtor's possession immediately before the case is commenced. All monies should be withdrawn from bank accounts, so that access to them is not prevented because they were turned over to the trustee or frozen. If possible, the filing should be delayed until after receipt of a tax refund, because the Internal Revenue Service also frequently pays such refunds to the trustee rather than to the debtor.

In chapter 13 cases, the situation is somewhat more clear. Because *section 1306 of the Bankruptcy Code* provides that the debtor is to remain in possession of all property of the estate, there is no reason for the trustee to retain any property turned over to him or her. Such property should be promptly delivered to the debtor. Indeed, it is unfortunate that there is no provision requiring turnover directly to the debtor to obviate the necessity for any trustee involvement, because in most cases, the right to use, sell, or lease property is that of the debtor, exclusive of the trustee.ⁿ²

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 522(l)*.

(n2)Footnote 2. *11 U.S.C. § 1303*. See 8 Collier on Bankruptcy, ch. 1303 (Matthew Bender).



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CHAPTER 12 Utility Services in Bankruptcy Cases

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§ 12.syn Synopsis to Chapter 12: Utility Services in Bankruptcy Cases

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CHAPTER 12 Utility Services in Bankruptcy Cases

1-12 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter discusses the rights of debtors and of utility providers under *section 366 of the Bankruptcy Code*, including notice procedures, grounds for termination, and adequate assurance requirements. The chapter also covers the special protections for customers of governmental utilities as well as the procedures to be followed by both the debtor and utility provider in ensuring that rights are protected.



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CHAPTER 12 Utility Services in Bankruptcy Cases

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P 12.01 Protection Afforded by Section 366

Closely akin to the automatic stay provisions of *section 362 of the Bankruptcy Code* are the provisions regarding refusal to provide utility service in section 366. While the general purpose of this section closely parallels that of the automatic stay, its operation and effect are somewhat different.

Obviously, it is critical for debtors to have access to utility services after a bankruptcy case is filed. Since such services are often provided by monopolies, which might refuse services to those who had not paid for them in the past, the Bankruptcy Code contains special provisions assuring that utility services are available, but also protecting the providers against a default in payments. Because the primary purpose of the section is to assure that a debtor can obtain vital services, the elimination of monopolies by deregulation should not free providers of services such as water, gas, electricity and telephone, from the requirements of section 366.ⁿ¹

FOOTNOTES:

(n1)Footnote 1. *See Collier on Bankruptcy P 366.05* (15th ed. Revised); *One Stop Realtour Place, Inc. v. Allegiance Telecom, Inc.* (*In re One Stop Realtour Place, Inc.*), 268 B.R. 430 (Bankr. E.D. Pa. 2001) (deregulated local telephone service provider was "utility" under § 366).



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CHAPTER 12 Utility Services in Bankruptcy Cases

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P 12.02 Service within 20 Days After Bankruptcy Case is Filed

The first part of section 366 sets forth a general rule for at least the first 20 days after the petition is filed. No utilityⁿ¹ may "alter, refuse, or discontinue service or discriminate against" the debtor solely on the basis of an unpaid prepetition debt or the filing of a bankruptcy case during that time period.ⁿ²

[1] Notice to Utility Provider

PLANNING NOTE

Section 366(a) clearly prohibits a utility with notice of the case from shutting off the debtor's utility service in the first 20 days after the bankruptcy petition is filed. Thus, the debtor should be sure to give notice of the case to utility providers if there is any chance that service would be terminated otherwise. Swift court relief, as well as possible fines and attorney's fees, should be available for illegal shutoffs.ⁿ³

In any event, if the utility provider is listed as a creditor, it will receive notice of the case when it is sent the notice of the meeting of creditors, normally within about twenty days after the case is filed.

[2] Disputes About Grounds for Termination

One problem that may occasionally arise is a shutoff which is ostensibly based not merely on the unpaid debt, but rather on defective equipment, an illegal hookup by the customer or some other reason. Naturally, such cases boil down to a problem of proof, with special attention being given to why the utility happened to terminate service immediately after bankruptcy.

PRACTICE NOTE

If the utility has at any time stated that a payment of money will cure the problem, it should not be hard to show that the shutoff was an attempt to collect money, rather than to protect the public from unsafe equipment. In fact, in such cases, the utility may also be liable for sanctions under section 362(h), if it can be shown that the shutoff was an effort to collect a prepetition debt.

[3] Restoration of Service

More complicated than termination of service after the petition is filed, which is rare, is the question of obtaining service if it was discontinued prior to the bankruptcy. Section 366(a) requires that the utility service be reinstated, because it cannot be "refused" solely on the basis of the unpaid debt. If service is refused due to an unpaid debt, section 366 is violated.ⁿ⁴

PRACTICE NOTE

However, a clever utility may argue that it requires an initial deposit from all customers and therefore is not refusing service based upon the unpaid debt.ⁿ⁵ The answer to this lies in whether the utility is "discriminating" on the basis of that debt. Under the utility's normal practices, would a deposit have been required of a new customer, or to effectuate a reinstatement of service if a customer had paid the back bill in full? In most cases the answer to this question is no, and in fact many state or local utility regulations provide that service can be reinstated if even a part of the prior bill is paid, with an agreement to pay the rest in installments. If this is the case, then a refusal to reinstate when the bill has not been paid should be considered discrimination solely on the basis of the unpaid debt.ⁿ⁶ However, a reasonable reconnection fee, if charged to all customers whose service is reinstated, could probably be required in these cases.

FOOTNOTES:

(n1)Footnote 1. The term "utility" covers any supplier of utility services with a monopoly position. The legislative history of section 366 states: "This section is intended to cover utilities that have some special position with respect to the debtor, such as an electric company, gas supplier, or telephone company that is a monopoly in the area so that the debtor cannot easily obtain comparable services from another utility." S. Rep. No. 987, 95th Cong., 2d Sess. 60 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5846. The cases have given the term a similarly broad reading. *In re Gehrke*, 57 B.R. 97 (Bankr. D. Or. 1985) (electric coop association is a utility); *In re Hobbs*, 20 B.R. 488 (Bankr. E.D. Pa. 1982) (condominium owners association that sells electricity to condominium owner treated as a utility for purposes of § 366). *But see In re Darby*, 470 F.3d 573 (5th Cir. 2006) (cable television not a utility when it was not a necessity).

(n2)Footnote 2. 11 U.S.C. § 366(a). *See* 3 *Collier on Bankruptcy*, P 366.02 (Matthew Bender).

(n3)Footnote 3. *See, e.g., In re Smith*, 170 B.R. 111 (Bankr. N.D. Ohio 1994) (actual damages and attorney's fees awarded for willful disconnection of telephone service after notice of bankruptcy).

(n4)Footnote 4. *In re Whittaker*, 882 F.2d 791 (3d Cir. 1989) .

(n5)Footnote 5. *See In re Roberts*, 8 C.B.C.2d 1403, 29 B.R. 808 (E.D. Pa. 1983) (deposit required before service provided where nonbankruptcy customer would be required to post deposit).

(n6)Footnote 6. *See In re Whittaker*, 882 F.2d 791 (3d Cir. 1989) ; *In re Kiriluk*, 76 B.R. 979 (Bankr. E.D. Pa. 1987) .



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CHAPTER 12 Utility Services in Bankruptcy Cases

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P 12.03 Service After 20 Days from the Filing of the Case

Section 366(a) is significantly limited by section 366(b) which provides that a utility may "alter, refuse or discontinue service" if the debtor does not, within 20 days after filing of a voluntary petition, furnish adequate assurance of future payment. Prior to the 2005 amendment enacting section 366(c),ⁿ¹ section 366(b) governed the provision of adequate assurance in all cases. Although it does not specifically so state, section 366(c), rather than section 366(b) appears to govern the provision of adequate assurance in chapter 11 cases.ⁿ² Adequate protection in consumer cases under chapter 7 and chapter 13 continues to be controlled by section 366(b).

[1] Procedure

Section 366(b) reads, at first glance, as if it is self-executing, and it is generally understood to mean that the utility may terminate service after 20 days without special permission from the court if it does not believe adequate assurance has been provided.ⁿ³

PRACTICE NOTE

If this is the case, then it behooves the debtor to come to some agreement with the utility as to what is adequate assurance before the 20 days has run. But counsel should become familiar with local practice regarding adequate assurance since, for example, some utilities do not require deposits or other forms of adequate assurance except in extraordinary cases. In cases in which there is a dispute, the debtor must seek the court's intervention along with preliminary relief if the utility will not agree to continue service.

However, a utility may take substantial risks in terminating service when the debtor has tendered what he or she believes to be adequate assurance. The second sentence of section 366(b) states that "[o]n request of a party in interest and after notice and a hearing, the court may order reasonable modification of the amount ...necessary to provide adequate assurance." Thus, the "parties in interest" required to seek court modification of a deposit or security with which they do not agree include the utility providers.

COMMENTARY

If a utility does not seek a determination regarding adequate assurance before altering service and if a court later determines the amount that had been tendered by a debtor sufficient for adequate assurance, it

can be strongly argued that the utility provider is in contempt of the requirements of section 366(b).ⁿ⁴ This reading, which places utilities terminating service without court permission at risk of contempt, more closely parallels the operation of the automatic stay provisions, as well as the executory contract provisions,ⁿ⁵ as section 366 was intended to do.ⁿ⁶

MORE INFORMATION

Automatic stay provisions are discussed further in chapter 8 *supra* and chapter 15 *infra* provides a detailed discussion of executory contracts and unexpired leases.

In most places the typical procedure is for the utility to send a notice to the debtor or the debtor's counsel containing a demand for the amount of deposit it seeks as adequate assurance. The notice usually provides 20 days from the date of the notice for the debtor to make the payment, or the first installment of several payments. However, some utility providers never seek adequate assurance, even though they are entitled to it.

[2] Forms of Adequate Assurance of Future Payment

In chapter 7 and chapter 13 cases, "adequate assurance" is not defined other than by reference to "[a] deposit or other security."ⁿ⁷ Certainly, the former of these is the most common in consumer cases. However, it is clear from the statute that there are other possibilities, including the voluntary granting of a lien on property of the debtor to be available in the event of a postpetition delinquency. In some states it may be possible to have a prepetition security deposit applied to provide postpetition adequate assurance.ⁿ⁸ Still another way of giving adequate assurance, at least in a chapter 13 plan in which significant payments are being made, would be the granting of priority status to any delinquent debt for postpetition utility service. This is clear both from the legislative history,^{n8a} and because there is no specific exclusion of the granting of an "administrative expense" (and thus priority status) in section 366(b) similar to that in section 366(c)^{n8b} or section 361.^{n8c} In short, adequate assurance may be given in any way that protects the utility from an unreasonable risk of nonpayment, even if it falls short of an absolute guarantee.ⁿ⁹

[3] Adequate Assurance Not Always Required

Adequate assurance is not always required. For example, it is clear in most places that service cannot be terminated if the bill is fully current. The mere filing of a bankruptcy petition should not suddenly give the utility the right to terminate in such a case. Another indication that it was not the intent of Congress to give the utilities greater rights than they already have under state law is that "discrimination," prohibited in section 366(a), is conspicuously omitted from the actions allowed in section 366(b) if adequate assurance is not provided. This conclusion is also supported by statements in the original Report of the Bankruptcy Commission that the term "adequate assurance," in a slightly different context, is not intended to give the nondebtor party greater rights in a case than it would otherwise have.

COMMENTARY

Thus, if the state regulations do not require any deposit for continuance of service to someone who pays a prior utility bill before termination, it can also be argued that it would be discrimination to require a deposit from a debtor in bankruptcy whose utility bills are current.ⁿ¹⁰ Alternatively, the debtor's past record of prompt payments should be considered, in itself, adequate assurance.ⁿ¹¹

Similarly, if a utility never requires a deposit from a new customer, then it should not be able to require one from a bankruptcy debtor, because that would be discrimination based upon the unpaid debt.ⁿ¹² However, in a case in which a previous security deposit was applied to pay the prebankruptcy debt, a utility may argue that it has the right to maintain the security deposit it would have been holding had the debt been paid in full.

[4] Amount Necessary for Adequate Assurance

The guidelines to be used in determining the amount necessary for adequate assurance have slowly emerged from case law. Although the precise amount varies from case to case, the courts have tended to look to "all of the circumstances," including the prebankruptcy history of the debtor, the nature of the debtor, how much was owed, the previous course of dealing and conduct on the part of the utility, the stability of the debtor's present circumstances, the speed with which the utility may terminate service, the frequency of payments, and the likely usage of the utility in months to come.ⁿ¹³ Adequate assurance need not be the equivalent of a guaranty of payment.ⁿ¹⁴ When the prepetition debt is small, the debtor and utility may agree that the debtor will voluntarily pay that debt as adequate assurance or the debtor may, with court approval, waive the automatic stay with respect to that debt.ⁿ¹⁵

Other factors that might be considered include the time of year (a deposit of one average monthly payment could pay for six months' heating service in nonwinter months), the possibility of sureties, and the likely availability of energy assistance for some consumers. One reported case that considered the matter used most of these factors and finally set a deposit approximately equal to one upcoming winter month's bill, payable in three monthly installments by the debtor, with the utility to refund half of the deposit, with interest, a year later, and the other half according to its normal practice. The court also provided for speedy termination in the event of nonpayment.ⁿ¹⁶

In any event, state utility regulations should set an upper limit on the amount of a deposit required.ⁿ¹⁷ While it is clear that the bankruptcy court has the power to set a lower deposit than required by such regulations for reinstatement,ⁿ¹⁸ the utility should have a heavy burden to show its entitlement to a deposit higher than the legal limit under state law deemed reasonable by the state regulatory body for even the worst cases.ⁿ¹⁹

COMMENTARY

However, it should be added that there seems to be nothing which would prevent the bankruptcy court from ordering continued service conditioned on prompt payments and specifically allowing a waiver of normal state termination procedures, with or without an additional court order, if those payments are not made. The debtor may, in fact, propose such a solution as a last resort if it is impossible to otherwise provide adequate assurance. Obviously, such a waiver of state protections involves significant risk to the debtor and should be considered only with the greatest caution.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. Adequate protection in chapter 11 cases is beyond the scope of this work. For more information see 3 *Collier on Bankruptcy*, P 366.03 (Matthew Bender).

(n3)Footnote 3. See 3 *Collier on Bankruptcy*, P 366.03 (Matthew Bender).

(n4)Footnote 4. See, e.g., *Matter of Tabor*, 46 B.R. 677 (Bankr. S.D. Ohio 1985) (utility fined \$250 as sanctions for contempt of court and \$526 in damages for applying amount tendered to prepetition debt and requesting excessive amount as adequate assurance).

(n5)Footnote 5. See ch. 15 *infra*.

(n6)Footnote 6. See 3 *Collier on Bankruptcy*, P 366.02 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 366.02 (Matthew Bender).

(n7)Footnote 7. 11 U.S.C. § 366(b). Section 366(c), added in 2005, does define "assurance of payment" with respect to chapter 11 cases. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

However, this section is inapplicable to consumer cases.

(n8)Footnote 8. *In re Cole*, 104 B.R. 736 (Bankr. D. Md. 1989) (prepetition security deposit that constituted exempt property of the estate could be used as postpetition adequate assurance). This strategy may not be available when the deposit secures a prepetition delinquency.

(n9)Footnote 8a. H.R. Rep. No. 595, 95th Cong., 1st Sess. 350 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n10)Footnote 8b. Section 366(c)(1)(B) specifically states that "administrative expense priority shall not constitute an assurance of payment" in chapter 11 cases. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. By implication this option remains available under section 366(b).

(n11)Footnote 8c. *See Virginia Electric and Power Co. v. Caldor, Inc.*, 117 F.3d 646, 38 C.B.C.2d 128 (2d Cir. 1997) (availability of administrative expense can be component of adequate assurance); *Steinebach v. Tucson Elec. Power Co.* (*In re Steinebach*), 303 B.R. 634 (Bankr. D. Ariz. 2003) (debtors delinquent in utility payments could provide for deposit in plan, for which utility could file proof of claim); *In re Epling*, 255 B.R. 549 (Bankr. S.D. Ohio 2000) (approving plan provision requiring any utility seeking a deposit to file an administrative claim to be paid by the trustee); *In re Hennen*, 17 B.R. 720 (Bankr. S.D. Ohio 1982) (every chapter 13 plan to include provision setting aside deposit out of initial payments to the trustee, to be held in reserve as adequate assurance for future service).

(n12)Footnote 9. *In re Keydata Corp.*, 4 C.B.C.2d 1018, 12 B.R. 156 (B.A.P. 1st Cir. 1981) .

(n13)Footnote 10. *See In re Heard*, 84 B.R. 454 (Bankr. W.D. Tex. 1987) .

(n14)Footnote 11. *Steinebach v. Tucson Elec. Power Co.* (*In re Steinebach*), 303 B.R. 634 (Bankr. D. Ariz. 2003) (utility has no unreasonable risk of nonpayment from debtor current in payments); *In re Demp*, 6 C.B.C.2d, 22 B.R. 331 (Bankr. E.D. Pa. 1982) .

(n15)Footnote 12. *See 3 Collier on Bankruptcy*, P 366.04 (Matthew Bender); *Steinebach v. Tucson Elec. Power Co.* (*In re Steinebach*), 303 B.R. 634 (Bankr. D. Ariz. 2003) (when utility not entitled to deposit under state regulations, those regulations provide guidance supporting decision that no deposit necessary under § 366(b)). *But see Hanratty v. Philadelphia Elec. Co.*, 907 F.2d 1418, 23 C.B.C.2d 1043 (3d Cir. 1990) (utility may require adequate assurance in bankruptcy even if it does not normally require security deposits from its new noncorporate customers).

(n16)Footnote 13. *In re Cunha*, 1 C.B.C.2d 154, 1 B.R. 330 (Bankr. E.D. Va. 1979) .

(n17)Footnote 14. *In re Adelphia Bus. Solutions, Inc.*, 280 B.R. 63 (Bankr. S.D.N.Y. 2002) .

(n18)Footnote 15. *In re Wells*, 280 B.R. 701 (Bankr. S.D. Ala. 2001) .

(n19)Footnote 16. *In re Cunha*, 1 C.B.C.2d 154, 1 B.R. 330 (Bankr. E.D. Va. 1979) .

(n20)Footnote 17. *See In re Kiriluk*, 76 B.R. 979 (Bankr. E.D. Pa. 1987) . *See also In re Cannon*, 2008 Bankr. LEXIS 1870 (Bankr. E.D. Wis. June 23, 2008) (debtor cannot be charged greater deposit than state regulations permit).

(n21)Footnote 18. *3 Collier on Bankruptcy*, P 366.03 (Matthew Bender.); *see also Sharon Steel Corp. v. National Fuel Gas Distrib. Corp.*, 871 F.2d 1217 (3d Cir. 1989) (court, not local regulating authority, has power to set terms under which service must be provided).

(n22)Footnote 19. *See In re Hennen*, 17 B.R. 720 (Bankr. S.D. Ohio 1982) (utility could not demand deposit in excess of that set by state regulation without violating § 366(a)).



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CHAPTER 12 Utility Services in Bankruptcy Cases

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P 12.04 Postpetition Termination Procedures

Once the debtor has provided adequate assurance to a utility, the involvement of the bankruptcy court normally ends. Absent a contrary procedure specifically ordered by the court or agreed to by the debtor as part of the adequate assurance, state law will govern the treatment of postpetition debts.ⁿ¹ Thus, any termination procedures required by state law or consumer rights provided by state law are applicable to debts arising after adequate assurance has been provided.ⁿ²

COMMENTARY

While the utility may argue that section 366(b), which allows termination after 20 days, overrides state regulations, there are several reasons why this argument should not prevail. Mainly, the overriding effect of the *Supremacy Clause* comes into effect only if there is a conflict between the state and federal law. Section 366(b) says only that the utility "may" discontinue service, not that it "shall" do so. If there are other reasons why, under state laws, the utility cannot discontinue service, then there is nothing which requires that those reasons be ignored.

If the debtor converts a case from chapter 13 to chapter 7, the preconversion postpetition usage is treated as a prepetition debt that is dischargeable debt.ⁿ³ The debtor may be required to again provide adequate assurance if there is a new delinquency, but cannot be required to pay for the postpetition usage to maintain service.ⁿ⁴

FOOTNOTES:

(n1)Footnote 1. *Begley v. Philadelphia Elec. Co.*, 760 F.2d 46, 12 C.B.C.2d 1000 (3d Cir. 1985) .

(n2)Footnote 2. *Id.*

(n3)Footnote 3. 11 U.S.C. § 348(d).

(n4)Footnote 4. *In re Davis*, 311 B.R. 922 (Bankr. M.D. Ga. 2004) .



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CHAPTER 12 Utility Services in Bankruptcy Cases

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P 12.05 Possible Special Protections for Customers of Governmental Utilities

There is a significant question as to the interplay of section 366 with *section 525 of the Code*, which prohibits discrimination by a governmental unit with respect to the granting of a "license, permit, charter, franchise, or other similar grant," solely because of bankruptcy or because of nonpayment of a debt discharged in bankruptcy. Assuming that the right to use normally monopolized utility service is some sort of license or grant, there is a good argument that the two sections must be read together in those frequent cases where utilities are also "governmental units."ⁿ¹

COMMENTARY

Reading these two sections together would mean that there could be no discrimination by such utilities based upon dischargeable debts and that bankruptcy debtors should be treated the same as persons who never had a debt to the utility.ⁿ² Since consumers in the latter category need not supply a deposit for continued service, bankruptcy debtors should not be required to do so either. Following the same rationale, for a reinstatement of service, debtors should have the same rights as someone who had no previous debt to the utility or to any of the other creditors listed in the petition. If such persons need not pay a deposit to obtain service under the utility's normal practices, then debtors should be given the same treatment.

In support of this argument, it should be noted that nothing in section 366 requires the utility to demand a deposit. Therefore, there is no contradiction between section 366 and section 525, and normal rules of statutory construction require that every effort be made to read the two sections harmoniously.

MORE INFORMATION

Chapter 30 *infra* provides a discussion of section 525 and examines other discrimination protections in more detail.

FOOTNOTES:

(n1)Footnote 1. "Governmental unit" is defined at *11 U.S.C. § 101*. See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender).

(n2)Footnote 2. See discussion of § 525 in ch. 30 *infra* .



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CHAPTER 12 Utility Services in Bankruptcy Cases

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P 12.06 Seeking a Court Determination of Amount Necessary for Adequate Assurance

Upon a failure to agree regarding adequate assurance, either the debtor or the utility provider may seek a determination by the court. The appropriate form of proceeding is a contested matter, initiated by a motion and governed by *Federal Rule of Bankruptcy Procedure 9014*. Usually, if the debtor has been receiving utility service and has tendered some form of adequate assurance, the utility is well-advised to continue the status quo during the short period until the court's decision, rather than to terminate service and thereby possibly indicate disrespect for the court's processes. As discussed above, termination of service may be contempt of court if the amount tendered is found to have been adequate.

FORMS

For forms of motions for modification of security deposit for utility service see *Collier Consumer Bankruptcy Forms, Form CS25.12-1* (Matthew Bender).

MORE INFORMATION

See ch. 32 *infra* for discussion of procedure in contested matters.

Of course, the filing of a motion may enhance the likelihood of settling on an agreeable amount, since both parties would then have the incentive to avoid litigation costs. If a hearing is held on the issue, the court can be expected to take evidence on and consider the factors identified above in deciding the appropriate amount



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CHAPTER 12 Utility Services in Bankruptcy Cases

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P 12.07 Enforcing Rights Under Section 366

The bankruptcy court has jurisdiction to enforce section 366,ⁿ¹ and a proceeding to enforce that section is a core proceeding affecting the administration of the bankruptcy case.ⁿ² Like enforcement of the automatic stay and the turnover provisions of the Code, enforcement of section 366 is usually achieved through an adversary proceeding seeking injunctive relief and sanctions such as money damages. If the utility has attempted to coerce payment of the prepetition debt, the complaint may also plead a violation of the automatic stay and seek attorney's fees and punitive damages under section 362(k).ⁿ³ If the utility is a governmental utility, the complaint may seek damages and attorney's fees under *section 1983 of title 42, United States Code*, for actions under color of law that violate rights guaranteed by federal law.ⁿ⁴

FORMS

For forms of a complaint seeking to enjoin refusal to reconnect utility service and damages *see Collier Consumer Bankruptcy Forms, Form 25.22-1* (Matthew Bender).

Often, filing an adversary proceeding will bring about a quick settlement. If it does not, temporary relief may be necessary, through a temporary restraining order or preliminary injunction, pending the final outcome of the case. The procedures for obtaining such relief are the same as those under the Federal Rules of Civil Procedure in the federal district court. The adversary proceeding rules also mirror the federal civil rules in most other respects.ⁿ⁵

FOOTNOTES:

(n1)Footnote 1. *See 3 Collier on Bankruptcy, P 366.06* (Matthew Bender); *1 Collier Bankruptcy Manual, P 366.06* (Matthew Bender).

(n2)Footnote 2. *28 U.S.C. § 157(b)(2)*.

(n3)Footnote 3. *See ch. 8 supra*.

(n4)Footnote 4. *See ch. 5 supra*.

(n5)Footnote 5. *See ch. 32 infra*.



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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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§ 13.syn Synopsis to Chapter 13: Exemptions: Claiming and Objecting to Them

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CHAPTER 13 Exemptions: Claiming and Objecting to Them

1-13 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter begins with an overview of the bankruptcy estate. The chapter next turns to the significance of the exemption provisions in bankruptcy. The chapter defines exempt property, then goes on to discuss the types of property a debtor may exempt. The chapter then outlines the procedure for making the claim of exemptions, and the procedure for a creditor or a trustee to object to an exemption. Finally, the chapter discusses the continuing protection afforded to exempt property after discharge.



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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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P 13.01 The Bankruptcy Estate

Fundamental to understanding the Bankruptcy Code's exemption scheme is an understanding of the bankruptcy estate. The commencement of a chapter 7 or 13 case creates a bankruptcy estate, which consists of all property subject to the jurisdiction of the bankruptcy court. The estate is comprised of all of debtor's property wherever located and by whomever held.ⁿ¹ Section 541(a) contains an expansive definition of property that includes all legal or equitable interests in property whether tangible or intangible, real or personal. In addition section 541(a) enumerates six general categories as property of the estate that arguably might not have fallen within the broad definition. These six categories are community property belonging to both the debtor and his or her spouse in community property states, property recovered by the bankruptcy trustee pursuant to certain avoidance powers, liens transferred to the estate by the bankruptcy court, certain property interests acquired by the debtor within 180 days after the commencement of the bankruptcy case, proceeds or profits from property of the estate, and any property interest that the estate acquires after commencement of the case.

In a chapter 13 case the bankruptcy estate also includes certain property acquired after the commencement of the case.ⁿ² Specifically, section 1306(a)(1) makes any property of the kind specified in section 541 that is acquired after the commencement of the case but before the case is closed, dismissed or converted, property of the estate. Additionally, section 1306(a)(2) directs that post-petition wages earned by the debtor also become property of the estate.

[1] Property Excluded from the Estate

Section 541(b) lists those items that are specifically excluded from being property of the estate, and for the most part, these exclusions are quite narrow. Many of these exclusions will rarely apply in consumer cases. However, the 2005 amendments to the Bankruptcy Code³ created four new categories of property that are excluded from the estate which may be significant in consumer cases: (1) certain funds placed in an education individual retirement account (also known as Coverdell education savings account;ⁿ⁴ (2) certain funds used to purchase a tuition credit under a qualified state tuition program;ⁿ⁵ (3) amounts withheld from wages by an employer or received from an employee for payment of a contribution to an ERISA-qualified plan, deferred compensation plan, tax-deferred annuity, or health insurance plan regulated by state law;ⁿ⁶ and (4) an interest of the debtor in tangible personal property that is pawned.ⁿ⁷

In addition, ERISA-qualified plans and other types of spendthrift trusts continue to be excluded from the estate under section 541(c)(2).ⁿ⁸

[2] Relation to Exempt Property

Unlike the exclusions provided in section 541(b), exempt property is property of the bankruptcy estate. However, it is property that the debtor is permitted to retain in a chapter 7 liquidation case. Other than exempt property, all of the debtor's interests in property that have significant value are transferred to the trustee for the benefit of the creditors. Historically, the purpose of exemption law has always been to allow debtors to keep those items of property deemed essential to daily life. In the bankruptcy context, exemptions serve the overriding purpose of helping the debtor to obtain a fresh start by maintaining essential property necessary to build a new life.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 541(a)*.

(n2)Footnote 2. *11 U.S.C. § 1306(a)*.

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. *11 U.S.C. § 541(b)(5)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. *11 U.S.C. § 541(b)(6)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. *11 U.S.C. § 541(b)(7)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n7)Footnote 7. *11 U.S.C. § 541(b)(8)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 8. *See Patterson v. Shumate*, 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519, 26 C.B.C.2d 1119 (1992) .



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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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P 13.02 Importance of the Exemption Provisions

The availability of exemptions is usually key to the determination of whether to file a bankruptcy in the first place, and also the determination as to which type of bankruptcy case to file. If the debtor has significant amounts of property that are not exempt, and thus would be lost in a chapter 7 liquidation, a chapter 13 case is usually preferable. And in a chapter 13 case, the value of nonexempt property may determine the minimum that must be paid to unsecured creditors;ⁿ¹ if that amount cannot be paid through the plan, then a chapter 13 case may not be feasible.

MORE INFORMATION

For a general discussion of counseling the debtor about bankruptcy options and chapter choice *see* chapter 4 *supra*. Also, the "best interests of creditors" chapter 13 test is discussed further in chapter 14 *infra*.

The exemption provisions are also related to parts of the Bankruptcy Code discussed in other chapters of this Guide. They give to the debtor many of the trustee's powers to avoid prepetition transfers of property, as well as some additional powers to avoid transfers over and above those of the trustee. The turn-over provisions of *section 542 of the Bankruptcy Code* specifically require that property that is in the possession of a third party and that the debtor can exempt must be turned over to the trustee. Similarly, the right to redeem certain types of property from liens under *section 722 of the Bankruptcy Code* applies only to exempt or abandoned property.

MORE INFORMATION

Avoiding powers of the debtor are reviewed in chapter 18 *infra*. For a complete analysis of turnover of property held by third parties and the right to redeem property *see* chapters 11 *supra* and 25 *infra*, respectively.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 1325(a)(4).



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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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P 13.03 Definition of Exempt Property

The Bankruptcy Code contains no formal definition of the terms "exemption" or "exempt property." Fundamentally, these are the designations given to the property that the debtor is permitted to retain in a chapter 7 liquidation case. Other than the exempt property, virtually all of the debtor's interests in property that have significant value are transferred to the trustee for the benefit of creditors.

With some exceptions,ⁿ¹ exemptions do not affect valid security interests or other liens on property of the debtor.ⁿ² A debtor must usually pay the secured creditor the amount of its secured claim to eliminate a lien. Since the lien can be thought of as diminishing the debtor's interest in the encumbered property, only the value of the interest remaining after subtraction of the lien amount need be claimed as exempt.

Exemptions are claimed and determined with respect to the debtor's property at the time of commencement of the case, except to the extent additional property becomes property of the estate thereafter, in which case the value of property is determined on the date the property becomes property of the estate.ⁿ³ Ordinarily, if a case is converted to chapter 7 from chapter 13, property acquired since the filing of the chapter 13 petition need not be claimed as exempt since it is not property of the estate in the converted case unless it would have been property of the estate on the date the chapter 13 petition was filed.ⁿ⁴

The Bankruptcy Code does not specify when exempt property loses its previous character as property of the estate. Is it when the claim of exemptions is filed (at the commencement of the case in most instances)?ⁿ⁵ At the latest, it should be after the time for objections has passed.ⁿ⁶ Similarly, the Code does not address the question of who shall possess exempt property during the period before the time for objections has run. Courts have generally assumed that the debtor has the right to remain in possession of exempt property throughout the case; it is hard to imagine debtors delivering all of their household goods to the trustee.

WARNING

However, a debtor must be careful in using property, especially cash, the exemption of which might ultimately be in dispute.ⁿ⁷ Moreover, if the property comes into the hands of the trustee, because of a turnover or avoidance of a transfer, there are no guidelines as to when the trustee must deliver it to the debtor in a chapter 7 case. Presumably, in view of the purposes of exemptions discussed below, this

should be done promptly.ⁿ⁸ It is clear in a chapter 13 case that prompt delivery to the debtor is required, since the debtor is entitled to possession of all property of the estate.ⁿ⁹

Historically, the purpose of exemption laws has always been to allow debtors to keep those items of property deemed essential to daily life. Without this bare grubstake, it was feared that debtors could not retain the minimum of dignity and self-respect to which all members of a society are entitled. Also, it was feared that stripping debtors of all of their property would increase the chances of their becoming public charges, unable to maintain themselves without assistance.

In the bankruptcy context, exemptions serve the overriding purpose of helping the debtor to obtain a fresh start. They allow the debtor to come out of the process with not only a minimum amount of dignity, but also the essentials upon which to build a new life. They leave at least a basic vestige of the possessions that the debtor has acquired over a lifetime, so that the debtor may proceed to move forward, rather than spend time struggling simply to exist.

FOOTNOTES:

(n1)Footnote 1. *See* ch. 18 *infra*.

(n2)Footnote 2. *In re Sloma*, 43 F.3d 637 (11th Cir. 1995) (debtor's claim that annuity payments were exempt did not affect bank's security interest in annuity, which debtor had assigned as collateral for loan).

(n3)Footnote 3. 11 U.S.C. § 522(a)(2). *See* 11 U.S.C. § 541(a)(5) for the limited types of property which may come into the estate after filing.

(n4)Footnote 4. 11 U.S.C. § 348(f)(1)(A). (with exception for bad faith conversions in § 348(f)(2)).

(n5)Footnote 5. *In re Peterson*, 897 F.2d 935, 22 C.B.C.2d 1147 (8th Cir. 1990) (debtor's death eight months after filing the petition does not constitute an abandonment of the debtor's homestead exemption or cause the exemption to lapse back into the estate).

(n6)Footnote 6. *In re Gamble*, 168 F.3d 442 (11th Cir. 1999) ; *In re Hahn*, 60 B.R. 69 (Bankr. D. Minn. 1985) . *See* Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 12 U. Mich. J. L. Ref. 3, 38 n. 158 (1978). *See also* *Wissman v. Pittsburgh Nat'l Bank*, 942 F.2d 867, 25 C.B.C.2d 605 (4th Cir. 1991) .

(n7)Footnote 7. *See In re Walter*, 18 C.B.C.2d 26, 83 B.R. 14 (B.A.P. 9th Cir. 1988) (order may be entered denying debtor use of funds in pension plan when the exempt character of those funds is in dispute). *See also* 11 U.S.C. § 363 insofar as it relates to use of property by a debtor.

(n8)Footnote 8. *But see Matter of Salzer*, 52 F.3d 708, 33 C.B.C.2d 581 (7th Cir. 1995) (erroneously holding that Indiana execution procedures permit a bankruptcy trustee to hold property after the deadline for objecting to exemptions has run until the trustee obtains an appraisal of the property; *pro se* debtor waived argument that commercial property in question was totally exempt).

(n9)Footnote 9. 11 U.S.C. § 1306(b).



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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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P 13.04 Choice of State or Federal Exemptions

In many states, a debtor may choose from two sets of exemptions. The first set, available to a debtor in any state, consists of the exemptions provided by state law and by federal nonbankruptcy law (*e.g.*, laws protecting social security benefits and veterans benefits, *etc.*).ⁿ¹ If the debtor chooses the state exemptions, then certain other property of the estate not normally subject to process under state law may also be claimed as exempt.

The Bankruptcy Code also provides a comprehensive list of special exemptions that are applicable only in bankruptcy cases. Debtors may choose these exemptions as an alternative to the traditionally available exemptions, only if their state of domicile has not "opted out" of the Bankruptcy Code's exemption scheme.ⁿ² The "opt out" provision allows any state to pass a law prohibiting the use of the special federal bankruptcy exemptions. Currently, 34 states have such a law,ⁿ³ and in those states, debtors may utilize only the state and federal nonbankruptcy exemptions plus the retirement account exemption of section 522(b)(3)(C). (A state may also opt out of the federal bankruptcy exemptions and pass its own bankruptcy exemptions, which may be different from its normal exemptions from execution.)ⁿ⁴ In any case, even when a state has opted out of the federal bankruptcy exemptions, the remaining provisions of section 522 remain applicable to enhance the exemptions that are available to the debtor; a state may not opt out of those provisions.ⁿ⁵

[1] Determination of Domicile for Exemption Purposes

The 2005 amendments to the Bankruptcy Code extend the period for determining the debtor's domicile for purposes of claiming exemptions from 180 days to 730 days.ⁿ⁶ The state exemption law that applies is determined by the state in which the debtor's domicile has been located for the 730 days immediately preceding the date of the filing of the petition. If the debtor's domicile has not been located in a single state for the 730-day period, then the controlling state law is that of the state in which the debtor was domiciled for the 180 days immediately preceding the 730-day period or for a longer portion of such 180-day period than in any other place. Notably, however, the domicile rules do not apply to exemptions under section 522(b)(3)(B) for entireties interests not subject to process, which are based on the law where the property is located.^{n6a}

It is also possible that the debtor was not domiciled in any state during those 180 days, either because the debtor was abroad or, since domicile includes an intent to stay, because the debtor did not have that intent.

However, if the effect of section 522(b)(3)(A) is to render the debtor ineligible for any exemption,ⁿ⁷ the debtor may

elect to exempt property of the kind specified under section 522(d).ⁿ⁸ The debtor is therefore permitted to exempt property under the federal exemption system in this situation notwithstanding that the state of the debtor's domicile as determined by section 522(b)(3)(A) is an opt-out state. The statute is somewhat ambiguous with respect to the situation of a debtor who qualifies for some, but not all, exemptions under a state's laws, because the phrase "ineligible for any exemption" could mean either ineligible for all exemptions or ineligible for any particular exemption. The better view is that the latter was intended. Otherwise, a debtor could be limited to only one or two particular exemptions with different wording than most of a state's exemptions.

[2] Choice of Exemptions in Joint Filings

In a joint filing of a husband and wife, both spouses must choose the same exemption scheme.ⁿ⁹ If the spouses cannot agree upon which exemptions to choose, they are deemed to have chosen the exemptions of the Bankruptcy Code.ⁿ¹⁰ They also, however, have the option of filing two separate petitions, with each spouse electing the exemptions of his or her choice.ⁿ¹¹ Even when a state has opted out of the federal exemptions, the state exemptions can probably be asserted separately by each debtor,ⁿ¹² since *section 522(m) of the Bankruptcy Code* provides that each debtor's exemptions must be treated separately.

FOOTNOTES:

(n1)Footnote 1. See 14 Collier on Bankruptcy (Matthew Bender) for a comprehensive listing of exemptions and exemption case law in each jurisdiction.

(n2)Footnote 2. 11 U.S.C. § 522(b)(1), (2), as amended and redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. The following states have opted out: Alabama, Alaska, Arizona, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Mississippi, Missouri, Montana, Nebraska, Nevada, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wyoming. Arkansas, which previously had opted out, repealed its opt-out law in 1991. New Hampshire repealed its opt-out law effective January 1, 1997. See *In re Gardner*, 139 B.R. 460 (Bankr. E. W.D. Ark. 1991) . See generally 14 Collier on Bankruptcy (Matthew Bender).

(n4)Footnote 4. Challenges to the ability of states to enact special exemptions applicable only in bankruptcy have, for the most part, been rejected. See *Sheehan v. Peveich*, 2009 U.S. App. LEXIS 16393 (4th Cir. July 24, 2009) . See 4 Collier on Bankruptcy, P 522.02[4] (Matthew Bender); 2 Collier Bankruptcy Manual, P 522.02[4] (Matthew Bender).

(n5)Footnote 5. *Owen v. Owen*, 500 U.S. 305, 111 S. Ct. 1833, 114 L. Ed. 2d 350, 24 C.B.C.2d 850 (1991) . See 4 Collier on Bankruptcy, P 522.02[2] (Matthew Bender); 2 Collier Bankruptcy Manual, P 522.02[2] (Matthew Bender).

(n6)Footnote 6. 11 U.S.C. § 522(b)(3)(A), formerly 522(b)(2)(A), as amended and redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n7)Footnote 6a. *In re Holland*, 366 B.R. 825 (N.D. Ill. 2007) ; *In re Schwarz*, 362 B.R. 532 (Bankr. S.D. Fla. 2007) ; *In re Zolnierowicz*, 380 B.R. 84 (Bankr. M.D. Fla. 2007) .

(n8)Footnote 7. This may occur if the exemption law of the debtor's domicile requires that the debtor must reside within the state to claim exemption rights or if the state law does not permit an exemption to be taken on property located outside the state.

(n9)Footnote 8. 11 U.S.C. § 522(b)(3), added by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. This provision found in the last sentence of subsection 522(b) was added by the 2005 Act and should have been designated as section 522(b)(3)(D). *In re Adams*, 375 B.R. 532 (Bankr. W.D. Mo. 2007) (because Florida law was construed to provide exemptions only to residents, debtor could claim federal exemptions).

(n10)Footnote 9. *11 U.S.C. § 522(b)(1)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 10. *11 U.S.C. § 522(b)(1)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n12)Footnote 11. *But see Fed. R. Bankr. P. 1015(b)* (court may order joint administration of husband's and wife's individual petitions and fix time in which they must choose same set of exemptions). If the husband and wife filed under different chapters, such joint administration would be far less likely.

(n13)Footnote 12. *Williams v. Wainwright*, 650 F.2d 58 (4th Cir. 1981) ; *In re Bartlett*, 8 C.B.C.2d 979, 24 B.R. 605 (B.A.P. 9th Cir. 1982) . *See also John T. Mather Mem. Hosp. v. Pearl*, 723 F.2d 193, 9 C.B.C.2d 670 (2d Cir. 1983) (based upon interpretation of state law). *But see In re Talmadge*, 832 F.2d 1120, 17 C.B.C.2d 1140 (9th Cir. 1987) (California's exemption scheme allowing spouses single set of exemptions does not violate Equal Protection and can be enforced despite § 522(m)); *Stevens v. Pike County Bank*, 829 F.2d 693 (8th Cir. 1987) (state could limit couple to one homestead exemption in bankruptcy); *First Nat'l Bank v. Norris*, 701 F.2d 902 (11th Cir. 1983) (section 522(m) does not create separate state exemptions for joint debtors). *But see also In re Pruitt*, 829 F.2d 1002 (10th Cir. 1987) (where only one homestead is allowed to a couple, value of single debtor's interest is computed by taking one half of the difference between value of property and homestead exemption). *See 4 Collier on Bankruptcy*, P 522.04[5] (Matthew Bender).



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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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P 13.05 Bankruptcy Code Exemptions

[1] In General

The property that can be claimed as exempt under the federal bankruptcy exemptions (in states that have not opted out) is listed in *section 522(d) of the Bankruptcy Code*.

[a] Use in Joint Cases

Because the exemptions may be claimed by each debtor individually,ⁿ¹ a husband and wife filing a joint case are each entitled to the full exemption amounts listed for each category of property in section 522(d), effectively doubling those amounts for jointly held property. (In many states there is a presumption that property acquired during the marriage is jointly owned.)

PLANNING NOTE

However, the same provisions would probably prevent the application of one spouse's unused exemption amount to the separate property of the other spouse. As a result, problems occasionally arise from the wording of some of the exemptions. For example, if there are two jointly held motor vehicles, each worth \$2,950,ⁿ² each joint debtor could only exempt one-half of the value of one car because the motor vehicle exemption applies to the debtor's interest in one motor vehicle.ⁿ³ This would leave the equivalent of one vehicle not exempted under that subsection. One simple solution to this problem would be a prebankruptcy trading of interests so that each spouse owned one car in full. Then each could exempt the full \$2,950 value of his or her car. Thus, prebankruptcy exemption planning may be especially important in joint filings.^{n3a}

[b] Adjustments of Dollar Amounts

The list of federal exemptions was amended in 1994 to double the previous dollar amounts of exemptions permitted, most of which had gone unchanged since 1978. Under the *Code section 104(b)*, the dollar amounts of the federal bankruptcy exemptions are now adjusted every three years to take into account changes in the cost of living.ⁿ⁴

[2] Homestead: § 522(d)(1)

The largest specific dollar amount applicable to particular property is the \$20,200⁵ that each debtor may claim as a homestead exemption.⁶ This exemption, like all of the other exemptions, applies only to the debtor's interest in property, *i.e.*, the equity over and above liens and security interests.

ILLUSTRATION

A debtor with a one-half interest in a \$60,000 jointly owned home encumbered by a \$30,000 mortgage, has a \$15,000 interest in that home ($1/2$ [\$60,000-\$30,000]). Being no more than a \$20,200 interest, the debtor's interest would be fully exempt. However, it is important to remember that in subtracting liens to determine equity, precomputed but as yet unearned interest should not be included. Only the current "payoff figure" due on the lien can properly be considered owing.⁷

As discussed earlier, two joint owners may exempt an interest of \$40,400 under this exemption. In fact, they may add an additional \$2,150 to that figure (or to any other exemption) since a different subsection permits each to exempt an interest of \$10⁷⁵ in "any property."⁸

The homestead exemption is applicable to interests in either real or personal property, and therefore it clearly includes mobile homes, houseboats, and so on.

It also clearly includes nonownership interests such as leases.⁹ The property must be a residence of the debtor or a dependent of the debtor, though it does not appear necessary that it be the principal residence. The debtor need not necessarily be occupying the property on the date of the petition.¹⁰ A burial plot may also be exempted under this subsection.

PLANNING NOTE

Unlike some state exemption schemes, the homestead exemption does not explicitly apply to proceeds of the sale of a homestead, though there are good arguments that it should apply at least to proceeds the debtor intends to use to purchase another residence. The sale of a property may also raise issues of whether the debtor occupies the homestead.¹¹ This uncertainty can frequently be avoided with careful prebankruptcy exemption planning. When a home is sold after bankruptcy is filed, the exemption is preserved because section 522(a)(2) explicitly states that exemptions are to be determined as of the date the bankruptcy petition was filed.¹²

[3] Motor Vehicle: § 522(d)(2)

A debtor may exempt an interest of up to \$3,225¹³ in one motor vehicle under section 522(d)(2). It is important to note the limitation in this provision to one vehicle per debtor. Again, the exemption need be applied only to the debtor's interest over and above any security interest or other lien. And an interest in excess of the \$3,225 amount may sometimes be picked up using another exemption, such as the exemption for any property,¹⁴ or in some cases, the exemption for tools of a trade.¹⁵

[4] Household Goods, Clothing, Animals or Crops: § 522(d)(3)

Section 522(d)(3) allows a debtor to exempt an interest of up to \$525¹⁶ in value in any item of household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments held primarily for the personal, family or household use of the debtor or the debtor's dependents. Like the other exemptions, this may be doubled in a joint case to include items of up to \$1,050 in value if jointly owned by the debtors. Thus, especially in joint cases in which the limit is doubled, all of the household belongings of most debtors may be saved under this provision. There is an aggregate dollar limit of \$10,125¹⁷ per debtor on the property that can be exempted under this subsection.

The limits under section 522(d)(3) are adjusted for inflation every three years beginning on April 1, 1998.ⁿ¹⁸

PRACTICE NOTE

One question which may theoretically arise concerns the definition of the term "item." When several related pieces of property may be considered a "set" worth over \$525, disputes could occur as to whether that set is an item. For example, it is not clear whether each chair in a dining room set, or each spoon in a set of silver, or each speaker in a stereo system, should be considered to be an item apart from the set as a whole.ⁿ¹⁹ Such issues arise very rarely in practice, however, because except in cases in which the debtors have a great deal of valuable property, trustees have little interest in litigating about the exemption of a few household goods.

The scope of the subsection may also raise questions. It will not generally include motor vehicles, though a lawn tractor is probably an exception. Similarly, most items specifically listed elsewhere in the exemption provisions, such as jewelry,ⁿ²⁰ are not usually included. Other items, such as guns, may be subject to a dispute because it is unclear whether they are household goods.ⁿ²¹

Finally, items used *primarily* for business purposes are not meant to be included. The language limiting the exemption to items used *primarily* for "personal, family, or household use" does make this clear. However, under the Code and other statutes using the same phrase, the case law and Federal Reserve Board interpretations and staff opinions have given that phrase a fairly broad meaning, and should be consulted if questions arise.

PRACTICE NOTE

It seems safe to say that, except for debtors who conduct a business in their home, this exemption should be applicable to just about all of the personal property normally kept at the debtor's residence that is not specifically mentioned in other exemptions.ⁿ²² It is clear that the scope of the exemption extends beyond necessities, since it does not include, as do some others,ⁿ²³ only amounts "reasonably necessary for the support of the debtor." The section is concerned only with how the property is used, and not whether it might be considered a luxury.

[5] Jewelry: § 522(d)(4)

Each debtor is allowed to exempt up to \$1,350ⁿ²⁴ worth of jewelry, as long as it is held primarily for personal, family, or household use of the debtor or a dependent. As with the household goods exemption, unused exemptions applicable to "any property" may be used to increase this amount. For example, a jewelry item worth \$1,400 may be exempted using the \$1,350 jewelry exemption plus \$50 worth of the exemption applicable to any property (sometimes referred to as the "wild card" exemption).

PLANNING NOTE

Some questions may arise under this provision concerning whether a particular item is classified as jewelry or wearing apparel.ⁿ²⁵ If the item is worth under \$525, it is usually to the debtor's benefit for it to be considered the latter, since a larger total exemption is available for wearing apparel worth less than \$525 per item. On the other hand, if the debtor has items worth more than \$525, the debtor's use of other exemptions will determine which interpretation is more favorable in a particular case. If none of the exemption for "any property" has been used and all of the jewelry exemption has been used, then it is preferable to argue that the items are wearing apparel so that on each item any value in excess of the \$525 available for wearing apparel may be exempted (until the wild-card exemption is exhausted). However, if the jewelry exemption has not yet been used, it is preferable to argue that the item is jewelry so that the amount available only for jewelry can be used so the wild-card exemption can be saved for

some other property. In any event, case law developed under the various state exemption laws pertaining to jewelry and wearing apparel will be relevant to the argument.

A common issue under this subsection arises with respect to wedding rings, engagement rings and other jewelry with great sentimental value. The monetary value of those items can sometimes exceed the amount of the available exemptions. Most trustees do not make a practice of taking a debtor's personal jewelry unless it is very valuable, but there is no way to make this guarantee about a particular item to a nervous debtor contemplating bankruptcy. In such situations, it may make sense to obtain an appraisal, because it is not uncommon for debtors to have an inflated opinion about the value of jewelry which is based in sentiment rather than reality. After appraisal, if the jewelry still cannot be exempted under any combination of available provisions, local practice should be checked. In some jurisdictions, given the practice of trustees, there may be little cause for worry. Further, a trustee who is interested in selling valuable jewelry may be willing to sell it to the debtor or a relative of the debtor in order to avoid liquidation costs and the hardship caused by sale of a highly personal item. Finally, if a sale cannot be avoided, the debtor will receive the amount of the exemption in cash, and that cash can be used to purchase a substitute item.

[6] Any Property: § 522(d)(5)

One of the most important of the federal exemptions is the exemption which can be applied to "any property," sometimes called the "wild card." The amount of this exemption is \$1,075ⁿ²⁶ per debtor, plus any unused amount of the homestead amount from subsection (d)(1) up to \$10,125ⁿ²⁷ per debtor. The applicability of the unused homestead exemption to any property, sometimes called the "homestead pourover," was originally intended to equalize homeowners and renters but was significantly reduced when a \$3,750 limit was added in 1984. That limit was raised to \$7,500 in 1994 and beginning on April 1, 1998, has been adjusted every three years to take into account changes in the cost of living.ⁿ²⁸ It gives tremendous flexibility to both homeowners and renters, however, since many homeowners may not choose to or need to use the entire homestead exemption for their residences.

As noted above, this exemption can be used in conjunction with any other specific exemption to pick up value in excess of the amount provided by the particular exemption, *e.g.*, the remaining \$75 on a \$3,300 car.ⁿ²⁹ It can also be applied to any possible property interest, including intangibles, nonliquid property, causes of action, tax refunds, cash, public benefits already received, *etc.* ⁿ³⁰ If the wild card exemption is not used in the debtors' initial exemption claim, it remains available to be raised by way of amendment to protect property which the trustee unexpectedly contends is to be non-exempt.

[7] Tools of the Trade: § 522(d)(6)

Each debtor may exempt up to \$2,025ⁿ³¹ worth of implements, professional books, or tools of the trade that belong to the debtor or a dependent of the debtor. This exemption, too, may overlap with some of the others. For example, a motor vehicle sometimes can be claimed as exempt under this subsection as well as subsection (d)(2) if it is used by the debtor in his or her trade (beyond normal commuting).ⁿ³² Thus, a vehicle worth \$4,800 per debtor could be claimed by combining these sections. Three way combinations, including the wild card exemption, are also possible.

PLANNING NOTE

As with jewelry, it may be preferable to argue that a particular item falls within the household goods exemption, *i.e.*, is held primarily for personal, nonbusiness use, if its value is under \$525, or if the tools of trade exemption has been exhausted on other property.

There are often significant questions as to whether farm equipment or livestock are included within this exemption or

similar exemptions under state law. Similar issues may arise with home office equipment. Although the importance of the issue is diminished in the federal scheme by the relatively low amount of the exemption, it has been raised in a number of reported cases, often in connection with motions to avoid nonpossessory nonpurchase-money security interests.ⁿ³³

[8] Unmatured Life Insurance: § 522(d)(7)

The subsection providing an exemption for unmatured life insurance, as distinguished from the subsection following it, is for those interests in life insurance owned by the debtor which do not have a cash or loan value. Thus, any interest in term insurance can be exempted. Those policies which do have a cash or loan value are, in effect, divided into two property interests: the interest in receiving proceeds and the cash or loan value. The former may be exempted in full under this subsection.

Credit life insurance is specifically excluded from the coverage of this subsection. And, if the debtor is merely the beneficiary of a policy insuring the life of a living person and owned by someone other than the debtor, no exemption need be used, since generally the debtor has no property interest in that policy. (However, if the insured dies within 180 days after the bankruptcy petition is filed, the debtor's interest in the proceeds does become property of the estate,ⁿ³⁴ must be listed in a supplemental schedule,ⁿ³⁵ and can usually be exempted under section 522(d)(11), discussed below.)ⁿ³⁶ It is important to note that the debtor need not be the person insured by the life insurance contract for this exemption to apply.

[9] Accrued Dividend, Interest, or Loan Value of Life Insurance: § 522(d)(8)

Interests in life insurance policies, which do have a cash value, may be exempted to the extent of \$10,775ⁿ³⁷ per debtor under subsection (d)(8). From this amount must be subtracted any amounts that are used by the insurance company to continue premium payments under a contract which provides for automatic payments out of the accrued value.

PLANNING NOTE

Unlike the exemption provided by the previous subsection, this exemption may only be applied to policies insuring the life of the debtor or someone of whom the debtor is a dependent. Nonetheless, because life insurance can be a relatively liquid type of property, if a debtor has excess liquid assets prior to filing a case that cannot be otherwise exempted, this exemption provides a way to exempt a substantial additional amount through a prebankruptcy purchase of life insurance.

[10] Health Aids: § 522(d)(9)

A debtor may exempt an unlimited amount of professionally prescribed health aids for the debtor or a dependent of the debtor. This exemption clearly covers such items as wheelchairs and artificial limbs. Arguably, it is much broader, and could include specially equipped automobiles, or even normal automobiles essential to receiving medical treatments. It is also possible that property prescribed for therapy, such as swimming pools, could be included.

[11] Disability, Retirement and Other Benefits Replacing Wages: § 522(d)(10)

Because of the Bankruptcy Code's broad definition of property of the bankruptcy estate,ⁿ³⁸ a debtor's entitlement to receive various benefits in the future has for the first time become subject to the claims of creditors. Rights to such entitlements must therefore be exempted if they are to be saved for the debtor's future use. Thus, section 522(d)(10) exempts the right to receive, in the future, social security, unemployment, welfare, disability, and illness benefits.ⁿ³⁹ Additionally, individual retirement account assets fall within the scope of this section.ⁿ⁴⁰ Worker's compensation benefits probably fall within this category or within section 522(d)(11)(D) or (E) (payments on account of personal injuries or in compensation for loss of future earnings).ⁿ⁴¹ When in doubt, a debtor should claim all possible

exemptions.

Alimony and support payments are also exempt but only to the extent reasonably necessary for the support of the debtor and any dependents of the debtor.ⁿ⁴² However, child support and awards for the benefit of someone other than the debtor need not be exempted since they can be considered to be held in trust for the real intended beneficiary.ⁿ⁴³

[a] Pension Plans

Similarly, payments under most pension plans and many employee benefit plans are exempt to the extent reasonably necessary for the support of the debtor and the debtor's dependents.ⁿ⁴⁴ A determination of whether a pension is reasonably necessary for the support of a debtor and any dependents requires an examination of the debtor's age, earning capacity, present and future financial needs and ability to reestablish a retirement fund.ⁿ⁴⁵ Some courts have rejected exemptions under this section in cases of younger middle- and upper-income debtors with no present need for support or right to receive the payments, but such decisions are of questionable validity after the Supreme Court's decision in *Rousey v. Jacoway*.^{n45a} In such cases, the state exemptions or section 522(d)(12) may provide superior protection.

PRACTICE NOTE

It is important to note that the Supreme Court has held that ERISA qualified pension and employee benefit plans do not come into a debtor's bankruptcy estate at all.ⁿ⁴⁶ When benefit plans are not in the estate, the debtor need not claim them as exempt. The Supreme Court pointed out, however, that at least two types of retirement accounts do not qualify under ERISA and, therefore, are not entitled to its protection. These are certain pensions established by governmental entities or religious organizations and individual retirement accounts (IRAs). Such plans may still be excluded from the estate under *section 541(c)(2) of the Bankruptcy Code* as spendthrift trusts.ⁿ⁴⁷ If they are not excluded from the estate, protections for those plans will have to be sought under § 522(d)(10)(E),ⁿ⁴⁸ § 522(d)(12), or applicable nonbankruptcy law. If there is any doubt about whether the plan is excluded from the estate, there is no reason not to claim the exemption in the alternative. Alternatively, interests in such plans may be claimed exempt under § 522(b)(3)(C)ⁿ⁴⁹ or any applicable state law exemption.ⁿ⁵⁰

[b] Benefits Already Received as of Petition Date

Property traceable to benefits already received may have to be exempted under other provisions of the federal exemptions. If so, this is a departure from some of the federal nonbankruptcy laws protecting income benefits such as veterans benefits, under which accrued benefits were also exempt from execution. Thus, a debtor who has saved from such benefits a substantial amount of money that cannot all be claimed as exempt, perhaps because of a large retroactive payment, may be better off choosing the alternative of the state and federal nonbankruptcy exemptions.ⁿ⁵¹

This problem does not exist in the case of Social Security and SSI benefits, and perhaps veterans' benefits. Since the Bankruptcy Code was passed, Congress has amended the Social Security Act to make clear that benefits thereunder are not subject to the bankruptcy laws and thus should not become property of the estate.ⁿ⁵² Therefore, they need not be exempted to be preserved for the debtor. This protection should apply not only to the right to receive benefits, but also to the benefits already received.ⁿ⁵³ Similar protections are likely to be found for Veterans benefits and perhaps other federal benefits with statutory language similar to the anti-alienation provisions of the Social Security Act.ⁿ⁵⁴

[c] Limitation to Amounts Reasonably Necessary for Support of Debtor or Dependents

As noted above, some types of property covered by this provision, *e.g.*, alimony, child support, and private retirement plans, are exempt only to the extent reasonably necessary for the support of the debtor and the debtor's dependents.ⁿ⁵⁵ This limitation was included primarily to prevent wealthy people with enormous amounts of income from such sources

from protecting all of that income in bankruptcy. With this in mind, the courts are relatively liberal in deciding what amounts are reasonably necessary for support. Although the statute gives no guidance, judges who see mostly middle-class debtors usually approve at least a living standard that supports a middle class lifestyle.

Another question likely to arise concerns the definition of the term "public assistance." Obviously, welfare cash payments are included. It also seems clear that supplements such as food stamps and energy assistance should come within this category.ⁿ⁵⁶ Similar issues arise with regard to the federal earned income tax credit, other tax credits and other subsidy programs.ⁿ⁵⁷

PRACTICE NOTE

It is usually not necessary to claim all of these benefits as exempt, although it may often be safer to do so. Trustees are unlikely to show much interest in such benefits, since they are probably not transferable, and may therefore be abandoned as of no value to the estate.ⁿ⁵⁸ Must all workers who have paid social security taxes list a vested or nonvested contingent right to receive social security benefits when they retire or become disabled? Local practice, which usually does not require the listing of such assets, generally provides a guide as to such questions. If a trustee does show interest, the schedules and claim of exemption can be amended at that time.

[12] Rights to Compensation for Injury or Losses and Payments for Lost Earnings: § 522(d)(11)

The last category listed among the federal bankruptcy exemptions covers the right to receive, and property traceable to, payments for various types of injury or loss. These include crime-victim reparations awards, as well as payments, not to exceed \$20,200,ⁿ⁵⁹ on account of bodily injury of the debtor or a person upon whom the debtor is dependent (but not including pain and suffering or pecuniary loss). Because this exemption provision, unlike section 522(d)(1), (3), (4), (5), (6) and (8), does not refer to the debtor's aggregate interest, the debtor may presumably exempt an amount up to the statutory dollar limit for each accident giving rise to exemptible damages.ⁿ⁶⁰

This provision also covers wrongful death awards based upon the death of someone of whom the debtor was a dependent, payments on life insurance that insured the life of someone of whom the debtor was a dependent, and payments in compensation for loss of future earnings of the debtor or one upon whom the debtor was a dependent.^{n60a}

PRACTICE NOTE

It is important to note, first, that this exemption category does include property that can be traced to the listed benefits, as well as the benefits themselves. This may pose difficult problems of tracing past payments, but to the extent exemption planning can maximize traceability, it should be carefully considered. Second, some but not all of the payments listed are limited to amounts reasonably necessary to the support of the debtor and the debtor's dependents. The comments made with respect to this limitation in section 522(d)(10) are equally applicable here.

One category has a specific dollar limit: on account of personal bodily injury. This category not only explicitly excludes pain and suffering and compensation for pecuniary loss (the latter being covered by a separate provision), but also implicitly seems to exclude punitive damages. It is unclear how the bankruptcy court will be able to divide lump sum awards or settlements into these component parts. Because the burden of proof in objections to exemptions is on the party objecting to the exemptions, the exemption should be allowed unless the objector can demonstrate that a specific portion of the award is not exempt.ⁿ⁶¹ It is also unclear to what extent damage recoveries, or the right thereto, for nonbodily injuries such as discrimination or invasion of privacy, may be protected. While these may not be covered by subsection (D) of section 522(d)(11), which is limited to personal bodily injuries, some portions of them may be deemed compensation for loss of future earnings, and thus exempt under subsection (E).ⁿ⁶² As with the personal injury

exemption, it is the trustee's burden to show what portion of an unallocated personal injury award is not for loss of future earnings.^{n62a}

PLANNING NOTE

In light of these considerations, it may be worthwhile to attempt to obtain a favorable designation of a damage award or settlement, if possible, prior to bankruptcy for the purposes of exempting as much property as possible under these provisions when permissible. In any event, the debtor's exempt share of any award should not be reduced to pay a pro rata portion of the attorney's fees incurred to obtain the funds.^{n62b}

[13] Retirement Funds

The debtor may exempt under section 522(d)(12), added by the 2005 Act,ⁿ⁶³ retirement funds to the extent they are in a fund or account that is exempt from taxation under *section 401, 403, 408, 408A, 414, 457 or 501(a) of the Internal Revenue Code*. These sections of the Internal Revenue Code deal with pension, profit-sharing and stock bonus plans; employee annuities; individual retirement accounts ("IRAs"); deferred compensation plans of state, local government and tax-exempt organizations; and certain trusts. Retirement funds are presumed to be exempt for purposes of section 522(d)(12) if the retirement fund has received a favorable determination under section 7805 of the Internal Revenue Service Code and that determination is in effect as of the date of filing. If the presumption does not apply, the funds may still be exempt if the debtor demonstrates that 1) no prior unfavorable determination has been made by a court or the Internal Revenue Service, and (2a) the retirement fund is either in substantial compliance with applicable requirements of the Internal Revenue Code, or (2b) the debtor is not materially responsible for any failure of the retirement fund to be in substantial compliance with applicable requirements of the Internal Revenue Code.ⁿ⁶⁴

In addition, retirement funds that are directly transferred from a tax-exempt fund or account continue to qualify for exemption under section 522(d)(12).ⁿ⁶⁵ The debtor's exemption rights under section 522(d)(12) also continue to apply to any distribution that qualifies as an eligible rollover distribution within the meaning of *section 402(c) of the Internal Revenue Code*, or an amount that is a distribution from a fund or account exempt from taxation under *section 401, 403, 408, 408A, 414, 457 or 501(a) of the Internal Revenue Code*, and is deposited to the extent allowed in such a fund or account not later than 60 days after the distribution of such amount.ⁿ⁶⁶

Section 522(n), also enacted in 2005,ⁿ⁶⁷ imposes a \$1,095,000ⁿ⁶⁸ cap on the aggregate value of assets that an individual debtor may claim as exempt property under section 522(d)(12) in individual retirement accounts established under either section 408 or 408A (Roth IRA) of the Internal Revenue Code, other than a simplified employee pension account under section 408(k) or a simple retirement account under *section 408(p) of the Internal Revenue Code*. This dollar limit does not apply to amounts attributable to rollover contributions, and any earnings thereon, made under *sections 402(c), 402(e)(6), 403(a)(4), 403(a)(5) and 403(b)(8) of the Internal Revenue Code*.

Since Congress did not amend section 522(d)(10) when this category of exempt funds was added as part of the 2005 Act, the exemption rights in section 522(d)(12) are intended to supplement those found in section 522(d)(10)(E). Significantly, unlike section 522(d)(10)(E), the debtor may exempt retirement funds under section 522(d)(12) without the necessity of proving that such funds are necessary for the support of the debtor and the debtor's dependents.ⁿ⁶⁹ On the other hand, section 522(d)(10)(E) permits the debtor to exempt payments from retirement plans that do not qualify for tax-exempt status under the Internal Revenue Code, subject to the exception in section 522(d)(10)(E)(i)-(iii) for plans established by an insider that employed the debtor.ⁿ⁷⁰

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 522(m).

(n2)Footnote 2. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$2,775 to \$2,950, effective April 1, 2004. For cases commenced before April 1, 2001, the amount in effect is \$2,575. The adjustments are made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n3)Footnote 3. 11 U.S.C. § 522(d)(2).

(n4)Footnote 3a. When some or all property is held as tenants by the entirety under some state laws, it may be possible for one spouse to exempt the full value of such property, which would permit the use of the other spouse's exemptions on other property. See *In re Brannon*, 476 F.3d 170 (3d Cir. 2007) (entireties co-tenant had interest in full value of property under Pennsylvania law and could exempt full value, not just one half of value).

(n5)Footnote 4. 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender). The most recent of these adjustments was effective on April 1, 2004. The new amounts in this Guide reflect this adjustment.

(n6)Footnote 5. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$18,450 to \$20,200, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$17,425. The adjustments are made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n7)Footnote 6. 11 U.S.C. § 522(d)(1).

(n8)Footnote 7. *In re Parenteau*, 7 C.B.C.2d 373, 23 B.R. 289 (B.A.P. 1st Cir. 1982) .

(n9)Footnote 8. 11 U.S.C. § 522(d)(5).

(n10)Footnote 9. *Keller v. Johnson* (*In re Johnson*), 288 B.R. 130 (B.A.P. 8th Cir. 2003) (lien interest awarded by divorce court was interest in residence that could be exempted); *Sticka v. Casserino* (*In re Casserino*), 290 B.R. 735 (B.A.P. 9th Cir. 2003) (Oregon homestead exemption applied to prepaid rent on leasehold interests).

(n11)Footnote 10. *In re DeMasi*, 227 B.R. 586 (D.R.I. 1998) (debtor who owned a remainder interest in home, had resided there previously and intended to reside there again was permitted to claim property as exempt).

(n12)Footnote 11. See 4 *Collier on Bankruptcy*, P 522.09[1] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.09[1] (Matthew Bender).

(n13)Footnote 12. See also *In re Reed*, 940 F.2d 1317 (9th Cir. 1991) (where property is sold prior to abandonment by trustee, debtors are entitled to exemption from the proceeds, but trustee may claim balance).

(n14)Footnote 13. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$2,950 to \$3,225, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$2,775. The adjustments are made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n15)Footnote 14. 11 U.S.C. § 522(d)(5). See P 13.04[6] *infra*.

(n16)Footnote 15. 11 U.S.C. § 522(d)(6). See P 13.04[7] *infra*.

(n17)Footnote 16. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$475 to \$525, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$450. The adjustments are made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n18)Footnote 17. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$9,850 to \$10,125, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$9,300. The adjustments are made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n19)Footnote 18. 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n20)Footnote 19. See *Matter of Wahl*, 14 B.R. 153 (Bankr. E.D. Wis. 1981) (each knife, fork or spoon in a set of silver considered an item; court looked to *Webster's Dictionary* for guidance).

(n21)Footnote 20. 11 U.S.C. § 522(d)(4).

(n22)Footnote 21. See 4 *Collier on Bankruptcy*, P 522.09[3] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.09[3] (Matthew Bender). Note, however, that the somewhat more restrictive definition of "household goods" in section 522(f)(4) is applicable only to section 522(f), not section 522(d).

(n23)Footnote 22. *In re McGreevy*, 955 F.2d 957, 26 C.B.C.2d 693 (4th Cir. 1992)

(n24)Footnote 23. See, e.g., section 522(d)(11)(B), (C), (E).

(n25)Footnote 24. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$1,225 to \$1,350, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$1,150. The adjustments are made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n26)Footnote 25. See, e.g., *SEC v. Fox*, 855 F.2d 247 (5th Cir. 1988) (under Texas law jewelry may be exemptible as clothing).

(n27)Footnote 26. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$975 to \$1,075, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$925. The adjustments are made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n28)Footnote 27. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$9,250 to \$10,125, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$8,725. The adjustments are made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n29)Footnote 28. 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n30)Footnote 29. *Augustine v. United States*, 675 F.2d 582, 6 C.B.C.2d 1053 (3d Cir. 1982) (section 522(d)(5) exemption may be used to exempt tools of trade in excess of \$750 limit applicable at that time).

(n31)Footnote 30. *In re Smith*, 640 F.2d 888, 3 C.B.C.2d 827 (7th Cir. 1981) (Truth in Lending claim could be exempted under 11 U.S.C. § 522(d)(5)). See 4 *Collier on Bankruptcy*, P 522.09[5] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.09[5] (Matthew Bender).

(n32)Footnote 31. Pursuant to 11 U.S.C. § 104(b), this amount is subject to periodic adjustment and was raised from \$1,850 to \$2,025, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$1,750. The adjustments are made every three years beginning April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n33)Footnote 32. See 4 *Collier on Bankruptcy*, P 522.09[6] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.09[6] (Matthew Bender).

(n34)Footnote 33. See, e.g., *In re Heape*, 886 F.2d 280 (10th Cir. 1989) (breeding livestock are tools of a livestock farmer's trade under Kansas law); *Matter of Patterson*, 825 F.2d 1140, 17 C.B.C.2d 339 (7th Cir. 1987) (cattle and farm machinery not tools of trade).

(n35)Footnote 34. 11 U.S.C. § 541(a)(5)(C).

(n36)Footnote 35. *Fed. R. Bankr. P.* 1007(h).

(n37)Footnote 36. See also *BancOhio Nat'l Bank v. Walters*, 724 F.2d 1081 (4th Cir. 1984) (when debtors claimed unmaturing life insurance policies as exempt under § 522(d)(7), policy proceeds acquired within 180 days of petition were included in that exemption).

(n38)Footnote 37. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$9,850 to \$10,775, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$9,300. The adjustment is made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n39)Footnote 38. 11 U.S.C. § 541, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See 5 *Collier on Bankruptcy*, P 541.04 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 541.04 (Matthew Bender).

(n40)Footnote 39. 11 U.S.C. § 522(d)(10)(A), (B), (C).

(n41)Footnote 40. *Rousey v. Jacoway*, 125 S. Ct. 1561, 161 L. Ed. 2d 563 (2005) .

(n42)Footnote 41. See 4 *Collier on Bankruptcy*, P 522.09[10][a] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.09[10][a] (Matthew Bender).

(n43)Footnote 42. 11 U.S.C. § 522(d)(10)(D).

(n44)Footnote 43. See *In re Poffenbarger*, 281 B.R. 379 (Bankr. S.D. Ala. 2002) (right to child support arrearages was in reality property of debtor's children; however, there is no exemption for alimony arrearages under Alabama law). Hughes, *Code Exemptions: Far-Reaching Achievement*, 28 DePaul L. Rev. 1025, 1033 n. 57 (1979) and cases cited therein.

(n45)Footnote 44. 11 U.S.C. § 522(d)(10)(E). See 4 *Collier on Bankruptcy*, P 522.09[10][a] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.09[10][a] (Matthew Bender).

(n46)Footnote 45. See *In re Moffat*, 959 F.2d 740 (9th Cir. 1992) (annuity established in contemplation of bankruptcy with quarterly payments of \$4,370 beginning immediately after bankruptcy was not reasonably necessary to debtor when he and his wife had income in excess of \$90,000 per year); *In re Kochell*, 732 F.2d 564 (7th Cir. 1984) (pension plans not necessary to support of 44-year old physician).

(n47)Footnote 45a. *Rousey v. Jacoway*, n.48 *supra*. See *In re Krebs*, 527 F.3d 82, 86 (3rd Cir. Pa. 2008) (overruling earlier case law based on *Rousey*).

(n48)Footnote 46. *Patterson v. Shumate*, 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519, 26 C.B.C.2d 1119 (1992) .

(n49)Footnote 47. See 5 *Collier on Bankruptcy*, P 541.11 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 541.12 (Matthew Bender).

(n50)Footnote 48. *In re Brucher*, 243 F.3d 242 (6th Cir. 2001) (exemption of IRAs allowed under section 522(d)(10)(E)); *Carmichael v. Osherow*, 100 F.3d 375 (5th Cir. 1996) (debtor's rights in IRA could be exempted under section 522(d)(10)(E)). But see *Rousey v. Jacoway* (*In re Rousey*), 347 F.3d 689 (8th Cir. 2003) , cert. granted, *Rousey v. Jacoway*, 124 S. Ct. 2817 (2004) (some IRAs are not exempt under § 522(d)(10)(E)).

(n51)Footnote 49. This exemption may be used in addition to exemptions under the laws of the debtor's state, even if the debtor's state has opted out of the federal exemption scheme.

(n52)Footnote 50. State law exemptions (as opposed to restrictions on transfer) are available only to those who must or choose to claim state exemptions under 11 U.S.C. § 522(b)(2). *In re Schlein*, 8 F.3d 745 (11th Cir. 1993) (Florida exemption for employee benefit plans protected debtor's SEP-IRA accounts and was not preempted by ERISA); *In re Walker*, 959 F.2d 894 (10th Cir. 1992) (Oklahoma exemption provisions protected debtor's nonERISA retirement plans and were not preempted by ERISA).

(n53)Footnote 51. See *Philpott v. Essex County Welfare Board*, 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973) (social security benefits in bank account could not be attached); *In re Bresnahan*, 33 C.B.C.2d 1592, 183 B.R. 506 (Bankr. S.D. Ohio 1995) (retirement fund distribution deposited in debtor's bank account was still exempt under Ohio exemption law).

(n54)Footnote 52. 42 U.S.C. §§ 407, 1383(d). *In re Buren*, 725 F.2d 1080, 10 C.B.C.2d 236 (6th Cir. 1984)

(n55)Footnote 53. See *Philpott v. Essex County Welfare Board*, 409 U.S. 413, 93 S. Ct. 590, 34 L. Ed. 2d 608 (1973) .

(n56)Footnote 54. See *In re Frazier*, 116 B.R. 675 (Bankr. W.D. Wis. 1990) (exemption covers not only future benefits but also lump sums received prior to bankruptcy filing).

(n57)Footnote 55. Alternatively, if applicable, debtor may wish to exempt retirement plan interests under section 522(d)(12) without needing to prove such funds are necessary for the support of the debtor and debtor's dependents.

(n58)Footnote 56. See *Morris v. Philadelphia Electric Co.*, 45 B.R. 350 (E.D. Pa. 1984) .

(n59)Footnote 57. See *Flanery v. Mathison*, 289 B.R. 624 (W.D. Ky. 2003) (earned income credit exempt public assistance under Kentucky law). State exemption law may also explicitly provide an exemption for the earned income credit. See *In re Sanderson*, 283 B.R. 595 (Bankr. M.D. Fla. 2002) (citing newly enacted Florida exemption for EITC).

(n60)Footnote 58. See ch. 28 *infra* for a discussion of abandonment of property under 11 U.S.C. § 554.

(n61)Footnote 59. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect

to cases filed on or after October 17, 2005, this amount is subject to periodic adjustment and was raised from \$18,450 to \$20,200, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$17,425. The adjustment is made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n62)Footnote 60. *In re Marcus*, 172 B.R. 502 (Bankr. D. Conn. 1994) . But see *In re Christo*, 192 F.3d 36 (1st Cir. 1999) (dollar limit applies to personal injury claims in the aggregate rather than to each claim).

(n63)Footnote 60a. See *In re Lewis*, 406 B.R. 518, 520 (E.D. Mich. 2009) (right to payments from Ford buyout program that gave debtor option of educational benefits or cash payout could be exempted under § 522(d)(11)(E)).

(n64)Footnote 61. See *In re Blizard*, 81 B.R. 431 (Bankr. W.D. Ky. 1988) (objecting trustee failed to meet his burden of proving portion of award attributable to personal bodily injury exceeded available exemption amount); *In re Harris*, 50 B.R. 157 (Bankr. E.D. Wis. 1985) (under Fed. R. Bankr. P. 4003(c), objectors had burden of showing how much of insurance settlement was attributable to pain and suffering.

(n65)Footnote 62. See Plumb, *The Recommendations of the Commission on the Bankruptcy Laws--Exempt and Immune Property*, 61 Va. L. Rev. 1, 94-95 (1975).

(n66)Footnote 62a. *In re Whitson*, 319 B.R. 614 (Bankr. E.D. Ark. 2005) .

(n67)Footnote 62b. *In re Harrington*, 306 B.R. 172 (Bankr. E.D. Tex. 2003) .

(n68)Footnote 63. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n69)Footnote 64. 11 U.S.C. § 522(b)(4)(B), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n70)Footnote 65. 11 U.S.C. § 522(b)(4)(C), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n71)Footnote 66. 11 U.S.C. § 522(b)(4)(D), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n72)Footnote 67. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n73)Footnote 68. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, the amount is adjusted every three years to account for changes in the cost of living.

(n74)Footnote 69. Although courts have generally held that section 522(d)(10) permits the debtor to exempt not only the right to distributions from a retirement plan but also the funds in the plan itself, e.g., *Carmichael v. Osherow* (*In re Carmichael*), 100 F.3d 375 (5th Cir. 1996) , section 522(d)(12) resolves this issue by making clear that funds held in the account for future distribution are exempt.

(n75)Footnote 70. See 5 *Collier on Bankruptcy*, P 522.09[10][a] (Matthew Bender).



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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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P 13.06 Using the State and Federal Nonbankruptcy Exemptions

[1] Bankruptcy Code Modifications of These Exemptions

In cases in which the federal bankruptcy exemptions are either not chosen or not available, debtors may use the exemptions provided for, on the date of the bankruptcy petition,ⁿ¹ by state or local law and by federal nonbankruptcy law.ⁿ² The term "local law" presumably includes Indian Tribal law, and any other provisions applicable to a particular locality. (For convenience, this collection of exemptions will sometimes be referred to simply as the "state exemptions.") Some states have special exemptions applicable only in bankruptcy cases.ⁿ³

It is not totally clear what effect state law exceptions to general exemption statutes have in bankruptcy (*e.g.*, where exemptions are not applicable to executions by certain creditors). Generally, these exceptions are not preserved in bankruptcy.ⁿ⁴

The property that the debtor may exempt in bankruptcy under a state exemption scheme may also include any property that is not subject to execution under state law, such as contingent tort claims.ⁿ⁵

In some states, such property is specifically made exempt. State law may also determine whether a debtor whose nondebtor spouse's interest in community property has been brought into the estate can utilize that spouse's exemptions to protect that interest.^{n5a}

Moreover, state exemption rights are significantly enhanced by the Bankruptcy Code in several ways. First, under section 522(b)(3)(C), added in 2005,ⁿ⁶ debtor's interest in certain retirement funds may be claimed as exempt, even if the debtor's state has opted out of the federal exemption scheme. The scope of the exemption is the same as that under section 522(d)(12).ⁿ⁷ Second, debtors have available to them all of the other protections of section 522. Any waiver of exemptions is unenforceable, regardless of whether exemptions could be waived under state law.ⁿ⁸ The extensive powers to avoid prebankruptcy transfers of exempt property are all applicable to the state as well as the federal exemptions, since the sections providing them refer to exemptions claimed under section 522(b), which includes both sets of exemptions.ⁿ⁹ And exempt property is permanently protected after the bankruptcy under section 522(c).^{n9a}

However, debtors may still have to comply with state procedural requirements for claims of exemptions. For example, in states that require debtors to file a declaration of homestead prior to the use of that exemption, courts are split on the

question of whether that requirement is also a prerequisite to claiming a state homestead exemption in bankruptcy.ⁿ¹⁰ The precise wording of the state statute involved and previous state case law interpreting it may be determinative.ⁿ¹¹

[2] Exemption of Property Not Subject to Process

Debtors who claim the state exemptions in bankruptcy may also be able to take advantage of another special provision that protects certain jointly owned property. This provisionⁿ¹² allows the debtor to claim as exempt "any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law."

The intent of this provision is to protect that property which a creditor of only the debtor (and not of both joint tenants) could not have levied upon as of the date that the bankruptcy was filed. In this way it duplicates what the debtor could have kept out of the estate under the 1898 Bankruptcy Act; there the trustee only had rights in that property of the debtor which a creditor of that debtor alone could attach. One example of such property is property owned as tenants by the entireties, in states where such property can be levied upon only by a joint creditor of the cotenants.ⁿ¹³ If one cotenant files a bankruptcy and claims the state exemptions, then such an interest in entireties property may be claimed as exempt, at a minimum from creditors holding claims against only that cotenant.ⁿ¹⁴

It is important to note several other aspects of this subsection:

- it applies to both real and personal property;
- it is unlimited in value;
- it is applicable to any interest.

Thus, debtors with significant amounts of property that fall within these provisions may be far better off choosing the state rather than the federal exemptions.

WARNING

However, as discussed below, the case law in the jurisdiction in which the case is filed should be carefully researched before that step is irrevocably taken.

The original purpose of this subsection was to preserve the protection given under the previous Bankruptcy Act to certain property that could not be levied upon under state law. Under the Act such property was usually not considered a part of the bankruptcy estate. Without the new subsection, debtors utilizing the state exemptions, either by choice or because their state had opted out, would have been worse off than before the Bankruptcy Code was enacted. Their interests in property such as entireties property or other property not subject to state law process would have, for the first time, been brought into the estate under section 541's broadened definition of property of the estate.ⁿ¹⁵ Such property, then, would have been available to their creditors, even though it had not been under state law, unless it could be exempted. And since it never had been available to creditors under state law, state exemption laws did not take such property into account, so that state exemption provisions were insufficient to protect it. Section 522(b)(3)(B)ⁿ¹⁶ was meant to fill this breach.

Despite the history and intent of section 522(b)(3)(B), several courts of appeals have interpreted that section far more restrictively. These courts have refused to find property exempt under section 522(b)(3)(B) whenever (but perhaps only to the extent that) a husband and wife had joint creditors.ⁿ¹⁷ Some of these courts also held, however, that when a joint creditor does not timely object to the use of the section 522(b)(3)(B) exemption, it is barred from pursuing the entireties

property after the bankruptcy.ⁿ¹⁸ Only the Seventh Circuit Court of Appeals, interpreting an Indiana statutory exemption of entireties property, has come to the result that was intended by Congress.ⁿ¹⁹

The net result of the decisions limiting the use of section 522(b)(3)(B) is that, where they are applicable, the principal use of this exemption may be in those cases in which all or almost all of the debts involved are debts of only one spouse. In such cases, at least, the entireties property is protected from liquidation or (if there are small joint debts) only a small portion of it may be found nonexempt under section 522(b)(3)(B).ⁿ²⁰ It seems clear from language of section 522(b)(3)(B), as well as the case law that, when there are joint creditors, only that amount of the property that is equal to the amount of the joint unsecured debts is not exempt.ⁿ²¹ This result should occur even if both spouses file a joint bankruptcy case, since their exemptions are claimed individually and consolidation of the estates has not been ordered.ⁿ²² Ordinarily, such consolidation would be improper, since it would seriously diminish the rights of joint creditors to the benefit of other creditors.

After the bankruptcy, the exempt property is protected because the debt of the cotenant who filed the bankruptcy petition has been discharged. Even if the other entireties cotenant dies during or after the bankruptcy, leaving the bankruptcy debtor as the sole owner, the exemption protects the property.ⁿ²³ And it is also important to remember that even if the debtor's interest in joint property is not exempt, the trustee may still be prohibited from liquidating it for the benefit of creditors by 11 U.S.C. § 363(h) which requires the court to consider the hardship to the nondebtor spouse that would be caused by liquidation.ⁿ²⁴

COMMENTARY

Moreover, despite the restrictive holdings cited above, it may nonetheless be worthwhile to claim the entireties exemption as to all creditors, because that exemption will be allowed if no party timely objects.ⁿ²⁵ Certainly, since there are strong arguments that restrictive holdings are wrong, there is nothing unethical about doing so and there may be little risk of adverse consequences where a chapter 13 case is filed that may be dismissed as a matter of right or where there is no alternative to bankruptcy in any case. Indeed, even if the debtor's interest is not exempt under section 522(b)(3)(B), there remains the issue of valuing that interest. A number of courts, particularly in New York, have used a method of subtracting the value of the nondebtor spouse's life and survivorship interests from the total value of the property, leaving a very small value for the estate in most cases.ⁿ²⁶

[3] State Homestead Exemption Caps

In 2005, Congress added two new subsections to section 522 that prevent the debtor from taking full advantage of state homestead exemptions under certain circumstances.ⁿ²⁷ These provisions impose a monetary limit of \$136,875ⁿ²⁸ on the amount of the debtor's interest in homestead property that may be exempted to the extent that there has been an acquisition of a homestead interest within a period of 1215 days before the commencement of the case or the commission of certain bad acts by the debtor. Courts have held that the cap does not apply to increases in value due to appreciation if the property is not otherwise subject to the cap.^{n28a} Nor does it apply to an exemption based on tenancy by the entireties, because such an exemption is not a state homestead exemption claimed under section 522(b)(3)(A).^{n28b}

If the limitations in subsection 522(p) or (q) are applicable, a debtor may not exempt any amount of interest that "exceeds in the aggregate" \$136,875 in value in homestead property. However, this language is not intended to impose an overall \$136,875 cap on the interests both debtors in a joint case may exempt in property under a state homestead exemption. Thus, to the extent that state law permits the "doubling" of a state homestead exemption by joint debtors, subsection 522(p) or (q), if applicable, would not preclude debtors in a joint case from exempting their total interest up to \$273,750 in homestead property, provided that such an exemption is available.

[a] Acquisitions During 1215-Day Period Before Filing

Section 522(p), added in 2005,ⁿ²⁹ serve to limit the debtor's exemption rights in homestead property acquired during the 1215-day period before the filing of the petition that exceeds the amount of \$136,875. This section applies to property that debtor or debtor's dependent use as a residence or claim as a homestead.ⁿ³⁰ The dollar limit imposed by section 522(p)(1) does not apply to any amount of interest of the debtor in homestead property that was:

- transferred from a debtor's previous principal residence to the debtor's current principal residence,
- provided that the debtor's previous residence was acquired before the 1215-day period, and
- both the previous and current residences are located in the same state.ⁿ³¹

In addition, the limitation does not apply to an interest claimed as exempt in a principal residence of a family farmer.ⁿ³² It is also doubtful that such limitations apply to homestead acquired through no affirmative action of the debtor, such as appreciation in the homestead's value resulting solely from changes in the real estate market or attributable to payments of regularly scheduled mortgage payments. When the homestead's value increases, it is not an interest acquired, but simply an increase in the value of the same interest.

Nor should designation of property as a homestead be considered acquiring an interest.^{n32a} However, some courts have held that a homestead is a separate property interest under particular state laws that may be acquired at a time after the debtor purchases the property.^{n32b}

Since the allowable homestead exemption in most states is less than \$136,875, section 522(p) should have little effect in the vast majority of bankruptcy filings.

[b] Cap Based on Certain Criminal or Unlawful Conduct

The debtor may not exempt any amount of interest in homestead property that exceeds \$136,875 if the debtor has been convicted of certain criminal or unlawful conduct. Under section 522(q)(1)(A), enacted in 2005,ⁿ³³ the monetary cap applies if the court determines that the debtor has been convicted of a felony (as defined in *18 U.S.C. § 3156*) which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions" of the Code. The \$136,875 dollar limit on the debtor's exemptible homestead interest may also be invoked under section 522(q)(1)(B) if the court determines that the debtor owes a debt arising from certain unlawful conduct. The debt must arise from one of the following categories:

- any violation of state or federal securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934),ⁿ³⁴ or any regulation or order issued under state or federal securities laws;
- fraud, deceit or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 or under section 6 of the Securities Act of 1933;
- any civil remedy under the Racketeer Influenced and Corrupt Organizations Actⁿ³⁵; or
- any criminal act, intentional tort or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding five years.

The monetary limits contained in section 522(q)(1) do not apply to the extent that the amount of the challenged interest in homestead property is "reasonably necessary for the support of the debtor and any dependent of the debtor."ⁿ³⁶

Factors to be considered in determining whether the affected homestead interest is reasonably necessary may include debtor's (or dependent's) age, health, earning capacity, present and future financial needs and ability, other assets, future financial obligations such as alimony and child support, and any special needs of the debtor and dependents. Consideration may also include the effect of the potential loss of the homestead property, obstacles to finding suitable replacement housing, the length of time the debtor has lived in the community, the costs of relocation, and the impact relocation would have on debtor's future income.

Presumably, any party in interest may file an objection to the debtor's exemption claim. The party challenging the exemption will have the burden of proof on whether either subsection of 522(q)(1) applies. If applicable, the debtor will have the burden of showing that the affected homestead property is reasonably necessary for support. For debts that have not been reduced to judgment in a prior proceeding, or in which no findings from a prior proceeding may be given collateral estoppel effect, the objecting party will need to prove all of the elements that would establish liability on the debt. In response to the objection, the debtor may present evidence establishing any defenses to owing the debt. This will effectively require the bankruptcy court conduct a trial on the matter in such situations as if the matter was being heard in the first instance in the bankruptcy court. Alternatively, the bankruptcy court may delay the granting of the debtor's discharge and lift the automatic stay so that a nonbankruptcy court can decide the underlying issue.

[4] Limitations on State Homestead Exemption Based on Fraudulent Conversion

Under section 522(o), added in 2005,ⁿ³⁷ a debtor's homestead exemption under state law may be limited if the debtor has fraudulently converted nonexempt property into homestead property within 10 years of the bankruptcy filing. For this limitation to apply, such conversion must have been done with intent to hinder, delay or defraud a creditor.ⁿ³⁸

[a] Actual Intent to Defraud Required

Section 522(o) requires that the disposition of nonexempt assets must be done with the intent to hinder, delay or defraud a creditor.ⁿ³⁹ Such intent must involve actual rather than constructive intent. Direct evidence of actual intent, however, is rarely exhibited in cases involving fraud. Thus, a party asserting an objection to the debtor's exemption under section 522(o) may attempt to prove actual fraud by relying upon circumstantial evidence, including the existence of any "badges of fraud."ⁿ⁴⁰ Even though Congress did not expressly incorporate examples of badges of fraud in section 522(o), courts may nevertheless consider such circumstantial evidence in a manner similar to that under section 727(a)(2).

[b] Standard of Proof

In *Grogan v. Garner*,ⁿ⁴¹ the Supreme Court held that preponderance of the evidence is the appropriate standard of proof for determining exceptions to discharge based on fraud. Because there is nothing in the language of section 522(o) or its legislative history to suggest that Congress intended to require the more exacting clear-and-convincing standard, the preponderance of the evidence standard should apply in proceedings brought under section 522(o). Application of this standard would permit the bankruptcy court to give collateral estoppel effect to elements of claims actually litigated in a prior proceeding that are identical to the elements of an objection under section 522(o).

FOOTNOTES:

(n1)Footnote 1. *In re Orso*, 214 F.3d 637 (5th Cir. 2000) (later enacted exemption may not be used even if state legislature intended retroactive effect); *In re Wolf*, 248 B.R. 365 (B.A.P. 9th Cir. 2000) (debtor could not take advantage of exemption enacted after petition, even if property interest not acquired until after enactment).

(n2)Footnote 2. Such federal nonbankruptcy exemptions include social security benefits, 42 U.S.C. § 407; veterans benefits, 38 U.S.C. § 5301; Railroad Retirement Act annuities and pensions, 45 U.S.C. § 231m; civil service retirement benefits, 5 U.S.C. § 8346; Foreign Service Retirement and Disability payments, 22 U.S.C. § 4060; compensation payments for injury or death from war risk hazards, 42 U.S.C. § 1717; wages of master and seamen, 46 U.S.C. § 11109;

Longshoremen's and Harbor Worker's Compensation Act death and disability benefits, 33 U.S.C. § 916; government employees' benefits for work-related injuries leading to disability or death; 5 U.S.C. § 8130; military survivors' benefits, 10 U.S.C. § 1450(i); and military annuities, 10 U.S.C. § 1440. The Supreme Court has held that pension plans covered by ERISA do not come into the estate at all. *Patterson v. Shumate*, 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992). Note that this holding is applicable regardless of whether the debtor utilizes state or federal bankruptcy exemptions.

(n3)Footnote 3. See, e.g., *In re Reaves*, 285 F.3d 1152 (9th Cir. 2002) (prior to determining that debtor could not exempt car under regular state law exemptions did not preclude exemption under special state exemptions for bankruptcy cases). Cf. *Williams v. Swenson* (*In re Williams*), 280 B.R. 857 (B.A.P. 9th Cir. 2002) (debtor could not claim normal state exemption in property when state court had denied claim of same exemption). But see *In re Cross*, 255 B.R. 25 (Bankr. N.D. Ill. 2000) (special bankruptcy exemptions unconstitutional).

(n4)Footnote 4. See Hertz, *Bankruptcy Code Exemptions: Notes on the Effect of State Law*, Am. Bankr. L. J. at 353-54 (1980); Stern, *State Exemption Law in Bankruptcy: The Excepted Creditor as a Medium for Appraising Aspects of Bankruptcy Reform*, 33 Rutgers L. Rev. 70 (1980); *In re Weinstein*, 164 F.3d 677 (1st Cir. 1999), cert. denied, 527 U.S. 1036, 119 S. Ct. 2394 (1999) (exceptions to state law exemptions do not apply in bankruptcy); *In re Cooley*, 72 B.R. 54 (N.D. Ala. 1987), aff'd 67 B.R. 229 (Bankr. N.D. Ala. 1986). But see *In re Ondras*, 846 F.2d 33 (7th Cir. 1988) (Indiana permitted to opt for exemption scheme treating tort and contract claims differently).

(n5)Footnote 5. *Eanes v. Shepherd*, 9 C.B.C.2d 1029, 33 B.R. 984 (W.D. Va. 1983). But see *In re Benn*, 491 F.3d 811 (8th Cir. 2007) (property not specifically listed as exempt in Missouri statute is not exempt despite fact that it is not subject to attachment or execution); *Howe v. Richardson*, 193 F.3d 60 (1st Cir. 1999), cert. denied, 529 U.S. 1021, 120 S. Ct. 1424, 146 L. Ed. 2d 315 (2000) (fact that property could not be attached was not equivalent to being exempt under Rhode Island law; issue depended on state law); *Matter of Wishcan*, 77 F.3d 875 (5th Cir. 1996) (debtor's personal injury claim could not be exempted under Louisiana state exemptions; debtor does not appear to have argued that property was exempt because it was not subject to process under state law); *Tignor v. Parkinson*, 729 F.2d 977, 10 C.B.C.2d 729 (4th Cir. 1984) (property not exempt though not subject to process because of specific provisions of state law).

(n6)Footnote 5a. See, e.g., *In re Perez*, 302 B.R. 661 (Bankr. D. Ariz. 2003) (nondebtor spouse's exemptions could be used to protect her interest in community property).

(n7)Footnote 6. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 7. See P 13.05[13] *supra*.

(n9)Footnote 8. 11 U.S.C. § 522(e). *In re Thompson*, 884 F.2d 1100 (8th Cir. 1989) (waiver of state law exemptions by voluntary encumbrance of property does not preclude lien avoidance).

(n10)Footnote 9. See *Owen v. Owen*, 500 U.S. 305, 111 S. Ct. 1833, 114 L. Ed. 2d 350, 24 C.B.C.2d 850 (1991).

(n11)Footnote 9a. *In re Cunningham*, 513 F.3d 318, 323 (1st Cir. Mass. 2008). See P 13.09 *infra*.

(n12)Footnote 10. Compare *In re Renner*, 822 F.2d 878 (9th Cir. 1987) (homestead declaration defective and therefore exemption disallowed); *Zimmerman v. Morgan*, 689 F.2d 471, 7 C.B.C.2d 859 (4th Cir. 1982) (homestead not exempt) with *In re Nguyen*, 211 F.3d 105 (4th Cir. 2000) (debtors had complied with procedural requirements for claiming homestead exemption under Virginia law, which was construed liberally in favor of debtor); *In re Michael*, 49 F.3d 499, 32 C.B.C.2d 1813 (9th Cir. 1995) (debtors could claim Montana homestead exemption after petition filed); *In re Martin*, 20 B.R. 235 (B.A.P. 9th Cir. 1982) (debtor could file postpetition claim for homestead). See also *In re Niland*, 825 F.2d 801 (5th Cir. 1987) (homestead declaration upheld).

(n13)Footnote 11. 11 U.S.C. § 522(b)(3)(A), formerly § 522(b)(2)(A), as amended and redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n14)Footnote 12. 11 U.S.C. § 522(b)(3)(B), formerly § 522(b)(2)(B), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n15)Footnote 13. These states are Delaware, District of Columbia, Florida, Indiana, Michigan, Maryland, Missouri, Montana, Mississippi, North Carolina, Pennsylvania, Rhode Island, Vermont, Virginia, and Wyoming. In other states, such as Massachusetts, tenancies by the entirety may be partially exempt from claims of one spouse's creditors. *But see United States v. Craft*, 535 U.S. 274, 122 S. Ct. 1414, 152 L. Ed. 2d 437 (2002) (federal tax lien against one entireties cotenant attaches to interest of that cotenant). The *Craft* decision should not alter the debtor's rights as to creditors other than those making claims under federal law. *In re Knapp*, 285 B.R. 176 (Bankr. M.D.N.C. 2002) .

(n16)Footnote 14. *In re Ford, Jr.*, 638 F.2d 14, 3 C.B.C.2d 549 (4th Cir. 1981) , *aff'g*, 1 C.B.C.2d 840, 3 B.R. 559 (D. Md. 1980) . Compare *In re Steury*, 94 B.R. 553 (Bankr. N.D. Ind. 1988) (separate chapter 7 cases of husband and wife consolidated to the extent necessary to allow trustee to liquidate property held by the entireties for the benefit of joint creditors).

(n17)Footnote 15. See 5 *Collier on Bankruptcy*, P 541.01 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 541.01 (Matthew Bender).

(n18)Footnote 16. 11 U.S.C. § 522(b)(3)(B), formerly § 522(b)(2)(B), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n19)Footnote 17. *In re Edmonston*, 107 F.3d 74, 37 C.B.C.2d 780 (1st Cir. 1997) ; *In re Garner*, 952 F.2d 232, 26 C.B.C.2d 274 (8th Cir. 1991) , *rev'g Garner v. Strauss*, 121 B.R. 356 (W.D. Mo. 1990) ; *Sumy v. Schlossberg*, 777 F.2d 921, 13 C.B.C.2d 1213 (4th Cir. 1985) ; *Matter of Grosslight*, 757 F.2d 773, 12 C.B.C.2d 525 (6th Cir. 1985) ; *Napotnik v. Equibank*, 679 F.2d 316 (3d Cir. 1982) .

(n20)Footnote 18. *Matter of Dembs*, 757 F.2d 777, 12 C.B.C.2d 591 (6th Cir. 1985) . See *Taylor v. Freeland and Kronz*, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280, 26 C.B.C.2d 487 (1992) (extending the holding in *Dembs*). *But see In re Williams*, 104 F.3d 688, 37 C.B.C.2d 548 (4th Cir. 1997) (even though no objection to exemption was filed within time permitted, debtor's interest in entireties property not protected from joint creditors).

(n21)Footnote 19. *Matter of Hunter*, 970 F.2d 299, 27 C.B.C.2d 536 (7th Cir. 1992) . The same result, prohibiting an *in rem* proceeding by a joint creditor against the entireties property claimed as exempt after an Indiana debtor had discharged his indebtedness in a nonjoint case was reached in *Matter of Paeplow*, 972 F.2d 730 (7th Cir. 1992) .

(n22)Footnote 20. *Somerset Savings Bank v. Goldberg*, 166 B.R. 776 (D. Mass. 1994) (debtor could claim property held as tenant by entireties as exempt because creditor was not permitted to execute on property under Massachusetts law); *Brown v. Eads (In re Eads)*, 271 B.R. 371 (Bankr. W.D. Mo. 2002) (proceeds of entireties property not fully exempt due to existence of joint creditor must first be divided, with nondebtor spouse's share distributed to her, joint creditors then paid from debtor's share, and any remaining funds from debtor's share distributed to debtor); *In re Pernus*, 143 B.R. 856 (Bankr. N.D. Ohio 1992) (all of debtor's interests in entireties property were exempt where debtor had no unsecured joint creditors). Compare *In re Van der Heide*, 164 F.3d 1183, 41 C.B.C.2d 961 (8th Cir. 1999) (one half of value of property became property of estate and debtor was entitled to one half of state homestead exemption).

(n23)Footnote 21. See, e.g., *Sumy v. Schlossberg*, 777 F.2d 921, 922, 13 C.B.C.2d 1213, 1214 (4th Cir. 1985) (debtor loses benefit of exemption to the extent of joint claims); *Matter of Grosslight*, 757 F.2d 773, 776, 12 C.B.C.2d 525, 528 (6th Cir. 1985) (debtor's interest in portion of entireties property reachable by joint creditors not exempt).

(n24)Footnote 22. *In re Bunker*, 312 F.3d 145 (4th Cir. 2002) .

(n25)Footnote 23. *In re Birney*, 200 F.3d 225 (4th Cir. 2000) .

(n26)Footnote 24. *In re Persky*, 893 F.2d 15, 21 C.B.C.2d 1460 (2d Cir. 1989) ; Sommer & McGarity, *Collier Family Law and the Bankruptcy Code*, P 2.06[3] (Matthew Bender).

(n27)Footnote 25. *Taylor v. Freeland and Kronz*, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280, 26 C.B.C.2d 487 (1992) ; *Matter of Dembs*, 757 F.2d 777 (6th Cir. 1985) . But see *In re Williams*, 104 F.3d 688, 37 C.B.C.2d 548 (4th Cir. 1997) (even though no objection to exemption was filed within time permitted, debtor's interest in entireties property not protected from joint creditors).

(n28)Footnote 26. See generally *In re Persky*, 893 F.2d 15, 21 C.B.C.2d 1460 (2d Cir. 1989) .

(n29)Footnote 27. 11 U.S.C. § 522(p), (q), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. These restrictions do not apply to homestead exemption claims under section 522(d)(1).

(n30)Footnote 28. Pursuant to 11 U.S.C. § 104(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, the amount is adjusted every three years.

(n31)Footnote 28a. *In re Sainlar*, 344 B.R. 669 (Bankr.M.D.Fla.2006) ; *In re Blair*, 334 B.R. 374, 376 (N.D. Tex. 2005) .

(n32)Footnote 28b. *In re Davis*, 403 B.R. 914 (Bankr. M.D. Fla. 2009) (homestead limitation in section 522(o) does not apply to debtor's tenancy by the entireties exemption).

(n33)Footnote 29. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n34)Footnote 30. 11 U.S.C. § 522(p)(1)(A), (B), (D), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. The section is also applicable to burial plots. 11 U.S.C. § 522(p)(1)(C), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n35)Footnote 31. 11 U.S.C. § 522(p)(2)(B), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n36)Footnote 32. 11 U.S.C. § 522(p)(2)(A), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n37)Footnote 32a. *Wallace v. Rogers (In re Rogers)*, 513 F.3d 212 (5th Cir. 2008) ; *In re Lyons*, 355 B.R. 387 (Bankr. D. Mass. 2006) .

(n38)Footnote 32b. *In re Greene*, 346 B.R. 835 (Bankr. D. Nev. 2006) (Nevada homestead may be acquired after purchase of property if debtor does not immediately reside there).

(n39)Footnote 33. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n40)Footnote 34. The term "securities laws" means the Securities Act of 1933 (15 U.S.C. § 77a et seq.), the Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.), the Sarbanes-Oxley Act of 2002, the Public Utility Holding Company Act of 1935 (15 U.S.C. § 79 et seq.), the Trust Indenture Act of 1939 (15 U.S.C. § 77aaa et seq.), the Investment Company Act of 1940 (15 U.S.C. § 80a-1 et seq.), the Investment Advisers Act of 1940 (15 U.S.C. § 80b-1 et seq.) and the Securities Investor Protection Act of 1970 (15 U.S.C. § 78aaa et seq.). See 15 U.S.C. § 78c(a)(47).

(n41)Footnote 35. *See 11 U.S.C. § 1964, et seq.*

(n42)Footnote 36. This test is similar to that under other subsections of 522 and other section of the Code. *See, e.g., 11 U.S.C. 1325(b)(2)(A).*

(n43)Footnote 37. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n44)Footnote 38. It is questionable whether section 522(o) should be applicable if no creditor who may have been affected years earlier by a fraudulent conversion is a creditor of the debtor at the time the petition is filed. In view of the apparent purpose of section 522(o) to protect the ability of the defrauded creditors to recover on their claims, the trustee or other parties in interest should not prevail on an exemption objection under section 522(o) if the claims of the defrauded creditors have been satisfied prior to the bankruptcy proceeding.

(n45)Footnote 39. Courts will likely look to case law under section 727(a)(2), which contains similar language, for guidance in construing the requisite intent under section 522(o).

(n46)Footnote 40. *See, e.g., Jensen v. Dietz (In re Sholdan), 217 F.3d 1006 (8th Cir. 2000)* (badges of fraud approach to infer fraudulent intent used in denying debtor's exemption based on conversion of assets to homestead property with intent to defraud creditors).

(n47)Footnote 41. *498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755, 24 C.B.C.2d 1 (1991) .*



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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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P 13.07 Procedure for Claiming Exemptions

[1] The Initial Claim

The Bankruptcy Code itself says little regarding the procedure for claiming exemptions, other than that the debtor or a dependent shall "file a list" of property claimed exempt.ⁿ¹ If the debtor does not file such a list, a dependent of the debtor may do so.ⁿ² As discussed in chapter 6, *supra*, the list is to be set forth on Schedule C of Official Form 6. Bankruptcy Rules require this list to be filed by a debtor as part of the schedules at the outset of the case. The property must be at least fairly specifically described.ⁿ³ If it is not, the debtor may later encounter problems in protecting property that was not specifically listed, or the proceeds of such property.ⁿ⁴ The description must be sufficient to put the trustee on notice of the nature of the property and the amount of the exemption.ⁿ⁵

WARNING

In some jurisdictions, debtors must be careful to make clear that they are claiming their entire interest in particular items of property as exempt. Some courts have held that if a debtor claims a homestead exemption of a specified amount in a particular property and does not also clearly assert that this is the total value of the debtor's interest in the property, the trustee may later sell the property and reserve for the debtor from the proceeds the dollar amount claimed as exempt.ⁿ⁶ Often, it should be obvious that the debtor is claiming his or her entire interest, since the amount claimed as exempt is the same amount as is listed as the value of the debtor's equity elsewhere on the debtor's schedules.^{n6a} Nonetheless, in order to prevent problems of this type, it is probably wise to state on the schedule of exemptions that, unless otherwise noted, the debtor claims as exempt the entire amount of the estate's interest in all property listed.ⁿ⁷

[2] Amending the Claim of Exemption

Under the Rules, any part of the schedules, including the exemption claim, may be amended as a matter of right before the case is closed.ⁿ⁸ Presumably, an amendment may include a change from the state to the federal exemption scheme or vice versa.ⁿ⁹ A debtor may sometimes even be allowed to reopen the case after discharge to amend the exemptions.ⁿ¹⁰

It has been held, however, that a debtor cannot exempt property which has been knowingly concealed from the

trustee.ⁿ¹¹ Additionally, some courts have held that a creditor's detrimental reliance on the debtor's original claim of exemption has been held to preclude later amendment,ⁿ¹² although the courts that have so held do not fully address why prejudice to the creditor in the absence of bad faith on the part of the debtor should be sufficient to preclude amendment or why there should be an exception that does not exist in the Federal Rules of Bankruptcy Procedure. Other courts have required the debtor who amends to include property brought into the estate by the trustee to pay the fees and costs expended by the trustee in obtaining the property.ⁿ¹³ At least with respect to property obtained by the trustee under the turnover and avoiding powers, the Code specifically provides that the exempted property is liable for its aliquot share of the costs and expenses of recovering the property.ⁿ¹⁴ In any event, a debtor may not, after the case is filed, convert nonexempt property into exempt property to claim it as exempt.

PRACTICE NOTE

One type of situation in which an amendment may be necessary is the case in which property acquired after the petition is filed becomes property of the estate.ⁿ¹⁵ The debtor is permitted to amend the exemption schedules to exempt such property if it fits within applicable exemption limits, regardless of whether a discharge has already been entered.ⁿ¹⁶

Any amendment, of course, should comply with *Rule 1009 of the Federal Rules of Bankruptcy Procedure* which requires service on all parties affected by an amendment; in the case of amended exemptions, service should presumably be made on the trustee and all creditors, except creditors already being paid in full. Failure to make proper service may extend the deadline for objections.ⁿ¹⁷

[3] Claim of Exemption by Dependent of the Debtor

In order to protect the rights of the debtor's dependents, at least to some extent, *section 522(l) of the Bankruptcy Code* permits a dependent of the debtor to claim exemptions if the debtor does not do so.ⁿ¹⁸ Clearly, this section should apply if the debtor has claimed no exemptions, perhaps due to incapacity or death. It should also apply if the debtor does not claim all of the exemptions to which the debtor is entitled, due either to negligence or spite. However, it is unlikely that a dependent could claim certain property as exempt on behalf of the debtor in lieu of other property claimed as exempt.

Federal Rule of Bankruptcy Procedure 4003(a) sets a deadline of 30 days after the debtor files schedules for a dependent to claim additional exemptions.ⁿ¹⁹ This time could presumably be extended by the court for cause under *Rule 9006(b)*, and a failure to meet the deadline could be excused for excusable neglect under the same rule.

It is not clear whether, once a dependent has claimed property as exempt, the debtor may amend that schedule, or whether the dependent may amend that schedule.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 522(l).

(n2)Footnote 2. 11 U.S.C. § 522(l). It has been held that even where the debtor files a list, a dependent of the debtor may supplement that list if other exemptions are available and unclaimed. *In re Crouch*, 9 C.B.C.2d 443, 33 B.R. 271 (Bankr. E.D.N.C. 1983). However, a nondebtor dependent may not supplement an incomplete list of federal exemptions with state exemptions. *In re Homan*, 112 B.R. 356 (9th Cir., B.A.P. 1989). See P 13.06[3] *infra*.

(n3)Footnote 3. *In re Andermahr*, 8 C.B.C.2d 1316, 30 B.R. 532 (B.A.P. 9th Cir. 1983).

(n4)Footnote 4. See *Preblich v. Battley*, 181 F.3d 1048 (9th Cir. 1999) (trustee's time for objecting to exemptions only began to run when debtor clarified that exemption claim covered escrow accounts as well as wages); *Matter of Yonikus*, 996 F.2d 866, 29 C.B.C.2d 114 (7th Cir. 1993) (debtor's exemption for workers' compensation claim denied

after debtor had initially fraudulently concealed existence of the claim); *Payne v. Wood*, 775 F.2d 202, 13 C.B.C.2d 1047 (7th Cir. 1985), cert. denied, 475 U.S. 1085 (1986) (debtors not permitted to exempt insurance proceeds of property not listed and intent to conceal property inferred).

(n5)Footnote 5. *Taylor v. Freeland and Kronz*, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280, 26 C.B.C.2d 487 (1992) (cause of action described but valued as "unknown" was sufficient to put trustee on notice of the exemption).

(n6)Footnote 6. E.g., *In re Alsberg*, 68 F.3d 312 (9th Cir. 1995) (erroneously holding that, even though debtor's interest was totally exempt at time of filing, appreciation of interest above exemption amount was not exempted); *In re Hyman*, 967 F.2d 1316 (9th Cir. 1992). The *Alsberg* holding is wrong based on 11 U.S.C. § 522(a)(2) which fixes the exemptions as of the date of filing. See *Polis v. Getaways, Inc.* (*In re Polis*), 217 F.3d 899 (7th Cir. 2000) (TILA claim should be valued for exemption purposes based on fair market value, discounted for contingency, on date of bankruptcy petition). The decision also creates a perverse incentive for trustees to hold estates open as long as possible in order to wait for property to appreciate and disincentives for debtors to make repairs and improvements to property while a case is pending.

(n7)Footnote 6a. *In re Reilly*, 534 F.3d 173 (3d Cir. 2008) (absent timely objection by trustee pursuant to *Fed. R. Bankr. P. 4003*, debtor's listing of property's value and exemption in identical amount rendered property fully exempt); *Allen v. Green* (*In re Green*), 31 F.3d 1098, 1100 (11th Cir. 1994) (debtor who exempts the entire reported value of an asset is claiming the "full amount" whatever it turns out to be); *In re Anderson*, 377 B.R. 865 (B.A.P. 6th Cir. 2007) (debtors who claimed exemption for full amount of equity listed on schedules had claimed their entire interest as exempt).

(n8)Footnote 7. See also *Mercer v. Monzack*, 53 F.3d 1, 33 C.B.C.2d 841 (1st Cir. 1995) (listing property as "100%" exempt under particular subsections of § 522(d) without giving value found to mean 100% of the available exemption under those subsections, so trustee could claim amount realized that was not within the scope of the exemption provisions cited); *Soost v. NAH, Inc.* (*In re Soost*), 262 B.R. 68 (B.A.P. 8th Cir. 2001) (debtor who claimed interest in property as exempt in amount of \$1.00 could only avoid lien to that extent). This decision is incorrect because 1) it did not follow the lien avoidance formula in 11 U.S.C. § 522(f)(2) and 2) section 522(f) refers to exemptions to which the debtor "would have been entitled" but for the lien, suggesting that technically the property is not exemptible until the lien is avoided. Nonetheless, the decision points up the need to clearly state that the debtor's entire interest is being exempted.

(n9)Footnote 8. *Fed. R. Bankr. P. 1009*; *In re Michael*, 163 F.3d 526 (9th Cir. 1998) (debtors had right to amend even after discharge if case not yet closed); *Matter of Williamson*, 804 F.2d 1355, 15 C.B.C.2d 1225 (5th Cir. 1986). See also *Lucius v. McLemore*, 741 F.2d 125, 11 C.B.C.2d 296 (6th Cir. 1984); *In re Shirkey*, 715 F.2d 859 (4th Cir. 1983); *Redmond v. Tuttle*, 698 F.2d 414, 8 C.B.C.2d 1183 (10th Cir. 1983) (exemptions may be amended at any time before case is closed); *Matter of Doan*, 672 F.2d 831, 6 C.B.C.2d 306 (5th Cir. 1982) (reversing a denial of debtor's motion to amend schedules to add exemption claim).

(n10)Footnote 9. *In re McQueen*, 21 B.R. 736 (Bankr. D. Vt. 1982).

(n11)Footnote 10. *In re King*, 27 B.R. 754 (Bankr. M.D. Tenn. 1983).

(n12)Footnote 11. See 4 *Collier on Bankruptcy*, P 522.08 (Matthew Bender).

(n13)Footnote 12. See *Kaelin v. Bassett* (*In re Kaelin*), 308 F.3d 885 (8th Cir. 2002) (debtor could exempt recently-discovered cause of action because debtor had acted promptly to amend exemptions after learning of its existence); *Osborn*, 24 F.3d 1199, 31 C.B.C.2d 92 (10th Cir. 1994) (stating that a limited exception to the general permissibility of amendments could exist if the debtors were equitably estopped, but declining to find exception applicable where misrepresentations relied upon by creditors were not made by both husband and wife debtors); *Hardage v. Herring Nat'l Bank*, 837 F.2d 1319 (5th Cir. 1988) (creditor may change litigation posture in reliance on

debtor's initial exemption claim resulting in prejudice precluding amendment).

(n14)Footnote 13. *In re Arnold*, 252 B.R. 778 (B.A.P. 9th Cir. 2000) .

(n15)Footnote 14. 11 U.S.C. § 522(k)(1).

(n16)Footnote 15. Certain types of property acquired within 180 days after the petition is filed, such as inheritances, life insurance proceeds and property settlements, become property of the bankruptcy estate. 11 U.S.C. § 541(a)(5).

(n17)Footnote 16. *In re Magness*, 160 B.R. 294 (Bankr. N.D. Tex. 1993) .

(n18)Footnote 17. Compare *In re Woodson*, 839 F.2d 610, 18 C.B.C.2d 674 (9th Cir. 1988) (creditor's objection to amendment was timely on 31st day after amendment because creditor had not been served with debtor's amendment, even though the creditor had actual knowledge of the asset about which the amendment was made) with *In re Peterson*, 929 F.2d 385 (8th Cir. 1991) (objection to amended exemption untimely where creditor had actual notice of the amendment by virtue of service of the trustee's objection 10 months earlier).

(n19)Footnote 18. A debtor may also be able to assert a nondebtor spouse's exemptions in community property, depending on state law. See *In re Perez*, 302 B.R. 661 (Bankr. D. Ariz. 2003) (debtor could assert community's exemptions in community property).

(n20)Footnote 19. See 9 Collier on Bankruptcy, P 4003.02[3] (Matthew Bender).



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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P 13.08 Objection to Claim of Exemptions

[1] Purpose of Objections

The purposes of an objection to an exemption claim are fairly obvious. The purpose of exemption laws has always been to allow debtors to keep those items of property deemed essential to daily life. Other than the exempt property, virtually all of the debtor's interests in property that have value are transferred to the trustee for the benefit of creditors. A trustee (on behalf of creditors) or a creditor stands to gain if a debtor's claim of exemptions are reduced, since the less a debtor is able to exempt, the more creditors may hope to receive in a payout. If the debtor undervalued an item on Schedule C, and the true value of that item is more than the allowable exemption, the trustee has the right to take possession of the item and sell it. The value of the item in excess of the exemption permitted will be distributed to creditors. Any property brought back into estate increases the size of the estate and therefore the trustee's fee. If the trustee wins an objection concerning a pension plan, for example, there may be a very substantial fund to liquidate or to distribute to creditors, of which the trustee will stand to receive a percentage as part of his or her fee.

Unless a party in interest objects to the debtor's exemptions, the property scheduled by the debtor as exempt shall be deemed to be exempt. This finalization of the exemptions effectively accepts the debtor's valuation of his or her interest in the property claimed as exempt within the scope and dollar value of the applicable exemption statutes.

[2] How to Object to an Exemption

The procedure and deadline for filing objections to the claim of exemptions are governed by *Federal Rule of Bankruptcy Procedure 4003(b)*.¹

[a] Who May Object

Section 522(1) of the Bankruptcy Code refers to the possibility of objections to claims of exemption by "a party in interest." In most cases the party who would be likely to object is the trustee. Although creditors can object to debtor's exemptions, they often do not object, instead letting the trustee shoulder the expense and burden of litigation.

[b] Procedure for Making an Objection

Under *Rule 4003(b)*, objections to exemptions must be filed and must therefore be in writing. Copies of all objections to

exemptions must be served on the trustee, the person filing the list of exemptions claimed and the attorney for that person. The copies may be served either by personal delivery or by mail. A process server is not required.

FORMS

For an example of an objection to an exemption see *Collier Consumer Bankruptcy Forms, Form CS17.13-1* (Matthew Bender).

An objection to exemptions initiates a contested matter under *Federal Rule of Bankruptcy Procedure 9014*. Under *Rule 9014* unless the court orders otherwise, no answer to the objections need be filed. However, while no response by the debtor is required to the objection to a claim of exemption, it is still desirable from the debtor's standpoint to respond. This response could be in writing or the debtor could merely attend the hearing on the objection and proffer evidence then.

MORE INFORMATION

For further discussion of procedure in contested matters see chapter 32 *infra*.

Although another proceeding in which the propriety of the exemption claim is raised may in some cases be an adequate substitute for a separate objection to exemptions, any such proceeding must clearly put the debtor and the debtor's counsel on notice of the objection to the exemptions claimed and be filed within the deadline set forth in *Rule 4003(b)*.ⁿ²

[c] Thirty Day Deadline for Filing Objections

In any case, all objections to exemptions must be filed within 30 days after the conclusion of the meeting of creditors held pursuant to *Rule 2003(a)*, or the filing of any amendment to the exemption list, unless a motion for an extension of time is filed within that time period and is thereafter granted by the court.ⁿ³ An objection to an amended exemption claim may only raise issues concerning the amendment if the time for objecting to the initial claim has run.ⁿ⁴ If an objection is not timely filed, it cannot be considered.ⁿ⁵

The only exceptions to the thirty-day rule for filing objections to exemptions are contained in *Bankruptcy Rule 4003(b)(2)* and *(3)*. *Rule 4003(b)(2)* permits the trustee, and only the trustee, to object to a fraudulently asserted exemption within one year after the case is closed. This exception is unlikely to be utilized often, because a trustee seldom devotes any attention to a case after it is closed. It would probably come into play only if some third party alerted the trustee to an alleged fraudulent exemption claim. Presumably, the usual standards for proving fraud would determine whether this extended deadline could be used by a trustee.

Rule 4003(b)(3) governs exceptions under section 522(q), which limits a state homestead exemption to \$136,875 for debtors who have been convicted of certain crimes or are liable for certain bad acts. This type of objection, which can only be made if the debtor claims a state homestead exemption in excess of that amount, will be rare. If made, it must be filed before the closing of the case. However, if the case is reopened, it may be made at any time before the reopened case is again closed.

Converting a case from another chapter to chapter 7 does not start a new 30-day period to object.ⁿ⁶ The deadline for objections to an amended claim of exemptions is also strictly enforced. Some courts have been willing, however, to allow such objections in exceptional cases in which a party with a significant interest in the debtor's exemptions was not served with the amendment.ⁿ⁷ In keeping with the court's function under the Bankruptcy Code of resolving only those disputes brought before it, such an extension of time will normally be granted only on motion of a party with standing to object to exemptions, and only for cause. The deadline for filing objections to exemptions is specifically excluded from

those deadlines which may be extended, under *Bankruptcy Rule 9006(b)*, after they expire due to excusable neglect.ⁿ⁸

[d] Burden of Proof on Party Objecting to Exemption

Rule 4003(c) follows the language of *section 522(l) of the Bankruptcy Code* in making the claim of exemptions presumptively valid by placing the burden of proof on the party alleging that the exemptions were not properly claimed.ⁿ⁹ Section 522(l) states "the property claimed as exempt is exempt" unless a party in interest objects to the claim. As the 1983 Advisory Committee Note to the Rule recognizes, this represents a substantial change from the prior rules, under which the trustee's report on exemptions was presumptively valid and any party who challenged it, including the debtor, bore the burden of proof.

[e] Validity of Objection to Exemption Must Be Determined at a Hearing

Rule 4003(c) requires the court to hold a hearing, on notice, regarding any objection to the list of exemptions claimed. Only after such a hearing may the court determine the issues presented by the objections, such as the scope of state or federal exemption statutes or other issues of law or fact.

[3] Grounds for Objections to Exemptions

[a] Objection When Value of Property Claimed Exceeds Amount Allowed By Statute

If the debtor undervalued an item on Schedule C, and the true value of that item is more than the allowable exemption, the trustee has the right to take possession of the item and sell it. Such valuation disputes are the most common types of exemption objections. Alternatively, the debtor may have claimed as exempt an amount higher than that permitted by applicable law. In either case, the excess value of the item will be distributed to creditors if a proper objection is filed.

[b] Objection to Exemption of Pension and Profit Sharing Plans

Undervaluation of pension and profit sharing plans of self-employed individuals is frequently a target of an attack on exemptions because of the large amounts of money involved. If these plans do not qualify as ERISA plans or as spendthrift trusts,ⁿ¹⁰ they must be exempted under state or federal law. For funds claimed exempt under section 522(d)(10)(E), this may raise issues of whether the pension is reasonably necessary for the debtor's support or the support of a dependent of the debtor. For funds claimed exempt under section 522(d)(12), it may raise issues of whether all or some of the funds in the fund were not eligible for tax deferral and therefore not protected by the relevant exemption statute.

The biggest issues concerning exemptions arise in chapter 7 cases filed by well-paid, self-employed debtors such as physicians. The chapter 7 trustee may raise the issue in a contested matter of how much, if any, of the sometimes hundreds of thousands of dollars in the professional person's self-settled pension and profit sharing plan, not otherwise exempt under 522(b)(3)(C), may be exempted under section 522(b)(3)(A) by virtue of state and federal nonbankruptcy law. Although from the date of appointment the chapter 7 trustee will not begin to administer the pension fund, the trustee will often become the representative of the prepetition creditors in objecting to the exemption.ⁿ¹¹ The trustee may end up with a very substantial fund to liquidate or to distribute to creditors, if the trustee wins on the objection.

[c] Bankruptcy Fraud Committed By Debtor

The trustee may allege that the debtor committed fraud by illegal prebankruptcy planning. For example, if the debtor sold property in contemplation of bankruptcy and used the proceeds to purchase exempt property in order to defraud creditors, that too may draw an objection. Usually, such objections arise when the debtor has recently changed the character of large amounts of property in the context of unlimited state exemptions for annuities and pension-like savings that are unlimited in scope. The case law on whether and to what extent such planning is permitted is very

confused.n12

Another type of bankruptcy fraud involves concealment of property. Concealment can exist in less obvious forms than the mere failure to list an item on Schedule C. The schedules that a debtor must complete are comprehensive in scope but are not subject to inspection for compliance when filed. Accordingly, some debtors have resorted to misleading descriptions of property, relying on generic rather than readily available descriptions. If these actions are done knowingly and fraudulently, these actions can constitute concealment in that although technically accurate, they impede the trustee's duties.n13

However, the level of specificity needed when filling out schedules is low. While descriptions such as "assets of the value of \$2,987.26" and "merchandise commonly sold in a self-service department store" have been held to be too vague, little more is necessary to cure any defect. Courts have upheld, for example, descriptions such as "merchandise inventory consisting of miscellaneous groceries." But sometimes a debtor will, with the requisite criminal intent, obscure the whereabouts of estate assets through creative or sloppy bookkeeping. Similarly, a debtor might disclose ownership of three Renoir paintings as "three paintings, value unknown," a statement which while technically accurate, demonstrates an intent to conceal some value in those paintings from the trustee.n14

WARNING

Bad faith exemption claims which are not grounded in fact or law not only create the risk of a successful objection and the loss of the property claimed as exempt, but also expose debtors and their counsel to the risk of sanctions. There are strong sanctions that could befall the debtor if it is proven that bankruptcy fraud was committed. The trustee has a duty under *section 704 of the Code* to oppose the discharge of the debtor "if advisable." A debtor could be denied a discharge under *section 727 of the Bankruptcy Code*,n15 or the debtor's case could be dismissed. Obviously, in circumstances that would warrant a prosecution by a United States attorney based on such actions, the debtor's case would also be dismissed by the court, or the debtor's discharge would be denied.

[d] Item Not Exempt Under the Code or State Statute

It is possible that (whether deliberately or inadvertently) a debtor might have listed as exempt an item that is not exempt under the applicable laws. For example, under the exemption law in the state of New Jersey, there is no exemption for an automobile. If a debtor wanted to use the New Jersey exemptions, the debtor could not claim as exempt any value in an auto. There may also be a legitimate dispute raised by the trustee or a creditor regarding whether an item fits within a category such as tools of the debtor's trade or the particular types of personal injury damages that may be exempted.

[e] Cap or Limitation on State Homestead Exemption

The 2005 amendments to the Bankruptcy Code created several potential limitations on the debtor's ability to maximize the homestead exemption under applicable state law for cases in which 1) a homestead interest has been acquired within 1215 days before the commencement of the case, 2) the debtor has committed certain criminal or unlawful acts, or 3) the debtor has fraudulently converted nonexempt assets to homestead property within the 10 years prior to filing and with intent to hinder, delay or defraud a creditor. In situations where the trustee or a creditor is successful in proving one of these limitations, there may be significant additional funds to distribute to creditors if the homestead property is liquidated.

[4] Valuation Questions

Valuation issues will be prominent in hearings on objections. As in other areas of bankruptcy procedure, questions of value may become critical in objections to exemption claims. Under *section 522(a)(2) of the Bankruptcy Code*, property claimed as exempt should be valued as of the date the petition was filed, unless it came into the estate on a later

date.ⁿ¹⁶ Conversion of a case from one chapter to another under *section 348(a) of the Bankruptcy Code* does not change the relevant date for calculating value for the purpose of determining exemptions.ⁿ¹⁷ Similarly, a change in the applicable exemption law following the filing of the case will not be applied after the fact. The law in effect at the time of filing determines the property which may be exempted.^{n17a}

PLANNING NOTE

It is likely that the trustee or creditor making the objection will have to have expert testimony as to the value of the item claimed exempt, which may mean hiring a real estate appraiser, auctioneer or other witness qualified to testify as to value of the property at issue. Discovery should normally be conducted to obtain before trial any appraisal reports or other evidence that will be introduced by the opposing party.

While the goal in some types of litigation may be to prove a high value for property, in exemption claims the debtor will usually want to show the property to have a low value, within the exemption limits. An objecting party, of course, will attempt to prove a higher value. While it can be argued that the different purposes of the valuations should lead to different values in each case, it is certainly preferable to try to be consistent, which means carefully planning strategy from the outset. In fact, at least if value is determined in one proceeding and the purpose of valuation is the same in a subsequent proceeding, collateral estoppel may bar a party from relitigating the question of value.

The debtor will usually want to argue that for exemption purposes the "fair market value" of section 522(a)(2) is liquidation value, since the purpose of the valuation is to see if liquidation of the property will produce cash in excess of the exemption amount. There is no purpose in a trustee liquidating property if the proceeds will all go to the debtor as exempt.

Of course, if the property is sold during the bankruptcy case, the sale price will normally be the best evidence of its value.ⁿ¹⁸ When property is sold by the bankruptcy trustee during the bankruptcy case and unexpected proceeds are realized, the debtors may be allowed to amend their exemption claim and thereby to obtain the exempt share of the funds raised.ⁿ¹⁹

[5] Exemptions Automatically Allowed Absent Objection

Pursuant to section 522(l), if no timely and successful objection to the debtor's exemptions is made, the exemptions listed by the debtor are automatically allowed.ⁿ²⁰ *Federal Rule of Bankruptcy Procedure 4003(b)* states that untimely objections cannot be entertained by the court, whether or not the original exemption was proper.ⁿ²¹

The significance of the deadline for objecting to a claim of exemption was emphasized by the Supreme Court in *Taylor v. Freeland and Kronz*.ⁿ²² Affirming a decision of the Court of Appeals for the Third Circuit,ⁿ²³ the Court held that there was no "bad faith" exception to the deadline for filing such objections, even when it was alleged that there was no colorable statutory basis for the exemptions claimed. Thus, although it eventually became clear in the *Taylor* case that the debtor's interest in an employment discrimination claim was far in excess of the applicable exemption limits, the failure of any party to file a timely objection to the debtor's scheduling of the entire claim as exempt meant that the trustee could not later challenge the exemption of the entire claim.

Noting that deadlines sometimes lead to unwelcome results, the Court reasoned that they nonetheless must be observed since they prompt parties to act and they promote finality.ⁿ²⁴ The Court observed that the trustee had notice of the claim's existence and uncertain value, and could have investigated further or sought an extension of time to object to the exemption.ⁿ²⁵ The possibility of debtors making groundless exemption claims with impunity was deemed an insufficient reason to ignore the plain language of the Rule and the statute, especially in view of other protections

against groundless claims,ⁿ²⁶ such as the possibility of a denial of discharge under *section 727 of the Bankruptcy Code*,ⁿ²⁷ or of civil or criminal sanctions under *Rule 9011*ⁿ²⁸ of the Federal Rules of Bankruptcy Procedure or *section 152 of title 18, United States Code*.ⁿ²⁹

This finalization of the exemptions effectively accepts the debtor's valuation of his or her interest in the property claimed as exempt within the scope and dollar value of the applicable exemption statutes.^{n29a} Only when a debtor's schedules specifically value the debtor's interest in the property at an amount higher than the amount claimed as exempt can it be argued that a part of the debtor's interest in property has not been exempted. In other words, the debtor's valuation of the property for exemption purposes must be accepted once the deadline for objections has passed. These same principles also apply, of course, to a list of exemptions claimed by a dependent of the debtor, although a dependent is probably not bound by the debtor's valuation of the property elsewhere in the schedules.

Debtors should also beware of trustees' attempts to indefinitely extend the time for objections. Some trustees have indefinitely "adjourned" the meeting of creditors to prevent the conclusion of the meeting, from which the time period begins to run. Such adjournments should not be permitted, since they render the deadline for objections meaningless.ⁿ³⁰ Others have attempted in other ways to keep their options open without litigating an objection.ⁿ³¹

PRACTICE NOTE

Since a trustee or a creditor can dispute an exemption only by affirmatively filing a timely objection, a debtor's attorneys should not acquiesce to a mere request to turn over property to the trustee which the debtor claims as exempt. In practice, as often as not, the trustee will never file the necessary objection. In those instances when an objection is actually timely filed, the debtor can then litigate the question of whether the property is actually exempt.

Once property is exempt by virtue of the expiration of the deadline for objections, nothing prevents the debtors from using or otherwise disposing of their exempt interest.ⁿ³² When a single piece of property is only partially exempt, the debtor may retain the entire property until the trustee pays the value of the exemption to the debtor in cash.ⁿ³³ Importantly, this means that the debtor can continue to reside in property which the trustee may liquidate without responsibility to the trustee for rent or other payments.ⁿ³⁴ Moreover, under section 522(k), the trustee must pay the entire exemption amount to the debtor before the trustee can use the proceeds of the sale to pay any costs or fees in connection with the sale.ⁿ³⁵

[a] Deadline for Filing Objections Cannot be Extended Once It Has Expired

Once the deadline for objections to exemptions has passed, no objection may be filed unless the claim of exemptions is later amended.ⁿ³⁶ Under *section 522 of the Bankruptcy Code*, then, if the debtors are not already in possession of the property claimed as exempt it should be turned over to them at this time to effectuate fully the fresh start purpose of the exemptions.ⁿ³⁷

[6] Consequences for Debtor if Objection Is Allowed

If the debtor loses a contested matter concerning a significant exemption, the debtor may need to rethink its entire case. If large amounts of property are not exempt, and thus would be lost in a chapter 7 liquidation case, a chapter 13 case will usually be preferable and the debtor could convert the case to chapter 13.ⁿ³⁸ In a chapter 13 case, the amount of nonexempt property may determine the minimum that must be paid to unsecured creditors.ⁿ³⁹ If that amount cannot be paid through the plan, then a chapter 13 case may not be feasible. The debtor may be forced then to dismiss his or her case.ⁿ⁴⁰ Of course, in either chapter 7 or chapter 13, the debtor could also continue the case and simply allow the now non-exempt property to be sold as part of the bankruptcy estate.

FOOTNOTES:

(n1)Footnote 1. *See* 9 *Collier on Bankruptcy*, P 4003.03 (Matthew Bender).

(n2)Footnote 2. *In re Harrigan*, 74 B.R. 224 (N.D. Ill. 1987) .

(n3)Footnote 3. *Fed. R. Bankr. P. 4003(b)*, as amended by the 2000 Amendments to the Federal Rules of Bankruptcy Procedure.

(n4)Footnote 4. *In re Kahan*, 28 F.3d 79 (9th Cir. 1994) *Matter of Kazi*, 985 F.2d 318 (7th Cir. 1993)

(n5)Footnote 5. *See* P 13.07[5] *infra*.

(n6)Footnote 6. *In re Bell*, 225 F.3d 203 (2d Cir. 2000) ; *In re Smith*, 235 F.3d 472 (9th Cir. 2000) . *But see Weissman v. Carr*, 173 B.R. 235 (M.D. Fla. 1994) (time period began to run again after chapter 7 meeting of creditors in converted case). *In re Robertson*, 105 B.R. 440 (Bankr. N.D. Ill. 1989) . *But see Alexander v. Jensen-Carter (In re Alexander)*, 236 F.3d 431 (8th Cir. 2001) (chapter 7 trustee could raise objection to exemptions claimed in new Schedule C in chapter 7 case after conversion from chapter 13 when debtor claimed same exemption that had been disallowed in chapter 13 case). At least one court has held that judicial decisions reached after the filing, but prior to conversion can be applied to a debtor's post-conversion exemptions. *In re Marcus*, 128 B.R. 294 (Bankr. D. Colo. 1991) .

(n7)Footnote 7. Thus, the Court of Appeals for the Ninth Circuit allowed an objection to an amendment adding a one million dollar exemption claim in a chapter 11 case, when the objection was filed one day late by a creditor holding ninety percent of the unsecured claims who had not been served with the amendment. *In re Woodson*, 839 F.2d 610, 18 C.B.C.2d 674 (9th Cir. 1988) . The court noted, however, that the debtor's duty to serve creditors is "narrower" in a case in which there is a trustee to protect the creditors' interests. *Woodson at 839 F.2d 615, n.6, 18 C.B.C.2d 680, n.6* .

(n8)Footnote 8. *See* 10 *Collier on Bankruptcy*, P 9006.08 (Matthew Bender).

(n9)Footnote 9. *See* 9 *Collier on Bankruptcy*, P 4003.04 (Matthew Bender).

(n10)Footnote 10. *See* P 13.04[11][a] *supra*.

(n11)Footnote 11. *See, e.g., Lichstrahl v. Bankers Trust (In re Lichstrahl)*, 750 F.2d 1488, 12 C.B.C.2d 211 (11th Cir. 1985) ; *Samore v. Graham (In re Graham)*, 726 F.2d 1268, 10 C.B.C.2d 111 (8th Cir. 1984) .

(n12)Footnote 12. *See* 4 *Collier on Bankruptcy*, P 522.08[4] (Matthew Bender).

(n13)Footnote 13. *United States v. Grant*, 971 F.2d 799, 807 (1st. Cir. 1992) (defendant's listing of "15 prints and photographs" at a certain address not sufficiently specific to rebut charge that other prints had been concealed).

(n14)Footnote 14. Evidence of the defendant's pattern of activity must be shown to prove fraud. *See United States v. Grant*, 971 F.2d 799 (1st Cir. 1992) .

(n15)Footnote 15. *See* ch. 29 *infra*.

(n16)Footnote 16. 11 U.S.C. § 522(a)(2). *See also Polis v. Getaways, Inc. (In re Polis)*, 217 F.3d 899 (7th Cir. 2000) (TILA claim should be valued for exemption purposes based on fair market value, discounted for contingency, on date of bankruptcy petition). *But see Alsberg v. Robertson (In re Alsberg)*, 68 F.3d 312 (9th Cir. 1995) , *cert. denied*, 517 U.S. 1168 (1996) (erroneously holding that, even though debtor's interest was totally exempt at time of filing, when debtor first claimed exemption long after the petition was filed, trustee could object that appreciation of interest above exemption amount was not exempted).

(n17)Footnote 17. See *In re Kaplan*, 97 B.R. 572 (Bankr. 9th Cir. 1989) .

(n18)Footnote 17a. *In re Hall*, 1 F.3d 853 (9th Cir. 1993) ; *In re Marcus*, 1 F.3d 1050 (10th Cir. 1993) .

(n19)Footnote 18. *Fitzgerald v. Davis*, 729 F.2d 306 (4th Cir. 1984) .

(n20)Footnote 19. *Armstrong v. Hursman*, 106 B.R. 625 (D.N.D. 1988) .

(n21)Footnote 20. See *Taylor v. Freeland and Kronz*, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280, 26 C.B.C.2d 487 (1992) . *Coie*, 36 F.3d 473, 32 C.B.C.2d 575 (5th Cir. 1994) (even if exemption is without merit, failure of any party to file a timely objection results in allowance of exemption); *In re Green*, 31 F.3d 1098, 31 C.B.C.2d 1449 (11th Cir. 1994) (if no party challenges debtor's valuation of asset claimed as fully exempt, debtor is entitled to exempt the entire asset regardless of what the value ultimately proves to be).

(n22)Footnote 21. *Taylor v. Freeland and Kronz*, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280, 26 C.B.C.2d 487 (1992) .

(n23)Footnote 22. 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280, 26 C.B.C.2d 487 (1992) .

(n24)Footnote 23. 938 F.2d 420, 25 C.B.C.2d 167 (3d Cir. 1991) .

(n25)Footnote 24. 503 U.S. 638, 644, 112 S. Ct. 1644, 1648, 118 L. Ed. 2d 280, 287, 26 C.B.C.2d 487, 491 .

(n26)Footnote 25. 503 U.S. 638, 644, 112 S. Ct. 1644, 1648, 118 L. Ed. 2d 280, 287, 26 C.B.C.2d 487, 491 .

(n27)Footnote 26. 503 U.S. 638, 644-645, 112 S. Ct. 1644, 1648-1649, 118 L. Ed. 2d 280, 287-288, 26 C.B.C.2d 487, 491-492 .

(n28)Footnote 27. See ch. 29 *infra*.

(n29)Footnote 28. See 10 *Collier on Bankruptcy*, P 9011.05-. 07 (Matthew Bender).

(n30)Footnote 29. See 1 *Collier on Bankruptcy*, P 7.02 (Matthew Bender).

(n31)Footnote 29a. However, resolving a dispute in the case law, *Bankruptcy Rule 4003(d)* was amended in 2008 to provide that a creditor can challenge the exemptibility of property in a lien avoidance proceeding even if the creditor did not object to the exemption of the property within the normal deadline for exemption objections under *Rule 4003(b)*. *Rule 4003(d)* now gives the creditor a second bite at the apple, stating that the creditor can defend a lien avoidance motion by challenging the validity of the exemption that the debtor claims is impaired by the lien. The Advisory Committee Note to this change makes clear that this right to object applies only to the lien avoidance proceeding and does not give the creditor the right to object to any other claims of exemption. 2008 Advisory Committee Note to *Federal Rule of Bankruptcy Procedure 4003*.

(n32)Footnote 30. See *In re Smith*, 235 F.3d 472 (9th Cir. 2000) (trustee could not adjourn section 341 meeting indefinitely; rules required specific place and time); 3 *Collier on Bankruptcy*, P 341.02[5][g] (Matthew Bender).

(n33)Footnote 31. *In re Thomas*, 236 B.R. 573 (Bankr. E.D.N.Y. 1999) (trustee could not file "no asset report," close case, and still retain right to reopen if cause of action proved to have unexpected value).

(n34)Footnote 32. *Wissman v. Pittsburgh Nat'l Bank*, 942 F.2d 867, 25 C.B.C.2d 605 (4th Cir. 1991) (debtors may pursue an exempt cause of action in order to recover their exemption). But see *In re Salzer*, 52 F.3d 708 (7th Cir. 1995) (reading Indiana law to delay revesting of exempt property in debtor).

(n35)Footnote 33. *Matter of Szekely*, 936 F.2d 897, 24 C.B.C.2d 2028 (7th Cir. 1991) ; *Home Ins. Co. v. Cooper & Cooper, Ltd.*, 889 F.2d 746, 748 (7th Cir. 1989) .

(n36)Footnote 34. *Matter of Szekely*, 936 F.2d 897, 24 C.B.C.2d 2028 (7th Cir. 1991) (homestead exemption in Illinois entitles a debtor to remain in home rent free until debtor receives the full cash value of the exemption).

(n37)Footnote 35. *In re Allen*, 203 B.R. 925 (W.D. Va. 1997) .

(n38)Footnote 36. *See In the Matter of Brandstaetter*, 767 F.2d 324 (7th Cir. 1985) .

(n39)Footnote 37. *Ball v. Nationscredit Fin. Serv. Corp.*, 207 B.R. 869 (N.D. Ill. 1997) (exempt property reverts in debtor when time to object to exemptions expires); *Seifert v. Selby*, 125 B.R. 174 (E.D. Mich. 1989) (once an item of property has been claimed as exempt without timely objection it reverts in the debtor, even when value of debtor's interest actually exceeds statutory exemption amount).

(n40)Footnote 38. *See* ch. 24 *infra*.

(n41)Footnote 39. *See* ch. 14 *infra*.

(n42)Footnote 40. *See* ch. 23 *infra*.



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CHAPTER 13 Exemptions: Claiming and Objecting to Them

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P 13.09 Protection of Exempt Property After Discharge

Still another important feature of the bankruptcy exemption scheme is the continuing protection given to exempt property after the discharge. Section 522(c) provides that, with a few exceptions, no creditor holding a prebankruptcy claim may ever execute against the property that has been claimed as exempt.

PRACTICE NOTE

The principal significance of this subsection is that even creditors holding claims that were not discharged may not reach exempt property to execute on their still-valid claims. Thus, if a debt is not discharged because of a false financial statement, because the debt was not listed, because of fraud, or willful and malicious injury, or on a student loan, the debtor may nevertheless be fully protected from execution on that debt if he or she has no property except the property exempted in the bankruptcy case.ⁿ¹ The only exceptions to this general rule are debts for nondischargeable taxes, domestic support obligations, liens that are not avoided during the bankruptcy, and debts in connection with student financial assistance fraud.^{n1a}

This provision serves the obvious purpose of ensuring that the debtor's fresh start is not frustrated by pre-existing debts. It gives the exemptions a permanent character, protecting that minimum grubstake afforded by the exemption provisions (either state or federal) from almost every attack arising out of the debtor's prebankruptcy circumstances.

The protections of section 522(c) do give rise to some issues as to how the exemptions will be applied in later executions on nondischarged prebankruptcy debts. Clearly, property acquired after the bankruptcy is not protected, unless the debtor is able to exempt it under one of the provisions allowing exemption of the right to receive certain benefits in the future.ⁿ² But does the exemption apply forever to the items exempted, or only to the extent of the value exempted? In other words, is a debtor's increased equity in a home totally protected because the home was exempted in the bankruptcy? Certainly, this would further the purpose of protecting the debtor's basic necessities if the increase was caused simply by inflation. But the result might be different if the increased equity was purchased with after-acquired assets used to make mortgage payments. Similarly, with more liquid assets, such as bank accounts, difficult problems of tracing may arise in determining whether certain property was exempted in the bankruptcy.

In such cases, there are also questions as to the interplay of the bankruptcy exemptions with the state's normal

exemptions from execution. If certain property of the debtor is protected from execution by section 522(c), presumably the debtor may then claim other property as exempt under the state's exemption scheme in the execution. Does it make a difference if, in the bankruptcy, the debtor had been claiming property under the state exemption scheme already, rather than the federal bankruptcy exemptions? In order to promote equality of treatment, it should not.

FOOTNOTES:

(n1)Footnote 1. *In re Cunningham*, 513 F.3d 318 (1st Cir. Mass. 2008) (creditor holding non-dischargeable debt could not execute against proceeds of homestead that was exempted in bankruptcy because allowing creditor to pursue proceeds would § 522(c) permanent immunization of exempt property from prepetition claims);

(n2)Footnote 1a. 11 U.S.C. § 522(c). These exceptions do not eliminate state law protections for property that would never have been subject to such claims outside of bankruptcy. *Davis*, 170 F.3d 475 (5th Cir. 1999) (*en banc*). However, an exception to this rule was created for domestic support obligations, under section 522(c)(1), as amended by Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005. This exception applies to execution after bankruptcy and does not permit a bankruptcy trustee to administer the property, the exemption of which removes it from the estate the trustee can administer.

(n3)Footnote 2. *E.g.*, 11 U.S.C. § 522(d)(10), (11).



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CHAPTER 14 The Chapter 13 Plan

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CHAPTER 14 The Chapter 13 Plan

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Scope

SCOPE NOTE

The chapter begins with a discussion of the purpose of the chapter 13 plan. Next, the chapter discusses the provisions which must be included in every plan, as well as other provisions that the debtor is permitted to include. The chapter then covers the standards for minimum payments to both secured and unsecured creditors, as well as the classifications of various claims. There is also an examination of the good faith test under which plans are evaluated. Finally, the chapter outlines the procedure for modification of the plan before confirmation.



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CHAPTER 14 The Chapter 13 Plan

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P 14.01 Purpose of the Chapter 13 Plan

Adjustment of debts under chapter 13 is an alternative to liquidation under chapter 7. Chapter 13 debtors, unlike chapter 7 debtors, typically keep some or all of their nonexempt assets. In return for this, creditors can look to the debtor's future income, as well as assets, to ensure that they will receive at least as much as they would receive under a chapter 7 liquidation. In addition, chapter 13 debtors have greater rights in dealing with secured creditors and receive a broader discharge than chapter 7 debtors.

Liquidation cases under chapter 7 and rehabilitation cases under chapter 13 are thus significantly different in the means employed to accomplish the similar aim of giving the debtor a fresh start. Liquidation cases offer debtors the opportunity to protect their future income stream and exempt assets from creditor collection efforts in return for the relinquishment of their nonexempt assets for ratable distribution among creditors. Chapter 13 is designed to facilitate adjustments of the debts of individuals with regular income through use of the debtor's future income, under the protection of the court. Chapter 13 debtors can keep all or some of their nonexempt assets and modify the rights of secured creditors in return for the relinquishment of a portion of their future income stream.

The vehicle for achieving relief in chapter 13 is the debtor's chapter 13 plan. The legislative history of chapter 13 demonstrates that Congress expanded debtors' rights in chapter 13 to encourage financially overextended individual debtors to make greater *voluntary* use of repayment plans commensurate with each debtor's abilities. By enacting a simplified, expanded, and more flexible chapter 13,ⁿ¹ Congress has effectively improved debtor relief and creditor recoveries.

FOOTNOTES:

(n1)Footnote 1. H.R. Rep. No. 595, 95th Cong., 1st Sess. 117-120 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).



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CHAPTER 14 The Chapter 13 Plan

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P 14.02 Filing Requirements for Chapter 13 Plans

[1] Time Requirements for Filing the Plan

Normally the chapter 13 plan is filed with the petition. If not filed with the petition, it may be filed within 14 days afterwards.ⁿ¹ When a case is converted to chapter 13, the plan must be filed within 14 days after the conversion.ⁿ² The time for filing the plan may not be further extended except for cause shown and on such notice as the court may direct.ⁿ³

Cause for extending the time for filing a plan more than 14 days after the filing of the chapter 13 petition could include:

- a financial emergency (*e.g.*, an impending foreclosure) in which there is an immediate need to file the petition, but all the information needed for the plan is not yet available;
- a sudden illness or emergency absence from the jurisdiction; or
- an emergency situation in the debtor's business, employment, or employment search.

If the debtor cannot file the plan within the 14 days normally permitted, the debtor must file a motion for an extension of time for filing the plan before that deadline expires. Often, this motion is combined with a motion for an extension of time to file the required schedules and statements.

[2] Number of Copies of Plan that Must Be Filed

In most cases the plan, like other documents, is filed electronically. When a paper copy is filed, only one original plan need be filed with the clerk of the bankruptcy court unless local rules require additional copies. Some courts require additional copies be filed for use by the chapter 13 trustee and the United States trustee. In addition, in some districts, sufficient copies of the plan, or summaries of the plan, must be filed for mailing by the clerk to each creditor, along with the notice of the hearing on confirmation.ⁿ⁴

Local rules may vary these procedures and may impose a direct requirement that the debtor serve copies of the plan on creditors and others. Gradually, the adoption of electronic case filing and availability of electronic access to documents is reducing these requirements for filing and service of hard copies.

[3] When Plan Payments Must Begin

Under section 1326(a)(1) (as amended)ⁿ⁵ of the Bankruptcy Code, the payments proposed by the plan must begin within 30 days of the filing of the plan, or the order for relief (petition or conversion date), whichever is earlier, unless the court orders otherwise. This means that payments typically begin before confirmation of the plan.

Section 1326(a)(2) of the Bankruptcy Code requires the trustee to retain the debtor's preconfirmation payments until confirmation or denial of confirmation. If the plan is confirmed, the trustee is directed to begin distribution "as soon as practicable." If confirmation is denied, the payments are returned to the debtor after a deduction for unpaid administrative expenses and any adequate protection payments that are due and owing creditors under section 1326(a)(3).

[4] Other Payments

Section 1326(a)(1) also requires payments, governed by the same deadline, to certain secured creditors and lessors of personal property.

[a] Adequate Protection Payments

Section 1326(a)(1)(C), enacted in 2005,ⁿ⁶ requires a chapter 13 debtor to make adequate protection payments directly to a creditor holding an allowed claim secured by personal property to the extent it is "attributable to the purchase of such property by the debtor for that portion of the obligation that becomes due after the order for relief." These payments are to commence within 30 days after the filing of the plan or the order for relief, whichever is earlier. Plan payments are to be reduced by the amount of such payments and the trustee is to be provided evidence of the payments, including the amounts and dates of the payments.

The amount of adequate protection payments presumably will initially be set by the debtor and be based on the rate of the collateral's depreciation.ⁿ⁷ This can be calculated for a vehicle by looking at the change in industry guide values over the previous few months. However, if a claim is substantially oversecured, and will remain oversecured, there should be no need for adequate protection payments, or they should be nominal. The amount of payments can be modified by order of the court "pending confirmation of a plan,"ⁿ⁸ which suggests that the plan will govern thereafter.

PRACTICE NOTE

There is no requirement that the payments be made at any particular time intervals. For ease of administration, a debtor may wish to make one payment, directly through the attorney's office to facilitate bookkeeping and providing evidence to the trustee. When such a payment for the preconfirmation period is less than a full plan payment, as will usually be the case, the amount paid will be deducted from the first plan payment due. Because the court can modify the adequate protection requirements, some courts have adopted general orders or local rules that direct payments to be made through the trustee for ease of administration and set a default percentage of value for such payments.

The statute does not specifically state whether adequate protection payments end as of plan confirmation. There is nothing in the provision that sets an ending date. However, the plan is required by language added to section 1325(a)(5) to provide that payments on allowed secured claims under the plan be sufficient to provide adequate protection, and the plan can certainly provide that adequate protection shall be provided by such payments.

The remedy for failure to make required adequate protection payments is likely to be relief from the automatic stay, the same remedy as under prior law for failure to provide adequate protection.ⁿ⁹ The main difference is that prior law in

effect placed the burden on the creditor to demand adequate protection, usually by filing a motion. However, a creditor will still have to file a motion for relief from the stay if adequate protection payments have not been provided, and the court may well allow a debtor to cure such a default in payments.

[b] Payments to Lessors of Personal Property

Section 1326(a)(1)(B), added in 2005,ⁿ¹⁰ requires a chapter 13 debtor to make payment scheduled in a personal property lease "directly to the lessor for that portion of the obligation that becomes due after the order for relief." These payments are to commence within the same 30 days after the filing of the plan or the order for relief, whichever is earlier. Plan payments are to be reduced by the amount of such payments and the trustee is to be provided evidence of the payments, including the amounts and dates of the payments.

For leases that a debtor intends to assume, it has long been the practice to make current payments to the lessor after a chapter 13 petition is filed and to cure any default, as provided in section 365, through plan payments. Therefore, for such leases, the practice will not be substantially changed. For leases the debtor intends to reject, the debtor may wish to continue lease payments to keep open the option of assumption, or the debtor may fail to comply with section 1326(a)(1)(B). If the lease is not assumed in the confirmed plan, it is deemed rejected as of the conclusion of the confirmation hearing and the stays under sections 362 and 1301 are automatically terminated.ⁿ¹¹

The remedy for failure to make current lease payments required by section 1326(a)(1)(B) is likely to be relief from the automatic stay, the same remedy as exists under current law for failure to make current lease payments.ⁿ¹² However, a lessor will still have to file a motion for relief from the stay if payments have not been made, and the court may well allow a debtor to cure such a default in payments. Rather than filing such a motion, the lessor may decide to await plan confirmation if the plan does not propose to assume the lease, because the automatic termination of the stay upon confirmation will usually take place in about the same amount of time as it would take to file a motion for relief from the stay and obtain a hearing on the motion.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 3015(b)*.

(n2)Footnote 2. *Fed. R. Bankr. P. 3015(b)*

(n3)Footnote 3. *Fed. R. Bankr. P. 3015(b)*.

(n4)Footnote 4. *Fed. R. Bankr. P. 3015(d)*.

(n5)Footnote 5. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n7)Footnote 7. However, if there are significant arrears in the creditor(s) claim, the language giving adequate protection to only the portions becoming due after the order for relief may permit lower payments.

(n8)Footnote 8. 1 U.S.C. § 1326(a)(3), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 9. Theoretically, a failure to make payments required by section 1326 could also be grounds for dismissal, but the creditor will usually prefer stay relief and the trustee has no reason to seek dismissal of an otherwise viable case.

(n10)Footnote 10. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. *11 U.S.C. § 365(p)(3)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n12)Footnote 12. Theoretically, a failure to make payments required by section 1326 could also be grounds for dismissal, but the lessor will usually prefer stay relief and the trustee has no reason to seek dismissal of an otherwise viable case. *See 11 U.S.C. § 1307(c)(4)*.



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CHAPTER 14 The Chapter 13 Plan

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P 14.03 Mandatory Requirements for Chapter 13 Plans

The chapter 13 plan should be clear and readily understood by creditors. It must contain the mandatory provisions required of all chapter 13 plans,ⁿ¹ as well as any permissive provisions,ⁿ² and other provisions not inconsistent with the Bankruptcy Code that the debtor chooses to include. *Rule 3015(c) of the Federal Rules of Bankruptcy Procedure* requires that every plan and any modification of it be dated.

The Bankruptcy Code sets forth several provisions that must be included in all chapter 13 plans.ⁿ³ A plan which does not contain all three of these provisions should not be confirmed.

[1] Submission of Enough Income or Property to Fund the Plan

The plan must include the submission of earnings or income sufficient for the execution of the plan.ⁿ⁴ Property other than or in addition to income or earnings may be submitted and used for the payment of claims. Only such future earnings or income of the debtor as are needed for the execution of the plan need be turned over to the trustee. And only payments to be made by the trustee under the plan need be considered in determining how much of the future income or earnings of the debtor must be submitted to the control of the trustee.ⁿ⁵

If the debtor contemplates paying postpetition claims, it is important to provide that the debtor will pay over additional sums to the trustee to cover any postpetition claims allowed under *section 1305 of the Bankruptcy Code*.ⁿ⁶ Unless this is done, postpetition claims may not be dischargeable. This could be a problem since many chapter 13 debtors will inevitably incur new debts during the course of the plan. Thus, the debtor may wish to provide a mechanism for paying these section 1305 debts if the debtor anticipates sufficient available income to do so.

MORE INFORMATION

Postpetition claims are discussed in more detail in chapter 19 *infra*.

[2] Provision for Full Payment of Priority Claims

The plan must provide for full payment of all claims entitled to priority under section 507. There are only two exceptions to this requirement. First, the holder of the priority claim may consent to different treatment. Second, section 1322(a)(4), added in 2005, provides that if the priority claim is a domestic support obligation that has been assigned to a

governmental unit, or is owed directly to a governmental unit, the debtor need not pay that obligation in full provided the plan provides that all of the debtor's projected disposable income over five years will be devoted to the plan. The unpaid support debt will, of course, remain undischarged pursuant to section 1328(a)(2). However, as priority debts these claims may be separately classified and paid before general unsecured debts.

Priority claims will generally include the trustee's compensation, attorney's fees, and arrearages for taxes and domestic support obligations.ⁿ⁷ Full payment of these claims may take the form of deferred cash payments. There is no requirement that the payments made to priority creditors have a present value equal to the amount of their claims. The language of *section 1322(a)(2) of the Bankruptcy Code* ("the full payment, in deferred cash payments ...") contrasts substantially with the language of section 1325(a)(5)(B)(ii) ("[T]he value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim."), a section of the Bankruptcy Code that clearly requires present value interest for allowed secured claims to be paid in installments. This difference in phrasing means that it is sufficient for the priority claims to be paid over the life of the plan without the application of any discount rate for deferred payments, except as might be required by the best interests of creditors test, discussed below.ⁿ⁸

In view of this difference, the debtor should consider proposing to defer payment of priority claims until all secured claims have been paid, since secured claims must be paid with an appropriate discount rate for deferred payment. However, administrative priority claims must be paid in full before (or *pro rata* along with) other claims,ⁿ⁹ so this option is not an option with respect to them.

[3] Provision for Equal Treatment for All Claims within the Same Class

If claims are classified, the plan must provide for the same treatment for each claim within a class.ⁿ¹⁰

[a] Secured Claims

Each secured claim may be put in a separate class and dealt with separately in the plan, or all secured claims may be put in the same class. The amount of each secured claim will, in the first instance, reflect the value of the collateral that secures the claim. The balance of the claim in excess of the value of the collateral is unsecured and must be dealt with along with all the other unsecured claims. Plans also commonly provide for the cure of arrearages on secured claims. Arrearages on secured claims are treated as secured claims. If the arrearages are on claims due before the end of the plan, curable under section 1322(b)(3), the debtor will usually pay off the claim, including the arrears, in the plan, unless an arrearage cure would result in less present value interest being paid.ⁿ¹¹

MORE INFORMATION

For a discussion of the determination of allowed secured claims *see* chapter 19 *infra*.

When the arrearages pertain to long-term debts, curable under section 1322(b)(5), it may be necessary to deal with them separately, either because section 1322(b)(5) imposes the special requirement that such arrearages be cured "within a reasonable time" or because the debtor plans to pay the current portion of the long-term debt outside the plan.

[b] Priority Claims

Priority claims may also be separately classified and, except for administrative claims required to be paid *pro rata* with each payment, included in a single class or separately classified according to the type of priority claim. Other than the provision with respect to administrative claims, there does not appear to be any requirement that priority claims be paid in order of priority, although almost all must normally be paid in full. The debtor in a particular case, for example, may need to pay tax claims before domestic support obligations.

[c] Unsecured Claims

All nonpriority unsecured claims--including the unsecured portions of secured claims--will fall into one class, and receive the same treatment, unless they are separately classified on some rational basis.ⁿ¹²

[4] Lien Retention Standard

The 2005 amendments to the Bankruptcy Code added new language to section 1325(a)(5)(B)(I), providing that to meet the lien retention standard the plan must permit the holder of an allowed secured claim to retain its lien until the earlier of the payment of the underlying debt determined under nonbankruptcy law or a discharge under section 1328.ⁿ¹³ The new language also states that the plan must provide that if the case is dismissed or converted without completion of the plan, the lien will also be retained to the extent recognized by applicable nonbankruptcy law.ⁿ¹⁴

[5] Property Distributed in Equal Monthly Payments

Section 1325(a)(5)(B)(iii)(I), enacted in 2005,ⁿ¹⁵ provides that if property to be distributed to the holder of an allowed secured claim is to be in the form of periodic payments, such payments shall be in equal monthly amounts. It is important to note that this provision refers to the distributions to the holder of the allowed secured claim and not to the debtor's plan payments. As long as the plan provides that the trustee's distributions to the holder of the allowed secured claim be in equal monthly amounts, the debtor's plan payments need not be equal.

PRACTICE NOTE

There is not any requirement that the equal monthly amounts extend throughout the plan. A debtor may, for example provide for equal monthly amounts to be distributed to a particular secured creditor for the first 24 months of a 36 month plan or, if the requirement of providing adequate protection is met, the last 24 months of a 36 month plan. Theoretically, this provision would require a debtor making a lump sum payment to the trustee to defer its payments to a secured creditor into at least two equal monthly payments, but it is hard to imagine a creditor objecting to a plan that provided for payment of the entire lump sum in the first month.

[6] No Modification of Retirement Fund Loans

Section 1322(f), enacted as part of the 2005 amendments to the Bankruptcy Code,ⁿ¹⁶ provides that a plan may not materially alter the terms of a loan described in section 362(b)(19). The types of plans enumerated in section 362(b)(19) are plans under *sections 401, 403, 408, 408A, 414, 457, or 501(c) of the Internal Revenue Code*, as well as a thrift savings plans permitted for government employees under subchapter III of chapter 84 of title 5, United States Code, essentially covering all types of retirement plans.

Because a chapter 13 may not alter the terms of such a loan, which normally require the withholding of payments by an employer from an employee's wages, the funds used to make those payments are not available to make payments under a chapter 13 plan and are not considered to be disposable income. The enactment of section 1322(f) reverses the holdings of many courts that had previously held that debtors could not continue repayment of a pension plan loan during a chapter 13 plan.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 1322(a)*.

(n2)Footnote 2. *11 U.S.C. § 1322(b)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *11 U.S.C. § 1322(a)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. *11 U.S.C. § 1322(a)(1)*.

(n5)Footnote 5. *See P 14.10[1] infra* for discussion of payments made under the plan that are not made through the trustee.

(n6)Footnote 6. Section 1305 provides for filing and allowance of any claim (1) for taxes that become payable to a governmental unit while the case is pending, or (2) that is a consumer debt, that arises after the date of the order for relief under chapter 13, and that is for property or services necessary for the debtor's performance under the plan. *See P 19.07 infra* for discussion of postpetition claims in chapter 13.

(n7)Footnote 7. *See* 4 Collier on Bankruptcy, ch. 507 (Matthew Bender), 2 Collier Bankruptcy Manual, ch. 507 (Matthew Bender) for discussion of the various types of priority claims.

(n8)Footnote 8. *See P 14.05[1] infra*.

(n9)Footnote 9. *11 U.S.C. § 1326(b)*.

(n10)Footnote 10. *11 U.S.C. § 1322(a)(3)*. The classification of claims is discussed further at *P 14.08 infra*.

(n11)Footnote 11. *See P 14.09[2][f][ii] infra* for discussion of payment of present value interest on allowed secured claims and in curing of arrearages.

(n12)Footnote 12. Permitted classifications of nonpriority unsecured claims are discussed at *P 14.08 infra*.

(n13)Footnote 13. This provision effectively overrules those cases that required elimination of the creditor's lien when the allowed secured claim had been paid.

(n14)Footnote 14. *11 U.S.C. § 1325(a)(5)(B)(i)(II)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n15)Footnote 15. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n16)Footnote 16. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 14 The Chapter 13 Plan

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P 14.04 Permissive Plan Provisions

There are eleven officially sanctioned categories of provisions whose inclusion in a plan is optional.

[1] Classification of Unsecured Claims; § 1322(b)(1)

The chapter 13 plan may, but is not required to, classify unsecured claims. It can explicitly or implicitly create different categories of unsecured claims and can, within limits based on fairness and rationality, treat the different categories differently. (A plan that provides for payment of certain claims outside the plan (*i.e.*, not to be paid by the chapter 13 trustee, but instead directly by the debtor) is an example of a plan with an implicit classification of claims.)

[2] Modification of the Rights of Claim Holders Leaving Unaffected the Rights of Holders of Any Class of Claims; § 1322(b)(2)

Both secured and unsecured claims are subject to modification. However, the rules governing the modification of secured claims are stricter than those governing unsecured claims, in view of the general doctrine that bankruptcy should not deprive secured creditors of the value of their collateral.ⁿ¹ Unsecured claims are protected only under very general standards, such as the rules requiring sufficient funding of the plan itselfⁿ² and the rules forbidding unfair discrimination within and among classes of claims. The chapter 13 plan will almost always modify the rights of the holders of unsecured claims, although it is legally permissible to leave unaffected the right of the holders of any class of claims.

[a] Modification of Unsecured Claims

Modification of unsecured claims will typically be by way of extension (stretching out the installments over time), composition (an across-the-board reduction from the face amount of the debts in the class; *e.g.*, 40 cents on the dollar), or both.

[b] Modification of Secured Claims

Allowed secured claims are generally not subject to composition, and while they may be modified by extension, the creditor is generally entitled to additional interest to compensate it to the extent of the extension. Special protections for certain home mortgages prohibit any modification of these debts unless the holder of the claim consents to the plan.ⁿ³

[3] Curing or Waiving Default; § 1322(b)(3)

It is very common for chapter 13 debtors to exercise the right to cure defaults with respect to secured claims, either under this provision or, for home mortgages and other long-term debts, under section 1322(b)(5). For most unsecured debts, there is no reason to exercise the right to cure arrearages; one notable exception might be a defaulted student loan, curable under this provision or, if the debt is long-term, under section 1322(b)(5).

PRACTICE NOTE

Because student loans are excepted from dischargeability in chapter 13, it is in the debtor's interests to pay as much as possible through the plan, so as to lower the debtor's post-plan debt burden or to regain eligibility for new student loans.ⁿ⁴

[4] Concurrent Payment of Secured and Unsecured Claims; § 1322(b)(4)

The chapter 13 plan may provide for the payment of any unsecured claim concurrently with the payment of any secured or any unsecured claim. Since most unsecured claims could be discharged under a chapter 13 hardship discharge or after a conversion to chapter 7 if the plan fails, debtors would normally not find it in their interests to pay the unsecured claims concurrently with the secured claims. However, the language permitting the debtor to choose any unsecured claim (or class of claims) to be paid concurrently with any other claim (or class of claims) further demonstrates the debtor's flexibility to pay classes of claims in any order, even if that order is not the normal order of priority.

If, as is often the case, a primary motivation of the chapter 13 debtor is the redemption of collateral or cure of a mortgage through a periodic payment plan, the debtor would be well advised to pay secured claims and priority claims first, and relegate the payment of general unsecured claims to the period after the completion of the payment of secured and priority claims. However, particular circumstances might dictate otherwise, and section 1322(b)(4) gives the debtor the flexibility to change the usual order of payments.

[5] Curing Defaults on Debts Extending Beyond the Term of the Chapter 13 Plan; § 1322(b)(5)

There are certain claims that the debtor cannot pay within the time period of the proposed plan, which can never exceed five years,ⁿ⁵ simply because they are large long-term obligations, such as home mortgages, that have many years of payments remaining before they are due to be fully satisfied. *Section 1322(b)(5) of the Bankruptcy Code* allows the debtor to cure a default on such an obligation within a reasonable period of time without having to pay the entire debt balance due within the time period of the plan.ⁿ⁶ Section 1322(b)(5) can be utilized to cure both prepetition and postpetition defaults.ⁿ⁷

While section 1322(b)(3) has long been held to provide a legal basis for curing short-term debts secured only by a security interest in the debtor's principal residence (because a "cure" is not a "modification" within the meaning of section 1322(b)(2)),ⁿ⁸ such debts clearly may now also be modified pursuant to sections 1322(c)(2) and 1325(a)(5). However, section 1322(b)(5) may in some cases be the only feasible remedy available with respect to defaults on long-term home mortgages.

Courts have generally ruled that land installment sales contracts are secured debts,ⁿ⁹ so that they too should be subject to the cure provisions of section 1322(b)(5). The treatment of such contracts as similar to mortgages under state law will often be determinative in deciding that they are to be treated like secured debts. If land installment sale contracts are held to be executory contracts rather than secured debts, defaults on such contracts may still be cured, but they must be cured "promptly" under section 365(b)(1)(A).

MORE INFORMATION

Curing defaults on executory contracts through chapter 13 plans is examined in chapter 15 *infra*.

[6] Payment of Postpetition Claims; § 1322(b)(6)

The plan may provide for the payment of section 1305 postpetition obligations. Such obligations may include taxes and consumer debts for property or services necessary for the debtor's performance under the plan. Normally, a postpetition claim may be included in a plan only if the holder of the claim agrees.

MORE INFORMATION

For a discussion of the steps in filing postpetition claims see chapter 19 *infra*.

Unless provision is made in the plan for payment of these postpetition claims, they may not be discharged. Section 1328(a) only discharges claims provided for in the plan.

[7] Assumption, Rejection, or Assignment of Executory Contracts and Unexpired Leases; § 1322(b)(7)

The chapter 13 plan may contain a provision for the assumption, rejection, or assignment of executory contracts, including unexpired leases. An onerous lease or executory contract could be rejected as part of the chapter 13 plan, if not previously rejected directly under *section 365 of the Code*. If assumed, a long-term executory contract or lease could give rise to a priority postpetition claim.

MORE INFORMATION

The assumption of executory contracts is examined in more detail in chapter 15 *infra*.

[8] Funding the Plan, Other than from Debtor's Future Earnings or Income; § 1322(b)(8)

Most chapter 13 plans, business and nonbusiness alike, provide for their funding from future earnings or income. However, exempt or nonexempt property of the debtor may be liquidated to pay creditors. Doing this may permit a debtor to propose a plan in which income-based funding would be supplemented with the liquidation of certain assets. Perhaps more significantly, the debtor's house or other major asset could be sold through normal market channels, getting a better price than what would be received through a foreclosure sale.ⁿ¹⁰

Essentially, section 1322(b)(8) gives a debtor the right to file a liquidating chapter 13 plan. In this event, no future earnings or income need be submitted to the supervision and control of the chapter 13 trustee. However, if the liquidating chapter 13 plan provides unsecured creditors only as much as they would have received in a chapter 7 case, it is questionable whether the plan would pass muster as being filed in good faith; it might be viewed as an attempt to take the benefits of chapter 13, such as the broader discharge, without bearing the normally greater financial burdens.ⁿ¹¹ A liquidating chapter 13 plan is also open to challenge under section 1325(b)(1), which requires the debtor to dedicate to the plan all of his or her disposable income for the applicable commitment period, unless there is otherwise enough funding to pay all unsecured claims in full.

Plans whose funding is to be based primarily on future asset sales rather than regular income--such as the sale of a house or a business--are also subject to attack on feasibility grounds: the court simply may not believe that the debtor can or will sell the asset in question at the projected price and at the projected time.ⁿ¹²

[9] Postconfirmation Vesting of Property of the Estate; § 1322(b)(9)

The plan can and should provide for the vesting of the property of the estate on confirmation of the plan, or at a later time. If it does not, property of the estate vests in the debtor upon confirmation of the plan, except as otherwise provided

by the plan.ⁿ¹³ Choosing the discharge or dismissal date, rather than the confirmation date, maintains the protection of the section 362 automatic stay provisions that pertain to property of the estate.

FORMS

For examples of language regarding vesting of property see sample chapter 13 plans in *Collier Consumer Bankruptcy Forms, Forms CS19.04-1 and CS19.05-1* (Matthew Bender).

[10] Postpetition Interest on Nondischargeable Debts; § 1322(b)(10)

Because some claims are not discharged at the end of a chapter 13 case, debtors may wish to pay accruing postpetition interest on such claims in order to avoid a large accumulation of interest at the conclusion of the plan. Section 1322(b)(10), enacted in 2005,ⁿ¹⁴ permits debtors to pay accruing interest on unsecured claims that are nondischargeable under section 1328(a) if the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims.

It is important to note that section 1322(b)(10) does not require that all allowed claims actually be paid in full before interest can be paid on nondischargeable claims. It requires only that the plan provide for full payment of all allowed claims. Thus, a debtor need not allow interest to accrue on nondischargeable claims while paying other claims. The interest on the nondischargeable claims can be paid before, concurrently with, or after the other claims, as long as the plan provides for full payment of those other claims.

The debtor may also become able to pay all allowed claims in full because not all creditors have filed claims. In that event, the debtor may amend the plan to provide for payment of interest on nondischargeable claims. Alternatively, the original plan could include a provision providing for such interest if, after the claims bar date, it becomes evident that the funds devoted to the plan are sufficient to pay all allowed claims in full.

[11] The Catch-All Clause: Plan May Include Other Appropriate Provisions Not Inconsistent with Code; § 1322(b)(11)

The chapter 13 plan may contain other provisions not inconsistent with the Bankruptcy Code. This catch-all provision permits the debtor to exclude certain secured claims from the operation of the plan, to set forth the effective date of the plan, to avoid liens on exempt property through the plan (if permitted under the law of the district) rather than by separate proceedings, and to request enlargement of time beyond the three-year payment period if necessary. Other possibilities include the conferring of priority status for postpetition utility defaults (to be deemed adequate assurance of future performance under section 366), a provision for the exemption of all property recovered by the trustee unless the applicable exemption is exhausted, an expansion of the codebtor stay,ⁿ¹⁵ and provisions varying the standards that section 1325(a) sets for secured creditors.

PRACTICE NOTE

In times of low mortgage interest rates, even a bankruptcy debtor may be able to refinance his or her mortgage at a lower rate than the existing mortgage. Such a refinancing may be preferable to continued payments under a chapter 13 plan, especially if it lowers the debtor's total monthly payments. For debtors who anticipate having trouble keeping up with payments, it may be the only way to salvage the benefits of chapter 13.

Generally, it is preferable to refinance a mortgage as part of a plan or a modified plan, rather than to dismiss the chapter 13 case before refinancing and lose the discharge of debts, lien avoidance rights, and other rights under chapter 13. If a plan has already been in effect for over 36 months, there should be little opposition to a modification that allows the debtor to pay off the remaining plan payments through

a refinancing. If the plan has been in effect less than 36 months, a trustee or unsecured creditor may oppose such a modification on the grounds that the debtor should continue monthly payments for the remainder of the 36 months. A debtor should have good arguments against such opposition, because by refinancing the remaining payments, the debtor is still making those payments. In essence, the debtor is simply taking on a mortgage to borrow the money for those payments, and will be paying that money back to the new lender. Requiring additional plan payments would be to make the debtor pay the money twice.

Plan provisions for refinancing a mortgage should describe the mechanics of the process. To avoid problems arising at the last minute from an excessive payoff demand on an existing mortgage, the plan may provide for the debtor to pay such a demand on closing of the new loan with continued jurisdiction of the bankruptcy court to resolve the dispute thereafter. If possible, the plan should also provide that remaining mortgage arrears be paid at closing of the new loan, rather than through the trustee, so that the prior mortgage can be completely paid off at closing; absent a complete payoff the existing mortgage holder may balk at providing a mortgage satisfaction, without which the new lender may not be willing to close the new loan. Such a provision would also avoid the trustee's percentage fee on the remaining arrearage claim, which is one reason why a trustee might oppose it.

MORE INFORMATION

For a discussion of lien avoidance *see* chapter 18 *infra*. Chapter 12 *supra* provides a detailed discussion of providing adequate assurance to utility providers.

FOOTNOTES:

(n1)Footnote 1. Modification of allowed secured claims is discussed at P 14.04[2][b] *infra*.

(n2)Footnote 2. *See* P 14.05 for discussion of the amounts which must be paid to holders of unsecured claims.

(n3)Footnote 3. Limits on the modification of home mortgages are discussed at P 14.09[2] *infra*.

(n4)Footnote 4. The exception to discharge for student loans is discussed at P 26.13 *infra*.

(n5)Footnote 5. 11 U.S.C. § 1322(d), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. Curing such defaults is further discussed at P 14.09[2] *infra*.

(n7)Footnote 7. *In re Mendoza*, 111 F.3d 1264 (5th Cir. 1997) ; *In re Hoggle*, 12 F.3d 1008 (11th Cir. 1994) (debtor could modify plan to cure postconfirmation default). *See* 8 Collier on Bankruptcy, P 1322.09[2] (Matthew Bender).

(n8)Footnote 8. *In re Clark*, 738 F.2d 869, 10 C.B.C.2d 1280 (7th Cir. 1984) ; *Grubbs v. Houston First American Savings Ass'n*, 730 F.2d 236, 10 C.B.C.2d 549 (5th Cir. 1984) ; *In re Taddeo*, 685 F.2d 24, 6 C.B.C.2d 1201 (2d Cir. 1982) .

(n9)Footnote 9. *In re Johnson*, 75 B.R. 927 (Bankr. N.D. Ohio 1987) ; *Matter of Leazier*, 55 B.R. 870 (Bankr. N.D. Ind. 1985) . *But see Brown v. First Nat'l Bank in Lenox*, 844 F.2d 580 (8th Cir. 1988) ; *Shaw v. Dawson*, 48 B.R. 857 (D.N.M. 1985) .

(n10)Footnote 10. Sale of property through the plan is discussed at P 14.11 *infra*.

(n11)Footnote 11. *In re Gavia*, 7 C.B.C.2d 813, 24 B.R. 573 (B.A.P. 9th Cir. 1982) .

(n12)Footnote 12. The feasibility standard is discussed further at *P 14.05[3] infra* .

(n13)Footnote 13. *11 U.S.C. § 1327(b)*. See 8 *Collier on Bankruptcy*, P 1327.03 (Matthew Bender).

(n14)Footnote 14. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n15)Footnote 15. *E.g.*, "By failing to object to this plan, or any modification thereof, all creditors holding claims agree not to make any effort to collect their claims from any cosigners that may exist, as long as this case remains pending." A provision of this nature was held permissible and valid against creditors who did not object to it in *In re Weaver*, 8 B.R. 803 (Bankr. S.D. Ohio 1981) . See also *In re Bonanno*, 78 B.R. 52 (Bankr. E.D. Pa. 1987) .



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CHAPTER 14 The Chapter 13 Plan

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P 14.05 Amount that Must Be Paid to General Unsecured Creditors Under Plan

Chapter 13 debtors are given the right to keep all or some of their nonexempt assets in return for their agreement to dedicate a certain portion of future income to debt repayment. Chapter 13 has three legal devices for regulating the amount of income to be dedicated:

- the best interests test, which ensures that creditors will be no worse off than under chapter 7;
- the disposable income test, which ensures that debtors will pay as much as they can afford; and
- the feasibility test, which ensures that the debtor's payment commitments are realistic in view of the size of the debtor's income and the other claims against it.

[1] Best Interests Test of Section 1325(a)(4)

Section 1325(a)(4), governing how much unsecured creditors should receive in a chapter 13 case, is known as the "best interests of creditors" test. This section provides that, if all other requirements are met, the court "shall confirm a plan if ... the value, as of the effective date of the plan, of property to be paid under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on the claim [in a chapter 7 case]."ⁿ¹

[a] Present Value Provision

This standard entitles creditors to payments with a present value equivalent to the value of the debtor's nonexempt property, *i.e.*, including interest to compensate for delay in their receipt. In other words, the court must capitalize the proposed payments, by converting deferred payments offered the creditor into an equivalent capital sum as of the effective date of the plan. Thus, *section 1325(a)(4) of the Bankruptcy Code* cannot be properly applied simply by comparing the sum total of the proposed deferred payments with the likely recovery on the unsecured claim in the event of liquidation. Unless the plan proposes that all payments to unsecured creditors will be made immediately upon the effective date of the plan, the present value language in the section dictates that interest be paid to compensate for the lost time value of the money caused by the deferral of payments. If a creditor holding an allowed unsecured claim would receive full payment of its claim in a chapter 7 liquidation, a plan would not meet the best interests test unless deferred payments to the creditor paid 100% of the claim plus interest.ⁿ² However, in taking time delay into account in figuring present value, the court should also take into account the delay that occurs before creditors receive dividends in

a chapter 7 case.

[b] Application of Test in Practice

In most cases, it is obvious that the best interests test has been met; the debtor's financial position is such that unsecured creditors clearly would get little or nothing in a chapter 7 case and, therefore, almost any distribution under a chapter 13 plan would pass the test (although not necessarily the other tests described below.) Therefore, most plans merely assert their compliance with the best interests test and substantiate this assertion with a flat comparison of the distributions under chapter 7 and chapter 13. In the unusual case in which an interest calculation might seem to tip the balance, the discussion of differing views as to which interest rate to apply in the secured creditor section below should be consulted.ⁿ³

The "best interests" test--with its implied present value component--was inserted into the Bankruptcy Code to ensure that general unsecured creditors would not be harmed by a debtor's choice of chapter 13 over chapter 7. There is no doubt that, unless the proposed plan meets the standard, a creditor may challenge it and the court need not confirm it.

There is some legal and practical disagreement over which claims should properly be considered in determining whether this test is met. The court should clearly only consider claims that are timely filed--that is, filed before the bar date. However, the application of this test can be complicated by some courts' practice of holding the confirmation hearing before the bar date. In that case, the court usually considers all claims filed or scheduled as of the confirmation hearing.

Because the court must compare the chapter 13 distributions to the outcome of a chapter 7 case, the appropriate date for valuing the nonexempt property that would be distributed to creditors is the date the chapter 13 petition was filed, since the filing date is the date of valuation in a chapter 7 case. Property acquired after the petition is filed generally should not be included in the determination of what creditors would receive for purposes of the best interests of creditors test. And the best interests test cannot be used as the basis for denying an exemption when no timely objection to the claimed exempt has been filed.^{n4an4}

Moreover, the court must take into account the costs of sale and other administrative expenses that would be incurred by a chapter 7 trustee.ⁿ⁵ These costs would also include mortgage payments and other carrying costs from the date of the petition to the date of sale. Unlike valuation of property for the purpose of determining allowed secured claims, the valuation for purposes of section 1325(a)(4) is clearly for purposes of determining liquidation value rather than replacement value to the debtor. The costs of sale could include any capital gains tax on the increase in value of the property since it was acquired by the debtor.ⁿ⁶

MORE INFORMATION

For an extensive discussion of valuing property in determining an allowed secured claim see chapter 19 *infra*.

In some cases, the test may require different unsecured creditors to receive different percentage recoveries. For example, if there is community property or entireties property involved, the Bankruptcy Code's distribution rules give different rights to creditors depending upon whether they have joint or community claims.ⁿ⁷ The amount of nonexempt assets may be such that only priority creditors would receive distributions in a chapter 7 case.

The statute's language, looking to the amount that would be paid if there was a chapter 7 liquidation, makes clear that a claim need not be paid in a chapter 13 plan merely because it would survive a chapter 7 discharge.ⁿ⁸ Holders of claims that are nondischargeable in chapter 7 receive no special dividends due to that status, and in a no asset case receive no dividends at all. Many such claims are never paid despite the lack of a discharge, since debtors remain unable to satisfy

them after bankruptcy.

However, some claims that are nondischargeable in chapter 7 are entitled to priority, *e.g.*, claims for taxes specified in sections 507(a)(3) and 507(a)(8), and claims for domestic support obligations, and almost all of these claims are entitled to full payment pursuant to section 1322(a)(2).⁹

[2] Disposable Income Test of Section 1325(b)

[a] Purpose of Section 1325(b)

Section 1325(b), specifically sets forth a standard for determining whether the debtor is dedicating an adequate amount of income to payments under the plan. If the standard is invoked and not met, confirmation of the plan must be denied. Before section 1325(b) was added, the principal legal device for ensuring that the debtor was dedicating enough income to payments under the plan was the good faith test of section 1325(a)(3). Section 1325(a)(3) prescribes denial of confirmation if a plan is not proposed in good faith; it was argued that a plan that left too much income for the debtor and not enough for payments to creditors was not proposed in good faith. This interpretation of section 1325(a)(3) was controversial from the start; many believed that section 1325(a)(3) was never intended to be a vehicle for requiring anything so substantive as adequate funding. By adding the new section 1325(b), separate and apart from the good faith standard, Congress apparently intended that the good faith test revert to a narrower meaning, which did not concern the size of the payments made by a debtor.¹⁰

Section 1325(b) was substantially amended by the 2005 amendments to the Bankruptcy Code.¹¹ Instead of simply looking at the debtor's actual income and expenses, these amendments in many cases attempt to create a bright line test to determine whether a debtor's plan is committing all disposable income. By creating a bright line test, Congress even more clearly indicated that it intended that section 1325(b), rather than the good faith test, to be the measure of whether the debtor was committing sufficient income to the plan.

[b] Meeting the Disposable Income Test

Section 1325(b) of the Bankruptcy Code provides that if (and only if) an unsecured creditor or the chapter 13 trustee objects to confirmation of the plan, the court must determine whether the plan either:

- pays the objecting creditor in full; or
- commits to the plan all of the debtor's "disposable income" for the applicable commitment period

The 2005 amendments to the Bankruptcy Code,¹² made significant changes to how "disposable income" is determined and to the required length of a chapter 13 plan.

Despite these recent changes, it remains true that a debtor need not have enough income to make substantial payments to unsecured creditors or, indeed, any payments to them. If a debtor has no disposable income, over and above the amount needed to pay secured claims, then a plan may be confirmed without payments to unsecured creditors if the other requirements of chapter 13 are met. The legislative history¹³ expressly states that the so-called zero payment plan is permissible in certain circumstances.¹⁴

[c] Procedure for Invoking the Disposable Income Test

The procedure under section 1325(b) is the same as that for other objections to confirmation and is thus governed by *Rule 3015(b) of the Federal Rules of Bankruptcy Procedure*. The Rule requires that objections be filed with the court and served on the debtor and trustee. They must be timely filed, prior to the confirmation of the plan.

MORE INFORMATION

For an outline of objections to confirmation *see* chapter 20 *infra*.

Normally, objections based on the disposable income test will be based on the debtor's schedules of current income and expenditures or the debtor's statement of current monthly income and disposable income calculation. It therefore behooves the debtor to complete these forms carefully, with both the disposable income and feasibility tests in mind.ⁿ¹⁵ This of course may pose a problem of balancing--the disposable income test requires that the debtor pay "enough"; the feasibility test, on the other hand, requires that the plan be "realistic"--that the debtor not undertake to pay "too much."

Under section 1325(b), only the trustee or the holder of an allowed unsecured claim has standing to object. Thus, a creditor who has not filed a proof of claim does not have standing to object.ⁿ¹⁶ The language of the provision and legislative history also make clear that, unlike the confirmation standards of section 1325(a), the disposable income test issue may not be raised by the court *sua sponte*,ⁿ¹⁷ nor may it be raised by the holder of only a secured claimⁿ¹⁸ nor by the United States trustee.ⁿ¹⁹

[d] Objector's Burden and Debtor's Responses

The person who objects will have at least an initial burden of production.ⁿ²⁰ Assuming that the objector's burden is met, the debtor may defeat the objection by proving one of two things: that he or she is proposing to pay the objecting creditor in full, or that he or she has met the disposable income test by dedicating all of his or her disposable income to the plan.

[e] Satisfying Test by Full Payment

The debtor may show that an objecting creditor will be paid in full. Obviously, this will be true if all unsecured claims are paid in full. It may also be true if the objecting claimant may be separately classified and paid in full, even if not all other creditors receive full payment.ⁿ²¹ Occasionally, it may be worthwhile to amend the plan to add such classification to satisfy the troublesome creditor, especially if the debtor anticipates difficulty meeting the alternative disposable income standard. If the trustee objects to confirmation, however, meeting the "full payment" test will likely require that all filed unsecured claims be paid in full. In any event, only full payment of the original claim should be necessary, and not the payment of additional interest to give the creditor the present value of its claim.ⁿ²²

[f] Disposable Income Test For Cases Filed Prior to Effective Date of 2005 Amendments

If an objection under section 1325(b) is filed and the full payment requirement cannot be met, the debtor will have to show that he or she has met the disposable income test. This test was significantly modified for cases filed on or after October 17, 2005--the effective date of the 2005 amendments.ⁿ²³ For cases filed prior to October 17, 2005, a plan of at least three years duration is probably mandatory if the debtor cannot pay all objecting creditors in full and therefore must rely on the disposable income test. Were this not the case, the disposable income test would essentially be rendered meaningless in that debtors could evade its requirements by shortening the length of the plan. To grant confirmation, the court must determine that the debtor has committed all of his or her "projected disposable income" to the plan. Thus, what is required is an estimate of projected income and an estimate of how much of that income will be disposable.

The debtor may choose to pay the amount required by the disposable income test over a period longer than three years to reduce the amount of the monthly payment. Though the test requires payment to unsecured creditors of the amount of disposable income the debtor would have in the first three years of the plan, that amount may be paid over a longer period of time so that the debtor may, for example, continue otherwise impermissible expenses or live with a budget that is less tight.ⁿ²⁴

[i] Estimating Disposable Income

For cases filed prior to October 17, 2005, "disposable income," is defined as income not reasonably necessary for the maintenance or support of the debtor or dependents of the debtor.ⁿ²⁵ If a debtor is engaged in business, "disposable income" also excludes funds necessary for the continuation, preservation and operation of the business.ⁿ²⁶

Normally, since changes in income or expenses can rarely be foreseen, the court will look to the debtor's current financial situation to decide whether the disposable income test has been met. As a practical matter, unless there are changes that can be clearly foreseen, the court must simply multiply the debtor's current monthly income by 36 when estimating projected income.

The estimation of how much income will be disposable may be even more difficult than that of projected total income. As with projected income, the court, in theory, is required to project what will happen to the debtor's expenses over three years. Such a projection would require the court to guess whether the debtor would have additional children, unexpected marital separations, medical bills, home repairs, or a wide variety of other future expenses. Obviously, this is impossible. As with the income side of the budget, the court will normally use the debtor's current expenses, unless a change in them is virtually certain.

[ii] Income Available

The debtor is not expected to commit income that may never be received because its receipt is uncertain or speculative.ⁿ²⁷ A debtor should not be ordered to work longer hours than the average worker in order to pay creditors. Even if the debtor has worked more than an average amount in the past, the court should not consider overtime pay or income from a second job to be "disposable income" which the debtor must continue to earn and commit to the plan. The debtor also should not be required to borrow money from a retirement plan to fund a chapter 13 plan.ⁿ²⁸ The mere fact that income might be exempt from execution under nonbankruptcy law does not mean it cannot be considered under the disposable income test.ⁿ²⁹ But the disposable income test does not require the debtor to commit exempt assets, as opposed to income, to the plan.ⁿ³⁰

Generally, if only one spouse files a chapter 13 case, the other spouse's income is not considered available for chapter 13 payments.ⁿ³¹ However, the availability of the nonfiling spouse's income is considered in determining the debtor's necessary expenses, since that spouse is expected to share in paying the expenses and thereby reduce the amount the debtor needs to pay. Therefore, there is usually no advantage with respect to disposable income in filing for only one spouse.

[iii] Expenses Deducted in Determining Disposable Income

Prior to the 2005 amendments to the Code, there was only limited guidance as to what expenses could be considered reasonably necessary and therefore properly deductible from the debtor's income. *Section 523(a)(2)(C) of the Bankruptcy Code* defines "luxury goods or services" as those which are not reasonably required for the support of the debtor or the debtor's dependents. A necessary corollary to that definition is the principle that all other expenses are reasonably required for such support.ⁿ³²

Thus, for cases filed before October 17, 2005, the inquiry under the "ability-to-pay" test should be limited to determining whether the debtors have included expenses for luxuries in their budgets, rather than whether they conform to some predetermined level of expenses. Courts cannot reasonably or fairly make decisions beyond that as to what expenses are more necessary or truly necessary. Different debtors will have widely varying expenses for housing and transportation, depending on their age, mobility, and place of residence, yet all but luxury-style residences should be considered necessary. Similarly, some debtors will feel that parochial school or other items are absolutely required. The court can realistically go no further than deciding whether clearly unnecessary luxuries are included in the budget, and

should not attempt to do so. And, if the debtors' total expenses are average or less than average, it is doubtful that the court should even look at the expenses individually, since such debtors could only afford luxuries by making sacrifices in other parts of their budgets.

The cases under former section 1325(b) have generally allowed debtors to maintain what might be considered an average American lifestyle. Although newspapers, for example, are not necessities of life, they are not "luxuries" that must be cut from the debtor's budget.ⁿ³³ It has been held that the debtor need not commit every last dollar not necessary for expenses to the plan and may preserve a small cushion (\$117.00/month in one case) to guard against life's unexpected events.ⁿ³⁴

Courts have split on whether a debtor is permitted to use part of the debtor's income to make repayments on a loan from a pension plan.ⁿ³⁵ The better view is that such a loan is a claimⁿ³⁶ under the Code's broad definition of "claim" and, like any other claim may be paid under the plan. And the disposable income test does not require the debtor to commit exempt assets, as opposed to income, to the plan.ⁿ³⁷

Because some courts had restricted debtors' tithing or other church contributions in applying the disposable income standard,ⁿ³⁸ Congress amended the Code in 1998 to make clear that such contributions are permissible and need not be curtailed in order to pay more to creditors. The Religious Liberty and Charitable Donation Protection Act of 1998ⁿ³⁹ amended section 1325(b) to provide that charitable contributionsⁿ⁴⁰ to qualified religious or charitable entities or organizations,ⁿ⁴¹ in an amount not exceeding 15 percent of the debtor's gross income for the year in which the contributions are made, are permissible expenses for a chapter 13 debtor under the ability to pay test. The amendment does not require that the permissible contributions be made to a religious organization. Nor does it apply only if the debtor had made such contributions in the past.ⁿ⁴² Thus, a chapter 13 debtor may choose to pay up to 15% of his or her income to charity rather than creditors over the course of a chapter 13 plan.ⁿ⁴³

On the other hand, courts have denied confirmation to debtors whose budgets provided for payments that might be described as self-indulgent or as violating the notion that debtors are expected to be just before they are generous. For example, payments of \$1,000 per month in private school tuition were not permitted.ⁿ⁴⁴ Making monthly investments in stocks and retirement accounts was not permitted,ⁿ⁴⁵ nor were payments on an expensive sports car.ⁿ⁴⁶

[iv] Business Expenses

For debtors engaged in business, the disposable income definition has an additional element. After the deduction of amounts necessary for support and maintenance of the debtor and the debtor's dependents, the court must also deduct from the debtor's gross income expenditures necessary for the continuation, preservation, and operation of the debtor's business.ⁿ⁴⁷ Such determinations will be more difficult for the court to make, especially when debtors are in chapter 13 because their businesses are faring poorly. Some businesses may have a negative cash flow or consume all of what would otherwise be the debtor's disposable income.

Ultimately, when a chapter 13 plan proposes to preserve a debtor's business, the real test is feasibility under section 1325(a)(6). The business must have some prospect of becoming profitable. However, assuming that test is met, then the court's task is limited to determining whether expenditures are necessary for the continuation, preservation, and operation of the business. And in that regard, considerable discretion must be given to the debtor, who will usually know the business far better than the court or the trustee.

[g] Disposable Income Test For Cases Filed On or After Effective Date of 2005 Amendments

The "disposable income test" was amended in a number of significant respects by the 2005 amendments to the Bankruptcy Code.ⁿ⁴⁸ These amendments altered the method of determining the debtor's income and the method for determining the debtor's expenses. They also increased the required commitment period for some debtors from three to

five years.ⁿ⁴⁹

For cases filed on or after October 17, 2005, "disposable income" is defined as "current monthly income" less reasonably necessary amounts for the maintenance and support of the debtor and debtor's dependents and amounts for post-petition domestic support obligations. The term also expressly excludes child support payments, foster care payments, or disability payments received for a dependent child to extent reasonably necessary to be expended for the child. Additionally, if a debtor is engaged in business, "disposable income" excludes funds necessary for the continuation, preservation and operation of the business.ⁿ⁵⁰

The first major change in the disposable income test of section 1325(b) is the use of "current monthly income" as the basis for determining disposable income. Current monthly income is multiplied by 12, and the product is then compared to the applicable state median family income. If the product is at or above the applicable figure, then disposable income and the amount paid to unsecured creditors will be determined in accordance with section 1325(b)(3). For debtors with income below this figure, the determination of the debtor's reasonable expenses will be much the same as it was prior to the 2005 amendments.

[i] Current Monthly Income

The term "current monthly income" is defined in section 101(10A) as the average of the last six months' income received from all sources by the debtor (or in a joint case, the debtor and the debtor's spouse) with certain adjustments. The six-month period is defined as the six months ending on the last day of the month before the petition is filed.ⁿ⁵¹ The debtor's actual income at the time of the petition may be significantly above or below the current monthly income.

The definition makes clear that the income of other household members, including a nondebtor spouse, can be considered only to the extent that it is regularly contributed to household expenses of the debtor or the debtor's dependents.ⁿ⁵² Benefits received under the Social Security Act are also excluded.ⁿ⁵³

The use of "current monthly income" as a starting point for determining "disposable income" creates an immediate interpretative difficulty because the use of historical income figures in determining "current monthly income" directly contradicts the language in section 1325(b)(1)(B) which refers to "projected disposable income." Obviously, the projection of future disposable income would seem to be something that could be quite different from the debtor's average monthly income in the past. To the extent courts give any meaning to the word "projected," they may have to adjust the debtor's prior income to calculate disposable income if circumstances have changed. A number of courts have adopted this approach, adjusting the debtor's income to take into account circumstances at the time of confirmation, while retaining the statutory exclusions from income and, if applicable, the means test formula for calculating expenses.^{n53a}

If courts disregard the word "projected," the use of "current monthly income" to determine disposable income will help some debtors, whose income has increased, and could harm those whose income has decreased, unless, as discussed below, the court permits an alternative calculation of current monthly income. If a debtor's income has decreased in the six months prior to filing, and is unlikely to change, the problem created by the conflicting language can be sensibly resolved if the trustee refrains from objecting to the plan based on the current monthly income figure. If the debtor is paying all disposable income as defined by pre-2005 law, trustees should have no legitimate interest in objecting to such plans. Similarly, where debtors are paying all that they can truly afford, unsecured creditors also would rarely have an interest in forcing debtors into chapter 7. Thus, absent an objection, a reasonable plan based on the debtor's true income may be confirmed.ⁿ⁵⁴

If the debtor's income has decreased at the time the petition is filed, and is unlikely to change, another alternative is to seek permission to delay the filing of Schedule I. The definition of "current monthly income" permits the normal six month prepetition calculation period to be disregarded if the debtor does not file the schedule of current income required

by section 521(a)(2)(B)(ii)(Schedule I) and the court determines current income as of a different date.^{n54a} Thus, several courts have permitted debtors who have not filed Schedule I to use a later date for the calculation of current monthly income that will take into account the decrease in income.^{n54b}

[ii] Applicable State Median Income

"Median family income" is defined in new section 101(39A)ⁿ⁵⁵ as the median family income "both calculated and reported by the Bureau of the Census in the then most recent year." If not available for the current year, the figure may be adjusted annually using the Consumer Price Index for All Urban Consumers for the years between the most recent calculated and reported year and the current year. It is anticipated that the Bureau of the Census will begin reporting the relevant median income numbers for each state every year.ⁿ⁵⁶

For a household of one, the relevant census figures are for a one-earner household. For households larger than four, instead of using the census figures (which go down because large families tend to be poorer) \$575 per month is added for each additional household member over four.ⁿ⁵⁷ This added amount will be periodically adjusted for inflation under section 104(b).ⁿ⁵⁸

[iii] Whether Disposable Income Is Determined Under § 1325(b)(3)

Once the current monthly income has been calculated and the applicable threshold for the state median income is found, a determination can be made as to whether the debtor must calculate his or her disposable income in accordance with new section 1325(b)(3). Section 1325(b)(3) provides that if the debtor has current monthly income, when multiplied by 12, greater than the applicable state median income for their household size, reasonably necessary expenses described in section 1325(b)(2) are to be calculated using the means test formula in section 707(b)(2)(A) and (B). Additionally, the applicable commitment period (length of the plan) remains three years if the annualized current monthly income of the "debtor and the debtor's spouse combined" is below the applicable state median income, but is five years if it that "annualized current monthly income" is above the applicable state median income.ⁿ⁵⁹

[iv] Deductions from Current Monthly Income

Considerable changes were made by the 2005 amendments in determining the debtor's expenses. For all debtors, payments on domestic support obligations first payable after the petition is filed are, under new language in section 1325(b)(2)(A)(i), specifically deducted from income in determining disposable income. Other important exclusions from disposable income include funds used for repayment of pension loans and contributions to pension plans. There is no requirement that the debtor show these contributions to be reasonable or necessary.^{n59a} New section 1322(f) provides that amounts required to repay loans described in section 362(b)(19) (basically loans from qualified plans) shall not constitute disposable income under section 1325(b).ⁿ⁶⁰ Although not all courts agree, the full amount of the monthly loan payment should be deducted in the means test even if the loan will be paid off before the end of the plan. The debtor has no power to reduce the monthly payment on the loan during the chapter 13 case, as could be done with a car loan, so the debtor cannot pro-rate the loan payments over the plan.^{n60a}

[A] Debtors with Current Monthly Income Above Applicable State Median Family Income

For debtors with annualized current monthly income above the applicable state median family income, other reasonably necessary expenses for the maintenance of the debtor or a dependent of the debtor must be determined in accordance with section 707(b)(2)(A) and (B). Under the 707(b) means test, current monthly income is reduced by various monthly expenses as set forth in the statute including certain expenses as specified in the collection standards of the Internal Revenue Service, even if they exceed the debtor's actual expenses,^{n60b} chapter 13 administrative expenses,ⁿ⁶¹ certain payments on account of secured debts, and payments for priority claims.ⁿ⁶² The total amount of expenses, as determined by the 707(b) means test, post-petition domestic support obligations, and payments made to pension loans are then deducted from currently monthly income to arrive at the debtor's "disposable income."

The provisions permitting the court to adjust expenses for special circumstancesⁿ⁶³ are among those incorporated, so that if there are other expenses for which there is no reasonable alternative, the court can take those facts into account. Ultimately, the special circumstances test is not terribly different than reasonably necessary test used today.

[B] Debtors with Current Monthly Income Below Applicable State Median Family Income

The calculation of other reasonably necessary expenses for debtors with annualized current monthly income below the applicable state median family income is much more similar to the expense calculation under prior law. Indeed, other than the specific deduction for postpetition payments on a domestic support obligation and funds used for the repayment of pension loans, the language is largely unchanged. However, as discussed above, these expenses are now deducted from "current monthly income" as defined in section 101.

[h] Modification of Plans to Account for Changes in the Debtor's Financial Position

Section 1329(a) of the Bankruptcy Code permits a debtor, unsecured creditor or the trustee to seek modification of the plan, raising or lowering payments, if the debtor's circumstances change substantially. Thus, when there has been a substantial and unanticipated change for the better in the debtor's financial condition after confirmation, the trustee or an unsecured creditor can move for a modification increasing the debtor's payments.ⁿ⁶⁴ Due to the conflicting language in new section 1325(b)(2) defining disposable income with reference to "current monthly income," an amount that is fixed as of the date of filing, and section 1325(b)(1)(B) calling for debtor to use "projected monthly income" in determining plan payments, it is not clear to what extent the trustee and unsecured creditors will actually be able to tap into debtor's increased income for plan payments in cases filed on or after October 17, 2005.

MORE INFORMATION

The modification of the plan after confirmation is examined in more detail in chapter 22 *infra*.

Although the amendment to section 1329(a) does not by its terms limit creditors' motions to cases in which there has been a change in income or expenses, any motions filed on other grounds, which could have been raised earlier, should be barred by the *res judicata* effect of the confirmation order.ⁿ⁶⁵ If the debtor is able to complete payments under the original plan before a motion to modify is filed, the court is precluded from modifying the plan, since section 1329(a) of the Bankruptcy Code permits modification only "before completion of payments under [the confirmed] plan."ⁿ⁶⁶

As a practical matter, this section will be utilized primarily by debtors seeking to lower payments because of lower income or higher expenses. Once again, it is unclear how courts will handle debtors seeking to lower payments in these circumstances for cases filed on or after October 17, 2005 given the conflicting language in 1325(b)(2) and 1325(b)(1)(B). If no objection is made by the trustee or an unsecured creditor to the modified plan the court should allow the modification since 1325(b) is only relevant if an objection is filed. If an objection is filed, a court may still permit the modification if it finds that debtor is truly paying all that he or she can afford. To do otherwise, thereby saddling the debtor with payments that are impossible to make, would undermine the purpose of chapter 13 to provide the debtor with an opportunity for a fresh financial start.

Additionally, the five-year "applicable commitment period" of section 1325(b)(4) does not appear to apply to modification of plans. Section 1329 is amended only to say that a modified plan cannot be *longer* than the applicable commitment period unless the court approves, with a five year maximum.ⁿ⁶⁷ Although there had been some dispute under prior law as to whether section 1325(b) applies to modifications, this specific reference seems to make clear that this part of section 1325(b), at least, does not apply.^{n67a} Without the availability of modification, the only solutions for a debtor's inability to complete a plan, even after 3 years, would be conversion, dismissal or, if possible, a hardship discharge.

Prior to the 2005 amendments, a few courts tried to take into account possible increases in debtors' incomes in advance by requiring that plan payments increase by the same percentage as the debtor's income, or by some percentage of any additional income the debtor receives.^{n67b} These cases are misguided for several reasons. The legislative history gives no indication that such automatic increases were contemplated; the mechanism discussed in the proposal that led to the 1984 amendments was the motion to amend the plan.ⁿ⁶⁸ Moreover, escalator clauses would create monitoring and verification problems, making it difficult for the court or trustee to know when, or if, the debtor had completed payments under the plan. In addition, an escalator clause could not adequately take into account inflation or other expenses that could decrease the debtor's real disposable income. A three percent salary increase in a period when the cost of living increases by six percent is a decrease in real income, leaving the debtor less able to afford plan payments.

It is for the reasons stated above that the only proper method for increasing plan payments is a case by case approach through motions to amend chapter 13 plans. As the Ninth Circuit Court of Appeals held in *In re Anderson*,ⁿ⁶⁹ a debtor should not be required to pledge increased plan payments upon later increases in income in order to obtain confirmation. The procedure of the bankruptcy court in that case, which permitted the trustee to determine that plan payments should be increased without a motion to modify the plan, was disapproved as contrary to the statutory scheme, which contemplates a modification motion as the appropriate vehicle to change plan payments.ⁿ⁷⁰ For the same reason, a court may not condition plan confirmation on the debtor submitting in the future periodic reports of income with current pay stubs, because the Code contains no such requirement.ⁿ⁷¹

[3] Feasibility Requirement of Section 1325(a)(6)

Section 1325(a)(6) requires that the court confirm a plan only if "the debtor will be able to make all payments under the plan and to comply with the plan." If the plan does not meet this standard, often called the "feasibility test," confirmation may be denied.ⁿ⁷²

While the best interests and disposable income tests are intended to ensure that debtors pay enough, the feasibility test is intended to ensure that debtors do not commit themselves to paying too much; the plan must have some likelihood of succeeding. Under the feasibility test, debtors' income and living costs must be realistically estimated; after living costs are deducted from income, there must be enough left to make the payments called for under the plan. Two of the principal duties of the chapter 13 trustee are linked with the feasibility test; to investigate the financial circumstances of each chapter 13 debtorⁿ⁷³ and to appear and present evidence to the court at the hearing on confirmation as to the ability of the debtor to make all payments proposed by the plan,ⁿ⁷⁴ giving appropriate consideration to the primary obligation of debtors to support their dependents.

[a] Meeting the Feasibility Test

The schedules' property and budget figures must show sufficient income or other financial resources to make the payments proposed. If the debtor does not present such evidence as is necessary to convince the court that payments can be made, the plan may be found not feasible.

Similarly, if the plan calls for a very large lump sum payment at the end of the plan, with no reasonable explanation of how it will be funded by the debtor, the plan will be found not to meet the feasibility test.ⁿ⁷⁵

The court may consider whether necessities such as potential medical expenses and clothing have been provided for, and whether there is sufficient "cushion" or "play" in the budget to cover unexpected expenses and inflation. Finally, it may simply find the expense estimates to be unreasonably low.

In view of the possibility of scrutiny under the feasibility test, it is important to note on the schedules of income and expenditures such facts as coverage of all medical expenses by medical assistance, receipt of food stamps and

emergency fuel grants, and any other noncash variations from a normal budget.

No one can anticipate every expenditure; planning for a "cushion" to meet them is useful both in meeting the feasibility test and in avoiding unrealistic burdens under the disposable income test. Of course, for very low income debtors, a "cushion" for unexpected expenses is virtually unheard of even outside the context of bankruptcy.

PRACTICE NOTE

Drafting a budget that includes a small cushion over and above the required plan payments is desirable. But the court may also look to additional ability to pay if an objection under the disposable income test of section 1325(b) is filed. Therefore, this cushion should not be overly large, lest the court decide the debtor could pay more into the plan. Ultimately, to maximize chances of confirmation, the debtor must steer a course between the floor of the feasibility test and the ceiling of the disposable income test.

[b] Ability to Pay Is Best Shown by Actually Making Payments

The best way of showing ability to make payments is to begin making the monthly payments before the confirmation hearing, as is now required by section 1326(a). If a debtor has demonstrated an ability to pay the monthly amounts provided in the plan, then few courts will deny a debtor the opportunity to at least try to comply with the plan.ⁿ⁷⁶ A court may well find it more likely than not that a debtor's financial situation will improve, rather than deteriorate, in the future.ⁿ⁷⁷ The debtor may also be able to obtain help in making the payments from friends and relatives.ⁿ⁷⁸ Even when the court has serious doubts about feasibility, debtors should usually be given a chance to attempt their proposed plan, especially where they have substantially complied with their plan obligations prior to confirmation.ⁿ⁷⁹ In close cases, which often involve vital property such as a home or automobile, the court should be reluctant to impose its idea of what sacrifices the debtor is able to make.ⁿ⁸⁰

[4] Methods of Payment Allocation to General Unsecured Creditors

After the amount to be dedicated to unsecured creditors has been determined under the best interests and disposable income tests, and after portions of that amount are deducted for allocation to special classifications, such as a nondischargeable student loan, a cosigned debt, or small claims, it will be necessary to specify the method by which payments of the remaining amount will be allocated to the residual class of general unsecured creditors. There are two leading methods: (1) the "percentage" method and (2) the "base" (or "pot") method.

Under the percentage method, the debtor starts with the amount dedicated to general unsecured creditors (*e.g.*, a total of \$7,200), then attempts to arrive at an estimate of the total amount of general allowed unsecured claims (*e.g.*, \$10,000), and then, in the plan, commits to pay each general unsecured creditor a specified percentage of its claim (here, \$7,200 divided by \$10,000, or 72%).

Under the base or pot method, the debtor also starts with the amount dedicated to general unsecured creditors (*e.g.*, a total of \$7,200), designates this as the base amount (or "throws it into the pot") and then merely directs in the plan that the \$7,200 to be dedicated to general unsecured creditors will be allocated among them *pro rata* according to the size of their claims over the applicable commitment period of the plan.

PRACTICE NOTE

Regardless of whether the debtor chooses the percentage method, the base method, or one of the hybrids discussed below, there is no requirement that payments to unsecured creditors be level--they may, for example, be graduated or even annual.ⁿ⁸¹ What is required is some assurance that the payments actually will be made. When the proceeds of a sale of a major asset are to be a principal funding source, the whole idea of level, periodic payments is obviously inapplicable.

The percentage method theoretically saves the trustee a small amount of arithmetic effort and offers creditors an ostensibly firm commitment as early as possible in the case as to how much of their claims will be paid. Weighing against these relatively small benefits is that it is often difficult or impossible to arrive at the fixed percentage figures upon which the percentage method depends at the time of drafting or even at the time of confirmation. Unless there are only one or two debts, it is usually impossible to specify the precise amounts that will actually be paid to different creditors under the plan at the time the plan is drafted or even when it is confirmed; in many districts, confirmation precedes the bar date for claims. In most cases, the ultimate distribution depends on a number of events that occur only after formulation of the plan. For example, the amount of a secured claim may be disputed. If the plan provides for a certain level of payments to the trustee, the amount to be distributed to claims paid after the disputed claim is calculable only after the amount of the disputed secured claim has been determined. Moreover, not all creditors file claims; nationally, 40% do not. Thus the amount each unsecured creditor receives out of the total allocated to unsecured claims depends upon how many other unsecured creditors file and sustain their claims.

The advantage of the base method is its feasibility. Its successful application does not depend on information that is typically unavailable when the plan is drafted. The disadvantage is that to the extent the trustee or creditors might prefer the supposed certainty of the percentage method, the use of the base method might complicate negotiations with them. Also, some debtors' counsel prefer the percentage method because if not all creditors file claims, the debtor may be permitted to pay a smaller total amount.

To circumvent the major problem with the percentage plan--the fact that the total amount of general unsecured claims is usually not known when the plan is drafted--two hybrid methods have been devised. Under one method, the debtor specifies both a base amount and, based on the best available estimates, a percentage. Payments cease as soon as either the base amount has been paid out or when each creditor has received the specified percentage of its claim. The problem with this method is that it invites objections under the disposable income test. If the total amount of allowed general unsecured claims is smaller than expected, the percentage figure will be triggered sooner than expected and the debtor will end up paying less than the base amount--that is, less than an amount that presumably is required under the disposable income test.

Under the second variation, as under the other hybrid method discussed above, the debtor specifies both a base amount and a percentage. But here, payments only cease when both the base amount has been paid out and when each creditor has received either the specified percentage or 100% of its claim. The problem with this method is that it forces the debtor to assume the risk of an underestimate of the total amount of claims. If the total amount of claims is greater than expected, the debtor will be forced to pay more than the base amount--that is, in many instances, more than what would be required under the disposable income test; in other words, more than the debtor can afford. This may require a modification of the plan, to provide for a lower percentage or for an extension of the length of the plan.

FOOTNOTES:

(n1)Footnote 1. See 8 *Collier on Bankruptcy*, P 1325.05 (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1325.05 (Matthew Bender).

(n2)Footnote 2. *In re Hardy*, 755 F.2d 75, 12 C.B.C.2d 127 (6th Cir. 1985) . See P14.09[4][a] for discussion of present value interest computation.

(n3)Footnote 3. See P 14.09 *infra*.

(n4)Footnote 4a. *In re Tyson*, 359 B.R. 239 (Bankr. E.D. Ark. 2007) .

(n5)Footnote 4. *Sumski v. Sanchez* (*In re Sanchez*), 270 B.R. 322 (Bankr. D.N.H. 2001) (cause of action that arose after filing of bankruptcy petition not considered in best interests test). See *In re Richardson*, 283 B.R. 783 (Bankr. D. Kan. 2002) (insurance proceeds received post-confirmation are property of the debtor under § 1327(b) and may be used

to pay off plan early). In rare cases, the debtor may acquire property after the petition that would be property of a chapter 7 estate due to § 541(a)(5) which brings into the estate marital settlements, life insurance proceeds and inheritances acquired within 180 days of the petition. This property probably would be considered in the best interests test, at least if it were acquired prior to confirmation of the plan.

(n6)Footnote 5. See 8 *Collier on Bankruptcy*, P 1325.05[2][d] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1325.05[2][d] (Matthew Bender).

(n7)Footnote 6. See 8 *Collier on Bankruptcy*, P 1325.05[2][d] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1325.05[2][d] (Matthew Bender). See also *In re Barden*, 105 F.3d 821 (2d Cir. 1997) (trustee not permitted to use debtor's home residence capital gain exclusion or stepped-up basis that was available to debtor for sale of debtor's principal residence). But see *In re Popa*, 42 C.B.C.2d 422, 238 B.R. 395 (N.D. Ill. 1999) (trustee can take debtor's capital gains exclusion for personal residence, which is no longer a one-time exclusion but may be claimed every two years); *In re Kerr*, 237 B.R. 488 (W.D. Wash. 1999) (same).

(n8)Footnote 7. 11 U.S.C. § 726(c). See *In re Chandler*, 148 B.R. 13 (Bankr. E.D. N.C. 1992) (because section 522(b)(2)(B) [redesignated in 2005 as 522(b)(3)(B)] permits exemption of entireties property from creditors not holding claims against both spouses, plan paying 100% to joint claims and 9.6% to nonjoint claims satisfied best interests test).

(n9)Footnote 8. *In re Rimgale*, 669 F.2d 426, 5 C.B.C.2d 1281 (7th Cir. 1982) . See P 14.03[2] *supra*.

(n10)Footnote 9. 11 U.S.C. § 523(a)(1), (5), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 10. See 8 *Collier on Bankruptcy*, P 1325.LH (Matthew Bender).

(n12)Footnote 11. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n13)Footnote 12. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n14)Footnote 13. The disposable income test was adopted from a proposal of the National Bankruptcy Conference. See Oversight Hearings on Personal Bankruptcy Before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 97th Cong. 1st and 2d Sess. 181-223 (1981-82).

(n15)Footnote 14. Oversight Hearings on Personal Bankruptcy Before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 97th Cong. 1st and 2d Sess. 223 (1981-82).

(n16)Footnote 15. See P 14.05[3] for discussion for the feasibility standard.

(n17)Footnote 16. *In re Stewart*, 12 C.B.C.2d 86, 46 B.R. 73 (Bankr. D. Or. 1985) .

(n18)Footnote 17. *In re Smith*, 100 B.R. 436 (S.D. Ind. 1989) .

(n19)Footnote 18. *In re Smith*, 100 B.R. 436 (S.D. Ind. 1989) .

(n20)Footnote 19. *Matter of Eaton*, 130 B.R. 74 (Bankr. S.D. Iowa 1991) .

(n21)Footnote 20. *Education Assistance Corp. v. Zellner*, 827 F.2d 1222, 17 C.B.C.2d 867 (8th Cir. 1987) .

(n22)Footnote 21. See P 14.08 *infra* for discussion of which claims may be separately classified.

(n23)Footnote 22. See 8 *Collier on Bankruptcy*, P 1325.08[3] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1325.08[3] (Matthew Bender).

(n24)Footnote 23. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n25)Footnote 24. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n26)Footnote 25. Former 11 U.S.C. § 1325(b)(2). "Dependent" may include a debtor's aged parent, even if the debtor provides less than half the parent's support. *In re Tracey*, 66 B.R. 63 (Bankr. D. Md. 1986) .

(n27)Footnote 26. Former 11 U.S.C. § 1325(b)(2).

(n28)Footnote 27. *Matter of Killough*, 900 F.2d 61, 23 C.B.C.2d 472 (5th Cir. 1990) (affirming confirmation of plan without requiring debtor to include projected overtime in calculating budget).

(n29)Footnote 28. *In re Stones*, 157 B.R. 669 (Bankr. S.D. Cal.1993) .

(n30)Footnote 29. *In re Freeman*, 86 F.3d 478, 36 C.B.C.2d 87 (6th Cir. 1996) (exempt status of tax refund under state law irrelevant to disposable income test).

(n31)Footnote 30. *In re Kerr*, 199 B.R. 370 (Bankr. N.D. Ill. 1996) (proceeds from sale of exempt homestead need not be committed to plan). *See also In re Baker*, 194 B.R. 881 (Bankr. S.D. Cal. 1996) (exempt life insurance proceeds not disposable income, but interest on proceeds would be disposable income). *But see Barbosa v. Soloman*, 235 F.3d 31 (1st Cir. 2000) (proceeds from sale of home, on which mortgage had been stripped off due to lack of equity prior to confirmation, required to be paid to creditors in modified plan when home sold for twice the value used for stripping of liens).

(n32)Footnote 31. *See In re Bottelberghe*, 253 B.R. 256 (Bankr. D. Minn. 2000) . *But see In re Hull*, 251 B.R. 726 (B.A.P. 9th Cir. 2000) (under Washington state's community property laws, each spouse has vested interest in income of other spouse).

(n33)Footnote 32. *See In re Jones*, 55 B.R. 462 (Bankr. D. Minn. 1985) .

(n34)Footnote 33. *In re Tinneberg*, 59 B.R. 634 (Bankr. E.D.N.Y. 1986) (court would exclude from maintenance and support only unnecessary luxuries, and newspapers were not luxuries).

(n35)Footnote 34. *In re Greer*, 60 B.R. 547 (Bankr. C.D. Cal. 1986) ; *In re Otero*, 48 B.R. 704 (Bankr. E.D. Va. 1985) .

(n36)Footnote 35. *Compare In re Anes*, 195 F.3d 177, 42 C.B.C.2d 1875 (3d Cir. 1999) ; *In re Harshbarger*, 66 F.3d 775 (6th Cir. 1995) (payments not permitted) *with In re Taylor*, 243 F.3d 124 (2d Cir. 2001) (payment permitted if reasonably necessary for support of debtor or debtor's dependents). New section 1322(f) specifically addresses this split of authority by excluding repayments on retirement fund loans from disposable income. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n37)Footnote 36. *In re Buchferer*, 39 C.B.C.2d 269, 216 B.R. 332 (Bankr. E.D.N.Y. 1997) , *citing Johnson v. Home State Bank*, 501 U.S. 78, 111 S. Ct. 2150, 115 L. Ed. 2d 66, 24 C.B.C.2d 1171 (1991) .

(n38)Footnote 37. *In re Kerr*, 199 B.R. 370 (Bankr. N.D. Ill. 1996) (proceeds from sale of exempt homestead need not be committed to plan). *See also In re Baker*, 194 B.R. 881 (Bankr. S.D. Cal. 1996) (exempt life insurance proceeds not disposable income, but interest on proceeds would be disposable income).

(n39)Footnote 38. *E.g., In re Sturgeon*, 51 B.R. 82 (Bankr. S.D. Ind. 1985) .

(n40)Footnote 39. Pub. L. No. 105-183, 112 Stat. 517 (1998), *reprinted in* Vol. F Collier on Bankruptcy, App. Pt. 41(o)(ii) (Matthew Bender), applicable to cases pending on or after June 19, 1998.

(n41)Footnote 40. The "charitable contribution" must meet the definition in section 548(d)(3), as amended by the same Act, and thus must consist of either a financial instrument or cash.

(n42)Footnote 41. Section 1325(b) incorporates the definition of "qualified religious or charitable entity or organization" in section 548(d)(4), which in turn requires the recipient of the contribution to be an entity described in section 170(c)(1) or 170(c)(2) of the Internal Revenue Code.

(n43)Footnote 42. Compare 11 U.S.C. §§ 548(a)(2)(B), 707(b), both of which appear to, in some cases, take past contributions into consideration.

(n44)Footnote 43. See *In re Cavanagh*, 250 B.R. 107 (B.A.P. 9th Cir. 2000) (Congress intended that contributions within the limit be deemed reasonable and necessary).

(n45)Footnote 44. *In re Jones*, 55 B.R. 462 (Bankr. D. Minn. 1985) .

(n46)Footnote 45. *In re Festner*, 54 B.R. 532 (Bankr. E.D. N.C. 1985) .

(n47)Footnote 46. *In re Rogers*, 65 B.R. 1018 (Bankr. E.D. Mich. 1986) .

(n48)Footnote 47. 11 U.S.C. § 1325(b)(2)(B).

(n49)Footnote 48. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n50)Footnote 49. See P 14.12 *infra*.

(n51)Footnote 50. However, to the extent current monthly income already takes into account business expenses through the use of net business income, debtor will not be able to deduct the same expenses a second time.

(n52)Footnote 51. 11 U.S.C. § 101(10A)(A)(i).

(n53)Footnote 52. 11 U.S.C. § 101(10A)(B)

(n54)Footnote 53. 11 U.S.C. § 101(10A)(B).

(n55)Footnote 53a. *E.g.*, *In re Nowlin*, 2009 U.S. App. LEXIS 15860 (5th Cir. 2009) (court may adjust based on evidence of present or reasonably certain future events that substantially change the debtor's financial situation); *In re Lanning*, 545 F.3d 1269 (10th Cir. 2008) (court properly adjusted for decline in debtor's income); *In re Frederickson*, 545 F.3d 652 (8th Cir. 2008) .

(n56)Footnote 54. Section 1325(b), by its own terms, comes into play only if an objection is filed.

(n57)Footnote 54a. 11 U.S.C. § 101(10a)(A)(ii).

(n58)Footnote 54b. *In re Dunford*, 2009 Bankr. LEXIS 1938 (Bankr. N.D. Ill. 2009) ; *In re Hoff*, 402 B.R. 683 (Bankr. E.D.N.C. 2009); *In re Montgomery*, No. 07-051781, 2008 Bankr. LEXIS 706, at *2 (Bankr. M.D.N.C. Mar. 4, 2008) .

(n59)Footnote 55. 11 U.S.C. § 101(39A), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n60)Footnote 56. 11 U.S.C. § 101(39A)(B).

(n61)Footnote 57. 11 U.S.C. § 707(b)(6)(C)

(n62)Footnote 58. 11 U.S.C. § 104(b)(1), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n63)Footnote 59. See P 14.12 *infra*.

(n64)Footnote 59a. 11 U.S.C. § 541(b)(7); *In re Devilliers*, 358 B.R. 849 (Bankr. E.D. La. 2007) .

(n65)Footnote 60. This provision reverses the holdings of many courts under the law in effect prior to the 2005 amendments.

(n66)Footnote 60a. *In re Roberts*, 2008 Bankr. LEXIS 2600 (Bankr. E.D. Pa. 2008) ; *In re Haley*, 354 B.R. 340 (Bankr. D.N.H. 2006) . But see *In re Lasowski*, 2009 U.S. App. LEXIS 17982 (8th Cir. Aug. 12, 2009) (only actual amount of payments to be made over plan period can be deducted); *In re Nowlin*, 2009 U.S. App. LEXIS 15860 (5th Cir. 2009) (court can require increased plan payments when loan repaid).

(n67)Footnote 60b. *In re Kagenveama*, 527 F.3d 990 (9th Cir. 2008) ; *In re Naslund*, 359 B.R. 781 (Bankr. D. Mont. 2006) (expenses determined under IRS standards even if they exceed amounts on Schedule J); *In re Guzman*, 345 B.R. 640 (Bankr. E.D. Wis. 2006) (same).

(n68)Footnote 61. For purposes of calculating means test deductions administrative expenses may not to exceed ten percent of the projected plan payments. This cap should not apply to actual administrative expenses in the chapter 13 case.

(n69)Footnote 62. See P 23.02[3][b][iv] *infra*.

(n70)Footnote 63. 11 U.S.C. 707(b)(2)(B). added by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n71)Footnote 64. *In re Arnold*, 869 F.2d 240, 20 C.B.C.2d 1168 (4th Cir. 1989) (debtor's income rose from \$80,000 per year to \$200,000 per year); *In re Powers*, 37 C.B.C.2d 192, 202 B.R. 618 (B.A.P. 9th Cir. 1996) (\$500 increase in debtor's income justified plan modification, even after taking into account debtor's increased expenses). But see *In re Forbes*, 39 C.B.C.2d 82, 215 B.R. 183 (B.A.P. 8th Cir. 1997) (under a literal reading of section 1329, the ability to pay test of section 1325(b) is not applicable to postconfirmation modifications).

(n72)Footnote 65. See, e.g., *In re Bonanno*, 78 B.R. 52 (Bankr. E.D. Pa. 1987) . But see *Barbosa v. Solomon*, 235 F.3d 31 (1st Cir. 2000) (plan may be modified without showing change of circumstances); *Matter of Witkowski*, 16 F.3d 739, 30 C.B.C.2d 1409 (7th Cir. 1994) (changed circumstances not a prerequisite for trustee's motion to modify plan after confirmation); *In re Brown*, 219 B.R. 191 (B.A.P. 6th Cir. 1998) (no substantial change of circumstances need be shown); *In re Than*, 39 C.B.C.2d 118, 215 B.R. 430 (B.A.P. 9th Cir. 1997) (no substantial and unanticipated changed circumstances required for trustee's motion to modify plan).

(n73)Footnote 66. *Bayshore Nat'l Bank v. Smith*, 252 B.R. 107 (E.D. Tex. 2000) ; *Profit v. Savage* (*In re Profit*), 283 B.R. 567 (B.A.P. 9th Cir. 2002) ; 8 *Collier on Bankruptcy*, P 1329.08 (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1329.08 (Matthew Bender). Cf., *In re Meza*, 467 F.3d 874 (5th Cir. 2006) (plan may be modified if motion is filed before completion of payments, even if payments completed before motion is heard).

(n74)Footnote 67. 11 U.S.C. § 1329(c), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n75)Footnote 67a. See *In re Robert*, 366 B.R. 27 (Bankr. W.D. Ark. 2007) (debtor could modify plan to pay less than amount originally determined under section 1325(b) when income dropped; § 1325(b) does not apply to modification); *In re Ewers*, 366 B.R. 139 (Bankr. D. Nev. 2007) (because § 1325(b) does not apply to modification,

debtor could modify to reduce term of plan to less than five year commitment period when income dropped).

(n76)Footnote 67b. *See, e.g., In re Akin*, 54 B.R. 700 (Bankr. D. Neb. 1985) .

(n77)Footnote 68. *Oversight Hearings on Personal Bankruptcy Before the Subcommittee on Monopolies and Commerce of the House Committee on the Judiciary*, 97th Cong. 1st and 2d Sess. 215, 221 (1981-1982).

(n78)Footnote 69. 21 F.3d 355, 30 C.B.C.2d 1570 (9th Cir. 1994) .

(n79)Footnote 70. *But see In re Broken Bow Ranch*, 33 F.3d 1005, 31 C.B.C.2d 1272 (8th Cir. 1994) (where confirmed chapter 12 plan did provide for general obligation to pay all disposable income at the end of three years to unsecured creditors, rather than specific amounts, debtors could be required to pay amounts that court determined were not necessary for support of debtor or dependents or operation of farm in order to obtain discharge, even though debtor would have to borrow to finance future operations).

(n80)Footnote 71. *Petro v. Mishler*, 276 F.3d 375 (7th Cir. 2002) .

(n81)Footnote 72. *See 8 Collier on Bankruptcy*, P 1325.07 (Matthew Bender); *3 Collier Bankruptcy Manual*, P 1325.07 (Matthew Bender).

(n82)Footnote 73. *See 11 U.S.C. § 704(4) and § 1302(b)(1)*.

(n83)Footnote 74. *See 11 U.S.C. § 1302(b)(2)(B)*.

(n84)Footnote 75. *See, e.g., In re Fantasia*, 38 C.B.C.2d 1132, 211 B.R. 420 (B.A.P. 1st Cir. 1997) (plan not feasible when debtors offered no evidence to show they could carry out intent of making large balloon payment by refinancing a parcel of property).

(n85)Footnote 76. *See In re Weaver*, 2 C.B.C.2d 315, 5 B.R. 522 (Bankr. E.D. Tenn. 1980) (court reluctant to judge what sacrifices a debtor can make).

(n86)Footnote 77. *See, e.g., In re Compton*, 88 B.R. 166 (Bankr. S.D. Ohio 1988) (court found it more likely than not that debtor would find employment before unemployment benefits ended).

(n87)Footnote 78. *In re Ward*, 25 C.B.C.2d 349, 129 B.R. 664 (Bankr. W.D. Okla. 1991) (because debtors were current in preconfirmation plan payments, court found plan feasible notwithstanding the fact that debtors had received help in making those payments from relatives and from their church).

(n88)Footnote 79. 11 U.S.C. § 1326(a), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n89)Footnote 80. *In re Ryals*, 1 C.B.C.2d 836, 3 B.R. 522 (Bankr. E.D. Tenn. 1980) .

(n90)Footnote 81. *In re Fiegi*, 61 B.R. 994 (Bankr. D. Or. 1986) .



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CHAPTER 14 The Chapter 13 Plan

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P 14.06 The Good Faith Tests

[1] Good Faith Filing of Plan; § 1325(a)(3)

Section 1325(a)(3) of the Bankruptcy Code requires that plans be proposed in good faith and not by any means forbidden by law. Most courts agree that this language justifies a denial of confirmation when debtors have been dishonest in filling out the schedules or do not sincerely intend to carry out the plan. Many courts also use the test as a safety valve to bar confirmation of plans that are technically lawful but nevertheless unethical, devious, or manipulative. After the disposable income test was added to the Bankruptcy Code in 1984, the good faith test was no longer used as a vehicle for requiring an adequate level of payments under the plan.

[a] Historical Background of Good Faith Test

Before 1984 (when the disposable income test was added), the good faith test of section 1325(a)(3) was used by many judges to refuse confirmation to technically lawful plans under which the debtor proposed to pay out far less of his or her income than what the judge thought the debtor should pay. Some judges went so far as to reject plans that did not offer "meaningful" payments (of at least 70%) to unsecured creditors. Other judges took an opposite approach, holding that good faith referred essentially to honesty and did not impose any substantive obligations with regard to levels of payments. An early compromise position--the "facts and circumstances" approach--soon emerged, under which judges considered a large number of amorphously defined factors, relating both to honesty and to levels of payments.ⁿ¹

In 1984, Congress added the disposable income test, which effectively preempted the use of the good faith test as a vehicle for ensuring an adequate level of payments to creditors. There is now a division between courts who apply the good faith test as a device for limiting any of a large number of substantive abuses and evasions, and a smaller number of courts who limit the good faith concept to basic honesty.

[b] Law of Good Faith Test After 1984

Most courts interpret the addition of the disposable income test as doing nothing more than eliminating certain issues--those going to whether minimal payments to unsecured creditors evidence bad faith--from the "facts and circumstances" examination of good faith.ⁿ² These courts still look to all of the "facts and circumstances" of the case in applying the good faith test. Various lists of relevant issues include:

- **Debtor's Sincerity**--Whether the debtor is making an "honest and sincere effort." (This factor might still have some vitality to the extent that honesty and sincerity are emphasized. However, the amount of "effort" required should normally not be more than that required under the disposable income test.);
- **The Length of the Plan.** The length of the proposed plan;
- **Debtor's Filing History.** Whether the debtor has been in bankruptcy before, especially if the time bar to a chapter 7 discharge is applicable;
- **The Discharge Sought.** Whether the debtor is attempting to obtain a discharge of debts not dischargeable under chapter 7;
- **The Debts Themselves.** The amount and type of debt involved.
- **Secured Claims.** The extent to which secured claims are involved. For example, when a debtor is trying to save a home from foreclosure, this is likely to be seen as a particularly appropriate use of chapter 13;
- **Fees and Costs.** The relation of attorneys' fees and administrative costs to the amount paid to unsecured creditors. (This factor might still be viable if it is applied in the unusual situation of a plan involving fees and costs that are greatly disproportionate to distributions. The adequacy of the total amount of distributions should, however, be determined under the disposable income test and other specific requirements of the Code.);
- **Unfair Preferences.** Whether the debtor has created preferences or preferred classes of creditors. (Note: The more direct remedy against unreasonable discrimination against classes of creditors is section 1322(b)(1).);
- **Nonincome Assets.** The availability of property that could be liquidated. (Note: The best interests of creditors test is the normal means of addressing the problem of wealthy but low-income debtors who would prefer not to liquidate their property.) This factor may relate to debtors who engage in so-called exemption "abuses," such as the practice of converting large amounts of non-exempt property to exempt property immediately before bankruptcy, or who change domiciles solely to take advantage of another jurisdiction's more generous exemption laws. The latter practice is more widely condemned than the former. Both practices have been curtailed by the 2005 amendments to the Bankruptcy Code.ⁿ³
- **Evasive Purpose.** Whether the case is a disguised chapter 7 case.

Before the enactment of the disposable income test in 1984, many courts considered the debtor's income and expenses along with the factors above in determining whether the debtor's plan was filed in good faith. Most courts now agree that these issues are addressed by the disposable income test.

Some courts use the good faith test as a last resort safety valve to deny confirmation to plans whose purpose is ethically dubious even if the provisions of the plan are not in violation of any specific legal mandate and even if the debtor has been perfectly candid. For example, if the debtor is perceived to be a scoundrel or something worse, it is felt that chapter 13 relief should not be available to help the debtor evade his or her obligations to the victims.ⁿ⁴ However, most courts have held that simply taking advantage of the broader chapter 13 discharge was contemplated by Congress and is not, in itself, an abuse constituting bad faith. These latter cases have been and continue to be the better reasoned, insofar as they effectuate the differences in the discharge available under chapter 7 and chapter 13 as enacted by Congress.ⁿ⁵

[2] Good Faith Filing of Petition: § 1325(a)(7)

Under section 1325(a)(7), added by the 2005 amendments to the Bankruptcy Code,ⁿ⁶ a plan can be denied confirmation if the action of the debtor in filing the bankruptcy petition was not in good faith. This paragraph differs from section 1325(a)(3) because that section refers to good faith proposal of a plan, rather than filing of the petition. Prior to the 2005 amendment, some courts found bad faith filing of the petition to be grounds for dismissal of the case. By providing a specific remedy in section 1325(a)(7) for bad faith filing of the petition, Congress has presumably indicated that denial of confirmation, rather than dismissal, is the appropriate way to prevent such conduct.

FOOTNOTES:

(n1)Footnote 1. See 8 *Collier on Bankruptcy*, P 1325.LH (Matthew Bender).

(n2)Footnote 2. *Matter of Smith*, 848 F.2d 813, 18 C.B.C.2d 1375 (7th Cir. 1988) ; *Education Assistance Corp. v. Zellner*, 827 F.2d 1222 (8th Cir. 1987) .

(n3)Footnote 3. See 11 U.S.C. § 522(b)(3) (modifying domicile requirements for exemption purposes); 11 U.S.C. § 522(o) (limiting homestead exemption for fraudulent conversion of nonexempt property into exempt homestead property).

(n4)Footnote 4. See, e.g., *Noreen v. Slattengren*, 974 F.2d 75 (8th Cir. 1992) (finding lack of good faith in plan of debtor who sought to eliminate liability for child sexual abuse with minimal payments); *In re LeMaire*, 898 F.2d 1346, 22 C.B.C.2d 1008 (8th Cir. 1990) (en banc) (good faith found lacking in large part due to heinous nature of debtor's prepetition acts).

(n5)Footnote 5. Compare 11 U.S.C. § 1328(a) with 11 U.S.C. § 523(a). See *In re Smith*, 286 F.3d 461 (7th Cir. 2002) ; *Matter of Chaffin*, 816 F.2d 1070, 16 C.B.C.2d 1263 (5th Cir. 1987) , modified, 836 F.2d 215, 18 C.B.C.2d 477 (5th Cir. 1988) .

(n6)Footnote 6. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 14 The Chapter 13 Plan

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P 14.07 Payments to Unsecured Priority Creditors

The Bankruptcy Code gives priority status to certain categories of debts: most notably, administrative claims, including trustee's and attorney's fees, tax claims, and claims for domestic support obligations. A chapter 13 plan must normally provide that the face value of these claims will be paid in full, although there is usually no requirement for present value interest. Administrative claims must be paid ahead of or along with other claims; under most court decisions, other priority claims may be paid after other claims are paid.

[1] Full Payment Required

Section 1322(a)(2) of the Bankruptcy Code requires that the plan must provide for payment in full of all claims entitled to priority under *section 507(a) of the Bankruptcy Code*. There are only two exceptions to this requirement. First, the holder of the priority claim may consent to different treatment. A creditor who fails to object to a plan proposing less than full payment may be deemed to have agreed to it.ⁿ¹ In any case, if such a plan is confirmed, the creditor is bound by it. Second, *section 1322(a)(4)*, added in 2005, provides that if the priority claim is a domestic support obligation that has been assigned to a governmental unit, or is owed directly to a governmental unit, the debtor need not pay that obligation in full so long as the plan provides that all of the debtor's projected disposable income over five years will be devoted to the plan.

MORE INFORMATION

Chapter 20 *infra* provides an extensive discussion of the effects of confirmation.

[2] Common Types of Priority Claims

The most common types of priority claims in chapter 13 cases are

- claims for filing fees and administrative expenses, such as the debtor's attorney's fees or the trustee's fees, and "use and occupancy" payments for executory contracts and leases;
- certain tax claims; and
- domestic support obligations

Debtors who have been in business may also owe priority debts for wages, withholding taxes (FICA or sales taxes) or consumer deposits.

While attorney's fees and trustee's fees are to be expected in most chapter 13 cases, the requirement that other priority claims be paid in full may be difficult for some debtors to meet.

It should be noted, however, that section 1322(a)(2) itself has generally been held not to require that priority creditors receive the present value of their claims, *i.e.*, the claims plus interest, over the course of the plan, as does the best interests of creditors test.ⁿ² Of course, if the priority claim would have been paid in full in a chapter 7 case, because the debtor is unusually rich in assets, present value interest on priority claims would be required under the best interests of creditors test itself.

Under *section 1326(b) of the Bankruptcy Code*, administrative claims must be paid ahead of or *pro rata* along with other claims. But there is no statutory requirement that priority claims other than those for fees and administrative expenses be paid before other claims.ⁿ³ In some cases, a debtor may want to provide for payment of large priority claims only after the secured claims are paid in full under the plan. If that is done and the debtor is then for some reason unable to complete the plan, there is a better chance that the secured claims will have been satisfactorily dealt with by the time the plan fails, in which case the debtor may seek a hardship discharge or choose to convert the case to chapter 7. If either of these alternatives is chosen, there is no requirement that any priority claims be paid in the bankruptcy case, although some priority taxes or support debts may not be discharged.ⁿ⁴ It should also be noted that while interest generally accrues on unpaid secured claims, the same is not always true for unsecured priority claims.

MORE INFORMATION

The hardship discharge and conversions are discussed in more detail in chapters 29 and 24 *infra*, respectively.

Usually, a debtor will want to provide for payment of priority claims before general unsecured claims are paid, however. Then, if the plan fails before it can be completed, there will be a greater chance that priority claims have been paid in full or almost paid in full, which could keep open the option of modifying the plan; any modified plan must also provide for full payment of priority claims. Alternatively, if the debtor seeks a hardship discharge or converts to chapter 7, taxes or alimony or support obligations that would not have been discharged will no longer be owing if they have already been paid in the chapter 13 plan.

[3] No Need to Pay a Priority Creditor Who Does Not File a Claim

It is quite clear that a priority creditor need not be paid if it fails to file a claim.

[a] Unfiled Tax Claims May Be Dischargeable

Occasionally, taxing authorities will fail to file claims for priority income or other taxes. For such cases filed prior to the effective date of the 2005 amendments, if tax debts were properly scheduled and the taxing authority had notice of the case, the taxes are dischargeable upon completion of the plan.ⁿ⁵ A similar analysis applies when a taxing authority fails to file a claim for the full amount it later claims is owed. Generally, if the omitted amounts derive from a different year or a different transaction, courts will not allow them to be added to the taxing authority's proof of claim by amendment after the claims bar date has passed.

The 2005 Act expanded the types of debts that are nondischargeable in chapter 13, including many tax debts. As a result, for cases filed on or after October 17, 2005, priority tax claims under section 507(a)(8)(C) and tax claims

described in section 523(a)(1)(B) and (1)(C) are nondischargeable. Therefore, it is in the debtor's best interest to file a claim for such nondischargeable priority tax debts to assure the creditor is paid ahead of nonpriority unsecured creditors. However, priority tax claims under section 507(a)(8)(A) and (B) continue to be dischargeable in chapter 13 and, in the rare cases where a taxing authority fails to file a claim, they need not be paid.

[b] Unfiled Domestic Support Obligation Claims Are Nondischargeable

Similarly, even if a priority domestic support obligation claim is not filed, the debt will not be discharged at the end of the case, because such claims are nondischargeable under *section 1328(a) of the Code*. Because support claims are nondischargeable, it is usually in the debtor's interest to file a claim for a priority support creditor (assuming that the debtor can afford to pay the claim in the plan) to assure that the creditor is paid ahead of nonpriority unsecured creditors. Alternatively, if the claim is to be paid by the debtor directly to the creditor outside the plan,ⁿ⁶ the debtor should ensure that his or her budget is adjusted to take the payments into account.

FOOTNOTES:

(n1)Footnote 1. *See In re Lindgren*, 85 B.R. 447 (Bankr. N.D. Ohio 1988); *In re Hebert*, 61 B.R. 44 (Bankr. W.D. La. 1986).

(n2)Footnote 2. *See 8 Collier on Bankruptcy*, P 1322.03[4] (Matthew Bender).

(n3)Footnote 3. 11 U.S.C. § 1326(b)(1); *In re Ferguson*, 26 C.B.C.2d 229, 134 B.R. 689 (Bankr. S.D. Fla. 1991) (en banc) (priority tax claims need not be paid in equal monthly payments and need not be paid ahead of other claims). *See* H.R. No. 595, 95th Cong., 1st Sess. 358 (1977), *reprinted in* Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender).

(n4)Footnote 4. 11 U.S.C. § 523(a)(1), (5).

(n5)Footnote 5. *In re Tomlan*, 907 F.2d 114 (9th Cir. 1990) . *See 8 Collier on Bankruptcy*, P 1322.0[3] (Matthew Bender).

(n6)Footnote 6. Because alimony and support claims are usually rather large, debtors often find it in their interests to have them paid outside the plan, to avoid trustee commissions. Debtors often arrange to have the payments separately deducted from their wages. *See P 14.10 infra*.



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CHAPTER 14 The Chapter 13 Plan

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P 14.08 Classification of Claims

One of the powers given to debtors by chapter 13 is the right to designate classes of claims.ⁿ¹ In essence, this is the right to treat some claims better than others in the chapter 13 plan. However, this right is subject to an important limitation. The plan may not "discriminate unfairly" against any class of claims.ⁿ² If there is an objection to the proposed classification, the debtor probably bears the burden of showing that the proposed classification in the chapter 13 plan does not discriminate unfairly.

[1] Discrimination Among Classes of Claims Must Be "Fair."

Generally, the prohibition against unfair discrimination requires that if certain claims are placed in a separate class for preferred treatment, some distinguishing characteristic of those claims must justify that preferred treatment, making it "fair." Claims within each class must be substantially similar and the discrimination among classes must be rationally related to a legitimate rehabilitative goal.ⁿ³ Otherwise, one of the cardinal principles of bankruptcy, equality among creditors, would be undermined. One judicially adopted standard for reviewing the fairness of a classification scheme is expressed in terms of:

- whether the discrimination had a reasonable basis;
- whether the debtor has the financial resources to carry out the plan without the discrimination;
- whether the discrimination is proposed in good faith; and
- whether the degree of discrimination is directly related to the basis or rationale for the discrimination.ⁿ⁴

The general idea--which is not as helpful as one might hope in deciding individual cases--is that given the debtor's limited resources, the discrimination should be no worse than what is reasonably necessary to create a viable plan.

Unfortunately, the Bankruptcy Code itself offers only the most general guidance as to what discrimination should be considered fair. In that the Code specifically authorizes classes of unsecured claims, it is clear that all unsecured claims need not be in the same class. Section 1322(b)(1) refers to section 1122, which provides for classification of claims in

chapter 11 cases. That section, in turn, provides a little more guidance. Under section 1122, a claim may be placed in a class only if it is "substantially similar" to other claims in the class. There is an exception to the "substantial similarity" requirement. Section 1122(b) specially authorizes the creation of a separate class of small unsecured claims, if necessary for administrative convenience.ⁿ⁵ The debtor might wish to pay off a large number of small claims first in order to satisfy most of his or her creditors quickly, especially if future business with those claimants is contemplated.ⁿ⁶

Some classifications that have been proposed by consumers, although not specifically directed or authorized by statute, have posed few problems. It is clear that secured claimants and priority claimants have greater rights in bankruptcy than unsecured claimants. Separate classifications of such claims merely carry forward the policies evident in the Bankruptcy Code. If the debtor wishes, such claims may even be divided into classes for different treatment in order of their priority or lien status. Similarly, a plan providing greater payments to creditors who would receive more in a chapter 7 case because of their rights against entireties property is not unfair discrimination.^{n6a}

Section 1322(b)(4) does expressly permit payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim.ⁿ⁷ However, it would probably be considered unfair to pay one class of claims before another class of claims that is not distinguishable in some meaningful way.

Section 1322(b)(5) also permits different treatment of unsecured claims with a final payment due after the conclusion of the plan, permitting them to be paid through maintenance of payments and curing of defaults.ⁿ⁸

Likewise, when the Code provides special treatment for particular contracts, such as executory contracts and unexpired leases, that treatment can be carried out through classification. To assume an executory contract or unexpired lease, the debtor must promptly cure a default. The debtor may effectuate that cure by paying the arrears on the contract, even if those arrears might otherwise be an unsecured claim, prior to other claims.ⁿ⁹ Assumption of the executory contract or lease renders the amount necessary to cure a priority administrative expense, which clearly can be separately classified.ⁿ¹⁰

MORE INFORMATION

Treatment of executory contracts and unexpired leases is discussed in chapter 15 *infra*.

A few courts have required payment of the debtor's attorney's fees concurrently with unsecured debts, despite their priority status, to assure that the debtor's attorney maintains an interest in the case.ⁿ¹¹ Other courts have permitted payment of attorney's fees prior to other claims.ⁿ¹²

MORE INFORMATION

For discussion of payment of attorney's fees through the plan *see* chapter 21 *infra*.

[2] Cosigned Claims

The most commonly proposed classification confronted by the courts has been that providing for favored treatment (usually 100% payment) to creditors who have obtained cosigners on their claims. Since in consumer cases such cosigners are almost always close friends or relatives, it is not surprising that debtors would want to place a higher priority on payment of these debts to avoid the bad feelings or embarrassment that could be engendered if the creditor sought payment from their cosigners. (Relief from the codebtor stay of collection efforts against cosigners may be obtained if the plan does not propose to pay such claims in full.) Thus, debtors in such cases argued that, for them, there was a substantial difference between these and other unsecured claims. The courts, however, were generally not particularly sympathetic to these arguments.ⁿ¹³

MORE INFORMATION

The chapter 13 codebtor stay is discussed extensively in chapter 9 *supra* .

Congress apparently did agree with debtors who sought to give special treatment to cosigned claims. The 1984 amendments to the Code specifically permit separate classification of claims with cosigners.ⁿ¹⁴ However, some courts have not permitted some discrimination in favor of cosigned claims that they believed was disproportionate.ⁿ¹⁵ These cases misconstrue the intent of the 1984 amendments.

[3] Claims That Are Nondischargeable in Chapter 13

Debtors in chapter 13 cases proposed a number of other types of classifications. Several have classified debts that would likely be nondischargeable in a chapter 7 case, or in both chapters 7 and 13, separately from others. Although these claims are not given priority in liquidation, such classifications have sometimes been allowed. For example, plans proposing favored treatment of child support arrearages were approved based on the nondischargeability of such debts and the different enforcement mechanisms available, *e.g.*, contempt of court. In *In re Leser* ⁿ¹⁶ the Eighth Circuit Court of Appeals held that the strong public policy in favor of obtaining funds for child support claims, including those assigned to governmental units, dictated that they could be separately classified and paid more than other unsecured claims.

Similarly, separate classification of student loan debts has been allowed by some courts.ⁿ¹⁷ Many of the same arguments applicable to child support debts also apply in the student loan context. As in the case of child support, the exception to the chapter 13 discharge for student loans is not one based on the fault of the debtor, or intended to punish the debtor. It was passed as part of a budget act as a way of providing revenues to the government.ⁿ¹⁸ Therefore, it is entirely in keeping with this purpose to allow separate classification and greater payments, which will increase the amount the government collects on such debts. At least one court has also pointed out that separate classification has another reasonable basis because, absent payment of a student loan, a debtor is often ineligible to obtain other financial assistance or to return to school.ⁿ¹⁹ For some courts, it has been a sufficient basis for classification that the debt is nondischargeable in chapter 13 and the debtor, therefore, has a significant interest in paying as much of it as possible.ⁿ²⁰

In any event, in the case of long-term student loan debts it is quite clear that a debtor may choose to cure and maintain payments pursuant to section 1322(b)(5), even if that means that the student loan creditor receives more than other unsecured creditors.ⁿ²¹ This may achieve the same practical result as separate classification in jurisdictions where separate classification is not otherwise allowed.

Finally, section 1322(b)(10) allows for payment of interest on nondischargeable claims, and not other claims, but only if the plan provides for full payment of all allowed claims.

[4] Classification Based Upon Compelling Need

Other proposals have involved preferred treatment to creditors with a special relationship to the debtor or with claims of a special nature. Courts have approved more favored treatment for doctors, landlords, trade creditors necessary for continued operation of a business, attorneys, and even banks from whom future credit is needed.ⁿ²² Such decisions have been justified by the fact that these debts were more likely to be paid in the nonbankruptcy world and that without payment to such creditors, the plan or even the debtor's well-being might be endangered, *e.g.*, if the only doctor in town refused treatment because of a discharged debt.ⁿ²³ A debtor also may be permitted to discriminate among creditors if such discrimination is necessary to maintain the income necessary for the plan.ⁿ²⁴ The sparse legislative history on the subject also seems to support a broad view of the debtor's right to classify claims,ⁿ²⁵ as does the justification given by Congress for separate classification of cosigned debts.

[5] Classification of Tax Claims

Classification may also be used to designate which portion of a claim for federal taxes a debtor wishes to pay. Generally, the debtor will wish to classify tax claims to make sure that priority and secured tax claims are paid before unsecured claims. Otherwise, the I.R.S. is likely to allocate the payments to unsecured, nonpriority claims, which would leave the debtor with a potentially larger burden if the plan fails. The Supreme Court has specifically held that a chapter 11 debtor may so designate the payments under its plan,ⁿ²⁶ so a chapter 13 debtor whose payments are, if anything, more voluntary than those of a chapter 11 debtor, should certainly be able to designate which tax years are being provided for in the plan.

[6] Implicit Classifications

Some courts have looked behind the classifications of debts explicitly stated in plans to find (and disapprove of) different treatment that has implicitly been granted to certain unsecured claims. This has usually occurred when debts are partially secured. In such cases, the partially secured debt should have been divided into a secured claim and an unsecured claim.ⁿ²⁷ Otherwise, full payment of the partially secured claim would mean full payment of the unsecured portion as well as the secured portion. When this has been proposed and when other unsecured creditors were not to be paid in full, confirmation of the plan has properly been denied.ⁿ²⁸

MORE INFORMATION

See discussion of claim bifurcation in chapter 19 *infra* .

[7] Payments Outside the Plan

Another type of provision that may be a classification is the designation of certain claims to be paid "outside the plan." What this means is that payments on these claims will be made by the debtor directly to the creditor, instead of through the trustee. Generally, such provisions may offer a number of advantages. They usually will save the debtor from paying the trustee's fees and costs of up to 10% on such debts, a factor that may be important in cases in which the payments on one debt, such as a home mortgage, are particularly large. (For this reason, trustees have sometimes objected to payments outside the plan.)ⁿ²⁹ Outside-the-plan payments may also avoid the delays sometimes encountered when payments are made through the trustee. In any case, it seems clear that to the extent the plan provides a creditor with a greater benefit from having payments made outside the plan, that designation does constitute a classification subject to the unfair discrimination test. It should also be noted that in some districts it is common practice to make all payments, including current mortgage payments, through the trustee.

[8] Practical Considerations in Classifying Claims

Generally, it is in the debtor's interest to classify some claims. Large secured claims may be paid outside the plan to avoid considerable trustee expenses. Also, it is usually advantageous to pay other secured claims, where liens cannot be avoided, and claims not dischargeable in chapter 13 or chapter 7, before general unsecured claims. If this is done, then after the chapter 13 case, or if later circumstances force a conversion to chapter 7 or dismissal, the debtor may have paid off, or at least reduced, those claims which would be most troublesome in chapter 7 or outside of bankruptcy. In addition, the debtor will usually want to provide for early payment of priority claims, at least before other unsecured claims. Once these are paid, if circumstances change the debtor may choose to modify the plan to terminate earlier, assuming the other mandatory requirements of chapter 13 have also been met by then. If priority claims have not yet been paid in full, such a modification is not available, and the options may be limited to a hardship discharge, conversion to chapter 7, or dismissal.

In view of the courts' general hostility toward special treatment of certain unsecured debts, it may not be possible to provide for such treatment in the plan. However, other alternatives that accomplish a similar result may be available. In

some cases the debtor may be able to propose a plan giving a low percentage payment to all unsecured creditors, and then make voluntary payments outside the plan to the preferred creditors. Because the plan would not provide for these payments, however, the debtor would not be bound to make them under section 1327(a). Nor could the debtor formally promise the creditor that the payments would be made without running afoul of the reaffirmation provisions in *section 524 of the Bankruptcy Code*. Although in these circumstances the creditor would be permitted to obtain relief from the stay of proceedings against a codebtor, it is unlikely that it would do so, especially if current payments were maintained. Similarly, a creditor who received continued voluntary payments would not be likely to deny services on the basis of a bankruptcy. Thus, so long as the payments are not provided for in the plan or binding upon the debtor, and the plan otherwise complies with chapter 13 (it might run afoul of the disposable income test if an objection is raised on that basis), there should be no impediment to giving preferred treatment voluntarily to particular creditors outside the plan.

MORE INFORMATION

Chapter 27 *infra* provides a detailed discussion of reaffirmation requirements. Chapter 9 *supra* provides a discussion of the codebtor stay.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 1322(b)(1).

(n2)Footnote 2. 11 U.S.C. § 1322(b)(1). See 8 Collier on Bankruptcy, P 1322.05 (Matthew Bender).

(n3)Footnote 3. *In re Gunn*, 37 B.R. 432 (Bankr. D. Or. 1984) .

(n4)Footnote 4. *In re Wolff*, 6 C.B.C.2d 1282 (B.A.P. 9th Cir. 1982) .

(n5)Footnote 5. 11 U.S.C. § 1122(b).

(n6)Footnote 6. See *In re Ratledge*, 31 B.R. 897 (Bankr. E.D. Tenn. 1983) (plan confirmed that proposed payment of first \$500 and 10% of remaining balance to all unsecured creditors). *Accord In re Terry*, 78 B.R. 171 (Bankr. E.D. Tenn. 1987) (first \$1,000 and 10% of remaining balance to be paid on unsecured claims).

(n7)Footnote 6a. *In re Raynard*, 354 B.R. 834 (B.A.P. 9th Cir. 2006) (plan paying 100% to joint creditors who could reach entireties property and smaller amount to other creditors did not unfairly discriminate).

(n8)Footnote 7. The Supreme Court has held that as to tax payments, a chapter 11 debtor may allocate payments to a particular tax liability if the allocation furthers the debtor's reorganization, despite the claims of the IRS that it had the right to allocate the payments due to their involuntary nature. *United States v. Energy Resources, Inc.*, 495 U.S. 545, 110 S. Ct. 2139, 109 L. Ed. 2d 580, 22 C.B.C.2d 1093 (1990) . The language of section 1322(b)(4) and the fact that a chapter 13 plan is, in all cases, completely voluntary in nature should militate for a similar result in chapter 13.

(n9)Footnote 8. See Lee, *Chapter 13 nee Chapter XIII*, 53 Am. Bankr. L. J. 303, 313 (1979).

(n10)Footnote 9. *In re Davis*, 38 C.B.C.2d 694, 209 B.R. 893 (Bankr. N.D. Ill. 1997) .

(n11)Footnote 10. *Nostas Assocs.*, 78 F.3d 18 (2d Cir. 1996) . See 4 Collier on Bankruptcy, P 503.06[6][b] (Matthew Bender).

(n12)Footnote 11. See *In re Lanigan*, 101 B.R. 530 (Bankr. N.D. Ill. 1986) (bankruptcy court had authority to order payment of fees over life of plan).

(n13)Footnote 12. *E.g., In re Tenney*, 63 B.R. 110 (Bankr. W.D. Okla. 1986) .

(n14)Footnote 13. See, e.g., *Barnes v. Whelan*, 689 F.2d 193, 8 C.B.C.2d 855 (D.C. Cir. 1982) (plan proposing

100% payment to cosigned debts and 1% to other debts discriminated unfairly; court left open possibility that complete equality of treatment might not be necessary, depending on the individual debtor's circumstances); *In re Cooper*, 1 C.B.C.2d 813, 3 B.R. 246 (Bankr. S.D. Cal. 1980) ; There were also some pre-1984 decisions approving the separate classification of cosigned debts.

(n15)Footnote 14. 11 U.S.C. § 1322(b)(1); *Southeastern Bank v. Brown*, 266 B.R. 900 (S.D. Ga. 2001) ; *In re Hill*, 255 B.R. 579 (Bankr. N.D. Cal. 2000) .

(n16)Footnote 15. *E.g.*, *In re Chacon*, 202 F.3d 725 (5th Cir. 1999) .

(n17)Footnote 16. 939 F.2d 669, 25 C.B.C.2d 382 (8th Cir. 1991) . *But see In re Crawford*, 324 F.3d 539 (7th Cir. 2003) (bankruptcy court did not abuse discretion in refusing to allow debtor to separately classify nonpriority child support owed to county, implying that permitting classification would also have been within court's discretion). *See also Sommer & McGarity, Collier Family Law and the Bankruptcy Code*, P 8.07 (Matthew Bender). Many of these debts are also priority claims which clearly can be separately classified.

(n18)Footnote 17. *Matter of Foreman*, 136 B.R. 532 (Bankr. S.D. Iowa 1992) ; *In re Boggan*, 125 B.R. 533 (Bankr. N.D. Ill. 1991) ; *In re Freshley*, 69 B.R. 96 (Bankr. N.D. Ga. 1987) . *In re Tucker*, 159 B.R. 325 (Bankr. D. Mont. 1993) . *But see In re Groves*, 39 F.3d 212 (8th Cir. 1994) (plan could not discriminate in favor of student loans solely due to their nondischargeability); *In re Sperna*, 173 B.R. 654 (B.A.P. 9th Cir. 1994) (same).

(n19)Footnote 18. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508 (1990), *reprinted in* Vol. F Collier on Bankruptcy, App. Pt. 41(h)(ii) (Matthew Bender). A similar argument could be made with respect to criminal restitution debts and drunk driving debts that are nondischargeable in chapter 13, in that they were made nondischargeable by amendments designed to give greater amounts of money to victims. Criminal Victims Protection Act of 1990, Pub. L. No. 101-581 (1990), *reprinted in* Vol. F Collier on Bankruptcy, App. Pt. 41(h)(iii) (Matthew Bender).

(n20)Footnote 19. *In re Freshley*, 69 B.R. 96 (Bankr. N.D. Ga. 1987) (separate classification of student loan debt allowed so debtor could return to school).

(n21)Footnote 20. *In re Boggan*, 125 B.R. 533 (Bankr. N.D. Ill. 1991) . *See also* 8 Collier on Bankruptcy, P 1322.05[2][a] (Matthew Bender).

(n22)Footnote 21. *In re Benner*, 29 C.B.C.2d 762, 156 B.R. 631 (Bankr. D. Minn. 1993) .

(n23)Footnote 22. *In re Kovich*, 2 C.B.C.2d 203, 4 B.R. 403 (Bankr. W.D. Mich. 1980) (landlord); *In re Hill*, 2 C.B.C.2d 681, 4 B.R. 694 (Bankr. D. Kan. 1980) (physicians, dentists, lawyers); *In re Sutherland*, 1 C.B.C.2d 571, 3 B.R. 420 (Bankr. W.D. Ark. 1980) (trade creditors, medical debts, banks). *See also Connors, Bankruptcy Reform: Relief for Individuals with Regular Income*, 13 U. Rich. L. Rev. 219, 237 (1978).

(n24)Footnote 23. For a discussion of the principles applied in such cases, *see Vihon, Classification of Unsecured Claims; Squaring a Circle?*, 55 Am. Bankr. L. J. 143 (1980).

(n25)Footnote 24. *See In re Gallipo*, 282 B.R. 917 (Bankr. E.D. Wash. 2002) (debtor allowed to separately classify and pay traffic fines because nonpayment would have jeopardized her ability to get to work).

(n26)Footnote 25. *See Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary*, 94th Cong., 2d Sess. 1425-26 (1976) (Statement of Claude L. Rice).

(n27)Footnote 26. *United States v. Energy Resources, Inc.*, 495 U.S. 545, 110 S. Ct. 2139, 109 L. Ed. 2d 580, 22

C.B.C.2d 1093 (1990) .

(n28)Footnote 27. *11 U.S.C. § 506(a)*.

(n29)Footnote 28. *In re Cooper*, 1 *C.B.C.2d* 813, 3 *B.R.* 246 (*Bankr. S.D. Cal.* 1980) ; *In re Tatum*, 1 *C.B.C.2d* 191, 1 *B.R.* 445 (*Bankr. S.D. Ohio* 1979) .

(n30)Footnote 29. Payments outside the plan are discussed at *P 14.10 infra*.



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CHAPTER 14 The Chapter 13 Plan

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P 14.09 Treatment of Secured Creditors

[1] Alternatives Available

Chapter 13's provisions permit the debtor to deal with secured creditors in a number of ways, even without their consent. The debtor may modify claims through extension and/or, if the debt is in default, deaccelerate the debt and cure the default by paying the arrearage through the plan. The debtor may also make other modifications of secured claims if the creditor accepts the plan. Alternatively, the debtor has the option of surrendering the collateral to the secured creditor and treating any deficiency as an unsecured claim. And in some cases, the debtor may attempt to deal with a secured debt outside the plan, leaving the secured debt's status unaffected by the bankruptcy.

[a] Modification

Both secured and unsecured claims can be "modified." Unsecured claims are most typically modified by composition--by paying them off at a reduced rate-- *e.g.*, 50 cents on the dollar, and/or by extension--paying them off over a longer period of time. The extent to which a secured claim can be modified is strictly limited. With the exception of debts secured solely by a security interest in the debtor's principal residence,ⁿ¹ undersecured secured debts that mature within the term of the plan can be divided up--bifurcated--into secured and unsecured claims. The unsecured claim is treated like any other unsecured debt (*i.e.*, modified by composition and/or extension). The creditor's rights with regard to oversecured claims and the secured portion of undersecured claims can be "modified" in some respects--most typically by extension or a change in interest rate--but the creditor must either consent to the modification or, under the requirements for a "cram down" under section 1325(a)(5), the plan must provide for paying the claim in full (with interest) and, until it is paid in full, for the creditor to retain its lien.ⁿ²

MORE INFORMATION

See discussion of secured claim bifurcation in chapter 19 *infra* .

As is further explained below, home mortgage debtsⁿ³ that mature after the end-date of the plan are sometimes not subject to modification other than a cure of arrearages.ⁿ⁴

[b] Cure of Arrearages

The debtor may also reverse the effect of an acceleration of the loan and can include a provision in the plan to cure the default (*i.e.*, pay the arrearage) over the course of the plan.ⁿ⁵ Arrearages can be cured even with respect to home mortgage claims that cannot be modified due to section 1322(b)(2), since a cure is not considered a modification.

[c] Surrender of the Collateral

Under section 1325(a)(5)(C), the debtor has the option of returning the collateral to the creditor. If the debtor surrenders the collateral, that creditor is in effect no longer a secured creditor, but only an unsecured creditor with respect to whatever debt remains.ⁿ⁶ The debtor need not secure the creditor's consent to exercise the option to surrender the property securing the debt.ⁿ⁷

[d] Not Providing for Allowed Secured Claim

The debtor may choose not to provide for one or more allowed secured claims in the plan. There is no requirement that every secured debt be provided for by the plan and the debtor may have no need to provide for a particular debt. For example, a mortgage might be held by a friendly relative, or a creditor that does not wish to foreclose. Or the debtor may be current on an automobile loan and may wish to continue payments outside the plan to avoid the trustee's charges. Or the debtor may simply believe that the creditor will never seek to enforce its security interest. (Most holders of security interests in low-value personal property never seek to enforce them.) In many cases, the debtor's attorney will know from experience that there is no danger of repossession. However, if the debtor does not provide for a secured creditor in the plan, that creditor may have good grounds for relief from the automatic stay.

MORE INFORMATION

For a discussion of relief from the automatic stay *see* chapter 10 *supra*.

[e] The Debtor's Task: Identify Secured Claims and Determine How to Deal with Them

The debtor must review the list of his or her secured debts and decide whether and how to deal with them.

- If the debtor decides to deal with the claim through the plan, the claim should be filed--either by the creditor or the debtor--so as to assure the status of an allowed secured claim. Most courts and chapter 13 trustees expect a debtor to file a claim for the creditor if that claim is to be paid by the plan.
- With respect to claims that have attained allowed secured claim status, the debtor will have to make certain decisions.
- If the debt is a home mortgage debt or a long-term debt and is in default, the debtor will have to decide whether to use the plan to cure the default.
- If the debt is a debt other than a nonmodifiable home mortgage debt or a long-term debt, the debtor will have to determine whether to cure any default and whether to attempt to modify the creditor's rights, either with the creditor's consent or via "cram down."
- With regard to regular, non-arrearage payments on debts that are not to be modified, the debtor will have to determine whether to attempt to make such payments through the trustee or outside-the-plan or whether to surrender the collateral.

MORE INFORMATION

For an outline of the proof of claim process *see* chapter 19 *infra*.

[2] Deacceleration and Arrearage Cure for Home Mortgage and Long-Term Debts

There are certain claims which the debtor cannot pay within the time period of the proposed plan, which can never exceed five years,ⁿ⁸ simply because they are large long-term obligations, such as home mortgages, that have many years of payments remaining before they are due to be fully satisfied. Section 1322(b)(5) allows the debtor to cure a default on such an obligation within a reasonable period of time without having to pay the entire debt balance due within the time period of the plan. It can be used to cure both prepetition and postpetition defaults.ⁿ⁹ It also be possible to cure a default on a mortgage loan modification agreement.^{n9a}

While section 1322(b)(3), the general default cure provision, may be used to cure defaults on short-term debts secured only by a security interest in the debtor's home, and while short-term debts secured by a security interest in the debtor's home may be modified pursuant to sections 1322(c)(2) (an exception to the limitation on modification of home mortgage debts), section 1322(b)(5) may in some cases be the only feasible remedy available with respect to defaults on long-term home mortgages.

Courts have generally ruled that land installment sales contracts are secured debts,ⁿ¹⁰ so that they too should be subject to the cure provisions of section 1322(b)(5). The treatment of such contracts as similar to mortgages under state law will often be determinative in deciding that they are to be treated like secured debts. If land installment sale contracts are held to be executory contracts, defaults on such contracts may still be cured, but they must be cured "promptly" under section 365(b)(1)(A).

MORE INFORMATION

Executory contracts are examined in chapter 15 *infra* .

[a] Cure of Mortgages After Acceleration or Foreclosure Judgment

Although a few courts originally held otherwise, it is now well-established that defaults on long-term debts such as mortgages may be cured under this section even if there has already been an acceleration and/or judgment which caused the entire balance to become due.ⁿ¹¹ In 1994, Congress codified those cases permitting cure after acceleration and judgment, by enacting *section 1322(c)(1) of the Bankruptcy Code*. That subsection provides that a default with respect to a lien on the debtor's principal residence may be cured under paragraph 1322(b)(3) or (b)(5) until such residence is actually sold at a foreclosure sale conducted in accordance with applicable nonbankruptcy law. This statutory language suggests that a cure may be effectuated under chapter 13 as long as the sale has not been completed under state law as of the time of the bankruptcy petition. Thus, if any step in the sale remains to be taken, such as an order confirming the sale or delivery of a deed, the debt giving rise to the foreclosure may be cured pursuant to section 1322(b)(3) or (b)(5).ⁿ¹²

[b] Cure Available Even if Debtor Has No Personal Liability on Mortgage Debt

A cure may be effected under *section 1322(b)(5) of the Bankruptcy Code* despite the fact that the debtor has no personal liability on the underlying obligation due to its discharge in a prior bankruptcy, since the creditor continues to have a claim and a "claim against the debtor" is defined to include a claim against property of the debtor.ⁿ¹³ Similarly, a debtor who has taken over payments on a mortgage when a property has been transferred to him or her may cure despite the absence of personal liability on the original obligation.ⁿ¹⁴ Indeed, at least one state court has held that, since a confirmed plan deaccelerating a mortgage debt is binding on a creditor, if that creditor later gets relief from the automatic stay the creditor must begin its foreclosure anew by reaccelerating the debt.ⁿ¹⁵

[c] Cure Period May Extend Beyond Original Payment Schedule

Section 1322(c) of the Bankruptcy Code also makes clear that the time period for cure under section 1322(b)(3) may

extend beyond the last scheduled payment date on the mortgage, as many courts have held,ⁿ¹⁶ and overrules the result of those courts that have held otherwise.ⁿ¹⁷ Notwithstanding the limitations of section 1322(b)(5), section 1322(c)(1) clearly permits cure of home mortgages under section 1322(b)(3), as well as under section 1322(b)(5), and section 1322(c)(2) permits modification of mortgages that mature before the end of the plan.

[d] Reasonable Time Permitted for Cure

The Bankruptcy Code does not define what period of time is "reasonable" for the purpose of section 1322(b)(5)'s requirement that the default be cured "within a reasonable time." Necessarily, this depends to some extent on the facts and circumstances of each case. It is not safe to assume that cure over the entire length of the plan will be found reasonable,ⁿ¹⁸ although in many cases that lengthy a time period has been allowed.ⁿ¹⁹ It may be possible to obtain a longer period of time to cure by arguing that the time for a plan to run does not begin until confirmation of the plan. At least one court of appeals has held that the plan can run for 60 months from that date.ⁿ²⁰

[e] Method of Curing While Maintaining Current Payments Outside Plan

Most courts permit current payments on long-term obligations that are being cured to be paid directly to the creditor outside the plan.ⁿ²¹ And, since these are often higher than any other, it is a common practice to make them in that manner to avoid adding to them the substantial cost of the trustee's percentage fees and expenses (up to 10%).ⁿ²²

On the other hand some trustees and practitioners prefer payment of the current mortgage payments through the trustee. Payments through the trustee are often more likely to be made, especially if they are made through a wage deduction order. Moreover, the trustee is able to easily provide an accounting of the payments, eliminating most disputes about whether payments have been made and obviating the need to reconcile the debtor's often fragmentary records of canceled checks and money order receipts. Although such payments are subject to the trustee's fee, in districts where current mortgage payments are routinely made through the trustee, the percentage fee is often at a much lower rate because the trustee's receipts are far higher.

[f] Amount Necessary to Effectuate Cure

[i] Creditor's Entitlement to Costs and Attorney's Fees

Another question arising under section 1322(b)(5) is the extent to which creditors may collect attorney's fees and costs as part of the amount needed to cure. The answer usually turns upon the precise language of the contract and state law. *Section 506(b) of the Bankruptcy Code*, applicable to determining the amount payable to the holder of an oversecured claim, provides for collection of such charges only if provided for in the parties' agreement.ⁿ²³ Agreements departing from the standard "American rule" that each party must bear its own fees are to be strictly construed, especially when drafted by the creditor trying to collect fees.ⁿ²⁴ In addition, many state statutes place significant limitations on fee provisionsⁿ²⁵ or prohibit them entirely.ⁿ²⁶ Such state laws are usually read into any contract to which they are applicable as implied terms.

COMMENTARY

In any case, fees should be allowed in a cure situation only to the extent that they are reasonable and necessary.ⁿ²⁷ Where a creditor's litigation is unsuccessful or unnecessary, it should not be rewarded by the assessment of attorney's fees against the debtor. Similarly, if the creditor does not provide adequate records to establish that its attorney's fees are fair and reasonable, the fees should be denied.ⁿ²⁸ The filing of a claim does not require an attorney, and thus no attorney's fees may be charged for that task.ⁿ²⁹ Some courts have held that the inclusion in a proof of claim of any attorney's fee incurred in connection with the bankruptcy case is improper unless the fee has been sought and approved under *Federal Rule of Bankruptcy Procedure 2016*, because the fee would be paid from property of the

bankruptcy estate.ⁿ³⁰

[ii] Interest Payments for Long-Term Debt Cures

The Supreme Court, in *Rake v. Wade*,ⁿ³¹ held that an oversecured creditor may demand that interest be paid on arrearages being cured through a chapter 13 plan. This interest is payable on the declining balance of the arrearages as they are paid through the plan. Because these interest payment obligations are viewed as arising pursuant to specific provisions of the Bankruptcy Code, they can be demanded by creditors even if the underlying contract does not require them and state law does not permit them. However, as is further discussed below, *Rake* was statutorily overruled with respect to agreements and refinancings entered into on or after October 22, 1994. The interest rate applied to arrearages under the *Rake* decision is normally the same rate that the district would apply under the "present value" interest requirement of section 1325(a)(5)(B)(ii).ⁿ³²

The Supreme Court reached its decision that oversecured creditors are entitled to interest on arrearages regardless of contract or state law through its holding that the arrearages are a separate "allowed secured claim,"ⁿ³³ even though the definition of allowed secured claim in the Bankruptcy Code encompasses the creditor's entire claim and does not carve out a special category of claims that would include only arrearages.ⁿ³⁴ The Court held that interest on the arrearages for the period preceding plan confirmation could be required with respect to an oversecured mortgage because section 506(b) of the Bankruptcy Code permits creditors to demand preconfirmation interest on any oversecured claim.ⁿ³⁵ For the period after confirmation, the Court found section 1325(a)(5) applicable to the "arrearage claim," and thus held that a creditor could demand present value interest.ⁿ³⁶ Hence, even under *Rake v. Wade*, creditors who are not oversecured could not demand preconfirmation interest on the arrearages as a condition of plan confirmation. Moreover, if the arrearage portion of the debt is undersecured the creditor may not be entitled to interest on that arrearage claim because it is not an allowed secured claim.ⁿ³⁷

In 1994, Congress overruled the result of *Rake v. Wade* by enacting a new section 1322(e) of the Code, which provides that in a cure of a default through a chapter 13 plan the interest or other charges that need be paid must be determined in accordance with the underlying contract and applicable state law. The subsection makes clear that it is an exception to both section 506(b) and section 1325(a)(5), thus covering both bases for the *Rake* holding, and the legislative history leaves no doubt of Congress' intent to overrule that case.ⁿ³⁸

Under section 1322(e), the amount necessary to cure a default is the same amount as would be required to cure if the debtor were not in bankruptcy. Two conditions must be met before interest or other charges can be required as part of a bankruptcy cure. First, the interest or charges must be required under the original agreement, and second, they cannot be prohibited by state law. In other words, the bankruptcy court will never require interest in excess of that permitted by state law, and will require none unless the agreement provides for interest.

However, unlike any other provision of the 1994 amendments, section 1322(e) is only effective with respect to agreements entered into after the enactment date of the amendments, October 22, 1994.ⁿ³⁹ The legislative history indicates that this includes refinancings entered into after October 22, 1994.ⁿ⁴⁰ But older mortgages are still governed by the *Rake* holding.

[g] After a Default Cure, the Original Amortization Schedule Should Be Restored

The effect of a cure under section 1322(b)(5) is to nullify all consequences of the default.ⁿ⁴¹ Thus, in the case of a long-term mortgage, the debtor would normally be returned to the original amortization schedule once the default has been cured. Sometimes, holders of long-term mortgages do not comply with this principle, and debtors' attorneys may have to bring proceedings at the end of a chapter 13 plan to assure that the cure is fully effectuated and not subverted by a mortgage holder's contrary bookkeeping practices.ⁿ⁴² The chances for success in such proceedings is enhanced if the chapter 13 plan specifically provided for how payments are to be applied and that, once the mortgage is cured under the

plan, the debtor will be treated as if the default never existed and returned to the original amortization schedule. Indeed, the absence of such specific language may make it more difficult to enforce the debtor's rights.^{n42a}

It is sometimes confusing to determine how this rule is applied when a creditor's claim has been bifurcated. For example, if \$5,000 of a \$15,000 lien is avoided, how are the monthly payments restructured? Are the next \$5,000 in payments due deemed paid, or is the final \$5,000 in payments excused? Generally, the reported decisions have resolved these issues by holding that a debtor who cures a mortgage default in chapter 13, may not alter the monthly payment or interest rate, with the result that the term of the loan is shortened.ⁿ⁴³

Thus, if a debtor does have grounds to bifurcate a long-term mortgage and also proposes to cure arrearages in a plan, the debtor should be able to have the unsecured portion of the claim discharged, since only the allowed secured claim is being provided for under *section 1322(b)(5) of the Bankruptcy Code* and is subject to the exception to discharge in *section 1328(a)(1)*.ⁿ⁴⁴

[3] Modification of Secured Claim with Consent of Creditor

The debtor may modify the rights of the holders of secured claims by consent of the holder of the claim.ⁿ⁴⁵ The parties may agree to the value of the collateral, the amount of each monthly payment, the discount rate, and the total of the stream of payments.ⁿ⁴⁶

When a secured creditor has filed a claim, but has failed to object to the debtor's plan, the creditor will be deemed to have accepted the plan, even in the absence of formal consent.ⁿ⁴⁷

[4] Modification without the Creditor's Consent: The Chapter 13 Cram Down

Much of the flexibility given to the debtor in chapter 13 comes from the broad right to modify the rights of secured creditors. In bankruptcy parlance, this right to limit the enforceability or change the terms of a creditor's contract over the creditor's objection is called a "cramdown." In the absence of consent, the debtor may modify secured claims in either of two ways:

- the chapter 13 debtor has the absolute right to surrender the collateral and treat the holder's deficiency claim, if any, as unsecured;ⁿ⁴⁸ or
- if, as is usually the case, the debtor desires to retain the collateral, the debtor may, without the consent of the holder of the secured claim, modify the rights of such holder by a plan that proposes a stream of payments whose present value equals the value of the collateral as of the effective date of the plan.ⁿ⁴⁹

[a] The Computation of What Payments Will Equal the Present Value of the Claim

After the amount of the allowed secured claim has been determined, it is then necessary to compute what payments will equal the present value of that claim. In order to do this it is also necessary to know (1) the amount of the trustee's fees and expenses and (2) the interest rate to be applied. While the former can easily be learned from the trustee, the latter has been a matter of considerable dispute.ⁿ⁵⁰

MORE INFORMATION

For a discussion on determination of the allowed secured claim *see* chapter 19 *infra*.

The purpose of the present value requirement is to place the holder of an allowed secured claim in the same position economically as if the debtor exercised the option of surrendering the collateral. Through the payment of interest, the

creditor is compensated for the delay in receiving the amount of the allowed secured claim, which would be received in full immediately upon confirmation if the collateral were liquidated. Since the creditor is deprived of these funds to the extent they are deferred through the plan, the creditor must obtain them elsewhere, for whatever purposes they were to be used.

Some creditors include what they believe to be the appropriate interest rate in their proofs of claim. It is up to the debtor to object if the rate is wrong or if the trustee adds interest to the creditor's claim automatically.

The Supreme Court, in *Till v. SCS Credit Corp.*,ⁿ⁵¹ held that a formula method is to be used to compute present value interest, with the prime rate of interestⁿ⁵² as the starting point, adjusted by a factor for risk.ⁿ⁵³ Although not setting any amount for the risk factor, the Court cited cases adding one to three percent to the interest rate. The amount added for risk should not be large and may be close to zero. If the creditor is significantly oversecured, the equity cushion will provide protection against risk. In other cases, assuming that risks of loss by fire or other damage are covered by insurance, as they typically are, the only real risk the creditor usually faces under a bankruptcy plan is the risk of a little delay in payments. If the debtor falls more than a little behind in payments, the chapter 13 plan will normally fail. In that event, the plan will be inoperative and the contract terms will be restored, including the interest rates and late charge provisions set forth therein, which would typically compensate the creditor for any delay.

The Court held that an objecting creditor has the burden of going forward with evidence that the interest rate proposed by the debtor is inadequate.ⁿ⁵⁴ It has been held that the chapter 13 trustee, as representative of the unsecured creditors, does not have standing to object to the alleged inadequacy of provisions dealing with secured creditors in the plan.ⁿ⁵⁵

Section 1325(a) of the Bankruptcy Code states that the court "shall" confirm a plan if the plan meets section 1325(a)'s standards and if the plan does not violate the requirements of section 1325(b). Section 1325(a) does not say that the court may not confirm a plan that does not meet its standards. Therefore, the court may confirm a plan that does not meet section 1325(a)(5)'s present value interest standard for secured creditors. The debtor may therefore want to consider proposing a plan that does not include this present value interest. If the secured creditor does not object to the plan, it is deemed to accept it.

[b] Cramdown for Certain Motor Vehicles and Purchase Money Security Interests

Language added at the end of section 1325 by the 2005 amendments to the Bankruptcy Codeⁿ⁵⁶ removes certain claims from the protections of section 1325(a)(5). This new language states that for purposes of section 1325(a)(5), section 506 shall not apply to certain claims. Such claims, therefore, cannot be determined to be allowed secured claims under section 506(a) and are not within the ambit of section 1325(a)(5). Such claims may still be modified under section 1322(b)(2), which allows modification of the rights of holders of secured claims, with certain exceptions, but the restrictions on modification that apply to allowed secured claims under section 1325(a)(5) do not apply. A debtor is presumably bound only by the dictates of good faith and the other provisions of the Code in determining how such claims may be modified.ⁿ⁵⁷ Courts, may look to prior law for guidance regarding what modifications are equitable.

The claims encompassed in this language at the end of section 1325 are two types of purchase money security interests. The first type is a purchase money security interest for a debt incurred within 910 days preceding the filing of the petition if the collateral for that debt consists of a motor vehicle, as defined in *section 30102 of title 49, United States Code*,ⁿ⁵⁸ acquired for the personal use of the debtor. This language would not include a mobile home, because a mobile home does not fit within the definition of title 49, section 30102. It also does not include a vehicle purchased for business use, or for the use of someone other than the debtor. The language "the collateral consists" suggests that if there is any other collateral, the paragraph is inapplicable.

The second type is a purchase money security interest for a debt incurred within one year preceding the filing of the petition, if the collateral consists of any other thing of value. Because the singular includes the plural pursuant to section

102(7) the Bankruptcy Code, this would include collateral that consists of multiple things of value as well.

It is important to remember that this language applies only to purchase money security interests. Thus, in the common situation in which a debtor trades in a vehicle that is worth less than the amount owed on the loan secured by the vehicle, and must finance the difference as part of the purchase of a new vehicle, the section should not apply.^{n58a} If this is the case, the court may look to state law to determine whether the disqualification applies to the entire transaction under what is called the "transformation rule" or only the portion that is not purchase money under the "dual status rule."

A number of courts have held that this language permits a debtor to surrender the collateral in full satisfaction of the debt.^{n58b} As many of these courts have noted, if a creditor covered by this language is deemed to have an allowed secured claim in the full amount of its claim, the language makes no distinction between the different subparagraphs of section 1325(a)(5) and the creditor must be deemed to have an allowed secured claim in that amount for each of those subparagraphs. However, most appellate courts have held that a creditor retains an unsecured deficiency claim if the debtor surrenders the property.^{n58c}

[5] Some Debts Secured Solely by a Security Interest in the Debtor's Principal Residence Cannot Be Modified

A debt secured solely by a security interest in real estate that is the debtor's principal residence is generally not subject to modification.ⁿ⁵⁹ This limitation is not quite as broad as it seems, however. The limitation does not apply when:

- the term of the mortgage ends before or within the three-to-five year length of the plan;
- the debt is not secured solely by the debtor's primary residence; *i.e.*, when property in addition to the debtor's home also secures the debt;
- the debtor's residence is not real estate, but is instead personal property; *e.g.*, a mobile home is often categorized as personal property;^{n59a}
- the debt is not really a secured debt; *e.g.*, the debt is a second or third mortgage and no collateral value remains to secure it;ⁿ⁶⁰ or
- the lien securing the debt is actually something other than a consensual security interest; *e.g.*, a judicial lien.

When the section 1322(b)(2) limitation does not apply, these mortgages, like other secured debts, are modifiable if the debtor has the resources to pay the allowed secured claim as modified within the three-to-five year length of the plan. This means that if the debtor is faced with a balloon payment of relatively manageable size, it might be possible to modify the debt by extension--paying it off over the three-to-five year length of the plan.

Also, if the debt is undersecured, the debtor might bifurcate it under section 506 and pay the unsecured portion of the claim along with other unsecured debts--frequently, subject to composition (*e.g.*, 70 cents on the dollar). The unsecured portion would normally be covered by the chapter 13 discharge. The allowed secured claim might or might not be modified by extension but would in any event have to be paid off over the course of the plan. To ensure confirmation, the allowed secured claim would be subject to the protection of the present value standard of section 1325(a)(5)(B)(ii)--modification by extension only and not by composition, and interest to compensate the creditor for lost time value.

Section 1322(c)(2), also creates a special exception from the home mortgage limitation applicable to home mortgages near the end of their term. Under this provision, if a mortgage's term expires during the term of the plan, the plan may

modify the mortgage just like any other secured claim, despite the 1322(b)(2) limitation.ⁿ⁶¹ This provision may be especially useful to debtors faced with a balloon payment obligation, at least if the obligation is a small enough balloon to permit full payment within the five-year maximum term of a plan.

However, if none of these exceptions applies, the Supreme Court's *Nobelman* decisionⁿ⁶² makes clear that an undersecured home mortgage cannot be bifurcated into an allowed secured claim and allowed unsecured claim. The Court held that the section 1322(b)(2) limitation protects the unsecured as well as the secured portion of a home mortgage debt from modification.

FOOTNOTES:

(n1)Footnote 1. Debts secured solely by security interests in the debtor's primary residence are generally protected from modification by a clause in 11 U.S.C. § 1322(b)(2).

(n2)Footnote 2. See P 14.09[3], [4] *infra*.

(n3)Footnote 3. Under the 1994 amendments, debts secured by the debtor's home are now also subject to bifurcation and modification if the last payment under the original payment schedule is due before the end date of the plan. 11 U.S.C. § 1322(c)(2).

(n4)Footnote 4. See P 14.09[2] *infra*.

(n5)Footnote 5. See P 14.09[2][a] for discussion of plan provisions to cure arrearages.

(n6)Footnote 6. The debtor may also choose to surrender only part of the collateral securing the debt, thereby reducing the allowed secured claim that must be paid. *In re Groff*, 131 B.R. 703 (Bankr. E.D. Wis. 1991) (debtor could surrender collateral other than residence plus 30 acres and pay only the value of remaining collateral). *But see In re Williams*, 168 F.3d 845, 41 C.B.C.2d 1127 (5th Cir. 1999) (debtor had to either transfer entire property or pay claim).

(n7)Footnote 7. *In re Harris*, 244 B.R. 556 (Bankr. D.Conn. 2000) .

(n8)Footnote 8. 11 U.S.C. § 1322(d), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 9. *Mendoza*, 111 F.3d 1264 (5th Cir. 1997) ; *In re Hoggle*, 12 F.3d 1008 (11th Cir. 1994) (debtor could modify plan to cure postconfirmation default). See 8 *Collier on Bankruptcy*, P 1322.09[1] (Matthew Bender).

(n10)Footnote 9a. See *In re Ward*, 392 B.R. 788 (Bankr. W.D. Mo. 2008) (debtor entitled to cure loan as modified by forbearance agreement; agreement terms purporting to nullify modification if bankruptcy was filed were invalid); *In re Epps*, 110 B.R. 691 (E.D. Pa. 1990) (debtor did not lose the benefit of Dep't of Housing and Urban Development forbearance agreement when prebankruptcy default on agreement was cured under chapter 13 plan).

(n11)Footnote 10. *In re Johnson*, 75 B.R. 927 (Bankr. N.D. Ohio 1987) ; *Matter of Leazier*, 55 B.R. 870 (Bankr. N.D. Ind. 1985) .

(n12)Footnote 11. See 8 *Collier on Bankruptcy*, P 1322.15 (Matthew Bender).

(n13)Footnote 12. See 8 *Collier on Bankruptcy*, P 1322.15 (Matthew Bender). *But see In re Connors*, 497 F.3d 314 (3rd Cir. 2007) (debtor no longer had right to cure under New Jersey law after hammer fell at foreclosure sale); *Colon v. Option One Mortg. Corp.*, 319 F.3d 912 (7th Cir. 2003) (right to cure under Illinois law is cut off upon completion of sale if time for redemption has run and does not continue until order confirming sale); *Canney*, 284 F.3d 362 (2d Cir. 2002) (under Vermont strict foreclosure law, automatic stay does not permit debtor to redeem property after end of redemption period, except as extended for 60 days by 11 U.S.C. § 108(b)).

(n14)Footnote 13. 11 U.S.C. § 102(2). *Johnson v. Home State Bank*, 501 U.S. 78, 111 S. Ct. 2150, 115 L. Ed. 2d 66, 24 C.B.C.2d 1171 (1991) .

(n15)Footnote 14. *In re Everhart*, 19 C.B.C.2d 538, 87 B.R. 35 (Bankr. N.D. Ohio 1988) .

(n16)Footnote 15. *Federal Nat'l Mortgage Ass'n v. Miller*, 123 Misc. 2d 431, 473 N.Y.S.2d 743 (Sup. Ct. 1984) .

(n17)Footnote 16. *E.g., Grubbs v. Houston First American Savings Ass'n*, 730 F.2d 236, 10 C.B.C.2d 549 (5th Cir. 1984) .

(n18)Footnote 17. *E.g., In re Seidel*, 752 F.2d 1382, 12 C.B.C.2d 106 (9th Cir. 1985) .

(n19)Footnote 18. *In re Coleman*, 2 C.B.C.2d 736, 5 B.R. 812 (Bankr. W.D. Ky. 1980) (reasonable time not synonymous with three-year duration of typical plan).

(n20)Footnote 19. *E.g., In re Capps*, 836 F.2d 773 (3d Cir. 1987) (60 months). *See* 8 *Collier on Bankruptcy*, P 1322.09[5] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1322.09[5] (Matthew Bender).

(n21)Footnote 20. *West v. Costen*, 826 F.2d 1376 (4th Cir. 1987) . *See also In re Black*, 17 C.B.C.2d 602, 78 B.R. 840 (Bankr. S.D. Ohio 1987) (no dismissal where payments extend over 66 months, if plan complied with duration requirements of the Code at the time of confirmation).

(n22)Footnote 21. *See* discussion of payments outside the plan at P 14.10 *infra* .

(n23)Footnote 22. *In re Conway*, 96 B.R. 311 (D. Colo. 1989) ; *In re Burkhart*, 94 B.R. 724 (Bankr. N.D. Fla. 1988) ; *In re Erickson Partnership*, 77 B.R. 738 (Bankr. D.S.D. 1987) . *But see In re Foster*, 670 F.2d 478, 6 C.B.C.2d 285 (5th Cir. 1982) (trustee's commission must be paid on payments outside the plan). The *Erickson Partnership* decision noted a change in statutory language which may overrule the *Foster* result.

(n24)Footnote 23. *In re Hatcher*, 208 B.R. 959 (B.A.P. 10th Cir. 1997) (creditor had no right, under § 506(b) or otherwise, to postpetition attorney's fees in addition to fees provided for in mortgage contract).

(n25)Footnote 24. *Matter of Kennedy Mortgage Co.*, 23 B.R. 466 (Bankr. D.N.J. 1982) (instrument did not allow fees when collection was by way of setoff); *In re Roberts*, 6 C.B.C.2d 892, 20 B.R. 914 (Bankr. E.D.N.Y. 1981) (participation in chapter 13 proceedings was not included in the attorney's fees provision of the mortgage).

(n26)Footnote 25. *Matter of Wilder*, 22 B.R. 294 (Bankr. M.D. Ga. 1982) (statutory attorney's fees could not be collected for work that could have been performed by nonlawyers).

(n27)Footnote 26. *In re Bertsch*, 5 C.B.C.2d 1525, 17 B.R. 284 (Bankr. N.D. Ohio 1982) (assessment of bank's attorney's fees against debtor disallowed as contrary to Ohio public policy).

(n28)Footnote 27. *In re A.J. Lane & Co.*, 23 C.B.C.2d 576, 113 B.R. 821 (Bankr. D. Mass. 1990) (prepayment charge disallowed because it was unreasonable); *In re Bailey*, 23 B.R. 222 (Bankr. E.D. Pa. 1982) (attorney's fees and costs denied for unsuccessful proceeding for relief from automatic stay).

(n29)Footnote 28. *In re Harmon*, 72 B.R. 458 (Bankr. E.D. Pa. 1987) .

(n30)Footnote 29. *See, e.g., In re East Side Investors*, 702 F.2d 214 (11th Cir. 1983) .

(n31)Footnote 30. *In re Tate*, 253 B.R. 653 (Bankr. W.D.N.C. 2000) . *See also In re Gifford*, 256 B.R. 661 (Bankr. D. Conn. 2000) (in future cases court would follow *Tate* and require oversecured creditors to seek approval of fees under Rule 2016). *But see Telfair v. First Union Mortgage Corp.*, 216 F.3d 1333 (11th Cir. 2000) , *cert. denied*, 531

U.S. 1073, 121 S. Ct. 765, 148 L. Ed. 2d 666 (2001) (when mortgage company assessed fees on payments made directly to mortgage company outside the plan, and property of the estate had reverted in the debtor at confirmation, *Rule 2016* was not applicable).

(n32)Footnote 31. 508 U.S. 464, 113 S. Ct. 2187, 124 L. Ed. 2d 424, 28 C.B.C.2d 983 (1993) .

(n33)Footnote 32. See P 14.09[4][a] *infra* for discussion of interest rates under section 1325(a)(5)(B)(ii).

(n34)Footnote 33. 508 U.S. at 469-470, 113 S. Ct. at 2192-93, 124 L. Ed. 2d at 434-435, 28 C.B.C.2d 989-991 (1993) .

(n35)Footnote 34. 508 U.S. at 469-470, 113 S. Ct. at 2192-93, 124 L. Ed. 2d at 434-435, 28 C.B.C.2d 989-991 (1993) .

(n36)Footnote 35. 508 U.S. at 469-470, 113 S. Ct. at 2192-93, 124 L. Ed. 2d at 434-435, 28 C.B.C.2d 989-991 (1993) .

(n37)Footnote 36. 508 U.S. at 469-470, 113 S. Ct. at 2192-93, 124 L. Ed. 2d at 434-435, 28 C.B.C.2d 989-991 (1993) .

(n38)Footnote 37. See 8 *Collier on Bankruptcy*, P 1322.09[4][a] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1322.09[4][a] (Matthew Bender).

(n39)Footnote 38. H.R. Rep. No. 835, 103d Cong., 2d Sess. 55 (1994).

(n40)Footnote 39. Pub. L. No. 103-394, § 702(b)(2)(D), *reprinted in* Vol. E *Collier on Bankruptcy*, App. Pt. 9(a) (Matthew Bender). The legislative history provides that for this purpose a refinancing is considered a new agreement. H.R. Rep. No. 835, 103d Cong., 2d Sess. 55 (1994).

(n41)Footnote 40. H.R. Rep. No. 835, 103d Cong., 2d Sess. 55 (1994), 140 Cong. Rec. H 10,770 (daily ed. Oct. 4, 1994) (remarks of Rep. Jack Brooks). See *In re Harding*, 274 B.R. 173 (Bankr. D. Md. 2002) .

(n42)Footnote 41. See 8 *Collier on Bankruptcy*, P 1322.09[3] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1322.09[3] (Matthew Bender).

(n43)Footnote 42. See, e.g., *In re Riser*, 289 B.R. 201 (Bankr. M.D. Fla. 2003) (mortgage company not entitled to payments for any charges incurred before or during bankruptcy that were not provided for in confirmed plan); *In re Chess*, 268 B.R. 150 (Bankr. W.D. Tenn. 2001) (mortgage company that did not notify debtor of escrow increases or respond to trustee's customary motion to deem mortgage current at end of plan could not assert debtor was in arrears at end of plan); *In re Rathe*, 114 B.R. 253 (Bankr. D. Idaho 1990) ; *In re Ward*, 73 B.R. 119 (Bankr. N.D. Ga. 1987) (late charges may not be added to current payments made pursuant to plan unless those payments are not made on time). Mortgage servicers often violate RESPA's escrow requirements in the course of chapter 13 cases. See generally 12 U.S.C. § 2609; Reg. X § 3500.17.

(n44)Footnote 42a. See *In re Nosek*, 544 F.3d 34 (1st Cir. 2008) (plan terms not sufficiently specific to permit sanctions for misapplication of payments).

(n45)Footnote 43. *In re Bellamy*, 962 F.2d 176, 26 C.B.C.2d 1459 (2d Cir. 1992) ; *In re Session*, 128 B.R. 147 (Bankr. E.D. Tex. 1991) . See also *Sapos v. Provident Inst. of Savings*, 967 F.2d 918 (3d Cir. 1992) .

(n46)Footnote 44. *Lomas Mortgage U.S.A. v. Roberts*, 137 B.R. 343 (D. Alaska 1992) .

(n47)Footnote 45. 11 U.S.C. § 1325(a)(5)(A).

(n48)Footnote 46. 11 U.S.C. § 1325(a)(5)(C).

(n49)Footnote 47. *In re Szostek*, 886 F.2d 1405, 21 C.B.C.2d 889 (3d Cir. 1989) .

(n50)Footnote 48. 11 U.S.C. § 1325(a)(5)(C).

(n51)Footnote 49. 11 U.S.C. § 1325(a)(5)(B).

(n52)Footnote 50. A creditor waives the right to dispute the interest rate if creditor fails to assert its arguments prior to or at the confirmation hearing. *In re Szostek*, 886 F.2d 1405, 21 C.B.C.2d 889 (3d Cir. 1989) .

(n53)Footnote 51. 124 S. Ct. 1951, 158 L. Ed. 2d 787 (2004) .

(n54)Footnote 52. The prime rate of interest may be found at: federalreserve.gov/releases/h15/data.htm#top

(n55)Footnote 53. Debtors who are on active duty in the armed forces may obtain plan confirmation of a present value interest rate of 6 percent based on § 527 of the Servicemembers Civil Relief Act. 50 U.S.C. Appx. § 527. *See Baxter v. Watson (In re Watson)*, 292 B.R. 441 (Bankr. S.D. Ga. 2003) (plan modified to reduce interest rate from 12 percent to 6 percent while debtor on active duty). A statutory exception to the *Till* doctrine was enacted in 2005 with respect to tax claims, for which present value interest is to be the statutory rate of interest. 11 U.S.C. § 511. *But see In re Sheffield*, 390 B.R. 302 (Bankr. S.D. Tex. 2008) (promissory note obligation to creditor that had paid debtor's tax claim was not a tax claim entitled to statutory interest).

(n56)Footnote 54. 124 S. Ct. 1951,1964, 158 L. Ed. 2d 787, 804 (2004) .

(n57)Footnote 55. *In re Brown*, 108 B.R. 738 (Bankr. C.D. Cal. 1989) . *See also Andrews v. Loheit (In re Andrews)*, 49 F.3d 1404 (9th Cir. 1995) (trustee may not raise issues under § 1325(a)(5), but may raise issue of adequate protection of secured creditor under § 1325(a)(1)).

(n58)Footnote 56. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n59)Footnote 57. It is possible that this language was intended to prohibit the use of section 506(a) to bifurcate a secured claim into an allowed secured claim and an allowed unsecured claim as part of the cramdown permitted by section 1325(a)(5)(B). However, because the language instead renders inoperable for some creditors the provision that classifies those creditors as holders of allowed secured claims, it does carry out such an intent.

(n60)Footnote 58. 49 U.S.C. § 30102 defines "motor vehicle" as meaning "a vehicle driven or drawn by mechanical power and manufactured primarily for use on public streets, roads, and highways, but does not include a vehicle operated only on a rail line."

(n61)Footnote 58a. *In re Penrod*, 392 B.R. 835 (B.A.P. 9th Cir. 2008) ; *but see In re Ford*, 2009 U.S. App. LEXIS 17198 (10th Cir. Kan. Aug. 3, 2009) ; *Matter of Peaslee*, 2009 NY Slip Op. 5197, 2009 N.Y. LEXIS 2475 (2009) ; *In re Price*, 562 F.3d 618 (4th Cir. 2009) ; *In re Graupner*, 537 F.3d 1295 (11th Cir. 2008) .

(n62)Footnote 58b. *E.g., In re Tompkins*, 2008 Bankr. LEXIS 2149 (Bankr. S.D.N.Y. Aug. 13, 2008) .

(n63)Footnote 58c. *Tidewater Finance Co. v. Kenney*, 531 F.3d 312 (4th Cir. 2008) ; *In re Ballard*, 526 F.3d 634 (10th Cir. 2008) ; *Capital One Auto Finance v. Osborn*, 515 F.3d 817 (8th Cir. 2008) ; *In re Long*, 519 F.3d 288 (6th Cir. 2008) ; *In the Matter of Wright*, 492 F.3d 829 (7th Cir. 2007) ; *In re Rodriguez*, 375 B.R. 535 (B.A.P. 9th Cir. 2007) .

(n64)Footnote 59. 11 U.S.C. § 1322(b)(2). *See generally* 3 Collier Bankruptcy Manual P 1322.06[1][a] (Matthew Bender).

(n65)Footnote 59a. *In re Reinhardt*, 563 F.3d 558 (6th Cir. 2009) ; *In re Ennis*, 558 F.3d 343 (4th Cir. 2009) ; *In re Coleman*, 2008 Bankr. LEXIS 3080 (B.A.P. 8th Cir. 2008).

(n66)Footnote 60. See 8 *Collier on Bankruptcy*, P 1322.06[1][a][i] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1322.06[1][a][i] (Matthew Bender); *Zimmer v. PSB Lending Corp.* (*In re Zimmer*), 313 F.3d 1220 (9th Cir. 2003) ; *Lane v. W. Interstate Bancorp* (*In re Lane*), 280 F.3d 663 (6th Cir. 2002) ; *American Gen. Fin., Inc. v. Dickerson* (*In re Dickerson*), 222 F.3d 924 (11th Cir. 2000) , *cert. denied*, 532 U.S. 972, 121 S. Ct. 1604, 149 L. Ed. 2d 470 (2001) ; *In re Pond*, 252 F.3d 122 (2nd Cir. 2001) ; *In re McDonald*, 205 F.3d 606 (3d Cir. 2000) , *cert. denied*, 531 U.S. 822 ; 121 S. Ct. 66 ; 148 L. Ed. 2d 31 (2000) .

(n67)Footnote 61. *In re Paschen*, 296 F.3d 1203 (11th Cir. 2002) , *cert. denied* 123 S. Ct. 696, 154 L. Ed. 2d 648 (2002) . See 8 *Collier on Bankruptcy*, P 1322.16 (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1322.16 (Matthew Bender). *But see Davidson*, 133 F.3d 499 (4th Cir. 1997) (erroneously holding that stripdown not permitted under § 1322(c)(2) because it provides for modification of payments and not claims).

(n68)Footnote 62. *Nobelman v. American Sav. Bank*, 508 U.S. 324, 113 S. Ct. 2106, 124 L. Ed. 2d 228, 28 C.B.C.2d 977 (1993) .



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P 14.10 The Extent to Which Debts Can Be Paid Outside the Plan

Debts that are modified by extension or composition usually must be paid within the plan, subject to the trustee's commission. The same applies to payments to cure an arrearage on a defaulted debt. And most courts agree that secured debts not subject to any form of modification or arrearage cure may be paid outside the plan, free of the trustee's commission. In most but not all courts, the regular payments on the unmodified portion of a mortgage or other debt that is subject to an arrearage cure may be paid outside the plan, free of commission.

PRACTICE NOTE

Some practitioners prefer the system of having current mortgage payments paid through the plan, citing as reasons the greater likelihood that payments will be made regularly when paid through a wage deduction, and the ability to obtain an easy accounting of payments made through the trustee's records when disputes arise either during or after the case about whether the debtor is current. (In some districts the trustee will actively get involved in supporting the debtor in such disputes.) These practitioners also note that in districts where current mortgage payments are made through the trustee, the percentage of the payment taken for the trustee's fee is usually lower, because so much more money is flowing through the trustee's office.

[1] Avoiding the Trustee's Commission on Payments Made Through the Plan

For debts paid through the plan, the debtor makes periodic payments to the trustee, who then deducts a fee or commission (of up to 10%) before forwarding the funds to the creditors in accordance with the plan's provisions.ⁿ¹ With respect to large secured claims, this commission may be sizeable.

In many districts, debtors have been able to make regular debt payments (such as mortgage and auto loan payments) directly to the creditor rather than through the trustee. Courts have permitted such outside-the-plan payments, and on a commission-free basis, when the creditor's rights have not been modified by the plan in any way.ⁿ² But, as is noted below, when a debt has been modified by the plan, it usually is not eligible for outside-the-plan payment. The most controversy surrounds a gray area: debts that are subject to arrearage cure but that are otherwise not subject to extension or other modification. Most courts permit the debtor to arrange for a cure under the plan (subject to the commission) while continuing to make regular payments directly to the creditor outside the plan, and without paying a commission on the regular payments.ⁿ³ The debtor's task is to determine which of his or her debts, in category and amount, are

legally and practically eligible for outside-the-plan payment.

PRACTICE NOTE

This issue should not be confused with the practice of excluding certain secured debts from the plan with the intention of not paying them (and surrendering the collateral) and having any deficiency treated as an unsecured debt. Surrendering collateral to the secured creditor may pose practical problems for the debtor, but it does not raise legal problems with regard to the trustee's fee. Nor should outside-the-plan payments be confused with the practice of simply not providing for the creditor at all in the plan, either on the assumption that the creditor will not enforce its rights or that the risks and costs of creditor enforcement would be tolerable. By contrast, if the plan provides for direct payment, the debt is said to be "provided for" by the plan: with respect to such a debt, the requirements of chapter 13 apply.

[2] Adjustments in the Trustee's Commission: An Alternative to Outside-the-Plan Payments

A possible alternative to making large payments outside the plan is to request an adjustment in the percentage charged by the trustee for expenses and compensation. The justification for this would be that with respect to such large payments, the commission would be unduly large in proportion to the expense and work involved.

Under section 586(e) of title 28, adopted in connection with the 1986 Amendments to the Bankruptcy Code, Congress expressly authorized the Attorney General, in consultation with the United States trustee, to fix the maximum fees to standing chapter 12 and 13 trustees. At the same time, under a parallel amendment to *section 326(b) of the Bankruptcy Code*, Congress inserted language that arguably removed the authority from the bankruptcy court to review or determine the compensation of standing chapter 12 and 13 trustees: section 326(b) now states that "the court may not allow compensation for services or reimbursement of expenses ... of a standing trustee." Thus, with regard to the authority of the court to review (and lower) these official percentage-based trustee fees, courts are now divided; at least one court has stated that the statutorily prescribed fee provisions have preempted judicial discretion; other courts have disagreed.ⁿ⁴

Another possible adjustment which may be requested is a reduction in the normal minimum fee of five dollars per month set forth in section 330(c). Section 330(c) provides that this fee must be paid unless the court orders otherwise. Such an order would seem to be appropriate in cases in which low-income debtors can only afford very modest plan payments. It should be considered proper to include a provision adjusting the minimum payment in a chapter 13 plan; if so, the order of confirmation would constitute the order required by section 330(c) for an exception to the usual minimum fee.

FOOTNOTES:

(n1)Footnote 1. *See* 8 *Collier on Bankruptcy*, P 1302.05[1] (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1302 (Matthew Bender).

(n2)Footnote 2. *See, e.g., In re Hines*, 7 B.R. 415 (Bankr. D.S.D. 1980) ; *In re Wittenmeier*, 4 B.R. 86 (Bankr. M.D. Tenn. 1980) .

(n3)Footnote 3. *See* 8 *Collier on Bankruptcy*, P 1302.05[1][c] (Matthew Bender).

(n4)Footnote 4. *E.g.,* Judicial fee review preempted: *In re Schollett*, 980 F.2d 639, 27 C.B.C.2d 1528 (10th Cir. 1992) . Judicial fee review permissible: *In re Melita*, 19 C.B.C.2d 791, 91 B.R. 358 (Bankr. E.D. Pa. 1988) (courts retain power to adjust standing trustees' percentage fees, but enabling the debtors to produce a confirmable plan was not adequate justification for doing so). *See* 8 *Collier on Bankruptcy*, P 1302.05[1][a] (Matthew Bender).



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CHAPTER 14 The Chapter 13 Plan

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P 14.11 The Sale of Property Through the Plan

In some cases, the sale of a house or other major asset may be a practical necessity if the debtor is to meet chapter 13's funding requirements. But the opportunity to sell property under a chapter 13 plan is itself sometimes the principal reason for filing under chapter 13. A chapter 13 sale offers a mechanism for selling property even over the objections of co-owners. And an orderly, negotiated sale under chapter 13 is likely to be better in protecting the debtor's equity than a nonbankruptcy foreclosure sale or a liquidation sale under chapter 7.

[1] Situations in Which Sale May be Useful

A sale of property through a chapter 13 plan may be useful when nonbankruptcy law prevents a debtor from selling property to realize exempt equity or to pay creditors. A chapter 13 plan providing for the liquidation of property may be a solution for a number of different types of problems.

For example, a sale through chapter 13 may be useful if only one of two cotenants by the entirety wishes to sell property that can be conveyed only by both spouses under state law. The plan may provide for the method of sale and the distribution of the proceeds, as well as the trustee's use of the power to partition entireties property under *section 363(h) of the Bankruptcy Code*, if necessary.ⁿ¹ This power permits the trustee, with some exceptions, to partition entirety or joint property that a single cotenant may not partition under state law.ⁿ² Under section 363(h), the appropriate inquiry is whether the benefit to the estate accruing from sale of the property would outweigh the detriment to the co-owner occurring due to partition. Courts may apply a variety of factors in making such a determination.ⁿ³

A chapter 13 filing may also be valuable to the debtor when a negotiated sale of real estate is impossible to complete in time to prevent an imminent foreclosure. Filing the petition in most cases will stay all proceedings against the property, allowing time for a sale.

MORE INFORMATION

Chapter 8 *supra* provides a detailed discussion of the automatic stay.

[2] What the Plan May Provide

In such cases, the debtor's plan may provide a specific procedure for sale of the property at or above a designated price.

Depending on the circumstances, other aspects of the sale or distribution of the proceeds should also be included.

FORMS

For an example of a plan providing for the sale of property *see Collier Consumer Bankruptcy Forms, Form CS19.04-1* (Matthew Bender).

[3] Obtaining an Order for a Sale Free of Liens

If it is real estate that is to be sold, it is sometimes advisable to obtain a specific order authorizing the sale free and clear of liens. Doing this will satisfy any questions of the title insurance company and any prospective purchaser concerning the debtor's authority to convey title. The order should also specify the distribution of the proceeds and set the compensation of any real estate broker.

PRACTICE NOTE

This can generally be accomplished by a motion⁴ seeking such an order, naming all lienholders and other affected parties as defendants. If the court has not approved the broker's fee in advance, it may not permit the payment of the fee from estate assets pursuant to section 330(a). In some districts, it may be necessary to obtain an order appointing the broker as a professional person in the case under section 327(a).⁵ A chapter 13 debtor who retains a broker is probably not subject to the provisions governing employment of professionals by the trustee. However, some courts may feel otherwise if estate assets are to be used to pay the broker.

[4] Sales Proceeds as Plan's Primary Funding Source

Under section 1322(b)(8), it is clear that property may be liquidated in a chapter 13 plan.⁶ It is less clear whether such a provision obviates the necessity to submit some income to the trustee as required by section 1322(a)(1).⁷ To be safe, the plan should provide for at least minimal payments in addition to the liquidation of property. Even when a mortgage will be cured and satisfied by the sale of property, the court may still require maintenance of current payments until the sale takes place.⁸ In any case, the sale of property through a chapter 13 plan is often a useful device, especially where an impending foreclosure threatens the loss of a large equity built up over years of ownership.

FOOTNOTES:

(n1)Footnote 1. *In re Belyea*, 253 B.R. 312 (Bankr. D.N.H. 1999) (debtor could partition jointly held property under section 363(h) as part of chapter 13 plan confirmation process).

(n2)Footnote 2. 11 U.S.C. § 363(h). *See* 3 *Collier on Bankruptcy*, P 363.08 (Matthew Bender) 15th Ed. Revised).

(n3)Footnote 3. *See* Sommer and McGarity, *Collier Family Law and the Bankruptcy Code*, P 2.06[3] (Matthew Bender).

(n4)Footnote 4. Local practice may vary, but usually a motion rather than a complaint is sufficient if there is no dispute about liens.

(n5)Footnote 5. *See In re Haley*, 950 F.2d 588 (9th Cir. 1991) (refusing commission to broker who had not been given approval to act as broker for debtor's property in chapter 11 case). *See* ch. 21 *infra* for discussion of compensation of professionals.

(n6)Footnote 6. *See* 8 *Collier on Bankruptcy*, P 1322.12 (Matthew Bender 15th Ed. Revised).

(n7)Footnote 7. *See In re Smith*, 51 B.R. 273 (Bankr. D.D.C. 1984) (motion to dismiss denied where already

confirmed plan funded solely from sale of property).

(n8)Footnote 8. *In re Gavia*, 24 B.R. 573 (B.A.P. 9th Cir. 1982) . But see *In re Vanasen*, 18 C.B.C.2d 530, 81 B.R. 59 (D. Or. 1987) (allowing debtors reasonable time to sell property did not violate prohibition against modification of mortgage claims in section 1322(b)(2)).



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CHAPTER 14 The Chapter 13 Plan

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P 14.12 The Length of the Plan

A very significant change made by the 2005 amendmentsⁿ¹ is the enactment of a differing "commitment period" for debtors with higher income who are not proposing to pay 100% of allowed unsecured claims.ⁿ² Section 1325(b)(4) sets an "applicable commitment period" for cases in which objections to the plan are filed under section 1325(b). The applicable commitment period remains three years if the annualized current monthly income of the "debtor and the debtor's spouse combined" is below the applicable state median income, but is five years if it that annualized current monthly income is above the applicable state median income.ⁿ³ However, a chapter 13 trustee is not compelled to demand a five year commitment period in these cases. Such demands may discourage some debtors who might otherwise file chapter 13 cases. They will also make plans more likely to fail by adding 67% more time in which an unexpected drop in income or emergency expense could occur. Moreover, there would appear to be nothing that prevents a debtor from paying unsecured creditors the amount required by the disposable income test (monthly disposable income multiplied by the number of months in the commitment period) more quickly, which may sometimes be easily done if the monthly disposable income is zero or a small amount.^{n3a}

For all cases filed prior to October 17, 2005 and for cases filed on or after October 17, 2005 in which the annualized current monthly income of the debtor and the debtor's spouse falls below the applicable state median income, the normal length of the plan remains three years. These plans, however, may be extended up to five years for cause. "Cause" for extension includes a need for extra time to meet the confirmation tests for secured or unsecured creditors or to cure a large default. It should be noted that although the plan must call for payments to be made within a period not to exceed five years, the five year limitation may run from the date the first payment under the plan becomes due following confirmation, rather than from the date of bankruptcy filing.ⁿ⁴ A court may also allow a debtor who has become a few months delinquent in a five-year plan to complete the plan.ⁿ⁵

[1] Procedure for Approval of Longer Plan

For cases in which the normal plan length is three years, the procedure for obtaining approval for extending a plan beyond this time period years is not set forth specifically in the Federal Rules of Bankruptcy Procedure. Many courts require a separate application and order to be filed, although it may be possible to incorporate the approval into the plan confirmation process.

[2] Cause for Approval of Longer Plan

Good cause for a longer plan may be that the debtor needs the additional time to meet the tests of sections 1325(a)(4) or 1325(a)(5), by paying the present value of nonexempt property or the collateral securing a debt. It may also be that four or five years is the minimum reasonable time in which a debtor can cure a default under section 1322(b)(5) on a long-term debt.

However, the desire simply to pay more to unsecured creditors may not be sufficient cause.ⁿ⁶ Sufficient cause may be lacking in such a case because, if the debtor chooses, the debtor can continue to pay creditors voluntarily after the end of the plan without being bound to do so.

[3] Plans Shorter than Three Years

It is clear that plans lasting less than the applicable commitment period may be confirmed as of right, so long as they comply with the other tests of chapter 13, including the disposable income test. They may also be confirmed if no party in interest objects. A plan may last only 18 months,ⁿ⁷ or may consist of only one payment, liquidating property designated by the debtor, if unsecured creditors are paid in full or if no party objects.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. *11 U.S.C. § 1325(b)(4)(B)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *11 U.S.C. § 1325(b)(4)(A)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Plans may be shorter than the applicable commitment period if unsecured creditors are paid in full or if no one objects.

(n4)Footnote 3a. *In re Kagenveama*, 527 F.3d 990 (9th Cir. 2008) . *But see In re Frederickson*, 545 F.3d 652 (8th Cir. 2008) .

(n5)Footnote 4. *West v. Costen*, 826 F.2d 1376 (4th Cir. 1987) . *See 8 Collier on Bankruptcy*, P 1322.17 (Matthew Bender).

(n6)Footnote 5. *In re Brown*, 296 B.R. 20 (Bankr. N.D. Cal. 2003) (refusing to dismiss case when debtor needed some extra time beyond 60 months to complete plan); *In re Black*, 17 C.B.C.2d 602, 78 B.R. 840 (Bankr. S.D. Ohio 1987) (Bankruptcy Code contains no provision for dismissing a chapter 13 case because payments extend over 66 months, if the plan complied with the duration limitations of the Code at the time of confirmation); *In re Eves*, 67 B.R. 964 (Bankr. N.D. Ohio 1986) (modification that could have been effective before five years following first payment after plan confirmation was timely, even though proposed modification was filed more than five years after first plan payment was made).

(n7)Footnote 6. *In re Festa*, 65 B.R. 85 (Bankr. S.D. Ohio 1986) .

(n8)Footnote 7. *In re Markman*, 2 C.B.C.2d 653, 5 B.R. 196 (Bankr. E.D.N.Y. 1980) .



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P 14.13 Modification of Plan Before Confirmation

The procedure for modification of a plan before confirmation is quite simple. The debtor simply files the modified plan, and the modified plan becomes the plan to be considered at the confirmation hearing.

One common reason for modifying a chapter 13 plan is a change in circumstances making it impossible for the debtor to carry out the terms of the original, or prior, plan. Thus, a plan may have to be modified to permit the debtor to cure a postpetition arrearage in mortgage payments or in payments to the trustee or some other default on the prior plan. Another common reason for a debtor to propose a modified plan is to resolve potential objections that the trustee or creditors may have to the plan, when these objections are brought to the debtor's attention at the creditors' meeting or at a later time. The modified plan must comport with the requirements of section 1322, which governs the contents of chapter 13 plans.

PRACTICE NOTE

Notice of the modification must be given, and proof of the notice should be filed with the clerk. *Federal Rule of Bankruptcy Procedure 2002(a)(6)* requires 21 days written notice to all creditors of the time to accept or reject a proposed modification of a plan. In some bankruptcy courts there are local rules of procedure specifying who should receive notice of plan modifications. These rules may require copies of the modified plan to be sent to all creditors, especially if they had required a copy of the original plan to be served on all creditors. They may also provide that the confirmation hearing must be postponed if a modification is filed shortly before its scheduled date, to allow creditors an opportunity to react to the modification and assure the 21 days' notice provided in *Rule 2002(a)(6)*. Because the debtor may file a modified plan at any time up to the point of confirmation, this may be the only way to provide the appropriate amount of time for creditors to respond to the debtor's new proposed plan.



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CHAPTER 14 The Chapter 13 Plan

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P 14.14 Summary: Construction of the Chapter 13 Plan

The form of the chapter 13 plan is not prescribed by the rules or the statute. As long as the plan meets all of the requirements of the statute, and clearly describes how creditors will be paid, its form should be acceptable. Most practitioners draft a standard plan that may then be modified to suit the needs of each case.

In some jurisdictions, chapter 13 trustees promulgate form plans, which are sometimes even required by local rules. This is probably not objectionable, as long as it does not in any way impair the debtor's flexibility in utilizing all of the options provided by chapter 13. Practitioners in a jurisdiction with a form plan should take care to add, delete or modify form provisions, as necessary, to create a chapter 13 plan which meets the debtor's objectives. The need to comply with a form should never be seen as a basis for limiting a chapter 13 debtor's substantive rights.ⁿ¹

As a practical matter, when formulating a chapter 13 plan, it is important to keep several broad principles in mind. A strategy must be designed for priority, secured and unsecured debts which meets the debtor's objectives, consistent with the Code and the debtor's available income. Legitimate priority debts generally must be paid in full, unless the creditor agrees otherwise. A secured debt may be treated in one of five ways: 1) pay it in full in the plan, 2) cure the default, 3) treat it outside the plan and let the lien ride through unaffected by bankruptcy, 4) avoid the lien and treat the debt as unsecured, or 5) surrender the property securing the debt. Unsecured creditors are entitled to at least what they would receive if the debtor's estate were liquidated in chapter 7 (the "best interest of the creditors' test").

The debtor must have sufficient income to pay at least the amounts necessary to meet these standards for secured, priority and unsecured debts as the plan is designed, plus the trustee's commission, which can vary from 2% to 10% of plan payments depending on the jurisdiction. In so providing, there is no need to accept any creditor's proof of claim as a given. It is possible to object to a creditor's characterization of a claim as "priority" or "secured," to the amount that the creditor is claiming, or to the creditor's right to a claim at all.ⁿ²

Once the amounts listed above are committed to the plan, the disposable income test must be used to determine if the debtor committing a sufficient amount to the plan. The trustee or a creditor will probably object if additional disposable income is available and not being paid to unsecured creditors.

Unless there are only one or two debts, it is usually impossible to specify the precise amounts that will actually be paid to different creditors under the plan. In most cases, the ultimate distribution is dependent on a number of events which

occur only after formulation of the plan. For example, the amount of a secured claim may be disputed. If the plan provides for a certain level of payments to the trustee, the amount to be distributed to claims paid after the disputed claim is calculable only after the amount of the disputed secured claim has been determined. Moreover, not all creditors file claims; nationally, 40% do not. Thus the amount each unsecured creditor receives from the total allocated to unsecured claims depends upon how many other unsecured creditors file their claims.

For these reasons, the plan need not specify how much each creditor will receive; it may simply describe the order of distribution in sufficient detail so the trustee will know how to proceed once the amounts of all allowed claims are known. So long as the amounts paid into the plan by the debtor appear to be sufficient to meet the requirements outlined above, the plan should be confirmed. In any case, as mentioned earlier, modifications are freely allowed if a problem does arise.

A plan formulated as prescribed above, which does not specify how much each general unsecured creditor will receive, is known as a "pot plan" because it simply provides a residual pot of money for unsecured creditors after all other claims have been paid. Its advantages, which stem from its flexibility in dealing with the unpredictability of claims, are described above.

Some practitioners, however, prefer to file a "percentage plan." This type of plan specifies that each general unsecured creditor will receive a certain percentage of its claim. The advantage of this type of plan, which is typically calculated on the assumption that all creditors will file claims, is that the debtor may not have to pay all of the debtor's disposable income if not all the creditors file claims. Precisely because of this possibility, some courts refuse to approve percentage plans if the trustee or a creditor objects to the plan. Percentage plans also leave the debtor uncertain regarding how much the ultimate plan payments will be until all secured claims and priority claims have been determined, and until the deadline for filing claims has passed. In addition, a percentage plan may require the debtor to object to unsecured claims filed in excessive amounts, because such claims would increase the debtor's payments. (If a pot plan has been filed, the debtor is not concerned if one unsecured creditor files an excessive claim, since that will simply reduce the other creditors' share of the pot.)

In any event, the plan should be clear about how the distribution to creditors is to be determined. If it is not, ambiguities are likely to be construed adversely to the debtor, who drafted the plan.ⁿ³

FOOTNOTES:

(n1)Footnote 1. *Sunahara v. Burchard* (*In re Sunahara*), 326 B.R. 768, 2005 Bankr. LEXIS 1270 (B.A.P. 9th Cir. 2005) (holding that court-mandated form plan impermissibly abridged debtor's substantive rights).

(n2)Footnote 2. See discussion of objections to claims in ch. 19 *infra* .

(n3)Footnote 3. See *Roberts v. Boyajian* (*In re Roberts*), 279 F.3d 91 (1st Cir. 2002) (plan providing both that debtor would pay fixed amount to trustee and that specified percentage return would be paid to unsecured creditors required debtor to pay the larger of the two amounts).



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CHAPTER 15 Executory Contracts and Unexpired Leases

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§ 15.syn Synopsis to Chapter 15: Executory Contracts and Unexpired Leases

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CHAPTER 15 Executory Contracts and Unexpired Leases

1-15 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter begins with the definition of executory contract for bankruptcy purposes. Next, the chapter discusses the assumption and rejection of leases or executory contracts, and the effects of such actions or inaction on the rights of the parties to such contracts. Finally, the chapter outlines strategies for the debtor and other parties to executory contracts in bankruptcy cases. The chapter also discusses certain contracts, known as "rent-to-own" contracts, which are sometimes denominated as leases, but which are often found to be installment sales of property.



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CHAPTER 15 Executory Contracts and Unexpired Leases

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P 15.01 Treatment of Executory Contracts

The Bankruptcy Code gives special treatment to certain contracts, such as an unexpired lease, in which there is an ongoing relationship between the parties that usually requires additional performance by each party to the contract. Such contracts may be of great value to the estate or, if continued, may place a great burden on the estate. The Code gives the trustee (or, in chapter 13, the debtor) the right to assume or reject such contracts.

If the contract is assumed, the estate thereby continues to be bound by all of its terms. If the contract is rejected, the estate is liable for damages, which are treated as a prepetition claim in the bankruptcy case. In some cases, there may be neither assumption nor rejection of the contract.ⁿ¹

FOOTNOTES:

(n1)Footnote 1. If a lease is never assumed or rejected during a chapter 11 case, and presumably also a chapter 13 case, some courts have held that the lease "rides through" and is not affected by the case. *Matter of Whitcomb & Keller Mortgage Co.*, 715 F.2d 375, 9 C.B.C.2d 312 (7th Cir. 1983) ; *In re Cochise College Park, Inc.*, 703 F.2d 1339 (9th Cir. 1983) . See 3 *Collier on Bankruptcy*, P 365.04[2][d] (Matthew Bender).



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CHAPTER 15 Executory Contracts and Unexpired Leases

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P 15.02 Definition of Executory Contracts and Rent-to-Own Contracts

[1] Executory Contracts

The Bankruptcy Code does not define what it means by the term "executory contract," and whether a particular contract is executory is sometimes an important question. Generally speaking, an executory contract is one "on which performance remains due to some extent on both sides."¹ Perhaps the prototype of such a contract is the unexpired lease, which is, of course, specifically included.

A more specific definition adopted by some courts classifies a contract as executory if "the obligations of both parties are so far unperformed that the failure of either party to complete performance would constitute a material breach and thus excuse the performance of the other."² However, other definitions have looked mainly to whether the debtor has an obligation other than one to pay money for property and services already received before the bankruptcy. If so, the contract is executory.³

Under any of these definitions, there are several types of executory contracts into which consumer debtors routinely enter. They include purchase and sale agreements for real estate,⁴ options for the sale of real estate or other property,⁵ most automobile leases,⁶ layaway contracts,⁷ contingent fee contracts with attorneys,⁸ insurance contracts,⁹ personal services contracts,¹⁰ installment payment contracts for cemetery plots, book clubs, magazine subscriptions, health clubs, and appliance or motor vehicle service contracts that are paid for in installments.¹¹

ILLUSTRATIONS

The Court of Appeals for the Seventh Circuit has held that an employee's agreement to participate in an Employee Stock Ownership Plan (ESOP) is not an executory contract that could be rejected to avoid the wage reduction involved while at the same time maintaining the employment that was a part of the contract.¹² And one court has held that a postnuptial agreement is an executory contract, at least if the parties are not yet divorced.¹³

[2] Land Installment Sale Agreements

Another type of contract that might present problems under this section is the land installment sales agreement, in which a debtor pays for property in installments, receiving a deed only when most or all of the payments have been made to

the seller. A number of courts have held such arrangements to be executory contracts, and have required debtors wishing to maintain them to cure defaults promptly.ⁿ¹⁴ However, whether this must always be so may depend on the nature of the agreement and the applicable state law. In some places, retention of the deed may be functionally equivalent to taking a security interest,ⁿ¹⁵ placing the transaction within the ambit of secured claims covered by sections 1322(b)(2), (b)(5) and 1325(a)(5) rather than *section 365 of the Bankruptcy Code*. Such a situation would be more analogous to a creditor holding the title to an automobile as security, an arrangement which seems clearly outside the scope of the executory contract provisions.ⁿ¹⁶

[3] Rent-to-Own Contracts

One other type of contract sometimes deemed executory by courts is the consumer "rent-to-own" transaction, in which a consumer agrees to make weekly or monthly "rental" payments for an appliance or furniture after which the consumer will become the owner of the property. Such transactions are very often disguised credit sales, in which the intent of both parties from the beginning is that the consumer will purchase the property. Therefore, they should not be treated as executory contracts under *section 1322(b)(7) of the Bankruptcy Code*.ⁿ¹⁷ Rather, such contracts should be treated as secured debts and therefore subject to redemption under section 722,ⁿ¹⁸ and cramdown in a chapter 13 plan.ⁿ¹⁹

[4] Automobile Title Pawn Transactions

Another fast-growing business preying on low income families is "title pawn" lending. The typical title pawn contract is a loan of a small amount of money, accompanied by a "pawn" of the automobile title to the lender and sometimes a lease-back of the car to the borrower. The effective interest rates in such transactions is often several hundred percent or more. While a title pawn lender may seek to characterize the transaction as an executory contract, courts have treated such transactions as disguised nonpossessory security interests. Thus, the normal rights of cramdown in chapter 13 apply.ⁿ²⁰ Chapter 13 thus provides a method of reducing the exorbitant finance charges, and often the amount of the secured claim owed to such lenders. Similarly, the right of redemption under section 722ⁿ²¹ may allow a debtor to eliminate the lien of such a lender by paying the value of the lender's allowed secured claim in cash. Even if possession of the property has been lost prior to bankruptcy, it may be possible to regain the vehicle. In most cases, a section 542 turnover would be required if the creditor still has possession.ⁿ²² In some cases, the taking of possession or other acts to improve the creditor's position may also constitute an avoidable preference.ⁿ²³

FOOTNOTES:

(n1)Footnote 1. H.R. Rep. No. 595, 95th Cong., 1st Sess. 347 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender). *See* 3 Collier on Bankruptcy, P 365.02 (Matthew Bender).

(n2)Footnote 2. *In re Wegner*, 839 F.2d 533, 536 (9th Cir. 1988) ; *In re Texscan Corp.*, 976 F.2d 1269 (9th Cir. 1992) (insurance contract was not executory where failure of debtor to pay premiums would not relieve insurer of obligation to perform); *Jenson v. Continental Financial Corp.*, 591 F.2d 477 (8th Cir. 1979) ; Countryman, *Executory Contracts in Bankruptcy*, 57 Minn. L. Rev. 439, 460 (1973). For one criticism of this definition, *see*, Julis, *Classifying Rights and Interests Under the Bankruptcy Code*, 55 Am. Bankr. L. J. 233, 252-59 (1981).

(n3)Footnote 3. *See* Shanker, *The Treatment of Executory Contracts and Leases in the 1978 Bankruptcy Code*, 25 Prac. Law. (No. 7) 11, 26 (1979).

(n4)Footnote 4. Such contracts remain executory and may be rejected even after one party has tendered performance. *In re Alexander*, 670 F.2d 885, 6 C.B.C.2d 771 (9th Cir. 1982) . But courts may refuse to allow rejection of a purchase and sale agreement if they find that this was the sole purpose of the bankruptcy filing. *In re Waldron*, 785 F.2d 936 (11th Cir. 1986) ; *In re Chinichian*, 784 F.2d 1440 (9th Cir. 1986) .

(n5)Footnote 5. *In re Hardie*, 100 B.R. 284 (Bankr. E.D.N.C. 1989) .

(n6)Footnote 6. *In re Wallace*, 122 B.R. 222 (Bankr. D.N.J. 1990) . It is often difficult to tell whether an automobile transaction is a sale or a lease. It is usually to the debtor's advantage if the transaction is deemed a credit sale. See *In re Mandrell*, 246 B.R. 528 (Bankr. D.S.C. 1999) (applying "economic test" of whether debtor acquired substantial equity in vehicle, determining that transaction was not a lease); *In re Lewis*, 185 B.R. 66 (Bankr. N.D. Cal. 1995) (General Motors "SmartBuy" contract was a credit sale, not a lease).

(n7)Footnote 7. *In re Davies*, 8 C.B.C.2d 760, 27 B.R. 898 (Bankr. E.D.N.Y. 1983) .

(n8)Footnote 8. *In re Aesthetic Specialties, Inc.*, 37 B.R. 679 (B.A.P. 9th Cir. 1984) .

(n9)Footnote 9. *In re Garnas*, 38 B.R. 221 (Bankr. D.N.D. 1984) .

(n10)Footnote 10. *Matter of Taylor*, 913 F.2d 102, 23 C.B.C.2d 1035 (3d Cir. 1990) . But see *Matter of Udell*, 18 F.3d 403, 30 C.B.C.2d 1192 (7th Cir. 1994) (granting relief from the automatic stay to enforce injunction obtained under covenant not to compete because equitable claim for injunction, which could be obtained under state law in addition to damages, was not a "claim" as defined in 11 U.S.C. § 101(5)(B)).

(n11)Footnote 11. See ch. 15 *infra*.

(n12)Footnote 12. *Matter of Crippin*, 877 F.2d 594 (7th Cir. 1989) .

(n13)Footnote 13. *In re Lawson*, 27 C.B.C.2d 1715, 146 B.R. 663 (Bankr. E.D. Va. 1992) .

(n14)Footnote 14. *In re Streets & Beard Farm Partnership*, 882 F.2d 233 (7th Cir. 1989) ; *In re Terrell*, 892 F.2d 469, 21 C.B.C.2d 1452 (6th Cir. 1989) ; *In re Speck*, 798 F.2d 279 (8th Cir. 1986) .

(n15)Footnote 15. *In re Kane*, 248 B.R. 216 (B.A.P. 1st Cir. 2000) (installment land sales contract not an executory contract); *In re Rehbein*, 15 C.B.C.2d 46, 60 B.R. 436 (B.A.P. 9th Cir. 1986) . See also *In re Climer*, 10 B.R. 872 (W.D. Tenn. 1977) .

(n16)Footnote 16. *Heartline Farms, Inc. v. Daly*, 934 F.2d 985 (8th Cir. 1991) ; *In re Rojas*, 10 B.R. 353 (B.A.P. 9th Cir. 1981) .

(n17)Footnote 17. *South Carolina Rentals, Inc. v. Arthur*, 187 B.R. 502 (D.S.C. 1995) ; *In re Puckett*, 60 B.R. 223 (Bankr. M.D. Tenn. 1986) . See also *Fogie v. Rent-A-Center*, 867 F. Supp. 1398 (D. Minn. 1993) .

(n18)Footnote 18. See ch. 25 *infra*.

(n19)Footnote 19. See ch. 14 *supra* for discussion of cramdown of secured claims in a chapter 13 plan.

(n20)Footnote 20. *In re Burnsed*, 224 B.R. 496 (Bankr. M.D. Fla. 1998) .

(n21)Footnote 21. See ch.25 *infra*.

(n22)Footnote 22. See ch.11 *supra*.

(n23)Footnote 23. *Mattheiss*, 214 B.R. 20 (Bankr. N.D. Ala. 1997) . See PP 17.05, 18.06[3] *infra* .



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CHAPTER 15 Executory Contracts and Unexpired Leases

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P 15.03 Assumption of Leases or Executory Contracts

One option with respect to an executory contract or unexpired lease is for the estate to assume the contract. In chapter 7, the trustee is the party who may elect to assume or reject the contract on behalf of the estate. In chapter 13, the debtor has the power to assume or reject any executory contract or unexpired lease. Indeed, a default or anticipated difficulties with respect to an executory contract or lease may be a prime reason for choosing chapter 13.ⁿ¹

While the assumption of a lease or executory contract by a chapter 7 trustee or chapter 13 debtor is on behalf of the estate, section 365(p) permits a chapter 7 debtor to assume a lease of personal property. As discussed below, the ramifications of such assumption are not entirely clear.

[1] Effects of Assumption by Estate

When a lease or executory contract is assumed, the terms of the contract remain in effect. The estate becomes liable for the entire amount due on the contract, as if it were a postpetition debt. Moreover, the amounts due may become administrative expenses entitled to priority under *section 503(b)(1)(A) of the Bankruptcy Code*.ⁿ² For this reason, a chapter 7 trustee will rarely assume a lease or executory contract unless that contract can be sold and assigned in exchange for cash.

[2] Reasons for Assumption by Estate

In many cases, a chapter 13 debtor will have much to gain from assumption of an executory contract or unexpired lease. For example, if moving would cause a hardship, or if a residential lease has favorable terms, it is usually advantageous to keep it in effect. This may be particularly true in a rent control jurisdictionⁿ³ or in public housing, since the debtor's occupancy may not otherwise be terminable even at the end of the lease term. (Staying beyond the term otherwise allowable may also be possible due to the operation of the automatic stay during the course of the plan.)

[3] Procedure for Assumption in Chapter 13

The approval of the court is required for the debtor to assume an executory contract or lease. Typically, the assumption, pursuant to section 1322(b)(7), is provided for in the debtor's chapter 13 plan.ⁿ⁴ Although a formal motion under *Rule 6006 of the Federal Rules of Bankruptcy Procedure* to assume an executory contract may be better practice, it has been held that confirmation of a chapter 13 plan containing a provision for assumption of a lease constitutes court approval as

required by section 365(a).ⁿ⁵ *Rule 6006*, which normally requires proceedings to assume to be brought by a motion under *Rule 9014 of the Federal Rules of Bankruptcy Procedure*, specifically applies to proceedings to assume *other than as part of a plan*.

FORMS

For an example of an individual debtor's chapter 13 plan providing for assumption of residential lease see *Collier Consumer Bankruptcy Forms, Form CS19.05-1* (Matthew Bender).

The debtor must be willing to assume the burdens as well as the benefits of the contract; a debtor may not assume only its favorable aspects.ⁿ⁶ To assume a lease or executory contract, the debtor must be willing and able to cure any default promptly. However, Section 365(b)(1), as amended in 2005,ⁿ⁷ excepts from this obligation the cure of nonmonetary defaults in certain unexpired real property leases that are not curable at or after assumption.ⁿ⁸ Additionally, a debtor need not pay a lease penalty for failure to perform nonmonetary obligations under the lease in order to cure.ⁿ⁹

If there has been a default, the debtor must also compensate the other party for any actual pecuniary loss under the lease resulting from the default,ⁿ¹⁰ as well as provide adequate assurance of future performance under the contract or lease.ⁿ¹¹ Such assurance is not required if no default exists.ⁿ¹²

These requirements raise other issues. How promptly must the default be cured?ⁿ¹³ What is meant by adequate assurance? "Promptness" will no doubt depend upon all of the circumstances of the individual case, including the amount in default, term of the contract or lease, and relative needs of the contracting parties. The phrase "adequate assurance" was adopted by the Commission on Bankruptcy Laws from the *Uniform Commercial Code, section 2- 609*. According to the comment to that section and case law thereunder, adequate assurance might consist of a cosigner, or a deposit, or even a simple showing of cash flow or credit sufficient to perform under the contract.ⁿ¹⁴

There may also be a dispute regarding whether, in fact, a default exists on the part of the debtor.ⁿ¹⁵ If it does not, no cure or adequate assurance is required by *section 365(b) of the Bankruptcy Code*. Naturally, such issues, whether relating to claims on consumer contracts or rights under implied warranties of habitability in residential leases, may be litigated in the bankruptcy court.

However, disputes about the contract's validity or breach of the contract need not be resolved in determining whether the contract may be assumed, and may instead be resolved after the assumption.ⁿ¹⁶ Once the contract has been assumed, the rights of the parties may be determined under the law that would ordinarily be applicable, absent contrary provisions in the Bankruptcy Code.ⁿ¹⁷

[4] Assumption of Leases or Contracts that May Have Been Terminated

Finally, the nondebtor party to the lease or contract may argue that the lease or contract cannot be assumed because it was validly terminated prior to the bankruptcy. This issue is particularly likely to arise in a case when the bankruptcy petition has been filed on the eve of an eviction. A number of courts and authorities have held that this argument is correct, finding that there is no contract or lease to assume.ⁿ¹⁸ The debtor's position is further complicated by section 362(b)(22) which limits the automatic stay if the lessor has obtained a judgment for possession.^{n18a} Although this stay exception does not directly affect the right to assume a lease, if the lessor is able to evict the debtor before a plan can be confirmed the debtor will rarely have any interest in assuming the lease. On the other hand, if a confirmed plan does provide for assumption, that should prevent a creditor from evicting the debtor, because an exception to the automatic stay permits only actions that a lessor may otherwise lawfully take.

The debtor seeking to assume has a number of strong counterarguments available, however. There may be questions as to whether the contract was validly terminated under state law,ⁿ¹⁹ or whether the debtor's right to cure the default is

still available.ⁿ²⁰Section 108(b) of the Bankruptcy Code may have extended such a cure period automatically to 60 days after the case was filed,ⁿ²¹ or the court may hold that the debtor has an independent right to cure under section 1322(b)(3).ⁿ²²

In addition, the debtor may point to section 365(c)(3), which specifically prohibits assumption of a terminated lease only if the lease is for nonresidential real property. By implication, a residential lease may be assumed despite its prior termination. Similarly, although section 362(b)(10) of the Bankruptcy Code provides an exception to the automatic stay as to nonresidential property under a lease which has expired before the case, there is no such exception for residential real property. These distinctions were obviously not accidental. Congress intended to provide protection to consumer debtors against evictions when those evictions are based simply on tenants' prepetition lease defaults or on tenants' bankruptcy filings.

FOOTNOTES:

(n1)Footnote 1. Although all leases of a debtor are usually deemed rejected by operation of law in chapter 7 cases, this usually has little practical effect. However, if a landlord does attempt to evict a tenant based upon the technical rejection, there may be problems (once the automatic stay is gone). The best answer to such an attempt is that the trustee's rejection did not terminate the debtor's rights or the lease. See P 15.04[4] *infra*. Another defense may be to argue that such an eviction would violate the fresh start of the bankruptcy discharge. See ch. 14 *supra*.

(n2)Footnote 2. As amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See *In re Parmenter*, 527 F.3d 606 (6th Cir. 2008) (even though debtor assumed lease, payments were not administrative expense because they were not included in list of administrative expenses in confirmed plan; modification of plan to pay more to car lessor was not permissible modification); *In re Allen*, 362 B.R. 866 (Bankr. N.D. Ohio 2007) (plan language calling for debtor to cure and maintain payments did not constitute assumption giving rise to administrative expense).

(n3)Footnote 3. See *In re Yasin*, 179 B.R. 43 (Bankr. S.D.N.Y. 1995) (rent stabilized lease could be assumed by chapter 13 debtor, preserving right of renewal; even if lease is rejected it may be possible for tenant to renew lease).

(n4)Footnote 4. *In re Harris Management Co.*, 791 F.2d 1412, 14 C.B.C.2d 955 (9th Cir. 1986) ; *Matter of Whitcomb & Keller Mortgage Co.*, 715 F.2d 375, 9 C.B.C.2d 312 (7th Cir. 1983) .

(n5)Footnote 5. *Department of Air Force v. Carolina Parachute Corp.*, 907 F.2d 1469, 23 C.B.C.2d 620 (4th Cir. 1990) (chapter 11 case); *In re Aneiro*, 16 C.B.C.2d 1070, 72 B.R. 424 (Bankr. S.D. Cal. 1987) .

(n6)Footnote 6. *Department of Air Force v. Carolina Parachute Corp.*, 907 F.2d 1469, 23 C.B.C.2d 620 (4th Cir. 1990) .

(n7)Footnote 7. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 8. This amendment suggests that assumption would require the cure of all nonmonetary defaults for personal property leases and executory contracts.

(n9)Footnote 9. 11 U.S.C. § 365(b)(2)(D).

(n10)Footnote 10. See *Brattleboro Hous. Auth. v. Parker* (*In re Parker*), 269 B.R. 522 (D. Vt. 2001) (cure does not require payment of amounts for which debtor not liable under nonbankruptcy law and in particular case did not require payment of attorney's fees or repair and utility charges).

(n11)Footnote 11. 11 U.S.C. § 365(b)(1). See 3 *Collier on Bankruptcy*, P 365.05 (Matthew Bender). 1 *Collier Bankruptcy Manual*, ch. 365 (Matthew Bender).

(n12)Footnote 12. See 3 *Collier on Bankruptcy*, P 365.05[1] (Matthew Bender). 1 Collier Bankruptcy Manual, ch. 365 (Matthew Bender).

(n13)Footnote 13. See *In re Expressco, Inc.*, 99 B.R. 395 (Bankr. M.D. Tenn. 1989) (two years too long under circumstances of case); *In re Coors of North Mississippi*, 27 B.R. 918 (Bankr. N.D. Miss. 1983) (three years may be prompt depending upon circumstances).

(n14)Footnote 14. See Fogel, *Executory Contracts and Unexpired Leases in the Bankruptcy Code*, 64 Minn. L. Rev. 341, 356-58 (1980).

(n15)Footnote 15. See, e.g., *In re Perretta*, 7 B.R. 103 (Bankr. N.D. Ill. 1980) (lessor has waived right to prompt payment by accepting late payments, so late payment not a default).

(n16)Footnote 16. *In re Orion Pictures Corp.*, 4 F.3d 1095, 29 C.B.C.2d 1341 (2d Cir. 1993) , cert. dismissed, 114 S. Ct. 1418, 128 L. Ed. 2d 88 (1994) .

(n17)Footnote 17. *Wainer v. A.J. Equities*, 984 F.2d 679 (5th Cir. 1993) .

(n18)Footnote 18. See, e.g., *Robinson v. Chicago Housing Authority*, 54 F.3d 316, 33 C.B.C.2d 603 (7th Cir. 1995) .

(n19)Footnote 18a. See P 8.03[4][d][I] *supra*.

(n20)Footnote 19. See, e.g., *In re Bronx-Westchester Mack Corp.*, 4 B.R. 730 (Bankr. S.D.N.Y. 1980) .

(n21)Footnote 20. *Brattleboro Hous. Auth.*, 197 F.3d 625 (2d Cir. 1999) (lease may be assumed even after state court eviction judgment based upon state law right to cure); *Robinson v. Chicago Housing Authority*, 54 F.3d 316, 33 C.B.C.2d 603 (7th Cir. 1995) (tenant has right to assume terminated lease as long as tenant has any way to revive lease under state law); *In re Windmill Farms, Inc.*, 841 F.2d 1467 (9th Cir. 1988) (lease may be assumed, even if it has been terminated, if state law gives lease a right to prevent forfeiture); *Moody v. Amoco Oil Co.*, 734 F.2d 1200, 11 C.B.C.2d 1 (7th Cir. 1984) ; *Ross v. Metropolitan Dade County*, 142 B.R. 1013 (S.D. Fla. 1992) , *aff'd*, 987 F.2d 774 (11th Cir. 1993) (debtor could assume public housing lease because state antiforfeiture doctrine gave right to prevent eviction through cure of default).

(n22)Footnote 21. See 2 *Collier on Bankruptcy*, P 108.03 (Matthew Bender). But see *Moody v. Amoco Oil Co.*, 734 F.2d 1200, 11 C.B.C.2d 1 (7th Cir. 1984) .

(n23)Footnote 22. Most of the cases considering section 365 have been under chapter 11, which has no comparable provision.



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P 15.04 Rejection of Leases or Executory Contracts

Problems are less likely to arise when the trustee or debtor chooses to reject an executory contract. This choice may be advantageous in a variety of situations, since many of the types of executory contracts listed above are unfair and burdensome to consumers. As discussed above,ⁿ¹ executory contracts that may be rejected can include those imposing restrictions on the debtor, such as a covenant not to compete with a former employer or business in which the debtor was involved.

[1] Procedure for Rejection

The procedure for rejecting a contract in chapter 13 is the same as that for assuming a contract. Rejection may be accomplished by a separate proceeding under *Rule 6006 of the Federal Rules of Bankruptcy Procedure*, or it may occur pursuant to a provision in a chapter 13 plan. Further, under new section 365(p)(3), enacted in 2005,ⁿ² leases for personal property in chapter 13 are deemed rejected if not assumed at the time of confirmation.

In chapter 7, a trustee may also bring a proceeding to reject a contract. However, rejection in consumer chapter 7 cases typically occurs automatically pursuant to section 365(d)(1), under which a lease of residential or personal property or an executory contract is deemed rejected automatically if not assumed within 60 days of the order for relief.

[2] Effects of Rejection

The effect of rejection is to give the other contracting party a prepetition damage claim against the estate.ⁿ³ For this purpose, the rejection is deemed a breach of the contract by the estate as of the time immediately prior to the filing of the bankruptcy petition.ⁿ⁴ As a prepetition claim, the debtor's liability on the contract is discharged.ⁿ⁵ As with any claim, the debtor may object to the amount claimed. If the contract is secured, however, and is to be provided for in the plan, the plan may have to provide for the claim to be paid consistent with the chapter 13 requirements for secured claims in order to obtain confirmation. Moreover, as discussed belowⁿ⁶ the rejection of a contract by the trustee does not necessarily terminate the contract with respect to the debtor.ⁿ⁷

MORE INFORMATION

For a discussion of claims and a detailed examination of objection to claims *see* chapter 19 *infra* and *see* chapter 14 *supra* for chapter 13 plan requirements.

[3] Rejection of Leases for Personal Property in Chapter 7

The power to assume or reject a lease on behalf of the bankruptcy estate may be exercised only by the trustee in a chapter 7 case. Moreover, as discussed above, an executory contract or unexpired lease is automatically deemed rejected unless the trustee assumes it within 60 days after the case is commenced.ⁿ⁸ Although all leases of a consumer debtor are thus usually deemed rejected by operation of law in chapter 7 cases, this usually has little practical effect.

The 2005 amendments to the Bankruptcy Code⁹ codify the view that, at least for personal property leases, rejection is simply the trustee's decision not to assume the lease on the part of the estate. Section 365(p)(1), enacted in 2005,ⁿ¹⁰ specifically provides that if a personal property lease is rejected, explicitly or by operation of law, the leased property is no longer property of the estate and the automatic stay is terminated with respect to that property. Section 365(p)(2), also enacted in 2005,ⁿ¹¹ provides the debtor an opportunity to assume the lease. The lessor may be condition assumption on the cure of any outstanding default of the contract.ⁿ¹² However, section 365(p)(2) is silent on what happens if the lessor is not willing to have the lease assumed. Irrespective of the lessor's objection to assumption, it would appear that the debtor should be able to cure the default and then simply keep paying on the debt to prevent repossession of the property.

[4] Rejection of Residential Leases in Chapter 7

As with personal property leases and other executory contracts, in chapter 7 a residential lease is automatically deemed rejected unless the trustee assumes it. And, similarly such rejection usually has little practical effect. First, most lessors are unaware that the bankruptcy has any effect on a lease when payments are current, and, since they usually have no special desire to evict a rent-paying tenant, they continue to treat the lease as still in effect. Although not explicit in the Code, the rejection of a residential lease, like a personal property lease, should be viewed only as the trustee's decision not to assume the lease on the part of the estate. It is a breach of the lease for bankruptcy purposes, but it does not terminate the lease. Thus, the trustee, by explicitly rejecting, or more commonly, not assuming the residential lease, simply abandons the leasehold interest back to the debtor.ⁿ¹³ In addition, if a landlord accepts rental payments after the expiration of the 60 day period, the debtor may argue that any possible breach of the lease has been waived.ⁿ¹⁴

[5] Rejection of Personal Property Leases in Chapter 13

Section 365(p)(3), enacted in 2005,ⁿ¹⁵ provides that in a chapter 13 case, a lease for personal property is deemed rejected if not assumed by the debtor as of the conclusion of the hearing on confirmation. If the lease is rejected, the automatic stay and, if applicable, the codebtor stay are terminated with respect to the property subject to the lease. Additionally, section 1322(b)(7) limits the debtor's ability to amend the chapter 13 plan to assume a lease which has already been rejected.

[6] Rejection of Residential Leases in Chapter 13

The rejection of a residential lease is advantageous to a chapter 13 debtor mainly when the debtor plans to move or has vacated the premises prior to the end of the lease term. The unpaid rent from the period prior to the bankruptcy usually becomes a general unsecured claim,ⁿ¹⁶ which is often paid little or nothing during the case. And the lessor's potential claim for lost rents is limited to one year's rent or 15% of the rent due for the remaining term of the lease, whichever is more.ⁿ¹⁷

However, payment for the period after the case is filed is treated somewhat differently. For the time between filing of the case and the debtor's rejection (and also after rejection, if the debtor stays on), the lessor may be entitled to receive from the estate the reasonable rental value of the property, often known as "use and occupancy payments."ⁿ¹⁸ The rent agreed upon previously is usually deemed to be the fair value,ⁿ¹⁹ but the court may be persuaded to set the value at a higher or lower level.ⁿ²⁰ If the rent provided for in the lease is greater than the fair value of the premises, it may thus be

to the debtor's advantage to reject the lease (or simply not assume it) but remain in occupancy paying rent, if the lessor agreesⁿ²¹ or the court allows the automatic stay to remain in effect.ⁿ²² In any case, once requested and allowed by the court, the use and occupancy expense will probably be considered an administrative expense, as a cost and expense of preserving the estate under *section 503(b)(1)(A) of the Bankruptcy Code*.ⁿ²³ Thus, in a chapter 13 case, it must be paid in full if filed as a priority claim, unless the case is dismissed, converted, or ended by a hardship discharge.ⁿ²⁴

In both chapter 13 and chapter 7, since the claim for damages arising from rejection of the lease, including damages relating to postpetition use, is considered a prepetition claim under section 502(g), that claim is normally dischargeable. Therefore, if the debtor does not wish to continue payments to maintain possession of the property, the lessor cannot sue the debtor after a bankruptcy case for damages arising from postpetition use of the property.ⁿ²⁵

[7] Credit Insurance

Another common type of contract that could be considered executory is the purchase of credit insurance which accompanies many consumer loans.ⁿ²⁶ More often than not, credit insurance is very expensive and a very bad bargain for the consumer.ⁿ²⁷ Rejection of the contract and termination of its benefits results in very little loss of real protection.

PRACTICE NOTE

If a debtor attempts to reject such a contract in order to obtain a refund for the remaining term, the creditor or insurance company can be expected to argue that the insurance was paid in full by the debtor at the outset of the loan with part of the amount financed. However, the debtor can show in most contracts that nonpayment of the loan will excuse the insurer from its obligation to perform; thus, each party still has obligations which, if breached, excuse performance by the other, making the contract executory under even the stricter definition discussed above. Moreover, the debtor can also point to the fact that such contracts typically provide for a refund for the remaining term if the loan is prepaid or, often, in the case of a default, making them more like installment contracts for which insurance is paid over a period of time. In fact, it is not uncommon for the creditor to make the actual payments on the debtor's behalf to the insurance company on an installment basis.

Creditors often take a security interest in the refund on credit insurance. If such a security interest is taken and is valid, there is little to be gained by rejecting the credit insurance on an otherwise unsecured debt which will not be paid in full under the plan. However, rejection of the insurance contract on a secured debt which must be paid in full under the plan could produce a refund of many hundreds, or even thousands, of dollars. This refund, even if held by the creditor as security, will ultimately go towards reducing the total amount payable.ⁿ²⁸

[8] Assumption of Personal Property Leases by Chapter 7 Debtor

Section 365(p)(1) and (2), enacted in 2005,ⁿ²⁹ permits a chapter 7 debtor to assume a personal property lease if the trustee does not assume the lease. The debtor must notify the lessor of a desire to assume the lease. The lessor may then condition the assumption on the cure of any outstanding default. If the debtor then assumes the lease, the liability under the lease will be assumed by the debtor and not the estate. However, because there is no reaffirmation of the lease debt, it is not entirely clear what this means. Personal liability on the lease will ordinarily be discharged if a chapter 7 discharge is entered, presumably even if the lease is assumed.

FOOTNOTES:

(n1)Footnote 1. See P 15.02 *supra*.

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. 11 U.S.C. § 502(g)(1), formerly § 502(g), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See 3 Collier on Bankruptcy, P 365.09 (Matthew Bender).

(n4)Footnote 4. *In re Aslan*, 909 F.2d 367 (9th Cir. 1990) .

(n5)Footnote 5. *Miller v. Chateau Communities (In re Miller)*, 282 F.3d 874 (6th Cir. 2002) (claim for damages under rejected lot lease was discharged despite fact that vacant mobile home remained on lot after bankruptcy case was filed); *Beck v. Gold Key Lease, Inc. (In re Beck)*, 272 B.R. 112 (Bankr. E.D. Pa. 2002) (claim for excess mileage under rejected automobile lease was prepetition claim even if it arose postpetition and debtor had continued to make lease payments postpetition).

(n6)Footnote 6. See P 15.04[4] *infra*.

(n7)Footnote 7. See generally *Leasing Service Corp. v. First Tennessee Bank Nat'l Ass'n*, 826 F.2d 434 (6th Cir. 1987) (rejection of contract does not affect creditor's secured status).

(n8)Footnote 8. 11 U.S.C. § 365(d)(1).

(n9)Footnote 9. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n10)Footnote 10. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n12)Footnote 12. 11 U.S.C. § 365(p)(2)(A). Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n13)Footnote 13. *In re Reed*, 94 B.R. 48 (E.D. Pa. 1988) (rejection results in abandonment of lease to debtor); *In re Rodall*, 30 C.B.C.2d 1322, 165 B.R. 506 (Bankr. M.D. Fla. 1994) (same). This conclusion is further supported by comparing the treatment of nonresidential tenants, who are required to vacate the property where the lease is not assumed. 11 U.S.C. § 365(d), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. There is no such requirement for a residential tenant.

(n14)Footnote 14. *In re Ranch House of Orange-Brevard, Inc.*, 773 F.2d 1166, 13 C.B.C.2d 1073 (11th Cir. 1985) ; *In re Storage Technology Corp.*, 53 B.R. 471 (Bankr. D. Colo. 1985) (rejection is a breach of lease that may be waived, not a termination of lease); *In re T.F.P. Resources, Inc.*, 13 C.B.C.2d 1345, 56 B.R. 112 (Bankr. S.D.N.Y. 1985) .

(n15)Footnote 15. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n16)Footnote 16. See *Matter of Whitcomb & Keller Mortgage Co., Inc.*, 715 F.2d 375, 9 C.B.C.2d 312 (7th Cir. 1983) .

(n17)Footnote 17. 11 U.S.C. § 502(b)(6).

(n18)Footnote 18. *Farber v. Wards Co.*, 825 F.2d 684 (2d Cir. 1987) . See 3 Collier on Bankruptcy, P 365.04[7] (Matthew Bender).

(n19)Footnote 19. *Farber v. Wards Co.*, 825 F.2d 684 (2d Cir. 1987) .

(n20)Footnote 20. *Zagata Fabricators v. Superior Air Products*, 893 F.2d 624 (3d Cir. 1990) ; *In re Dant & Russell, Inc.*, 853 F.2d 700 (9th Cir. 1988) .

(n21)Footnote 21. *Farber v. Wards Co.*, 825 F.2d 684 (2d Cir. 1987) .

(n22)Footnote 22. *Zagata Fabricators v. Superior Air Products*, 893 F.2d 624 (3d Cir. 1990) ; *In re Thompson*, 788 F.2d 560 (9th Cir. 1986) (where debtors only use part of leased premises, they must pay administrative expense only for use and occupancy of that portion). See *In re Schnabel*, 612 F.2d 315, 317 (7th Cir. 1980) .

(n23)Footnote 23. See 3 *Collier on Bankruptcy*, P 503.04 (Matthew Bender). See also *Zagata Fabricators v. Superior Air Products*, 893 F.2d 624 (3d Cir. 1990) ; *In re Standard Furniture Co.*, 2 C.B.C.2d 274, 3 B.R. 527 (Bankr. S.D. Cal. 1980) .

(n24)Footnote 24. 11 U.S.C. § 1322(a)(2).

(n25)Footnote 25. *Miller v. Chateau Communities (In re Miller)*, 282 F.3d 874 (6th Cir. 2001) (claim for damages under rejected lot lease was discharged despite fact that vacant mobile home remained on lot after bankruptcy case was filed); *In re Maupin*, 30 C.B.C.2d 1758, 165 B.R. 864 (Bankr. M.D. Tenn. 1994) .

(n26)Footnote 26. See *In re Garnas*, 38 B.R. 221 (Bankr. D.N.D. 1984) (insurance contract considered executory).

(n27)Footnote 27. The credit insurance industry is not very well regulated. Consumers typically have a poor understanding of the nature of these policies and of their very limited benefits.

(n28)Footnote 28. See *In re Waiwada*, 248 B.R. 258 (Bankr. M.D. Pa. 2000) (contract provided that debtor could cancel life and disability insurance, but creditor permitted to retain refund and apply to balance of debt).

(n29)Footnote 29. Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005.



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CHAPTER 15 Executory Contracts and Unexpired Leases

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P 15.05 Strategies for Debtors

In a chapter 13 case, the debtor is not normally required to choose assumption or rejection until the time of confirmation of the plan.ⁿ¹ Normally, it is to the debtor's advantage to wait until the last possible moment before choosing assumption or rejection, at least with leases. This is not difficult to do, since a chapter 13 plan may be modified as a matter of course until confirmationⁿ² and the debtor can simply change the plan provision governing the executory contract. By waiting, the debtor can keep all options open and also postpone the time by which defaults must be promptly cured as part of an assumption. The nondebtor party to the executory contract or lease is bound to honor the contract until it is rejected.ⁿ³ During the period before assumption, the debtor can save money, making an immediate or prompt cure of the default easier. Alternatively, the savings can finance a move to another home.

As discussed earlier, during this interim period the debtor-lessee also builds up a debt for use and occupancy, usually at the agreed rate of rental payments. Current payments of this rent debt after the bankruptcy is filed satisfy the debtor's only obligation to the lessor at this time, and usually keep the lessor satisfied to let the proceedings run their course (especially if the lessor is told that back rent payments will eventually be paid under the chapter 13 plan). A lessor who is satisfied with such an arrangement is unlikely to seek counsel to exercise the right to seek adequate protection or to force an early election of assumption or rejection.

MORE INFORMATION

Chapter 8 *supra* provides an extensive examination of adequate protection and the automatic stay.

After weighing the factors involved, the debtor usually should assume or reject the lease by the time of confirmation. If this is done, the consequences described above will transpire. If not, it is somewhat less clear what will happen.

At a minimum, if the lease is for personal property, the lease will be deemed rejected and the automatic stay will be terminated.ⁿ⁴ Presumably, the automatic stay remains in effect for residential leases and other executory contracts. However, a debtor's failure to assume the lease when given the opportunity might be considered cause for relief from the stay under section 362(d). On the other hand, especially if a lease contains burdensome clauses the debtor does not wish to assume, the debtor can argue that the stay should be continued, regardless of the failure to assume (or, for that matter, the conclusion of the lease term), as long as the lessor has adequate protection and continued occupancy is necessary for rehabilitation.ⁿ⁵

PRACTICE NOTE

It should be remembered, though, that since use and occupancy claims may have priority, the postpetition rental payments often will have to be paid in a chapter 13 case at some point.^{n5a} However, if the case is converted to chapter 7 or found appropriate for a hardship discharge, such postpetition claims would normally be discharged just as most other unsecured priority claims are discharged in such cases.

Consequently, even if a lease is not assumed, it is not clear that the debtor must therefore vacate the premises.ⁿ⁶ Moreover, if there is otherwise an entitlement to remain, as in public housing situations, an eviction may still be prohibited, especially where it would violate the section 525 prohibition on discrimination based solely on the discharged debt for back rent.ⁿ⁷

With respect to executory contracts and unexpired leases, other than leases for personal property, it is unclear whether a chapter 13 plan can be modified after confirmation to assume or reject that contract or lease. While section 365(d)(2) states that the election must be made before confirmation, section 1322(b)(7) allows a plan (and thus perhaps a modified plan) to provide for assumption or rejection of any lease or executory contract not previously rejected.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 365(d)(2).

(n2)Footnote 2. 11 U.S.C. § 1323. See 8 Collier on Bankruptcy, P 1323.02 (Matthew Bender).

(n3)Footnote 3. *In re Public Service Co. of New Hampshire*, 884 F.2d 11 (1st Cir. 1989) .

(n4)Footnote 4. 11 U.S.C. 365(p)(3), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. See discussion of relief from the stay with respect to leases in ch. 8 *supra* . However, some courts have held that where a lease is neither assumed nor rejected, it rides through the bankruptcy case unaffected. See P 15.02 *supra*. Therefore, failing to assume the lease may not relieve the debtor of burdensome lease terms, though if the debtor later leaves the property any liability for rent under the lease would probably be deemed discharged.

(n6)Footnote 5a. *But see In re Badgley*, 308 B.R. 293 (Bankr. E.D. Mich. 2004) (claim arising from rejection was not administrative claim, even though debtor's original, unconfirmed plan had provided for assumption of lease).

(n7)Footnote 6. See *In re Adams*, 65 B.R. 646 (Bankr. E.D. Pa. 1986) (rejection of lease does not automatically grant landlord relief from automatic stay or relieve landlord of necessity of resorting to state court eviction proceedings).

(n8)Footnote 7. 11 U.S.C. § 525(a). See ch. 30 *infra*.



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CHAPTER 15 Executory Contracts and Unexpired Leases

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P 15.06 Strategies for Nondebtor Parties to Executory Contracts or Leases with the Debtor

The primary strategy available to the nondebtor party to an executory contract or lease in a chapter 13 case is to force an earlier election of assumption or rejection by requesting the court to set a specified earlier date by which the choice must be made.ⁿ¹ Filing a motion to require an early election prevents a debtor from waiting until the last minute to decide on a course of action and provides some certainty to the nondebtor party.

FORMS

For an example of a form of motion for order fixing time for assumption or rejection of executory contract see *Collier Consumer Bankruptcy Forms, Form CS16.04-1* (Matthew Bender).

Additionally, although courts are split on this point, a lessor may seek relief from the stay prior to a decision on assumption or rejection, arguing that its interest in the property is not adequately protected.ⁿ² Typically, a debtor who is delinquent in postpetition rent payments will not be permitted to remain in a property without being required to bring the rent current over a relatively short time period. The lessor can also protect itself against such a loss by demanding adequate protection in the form of a new security deposit, a cosigner, or other device. Of course, in chapter 7 cases the stay usually will end within a few months or, in any event, at the time the case is closed and the least expensive course of action may be simply to wait until that time to pursue remedies under state law.ⁿ³

In a chapter 13 or a chapter 7 case in which assets will be available for distribution to creditors, the nondebtor party should file a claim for any rent due as a result of any rejection of an executory contract or lease. If the debtor has remained in leased premises after the petition was filed in a chapter 13 case, a request for payment of administrative expenses for postpetition rent that has not been paid may also be made. In many courts, such a request may be made by filing a priority proof of claim, but local practice on the method of requesting administrative expenses varies.ⁿ⁴

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 365(d)(2).

(n2)Footnote 2. Compare, e.g., *In re Sweetwater*, 10 C.B.C.2d 985, 40 B.R. 733 (Bankr. D. Utah 1984) (relief from stay not available to lessor prior to assumption or rejection) with *In re Borbridge and DeSantis*, 66 B.R. 998 (Bankr. E.D. Pa. 1986) (contra).

(n3)Footnote 3. *11 U.S.C. § 362(c). See ch. 8 supra.*

(n4)Footnote 4. *See 4 Collier on Bankruptcy, P 503.02 (Matthew Bender).*



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CHAPTER 16 Meeting of Creditors

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CHAPTER 16 Meeting of Creditors

1-16 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the section 341(a) meeting of creditors, a meeting which occurs in every bankruptcy case. The chapter explains the purpose of the meeting, as well as the procedures followed in scheduling and conducting the meeting. In addition, the chapter discusses steps a debtor's counsel should take in preparing for and representing clients at the meeting and strategies for creditors' counsel in connection with the meeting.



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CHAPTER 16 Meeting of Creditors

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P 16.01 Meeting of Creditors

In many a routine chapter 7 bankruptcy case, the only event of any importance between filing and discharge is the meeting of creditors, sometimes colloquially called the "first meeting of creditors" or the "section 341(a) meeting," in honor of the relevant statutory provision. While the meeting may pose occasional problems, the proceeding is usually routine and uneventful.

Section 341 of the Bankruptcy Code requires the convening of a meeting of creditors after an order for relief is entered. *Federal Rule of Bankruptcy Procedure 2003(a)* deals with the procedure for calling the meeting. *Rule 2003(a)* provides that, in a chapter 7 bankruptcy case, the meeting ordinarily should be convened 21 to 40 days after the order for relief.ⁿ¹ In a chapter 13 debt adjustment case, the meeting should be convened 21 to 50 days after the order for relief.ⁿ² The debtor must attend the meeting and submit to examination under oath.ⁿ³ This represents the first opportunity for creditors to examine the debtor. In almost all districts the meeting is presided over by the United States trustee, who usually delegates the task to the trustee handling the case.ⁿ⁴

In a chapter 7 case, creditors have the right, which is rarely exercised, to elect a trustee and a creditor's committee.ⁿ⁵ In cases under any chapter, creditors may question the debtor concerning transactions involving the debtor, the debtor's financial condition, or as to any matter that may affect the administration of the estate or the debtor's right to discharge. Creditors may seek to bring to light concealed assets, fraudulent or preferential transfers, grounds for a dischargeability complaint, or grounds for objecting to the discharge of the debtor. A creditor or attorney who intends to examine the debtor along these lines should be familiar with the schedules and with the debtor's statement of affairs, or become familiar with them at the meeting prior to examining the debtor. The examination may also relate to other matters relevant to the case or the formulation of the plan in a chapter 13 case.

MORE INFORMATION

For discussion of fraudulent transfers and preferences that may be avoided by a trustee *see* chapter 17 *infra*. Chapter 26 *infra* examines dischargeability complaints while chapter 29 *infra* outlines objections to discharge. For a discussion of chapter 13 plans *see* chapter 14 *supra*.

The section 341 examination does not provide unlimited discovery. Many trustees, who typically schedule a large number of meetings over a few hours, will seek to cut short extensive questioning. If a creditor wishes to probe further

(perhaps with a possible objection in mind), such creditor may need to look to *Rule 2004 of the Federal Rules of Bankruptcy Procedure*, which permits the creditor to seek an order scheduling a separate examination of the debtor.ⁿ⁶

PRACTICE NOTE

Law offices filing several bankruptcy cases during a short time period may wish to check with the office of the United States trustee as to how the date of filing affects the dates of later proceedings, such as the section 341 meeting of creditors. Especially where the meeting place is located at some distance from the office, it is obviously a more efficient use of resources to have more than one meeting scheduled for a single date. This can often be accomplished by filing several bankruptcy cases simultaneously. Even if the cases cannot be filed together, however, it is worthwhile to check with the court, the trustee, or the United States trustee on the possibility of having several meetings scheduled on the same day. (This would have to be done promptly, however, since the notice of the meeting of creditors is usually sent out shortly after filing.)

FOOTNOTES:

(n1)Footnote 1. If the meeting is scheduled for a place not regularly staffed by a United States trustee or an assistant United States trustee, it may be scheduled up to 60 days after the order for relief. *See 9 Collier on Bankruptcy, P 2003.01[2]* (Matthew Bender).

(n2)Footnote 2. This extension was originally meant to provide for flexibility in scheduling the creditor's meeting so that the court could, if it wished, hold the meeting of creditors and the confirmation hearing on the same day. The 2005 amendments to the Bankruptcy Code now require that the confirmation hearing not be held earlier than 20 days after the meeting of creditors unless the court determines that it would be in the best interests of creditors and the estate to hold an earlier hearing and there is no objection to the earlier date. *11 U.S.C. § 1324(b)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *See 3 Collier on Bankruptcy, P 341.02* (Matthew Bender).

(n4)Footnote 4. In Alabama and North Carolina, where there is no United States trustee, the bankruptcy administrator of the court presides or delegates the duty to the trustee handling the case. *See 3 Collier on Bankruptcy, P 341.02[4]* (Matthew Bender).

(n5)Footnote 5. *See 3 Collier on Bankruptcy, P 341.02[5][b]-[c]* (Matthew Bender).

(n6)Footnote 6. *See 3 Collier on Bankruptcy, ch. 343 and 9 Collier on Bankruptcy, ch. 2004* (Matthew Bender).



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CHAPTER 16 Meeting of Creditors

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P 16.02 Initiation of Meeting

[1] Place of Meeting

Pursuant to *Rule 2003(a) of the Federal Rules of Bankruptcy Procedure*, the meeting of creditors may be held where the court sits or at any other place designated by the United States trustee within the court's district that is convenient for the parties in interest. The trustee or counsel for the debtor should advise the United States trustee if special arrangements are required. (For example, in the event that many attendees are expected, a larger room than the standard hearing room will be needed to accommodate the attendees.)

[2] Notice of Meeting

Pursuant to *Rule 2002(a)(1) of the Federal Rules of Bankruptcy Procedure*, in a chapter 7 or 13 case the clerk of the bankruptcy court in which the case is pending, or some other person as the court may direct, other than the United States trustee, must mail a written notice of the meeting of creditors to be held, pursuant to *section 341 of the Bankruptcy Code*, to the debtor (and counsel for the debtor), each known creditor of the debtor, the trustee of the case, if any, and any indenture trustees at least 21 days prior to the date fixed for the meeting.ⁿ¹ This notice, which must conform to the appropriate version of Official Form 9, must contain the name, address, social security number, and any other and taxpayer identification number of the debtor.ⁿ²

FORMS

For examples of notices of commencement of case (Official Form 9) see *Collier Consumer Bankruptcy Forms*, § CS10.32 (Matthew Bender).

[3] Warning: Creditors Should Take Heed of Meeting Notice

[a] Creditors May Suffer Loss of Important Rights

The notice of the creditors meeting is often the first information that creditors obtain regarding the debtor's filing of a petition for relief under the Bankruptcy Code. The notice of the creditors meeting is normally contained in the "Notice of Commencement of Case", which gives important information such as the name and address of the debtor, the chapter under which the case is filed, the docket or case number, the date and location of the meeting of creditors, a preliminary

statement as to whether there will be any assets to be distributed to creditors, and other discussion of sections of the Bankruptcy Code, such as section 362 and section 523(a). In a chapter 13 case it is normally accompanied by the debtor's plan or a summary of the plan. Creditors should not ignore the notice because they may suffer the loss of important rights, such as the right to receive dividends if they fail to file a proof of claim or, when justified by the facts, subject themselves to sanctions for violating the automatic stay of actions and lien enforcement under section 362(a) or section 1301.

MORE INFORMATION

Chapter 19 *infra* examines filing a proof of claim. For discussion of the automatic stay and chapter 13 code debtor stay *see* chapters 8 and 9 *supra*, respectively.

[b] Original Date of Meeting Starts Clock Running for Many Key Deadlines

The original date of the meeting--whether held, continued prior to its scheduled date, or convened and continued--is the date on which the time periods begin to run for filing claims under *Rule 3002(c)*, objections to discharge in chapter 7, and objections to discharge of particular debts in chapter 7. The deadlines for a specific case are set forth in the notice of the meeting of creditors for that case. The original date set is, therefore, a crucial event for a case under any of the Code chapters.

MORE INFORMATION

For a discussion of filing claims *see* chapter 19 *infra*. Chapter 29 *infra* outlines objections to discharge, while chapter 26 *infra* examines dischargeability proceedings.

When the Rules refer to the date first set for the meeting held under *Rule 2003(a)* and section 341, the date referred to is the date originally set for the meeting of creditors and not the date on which the meeting of creditors is actually held. In particular, *Rule 3002(c)* requires proofs of claim in cases under chapter 7 and chapter 13 to be filed within 90 days of that date, although governmental creditors have a different deadline of 180 days from the order for relief,ⁿ³ and yet another deadline may exist for certain tax claims in chapter 13 cases.^{n3a} *Bankruptcy Rule 1017(e)(1)* requires a motion under section 707(b) to dismiss a chapter 7 case for "abuse" to be filed within 60 days of the first date set for the meeting of creditors.^{n3b} *Rule 4004(a)* requires that all objections to discharge be filed within 60 days of that date; and *Rule 4007* requires certain types of proceedings to challenge the dischargeability of a debt be filed within 60 days of that date. These dates, except the date for filing a proof of claim, may be extended for cause by the court if a motion for an extension is filed before the deadline.ⁿ⁴

On the other hand, *Rule 4003* requires that objections to exemptions be filed within 30 days of the *conclusion* of the meeting, with very limited exceptions. If the meeting is postponed, or for some other reason concluded on a later date, the time period runs from that date. Thus, the notice of the creditors meeting does not state a specific deadline for objections to exemptions. This deadline may also be extended on motion, but only if the motion is filed before expiration of the deadline.ⁿ⁵

MORE INFORMATION

Chapter 13 *supra* outlines the various objections to exemptions.

FOOTNOTES:

(n1)Footnote 1. *See* 9 *Collier on Bankruptcy*, P 2002.02 (Matthew Bender).

(n2)Footnote 2. Although the notice of the creditors meeting served on a creditor contains the debtor's social security number, the copy of the notice that is filed does not, in order to somewhat protect the debtor's private

information. See 2003 Advisory Committee Note to *Bankruptcy Rule 2002*.

(n3)Footnote 3. *Fed. R. Bankr. P. 3002(c)(1)*.

(n4)Footnote 3a. U.S.C. § 502(b)(9), as amended by Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005.

(n5)Footnote 3b. *Fed. R. Bankr. P. 1017(e)(1)*.

(n6)Footnote 4. *Fed. R. Bankr. P. 4004(b), 4007(c)*. Compare *Fed. R. Bankr. P. 3002(c)*, which allows an extension only in very limited circumstances.

(n7)Footnote 5. *Fed. R. Bankr. P. 4003(b)*.



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CHAPTER 16 Meeting of Creditors

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P 16.03 Purpose of the Meeting of Creditors

The purpose of the meeting is to obtain further information about the debtor's case, particularly the assets and liabilities which exist. This is accomplished through a set of routine questions usually propounded by the presiding officer, who may be the trustee or the United States trustee, depending on local rules and practices. In a few jurisdictions, the debtor's attorney may pose questions as in a direct examination.

The questions seek to check the accuracy of the schedules and statement filed, and in a chapter 7 case, determine whether the filing might be considered an "abuse" under section 707(b).ⁿ¹ In a Chapter 13 case, the trustee's inquiries may be directed towards, the ability of the debtor to perform under his or her plan. It is not uncommon for information somewhat inconsistent with the previously filed documents to come out, but it is rare that any serious problems arise. Usually, any discrepancies can be cured by amendment.

MORE INFORMATION

For discussion of amendments to schedules and statements *see* chapter 6 *supra*.

The questions may also go to the right to a discharge. Rarely will these questions be very detailed unless a particular creditor has appeared to seek information on a debt it claims is nondischargeable. Then the proceeding may become for all practical purposes a deposition by that creditor, at least to the extent the trustee permits the creditor time to ask questions.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 707(b)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 16 Meeting of Creditors

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P 16.04 Preparation for the Meeting of Creditors

Despite the attorney's knowledge that the meeting is rarely anything to worry about, most debtors cannot believe that it will all be so simple; many expect their creditors to turn out in force to grill them about why they are not paying their "just obligations." Therefore, it is important to give the client a detailed explanation of the procedure and the questions that are likely to be asked, in much the same manner one would use in preparing for a trial or deposition.

In preparing for the examination of the debtor, which may reach into every area related to the debtor's conduct or property, the debtor and counsel should anticipate questions that the trustee or creditors will ask and review any information relevant thereto. In rare cases it may be appropriate for debtor's counsel to suggest a consultation, before the examination, with an attorney experienced in criminal law, especially if there is some chance that the debtor would need to invoke the *Fifth Amendment* privilege against self-incrimination.ⁿ¹

Counsel for a debtor should also advise the client of the nature and extent of the attorney-client privilege, and that the debtor's statements to the attorney, oral or written, are confidential and protected from disclosure. The debtor may be put at ease by a reminder that counsel will object if any question is improper and that the debtor may consult with counsel before answering a question.

MORE INFORMATION

For examples of forms used in preparing for the examination of debtor and examining absent debtor by interrogatories *see Collier Consumer Bankruptcy Forms*, § 18.22-. 23, consecutively (Matthew Bender).

[1] Review Statements and Schedules with the Debtor

Anticipating the trustee's questions usually will not be difficult, as most trustees tend to ask the same questions in every case. Since the questions center on the schedules and statements already filed, reviewing these carefully with the client is essential, paying particular attention to those items claimed as exempt and the values given them. In particular, the debtor should know how the value of real estate was determined, which is usually by recent sales of similar properties. It is sometimes a good idea to give the debtor a copy of all or part of the schedules to take home and review, although this may only heighten the anxiety of some clients.

[2] Tax Returns to be Filed with Taxing Authorities or Provided to Trustee Prior to Hearing

At least 7 days before the section 341 meeting, the debtor must provide to the trustee a copy of the federal income tax return required under applicable law for the most recent tax year ending immediately before the commencement of case and for which a federal income tax return was filed, or a tax transcript of such return.ⁿ² At the same time as the return or transcript is provided to the trustee, it must be provided to any creditor that timely requests it.ⁿ³ By the plain words of the statute, if the return has already been provided to the trustee, a request from a creditor is not timely.^{n3a} *Bankruptcy Rule 4002(b)(4)* states that the debtor must comply with a creditor's request for a tax return that is to be provided if the request is made at least 14 days before the first date set for the section 341 meeting, thereby requiring creditors to meet an earlier deadline than the deadline for the debtor.^{n3b} The rule does not appear to compel production to a creditor of a tax return that has previously been provided to the trustee, because it speaks only of a return "to be provided." Thus, debtors who are concerned that a creditor may request a copy of the tax documents may want to provide them to the trustee immediately after the commencement of the case. However, few creditors bother to make such requests. In addition, the provision of tax returns is subject to procedures to be established by the Director of the Administrative Office of the United States Courts to safeguard confidentiality of tax information required to be provided, including restrictions on creditor access to the information.ⁿ⁴

Additionally, section 1308, enacted in 2005,ⁿ⁵ requires chapter 13 debtors to file with appropriate taxing authorities, by the day before the section 341 meeting, all tax returns that the debtor was required to file for all taxable periods ending in the four years before the petition.ⁿ⁶ If the required returns are not filed by the first date set for the meeting of creditors, the trustee is permitted to hold the meeting open, subject to certain time limitations, to give the debtor an opportunity to file them.ⁿ⁷ However, if the trustee does not hold the meeting open and the court does not extend the deadline, the case is subject to dismissal.^{n7a}

[3] Documents to Be Produced at the Hearing

It is also necessary to assemble whatever documents the trustee requires that the debtor bring to the meeting under local practice. Trustees will ask to see, at a minimum, a social security card or other documentary proof of the debtor's social security number as well as some identification of the debtor, which are specifically mentioned in the statute.^{n7b} In addition, *Interim Bankruptcy Rule 4002(b)* requires debtors to produce proof of current income, bank or other deposit account statements that cover the petition date, and documentation of any actual expenses that is required by section 707(b).^{n7c} In the alternative, the rule provides that the debtor can provide a written statement that such documents do not exist or are not in the debtor's possession. The trustee may wish to see deeds, titles to motor vehicles, tax returns, rent receipts, bank statements, pay stubs, real estate tax assessment documents, *etc.* Often these requests will be in a notice or letter sent to the debtor before the meeting. In a few places, local rules list documents that must be brought to the meeting. If an advocate is in doubt about these requirements, local practice should be checked as soon as possible.

The attorney should be aware that a debtor's record keeping could be unsatisfactory. Give the debtor time to produce documents. In addition, some documents the trustee might want to examine may have to be obtained from a different source (such as a safe deposit box) or might have to be located in the debtor's home. A few trustees request bank statements for an entire year prior to bankruptcy. Not all clients will keep this sort of information. Some may have to go to their bank or credit union to obtain copies from the bank's records. However, the debtor should not normally be required to produce any document the debtor does not have and cannot readily obtain with little or no cost and effort. The trustee has other tools for obtaining such documents if they are truly needed. In any event, it is a good idea for the attorney to bring the entire case file in the event something unexpected is requested.

[4] Check Proofs of Claim; Chapter 13 Case

The meeting of creditors is a good time to check on which creditors have filed proofs of claim. Since generally only creditors for whom proofs of claim are filed will be paid in a chapter 13 plan (or in those few chapter 7 cases where there are dividends), debtor's counsel should make sure to file claims on behalf of any creditors who have not filed and

whom the debtor wants to pay. Typically, these claims will be for secured debts, debts on which friends or relatives have cosigned, or debts that are not dischargeable in the debtor's case. The debtor may file such claims for creditors that do not file claims by the claims bar date at any time up to 30 days after the deadline for a particular creditor to file its claim pursuant to *Rule 3004 of the Federal Rules of Bankruptcy Procedure*.ⁿ⁸ Under that same rule, notice of the claim is given to the creditor, and it may then be permitted to amend the claim filed by the debtor.

In addition, it is useful to check the claims filed at this time, as well as shortly after the deadline for filing claims, to determine if there are any claims to which the debtor wishes to object. Of course, the claims may also be checked at other times, but the time of the creditors' meeting is often an opportune time because the meeting is often held at or near the courthouse and the date after the meeting is the first date on which the debtor may file a claim on behalf of a creditor.

MORE INFORMATION

The advisability of a debtor filing a claim on behalf of a creditor and discussion of objections to claims is found in chapter 19 *infra*.

In most bankruptcy courts, it is possible to access the docket and the claims register electronically, at a small cost, through the "PACER" program. Information on electronic access to court records should be readily available from the clerk of the court.

FOOTNOTES:

(n1)Footnote 1. For discussion of *Fifth Amendment* issues in bankruptcy cases see 3 Collier on Bankruptcy, P 344 (Matthew Bender).

(n2)Footnote 2. 11 U.S.C. § 521(e)(2)(A), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. 11 U.S.C. § 521(e)(2)(A)(ii), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 3a. *In re Fontaine*, 397 B.R. 191 (Bankr. D. Mass. 2008) ; *In re Collins*, 393 B.R. 835 (Bankr. E.D. Wis. 2008) .

(n5)Footnote 3b. See 9 Collier on Bankruptcy, P 4002.10 (Matthew Bender). *Bankruptcy Rule 4002(b)(4)* also provides that, in the alternative, the debtor may provide at least seven days before the first date set for the section 341 meeting a written statement that the tax documentation does not exist.

(n6)Footnote 4. Pub. L. No. 109-8 § 315(c)(2005). The Director of the Administrative Office of the United States Courts is required to establish these guidelines by October 17, 2005. *Id.*

(n7)Footnote 5. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 6. 11 U.S.C. § 1308(a), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. If the debtor was not required to file a return, or has filed all required returns, no additional return need be filed.

(n9)Footnote 7. 11. U.S.C. 1308(b).

(n10)Footnote 7a. See *In re Cushing*, 401 B.R. 528 (B.A.P. 1st Cir. 2009) (return must be filed even if not yet due under tax law unless trustee affirmatively holds meeting open or court extends time before it has expired). There is a good argument that this decision is erroneous insofar as it required the debtor to file tax returns that were not yet

required under non-bankruptcy law.

(n11)Footnote 7b. *11 U.S.C. § 521(h)*, enacted by Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005.

(n12)Footnote 7c. *Fed. R. Bankr. P. 4002(b)*.

(n13)Footnote 8. Since the time for a governmental unit to file a claim was extended to 180 days after the order for relief, *11 U.S.C. § 502(b)(9)*, the time for the debtor to file a claim on behalf of a governmental creditor is different from the time the debtor must file for any other creditor.



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CHAPTER 16 Meeting of Creditors

1-16 Collier Consumer Bankruptcy Practice Guide P 16.05

P 16.05 Creditor's Counsel--Should the Creditor Attend?

Although not required to attend the meeting of creditors, each creditor should consider various factors before deciding whether or not to attend the meeting in order to protect his, her or its interests.

[1] Creditor Attendance Not Mandatory

A creditor has no duty to attend the meeting of creditors. Official Form 9, by which creditors receive notice of the meeting of creditors, states: "Creditors are welcome to attend, but are not required to do so." Each creditor may attend or not attend, as the creditor wishes. It is unusual for creditors to attend creditor meetings in chapter 7 consumer cases or, in most places, in chapter 13 cases.

[2] Considerations in Determining Whether to Attend

The answers to the following questions, among others, may assist a creditor in determining whether or not to attend the meeting of creditors or otherwise participate in the case:

- Will the interests of the creditor be adequately represented by the trustee or similarly situated creditor?
- Is the amount of the creditor's claim so significant as to warrant individual representation?
- If the creditor's claim is a secured claim, is the creditor's interest being adequately protected through an equity cushion or adequate protection order approved by the court?
- Is information required to enable the creditor to make an informed judgment as to the desirability of bringing a dischargeability complaint, a complaint objecting to discharge, an objection to confirmation of a chapter 13 plan, or an objection to an exemption?
- Does negotiation about the chapter 13 plan occur at chapter 13 creditors meetings in the jurisdiction where the case is filed?
- Will it be inconvenient or unduly expensive for the creditor to attend the meeting?

[3] Attendance Advisable when Nondischargeable Debts of an Individual Debtor Exist

If the creditor's claim is not *de minimis* in amount and it appears that the creditor's claim may fall within one of the categories of debt that may be excepted from discharge, the creditor would be well advised to have an attorney attend the meeting.

MORE INFORMATION

For discussion of debts that may be excepted from discharge *see* chapter 26 *infra*.

Often, examination at the meeting of creditors is a way of determining whether there are grounds for a valid dischargeability complaint. The debtor, who may be ill-prepared to answer specific questions, may make significant admissions that would help in the litigation of an exception to discharge. On the other hand, facts may emerge which dissuade a creditor from filing a complaint.

Sometimes, information may also be obtained from other creditors in attendance at the meeting which may be useful to the creditor in determining the creditor's future course of action and the extent to which the creditor wishes to participate in the case.

Additionally, many courts have looked askance at creditors who file dischargeability complaints without having conducted some initial investigation at the creditors meeting. If a creditor who is unsuccessful in a proceeding brought under section 523(a)(2) alleging fraud, false pretenses, or a false financial statement has not attended the meeting, the court is far more likely to find that attorney's fees are appropriate under section 523(d) because the complaint was not substantially justified.ⁿ¹

[4] Necessity or Advisability of Appearance by Counsel

The majority of unsecured creditors usually conclude, after analyzing their situation, that attendance at creditors' meetings personally or by counsel is either inefficient, unduly expensive or an unwarranted distraction from other important business concerns.

If the creditor elects to attend the meeting of creditors, the decision should be made whether to attend alone, retain counsel to do so, or to attend the meeting with counsel. Generally, if the facts of the case raise more than simple legal issues, counsel should attend the meeting. If counsel is to attend, either alone or with the client, the creditor should specify the areas to be inquired into and furnish counsel with such factual background as will facilitate the propounding of questions.

Rejecting the minority view that appearing for a corporate creditor is the practice of law and expanding on the majority view that a corporate creditor may be represented by a nonattorney, the 2005 amendments to section 341 permit a nonattorney to appear and participate in a creditors' meeting on behalf of any creditor holding a consumer debt in a chapter 7 or chapter 13 case.ⁿ² In some cases, unsecured creditors may seek the assistance of a trade association to represent them at the meeting of creditors.

Many trade associations maintain a credit collection section which will act on behalf of regular members of the association who become involved in business bankruptcy cases. In appropriate cases, the association will retain counsel to represent those members. Customarily, the fees and costs of such representation will not be billed to the member-creditor, but a charge usually will be made based on the amount actually received by the creditor.

[5] Attendance by Secured Creditors

Since creditors with secured claims enjoy a preferred status over creditors with purely unsecured claims, attendance by secured creditors may not be necessary. In deciding whether or not to attend the meeting of creditors, a secured creditor should consider the significance of the claim, the existence of an equity cushion, and the need to obtain information regarding the collateral, including the debtor's intentions with respect to the collateral. In chapter 13 cases, some trustees encourage secured creditors to attend to negotiate about these creditors' treatment in the plan.

FOOTNOTES:

(n1)Footnote 1. *See* ch. 26 *infra*.

(n2)Footnote 2. *11 U.S.C. § 341(c)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 16 Meeting of Creditors

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P 16.06 Procedure at the Meeting of Creditors

[1] Debtor Must Attend the Meeting in Person

Pursuant to *section 343 of the Bankruptcy Code*, the debtor must attend the meeting of creditors. Under *Rule 2003*, the individual debtor (or both debtors, in a joint petition) must attend the meeting in person and submit to examination.ⁿ¹ If the debtor cannot attend or does not attend, it is often possible to obtain at least one postponement of the meeting. However, failure to attend or to obtain a postponement will ordinarily lead to dismissal, unless a reasonable excuse is provided.^{n1a}

In exceptional cases of hardship, including illness or incarceration, the personal appearance of the debtor may be excused, upon a motion filed by the debtor, and the debtor may be examined by telephone or by interrogatories.ⁿ² In many cases, it may be a good idea to request that the trustee agree to such a procedure in advance.

FORMS

For a form of motion to excuse the debtor's personal attendance *see Collier Consumer Bankruptcy Forms, Form CS18.12-1* (Matthew Bender).

[2] Attorney Should Attend Creditors' Meeting with Debtor

WARNING

Having prepared the debtor's bankruptcy petition and other related papers, it is important for the attorney to attend the creditors' meeting with the debtor. Most courts consider attendance at the meeting as a fundamental component of the services for which the attorney is being paid. There may be reduction of compensation and the imposition of sanctions upon counsel for failure to attend the first meeting.ⁿ³ Courts generally do not approve of anyone other than an attorney, such as a paralegal, representing the debtor at the meeting.ⁿ⁴

In addition, creditor representatives frequently approach debtors outside of the meeting room in attempts to convince them to reaffirm debts.^{n4a} In fact, these representatives have even been known to approach debtors while the debtors' attorneys were in creditor meetings for other clients. Thus, it is important both

for an attorney to attend the meeting to deal with approaches by creditors and also for the attorney to warn clients that they should not talk to any creditors or their representatives without their attorney being present. Debtors should also be instructed to report any creditor approaches to the attorney, so that the debtor may be counseled regarding the alternatives available and appropriate actions can be taken with respect to any improper activities of creditors.

[3] Scope of Examination

It is important that the debtor and counsel properly prepare for the debtor's attendance at the creditors' meeting, especially if the case presents issues that are out of the ordinary. The examination of the debtor may reach into every conceivable area related to the debtor's acts, conduct or property, the liabilities and financial condition of the debtor, or any matter that may affect the administration of the estate, or the debtor's right to a discharge. In a chapter 13 case, it is possible that the examination may also relate to the operation of a business and the desirability of its continuance, the debtor's disposable income and the feasibility of the debtor's plan.

By and large, though, the questions asked parallel those in the official forms already answered, and have similar purposes.^{n4b} They seek information as to fraudulent transfers, preferences, former bankruptcies and, usually, how the debtor fell into financial difficulty. Unless an answer arouses suspicion, the questions may not be followed up. In many districts, though, trustees are careful to ask about types of property frequently not listed by debtors, such as tax refunds, security deposits and the like. If the attorney was careful in eliciting information from the debtor, no surprises should surface. However, even if new property is uncovered, it usually can still be claimed as exempt by amendment of the schedules or statement, and if necessary the chapter 13 plan can similarly be modified without difficulty.

MORE INFORMATION

See chapter 6 *supra* for discussion of the purposes of the questions on the schedules and amendment of schedules, chapter 13 *supra* for discussion of amending exemptions, and chapter 14 *supra* for discussion of modifying a chapter 13 plan.

Generally, the meeting of creditors is likely to be short and informal in the case of a typical consumer debtor. Despite its popular name, it is rarely graced by the presence of any creditors. Those who do come often do so only because of a mistaken belief that their attendance is required. Indeed, neither trustees nor creditors show much interest in the cases of most consumer debtors, since they well know that such debtors rarely have assets of significant value.

[4] Debtor's Obligation to Answer Questions and Produce Documents

Depending upon the attitude of the trustee, creditors and other parties in interest may be given wide latitude in their interrogation. Sometimes examinations at the meeting may indeed constitute "fishing expeditions."ⁿ⁵ However, this does not mean that creditors or their attorneys may harass or intimidate a debtor.

Since the bankruptcy judge is not present at the meeting, there may occasionally be disputes which arise either between the debtor and creditors, or between the debtor and the trustee. For example, it may be necessary to object to certain questions for any one of several reasons, such as privilege, the *Fifth Amendment*,ⁿ⁶ relevance, or repetitiveness. Although neither the statute nor the Rules address how such disputes are to be resolved, it is clear that neither the trustee nor the United States trustee can issue orders. The procedure to be followed is similar to that of a deposition which includes an instruction to the client not to answer, if necessary, with the dispute reserved for the court's decision. It would then fall to the proponent of the unanswered question to follow up with a motion requesting the court to order the debtor to answer. In many cases, such a motion will never be filed.

There is some confusion as to how much a debtor may consult counsel during the examination. In most jurisdictions,

the practice is quite liberal; the client is allowed to confer with counsel before answering a question and counsel is allowed to interject clarifying remarks when necessary.

The same considerations apply to requests for documents from the debtor. Sometimes, a debtor is unable to produce a social security card or some other document demanded by a trustee, simply because the debtor does not have it. Again, it must be emphasized that neither the trustee nor the United States trustee, who supervises the trustee, has authority to require the debtor to produce documents other than documents required by the statute or the rules.^{n6a} In most cases, the demand for any other document results from directives of the United States trustee, or a particular trustee's interpretation of such directives. If the document cannot be produced, the only thing the trustee can do is move to dismiss the case, and in that event it is up to the court to decide whether the document is really necessary. Indeed, the Code does not even require that the debtor have a social security number.ⁿ⁷ The forms and rules simply require the debtor to provide the number if it exists. Unless there is a serious question about the debtor's identity or social security number, especially if the documents demanded by the trustee do not exist or are not in the debtor's possession, there is little chance that a court would dismiss the case. Many trustees will back down without even filing a motion, or will accept some alternative method of identification. However, in some cases, the easiest course of action will be to have the debtor obtain the documents demanded by the trustee.

[5] Surrender of Debtor's Credit Cards

One practice that has arisen in some jurisdictions is a request by the trustee that debtors surrender all credit cards still in their possession at the time of the section 341 meeting. Most debtors are quite willing to relinquish possession of the cards, if they have not already done so. Accounts that were listed on the debtor's petition, and which will be discharged in bankruptcy probably have already been canceled by the credit card company.

However, some debtors may have legitimate objections to this procedure, especially as to necessary accounts which may not have had balances when the petition was filed. If the debtor wishes to retain possession of the cards, the request for their surrender should be opposed. Most judges and trustees admit that since there is no specific authority for the turnover of the cards absent a request by the creditors involved, they will not pursue the issue, especially if the debtor has shown good reason for retaining the cards. Indeed, it has been held that, at least in the case of a chapter 13 debtor, a creditor has no right to revoke a nondelinquent credit card based solely on a bankruptcy filing and the debtor may continue to use the card.^{n7a}

[6] Trustee Inquiry Mandated in Chapter 7 Cases

In chapter 7 cases only, the 1994 amendments to the Bankruptcy Code added one additional procedure to the meeting of creditors. Pursuant to *section 341(d) of the Bankruptcy Code*, the trustee must orally examine the debtor to "ensure" that the debtor is aware of several things.ⁿ⁸ The legislative history makes clear that the sole purpose of this examination is informational.ⁿ⁹

[a] Debtor's Understanding of the Consequences of Filing Bankruptcy

The first question that must be asked is the debtor's understanding of the potential consequences of bankruptcy on a person's credit history. However, other than the fact that bankruptcy appears on a credit report for 10 years, it is hard to see what a trustee can say on this topic. If the idea was to convince a debtor not to file a bankruptcy case, the information would come too late; the bankruptcy has already been filed by the time of the meeting and cannot be removed from a credit history. Moreover, as the legislative history states, the trustee cannot and should not prognosticate about how bankruptcy will affect future credit, or that dismissal or conversion to chapter 13 would improve the debtor's chances of obtaining credit.ⁿ¹⁰ Some creditors give credit to recent bankruptcy debtors. Indeed, if the debtor's income is freed up from numerous obligations, the debtor may have a better chance of obtaining credit. And, since many creditors do not distinguish between chapter 7 and chapter 13 cases on credit reports, the trustee

cannot and should not predict that the debtor's credit will be better if the case is converted to chapter 13.

[b] Debtor's Knowledge of Availability of Other Types Of Bankruptcy Relief

The second topic is the debtor's ability to file a petition under a different chapter. This information is presumably to ensure that a chapter 7 debtor knows that chapter 13 is also available. However, the debtor should have already been informed of that fact both by counsel (who must swear in the petition that this information was given) and by the clerk, who pursuant to section 342(b), must give notice of the chapters available to every debtor.ⁿ¹¹

[c] Debtor's Knowledge of Effect of Receiving a Discharge

The third topic for the trustee's questions is on the effect of receiving a discharge of debts under the Code. This includes not only the fact that the discharge eliminates liability on most debts, but also the risks of and procedures for reaffirming debts.ⁿ¹² In this context, the debtor should be informed that a debt may be paid voluntarily after discharge without a reaffirmation, which waives the protections of the discharge. As the legislative history points out, most debtors who reaffirm debts will no longer receive the warnings about the dangers of reaffirmation from the court, so it is important that this information be given by the trustee.ⁿ¹³

[d] Trustee Often Provides Written Explanation

In most cases, trustees will attempt to minimize the time necessary for the oral examination by giving out the information in written form and then inquiring whether the debtor has read it.ⁿ¹⁴ If the debtor is given such a handout and has questions about it, the creditors' meeting is a good time for the debtor's attorney to answer them.

FOOTNOTES:

(n1)Footnote 1. *See* 3 *Collier on Bankruptcy*, P 343.09[1] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 343.09[1] (Matthew Bender).

(n2)Footnote 1a. *But see Dinova*, 212 B.R. 437 (B.A.P. 2d Cir. 1997) (case could not be dismissed without notice and a hearing after debtor failed to attend § 341 meeting, notwithstanding legend in notice of meeting that "failure by the debtor(s) to appear ... shall result in dismissal of the case upon ex parte order").

(n3)Footnote 2. *See* 3 *Collier on Bankruptcy*, P 343.09[1] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 343.09[1] (Matthew Bender).

(n4)Footnote 3. *See, e.g., In re Wright*, 48 B.R. 172 (Bankr. E.D.N.C. 1985) .

(n5)Footnote 4. Some courts do, however, have local rules permitting law student practice under the supervision of an attorney.

(n6)Footnote 4a. *See* P 16.07 *infra*.

(n7)Footnote 4b. The questions typically propounded, as well as other guidelines set for section 341(a) meetings and administration of chapter 7 cases by the Executive Office of the United States Trustees, can be found in the Chapter 7 Trustee Handbook published by that office, available at <http://www.usdoj.gov/ust/library/trusteelib.htm>.

(n8)Footnote 5. *See* 9 *Collier on Bankruptcy*, P 2004.02 (Matthew Bender) for discussion of the proper scope of the examination.

(n9)Footnote 6. Discharge cannot be denied for refusal to answer a question on this ground unless the debtor has first been granted immunity with respect to the matter involved. 11 U.S.C. § 727(a)(6).

(n10)Footnote 6a. *11 U.S.C. 521(h)*, as enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005; *Fed. R. Bankr. P 4002(b)*.

(n11)Footnote 7. *In re Merlo*, 265 B.R. 502 (Bankr. S.D. Fla. 2001) . The Statement of Social Security Number submitted with the petition and schedules provides that the debtor may check a box indicating that he or she does not have a social security number. *See* Official Form 21.

(n12)Footnote 7a. *United Counties Trust Co.*, 137 B.R. 582 (Bankr. D.N.J. 1992) (under *11 U.S.C. § 541(c)(1)(B)* the prepetition property rights of the debtor become property of the bankruptcy estate notwithstanding any contractual provision that gives an option to terminate the contract upon a bankruptcy filing).

(n13)Footnote 8. *See* 3 *Collier on Bankruptcy*, P 341.05 (Matthew Bender).

(n14)Footnote 9. H.R. Rep. No. 835, 103d Cong., 2d Sess. 43 (1994).

(n15)Footnote 10. H.R. Rep. No. 835, 103d Cong., 2d Sess. 43 (1994).

(n16)Footnote 11. *See* ch. 6 *supra*.

(n17)Footnote 12. H.R. Rep. No. 835, 103d Cong., 2d Sess. 43 (1994).

(n18)Footnote 13. H.R. Rep. No. 835, 103d Cong., 2d Sess. 43 (1994).

(n19)Footnote 14. For the contents of this form *see* 3 *Collier on Bankruptcy*, P 341.05[2] (Matthew Bender).



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CHAPTER 16 Meeting of Creditors

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P 16.07 Creditors' Attempts to Obtain Reaffirmation

Situations where creditors attend meetings seeking to pressure debtors into agreeing to enter into reaffirmation agreements are cropping up frequently in some jurisdictions. Often those creditors threaten repossession of items of personal property pursuant to questionable or non-existent security interests, or threaten nondischargeability litigation.

PRACTICE NOTE

In almost every case, a debtor should be advised to reject the reaffirmation agreement that is offered. Very often the creditors involved have claimed that they have a security interest pursuant to a credit card agreement. These security interests, if they exist, are difficult, if not impossible, to enforce. They are generally based on an adhesion contract which is mailed to the debtor with the card. In the case of a revolving charge, it is often impossible to determine whether the secured claims have been paid off.

Clients may need to be reassured, however, that repossession is unlikely, and that if the clients simply refuse to allow a creditor to enter their home to repossess, the creditor will need to obtain a court order permitting repossession.ⁿ¹ In the unusual instance where that occurs, issues concerning the validity of the security interest can be addressed in that proceeding and, more likely than not, the client could then pay a smaller amount of money to keep the property.

When the creditor threatens dischargeability litigation, the best response is usually that it will be vigorously contested. The creditors who routinely threaten such litigation are unlikely to follow through when it will be contested, since their aim is to obtain quick reaffirmations, settlements, or default judgments.

MORE INFORMATION

For more detailed analysis of reaffirmation *see* chapter 27 *infra*.

FOOTNOTES:

(n1)Footnote 1. Under *U.C.C. § 9-503*, a self-help repossession may not cause a breach of the peace.



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CHAPTER 16 Meeting of Creditors

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P 16.08 Debtor's Privilege Against Self-Incrimination

The debtor party may assert the privilege against self-incrimination granted by the *Fifth Amendment to the Constitution of the United States*. Unless the United States Attorney requests immunity from prosecution for the witness and such immunity is granted by the United States district court pursuant to part V of title 18, United States Code, the witness may refuse to testify.ⁿ¹ If an individual debtor properly invokes the privilege against self-incrimination in refusing to testify and has not received immunity, the debtor will not be denied a discharge solely because of his or her failure to testify.ⁿ² If immunity has been granted and the debtor still refuses to testify, discharge may be denied because of such refusal.ⁿ³

FOOTNOTES:

(n1)Footnote 1. *See generally* 3 Collier on Bankruptcy, ch. 344 (Matthew Bender).

(n2)Footnote 2. 11 U.S.C. § 727(a)(6)(B). *See* 6 Collier on Bankruptcy, P 727.09[2] (Matthew Bender).

(n3)Footnote 3. *See also* *Martin-Trigona v. Belford (In re Martin-Trigona)*, 732 F.2d 170, 173 (2d Cir.) , *cert. denied*, 469 U.S. 859, 105 S. Ct. 191, 83 L. Ed. 2d 124 (1984) (debtor who had been granted immunity but continued to assert *Fifth Amendment* privilege in response to questions of bankruptcy trustee's counsel could be held in civil contempt, as well as denied a discharge).



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CHAPTER 16 Meeting of Creditors

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P 16.09 Lack of Interest on the Part of Creditors Typical

Usually in consumer bankruptcy cases, few creditors bother to attend the creditors meeting and the meeting may be over in 10 minutes or less. There are several reasons for this lack of interest. Probably paramount is the feeling that there are rarely any assets worth pursuing in such cases and that the cost in time and effort required for the trustee and creditors is not justified by the benefits achieved. The amount of the trustee's compensation is set by *sections 326(a) and 330(b) of the Bankruptcy Code*. Unless the trustee can obtain property for the estate worth well over \$1,000, his or her fee will not be significantly increased in a chapter 7 case. Most creditors realize that there is little they can accomplish at the meeting other than perhaps some discovery. Occasionally creditors will appear to find out the location of their collateral and to attempt to negotiate its future disposition.

PRACTICE NOTE

Local practice does, however, vary somewhat from jurisdiction to jurisdiction. In a few localities, for example, it is relatively common for creditors to appear in chapter 13 cases in order to negotiate with the debtor's counsel and the trustee concerning various provisions of the plan. Where this occurs, it is important to remember that the trustee has no power to make a final decision on whether a particular plan will be confirmed. When issues are contested, the trustee or a creditor may file an objection, and the debtor may present opposition if necessary and obtain judicial resolution. As often as not, even when issues are raised at the meeting of creditors, neither the trustee nor any creditor will go to the effort necessary to formally raise the appropriate objection.

MORE INFORMATION

See chapter 20 *infra* for discussion of confirmation procedures and objections to confirmation.



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CHAPTER 16 Meeting of Creditors

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P 16.10 Record of Meeting

Whenever there is testimony under oath at a meeting of creditors, *Rule 2003(c)* requires that a verbatim electronic or other record be kept.ⁿ¹ The record must be retained for two years by the United States trustee. The United States trustee must provide, on request, a certified copy or transcript, for which the United States trustee is allowed to charge a reasonable fee.

FOOTNOTES:

(n1)Footnote 1. *See 9 Collier on Bankruptcy, P 2003.03* (Matthew Bender).



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CHAPTER 16 Meeting of Creditors

1-16 Collier Consumer Bankruptcy Practice Guide P 16.11

P 16.11 Adjournment and Conclusion

Creditors' meetings may be adjourned and reconvened. The announcement of the date and time of the reconvened meeting may be made at the meeting to be adjourned. In such cases, no further written notice is required.ⁿ¹ A common reason to adjourn a meeting is to obtain more information about a possible objection to an exemption. However, debtors' counsel and the court should not permit trustees to adjourn meetings in every case, simply for the purpose of relieving themselves of the deadline for objection to exemptions, since that would render the deadline meaningless.ⁿ²

If the meeting has been adjourned and not been reconvened, the court possesses the power to force the presiding person (trustee or United States trustee) to reconvene and conclude the meeting or to simply declare the meeting concluded.ⁿ³

FOOTNOTES:

(n1)Footnote 1. *See* 9 *Collier on Bankruptcy*, P 2003.05 (Matthew Bender).

(n2)Footnote 2. *In re Smith*, 235 F.3d 472 (9th Cir. 2000) (trustee could not adjourn section 341 meeting indefinitely; rules require specific place and time); *see also In re Dutkiewicz*, 2009 Bankr. LEXIS 1695 (B.A.P. 6th Cir. July 6, 2009) (at a minimum, trustee must announce meeting is being held open); 3 *Collier on Bankruptcy*, P 341.02[5][g] (Matthew Bender). *But see In re Peres*, 530 F.3d 375 (5th Cir. 2008) (adopting case by case approach, court held that repeated continuances were permitted, when several continuances were requested by debtors and debtors never sought to conclude meeting).

(n3)Footnote 3. *In re Kelton Motors, Inc.*, 121 B.R. 166, 193-95 (Bankr. N.D. Okla. 1990)



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CHAPTER 16 Meeting of Creditors

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P 16.12 Chapter 7 Cases After the Meeting of Creditors

In the typical no-asset bankruptcy, there is little to be done by the debtor's counsel between the creditors' meeting and the discharge. Proceedings already started, such as for lien avoidance or redemption, may continue or such proceedings may be commenced. Amendments to the schedules or statement of affairs may be necessary. If the debtor has not yet taken the personal financial management course, that must ordinarily be done in time to file a certificate of its completion within 45 days of the first date set for the meeting of creditors.ⁿ¹

If there are more than nominal nonexempt assets, of course, they are turned over or their value is paid to the trustee, who will liquidate them.^{n1a} This rarely happens, since those few consumer debtors with nonexempt assets usually opt for chapter 13. However, when this does occur, it is important for the debtor to check to make sure that claims are filed for debts that may be nondischargeable, in order to maximize the amount that is paid toward those debts from the assets of the estate.

MORE INFORMATION

For a brief discussion of chapter 7 asset cases *see* chapter 1 *supra* and chapter 19 *infra* for discussion of claims filed by the debtor.

In some districts, the trustee will file a report to the court as to whether he or she objects to the exemptions claimed or to the discharge of the debtor. The necessity of this report, which was required under a provision of the prior Federal Rules of Bankruptcy Procedure not included in the current Rules, is doubtful since under the Bankruptcy Code the exemptions are self-executing if no objection under section 522 is filed. The trustee, or any creditor who wishes to object to the exemptions claimed, must file such objections in writing and serve them within 30 days after the conclusion of the meeting of creditors or, if later, 30 days after the date of any amendment to the exemptions claimed.ⁿ² Thereafter, there must be a hearing on the objections, at which the objecting party has the burden of proving the exemptions are not properly claimed.

MORE INFORMATION

Objections to exemptions are discussed further in chapter 13 *supra* .

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 1007(c)*.

(n2)Footnote 1a. For further discussion of chapter 7 asset cases *see* Collier Handbook for Trustees and Debtors in Possession (Matthew Bender).

(n3)Footnote 2. *Fed. R. Bankr. P. 4003(b)*.



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CHAPTER 16 Meeting of Creditors

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P 16.13 Chapter 13 Cases After the Meeting of Creditors

In a chapter 13 case, the first meeting of creditors is just the beginning. There will be a hearing on the confirmation of the chapter 13 plan.ⁿ¹ During or after the first meeting, the trustee is required to decide whether to object to any of the claims filed. The debtor may also object to the amount, validity or status of a claim.ⁿ² Ultimately, all these disputes will have to be decided by the bankruptcy judge. Of course, the debtor must perform the obligations imposed by the plan, usually during the applicable commitment period, and take a personal financial management course,ⁿ³ before the case can finally end with a full chapter 13 discharge.

FOOTNOTES:

(n1)Footnote 1. *See* ch. 20 *infra*.

(n2)Footnote 2. *See* ch. 19 *infra*.

(n3)Footnote 3. *11 U.S.C. § 1328(g)*, enacted by Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005.



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CHAPTER 17 Avoiding Powers of the Trustee

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CHAPTER 17 Avoiding Powers of the Trustee

1-17 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the various powers granted to a bankruptcy trustee to avoid certain types of transfers of property from the debtor. The trustee exercises this power for the benefit of the bankruptcy estate and, ultimately, the unsecured creditors. The chapter discusses the trustee's "strong arm" powers under section 544, preference avoidance under section 547, and fraudulent transfer avoidance under section 548, as well as avoidance of certain statutory liens, postpetition transfers, setoffs and tax penalty liens.



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CHAPTER 17 Avoiding Powers of the Trustee

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P 17.01 Introduction

The bankruptcy laws have long empowered the bankruptcy trustee, as representative of the bankruptcy estate, to avoid, *i.e.*, undo or nullify, certain types of transfers of property that have reduced the amount of property that would otherwise be available in the estate for unsecured creditors. The Bankruptcy Code sets forth several types of transfers that the trustee may avoid, transfers that Congress has decided are unfair to other creditors and, as a matter of policy, ought not be allowed to stand. While the rationales for reversing different types of transfers vary, the overall goal of giving the trustee the right to avoid transfers is to distribute property more equitably among the debtor's creditors.

The avoiding powers discussed in this chapter are available to any trustee in bankruptcy, under any chapter of the Bankruptcy Code. However, as a practical matter, they are rarely exercised by chapter 13 trustees.¹¹ In some cases a chapter 13 trustee will file an avoiding power proceeding if the debtor requests it and it will mean greater dividends for unsecured creditors, especially if debtor's counsel offers to help prepare the necessary papers. It may also be possible to provide in a chapter 13 plan for the trustee to bring an avoidance proceeding. In any event, lien or transfer avoidance in a chapter 13 case may be very useful, since the debtor has the right to possession of any property recovered¹² and the proceeding may allow the debtor to redirect funds that are recovered to priority or secured creditors that must be paid in the plan.

Whether a chapter 7 trustee will choose to exercise an avoiding power depends on the relationship between the amount likely to be recovered and the cost of doing so. Since avoiding a lien or other transfer always involves litigation and the hiring of counsel for the trustee, it is rare that a trustee will bother to seek avoidance unless the amount is well over a thousand dollars and, in some places, over several thousand dollars. If the litigation will be complex, the threshold is even higher. Similarly, the trustee has little incentive to seek avoidance of a transfer if the debtor will be able to exempt the property recovered under *section 522(g) of the Bankruptcy Code*.

MORE INFORMATION

¹¹ *U.S.C. § 522(g)* permits the debtor to exempt certain property recovered by a trustee. *See P 18.05 infra*.

PRACTICE NOTE

Beyond knowing how the avoiding powers might be exercised once a bankruptcy case has been filed, it

is important for potential debtors and their creditors to know about those powers for planning and strategic purposes. A debtor may wish to refrain from making a transfer that could be avoided by a trustee, or may wish to wait to file a bankruptcy case after such a transfer until the applicable reach-back period has passed. For example, most preferences can be avoided if they occurred within 90 days prior to a bankruptcy petition, and preferences to relatives or other insiders may be avoided if they occurred within one year before a bankruptcy.ⁿ³ A debtor who has made or wishes to make a repayment that would be classified as a preference may therefore wish to make sure that a bankruptcy is not filed until after the applicable period has run.

Creditors also must be aware of the potential avoidance of transfers they receive. Although the potential for avoidance is rarely a good reason for declining to accept a transfer from the debtor, it may influence when the transfer occurs or how the transfer is structured. For example, because foreclosure sales are usually protected from avoidance as fraudulent transfers under section 548,ⁿ⁴ it may be better to take the debtor's property through a foreclosure sale rather than a deed in lieu of foreclosure. Creditors also must be careful to properly perfect their liens to prevent avoidance in a bankruptcy case.

FOOTNOTES:

(n1)Footnote 1. A few cases have held that a chapter 13 debtor is a type of debtor in possession who may exercise the trustee's avoiding powers without the need to utilize section 522(h), which is discussed in ch. 18 *infra*. *E.g.*, *Houston v. Eiler (In re Cohen)*, 305 B.R. 886 (B.A.P. 9th Cir. 2004) ; *In re Freeman*, 72 B.R. 850 (Bankr. E.D. Va. 1987) . However, this is clearly a minority view. *See also In re Hearn*, 337 B.R. 603 (Bankr. E.D. Mich. 2007) (creditor bound by provision in confirmed plan giving debtor right to exercise trustee's avoiding powers).

(n2)Footnote 2. 11 U.S.C. § 1306(b).

(n3)Footnote 3. *See P 17.05 infra*.

(n4)Footnote 4. *See P 17.06 infra*.



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CHAPTER 17 Avoiding Powers of the Trustee

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P 17.02 Procedure for Use of Trustee's Avoiding Powers

It is the trustee's burden to file a lien or transfer avoidance proceeding; if none is filed, all liens on the debtor's property and all prebankruptcy transfers of the debtor's property will normally survive the bankruptcy.ⁿ¹

[1] Adversary Proceeding Required

The Federal Rules of Bankruptcy Procedure prescribe the procedure to be followed for use of the trustee's avoiding powers. Transfer or lien avoidance by the trustee requires an adversary proceeding initiated by complaint.ⁿ² The procedures to be followed in an adversary proceeding are discussed in chapter 32 of this volume.

FORMS

For forms pertaining to the trustee's avoiding powers see *Collier Consumer Bankruptcy Forms*, Part CS 7 (Matthew Bender).

[2] Right to Jury Trial

At least some avoidance actions carry with them a right to trial by jury. The Supreme Court has made clear that a defendant in a fraudulent conveyance or preference action who has not filed a proof of claim in the bankruptcy case has a right to jury trial that is protected by the *Seventh Amendment*.ⁿ³

[3] Statute of Limitations

Most actions by the trustee to avoid transfers are subject to a statute of limitations.ⁿ⁴ Such actions must be brought within two years of the order for relief (in the case of a voluntary petition, two years from the date the petition is filed) or by the date the case is closed or dismissed, whichever is earlier. The limitations period may be extended beyond two years after the order for relief if the trustee is first appointed or elected within two years of such order for relief. In such cases, actions may be brought within one year of the trustee's appointment or the date the case is closed or dismissed, whichever is earlier. The limitations period may be tolled if the debtor or others conceal material facts necessary to discover the avoidable transfer.ⁿ⁵ The limitations period may also be waived.ⁿ⁶

[4] Relief to Be Obtained

The trustee should be sure to obtain an order giving complete relief, including a requirement that the transferee (usually a creditor) take all steps necessary to reflect the avoidance of the transfer in state and local recording offices, or else an order suitable for filing in those offices by the trustee's counsel. Keep in mind as well that if a separate action is necessary to recover property subsequent to avoidance of a transfer of that property, it must be brought within one year.ⁿ⁷

FOOTNOTES:

(n1)Footnote 1. *Federal Deposit Insurance Corporation v. Davis*, 733 F.2d 1083, 10 C.B.C.2d 1413 (4th Cir. 1984) . But see *Matter of Penrod*, 50 F.3d 459 (7th Cir. 1995) (default rule in chapter 11, based on language of section 1141(c), is that if confirmed plan provides for creditor but is silent about whether creditor retains its lien, that lien is automatically extinguished). The *Penrod* rationale should apply equally in chapter 13 under section 1327(c).

(n2)Footnote 2. *Fed. R. Bankr. P. 7001*.

(n3)Footnote 3. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S. Ct. 2782, 106 L. Ed. 2d 26, 20 C.B.C.2d 1216 (1989) . See 1 *Collier on Bankruptcy*, P 3.08[1] (Matthew Bender).

(n4)Footnote 4. 11 U.S.C. § 546(a). Note that the limitations period does not apply to transfers avoidable under section 549 or section 724(a).

(n5)Footnote 5. See *Olsen v. Zerbetz (In re Olsen)*, 36 F.3d 71 (9th Cir. 1994) (statute could be equitably tolled due to debtors' conduct failing to comply with duty to cooperate with trustee).

(n6)Footnote 6. *Pugh v. Brook (In re Pugh)*, 158 F.3d 530 (11th Cir. 1998) .

(n7)Footnote 7. 11 U.S.C. § 550(f). See P 17.11 *infra*.



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CHAPTER 17 Avoiding Powers of the Trustee

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P 17.03 The "Strong Arm Clause;" § 544

Through the use of section 544, the trustee is able to avoid a wide variety of transfers. Section 544(a) allows the trustee to avoid any transfer or obligation incurred by the debtor that is voidable by:

- a creditor that extends credit to the debtor at the time of commencement of the case, and that obtains at that time and with respect to such credit a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;
- a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or
- a bona fide purchaser of real property other than fixtures from the debtor against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

In addition, section 544(b) bestows the power to avoid any transfer or obligation that is avoidable under applicable law by an actually existing creditor holding an unsecured claim.

All of these rights depend on the powers given to creditors or purchasers under state or local law. They make clear that the first three powers, relating to a "hypothetical" creditor, rather than actual existing creditors, assume that the hypothetical creditor had no knowledge of the transfer, to the extent that knowledge might otherwise bar the avoidance of a transfer.ⁿ¹

The most frequent use of the section 544(a) powers in the past was the avoidance of unrecorded security interests and other liens. Such liens are generally considered unfair to other creditors because the lack of recording conceals the fact that the debtor's assets are less than they appear. *Section 9-301(1)(b) of the Uniform Commercial Code* gives a lien creditor priority over the holder of an unperfected UCC security interest.

PRACTICE NOTE

A close examination of the nature and manner of perfection of a creditor's security interest may turn up avoidable transfers. In many cases trustees have successfully asserted these rights when financing statements were incorrectly filed,ⁿ² thus rendering the security interest unperfected, or when a transaction denominated as a lease was found to be a disguised security interest with no financing statement filed. Similarly, the law in most states gives judicial lien creditors and bona fide purchasers priority over unrecorded or improperly recorded mortgages and many other unrecorded liens on real estate.ⁿ³

The "bona fide purchaser" power also allows the cutoff of other rights (in real property only), such as equities created by fraud, unperfected or constructive trusts,ⁿ⁴ and in most states, unrecorded deeds. In such proceedings, most often, one issue is whether the trustee can be considered a bona fide purchaser or whether he or she must be deemed to have constructive notice.ⁿ⁵

Under section 544(b) certain other transfers may also be totally avoided, if they could have been avoided, even in part, by an actually existing unsecured creditor.ⁿ⁶ This provision allows the trustee to make use of applicable state laws to avoid fraudulent conveyances, bulk transfers in which the notices required by *Article 6 of the Uniform Commercial Code* were not given, and other types of transfers avoidable under state law by existing creditors.ⁿ⁷

The section 544(b) power is most often used to attempt avoidance through incorporation of state fraudulent transfer laws. In a few states, this means the Uniform Fraudulent Conveyance Act (UFCA). Most others have adopted the Uniform Fraudulent Transfer Act (UFTA). Still other states have varying case law derived from the old English Statute of 13 Elizabeth.

However, in 1998 Congress enacted a restriction on the trustee's right to use state fraudulent transfer laws, and indeed upon creditors' rights to use such laws outside of bankruptcy, to recover religious or charitable contributions of the debtor. The Religious Liberty and Charitable Donation Protection Act of 1998ⁿ⁸ amended section 544(b) to provide that charitable contributionsⁿ⁹ to qualified religious or charitable entities or organizations,ⁿ¹⁰ that are protected from avoidance under section 548, as amended by the same Act, are also protected from avoidance under section 544 and under state law.ⁿ¹¹ As discussed below,ⁿ¹² section 548(a)(2) protects from avoidance religious or charitable contributions within the year prior to the bankruptcy of up to 15% of the debtor's gross income in the year they were made, or even more if consistent with past giving. Under the language of the provision, the 15 percent limit applies to each transfer individually, even if the aggregate in a single year exceeds 15 percent.

FORMS

For sample forms pertaining to the section 544 strong arm clause see *Collier Consumer Bankruptcy Forms*, § CS7.02-. 04 (Matthew Bender).

FOOTNOTES:

(n1)Footnote 1. See 5 *Collier on Bankruptcy*, P 544.03 (Matthew Bender).

(n2)Footnote 2. See *Boyd v. Chase Manhattan Mort. Corp.* (*In re Kroskie*), 315 F.3d 644 (6th Cir. 2003) (security interest not properly perfected under state mobile home law is avoidable).

(n3)Footnote 3. See 5 *Collier on Bankruptcy*, P 544.05,. 08 (Matthew Bender); *Simon v. Chase Manhattan Bank (In re Zaptocky)*, 250 F.3d 1020 (6th Cir. 2001) (improperly witnessed mortgage could be avoided).

(n4)Footnote 4. See 5 *Collier on Bankruptcy*, P 544.04 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 544.04 (Matthew Bender).

(n5)Footnote 5. *E.g., In re Probasco*, 839 F.2d 1352, 18 C.B.C.2d 523 (9th Cir. 1988) ; *McCannon v. Marston*, 679 F.2d 13, 6 C.B.C.2d 875 (3d Cir. 1982) .

(n6)Footnote 6. The principle, adopted in the Code, that if a transfer could be avoided by any creditor it could be avoided by the trustee *in toto*, regardless of how small the actual creditor's claim, is known as the rule of *Moore v. Bay*, 284 U.S. 4, 52 S. Ct. 3, 76 L. Ed. 133 (1931) , the Supreme Court case which first announced it.

(n7)Footnote 7. *See* 5 *Collier on Bankruptcy*, P 544.09 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 544.09 (Matthew Bender).

(n8)Footnote 8. Pub. L. No. 105-183, 112 Stat. 517 (1998), *reprinted in* Vol. F *Collier on Bankruptcy*, App. Pt. 41(o)(ii) (Matthew Bender), applicable to cases pending on or after June 19, 1998.

(n9)Footnote 9. The "charitable contribution" must meet the definition in section 548(d)(3), as amended by the same Act, and thus must consist of either a financial instrument or cash.

(n10)Footnote 10. Section 544(b) incorporates section 548(a)(2), which incorporates the definition of "qualified religious or charitable entity or organization" in section 548(d)(4), requiring the recipient of the contribution to be an entity described in *section 170(c)(1) or 170(c)(2) of the Internal Revenue Code*.

(n11)Footnote 11. 11 U.S.C. § 544(b)(2).

(n12)Footnote 12. *See* P 17.06 *infra*.



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CHAPTER 17 Avoiding Powers of the Trustee

1-17 Collier Consumer Bankruptcy Practice Guide P 17.04

P 17.04 Statutory liens; § 545

Under section 545, certain statutory liens may be avoided. These include any lien that first becomes effective upon insolvency or insolvency proceedings of various types, liens which could be defeated by a bona fide purchaser on the date of commencement of the case (except for a purchaser described in 6323 of the *Internal Revenue Code*, or similar provision under state or local law), liens for rent and liens of distress for rent. Such liens may be avoided even if they have already been enforced by a sale before the filing of the bankruptcy case.ⁿ¹

For cases filed prior to the effective date of the 2005 amendments, section 545 was sometimes used to avoid unfiled federal tax liens and, in certain cases, even recorded tax liens.ⁿ² However, amended section 545,ⁿ³ eliminates this possibility by excepting from the bona fide purchaser rule a purchaser described in *section 6323 of the Internal Revenue Code*, or similar provision of state or local law.ⁿ⁴ The trustee continues to be able to use section 545 in states where landlords' liens and distress for used in cases involving mechanics' liens, innkeepers' liens, and other statutory liens, to the extent those liens are subject to the rights of bona fide purchasers under state law. However, it should be noted that statutory liens may lose their character as statutory liens in some states if they are reduced to judgment, and thus become immunized to attack. On the other hand, if the lien becomes effective only upon recordation, it may not be a statutory lien at all, but rather a judicial lien, since it does not arise solely by force of a statute.ⁿ⁵ In addition, trustees are likely to use section 545 in states where landlords' liens and distress for rent are common.ⁿ⁶

FORMS

For a sample complaint to avoid a statutory lien see *Collier Consumer Bankruptcy Forms, Form CS7.12-1* (Matthew Bender).

FOOTNOTES:

(n1)Footnote 1. H.R. Rep. No. 595, 95th Cong., 1st Sess. 371 (1977), *reprinted in* Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender).

(n2)Footnote 2. See 5 *Collier on Bankruptcy*, P 545.03[4] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 544.03[4] (Matthew Bender). Such liens may also be avoidable under section 544(a). *But see In re Berg*, 121 F.3d 535, 38 C.B.C.2d 836 (9th Cir. 1997) (trustee not entitled to bona fide purchaser status and could not avoid tax lien); *In re Janssen*, 38 C.B.C.2d 1574, 213 B.R. 558 (B.A.P. 8th Cir. 1997) (same).

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. *11 U.S.C. 545(2)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. *See 11 U.S.C. § 101(53)* defining "statutory lien."

(n6)Footnote 6.

Reiter v. Fokkena (In re Wedemeier), 237 F.3d 938 (8th Cir. 2001) (avoidance of landlord's lien). *See 5 Collier on Bankruptcy*, P 545.04 (Matthew Bender); *2 Collier Bankruptcy Manual*, P 545.04 (Matthew Bender).



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CHAPTER 17 Avoiding Powers of the Trustee

1-17 Collier Consumer Bankruptcy Practice Guide P 17.05

P 17.05 Preferences; § 547

By far the most frequently used trustee avoiding power is the power to avoid preferences, codified in 11 U.S.C. § 547. With certain exceptions, set forth in section 547(c), 547(h) and 547(i), the trustee may avoid any transfer of property of the debtor:

- to or for the benefit of a creditor;n1
- for or on account of an antecedent debt owed by the debtor before such transfer was made;
- made while the debtor was insolvent;n2
- made
 - (A) on or within 90 days before the date of filing of the petitionn3 or
 - (B) between 90 days and one year before the date of filing of the petition, if such creditor, at the time of such transfer was an insider;n4 and
- that enables such creditor to receive more than such creditor would receive if
 - (A) the case were a case under chapter 7 of the 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 Code.

The basic purpose of this section is to promote equality among creditors by invalidating prebankruptcy seizures or transfers of the debtor's property that would give particular creditors more than they would receive in a chapter 7 liquidation. But the fact that the debtor might have been able to exempt the property is not a defense to a preference

action.ⁿ⁵ The power to avoid preferences also serves to deter creditors from engaging in a race to get at the debtor's property before bankruptcy, since they know that if they do obtain the property and perhaps hasten a bankruptcy, they will only have to surrender it to a trustee exercising the power to avoid preferences.ⁿ⁶

The first issue in preference analysis is, of course, whether property of the debtor has been transferred at all. In some cases the debtor may merely be transferring property held in trust for others.ⁿ⁷ But if a party owing a debt to the debtor, as part of a transaction involving the debtor, pays that debt to a creditor of the debtor at the debtor's request, there has been a transfer of the debtor's property.ⁿ⁸ And if a debtor borrows money from one creditor and chooses to use it to pay another, the debtor has transferred her own property. Thus, several appellate courts have held that balance transfers can be avoided because the debtor exercised dominion over the funds by choosing which creditor to repay.^{n8a}

In addition, all of the elements listed above must be present for a transfer to be considered a preference. Thus, if a validly secured creditor, with a security interest not otherwise avoidable, repossesses property worth less than the amount of the secured debt, no preference exists since that creditor would have had a right to that property or its full value in a liquidation.ⁿ⁹ But if an unsecured or partially secured creditor receives a payment on the debt within 90 days, that payment probably is a preference, since it will presumably be applied to that portion of the debt which is unsecured, and will allow the secured creditor to receive more than the total it would otherwise receive in a liquidation.ⁿ¹⁰ If property is transferred in exchange for a new debt, rather than an antecedent debt, no preference exists, nor does one exist if the property the creditor receives belongs to someone other than the debtor, such as a comaker, or such as money that passes through the debtor's hands but is "earmarked" solely for payment to the creditor.ⁿ¹¹ Of course, a transfer outside the specified time periods cannot be a preference; section 547(e) sets forth rules for determining the date a transfer is deemed to have occurred.ⁿ¹²

FORMS

For sample forms pertaining to avoidance of preferential transfers see *Collier Consumer Bankruptcy Forms*, § CS7.21-. 24 (Matthew Bender).

[1] Exceptions to Preference Avoiding Power

The major exceptions to the preference section are listed in section 547(c). The creditor has the burden of establishing that it falls within one of the exceptions.ⁿ¹³ Sections 547(h) and 547(i), added in 2005,ⁿ¹⁴ also limit the trustee's preference avoiding power.

The first exception under section 547(c) is for exchanges that are intended to be and are in fact "substantially contemporaneous" exchanges for new value, *e.g.*, cash purchases, purchases paid for immediately by check, or security interests securing new value.ⁿ¹⁵ The Bankruptcy Code does not define "substantially contemporaneous." The court may look to the intent of the parties to determine whether an "exchange" has taken place. Also excepted are transfers made prior to the debtor's receipt of new value from the creditor, as long as the creditor obtained no other nonavoidable security for the new value.ⁿ¹⁶

Similarly, payments on debts incurred in the ordinary course of business or financial affairs of the debtor and transferee are excepted.ⁿ¹⁷ To be within the ordinary course of business, the payments must be ordinary in relation to other business dealings between creditor and debtor or made according to ordinary business terms.ⁿ¹⁸ Some courts have further concluded that late payments may be considered within the ordinary course of business if they are consistent with the pattern of prior payments and within the range of ordinary practices of similar firms. This includes most payments for current utility services, goods bought with payment due in 30 days, and most charge accounts. Unusually late payments are not excepted, however. Payments made pursuant to settlement agreements have been found to be outside the ordinary course of a debtor's business.ⁿ¹⁹ Nor may a payment following a special or unusual request by a creditor for payment be considered to be within the ordinary course of business.ⁿ²⁰ It is not clear whether a major loan

of a type incurred only once or a few times in a debtor's lifetime would be considered to be in the ordinary course of the debtor's financial affairs.ⁿ²¹ The "ordinary course" language may also open the door to challenges of fraudulent or unfair transactions in which security interests are taken in the debtor's property, or loans and refinancings prompted by extraordinary factors in the debtor's situation.

Certain security interests created within 90 days are also excluded from the preference category. These are:

- security interests that secure new value given by the secured party to enable the debtor to acquire property and used by the debtor for that purpose, if perfected within 30 days after the debtor receives possession of the property;ⁿ²²
- security interests in inventory or receivables, to some extent;ⁿ²³ and
- statutory liens that are not avoidable under section 545.ⁿ²⁴

Under section 547(c)(7), amended in 2005,ⁿ²⁵ a preference also may not be avoided if the transfer was a bona fide payment of a debt for a domestic support obligation. It clear that the exception in section 547(c)(7) now includes debts for a domestic support obligation that have been assigned to another entity.ⁿ²⁶

Section 547(c)(8) limits the avoidance power of the trustee if the preference or preferences total less than \$600 to a single creditor and the debtor has primarily consumer debts.ⁿ²⁷ This provision, undoubtedly directed at preference actions against loan companies and utilities, reduces the number of preferences avoidable by debtors under section 522(h).

PRACTICE NOTE

The exception does not, however, allow a creditor receiving an avoided preference to retain the initial \$599.99.ⁿ²⁸ It also does not shield particular transfers under \$600 if the aggregate of all transfers to a creditor is at least \$600.ⁿ²⁹ It is important to note, moreover, that it applies only to section 547, and not to any of the other avoiding powers.

The 2005 amendments to the Bankruptcy Code³⁰ created several additional limitations on the avoidance of preferences. Under section 547(c)(9), a trustee may not avoid a transfer in a case filed by a debtor who is not a consumer debtor if the transfer is less than \$5,475.ⁿ³¹ Section 547(h) provides that a trustee may not avoid a transfer made as part of an alternative repayment schedule between the debtor and creditor created by an approved nonprofit budget and credit counseling agency. And, section 547(i) excepts from the trustee's preference avoiding power certain transfers for the benefit of creditors who are insiders.

FOOTNOTES:

(n1)Footnote 1. The benefit may be indirect, as when a guarantor benefits from the payment of a debt of the debtor which he or she guaranteed. Because the guarantor would normally have a contingent claim against the debtor for contribution or indemnification in the event the guarantor ultimately paid the debt, the guarantor is a creditor who benefits from the transfer and has therefore received a preference. *See 5 Collier on Bankruptcy, P 547.03[3][a]* (Matthew Bender); *2 Collier Bankruptcy Manual, P 547.03[3][a]* (Matthew Bender).

(n2)Footnote 2. "Insolvent" is defined in *11 U.S.C. § 101(32)* in a way that would include virtually all low-income debtors. Under that definition a debtor is solvent only if his or her assets exclusive of exempt property exceed his or her obligations. Under *11 U.S.C. § 547(f)* there is a rebuttable presumption that the debtor was insolvent during the 90 days prior to filing a case.

(n3)Footnote 3. See 5 *Collier on Bankruptcy*, P 547.03[6] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.03[6] (Matthew Bender). The period is not extended just because the final day for filing falls on a weekend or holiday. *In re Greene*, 223 F.3d 1064 (9th Cir. 2000). The Code provides that a transfer is perfected only when a bona fide purchaser from the debtor of real property or a judicial lien creditor on a simple contract for personal property or fixtures cannot acquire an interest superior to the trustee. 11 U.S.C. § 547(e). Thus, a transfer of a security interest normally occurs only when it has been perfected. See 5 *Collier on Bankruptcy*, P 547.05 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.05 (Matthew Bender). But a belated perfection of a security interest may be deemed under state law to relate back to the date it was granted. E.g. U.C.C. §§ 9-301(d)(2), 9-304(4)(b) and 9-304(5). For purposes of this section, a transfer made by check is deemed made when the check is honored. *Barnhill v. Johnson*, 503 U.S. 393, 112 S. Ct. 1386, 118 L. Ed. 2d 39, 26 C.B.C.2d 323 (1992).

(n4)Footnote 4. "Insider" is defined at section 101(31) to include relatives of the debtor. "Relative" is defined at section 101(45). See *In re Suffola, Inc.*, 2 F.3d 977, 29 C.B.C.2d 984 (9th Cir. 1993) (payment to outside creditor on debt guaranteed by insider was a payment for the benefit of the insider). The results, but not the reasoning, of such cases were overruled by a 1994 amendment creating a new section 550(c), which prohibits recovery of money or property transferred through insider preferences made more than 90 days before the petition from anyone other than the insider creditor who was preferred. However, this amendment does not prevent recovery from a noninsider when an insider was preferred during the 90 days prepetition, nor does it prevent avoidance of the transfer without an affirmative recovery, which may be all that is necessary if, for example, the transfer was the granting of a lien on property.

(n5)Footnote 5. *In re Noblit*, 72 F.3d 757 (9th Cir. 1995).

(n6)Footnote 6. H.R. Rep. No. 595, 95th Cong., 1st Sess. 177-178 (1977), reprinted in Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender).

(n7)Footnote 7. *Bejier v. Internal Revenue Service*, 496 U.S. 53, 110 S. Ct. 2258, 110 L. Ed. 2d 46 (1990) (excise taxes which are supposed to be held by businesses in trust for the IRS are trust property of the IRS regardless of whether they are held in the debtor's general account; therefore payments of those funds to the IRS cannot be preferential even if made within 90 days of the debtor's bankruptcy). See 5 *Collier on Bankruptcy*, P 547.03[2] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.03[2] (Matthew Bender).

(n8)Footnote 8. *In re Interior Wood Products*, 986 F.2d 228 (8th Cir. 1993) (payment to unsecured creditor by purchaser of debtor's assets was a preference); *In re Food Catering & Housing, Inc.*, 971 F.2d 396 (9th Cir. 1992) (same).

(n9)Footnote 8a. *In re Egidi*, 571 F.3d 1156 (11th Cir. 2009); *In re Dilworth*, 560 F.3d 562 (6th Cir. 2009); *In re Marshall*, 550 F.3d 1251, 1255 (10th Cir. 2008).

(n10)Footnote 9. However, a security interest does not insulate a payment from being a preference if the security interest is in property owned by an entity other than the debtor, since that security interest would not provide better treatment for the creditor in the distribution of the debtor's assets. *In re Virginia-Carolina Financial Corp.*, 954 F.2d 193, 26 C.B.C.2d 279 (4th Cir. 1992).

(n11)Footnote 10. See 5 *Collier on Bankruptcy*, P 547.03[7] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.03[7] (Matthew Bender).

(n12)Footnote 11. *Brown v. First Nat'l Bank of Little Rock*, 748 F.2d 490 (8th Cir. 1984). But see *In re Bohlen Enterprises, Ltd.*, 859 F.2d 561, 19 C.B.C.2d 986 (8th Cir. 1988) (for earmarking doctrine to apply to funds lent to debtor to pay off an antecedent debt and thereby save payment from preference avoidance, debtor must have no control over the use of the nondebtor transferor's funds); *In re Hartley*, 825 F.2d 1067, 17 C.B.C.2d 550 (6th Cir. 1987) (debtor's transfer of security interest to third party who paid debtor's antecedent debt was a preference). One court has also held that no preference exists to the extent a creditor is paid more than the amount of its claim. *In re Cohen*, 875

F.2d 508, 21 C.B.C.2d 554 (5th Cir. 1989) . Presumably, however, a fraudulent transfer has occurred. *Id.* See P 17.06 *infra*.

(n13)Footnote 12. See 5 *Collier on Bankruptcy*, P 547.05 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.05 (Matthew Bender).

(n14)Footnote 13. See 5 *Collier on Bankruptcy*, P 547.04 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.04 (Matthew Bender).

(n15)Footnote 14. 11 U.S.C. § 547(h), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005; 11 U.S.C. 547(i), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases pending or commenced on or after April 20, 2005.

(n16)Footnote 15. 11 U.S.C. § 547(c)(1). See 5 *Collier on Bankruptcy*, P 547.04[1] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.04[1] (Matthew Bender).

(n17)Footnote 16. 11 U.S.C. § 547(c)(4). To assert this defense, the new value for each transfer must be given after the transfer that the debtor seeks to avoid. See 5 *Collier on Bankruptcy*, P 547.04[4] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.04[4] (Matthew Bender).

(n18)Footnote 17. 11 U.S.C. § 547(c)(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Section 547(c)(2) applies equally to long-term and short-term debt. *Union Bank v. Wolas*, 502 U.S. 151, 112 S. Ct. 527, 116 L. Ed. 2d 514, 25 C.B.C.2d 1011 (1991) .

(n19)Footnote 18. See 5 *Collier on Bankruptcy*, P 547.04[2][a] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.04[2][a] (Matthew Bender).

(n20)Footnote 19. *In re Richardson*, 94 B.R. 56 (Bankr. E.D. Pa. 1988) (public housing tenants' payment made pursuant to settlement of eviction action found to be an avoidable preference).

(n21)Footnote 20. See, e.g., *Matter of Seawinds, Ltd.*, 888 F.2d 640 (9th Cir. 1989) (payments made under creditor pressure not within ordinary course).

(n22)Footnote 21. *In re Finn*, 86 B.R. 902 (Bankr. E.D. Mich. 1988) (long-term loan is not within the debtor's ordinary course of business), *rev'd* 909 F.2d 903 (6th Cir. 1990) (incurring long-term consumer debt may be in ordinary course of debtor's affairs, depending upon the facts of the case). See also *Union Bank v. Wolas*, 502 U.S. 151, 112 S. Ct. 527, 116 L. Ed. 2d 514, 25 C.B.C.2d 1011 (1991) (section 547(c)(2) applies to long-term debt).

(n23)Footnote 22. 11 U.S.C. § 547(c)(3), amended in 2005, Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See 5 *Collier on Bankruptcy*, P 547.04[3] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.04[3] (Matthew Bender). See also *Fidelity Financial Services Inc. v. Fink*, 522 U.S. 211, 118 S. Ct. 651, 139 L. Ed. 2d 571, 38 C.B.C.2d 1155 (1998) (time period in Code takes precedence over longer perfection period in state law). But see *In re Dorholt, Inc.*, 224 F.3d 871 (8th Cir. 2000) (transfer of security interest can be substantially contemporaneous even if security interest not perfected within time period allowed for relation back under different Code provision). The time period for perfection was changed from 10 days to 20 days by the 1994 amendments to the Code.

(n24)Footnote 23. 11 U.S.C. § 547(c)(5). See 5 *Collier on Bankruptcy*, P 547.04[5] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.04[5] (Matthew Bender).

(n25)Footnote 24. 11 U.S.C. § 547(c)(6). *In re Lionel Corp.*, 29 F.3d 88, 31 C.B.C.2d 1090 (2d Cir. 1994) (mechanic's lien could not be avoided under section 547). See 5 *Collier on Bankruptcy*, P 547.04[6] (Matthew Bender);

2 *Collier Bankruptcy Manual*, P 547.04[6] (Matthew Bender).

(n26)Footnote 25. Pub. L. No. 109-8 (2005). Amendments to section 547, except 547(i) are effective with respect to cases filed on or after October 17, 2005.

(n27)Footnote 26. Under the previous version of section 547(c)(7), the exception to the preference avoiding power did not apply to debts in the nature of alimony, maintenance, or support to spouse, former spouse, or child of the debtor that had been assigned to a governmental unit or any other entity.

(n28)Footnote 27. 11 U.S.C. § 547(c)(8). See 5 *Collier on Bankruptcy*, P 547.04[8] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 547.04[8] (Matthew Bender).

(n29)Footnote 28. *In re Via*, 22 C.B.C.2d 62, 107 B.R. 91 (Bankr. W.D. Va. 1989) ; *In re Vickery*, 63 B.R. 222 (Bankr. E.D. Tenn. 1986) .

(n30)Footnote 29. *In re Hailes*, 77 F.3d 873 (5th Cir. 1996) .

(n31)Footnote 30. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n32)Footnote 31. For cases filed prior to April 1, 2007, the amount is \$5,000. The amount is adjusted for inflation every three years pursuant to 11 U.S.C. § 104(b).



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CHAPTER 17 Avoiding Powers of the Trustee

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P 17.06 Fraudulent Transfers; § 548

Besides the power to avoid transfers fraudulent under state law that is bestowed upon the trustee through section 544, the Code also contains its own fraudulent transfer avoidance power, in section 548.n1

Under the Code's definition, the trustee may avoid a transfer or obligation if the transfer or obligation was made or incurred within two years² before the case was filed and:

(1)

(A) the transfer or obligation was made or incurred with actual intent to hinder, delay or defraud any entity to which the debtor was or became indebted, on or after the date that the transfer occurred or obligation was incurred; or

(B)

(i) the debtor received less than a reasonably equivalent value for the transfer or obligation and

(ii)

(I) the debtor was insolvent³ on the date of the transfer or obligation or became insolvent as a result of the transfer or obligation; or

(II) the debtor was engaged in business or was about to engage in a business or transaction with unreasonably small capital; or

(II) the debtor was engaged in business or was about to engage in a business or transaction with unreasonably small capital; or

(II) the debtor was engaged in business or was about to engage in a business or transaction with unreasonably small capital; or

(IV) the debtor made a transfer to or for the benefit of an insider or incurred an

obligation to or for the benefit of an insider under an employment contract and not in the ordinary course of business.

Additionally, under section 548(e), enacted in 2005,ⁿ⁴ the trustee may avoid certain transfers of the debtor's interest in property to a self-settled trust, or similar device, that was made within 10 years before the date of filing the petition.ⁿ⁵

FORMS

For sample forms pertaining to avoiding fraudulent transfers see *Collier Consumer Bankruptcy Forms*, § CS7.32-. 34 (Matthew Bender).

[1] Transfers Intended to Hinder or Defraud Creditors

Since debtors rarely admit that they have transferred property with the intent to defraud or hinder their creditors, courts applying section 548(a)(1)(A), pertaining to intentional fraudulent transfers, have looked to various indicia of fraudulent intent, sometimes called badges of fraud.ⁿ⁶ Although a single badge of fraud may spur suspicion of fraudulent intent, confluence of several badges can be conclusive evidence of actual intent to defraud.ⁿ⁷

FORMS

For a sample complaint to avoid a transfer under section 548(a)(1)(A), see *Collier Consumer Bankruptcy Forms*, Form CS7.32-1 (Matthew Bender).

[2] Transfers Deemed Fraudulent Regardless of Intent

The most important of these provisions for consumer debtors is section 548(a)(1)(B),ⁿ⁸ which classifies as fraudulent any transfer that occurred within two years preceding the petition for less than reasonably equivalent value while the debtor was insolvent.ⁿ⁹ For cases filed on or before April 20, 2006, section 548(a) applies only to transfers that occurred within one year preceding the filing of the petition.ⁿ¹⁰ This subsection is designed to bring property into the estate that the debtor gave away or otherwise conveyed without receiving fair payment for it. Since most consumer debtors are insolvent under the Code's definition in section 101(32), this section allows the trustee to avoid any transfer (as transfer is broadly defined in section 101(54)) within the previous two yearsⁿ¹¹ which was for less than reasonably equivalent value.

Occasionally, consumer debtors, or their friends or relatives, may face the trustee's use of this avoiding power to undo transfers debtors have made during the two years preceding bankruptcy.ⁿ¹² Sometimes, a threshold question is whether a transfer of the debtor's property has occurred at all.ⁿ¹³ Courts have considered, with varying results, whether charitable contributions are fraudulent transfers under this section.ⁿ¹⁴ And trustees have also attempted to avoid transfers for gambling losses as transfers made without reasonably equivalent value in exchange.ⁿ¹⁵

Because some courts had allowed trustees to set aside religious contributions as transfers without adequate consideration, in 1998 Congress amended section 548 to specifically protect most religious or charitable contributions from avoidance by the trustee.ⁿ¹⁶ Such contributions are protected if they did not exceed 15% of the debtor's gross income in the year they were made or, if they were greater than that amount, were consistent with past giving practices of the debtor.ⁿ¹⁷ Under the language of the provision, the 15 percent limit applies to each transfer individually, even if the aggregate in a single year exceeds 15 percent. However, some courts have held that if the contribution does not fall within the statutory language no part of the contribution is protected.ⁿ¹⁸ Section 548(d)(3) defines "charitable contribution" as a contribution made by a natural person consisting of cash or a financial instrument, and section 548(d)(4) defines "qualified religious or charitable entity or organization" as an entity described in section 170(c)(1) or 170(c)(2) of the *Internal Revenue Code*.

A common use of the fraudulent transfer avoiding power in the past was to avoid transfers such as mortgage foreclosures, tax sales, repossessions or execution sales where the property in question was worth significantly more than the value received for it.ⁿ¹⁹ Despite seemingly clear language in the statute supporting such use, the Supreme Court held in *BFP v. Resolution Trust Corporation*,ⁿ²⁰ that a regularly conducted, noncollusive foreclosure sale could not be avoided under section 548. The court's holding appears to also preclude use of section 548 in cases where secured creditors sell property at public auctions pursuant to *Article 9 of the Uniform Commercial Code*, but should leave open the possibility of challenging a private sale or a strict foreclosure pursuant to the provisions of that Article.ⁿ²¹ Obviously, the Court's ruling also leaves open the possibility of using section 548 to avoid transfers pursuant to foreclosure sales that were not regularly conducted or that were collusive.

In the *BFP* opinion, the Supreme Court expressly limited its holding to mortgage foreclosures of real estate, stating that "the considerations bearing on other foreclosures and forced sales (to satisfy tax liens, for example) may be different."ⁿ²² For tax foreclosures which do not involve a formal sale of the property (*i.e.*, where the purchaser obtains a lien or a certificate rather than an actual deed), the *BFP* analysis should not be relevant.ⁿ²³ Typically, the purchaser of a tax lien pays only the amount of delinquent taxes, an amount which bears no relationship to the value of the property. For this reason, there is no logical basis on which to conclude that the tax lien purchase price is a "reasonably equivalent value."

Other creative uses of section 548, such as to avoid forfeitures under real estate sale agreements,ⁿ²⁴ real estate installment sales contracts,ⁿ²⁵ pawnbroker agreements,ⁿ²⁶ including automobile title pawns,ⁿ²⁷ or extortionate charges under consumer contracts, should also be considered. For example, large check cashing fees or loan broker charges might be challenged as fraudulent transfers. Similarly, the grant of a mortgage or other security interest by a cosigner or accommodation party who received no consideration in a transaction may be challenged, since only the value that the debtor received should be considered relevant under section 548.

FORMS

For a sample complaint to avoid a transfer under section 548(a)(1)(B), see *Collier Consumer Bankruptcy Forms, Form CS7.33-1* (Matthew Bender).

[3] Protection for Good Faith Purchasers for Value

A major limitation on the use of section 548 should be noted, however. Under subsection 548(c), if a transfer is avoidable only under section 548, any transferee who takes for value and in good faith is given a lien on the interest transferred or may enforce the obligation incurred to the extent of the value given to the debtor.ⁿ²⁸

PRACTICE NOTE

Several issues may arise where section 548(c) is invoked. The most important issue is probably that of good faith, since the subsection can only be invoked by a good-faith transferee. In many cases the transferee is the creditor or a party closely connected with the creditor. If the transferee knew of the debtor's insolvency, or even had reason to inquire into the financial straits of the debtor, good faith may be found lacking, especially if the value given was grossly inadequate.ⁿ²⁹ Other problems may include a determination of how much value was given to the debtor if the amount of the debt was in dispute. Since the lien is measured by value given to the debtor, it seems fairly clear that costs incurred in the process of transfer should not be included in this figure.ⁿ³⁰

[4] Asset Protection Trusts

Under new section 548(e)(1), enacted in 2005,ⁿ³¹ a trustee can avoid the debtor's transfer in an interest in property

made within 10 years of the filing if the transfer was made to a self-settled trust, or similar device, by the debtor for the benefit of the debtor and the transfer was made with the actual intent to hinder, delay or defraud any entity to which obvious debtor was or became indebted to after the date of the transfer. As with section 548(a)(1)(A), courts are likely to look to various indicia of fraudulent intent to determine whether the debtor had "actual intent to hinder, delay or defraud" creditors.ⁿ³² Section 548(e)(2), also enacted in 2005,ⁿ³³ defines transfers for purpose of section 548(e) to include transfers made in anticipation of civil or criminal liability under state or federal securities laws.

Section 548(e) was enacted in response to the use of self-settled spendthrift trusts, also known as asset protection trusts, that allowed debtors to shelter assets from creditors while still enjoying the benefits of the assets. While it is apparent that Congress intended to limit the use of these self-settled trusts, it is unclear what it meant by a "similar device." The term "similar device" is not defined anywhere in the Code and there is uncertainty as to whether such term will encompass trusts in which the debtor has a limited interest or certain insurance products.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 548*, as amended by Pub. L. No. 109-8 (2005). Amendments to section 548, except the change in the reach back period from one to two years and the new ability to avoid certain insider transfers under employment contracts, are effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. *11 U.S.C. § 548(a)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed after April 20, 2006.

(n3)Footnote 3. It should be remembered that insolvency is defined at *11 U.S.C. § 101(32)* as something other than normal balance sheet insolvency. In determining whether a debtor is insolvent, the liability on a contingent debt, such as a guarantee, is computed by multiplying the amount of the debt by the probability that the debtor would have to pay it. *Covey v. Commercial Nat'l Bank of Peoria*, 960 F.2d 657 (7th Cir. 1992).

(n4)Footnote 4. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. *See P 17.06[4] infra.*

(n6)Footnote 6. *See 5 Collier on Bankruptcy*, P 548.04 (Matthew Bender); *2 Collier Bankruptcy Manual*, P 548.04 (Matthew Bender).

(n7)Footnote 7. *Max Sugarman Funeral Home Inc. v. A.D.B. Investors*, 926 F.2d 1248, 24 C.B.C.2d 1414 (1st Cir. 1991).

(n8)Footnote 8. Section 548(a)(1)(B), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 9. *See 5 Collier on Bankruptcy*, P 548.05 (Matthew Bender); *2 Collier Bankruptcy Manual*, P 548.05 (Matthew Bender).

(n10)Footnote 10. *11 U.S.C. § 548(a)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed after April 20, 2006.

(n11)Footnote 11. Section 548(d)(1) governs how the two years is calculated. *See 5 Collier on Bankruptcy*, P 548.02[2] (Matthew Bender); *2 Collier Bankruptcy Manual*, P 548.02[2] (Matthew Bender).

(n12)Footnote 12. *See, e.g., In re Bledsoe*, 569 F.3d 1106 (9th Cir. 2009) (transfer by judgement in regularly conducted dissolution proceeding conclusively presumed to be for reasonably equivalent value); *In re Erlewine*, 349 F.3d 205, 212 (5th Cir. Tex. 2003) (same); *In re Roosevelt*, 220 F.3d 1032 (9th Cir. 2000) (trustee permitted to avoid transfer of property pursuant to marital settlement agreement because wife's relinquishment of community property

income in debtor's professional education not considered value under section 548). *Butler v. NationsBank*, 58 F.3d 1022 (4th Cir. 1995) (trustee permitted to recover payment made by debtor to satisfy her husband's debt).

(n13)Footnote 13. See *In re Atchison*, 925 F.2d 209, 24 C.B.C.2d 1428 (7th Cir. 1991) (no transfer occurs under state law when debtor disclaims inheritance). But see *In re Green*, 986 F.2d 145 (6th Cir. 1993) (in unusual situation of debtor who, having a contractual right to receive property under a will, agreed to give up that right, the exercise of a power of appointment to terminate the debtor's rights under a will was found to be a fraudulent transfer).

(n14)Footnote 14. See *In re Young*, 82 F.3d 1407, 36 C.B.C.2d 163 (10th Cir. 1996) , remanded for consideration in light of subsequent Supreme Court decision, *Christians v. Evangelical Free Church*, 521 U.S. 1114, 117 S. Ct. 2502, 138 L. Ed. 2d 1007 (1997) and reaffirmed to the extent that RFRA modified federal and not state law, 141 F.3d 854 (8th Cir.) , cert. denied, 525 U.S. 811, 119 S. Ct. 43 (1998) (application of section 548 to church contributions violates Religious Freedom Restoration Act, 42 U.S.C. § 2000bb). The issue was essentially mooted by The Religious Liberty and Charitable Donation Protection Act of 1998 amending sections 544 and 548 as discussed below.

(n15)Footnote 15. See *In re Chomakos*, 69 F.3d 769 (6th Cir. 1995) (denying avoidance because debtors received reasonably equivalent value for their bets).

(n16)Footnote 16. Pub. L. No. 105-183, 112 Stat. 517 (1998), reprinted in Vol. F Collier on Bankruptcy, App. Pt. 41(o)(ii) (Matthew Bender), applicable to cases pending on or after June 19, 1998.

(n17)Footnote 17. 11 U.S.C. § 548(a)(2).

(n18)Footnote 18. *In re Jackson*, 249 B.R. 373 (Bankr. D.N.J. 2000) ; *In re Zohdi*, 234 B.R. 371 (Bankr. M.D. La. 1999) .

(n19)Footnote 19. See, e.g. *In re Hulm*, 738 F.2d 323, 11 C.B.C.2d 152 (8th Cir.) , cert. denied, 469 U.S. 990, 105 S. Ct. 398, 83 L. Ed. 2d 331 (1984) .

(n20)Footnote 20. 511 U.S. 531, 114 S. Ct. 1757, 128 L. Ed. 2d 556, 30 C.B.C.2d 345 (1994) .

(n21)Footnote 21. The BFP decision does not appear to apply at all to tax lien execution or other process which does not involve an auction. See, e.g., *Sherman*, 41 C.B.C.2d 102, 223 B.R. 555 (B.A.P. 10th Cir. 1998) (BFP decision not applicable to tax sale with no competitive bidding); *In re McKeever*, 25 C.B.C.2d 1260, 132 B.R. 996 (Bankr. N.D. Ill. 1991) .

(n22)Footnote 22. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537 n3, 114 S. Ct. 1757, 1761 n3, 128 L. Ed. 2d 556, 564 n3, 30 C.B.C.2d 345, 349 n3 . But see *In re McGrath*, 31 C.B.C.2d 586, 170 B.R. 78 (Bankr. D. N.J. 1994) (applying BFP analysis to tax sales).

(n23)Footnote 23. E.g., *In re Fitzgerald*, 237 B.R. 252 (Bankr. D. Conn. 1999) (BFP not applicable to foreclosure without public sale); *In re Grady*, 202 B.R. 120 (Bankr. N.D. Iowa 1996) (BFP not applicable to land contract forfeiture); *In re Butler*, 31 C.B.C.2d 1377, 171 B.R. 321 (Bankr. N.D. Ill. 1994) ; *In re Sporting Club*, 132 B.R. 792 (Bankr. N.D. Ill. 1991) . In Illinois, the property transfer is an administrative act based on prior sale of the tax lien and a failure to redeem; there is no property sale to which the BFP analysis could apply.

(n24)Footnote 24. See *In re McConnell*, 934 F.2d 662 (5th Cir. 1991) (forfeiture of \$600,000 down payment under real estate sale agreement avoided as fraudulent transfer).

(n25)Footnote 25. *In re Grady*, 202 B.R. 120 (Bankr. N.D. Iowa 1996) (BFP does not apply to forfeiture of real estate installment sale contract; property interest of \$40,000 forfeited to satisfy \$16,000 debt under the contract constituted fraudulent transfer).

(n26)Footnote 26. *In re Carter*, 38 C.B.C.2d 345, 209 B.R. 732 (Bankr. D. Or. 1997) (forfeiture of right to redeem jewelry from pawnbroker was avoidable involuntary transfer).

(n27)Footnote 27. *See Bell v. Instant Car Title Loans (In re Bell)*, 279 B.R. 890 (Bankr. N.D. Ga. 2002) (pawnbroker preliminarily enjoined from selling car worth over \$10,000 that was taken for failure to pay \$5,300 redemption price on \$4,000 loan).

(n28)Footnote 28. *See 5 Collier on Bankruptcy*, P 548.07 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 548.07 (Matthew Bender).

(n29)Footnote 29. *Meeks v. Red River Entm't (In re Armstrong)*, 285 F.3d 1092 (8th Cir. 2002) (casino transferee was not in good faith when it was on notice that debtor was having financial difficulties and might be insolvent). *See 5 Collier on Bankruptcy*, P 548.07 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 548.07 (Matthew Bender).

(n30)Footnote 30. *In re Richardson*, 23 B.R. 434 (Bankr. D. Utah 1982) . *But see In re Jones*, 20 B.R. 988 (Bankr. E.D. Pa. 1982) (including sheriff's costs in lien given to buyer).

(n31)Footnote 31. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n32)Footnote 32. *See P 17.06[1] supra*.

(n33)Footnote 33. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 17 Avoiding Powers of the Trustee

1-17 Collier Consumer Bankruptcy Practice Guide P 17.07

P 17.07 Postpetition Transfers; § 549

In line with the general principle that filing a bankruptcy freezes the debtor's property for administration by the bankruptcy court, section 549ⁿ¹ allows the trustee to avoid most postpetition transfers of the debtor's property. As elsewhere in the Code, "transfer" is broadly defined to mean almost any parting with an interest in property.ⁿ²

[1] Exceptions to General Rule

There are a number of exceptions to this general rule.ⁿ³ One of the most important exceptions protects third party transferors of the debtor's property that have no notice of the bankruptcy case.ⁿ⁴ The most typical example of this is a bank that transfers funds in a debtor's bank account to honor a check drawn by the debtor. However, section 549(a)(2)(A) protects only the party that makes the transfer, and not the transferee.ⁿ⁵ In addition, any transfer authorized by a specific Code provisionⁿ⁶ or by the bankruptcy court is not avoidable.ⁿ⁷

Besides these exceptions, several others exist. Transfers made by a debtor against whom an involuntary case has been filed are protected, if they arise out of the debtor's normal affairs.ⁿ⁸ However, such transfers may be invalidated to the extent they are intended to satisfy prepetition debts.ⁿ⁹ And there are two exceptions applicable only to interests in real property.ⁿ¹⁰ A postpetition transfer of such property may not be avoided if it was sold to:

- a good faith purchaser;
- without knowledge of the bankruptcy;ⁿ¹¹
- for present fair equivalent value;
- unless a copy or notice of the bankruptcy petition was filed in the county recording office before the transfer was so far perfected that it could not be invalidated by a bona fide purchaser or judicial sale purchaser.ⁿ¹²

The bona fide purchaser test in this section assumes a hypothetical purchaser with no notice of the transfer.ⁿ¹³ It is also important to note that the term "purchaser" is defined in *Code section 101* to mean only a transferee in a voluntary transfer.

To the extent that a good faith purchaser meets all of the requirements except present fair equivalent value, that purchaser has a lien to the extent of any present value given.ⁿ¹⁴ It should be noted, however, that this section speaks only of *present value* given in return for the property. This means that to the extent a purchaser has taken the property in satisfaction of a prior debt, that purchaser is not protected.ⁿ¹⁵ It is also important to note that the definition of "purchaser" in *section 101 of the Code* is "transferee of a voluntary transfer and includes immediate or mediate transferee of such transferee." Thus, section 549(c) does not apply at all to involuntary transfers, a fact that seems to have escaped some courts considering such transfers (perhaps because it was never argued by the debtor or trustee). Moreover, section 549(c) does not provide a shield for transfers that occurred in violation of the automatic stay.ⁿ¹⁶

The trustee may use section 549 in conjunction with the automatic stay provisions to invalidate involuntary postpetition transfers. One example of a case in which the stay might need such supplementation is a repossession ordered by a creditor without notice of the bankruptcy. Although the creditor would probably not be held in contempt since it had no notice of the case, the repossession could clearly be reversed. A setoff after the bankruptcy could be similarly undone. And in chapter 13 cases in which the debtor's postpetition income is property of the estate,ⁿ¹⁷ any deduction by a credit union from wages would be avoidable.ⁿ¹⁸

MORE INFORMATION

For a discussion of the effect of the automatic stay on the validity of transfers *see* chapter 8 *supra*.

For purposes of section 549, it has been held that a transfer by check occurs when the check is delivered.ⁿ¹⁹ However, due to recent Supreme Court precedent to the contrary under section 547,ⁿ²⁰ other cases have held that the date of transfer by check occurs on the date it is honored.ⁿ²¹ For this reason, debtors must be careful to assure that any large check written shortly before the bankruptcy petition, such as a check for a mortgage payment, has been honored. Otherwise, there is a danger that the trustee could recover the funds from the payee of the check.ⁿ²²

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 549, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. 11 U.S.C. § 101(54), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *In re McConville*, 110 F.3d 47, 37 C.B.C.2d 1224 (9th Cir. 1997) (holding creation of a postpetition consensual lien is not a transfer of property for purposes of § 549) is effectively overruled by the 2005 amendments to section 101(54), which now specifically includes creation of a lien in the definition of a "transfer."

(n3)Footnote 3. If no exception applies, the transfer is avoidable, no matter how harsh the result. *See In re Rice*, 83 B.R. 8 (B.A.P. 9th Cir. 1987) (transferee has no rights in transferred property where it does not come within an exception to section 549).

(n4)Footnote 4. 11 U.S.C. § 549(a)(2)(A), incorporating 11 U.S.C. § 542(c).

(n5)Footnote 5. *See* 5 *Collier on Bankruptcy*, P 549.03[3] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 549.03[3] (Matthew Bender).

(n6)Footnote 6. For example, a transfer made within the ordinary course of the debtor's business pursuant to 11 U.S.C. § 363 is not avoidable. *See In re Dant & Russell*, 853 F.2d 700, 20 C.B.C.2d 369 (9th Cir. 1988) .

(n7)Footnote 7. 11 U.S.C. § 549(a)(2)(B). *See* 5 *Collier on Bankruptcy*, P 549.03[1] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 549.03[1] (Matthew Bender).

(n8)Footnote 8. 11 U.S.C. § 549(a)(2)(A), incorporating 11 U.S.C. § 303(f).

(n9)Footnote 9. 11 U.S.C. § 549(b). See generally *Matter of Texas Research, Inc.*, 862 F.2d 1161 (5th Cir. 1989) .

(n10)Footnote 10. 11 U.S.C. 549(c), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. See *Matter of Allen*, 816 F.2d 325 (7th Cir. 1987) (mortgagee/purchaser at foreclosure sale was not good faith purchaser without knowledge of the bankruptcy where mortgagee had been told bankruptcy petition would be filed that day).

(n12)Footnote 12. *In re Walker*, 861 F.2d 597 (9th Cir. 1988) (confirmation of foreclosure sale did not constitute requisite perfection of transfer under California's recording statute). See 5 *Collier on Bankruptcy*, P 549.06 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 549.06 (Matthew Bender).

(n13)Footnote 13. *In re Ward*, 837 F.2d 124 (3d Cir. 1988) .

(n14)Footnote 14. 11 U.S.C. § 549(c), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n15)Footnote 15. *In re Major*, 39 C.B.C.2d 1189, 218 B.R. 501 (Bankr. W.D. Mo.1998) (credit bid by foreclosing creditor was not present fair equivalent value).

(n16)Footnote 16. 40235 Wash. St. Corp. v. Lusardi, 329 F.3d 1076 (9th Cir. 2003) (section 549(c) not available for transactions that are void because they occurred in violation of the automatic stay).

(n17)Footnote 17. 11 U.S.C. § 1306(a).

(n18)Footnote 18. *In re Shepherd*, 4 C.B.C.2d 1479, 12 B.R. 151 (E.D. Pa. 1981) .

(n19)Footnote 19. *Quinn Wholesale, Inc. v. Northen*, 873 F.2d 77 (4th Cir. 1989) .

(n20)Footnote 20. *Barnhill v. Johnson*, 503 U.S. 393, 112 S. Ct. 1386, 118 L. Ed. 2d 39 (1992) (transfer by check occurs when check is honored for purposes of preference analysis).

(n21)Footnote 21. *Guinn*, 203 F.3d 406 (6th Cir. 2000) . See also *In re Mora*, 199 F.3d 1024, 43 C.B.C.2d 549 (9th Cir. 1999) (transfer of cashiers check is on date of delivery, but suggesting that transfer of ordinary check is on date it is honored).

(n22)Footnote 22. See *In re Pyatt*, 2007 U.S. App. LEXIS 12019 (8th Cir. 2007) (trustee's remedy in such a situation is to seek recovery from payee of check under section 549 and not from debtor); *In re Mora*, 199 F.3d 1024, 43 C.B.C.2d 549 (9th Cir. 1999) (trustee recovered large payment deemed made to mortgage company by check transferring prepetition funds that were deemed transferred after petition was filed).



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CHAPTER 17 Avoiding Powers of the Trustee

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P 17.08 Setoff; § 553

The Code gives the trustee the power to avoid some, but not all, setoffs of mutual debts in the 90 days prior to filing of the petition.ⁿ¹ If a setoff is otherwise permissible under nonbankruptcy law, section 553ⁿ² provides certain tests which must be met before it can be avoided. Generally, a setoff will involve a bank account or other "cash collateral" as defined in section 363(a). No setoff probably occurs when a bank has foreclosed a valid security interest in an account.ⁿ³

[1] Mutuality of Debts

First, a setoff may be avoided if it is not for a mutual debt.ⁿ⁴ If the debtor owes the debt in a capacity other than that in which a debt is owed to the debtor, no mutuality exists and no setoff is permitted. For example, if the debtor has deposited money in his or her individual account, a setoff of that deposit against the debtor's obligation as a trustee for another person by the bank may be avoided, since it is against the debtor in a different capacity. This principle is frequently applied to setoffs involving debtors' IRA accounts.ⁿ⁵ Similarly, a creditor may not set off a prepetition claim against a postpetition claim, both because of the express wording of section 553(a) and because the debts are not considered to be mutual.ⁿ⁶

However, it is not always easy to determine whether mutual debts exist. In particular, courts have disagreed about whether debts owed to different agencies of the same government are mutual debts.ⁿ⁷

[2] Claim of Creditor Must Be Allowable

Second, a setoff may be avoided if it is exercised to satisfy a claim against the debtor other than an allowable claim. Thus, if defenses to the claim's allowability, including defenses to the claim itself, are successfully asserted, a setoff may be avoided.ⁿ⁸ However, one court of appeals has held that a creditor need not file a proof of claim as a prerequisite to asserting a right of setoff.ⁿ⁹ And a claim may be eligible for setoff even if it has not been reduced to judgment.ⁿ¹⁰

[3] Setoff that Improves Creditor's Position Before Bankruptcy

A setoff may be avoided to the extent that it results in the creditor's improving its position over what it was either 90 days prior to the filing of the petition or if no "insufficiency" existed on that date, the first date an insufficiency existed.ⁿ¹¹ The Code defines "insufficiency" as the "amount, if any, by which a claim against the debtor exceeds a

mutual debt owing to the debtor by the holder of such claim."¹²

ILLUSTRATION

For example, if the debtor owed \$5,000 to a bank and 90 days prior to the filing of the case had a deposit balance of \$200, there would be an insufficiency on that date of \$4,800 (\$5,000 minus \$200). If 40 days prior to the filing the bank was then owed \$3,000 and the debtor had a deposit of \$2,000 there would be an insufficiency on that date of only \$1,000 (\$3,000 minus \$2,000). If the bank then set off against the entire deposit, that setoff could be avoided in its entirety, since on the date of setoff the bank's insufficiency position had improved to the extent of \$3,800 (\$4,800 minus \$1,000) an amount greater than the amount of setoff. If, instead of \$200, there had been \$2,500 on deposit 90 days before filing then the improvement in position would have been \$1,500 and that amount of the \$2,000 setoff would be avoidable.¹³ And if the amount on deposit 90 days before the filing had been \$6,000 and then, three days before filing the debtor for the first time withdrew \$3,500, then the first insufficiency would be \$1,500. A setoff after that date would be avoidable to the extent that the insufficiency on the date of setoff exceeded \$1,500.¹⁴

[4] Other Limitations on Setoff

If a creditor exercising a setoff acquires its claim from another entity either after the filing of the petition or within 90 days before filing while the debtor was insolvent, the setoff may be avoided.¹⁵

In addition, if a creditor exercising a setoff has caused the debtor to increase the amount owed by the creditor to the debtor (*e.g.*, by pressuring the debtor to "build up" its bank deposits) while the debtor was insolvent in order to obtain a setoff, the setoff so obtained may be avoided.¹⁶

Arguably, any deposit to a creditor bank is a transfer to the bank which could be avoided as a setoff if it improved the bank's position.¹⁷ However, there is a significant line of cases holding that deposits in the ordinary course of business are not preferences.¹⁸

[5] Postpetition Setoffs

It is important to note that section 553(b) addresses only setoffs prior to the filing of the petition. It does not appear that the improvement-in-position test applies at all to setoffs after filing, once the automatic stay is no longer in effect. Generally, such setoffs by creditors having the right to setoff for mutual debts are permissible, though they may be prohibited by a court in exercise of its discretion, and the right to setoff can be eliminated by a confirmed plan that does not preserve that right or modifies it.¹⁹ In addition, a creditor waives its right to setoff to the extent that it releases funds held prepetition that were subject to setoff, and cannot setoff against funds acquired from the debtor postpetition to collect a prepetition debt.²⁰ Also, several courts have held that no setoff may be had against exempt property.²¹ Creditors occasionally attempt to use the doctrine of "recoupment" to justify refusal to pay to the debtor or trustee money that they owe the debtor, claiming that it is reduced by money the debtor owed them with respect to the same transaction. This doctrine is quite limited.²²

FOOTNOTES:

(n1)Footnote 1. The automatic stay prevents setoffs after the petition is filed, though the stay may be lifted if certain prerequisites are met and a creditor may "freeze" a debtor's account in anticipation of set off. *Citizens Bank v. Strumpf*, 516 U.S. 16, 116 S. Ct. 286, 133 L. Ed. 2d 258, 33 C.B.C.2d 869 (1995) . See ch. 8 *supra*.

(n2)Footnote 2. 11 U.S.C. § 553, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. The 2005 amendments to section 553, which are inapplicable in consumer cases, limit the avoidance of setoffs with respect to certain business contracts (*e.g.*, securities contract, futures contracts, swap

agreements, repurchase agreements, and master netting agreements).

(n3)Footnote 3. *See Smith v. Mark Twain Nat'l Bank*, 805 F.2d 278, 15 C.B.C.2d 1160 (8th Cir. 1986) . Compare *In re Knudson*, 929 F.2d 1280 (8th Cir. 1991) (security agreement in bank accounts held invalid).

(n4)Footnote 4. *See 5 Collier on Bankruptcy*, P 553.03[3] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 553.02[3] (Matthew Bender).

(n5)Footnote 5. *In re Mastroeni*, 57 B.R. 191 (Bankr. S.D.N.Y. 1986) . *See also Matter of Bevill, Bresler & Schulman Asset Mgmt.*, 896 F.2d 54 (2d Cir. 1990) (creditor withholding income from government bonds which rightfully belonged to debtor was mere trustee holding debtor's funds and thus owed debtor no debt which could be set off).

(n6)Footnote 6. *Cooper Jarrett Inc. v. Central Transport, Inc.*, 726 F.2d 93 (3d Cir. 1984) .

(n7)Footnote 7. *See United States v. Maxwell*, 157 F.3d 1099, 40 C.B.C.2d 1423 (7th Cir. 1998) (federal government a single entity for setoff purposes); *In re Turner*, 84 F.3d 1294, 35 C.B.C.2d 1413 (10th Cir. 1996) (*en banc*) (the United States is a unitary creditor for setoff purposes); *Westamerica Bank v. United States*, 178 B.R. 493 (N.D. Cal. 1995) (mutuality did not exist for debts involving different agencies). *But see Doe v. United States (In re Doe)*, 58 F.3d 494 (9th Cir. 1995) ; *In re Mohar*, 140 B.R. 273, 277 (Bankr. D. Mont. 1993) (there is only one federal government so debts are mutual).

(n8)Footnote 8. 11 U.S.C. § 553(a)(1), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 9. *In re G.S. Omni Corp.*, 835 F.2d 1317, 17 C.B.C.2d 1429 (10th Cir. 1987) .

(n10)Footnote 10. *Matter of Bevill, Bresler & Schulman Asset Mgmt.*, 896 F.2d 54, 22 C.B.C.2d 551 (2d Cir. 1990) .

(n11)Footnote 11. 11 U.S.C. § 553(b)(1), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n12)Footnote 12. 11 U.S.C. § 553(b)(2).

(n13)Footnote 13. The bank's position would have improved from a deficiency of \$2,500 (\$5,000 minus \$2,500) to a deficiency of \$1,000 (\$3,000 minus \$2,000).

(n14)Footnote 14. *See 5 Collier on Bankruptcy*, P 553.09[2] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 553.08[2] (Matthew Bender).

(n15)Footnote 15. 11 U.S.C. § 553(a)(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n16)Footnote 16. 11 U.S.C. § 553(a)(3). *See In re Klein*, 10 B.R. 356 (Bankr. C.D. Cal. 1981) (avoiding setoffs by credit unions of funds deposited for purpose of prepaying loan).

(n17)Footnote 17. *See S. Rep. No. 989*, 95th Cong., 2d Sess. 27 (1978), *reprinted in* Vol. D *Collier on Bankruptcy*, App. Pt. 4(e)(i) (Matthew Bender); *H.R. Rep. No. 595*, 95th Cong., 1st Sess. 314 (1977), *reprinted in* Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender) stating the term "transfer" includes a deposit in a bank account.

(n18)Footnote 18. *See 5 Collier on Bankruptcy*, P 553.03[5][b] (Matthew Bender). 2 *Collier Bankruptcy Manual*, ch. 553 (Matthew Bender). *See also In re Bohlen Enterprises, Ltd.*, 859 F.2d 561, 19 C.B.C.2d 986 (8th Cir. 1988)

(deposit not in ordinary course of business made for purpose of creating right of set-off is avoidable under section 553(a)(3)).

(n19)Footnote 19. *In re Continental Airlines*, 134 F.3d 536 (3rd Cir. 1998) .

(n20)Footnote 20. *In re Orr*, 234 B.R. 249 (Bankr. N.D.N.Y. 1999) ; *In re Kleather*, 38 C.B.C.2d 80, 208 B.R. 406 (Bankr. S.D. Ohio 1997) .

(n21)Footnote 21. *In re Alexander*, 245 B.R. 280 (W.D. Ky. 1999) (IRS set off to collect dischargeable prepetition debt prohibited by section 522(c)); *In re Jones*, 230 B.R. 875 (M.D. Ala. 1999) (same); *In re Miel*, 134 B.R. 229 (Bankr. W.D. Mich. 1991) (Internal Revenue Service could not carry out postpetition offset of dischargeable prepetition taxes owed against tax refund claimed as exempt by debtor); *In re Wilde*, 85 B.R. 147 (Bankr. D.N.M. 1988) ; *In re Haffner*, 12 B.R. 371 (Bankr. M.D. Tenn. 1981) . *But see IRS v. Luongo* (*In re Luongo*), 259 F.3d 323 (5th Cir. 2001) (permitting IRS to setoff prepetition refund against discharged tax debt).

(n22)Footnote 22. *See In re Malinowski*, 156 F.3d 131, 40 C.B.C.2d 1054 (2d Cir. 1998) (state unemployment agency could not recoup overpayment arising from one period of unemployment from benefits due for a different period of unemployment). 5 *Collier on Bankruptcy*, P 553.10 (Matthew Bender). 2 Collier Bankruptcy Manual, ch. 553 (Matthew Bender).



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CHAPTER 17 Avoiding Powers of the Trustee

1-17 Collier Consumer Bankruptcy Practice Guide P 17.09

P 17.09 Liens Securing Fines, Penalties and Forfeitures; § 724(a)

The final type of transfer that is avoidable by the trustee is described in section 724(a), which in turn incorporates section 726(a)(4). Because this avoiding power is contained in chapter 7, it applies only in cases under that chapter, and not in chapter 13 cases.

Basically, this section allows avoidance of liens for penalties, fines, punitive damages, multiple damages, and the like, to the extent the amount secured by that lien does not represent compensation for actual pecuniary loss. Under this section, to the extent a tax lien secures penalties for late payment, for example, it can be avoided.ⁿ¹

In addition, the power may also be available to challenge that portion of a lien arising from a consumer contract which represents a penalty, including, for example, late charges and prepayment penalties.

FOOTNOTES:

(n1)Footnote 1. *See 6 Collier on Bankruptcy, P 724.02* (Matthew Bender).



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CHAPTER 17 Avoiding Powers of the Trustee

1-17 Collier Consumer Bankruptcy Practice Guide P 17.10

P 17.10 Other Limitations on Use of Trustee Avoiding Powers

The avoiding powers are subject to the limitations placed upon the trustee by *section 546 of the Bankruptcy Code*. As discussed earlier,ⁿ¹ section 546 sets a statute of limitations for most avoidance actions.

Section 546 also subordinates the trustee's powers to any applicable law that allows perfection of an interest to relate back to an earlier date,ⁿ² and to certain sellers' rights of reclamation of goods sold.ⁿ³

FOOTNOTES:

(n1)Footnote 1. *See P 17.02 supra*.

(n2)Footnote 2. *11 U.S.C. § 546(b)*. *See 5 Collier on Bankruptcy, P 546.03* (Matthew Bender). *See also 11 U.S.C. § 362(b)(3)*.

(n3)Footnote 3. *11 U.S.C. § 546(c)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005; *11 U.S.C. § 546(d)*. *See 5 Collier on Bankruptcy, P 546.04* (Matthew Bender).



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CHAPTER 17 Avoiding Powers of the Trustee

1-17 Collier Consumer Bankruptcy Practice Guide P 17.11

P 17.11 Recovery of Property After Transfer Is Avoided

When a transfer is avoided, the trustee does not automatically receive the property that was transferred. Section 550 provides the tool for the trustee to obtain that property and generally allows recovery of the transferred property (or its value in some cases) from both the initial transferee and a subsequent transferee.ⁿ¹ (A party must have actual dominion or control over funds to qualify as a transferee. Thus a bank receiving funds to be deposited in a bank account is normally not a transferee, since the person owning the account ordinarily controls that money.)ⁿ² In some cases, after an avoidance proceeding, a separate action must be brought under section 550 to recover the property that was transferred.

There are several major exceptions to the general right to recover property after a transfer is avoided, however. The trustee may not recover from any transferee subsequent to the initial transferee if that transferee has either taken for value in good faith without knowledge of the voidability of the transfer or taken from a prior transferee who has taken for value in good faith and without knowledge.ⁿ³ (In such cases, the only recovery can be the value of the property from the initial transferee.) And, if an initial transferee acted in good faith, the transferee, while returning the property, retains a lien for the cost of or increase in value due to any improvements on the property, whichever is less.ⁿ⁴ However, willful ignorance cannot constitute good faith under section 550.ⁿ⁵

Generally, a transferee of an avoided transfer from whom property has been recovered is given a claim against the estate under section 502(h). A transferee of an avoided transfer in payment of a claim which would have been non-dischargeable may also, in some cases, again be able to assert that claim against the debtor.^{n5a}

Finally, an action to recover property subsequent to the avoidance of a transfer must be commenced within one year after the avoidance, or before the case is closed, whichever comes first.ⁿ⁶

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 550(a); *In re Bremer*, 2009 Bankr. LEXIS 1592 (B.A.P. 10th Cir. June 29, 2009) (where preservation of lien is sufficient to avoid transfer, trustee cannot recover value transferred); *In re Taylor*, 390 B.R. 654, 667 (B.A.P. 9th Cir. 2008) (bankruptcy court, in its discretion, can award either property or its value). See 5 *Collier on Bankruptcy*, P 550.02 (Matthew Bender). 2 *Collier Bankruptcy Manual*, ch. 550 (Matthew Bender).

(n2)Footnote 2. *In re First Security Mortgage*, 33 F.3d 42 (10th Cir. 1994) . Cf. *Abele v. Mod. Fin. Plans Servs.* (

In re Cohen, 300 F.3d 1097 (9th Cir. 2002) (when debtor transferred to her husband cashier's check made payable to husband's creditor, creditor was only party that could exercise dominion and control and was therefore initial transferee).

(n3)Footnote 3. 11 U.S.C. § 550(b). See 5 Collier on Bankruptcy, P 553.03 (Matthew Bender). 2 Collier Bankruptcy Manual, ch. 550 (Matthew Bender).

(n4)Footnote 4. 11 U.S.C. § 550(e).

(n5)Footnote 5. *In re Harbour*, 845 F.2d 1254, 18 C.B.C2d 1214 (4th Cir. 1988) (transfer recovered from initial transferee who kept herself willfully ignorant of the circumstances of the transaction even though she retained no funds from the transfer for herself).

(n6)Footnote 5a. *In re Laizure*, 548 F.3d 693 (9th Cir. 2008) .

(n7)Footnote 6. 11 U.S.C. § 550(f).



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CHAPTER 17 Avoiding Powers of the Trustee

1-17 Collier Consumer Bankruptcy Practice Guide P 17.12

P 17.12 Preservation of Avoided Transfers or Recovered Property

An important but often overlooked addition to the avoiding powers is the right to preserve avoided transfers for the benefit of the estate. Section 551 provides that a transfer avoided by the trustee is preserved for the benefit of the estate.ⁿ¹

ILLUSTRATION

What this means, in effect, is that the estate steps into the shoes of the holder of the avoided transfer vis a vis any other entity with rights junior to that holder, and thereby obtains rights superior to junior lienholders. For example if the trustee avoids a \$10,000 first mortgage on a \$10,000 property that also has a second mortgage, the second mortgage does not then become the first lien on the property.ⁿ² The avoided lien remains on the property, but becomes a lien in favor of the estate. Without preservation of that lien (a transfer) the avoidance would not benefit the estate, since it would merely move the second mortgage up in priority from a position of being unsecured to being fully secured in the amount of \$10,000. By allowing the trustee to preserve the avoided lien for the estate's benefit, the Code keeps the second mortgage in its previous position. Needless to say, this power can be of great importance in cases in which there are multiple liens on a particular property.

FOOTNOTES:

(n1)Footnote 1. *See* 5 *Collier on Bankruptcy*, P 551.02 (Matthew Bender).

(n2)Footnote 2. *See* *Kors, Inc. v. Howard Bank*, 819 F.2d 19 (2d Cir. 1987) ; *In re Losieniecki*, 17 B.R. 136 (Bankr. W.D. Pa. 1981) . *But see* *In re Simonson*, 758 F.2d 103, 12 C.B.C.2d 777 (3d Cir. 1985) (refusing to apply section 522(i)(2) or avoid liens where total of mortgages exceeded value of property even though intervening judicial liens rendered one mortgage largely unsecured). *Simonson* case was overruled by the 11 U.S.C. § 522(f)(2), enacted in 1994.



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CHAPTER 18 Avoiding Powers of the Debtor

1-18 Collier Consumer Bankruptcy Practice Guide 18.syn

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CHAPTER 18 Avoiding Powers of the Debtor

1-18 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the powers of a consumer debtor to avoid liens and other transfers of property independently of the trustee in cases in which the transfer impairs the ability to exempt property. The chapter discusses the powers under section 522(f) to avoid judicial liens and nonpossessory nonpurchase-money security interests, as well as the debtor's right, in certain circumstances, to exercise the trustee's avoiding powers. Actions to recover property subsequent to the avoidance of a transfer and the preservation of avoided transfers or recovered property are also discussed.



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CHAPTER 18 Avoiding Powers of the Debtor

1-18 Collier Consumer Bankruptcy Practice Guide P 18.01

P 18.01 Introduction

One of the most far-reaching changes made by the 1978 Bankruptcy Reform Act was its grant to the debtor of the power to avoid (nullify) many types of prebankruptcy transfers of exempt property. The power to avoid transfers is expansive due, in part, to the broad definition of the word "transfer." *Section 101(54) of the Bankruptcy Code*¹ includes within this term any lien, execution sale, setoff, or any other mode of disposing of or parting with an interest in property, whether voluntarily or involuntarily, including foreclosure of the debtor's equity of redemption.

The debtor, with certain limitations, may thus invalidate numerous types of transfers, and recover valuable interests in property, as long as those interests can be claimed as exempt. Put another way, if the interest in property involved fits within the exemption scheme utilized by the debtor and if the interest is impaired by a transfer of a type covered by section 522, then that transfer may be avoided. But if only a portion of the transferred property may be claimed as exempt, the transfer may be avoided only to that extent. Since the issue is whether property may be claimed as exempt, and exemptions are determined as of the petition date, property is valued as of the petition date for purposes of the debtor's avoiding powers.²ⁿ³⁻⁴

Bankruptcy Rule 4003(d) provides that a creditor can challenge the exemptibility of property in a lien avoidance proceeding even if the creditor did not object to the exemption of the property within the normal deadline for exemption objections under *Rule 4003(b)*. *Rule 4003(d)* now gives the creditor a second bite at the apple, stating that the creditor can defend a lien avoidance motion by challenging the validity of the exemption that the debtor claims is impaired by the lien.

MORE INFORMATION

For further discussion of exemptions see chapter 13 *supra*.

The avoiding powers may be invoked even if the debtor has no equity in a particular property, as long as the debtor can claim some interest in that property as exempt, even a mere right to possession or to redemption.⁵ Nor is it necessary to show that the debt upon which a transfer is based is a dischargeable debt before the transfer can be avoided. The statute seems clear that nondischargeability of an underlying debt is no defense to an otherwise proper action to avoid a transfer that impairs an exemption.⁶ And the avoiding powers are equally available in chapter 7 and chapter 13.⁷

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. 101(54)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. *11 U.S.C. § 522(a)(2)*; *In re Finn*, 28 C.B.C.2d 775, 151 B.R. 25 (Bankr. N.D.N.Y. 1992) .

(n3)Footnote 3-4. [Reserved]

(n4)Footnote 5. *In re Bland*, 793 F.2d 1172, 15 C.B.C.2d 666 (11th Cir. 1986) (en banc). *See* 4 Collier on Bankruptcy, P 522.11[3] (Matthew Bender).

(n5)Footnote 6. *Walters v. United States Nat'l Bank*, 879 F.2d 95 (3d Cir. 1989) (debtor may avoid lien of creditor whose claim is nondischargeable on ground of fraud); *In re Liming*, 797 F.2d 895 (10th Cir. 1986) . *See also In re Clark*, 217 B.R. 943 (Bankr. M.D. Fla. 1998) (debtor had lien avoidance powers even though he was denied a discharge). However, a judicial lien or preference for payment of alimony, maintenance, or support to a spouse, former spouse, or child of the debtor may not be avoided. *11 U.S.C. §§ 522(f)(1)(B), 547(c)(7)*.

(n6)Footnote 7. *In re Hall*, 752 F.2d 582, 11 C.B.C.2d 1367 (11th Cir. 1985) . *See also* McLaughlin, *Lien Avoidance by Debtors in Chapter 13 of the Bankruptcy Reform Act of 1978*, 58 Am. Bankr. L. J. 45 (1984); 8 Collier on Bankruptcy P 1300.81 (Matthew Bender). 3 Collier Bankruptcy Manual, ch. 1300 (Matthew Bender).



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CHAPTER 18 Avoiding Powers of the Debtor

1-18 Collier Consumer Bankruptcy Practice Guide P 18.02

P 18.02 Procedure for Use of Debtor's Avoiding Powers

The Federal Rules of Bankruptcy Procedure prescribe the procedure to be followed for lien avoidance by the debtor. *Rule 4003(d)* provides that lien avoidance under section 522(f) shall be by motion in accordance with *Bankruptcy Rule 9014*. However, transfer or lien avoidance under section 522(h), which is often a more complicated matter, requires an adversary proceeding initiated by complaint.ⁿ¹ Regardless of whether the proceeding is a motion under *Rule 9014* or an adversary proceeding, the adversary proceeding service rules apply, and have special requirements for serving insured depository institutions.ⁿ²

MORE INFORMATION

For a detailed discussion of procedures in contested matters and adversary proceedings *see* chapter 32 *infra*.

FORMS

For forms pertaining to the debtor's avoiding powers *see* Collier Consumer Bankruptcy Forms, Part CS17 (Matthew Bender).

At least some avoidance actions carry with them a right to trial by jury. The Supreme Court has made clear that a defendant to a fraudulent conveyance or preference action who has not filed a proof of claim in the bankruptcy case has a right to jury trial that is protected by the *Seventh Amendment*.ⁿ³

It is the debtor's burden to file a lien avoidance proceeding; if none is filed, all liens on the debtor's property, including otherwise exempt property, will normally survive the bankruptcy.ⁿ⁴

The statute does not specify whether lien avoidance under section 522(f) has to take place prior to discharge, and since exemptions are afforded continued protection after the bankruptcy, they could continue to be impaired after the bankruptcy by an otherwise avoidable lien. Presumably, then, an action to avoid a lien under section 522(f) may be filed after the discharge.ⁿ⁵ Unlike many of the other Bankruptcy Rules, the Rules providing for debtor lien avoidance set no time limits. And since lien avoidance is a personal right which does not affect the administration of the bankruptcy case, there is no need for the bankruptcy case to be reopened in order for the debtor to avoid a lien.ⁿ⁶

In contrast, most actions to avoid transfers under section 522(h) are subject to a statute of limitations.ⁿ⁷ They must be brought within two years of the order for relief (the date a voluntary petition is filed) or by the date the case is closed or dismissed, whichever is earlier. The limitations period may be extended beyond two years after the order for relief if the trustee is first appointed or elected within two years of such order for relief. In such cases, actions may be brought within one year of the trustee's appointment or the date the case is closed or dismissed, whichever is earlier. To be safe, it is better to avoid liens and other transfers within the limitations period and prior to discharge whenever possible.

It might also be possible to include in a chapter 13 plan provisions which effectuate the avoidance of transfer upon confirmation.ⁿ⁸ Although the Rules provide that a motion or complaint is necessary in a "proceeding" to avoid a lien, it can be argued that if the lien is avoided in the plan, no separate "proceeding" is necessary. Otherwise, the Rules might conflict with section 1322(b)(10) which allows plans to incorporate any appropriate provision not inconsistent with the Code.ⁿ⁹ However, to avoid doubt on these issues, the best practice is to seek to avoid the lien in a separate proceeding rather than to rely on a plan provision.

PRACTICE NOTE

Whatever the method used, the debtor's counsel should be sure to obtain an order giving complete relief, including a requirement that the transferee (usually a creditor) take all steps necessary to reflect the avoidance of the transfer in state and local recording offices, or else an order suitable for filing in those offices by the debtor's counsel. Keep in mind as well that if a separate action is necessary to recover property subsequent to avoidance of a transfer of that property, it must be brought within one year.ⁿ¹⁰

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 7001*.

(n2)Footnote 2. *Hamlett v. Amsouth Bank (In re Hamlett)*, 322 F.3d 342 (4th Cir. 2003) (judgment properly vacated when officer of institution not served); *In re Villar*, 317 B.R. 88 (B.A.P. 2004) (default order avoiding lien reversed because service did not comply with *Fed. R. Bankr. P. 7004(b)(3)* or due process).

(n3)Footnote 3. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 109 S. Ct. 2782, 106 L. Ed. 2d 26, 20 C.B.C.2d 1216 (1989). See 1 *Collier on Bankruptcy*, P 3.08 (Matthew Bender).

(n4)Footnote 4. *Federal Deposit Insurance Corporation v. Davis*, 733 F.2d 1083, 10 C.B.C.2d 1413 (4th Cir. 1984). But see *Matter of Penrod*, 50 F.3d 459, 33 C.B.C.2d 263 (7th Cir. 1995) (default rule in chapter 11, based on language of section 1141(c), is that if confirmed plan provides for creditor but is silent about whether creditor retains its lien, that lien is automatically extinguished). The *Penrod* rationale should apply equally in chapter 13 under section 1327(c).

(n5)Footnote 5. *In re Wilding*, 475 F.3d 428 (1st Cir. 2007) (debtor permitted to avoid judicial lien under section 522(f) two years after discharge even if he has satisfied the lien prior to filing a motion to avoid, so long as the lien in question impaired an exemption as of the bankruptcy petition date); *In re Ricks*, 19 C.B.C.2d 1437, 89 B.R. 73 (B.A.P. 9th Cir. 1988) (creditor's action to execute on lien after bankruptcy does not constitute sufficient prejudice to bar reopening of case to avoid lien); *In re Yazzie*, 9 C.B.C.2d 62, 24 B.R. 576 (B.A.P. 9th Cir. 1982) (post discharge avoidance allowed where no prejudice to creditor from delay); *In re McDonald*, 30 C.B.C.2d 564, 161 B.R. 697 (D. Kan. 1993) (local bankruptcy rule that required lien avoidance motions to be filed at least five days before date set for discharge was invalid and court could allow reopening of case for motion to avoid lien unless equitable considerations dictated otherwise). But see *Hawkins v. Landmark Finance Co.*, 727 F.2d 324, 10 C.B.C.2d 94 (4th Cir. 1984) (court has discretion to refuse to reopen a case for amendment of exemptions and lien avoidance).

(n6)Footnote 6. See 9 *Collier on Bankruptcy*, P 4003.05 (Matthew Bender).

(n7)Footnote 7. 11 U.S.C. § 546(a). Note that the limitations period does not apply to transfers avoidable under §§ 522(f), 549 or 724(a).

(n8)Footnote 8. McLaughlin, *Lien Avoidance by Debtors in Chapter 13 of the Bankruptcy Reform Act of 1978*, 58 *Am. Bankr. L. J.* 56 (1984); 8 *Collier on Bankruptcy*, P 1300.81 (Matthew Bender). *But see In re Commercial Western Finance Corp.*, 761 F.2d 1329, 12 C.B.C.2d 1177 (9th Cir. 1985) (Bankruptcy Rules require individual proceedings against investors whose security interests trustee wished to avoid in chapter 11 case); *In re McKay*, 732 F.2d 44, 10 C.B.C.2d 1303 (3d Cir. 1984) (chapter 13 lien avoidance must be by motion).

(n9)Footnote 9. *But see In re Commercial Western Finance Corp.*, 761 F.2d 1329, 12 C.B.C.2d 1177 (9th Cir. 1985) ; *In re McKay*, 732 F.2d 44, 10 C.B.C.2d 1303 (3d Cir. 1984) (lien avoidance must be by motion rather than in plan). There could also be due process concerns if the lienholder did not receive very specific notice of the proposed plan provision avoiding the lien.

(n10)Footnote 10. 11 U.S.C. § 550(f). *See P 18.08 infra.*



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CHAPTER 18 Avoiding Powers of the Debtor

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P 18.03 Power to Avoid Judicial Liens; § 522(f)(1)(A)

[1] Liens Considered Judicial Liens

Section 522(f)(1)(A) gives the debtor an unqualified right to avoid any judicial lien that impairs an exemption, subject only to an exception for domestic support obligations.ⁿ¹ Since the term "judicial lien" is defined broadlyⁿ² to include levies, judgment liens (including confessed judgments) and liens obtained by sequestration or any other legal or equitable proceeding, this section provides a powerful tool for the debtor. To the extent a creditor's lien is avoided, the creditor becomes an unsecured creditor and the lien cannot attach to property that the debtor acquires after the petition is filed.ⁿ³ Occasionally there is a dispute as to whether a particular lien is a judicial lien, sometimes involving liens granted in divorce proceedings.ⁿ⁴ In such cases, careful analysis of the Code's definition is required. However, some of the difficult questions about whether certain divorce related liens are judicial liens have been rendered moot by a Code provision, added in 1994 and amended in 2005, which makes liens for domestic support obligations nonavoidable.ⁿ⁵

FORMS

For forms pertaining to avoiding judicial liens on exempt property *see Collier Consumer Bankruptcy Forms*, § CS17.24 (Matthew Bender).

[2] Types of Property Which May Be Freed from Judicial Liens

The power to avoid judicial liens extends to every type of exempt property, without limitation, including property exempt under a wild card provision.ⁿ⁶ Unlike some of the other avoiding powers, the lien need not have been obtained within a certain time period before the bankruptcy petition. Even if the lien has caused the property to have been removed from the debtor's possession, it can be avoided, forcing the return of the property.ⁿ⁷

[3] Determining Whether Exemption Is Impaired by Lien

In some cases, courts refused to avoid liens because of provisions in state exemption laws which they read to prevent the debtor from claiming any exemption in bankruptcy which could be impaired.ⁿ⁸ For the most part these decisions have been overruled by the Supreme Court.ⁿ⁹ In *Owen v. Owen* the Court held that a state law limiting exemptions from execution to property that is not subject to certain liens does not preclude avoidance of those liens under section 522(f).ⁿ¹⁰ This principle may not apply, however, to debtors who fail to meet the conditions for claiming the state law

exemption in the first instance.ⁿ¹¹

In 1994, responding to several cases which had misconstrued the lien avoidance provisions, Congress amended section 522(f) to specifically set forth a general arithmetic formula for determining whether a lien could be avoided under that section.ⁿ¹² Section 522(f)(2) specifies that a judicial lien is avoidable to the extent that the lien, plus all other liens on the property, plus the amount of the exemption that the debtor could claim if there were no liens on the property exceeds the value that the debtor's interest in the property would have in the absence of any liens.ⁿ¹³ Once a lien has been avoided, it is not counted for the calculation of whether other liens impair exemptions.ⁿ¹⁴ And the formula does not apply to judgments arising out of mortgage foreclosures.ⁿ¹⁵

As the legislative history makes clear, this language adopts the conclusion of those cases holding that a debtor who has no equity in a property may still avoid liens on the property.ⁿ¹⁶ It also overrules cases which had held that a partially secured creditor could protect against lien avoidance that portion of its lien which exceeds the value of the collateral, and similar cases which had held that a debtor could not avoid a lien to the extent that the amount of the lien exceeded the debtor's exemption.ⁿ¹⁷ Finally, by focusing on the dollar amount of the exemption in defining when an exemption is impaired, the amendment overrules cases that had held that a debtor's exemption was not impaired unless the creditor was executing on that lien.ⁿ¹⁸

[4] Limitations on Power to Avoid Judicial Liens

ILLUSTRATION

In applying the formula of section 522(f)(2), as with the other avoiding powers, if the lien only partially impairs the exemption, only that part may be avoided. Thus, if a \$3,000 judgment lien encumbers a house worth \$19,000, in which an interest of \$17,425 can be claimed as exempt and in which an interest of \$1,575 is not exempt, only \$1,425 worth of the lien can be avoided.ⁿ¹⁹ The other \$1,575 is deemed an encumbrance on that interest in the house which is not exemptible. In such cases, the debtor should, if at all possible, obtain an order specifying the amount of the creditor's remaining lien, so that any post bankruptcy appreciation inures to the benefit of the exempt interest and not the creditor. On the other hand, when the total value of the lien property can be claimed as exempt, then any amount of liens can be avoided, since even if only a few dollars worth of liens remained, they would impair the exemption. Hence, if a house with \$17,425 of equity in excess of a mortgage is claimed as totally exempt, all judgment liens on that house may be avoided under this section no matter what their amount. When only some liens may be avoided, the most junior avoidable liens are presumably the ones which impair the debtor's exemption.

In *Farrey v. Sanderfoot*,ⁿ²⁰ the Supreme Court held that section 522(f)(1) can only be used to avoid the fixing of a lien on a debtor's pre-existing interest in property. Unless the debtor has an interest in the property *before* the lien attached to the property, the lien cannot be avoided. In applying this principle to a lien granted in a divorce decree that conveyed jointly held property to the debtor, the Court found that the divorce decree extinguished the debtor's pre-existing undivided half-interest in the marital home and granted him a new fee simple interest. The Court therefore concluded that the simultaneously created lien for the benefit of the debtor's former spouse did not attach to a preexisting interest of the debtor in property and that section 522(f)(1) was not available to avoid the lien. The Court assumed without deciding that the divorce decree did create a judicial lien. It also left open the possibility that a divorce decree lien could be avoided if it attached to property that had previously been titled only in the name of the debtor spouse.ⁿ²¹

The Eleventh Circuit extended the *Farrey* rationale to a debtor who obtained a homestead in a jurisdiction where an unsatisfied judgment had previously been recorded against him.ⁿ²² The judgment automatically fixed as a lien on property in that jurisdiction when it was acquired by the debtor. The Court concluded that the lien could not be avoided because it did not fix on a preexisting interest of the debtor in property.

PRACTICE NOTE

While this seems on the surface like a reasonable extension of *Farrey*, it is inconsistent with the Congressional purpose in allowing the avoidance of judicial liensⁿ²³ and illogically gives more protection to a judgment lien creditor that had no lien when it obtained a judgment than to one with a judgment lien interest in the debtor's property that arose at the time it obtained its judgment. The decision also goes beyond the Supreme Court's expressed concern in *Farrey* with protecting against fraudulent transfers of property which is already subject to a lien to a third person who could avoid that lien in bankruptcy.ⁿ²⁴

The 1994 amendments also added an exception to the power to avoid judicial liens. In order to better protect a spouse, former spouse, or child who is owed alimony, maintenance, or support, section 522(f)(1)(A) now makes liens for domestic support obligations nonavoidable.ⁿ²⁵ⁿ²⁶

FOOTNOTES:

(n1)Footnote 1. See 4 *Collier on Bankruptcy*, P 522.11 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.11 (Matthew Bender).

(n2)Footnote 2. 11 U.S.C. § 101(36). See 2 *Collier on Bankruptcy*, ch. 101 (Matthew Bender); 1 *Collier Bankruptcy Manual*, ch. 101 (Matthew Bender).

(n3)Footnote 3. *In re Marshall*, 37 C.B.C.2d 898, 204 B.R. 838 (Bankr. S.D. Ga. 1997) .

(n4)Footnote 4. See generally Sommer & McGarity, *Collier Family Law and the Bankruptcy Code*, P 7.04[3][a] (Matthew Bender)

(n5)Footnote 5. 11 U.S.C. 522(f)(1)(A), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. *In re Groff*, 223 B.R. 697 (Bankr. S.D. Ill. 1998) (debtors could avoid lien that impaired their equitable interest in property being purchased under land installment sales contract); *In re Garcia*, 149 B.R. 530 (Bankr. N.D. Ill. 1993) (wages in the hands of an employer can be exempted under Illinois wild card provision so that lien giving rise to the wage garnishment can be avoided).

(n7)Footnote 7. See *Culver, LLC v. Kai-Ming Chiu* (*In re Kai-Ming Chiu*), 304 F.3d 905 (9th Cir. 2002) (debtors must show only that they had interest in property when lien attached); *In re Brown*, 734 F.2d 119, 10 C.B.C.2d 1405 (2d Cir. 1984) (debtor could exempt and avoid judicial lien on cash proceeds of execution sale of property where proceeds were still in hands of state court commissioner).

(n8)Footnote 8. See, e.g., *In re Dixon*, 885 F.2d 327 (6th Cir. 1989) (Ohio exemption scheme does not contemplate any homestead exemption absent execution on judgment; therefore liens may not be avoided in bankruptcy as impairing a debtor's exemption). This decision was overruled by the 1994 amendments to the Bankruptcy Code which now define what it means to impair an exemption. See *In re Holland*, 151 F.3d 547 (6th Cir. 1998) (*Dixon* overruled by 1994 amendments). 11 U.S.C. § 522(f)(2). See H.R. Rep. No. 835, 103d Cong., 2d Sess. 53 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3362.

(n9)Footnote 9. *Owen v. Owen*, 500 U.S. 305, 111 S. Ct. 1833, 114 L. Ed. 2d 350, 24 C.B.C.2d 850 (1991) ; *Tower Loan*, 15 F.3d 1347, 30 C.B.C.2d 1510 (5th Cir. 1994) (prior case law of circuit on this issue had been overruled by *Owen*). See also *In re Snow*, 899 F.2d 337, 22 C.B.C.2d 1031 (4th Cir. 1990) , cert. denied, 500 U.S. 952, 111 S. Ct. 2256 (1991) (debtors entitled to avoid judicial lien on personal property based on back rent even though state law provided that exemption does not apply to claims for rent); *In re Kinnemore*, 181 B.R. 516 (Bankr. D. Idaho 1995)

(landlord's lien could be avoided despite state statute excluding exempt property from protection with respect to claims for unpaid rent).

(n10)Footnote 10. *Henderson*, 18 F.3d 1305 (5th Cir. 1994) , cert. denied, 513 U.S. 1014, 115 S. Ct. 573, 130 L. Ed. 2d 490 (1994) (judicial lien could be avoided even though no execution on the lien was possible because lien was unenforceable as to homestead). See also *Wolfson v. Watts* (*In re Watts*), 298 F.3d 1077 (9th Cir. 2002) (California law limiting judicial liens to surplus equity did not prevent lien from attaching and thereby becoming avoidable).

(n11)Footnote 11. See, e.g., *In re Amiri*, 184 B.R. 60 (Bankr. 9th Cir. 1995) (failure to timely file for homestead exemption under state law precludes avoidance of lien).

(n12)Footnote 12. 11 U.S.C. § 522(f)(2).

(n13)Footnote 13. See *In re Silveira*, 141 F.3d 34 (1st Cir. 1998) (applying formula to partially avoid lien); *In re Cozad*, 208 B.R. 495 (B.A.P. 10th Cir. 1997) (in applying formula to jointly held property when only one debtor is in bankruptcy, formula must be followed literally and total of liens and exemption must be subtracted from only debtor's interest in property). But see *Miller v. Okmi Sul* (*In re Miller*), 299 F.3d 183 (3d Cir. 2002) (total value of property used even though only one co-owner filed); *In re Lehman*, 205 F.3d 1255 (11th Cir. 2000) (total value of property used even though only one co-owner filed); *In re Nelson*, 192 F.3d 32, 42 C.B.C.2d 1647 (1st Cir. 1999) (despite language of statute, lien avoidance formula applied only to debtor's 50% interest in property).

(n14)Footnote 14. It is not clear whether liens must be avoided in reverse order of priority, i.e., the most junior judicial lien first as some courts have held. E.g., *In re Hanger*, 39 C.B.C.2d 677, 217 B.R. 592 (B.A.P. 9th Cir. 1998) , *aff'd* 196 F.3d 1292 (9th Cir. 1999) . An earlier version of the statute would have required this, but the priority language was deleted from the final version. See S.540, § 303, 103d Cong., 2d Sess. (1994).

(n15)Footnote 15. 11 U.S.C. § 522(f)(2)(C). See *Banknorth, N.A. v. Hart* (*In re Hart*), 328 F.3d 45 (1st Cir. 2003) (deficiency judgment not a lien arising out of mortgage foreclosure); *In re Been*, 153 F.3d 1034 (9th Cir. 1998) (§ 522(f)(2)(C) did not protect judgment lien obtained by creditor's suit on note after its junior lien on another property was extinguished by senior lienholder's foreclosure sale). Since judgments arising out of mortgage foreclosures, except perhaps for deficiency judgments, are not normally considered to be avoidable judicial liens, this provision will have little impact.

(n16)Footnote 16. H.R. Rep. No. 835, 103d Cong., 2d Sess. 52-54 (1994) *reprinted in* 1994 U.S.C.C.A.N. 3340, 3361-3363. The legislative history also states that the legislation overruled *In re Simonson*, 758 F.2d 103 (3d Cir. 1985) , in which the court had held that a judicial lien could not be avoided if it was senior to a nonavoidable mortgage and the nonavoidable mortgages on the property exceeded the value of the property; *In re Brinley*, 403 F.3d 415 (6th Cir. 2005) (debtor could avoid lien even though it was senior to nonavoidable liens); *Kolich v. Antioch Laurel Veterinary Hosp., Inc., P.C.* (*In re Kolich*), 273 B.R. 199 (B.A.P. 8th Cir. 2002) . See also *In re Holloway*, 81 F.3d 1062, 1069 n10, 35 C.B.C.2d 974, 983 n10 (11th Cir. 1996) (recognizing that prior case law not applicable to postamendment cases).

(n17)Footnote 17. H.R. Rep. No. 835, 103d Cong., 2d Sess. 52-54 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3361-3363. See *In re Toplitzky*, 227 B.R. 300 (B.A.P. 9th Cir. 1998) (formula in 1994 amendments precluded creditor from retaining its lien by paying debtor amount of equity in property above senior lien).

(n18)Footnote 18. H.R. Rep. No. 835, 103d Cong., 2d Sess. 52-54 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3361-3363. *In re Holland*, 151 F.3d 547 (6th Cir. 1998) .

(n19)Footnote 19. See *In re Silveira*, 141 F.3d 34 (1st Cir. 1998) (explaining partial lien avoidance).

(n20)Footnote 20. 500 U.S. 291, 111 S. Ct. 1825, 114 L. Ed. 2d 337, 24 C.B.C.2d 841 (1991) .

(n21)Footnote 21. See *McVay*, 7 F.3d 76 (5th Cir. 1993) , cert. denied, 511 U.S. 1006, 114 S. Ct. 1373, 128 L. Ed. 2d 49 (1994) (divorce lien attaching to debtor's preexisting separate property could be avoided); *In re Stoneking*, 40 C.B.C.2d 1408, 225 B.R. 690 (B.A.P. 9th Cir. 1998) (debtor could avoid lien which first attached to property when it was held with spouse as community property despite fact that it later became debtor's separate property, because lien fixed on property at time debtor had interest in property). See generally Sommer & McGarity, *Collier Family Law and the Bankruptcy Code*, P 7.04 (Matthew Bender).

(n22)Footnote 22. *In re Owen*, 961 F.2d 170, 26 C.B.C.2d 1758 (11th Cir. 1992) . See also *In re Scarpino*, 113 F.3d 338 (2d Cir. 1997) (same result under New York law). Compare *In re Pederson*, 39 C.B.C.2d 1, 215 B.R. 768 (Bankr. N.D. Cal. 1997) (under California law, judgment lien attaches at moment after debtor acquires property); *In re Conyers*, 129 B.R. 470 (Bankr. E.D. Ky. 1991) (relying on the Supreme Court decision in *Owen* to avoid a lien based on a judgment which arose before the debtor acquired the otherwise exempt homestead).

(n23)Footnote 23. Congress enacted section 552(f)(1)(A) to protect the debtor's right to exempt property and to eliminate an otherwise unsecured creditor's "race to the courthouse" to obtain a lien before the debtor declared bankruptcy. See *Farrey v. Sanderfoot*, 500 U.S. 291, 111 S. Ct. 1825, 1830, 114 L. Ed. 2d 337, 24 C.B.C.2d 841 (1991) .

(n24)Footnote 24. *Farrey v. Sanderfoot*, 500 U.S. 291, 111 S. Ct. 1825, 1830, 114 L. Ed. 2d 337, 24 C.B.C.2d 841 (1991) .

(n25)Footnote 25. 11 U.S.C. 522(f)(1)(A), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n26)Footnote 26. [Reserved]



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 18 Avoiding Powers of the Debtor

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P 18.04 Power to Avoid Nonpossessory, Nonpurchase-Money Security Interests in Certain Items; § 522(f)(1)(B)

Another potent avoiding power is that provided by section 522(f)(1)(B), the power to avoid nonpossessory, nonpurchase-money security interests in the following items:

- household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;
- implements, professional books, or tools of the trade of the debtor or the trade of a dependent of the debtor; and
- professionally prescribed health aids for the debtor or a dependent of the debtor.ⁿ¹

As the above list illustrates, this avoiding power extends to most, but not quite all, exempt tangible personal property of the debtor that is not in the creditor's possession. It may also be possible to recover property that was repossessed by a creditor who had held a nonpossessory non-purchase-money security interest.ⁿ²

FORMS

For forms pertaining to avoiding nonpurchase-money security interests see *Collier Consumer Bankruptcy Forms*, § CS17.22 (Matthew Bender).

[1] Definition of "Household Goods" for Purposes of Section 522(f)(1)(B)

The Code as enacted in 1978 did not define "household goods" for purposes of lien avoidance under section 522(f)(1)(B). Courts generally had adopted a broad definition of household goods that included certain basic items of personal property "kept in or around the home and used by the debtor or his dependents to support and facilitate day to day living within the home..."ⁿ³ However, in the 2005 amendments to the Bankruptcy Code, Congress has adopted a more restrictive definition of "household goods." Section 522(f)(4)(A), enacted in 2005,ⁿ⁴ provides that for purposes of lien avoidance under section 522(f)(1)(B), the term "household goods" means:

- clothing;
- furniture;
- appliances;
- 1 radio;
- 1 television;
- 1 VCR;
- linens;
- china, crockery and kitchenware;
- educational materials and educational equipment primarily for the use of minor dependent children of the debtor;
- medical equipment and supplies;
- furniture exclusively for the use of minor children, or elderly or disabled dependents of the debtor;
- personal effects (including the toys and hobby equipment of minor dependent children and wedding rings) of the debtor and the dependents of the debtor; and
- 1 personal computer and related equipment.

Section 522(f)(4)(B), also added in 2005,ⁿ⁵ provides that the term "household goods" *does not include*:

- works of art (unless by or of the debtor, or any relative of the debtor);
- electronic entertainment equipment with a fair market value of more than \$550 in the aggregate (except 1 television, 1 radio and 1 VCR);
- items acquired as antiques with a fair market value of more than \$550 in the aggregate;
- jewelry with a fair market value of more than \$550 in the aggregate (except wedding rings);
- and a computer (except as provided for in section 522(f)(4)(A)), motor vehicle (including a tractor or lawn tractor), boat, or a motorized recreational device, conveyance, vehicle, watercraft or aircraft.

The statutory language is unclear as to how to integrate the definition with the remainder of items listed in section 522(f)(1)(B). For example, items such as appliances and clothing appear in both section 522(f)(1)(B) and section 522(f)(4)(B), while other items included in the definition of household goods in section 522(f)(4)(B), such as furniture, may similarly be treated as "household furnishings" under section 522(f)(1)(B). Because "household furnishings" referenced in section 522(f)(1)(B) remains a separate, yet undefined, category of property for lien avoidance purposes, nonpossessory, nonpurchase-money security interests on items considered household furnishings may nevertheless be avoided. Because there has always been an overlap in the categories in section 522(f)(1)(B), there is no reason a lien cannot be avoided on items that are appliances, jewelry, tools of the trade, household furnishings or in other categories

listed in that subsection simply because they are not "household goods."

In addition, the precise definition of household goods provided in section 522(f)(4) is not only impractical, it will inevitably become obsolete if not amended. For example, the definition refers to a VCR which has been replaced by a DVD player in many households. In order to keep pace with changing consumer goods, court will likely need to develop a standard for including reasonable substitutes for the listed items.

FORMS

For forms pertaining to avoiding nonpurchase-money security interests in household goods *see Collier Consumer Bankruptcy Forms*, § CS17.23 (Matthew Bender).

These items need not be within the value limitation set forth in section 522(d)(3), as long as they have been validly claimed as exempt under some subsection or combination of subsections in section 522(d) or other applicable exemption law (including a wild card provision).ⁿ⁶

[2] Tools of the Trade

Similarly, if an item is a tool of the trade of the debtor or a dependent of the debtor, lien avoidance can occur regardless of the exemption provision used to exempt it. Thus, if a motor vehicle is claimed as exempt using the motor vehicle exemption, but is also used as a tool of the debtor's trade, a nonpossessory, nonpurchase-money lien on that vehicle may be avoided.ⁿ⁷ The dispute in such cases often centers on the definition of "tools of trade" under state or federal law, since many states have an exemption for tools of trade that is large or unlimited in amount.ⁿ⁸

COMMENTARY

Disputes concerning tools of the trade will only be increased by an incomprehensible 1994 amendment which purports to create an exception to the power to avoid nonpossessory nonpurchase-money security interests on tools of the debtor's trade, farm animals, or crops in certain cases. Section 522(f)(3) states that if certain conditions are met and the items in question exceed \$5,475 in value, such a lien cannot be avoided. However, among the conditions which must be met are that the state either permits the debtor to claim exemptions that are unlimited in amount, except to the extent that property is encumbered by a consensual lien, or the state prohibits avoidance of consensual liens. Since no state has unlimited exemptions, and no state could have had, consistent with the *Supremacy Clause*, a law prohibiting avoidance of liens in bankruptcy, it is not clear that the exception can be invoked in any state.ⁿ⁹ The legislative history does make clear that the exception applies only to exemptions claimed under state exemption schemes, and has no applicability to a debtor choosing the federal bankruptcy exemptions.ⁿ¹⁰ It also states that the \$5,475 limit, if it is ever applicable, is calculated separately for each debtor in a joint case.ⁿ¹¹ When the exception is applicable, the \$5,475 limit is designed to free \$5,475 of equity in tools of the trade from liens, not to limit the amount of the lien that could be avoided to \$5,475.ⁿ¹²

[3] Determining if Security Interest Is Nonpurchase Money

Issues may also arise as to whether or not a nonpurchase-money security interest exists. For example, the debtor may have entered into a series of credit purchases with cross-collateral clauses. These clauses secure each purchase with property previously purchased, even if that property had been fully paid for, through language stating that the property purchased in each transaction is security for subsequent purchase transactions. In such cases, it has been held that no purchase-money security interest exists, even as to the last item purchased.

Under the former provisions of the Uniform Commercial Code, the term purchase-money security interest had been narrowly defined to exclude any transactions in which the agreement purports to make collateral secure a debt other

than its own price.ⁿ¹³ The revised Uniform Commercial Code takes no position on the issue, leaving it for courts to decide, presumably in light of prior case law.ⁿ¹⁴ Thus, whenever such clauses exist, stating that the collateral will secure future indebtedness, it should be held that no purchase-money security interest exists, even if there has been no later indebtedness.ⁿ¹⁵ Certainly, when a refinancing has occurred, and the collateral in fact secures indebtedness other than its price, any possible purchase money character should be extinguished.ⁿ¹⁶ And similarly, if a loan involves other funds besides the purchase price (perhaps even those used to buy insurance), then property purchased using only some of the proceeds should not be considered subject to a purchase money security interest.ⁿ¹⁷

[4] Federal Trade Commission Limitations on Security Interests

In addition, it should be noted that the Federal Trade Commission has promulgated a rule which makes the taking of certain nonpossessory, nonpurchase-money liens in personal property an unfair trade practice.ⁿ¹⁸ The rule can be used in litigation asserting the unfair practice, and in at least one instance has been used in bankruptcy to avoid otherwise nonavoidable liens.ⁿ¹⁹

FOOTNOTES:

(n1)Footnote 1. *See* 4 *Collier on Bankruptcy*, P 522.11[6] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.11[6] (Matthew Bender).

(n2)Footnote 2. *In re Vann*, 177 B.R. 704 (D. Kan. 1995) (debtors allowed to avoid lien on tool of trade and recover it from creditor even though tool had been repossessed prior to bankruptcy filing).

(n3)Footnote 3. *In re McGreevy*, 955 F.2d 957, 960 (4th Cir. 1992) ; *see also In re Bandy*, 62 B.R. 437, 439 (Bankr. E.D. Cal.1986) (personal property that "enables the debtor and his dependents to live in a usual convenient and comfortable manner or that has entertainment or recreational value").

(n4)Footnote 4. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. *In re Liming*, 797 F.2d 895 (10th Cir. 1986) .

(n7)Footnote 7. *See Dominion Bank of Cumberlands v. Nuckolls*, 780 F.2d 408, 13 C.B.C.2d 1249 (4th Cir. 1985) (restaurant equipment exempted with homestead exemption is subject to lien avoidance as tool of trade); *In re Graettinger*, 20 C.B.C.2d 519, 95 B.R. 632 (Bankr. N.D. Iowa 1988) (liens could be avoided in pick-up truck exempted as motor vehicle, because truck was a tool of debtor's trade).

(n8)Footnote 8. *See, e.g., In re Taylor*, 861 F.2d 550 (9th Cir. 1988) (logging equipment worth \$50,000 could be freed from nonpossessory nonpurchase money security interest).

(n9)Footnote 9. *See In re Ehlen*, 202 B.R. 742 (Bankr. W.D. Wis. 1996) (section 522(f)(3) inapplicable in Wisconsin), *aff'd* 207 B.R. 179 (W.D. Wis. 1997) ; *In re Zimmer*, 185 B.R. 786 (Bankr. D. Minn. 1995) (Minnesota did not allow unlimited exemptions or permit debtors to waive exemptions, so section 522(f)(3) was inapplicable).

(n10)Footnote 10. H.R. Rep. No. 835, 103d Cong., 2d Sess. 56-7 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3365-3366.

(n11)Footnote 11. H.R. Rep. No. 835, 103d Cong., 2d Sess. 56-7 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3365-3366.

(n12)Footnote 12. *In re Duvall*, 218 B.R. 1008 (Bankr. W.D. Tex. 1998) (also holding that \$5,000 limit does not apply to each tool individually).

(n13)Footnote 13. *In re Freeman*, 956 F.2d 252 (11th Cir. 1992) (security interest lost its purchase money character when debt consolidated with other debts under Alabama law); *In re Manuel*, 507 F.2d 990 (5th Cir. 1975) .

(n14)Footnote 14. Official Comment 8 to U.C.C. § 9-103.

(n15)Footnote 15. *Southtrust Bank v. Borg-Warner Acceptance Corp.*, 760 F.2d 1240 (11th Cir. 1985) ; *In re Jones*, 5 B.R. 655 (Bankr. M.D.N.C. 1980) . But see *Pristas v. Landaus of Plymouth*, 742 F.2d 797 (3d Cir. 1984) (Pennsylvania Goods and Services Statute provided a method of apportioning payments so purchase-money character retained even if later sales made).

(n16)Footnote 16. *In re Matthews*, 724 F.2d 798, 10 C.B.C.2d 245 (9th Cir. 1984) .

(n17)Footnote 17. *In re Mulcahy*, 1 C.B.C.2d 887, 3 B.R. 454 (Bankr. S.D. Ind. 1980) .

(n18)Footnote 18. 16 C.F.R. § 444.

(n19)Footnote 19. *In re Raymond*, 103 B.R. 846 (Bankr. W.D. Ky. 1989) .



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CHAPTER 18 Avoiding Powers of the Debtor

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P 18.05 Power to Exempt Property Recovered by Trustee; § 522(g)

A power of the debtor somewhat less likely to be used is provided in section 522(g). This provision allows the debtor to exempt any property that the trustee recovers using the various trustee powers to recover property.ⁿ¹ Thus, if such property comes into the trustee's hands, the debtor may claim it as exempt, as long as the prebankruptcy transfer of the property from the debtor was not voluntary and the debtor did not conceal the property. The debtor may also exempt the property, under section 522(g)(2), if the debtor could have avoided the transfer because the transfer was pursuant to a nonpossessory, nonpurchase-money security interest.ⁿ²

FORMS

For a form pertaining to the debtor's power to exempt property recovered by the trustee *see Collier Consumer Bankruptcy Forms, Form CS17.32-1* (Matthew Bender).

MORE INFORMATION

A detailed discussion of the trustee's avoiding powers is found in chapter 17 *supra* .

[1] Determining Whether Transfer Was Voluntary

In some cases, under both section 522(g)(1) and section 522(h),ⁿ³ an issue may arise as to whether the transfer avoided by the trustee was a voluntary transfer. For example, there is no question that a debtor who pays money with a gun to his or her head has made an involuntary transfer. Would it be much different if the debtor paid a large utility arrearage upon the threat of a shut-off of heating or water service to a home in which the debtor's children live (or perhaps an elderly or sick relative)? What about a debtor threatened with lesser evils, *e.g.*, repossession of property necessary for daily existence, such as a refrigerator?ⁿ⁴ Thus, a seemingly voluntary transfer made under threat of foreclosure or based on misrepresentations about the circumstances of the transfer may be found to be involuntary for purposes of section 522(g) or (h).ⁿ⁵

[2] Section 522(g) as Limitation on Exemption Rights

It is also a little unclear whether section 522(g) is really an expansion of the debtor's powers to exempt property or

rather, in fact, a limitation. Since under section 522(b) the debtor already may claim exempt property from any property of the estate, and since property of the estate under section 541(a)(3) and (4) includes property recovered by the trustee under sections 543, 550, 551, 553 and 723, section 522(g) seems to add only a right to exempt property recovered by the trustee under sections 510(c) and 542. But section 522(g) does not allow the property to be exempted if it was transferred voluntarily or concealed by the debtor. This could mean that property which could be otherwise claimed as exempt under section 522(b) may not be claimed as exempt because of the limitations in section 522(g).ⁿ⁶ On the other hand, the legislative history states that the several provisions of section 522 are cumulative,ⁿ⁷ and therefore if property can be exempted under section 522(b), section 522(g) should not impair that right. In some cases, there may be an issue regarding whether the trustee recovered property or whether it was in the estate all along.ⁿ⁸ In any event, if the trustee acquires property other than through use of the provisions listed in section 522(g), section 522(g) does not prevent the debtor from exempting the property.ⁿ⁹

PRACTICE NOTE

In any case, it is not very likely that such disputes will arise often under section 522(g), since it will be a rare case in which the trustee bothers to avoid a transfer of property that the debtor may claim as exempt. Indeed, it is unusual for trustees to avoid the small transfers involved in consumer cases at all; when the only result will be more exempt property for the debtor rather than proceeds for the creditors, trustees have no incentive to do so. Except in cases in which the trustee would recover a substantial amount of nonexempt property along with the exempt property, the trustee's avoiding powers, and thus section 522(g), are not likely to be used often in consumer cases. However, in those cases in which the trustee does move to avoid a transfer, the debtor may be obligated to intervene in that action to protect his or her rights.ⁿ¹⁰ And when the trustee does avoid a transfer, the debtor's exempt share can be reduced by a pro rata share of the costs and expenses of avoiding the transfer.ⁿ¹¹

Occasionally, when the trustee does move to avoid an unperfected lien on a car or other property, it may also cause problems for the debtor by creating nonexemptible equity in the property. For example, the trustee may avoid a security interest of \$6,000 on an \$8,000 vehicle. The debtor usually would not be able to exempt the equity created because a security interest is usually a voluntary transfer of property and because applicable law may not permit an exemption in that high an amount. In such cases, the trustee may attempt to liquidate the property if the debtor does not pay the trustee its value. The debtor should argue that the trustee has merely stepped into the shoes of the former holder of the avoided lien, because the lien is preserved for the benefit of the estate under section 551, in which case the trustee has no greater rights than the former lien holder.ⁿ¹²

FOOTNOTES:

(n1)Footnote 1. See 4 *Collier on Bankruptcy*, P 522.12[1] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.12[1] (Matthew Bender).

(n2)Footnote 2. *In re Flitter*, 181 B.R. 938 (Bankr. D. Minn. 1995) (debtor may exempt property recovered by trustee if debtors could have avoided transfer under section 522(f), even if transfer was voluntary).

(n3)Footnote 3. 11 U.S.C. § 522(h) is discussed in P 18.06 *infra*.

(n4)Footnote 4. See 4 *Collier on Bankruptcy*, P 522.12[2][b] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.12[2][b] (Matthew Bender).

(n5)Footnote 5. *In re Davis*, 169 B.R. 285 (E.D.N.Y. 1994) (sale/leaseback agreement in which debtor executed a deed to avoid a threatened foreclosure was set aside as a fraudulent transfer under 11 U.S.C. § 548).

(n6)Footnote 6. See *Zubrod v. Duncan* (*In re Duncan*), 329 F.3d 1195 (10th Cir. 2003) (debtor not entitled to

homestead exemption in property recovered by trustee as fraudulent transfer to tenancy by entireties based on § 522(g) even though trustee failed to object to debtor's claim of exemption in property within 30-day period under *Fed. R. Bankr. P. 4003(b)*; trustee recovered, and debtor could not exempt, all interests in property that had been transferred under Wyoming law); *In re Wilson*, 694 F.2d 236, 7 C.B.C.2d 895 (11th Cir. 1982) (section 522(g) is a limitation on general power to exempt any property of estate, and does not apply to property not brought into estate by trustee avoiding powers enumerated therein).

(n7)Footnote 7. S. Rep. No. 989, 95th Cong., 2d Sess. 77 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender); H.R. Rep. No. 595, 95th Cong., 1st Sess. 363 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n8)Footnote 8. *See In re Moody*, 862 F.2d 1194 (5th Cir. 1989) (attempted fraudulent transfer of property did not preclude debtor from later claiming homestead exemption under Texas law); *In re Pancratz*, 175 B.R. 85 (D. Wyo. 1994) (transfer of property to self-settled spendthrift trust was invalid, so property was property of the estate at outset of case and section 522(g) was inapplicable).

(n9)Footnote 9. *McFatter v. Cage*, 204 B.R. 503 (S.D. Tex. 1996) .

(n10)Footnote 10. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 362 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n11)Footnote 11. 11 U.S.C. § 522(k)(1). *But see In re Breen*, 123 B.R. 357 (B.A.P. 9th Cir. 1991) (section 522(k)(1) not applicable where trustee recovers property through methods other than avoiding powers).

(n12)Footnote 12. *See In re Carvell*, 222 B.R. 178, 180 (B.A.P. 1st Cir. 1998) (preservation for the benefit of the estate puts the estate in the shoes of the creditor whose lien was avoided, the trustee assumes the position that the lien holder previously held, and the mortgage is treated as if it had not been avoided, as between the debtor and the trustee).



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 18 Avoiding Powers of the Debtor

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P 18.06 Debtor's Right to Utilize Trustee's Avoiding Powers; § 522(h)

More likely to be used are the provisions of section 522(h), which give the debtor the wide panoply of avoiding powers available to the trustee under sections 544, 545, 547, 548, 549, 553 and 724(a) in cases in which the trustee does not choose to avoid a transfer.ⁿ¹

FORMS

For a form pertaining to the debtor's use of the trustee's avoiding power *see Collier Consumer Bankruptcy Forms, Form CS17.33-1* (Matthew Bender).

The use of these powers is subject to the same limitations as section 522(g); the transfer to be avoided cannot have been a voluntary transfer, and the debtor may not use these powers to exempt property that was concealed by the debtor. The discussion above on voluntariness under section 522(g) is equally applicable to this section.ⁿ²

The debtor's powers under this section are otherwise the same as those of the trustee.

MORE INFORMATION

The trustee's avoiding powers are discussed in chapter 17 *supra*.

PRACTICE NOTE

In some cases, especially under chapter 13, a debtor may be able to convince a trustee to exercise an avoiding power the debtor cannot use because transfer was voluntary, especially if it will mean greater dividends for unsecured creditors. It may even be possible to provide that the trustee will do so as part of the chapter 13 plan.ⁿ³ The debtor in chapter 13 has a right to possession of any property recovered in this manner (though it cannot be exempted).ⁿ⁴ When a plan does provide for the trustee to avoid a transfer, the trustee's prior concurrence in such a provision should be sought if possible. Because the recovery of such property for use in funding the plan can also be enormously helpful to the debtor in paying priority or secured claims, debtor's counsel might even offer to draw up all of the necessary

papers for use by the trustee. Alternatively, some courts have simply held that a chapter 13 debtor may exercise the trustee's avoiding powers.^{n4a}

[1] The "Strong-Arm Clause"; § 544

The debtor's rights to use the trustee's section 544 powers are somewhat limited by the incorporation of language from section 522(g) into section 522(h) excluding voluntary transfers. Many security interests and other transfers of property that are avoidable by the trustee are voluntary, and those transfers will not be avoidable by the debtor. As discussed above,ⁿ⁵ the debtor may sometimes seek to have these transfers avoided by the trustee, though in other instances avoidance may be detrimental to the debtor.ⁿ⁶

The powers of section 544(a) can be used by the debtor to avoid various types of unperfected or improperly perfectedⁿ⁷ involuntary liens, such as mechanics' or repairmen's liens, and tax liens, if they are subordinate to judicial liens or the rights of bona fide purchasers under state law. These powers can also be used to cut off various equitable rights in real property, such as constructive trusts, if those rights were not created voluntarily by the debtor. Depending upon state law, the power to avoid transfers that are not enforceable against a bona fide purchaser of real estate may permit the debtor to avoid foreclosure sale transfers that have not been completed by the filing of a deed.ⁿ⁸

The section 544(b) power will likely be used most by debtors to attempt avoidance through incorporation of state fraudulent transfer laws.ⁿ⁹ A possible difficulty in using the Uniform Fraudulent Conveyance Act is the question of whether it is applicable at all to involuntary transfers. This issue was resolved in the Uniform Fraudulent Transfer Act, which is clearly applicable to involuntary transfers. However, a specific provision was included in the UFTA to except "a regularly conducted, noncollusive foreclosure sale or execution of a power of sale ... upon default under a mortgage, deed of trust or security agreement."ⁿ¹⁰ If avoidance of involuntary transfers is possible, then a wide variety of execution sales and defectively conducted foreclosures could be invalidated by debtors' use of this section. In each case, state law is the determining factor. This issue is further addressed below in the discussion of the section 548 avoiding powers for conveyances deemed fraudulent under federal law.

[2] Statutory Liens; § 545

Under section 545, certain statutory liens may be avoided.ⁿ¹¹ For cases filed prior to the effective date of the 2005 amendments, section 545 was sometimes used to avoid unfiled federal tax liens and, in certain cases, even recorded tax liens.ⁿ¹²

COMMENTARY

However, amended section 545,ⁿ¹³ eliminates this possibility by excepting from the bona fide purchaser rule a purchaser described in *section 6323 of the Internal Revenue Code*, or similar provision of state or local law.ⁿ¹⁴

In addition, debtors are likely to use section 545 in states where landlords' liens and distress for rent are common. It can also be used in cases involving mechanics' liens,ⁿ¹⁵ innkeepers' liens, and other statutory liens, to the extent those liens are subject to the rights of bona fide purchasers under state law. However, it should be noted that statutory liens may lose their character as statutory liens in some states if they are reduced to judgment, and thus become immunized to attack. On the other hand, if the lien becomes effective only upon recordation, it may not be a statutory lien at all, but rather a judicial lien,ⁿ¹⁶ since it does not arise solely by force of a statute.ⁿ¹⁷

[3] Preferences; § 547

The debtor's use of the section 547 avoiding powers through section 522(h) can be quite varied. Levies and execution sales by otherwise unsecured creditors,ⁿ¹⁸ including wage garnishmentsⁿ¹⁹ within 90 days prior to filing of the

bankruptcy, are clearly avoidable. However, a levy may be held to relate back to the date of the writ of execution under state law, at least in the Third and Fifth Circuits.ⁿ²⁰ And some courts have held that under particular state laws the garnishment must have been first initiated within the ninety days.ⁿ²¹ These latter cases do not properly recognize the provision in section 547(e)(3) that the transfer is not made until the debtor has acquired rights in the property. They were also undermined by the Supreme Court's decision in *Barnhill v. Johnson*,ⁿ²² which held that a transfer by check did not occur until the bank honored the check.ⁿ²³

A payment made pursuant to a criminal restitution order can be recovered though the debtor's use of section 547, even if it was made through a third party, such as a court clerk.ⁿ²⁴ Tax refund intercepts made by the Internal Revenue Service on behalf of another entity, such as a state student loan guarantee agency, or other governmental agency other than for a domestic support obligation, can be set aside as preferences if made within the ninety day look back period.

Additionally, payments made to and retained by collection agencies can be recovered directly from the agency.ⁿ²⁵ These types of transfers normally meet all of the required tests for preferences and are definitely considered involuntary. The fact that a debt is nondischargeable should not affect the use of this power.ⁿ²⁶ Thus, a debtor may be able to set aside a tax levy,ⁿ²⁷ or perhaps other tax payments.ⁿ²⁸ However, the actual fixing of a tax lien is not avoidable to the extent that it is a statutory lien not avoidable under section 545. In addition, recovery from a state may be barred by the *Eleventh Amendment* if the state has not waived its immunity.ⁿ²⁹

Repossessions pursuant to valid security interests which could not otherwise be avoided generally do not constitute preferences. However, if the security interest was extracted within the preference period in exchange for forbearance on a pre-existing debt, or if new security during that period for a refinancing exceeds the new value given, then the security interest and any enforcement of it would constitute preferences. Also, if property of greater value than the debt has been repossessed and not sold by the creditor either because the sale has not yet been scheduled or because the creditor has chosen to exercise a right of strict foreclosure and keep the property, then the creditor has received a preference by recovering property of greater value than it would receive in a liquidation.ⁿ³⁰

Security interests in general, though, raise the thorny problems of voluntariness. Security interests are almost voluntary by definition. Section 101(51) defines security interest as a "lien created by agreement." But what of the security interest granted only under threat of dire consequences *e.g.*, foreclosure or eviction? Like the payment of utility arrearages under a threat of midwinter cutoff, rent arrearages under threat of eviction, or debt arrearages under threat of imprisonment, such a transfer can quite arguably be considered involuntary and made under duress.ⁿ³¹ Other transfers that might well be considered involuntary include those pursuant to contractual terms that a debtor does not understand.ⁿ³² Since it is widely accepted that many of the terms used in consumer credit contracts are neither bargained for nor understood by consumers, this could mean setting aside wage assignmentsⁿ³³ and other security arrangements.

[4] Fraudulent Transfers; § 548

The most important part of section 548ⁿ³⁴ for consumer debtors is the provision which classifies as fraudulent any transfer that occurred within two years preceding the petition for less than reasonably equivalent value while the debtor was insolvent. Since most consumer debtors are insolvent under the Code's definition in section 101(32), this section allows the debtor to avoid any transfer (as transfer is broadly defined in section 101(54)) within the previous two years which was for less than reasonably equivalent value, as long as the transfer was not voluntary and the debtor did not conceal the property.ⁿ³⁵

A common use of this power by consumer debtors in the past was to avoid transfers such as mortgage foreclosures, tax sales, repossessions or execution sales where the property in question was worth significantly more than the value received for it.ⁿ³⁶ Despite seemingly clear language in the statute supporting such use, the Supreme Court held in *BFP v. Resolution Trust Corporation*,ⁿ³⁷ that a regularly conducted, noncollusive foreclosure sale could not be avoided under section 548. The court's holding appears to also preclude use of section 548 in cases where secured creditors sell

property at public auctions pursuant to Article 9 the Uniform Commercial Code, but should leave open the possibility of challenging a private sale or a strict foreclosure pursuant to the provisions of that Article.ⁿ³⁸ Obviously, the court's ruling also leaves open the possibility of using section 548 to avoid transfers pursuant to foreclosure sales that were not regularly conducted or that were collusive.

Additionally, sales may be challenged in most states where the price received is considered "grossly" inadequate.ⁿ³⁹ The bankruptcy court, if that is the preferred forum, should have jurisdiction over an action to set aside a sale on state law grounds, because it would be an action to recover property for the estate. Such an action, or an action raising other state law defects in the sale, may be brought directly in the bankruptcy court or by removal of a state court foreclosure proceeding.ⁿ⁴⁰

Other creative uses of section 548, such as to avoid forfeitures under real estate sale agreements,ⁿ⁴¹ real estate installment sales contracts,ⁿ⁴² pawnbroker agreements,ⁿ⁴³ including automobile title pawns,ⁿ⁴⁴ or extortionate charges under consumer contracts, should also be considered. For example, large check cashing fees or loan broker charges might be challenged as fraudulent transfers.ⁿ⁴⁵ In such cases, a major question will be whether the transfer was voluntary. Use of this avoiding power may be an effective way of remedying home equity scams, in which mortgagors in trouble are tricked into conveying title to their properties to those who say they will help them.ⁿ⁴⁶ Similarly, the grant of a mortgage or other security interest by a cosigner or accommodation party who received no consideration in a transaction may be challenged, since only the value that the debtor received should be considered relevant under section 548. However, such transactions may not be considered involuntary, in which case action by the trustee would be required. When the two year limitation period under section 548 has passed, it may still be possible to seek to avoid such transfers pursuant to section 544 under a longer state law limitations period for fraudulent transfers.

In the *BFP* opinion, the Supreme Court expressly limited its holding to mortgage foreclosures of real estate, stating that "the considerations bearing on other foreclosures and forced sales (to satisfy tax liens, for example) may be different."ⁿ⁴⁷ For tax foreclosures which do not involve a formal sale of the property (*i.e.*, where the purchaser obtains a lien or a certificate rather than an actual deed), the *BFP* analysis should not be relevant.ⁿ⁴⁸ Typically, the purchaser of a tax lien pays only the amount of delinquent taxes, an amount which bears no relationship to the value of the property. For this reason, there is no logical basis on which to conclude that the tax lien purchase price is a "reasonably equivalent value."

PRACTICE NOTE

A major limitation on the use of section 548 should be noted, however. Under subsection 548(c), if a transfer is avoidable only under section 548, any transferee who takes for value and in good faith is given a lien on the interest transferred or may enforce the obligation incurred to the extent of the value given to the debtor. If the creditor had executed on a previously unsecured debt, this lien might not be avoidable under any of the debtor's other avoiding powers. However, it could presumably be paid in installments in a chapter 13 plan.

MORE INFORMATION

For a discussion of dealing with secured claims in chapter 13 see chapter 14 *supra*.

[5] Postpetition Transfers; § 549

The debtor may use section 549 in conjunction with the automatic stay provisions to invalidate involuntary postpetition transfers.ⁿ⁴⁹ One example of a case in which the stay might need such supplementation is a repossession ordered by a creditor without notice of the bankruptcy. Although the creditor would probably not be held in contempt since it had no notice of the case, the repossession could clearly be reversed. A setoff after the bankruptcy could be similarly undone.

MORE INFORMATION

For discussion of the effect of the automatic stay on the validity of transfers see chapter 8 *supra*.

PRACTICE NOTE

Also, in chapter 13 cases in which the debtor's postpetition income is property of the estate,ⁿ⁵⁰ any deduction by a credit union from wages would be avoidable.ⁿ⁵¹ To prevent any problems in effecting this last type of avoidance, it is advisable to withdraw, before the bankruptcy, any prior authorization for such deductions that might muddy the issue of voluntariness.

[6] Setoff; § 553

Since setoffs are normally involuntary, they can often be avoided by debtors through use of the trustee's powers under section 553.ⁿ⁵² For example a debtor may recover a setoff against a bank or credit union account.ⁿ⁵³ Setoffs by taxing authorities are also common targets of debtor proceedings under section 553.ⁿ⁵⁴ Similarly, setoffs by other government agencies may be reversed,ⁿ⁵⁵ although recovery from a state may be barred by the *Eleventh Amendment*.

Arguably, any deposit to a creditor bank is a transfer to the bank which could be avoided as a setoff if it improved the bank's position.ⁿ⁵⁶ In any case, this is rarely an issue with respect to the debtor's avoiding powers, since the deposit is normally a voluntary transfer and thus not avoidable under section 522(h).

[7] Liens Securing Fines, Penalties and Forfeitures; § 724(a)

The final type of transfer that is avoidable by the trustee, and sometimes by the debtor, is described in section 724(a), which applies only in cases under that chapter, and not in chapter 13 cases.ⁿ⁵⁷ In cases involving judgment liens, this power will add little to the debtor's arsenal beyond the broader power which is available under section 522(f)(1)(A).ⁿ⁵⁸

PRACTICE NOTE

However, under some consumer contracts the power may be available to challenge that portion of a lien which represents a penalty, including, for example, late charges and prepayment penalties. In such cases one issue likely to arise for a debtor seeking to use the power is the voluntariness of the transfer. The debtor should argue that the imposition of the penalty represents a separate involuntary transfer from the underlying transaction granting the security interest.

FOOTNOTES:

(n1)Footnote 1. See *Deel Rent-A-Car v. Levine*, 721 F.2d 750, 9 C.B.C.2d 1261 (11th Cir. 1983) (debtor may avoid transfer that trustee could have avoided even though transfer was pursuant to prebankruptcy execution on property that would not otherwise have been exempt due to liens eliminated by the execution).

(n2)Footnote 2. See P 18.05 *supra*.

(n3)Footnote 3. *In re Johnson*, 26 B.R. 381 (Bankr. D. Colo. 1982) (plan could provide for chapter 13 trustee to avoid fraudulent transfer).

(n4)Footnote 4. 11 U.S.C. § 1306.

(n5)Footnote 4a. See, e.g., *In re Cohen*, 305 B.R. 886 (B.A.P. 9th Cir. 2004) . But see, e.g., *In re Stangel*, 219 F.3d 498 (5th Cir. 2000) .

(n6)Footnote 5. See P 17.03 *supra*.

(n7)Footnote 6. *See P 18.05 supra*.

(n8)Footnote 7. *See, e.g., McLean v. City of Philadelphia*, 891 F.2d 474 (3d Cir. 1989) (city's liens for utility service found avoidable based on failure to properly comply with state lien indexing law).

(n9)Footnote 8. *In re Elam*, 194 B.R. 412 (Bankr. E.D. Tex. 1996) .

(n10)Footnote 9. *See, e.g., Havee v. Belk*, 775 F.2d 1209 (4th Cir. 1985) .

(n11)Footnote 10. Section 3 of the Uniform Act creates a presumption that the value given for a transfer of this type is reasonably equivalent value. It may nevertheless be possible under the UFTA to challenge a foreclosure sale as not regularly conducted or noncollusive.

(n12)Footnote 11. *See P 17.04 supra*.

(n13)Footnote 12. *In re Znider*, 150 B.R. 239 (Bankr. C.D. Cal. 1993) (debtors permitted to avoid filed tax liens on money, stock and vehicle and unfiled tax liens on all real and personal property); *In re Sierer*, 24 C.B.C.2d 1039, 121 B.R. 884 (Bankr. N.D. Fla. 1990) (permitting avoidance of perfected federal tax liens on automobiles, money market account, household goods, stocks, IRA, tools, promissory note and cash, but not as to insurance), *aff'd*, *United States v. Sierer*, 139 B.R. 752 (N.D. Fla. 1991) ; *see I.R.C. § 6323(b)-(e)*; S. Rep. No. 989, 95th Cong., 2d Sess. 86 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender). *See also In re Hudgins*, 967 F.2d 973, 27 C.B.C.2d 114 (4th Cir. 1992) (tax lien filed against Michael Hudgins, Inc. avoidable with respect to debtor's nonbusiness assets, even though the corporation had ceased to exist prior to filing of the lien, since notice of lien did not put bona fide purchasers on notice that debtor's personal assets were lien).

(n14)Footnote 13. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n15)Footnote 14. 11 U.S.C. 545(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n16)Footnote 15. *See, e.g., In re English*, 112 B.R. 20 (Bankr. W.D. Ky. 1989) (mechanic's lien avoided where debtor had personal knowledge of intent to file lien but, in capacity of bona fide purchaser for value, could avoid lien which had not yet been perfected at time of filing).

(n17)Footnote 16. *In re Barbe*, 24 B.R. 739 (Bankr. M.D. Pa. 1982) .

(n18)Footnote 17. *See 11 U.S.C. § 101(53)* defining "statutory lien."

(n19)Footnote 18. *E.g., Deel Rent-A-Car v. Levine*, 721 F.2d 750, 9 C.B.C.2d 1261 (11th Cir. 1983) ; *In re Rhoads*, 130 B.R. 565 (Bankr. C.D. Cal. 1991) (recordation of abstract of judgment avoided as preferential).

(n20)Footnote 19. *E.g., In the Matter of Pierce*, 2 C.B.C.2d 148, 6 B.R. 18 (Bankr. N.D. Ill. 1980) . *See also Bank of America N.A. (USA) v. Stine*, 252 B.R. 902 (D. Md. 2000) (state statute making exemptions inapplicable to wage garnishment did not preclude avoidance of garnishment as preference and exemption of proceeds).

(n21)Footnote 20. *In re Latham*, 823 F.2d 108 (5th Cir. 1987) ; *In re RAMCO American Int'l*, 754 F.2d 130, 12 C.B.C.2d 40 (3d Cir. 1985) .

(n22)Footnote 21. *See 5 Collier on Bankruptcy*, P 547.05[7][b] (Matthew Bender); *2 Collier Bankruptcy Manual*, P 547.05[7][b] (Matthew Bender).

(n23)Footnote 22. 503 U.S. 393, 112 S. Ct. 1386, 118 L. Ed. 2d 39, 26 C.B.C.2d 323 (1992) .

(n24)Footnote 23. See *In re Morehead*, 249 F.3d 445 (6th Cir. 2001) (Ridderwold and Coppie ignore plain meaning of § 547(e)(3)); *Freedom Group*, 50 F.3d 408, 32 C.B.C.2d 1958 (7th Cir. 1995) (Barnhill overruled cases that had held that notice of garnishment of bank account constituted transfer); *In re Wade*, 219 B.R. 815 (B.A.P. 8th Cir. 1998) (debtor could avoid garnishment of wages earned within 90 days of petition); *In re Arway*, 41 C.B.C.2d 141, 227 B.R. 216 (Bankr. W.D.N.Y. 1998) (Second Circuit garnishment case overruled by Barnhill).

(n25)Footnote 24. *In re Kirk*, 10 C.B.C.2d 815, 38 B.R. 257 (Bankr. D. Kan. 1984) .

(n26)Footnote 25. *In re Mill St., Inc.*, 96 B.R. 268 (Bankr. 9th Cir. 1989) .

(n27)Footnote 26. See *In re Chase & Sanborn Corp.*, 904 F.2d 588, 23 C.B.C.2d 5 (11th Cir. 1990) (prebankruptcy fraud does not preclude avoiding preferential payments on the resulting debt); *In re Car Renovators*, 946 F.2d 780, 25 C.B.C.2d 1185 (11th Cir. 1991) (nondischargeable restitution payment may be avoided as a preference).

(n28)Footnote 27. See e.g., *In re Williams*, 153 B.R. 74 (Bankr. S.D. Ala. 1992) (IRS levy on debtor's wages within 90 days before petition avoided as preference).

(n29)Footnote 28. *Drabkin v. District of Columbia*, 824 F.2d 1102, 17 C.B.C.2d 945 (D.C. Cir. 1987) . Again the question of voluntariness arises. In view of the criminal penalties for nonpayment, are tax payments voluntary?

(n30)Footnote 29. See 2 *Collier on Bankruptcy*, P 106.02 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 106.02 (Matthew Bender).

(n31)Footnote 30. *Matter of Park North Partners, Ltd.*, 19 C.B.C.2d 367, 85 B.R. 916 (Bankr. N.D. Ga. 1988) (creditor received preference when it purchased property of debtor at foreclosure sale, the value of which exceeded the amount of the debtor's secured obligation to the creditor); *In re Seidel*, 27 B.R. 347 (Bankr. E.D. Pa. 1983) (truck returned to creditor worth more than secured debt).

(n32)Footnote 31. See *In re Mason*, 69 B.R. 876 (Bankr. E.D. Pa. 1987) (payments of rents into escrow pursuant to court order pending appeal held involuntary).

(n33)Footnote 32. See *In re Davis*, 169 B.R. 285 (E.D.N.Y. 1994) (sale/leaseback agreement in which the debtor executed a deed to avoid a threatened foreclosure found to be involuntary based on misrepresentations made by the transferee).

(n34)Footnote 33. *In re Peterson*, 14 *Clearinghouse Rev.* 459, Clearinghouse No. 29,153 (Bankr. W.D. Mich. 1980) (wage assignment deemed involuntary due to lack of debtor understanding).

(n35)Footnote 34. 11 U.S.C. § 548, as amended by Pub. L. No. 109-8 (2005). Amendments to section 548, except the change in the reach back period from one to two years and the new ability to avoid certain insider transfers under employment contracts, are effective with respect to cases filed on or after October 17, 2005. For the change in reach back period from one to two years the effective date is for cases filed after April 20, 2006.

(n36)Footnote 35. 11 U.S.C. § 522(h).

(n37)Footnote 36. See, e.g. *In re Hulm*, 738 F.2d 323, 11 C.B.C.2d 152 (8th Cir.) , cert. denied, 469 U.S. 990, 105 S. Ct. 398 (1984) .

(n38)Footnote 37. 511 U.S. 531, 114 S. Ct. 1757, 128 L. Ed. 2d 556, 30 C.B.C.2d 345 (1994) .

(n39)Footnote 38. The *BFP* decision does not appear to apply at all to tax lien execution or other process which does not involve an auction. See, e.g., *In re McKeever*, 25 C.B.C.2d 1260, 132 B.R. 996 (Bankr. N.D. Ill. 1991) .

(n40)Footnote 39. *See, e.g., Gumz v. Chickering*, 19 Wis. 2d 625, 121 N.W.2d 279 (1993) . *See generally* Washburn, *The Judicial Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 So. Cal. L. Rev. 843 (1980).

(n41)Footnote 40. *See, e.g., In re Graves*, 33 F.3d 242 (3d Cir. 1994) (sheriff's sale was voidable because purchaser had notice of unrecorded ownership interest of the debtor). For a discussion of removal of state court actions, *see* 1 *Collier on Bankruptcy*, P 3.07 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 3.07 (Matthew Bender).

(n42)Footnote 41. *See In re McConnell*, 934 F.2d 662 (5th Cir. 1991) (forfeiture of \$600,000 down payment under real estate sale agreement avoided as fraudulent transfer).

(n43)Footnote 42. *In re Grady*, 202 B.R. 120 (Bankr. N.D. Iowa 1996) (BFP does not apply to forfeiture of real estate installment sale contract; property interest of \$40,000 forfeited to satisfy \$16,000 debt under the contract constituted fraudulent transfer).

(n44)Footnote 43. *In re Carter*, 38 C.B.C.2d 345, 209 B.R. 732 (Bankr. D. Or. 1997) (forfeiture of right to redeem jewelry from pawnbroker was avoidable involuntary transfer by debtor under section 522(h)).

(n45)Footnote 44. *Geddes v. Mayhall Enters., LLC (In re Jessie Jones)*, 304 B.R. 462 (Bankr. N.D. Ala. 2003) (debtor in title pawn transaction did not receive reasonably equivalent value); *See Bell v. Instant Car Title Loans (In re Bell)*, 279 B.R. 890 (Bankr. N.D. Ga. 2002) (pawnbroker preliminarily enjoined from selling car worth over \$10,000 that was taken for failure to pay \$5,300 redemption price on \$4,000 loan).

(n46)Footnote 45. *See In re Wernly*, 91 B.R. 702 (Bankr. E.D. Pa. 1988) (\$1,150 fee paid to check cashing company to cash check was not paid due to fraud or duress so as to make the payment involuntary and therefore avoidable).

(n47)Footnote 46. *See, e.g., In re Davis*, 169 B.R. 285 (E.D.N.Y. 1992) (conveyance in sale/leaseback transaction based on misrepresentations of transferee and without understanding of consequences found to be involuntary).

(n48)Footnote 47. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537 n3, 114 S. Ct. 1757, 1761 n3, 128 L. Ed. 2d 556, 564 n3, 30 C.B.C.2d 345, 349 n3 . *But see In re McGrath*, 31 C.B.C.2d 586, 170 B.R. 78 (Bankr. D.N.J. 1994) (applying BFP analysis to tax sales).

(n49)Footnote 48. *E.g., In re Fitzgerald*, 237 B.R. 252 (Bankr. D.Conn. 1999) (BFP not applicable to foreclosure without public sale); *In re Wentworth*, 40 C.B.C.2d 132, 221 B.R. 316 (Bankr. D. Conn. 1998) (tax forfeiture proceeding without judicial oversight or competitive bidding not governed by BFP decision); *In re Grady*, 202 B.R. 120 (Bankr. N.D. Iowa 1996) (BFP not applicable to land contract forfeiture); *In re Butler*, 31 C.B.C.2d 1377, 171 B.R. 321 (Bankr. N.D. Ill. 1994) ; *In re Sporting Club*, 132 B.R. 792 (Bankr. N.D. Ill. 1991) . In Illinois, the property transfer is an administrative act based on prior sale of the *tax lien* and a failure to redeem; there is no property sale to which the BFP analysis could apply.

(n50)Footnote 49. 11 U.S.C. § 549, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n51)Footnote 50. 11 U.S.C. § 1306(a).

(n52)Footnote 51. *In re Shepherd*, 4 C.B.C.2d 1479, 12 B.R. 151 (E.D. Pa. 1981) .

(n53)Footnote 52. 11 U.S.C. § 553, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. The 2005 amendments to section 553, which are inapplicable in consumer cases, limit the avoidance of setoffs with respect to certain business contracts (e.g., securities contracts, futures contracts, swap

agreements, repurchase agreements, and master netting agreements).

(n54)Footnote 53. *In re Moreira*, 32 C.B.C.2d 39, 173 B.R. 965 (Bankr. D. Mass. 1994) (debtor could challenge setoff against credit union account to extent she could claim funds in account were exempt).

(n55)Footnote 54. However, section 362(b)(26), enacted in 2005, provides that post-petition a taxing authority may setoff an income tax refund based on a prepetition taxable period against a prepetition tax liability. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n56)Footnote 55. *In re Fox*, 62 B.R. 432 (Bankr. D.R.I. 1986) (avoiding Veterans Administration withholding of benefits to recover money paid out on a mortgage guarantee).

(n57)Footnote 56. See S. Rep. No. 989, 95th Cong., 2d Sess. 27 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender); H.R. Rep. No. 595, 95th Cong., 1st Sess. 314 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender), stating the term "transfer" includes a deposit in a bank account.

(n58)Footnote 57. See P 17.09 *supra*.

(n59)Footnote 58. See P 18.03 *supra*.



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CHAPTER 18 Avoiding Powers of the Debtor

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P 18.07 Other Limitations on Debtor's Use of Trustee Avoiding Powers

In addition to the overriding limitations on sections 522(g) and (h) that the debtor may not avoid any voluntary transfer or transfer where the debtor concealed property, there are a number of other limitations on the debtor's avoiding powers.

Naturally, the avoiding powers are limited by the extent of the debtor's available exemptions. Subsection 522(j) permits exemption of particular property only to the extent that the exemption for that type of property is still available.

More importantly, the avoiding powers are subject to the limitations placed upon the trustee by sections 546 and 550. Section 546 sets a statute of limitations for avoidance actions at the earlier of 1) two years after the entry of the order for relief (normally the date of the petition) or 2) the time the case is closed or dismissed.ⁿ¹

Section 546 also subordinates the trustee's powers to any applicable law that allows perfection of an interest to relate back to an earlier date,ⁿ² and to certain sellers' rights of reclamation of goods sold.ⁿ³

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 546(a)*.

(n2)Footnote 2. *11 U.S.C. § 546(b)*.

(n3)Footnote 3. *11 U.S.C. § 546(c)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005; *11 U.S.C. § 546(d)*.



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CHAPTER 18 Avoiding Powers of the Debtor

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P 18.08 Recovery of Property After Transfer Is Avoided

When a transfer is avoided, section 522(i)(1) generally allows recovery of the transferred property (or its value in some cases) from both the initial transferee and a subsequent transferee.ⁿ¹ Pursuant to that subsection, however, the debtor is subject to the same limitations on recovery as apply to the trustee under section 550. Among these are that an action to recover property subsequent to the avoidance of a transfer must be commenced within one year after the avoidance, or before the case is closed, whichever comes first.ⁿ²

MORE INFORMATION

For discussion of section 550 *see P 17.11 supra*.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 550(a). *See In re Willaert*, 944 F.2d 463 (8th Cir. 1991) (proceeds of sale of transferred property can be recovered). A party must have actual dominion or control over funds to qualify as a transferee. Thus a bank receiving funds to be deposited in a bank account is normally not a transferee, since the person owning the account ordinarily controls that money. *In re First Security Mortgage*, 33 F.3d 42 (10th Cir. 1994) .

(n2)Footnote 2. 11 U.S.C. § 550(f).



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CHAPTER 18 Avoiding Powers of the Debtor

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P 18.09 Preservation of Avoided Transfers or Recovered Property

An important but often overlooked addition to the avoiding powers is the right to preserve avoided transfers for the benefit of the debtor. Subsection 522(i)(2) provides that a transfer avoided or property recovered by the debtor or the trustee may be preserved for the benefit of the debtor to the extent that the debtor may exempt that property.

What this means, in effect, is that the debtor steps into the shoes of the holder of the avoided transfer vis-a-vis any other entity with rights junior to that holder, and thereby obtains rights superior to junior lienholders.

ILLUSTRATION

For example, if two joint debtors have a home worth \$10,000 which has an \$8,000 judicial lien and a \$10,000 mortgage junior to the judicial lien, the debtors, if they are able to exempt their \$10,000 interest (as they could under the federal exemptions) may avoid the judicial lien under section 522(f)(1).ⁿ¹ Without preservation of that lien (a transfer) for their benefit, however, this would not benefit the debtors, since it would merely move the mortgage up in priority from a position of being secured in the amount of \$2,000 and unsecured in the amount of \$8,000 to being fully secured in the amount of \$10,000. By allowing the debtors to preserve the avoided judicial lien for their own benefit, the Code keeps the mortgage in its previous position, *i.e.*, secured only to the extent of \$2,000 and unsecured as to the remaining \$8,000. Needless to say, this power can be of great importance in cases in which there are multiple liens on a particular property.

It is unclear what, if any, affirmative action must be taken to preserve a transfer under section 522(i)(2). Unlike the trustee's power to have transfers preserved under section 551,ⁿ² it appears that the preservation for the debtor may not be automatic, since the language of section 522(i)(2) states that a transfer "may be preserved," and not that it "is preserved." In view of this, it is advisable to seek preservation affirmatively as part of the relief when a transfer is avoided, in order to eliminate any possible doubts as to this question. Proper recording of any order so obtained will have the practical benefit of preserving the value of the exemption for the debtor if, for example, the property is sold many years after bankruptcy and a title company is distributing the proceeds of sale.

FOOTNOTES:

(n1)Footnote 1. *See Kors, Inc. v. Howard Bank*, 819 F.2d 19 (2d Cir. 1987) ; *In re Losieniecki*, 17 B.R. 136 (Bankr.

W.D. Pa. 1981) .

(n2)Footnote 2. *See In re Van De Kamp's Dutch Bakeries*, 908 F.2d 517 (9th Cir. 1990) (transfer avoided by trustee as fraudulent was automatically preserved for benefit of estate, regardless whether interest could have been avoided by competing creditor in prepetition state court proceeding).



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CHAPTER 19 Filing and Objecting to Proofs of Claims

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CHAPTER 19 Filing and Objecting to Proofs of Claims

1-19 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the procedures for filing proofs of claims. First, the purpose and consequences of filing a proof of claim are reviewed, as well as notice procedures. The chapter next discusses considerations for creditors who must file proofs of claim, including postpetition claims, as well as cases in which debtors or codebtors must file on behalf of a creditor. The time for filing is also reviewed. In addition, the chapter details the procedures for objections to claims.



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CHAPTER 19 Filing and Objecting to Proofs of Claims

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P 19.01 Introduction

A proof of claim, as defined by *Rule 3001(a) of the Federal Rules of Bankruptcy Procedure*, is a written statement setting forth a creditor's claim that can be filed by the parties identified in *section 501 of the Bankruptcy Code*.ⁿ¹ A proof of claim is filed on a form that should substantially conform to Official Bankruptcy Form 10.

FORMS

For examples of proofs of claim by creditors see *Collier Consumer Bankruptcy Forms*, § CS8.02 (Matthew Bender).

The term "proof of claim" also applies to proofs of interest. For the purposes of section 501, a proof of "interest" includes the interest of a general or limited partner in a partnership, the interest of a proprietor in a sole proprietorship, and the interest of a common or preferred stockholder in a corporation. Such proofs of interest are not filed in normal consumer bankruptcy cases.

The term "claim" is broadly defined in *section 101 of the Bankruptcy Code* as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."ⁿ² It includes a "right to an equitable remedy for breach of performance if such breach gives rise to a right of payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured." The assertion of any such claim is governed by section 501.

FOOTNOTES:

(n1)Footnote 1. See *P 19.04 infra* for discussion of parties that may file a proof of claim.

(n2)Footnote 2. See 2 *Collier on Bankruptcy*, ch. 101 (Matthew Bender); 1 *Collier Bankruptcy Manual*, ch. 101 (Matthew Bender).



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CHAPTER 19 Filing and Objecting to Proofs of Claims

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P 19.02 Purpose and Consequences of Filing Proof of Claim or Interest

[1] Purpose in Chapter 7 Cases

The function of a proof of claim or interest in a chapter 7 case is to state the amount the creditor believes is due and to enable the holder of the claim or interest to participate in the distribution of the assets of the estate.

Section 726(a)(1) through (6), which deal with distribution of the estate in a chapter 7 case, provide that property of the estate shall be distributed in the following order:

- (1) payment of priority claims, including certain tardily filed priority claims;
- (2) payment of any allowed unsecured claim which is timely filed;
- (3) payment of any allowed unsecured claim which is tardily filed;
- (4) payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim;
- (5) payment of interest at the legal rate from the date of the filing of the petition, on any claim described above; and
- (6) to the debtor.ⁿ¹

WARNING

In chapter 7 cases, a creditor who does not file a proof of claim may not participate in the distribution of the estate. Furthermore, in most cases (unless the claim is nondischargeable under section 523(a)), a creditor who does not file a proof of claim will find that the claim has been discharged even though the creditor did not participate in the distribution.ⁿ²

Rule 2002(h) of the Federal Rules of Bankruptcy Procedure provides that the court in a chapter 7 case may, after 90 days following the first date set for the section 341 meeting of creditors, direct that all required notices be mailed only to creditors whose claims have been filed. The creditor will receive these notices even if the creditor's claim was not scheduled by the debtor.

Section 702(a)(1) and *Bankruptcy Rule 2003(b)(3)* provide that only creditors who have filed proofs of claim may vote in an election for a trustee.

[2] Purpose in Chapter 13 Cases

In chapter 13 cases, a creditor (except, in some cases, certain types of secured creditors) must file a proof of claim in order to be able to participate in the distribution under the chapter 13 plan.ⁿ³ Thus, if the holder of a claim wishes to participate in a chapter 13 distribution, a proof of claim must be filed with the clerk. The necessity for unsecured creditors to file a proof of claim is provided in *Rule 3002(a)*. In addition, a creditor that has not filed a timely proof of claim probably has no standing to participate in the case once the time for filing has run, at least to the extent that events in the case, such as modification of the plan, will have no effect on that creditor.

[3] Consequences of Filing Proof of Claim in All Title 11 Cases

[a] Proof of Claim is *Prima Facie* Evidence of Validity and Amount of Claim.

The most important consequence of filing a proof of claim is that a properly executed and timely filed proof of claim constitutes *prima facie* evidence of the validity and the amount of the claim.ⁿ⁴ Thus, unless the proof of claim is successfully challenged, it determines the amount of the claim for purposes of the bankruptcy case. Although there is contrary authority, under general principles of claim and issue preclusion, a proof of claim that has not been challenged by a litigated objection should not have a collateral estoppel or *res judicata* effect in other cases, since it is not a litigated judgment.^{n4a} And, although *Bankruptcy Rule 3001(f)* provides that a properly filed proof of claim is *prima facie* evidence of the validity and amount of the claim, some courts hold that there need not be a hearing to disallow the claim if the claimant has been given notice and an opportunity for a hearing.^{n4b}

[b] Conversion of Trustee's or Debtor's Suit Against Creditor to a Core Proceeding

Title 28 U.S.C. § 157(b)(2)(C) provides that the filing of a proof of claim subjects the claimant to all counterclaims which may be filed by a trustee, and that such matters are core proceedings. Thus, one consequence of filing a proof of claim is that a trustee's or debtor's suit against the creditor might be converted from a related non-core matter to a core matter.ⁿ⁵ If a trustee or chapter 13 debtor has a cause of action against a nonfiling creditor, a complaint would commence a related matter, in which the dispositive order must be entered by the district court, although the hearing will (unless the reference is withdrawn) be conducted by the bankruptcy judge.ⁿ⁶ However, if the trustee's cause of action is asserted as a counterclaim to a proof of claim filed by a claimant, the matter then becomes a core proceeding in which judgment is entered by the bankruptcy judge.ⁿ⁷ Further, treatment of the proof of claim and counterclaim as a core proceeding makes inapplicable the mandatory abstention provisions of 28 U.S.C. § 1334(c)(2), which apply only to a cause of action "related to a case under title 11 but not arising under title 11 or arising in a case under title 11..."ⁿ⁸

[c] Forfeiture of Right to Jury Trial

Another consequence that follows from filing a proof of claim is that jury trial rights are forfeited. The Supreme Court, in *Granfinanciera, S.A. v. Nordberg*,ⁿ⁹ held that a defendant in an action to recover a fraudulent conveyance or preference is entitled to a jury trial, even though such suits are characterized as "core" proceedings.ⁿ¹⁰ However, in a later decision, relying in part upon *Katchen v. Landy*,ⁿ¹¹ the Supreme Court held that the defendant's right to a jury trial is waived if the defendant has filed a proof of claim.ⁿ¹²

[d] Effect on Governmental Immunity

Filing a proof of claim can also have a disadvantage for certain governmental units. Under *section 106(b) of the Code*, a governmental unit that files a proof of claim is deemed to have waived immunity from suit with respect to any claim against it that arises out of the same transaction or occurrence as that which underlies the proof of claim.ⁿ¹³ This provision has been held constitutional even with respect to states' *Eleventh Amendment* immunity.ⁿ¹⁴

FOOTNOTES:

(n1)Footnote 1. *See* 6 *Collier on Bankruptcy*, P 726.02 (Matthew Bender).

(n2)Footnote 2. *See* ch. 26 *infra*.

(n3)Footnote 3. *See* 8 *Collier on Bankruptcy*, P 1300.70 (Matthew Bender).

(n4)Footnote 4. *Fed. R. Bankr. P. 3001(f)*. *See* 9 *Collier on Bankruptcy*, P 3001.10 (Matthew Bender).

(n5)Footnote 4a. *But see EDP Medical Computer Systems, Inc. v. U.S.*, 480 F.3d 621 (2d Cir. 2007) (failure to object to proof of claim in asset case made claim allowance res judicata, especially because claim was allowed by specific court order); *Siegel v. Fed. Home Loan Mortgage Corp.*, 143 F.3d 525 (9th Cir. 1998) (erroneously holding that failure to object can give claim res judicata effect).

(n6)Footnote 4b. *In re Pierce*, 435 F.3d 891 (8th Cir. 2006) .

(n7)Footnote 5. 28 U.S.C. § 157(b)(2)(C). *See* 1 *Collier on Bankruptcy*, P 3.02[3][d][i] (Matthew Bender).

(n8)Footnote 6. 28 U.S.C. § 157(c)(1). But it should be noted that under 28 U.S.C. § 157(b)(5), personal injury torts and wrongful death claims, even if they are core matters, must be tried in the district court in which the bankruptcy case is pending, or in the district court in the district in which the claim arose, as determined by the district court in which the bankruptcy case is pending.

(n9)Footnote 7. *Southeastern Sprinkler Co. v. Meyertech Corp.* (*In re Meyertech Corp.*), 831 F.2d 410, 18 C.B.C.2d 34 (3d Cir. 1987) .

(n10)Footnote 8. *See* 1 *Collier on Bankruptcy*, P 3.05[2] (Matthew Bender).

(n11)Footnote 9. 492 U.S. 33, 109 S. Ct. 2782, 106 L. Ed. 2d 26, 20 C.B.C.2d 1216 (1989) .

(n12)Footnote 10. 28 U.S.C. § 157(b)(2)(F), (H).

(n13)Footnote 11. 382 U.S. 323, 86 S. Ct. 467, 15 L. Ed. 2d 391 (1966) . In *Katchen v. Landy*, the Supreme Court

(n14)Footnote 12. *Langenkamp v. Culp*, 498 U.S. 42, 111 S. Ct. 330, 112 L. Ed. 2d 343, 23 C.B.C.2d 973 (1990) . *See also In re Hooker Investments, Inc.*, 122 B.R. 659 (S.D.N.Y.) , *appeal dismissed, mandamus granted and relief denied*, 937 F.2d 833, 25 C.B.C.2d 75 (2d Cir. 1991) (bankruptcy judge had not abused her discretion in denying an exemption from a bar order fixing a deadline for filing claims to certain banks which alleged that, by filing a proof of claim, they would be forced to forgo a jury trial; the order merely put the banks to a choice of litigation strategy: file a proof of claim and waive the right to a jury trial, or not file a proof of claim and take the consequences). *See* 1 *Collier on Bankruptcy*, P 3.08 (Matthew Bender).

(n15)Footnote 13. *See* 2 *Collier on Bankruptcy*, P 106.06 (Matthew Bender).

(n16)Footnote 14. *Arecibo Cmty. Health Care, Inc. v. Puerto Rico*, 270 F.3d 17 (1st Cir. 2001) , *cert. denied*, *Puerto Rico v. Arecibo Cmty. Health Care, Inc.*, 537 U.S. 813, 123 S. Ct. 73, 154 L. Ed. 2d 15 (2002) (filing a claim

waives *Eleventh Amendment* immunity for compulsory counterclaims, even if they could result in affirmative recovery); *California v. Harleston (In re Harleston)*, 275 B.R. 546 (B.A.P. 9th Cir. 2002) (state taxing agency's filing of proof of claim waived *Eleventh Amendment* immunity with respect to action for determination of claim's dischargeability). See also *Lapides v. Board of Regents*, 535 U.S. 613, 122 S. Ct. 1640, 152 L. Ed. 2d 806 (2002) (by removing action to federal court, a state waives *Eleventh Amendment* immunity (relying on *Gardner v. New Jersey*, 329 U.S. 565, 574 (1947) which held that filing a proof of claim waives a state's immunity)).



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CHAPTER 19 Filing and Objecting to Proofs of Claims

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P 19.03 Notice of Opportunity to File a Proof of Claim

[1] Notice Normally Given with Notice of Meeting of Creditors

The debtor is obliged to list all creditors and the amount and nature of their claims on the schedules.ⁿ¹ If schedules are not filed with the petition, the debtor is required to file a list of creditors' names and addresses with the petition.ⁿ² Therefore, in most cases, the debtor's filed papers provide the bankruptcy court with notice of the potential claimants or creditors. Normally, within a few weeks of the filing of a voluntary petition, the clerk will mail to all creditors, the debtor and the debtor's attorney, the appropriate version of Official Form 9, a notice of the automatic stay and the date of the meeting of creditors. The notice will also include deadlines for creditors who wish to file claims. However, it should be noted that if the case appears to be a no asset chapter 7 case, there will be a statement in the notice that no deadline for filing claims has been set and that claims should not be filed.

FORMS

Official Forms 9C and 9I are reproduced in *Collier Consumer Bankruptcy Forms, Forms CS10.32-2* and *CS10.32-5* (Matthew Bender), consecutively. Official Form 9A, for use in a no asset chapter 7 case, is reprinted in *Collier Consumer Bankruptcy Forms, Form CS10.32-1* (Matthew Bender).

[2] Creditors Who Do Not Receive Notice

If a creditor files a late proof of claim because the creditor does not receive notice or does not have actual knowledge of the case, that creditor, in a chapter 7, case may be permitted to receive payment and enjoy distribution along with other general unsecured creditors. The creditor must have filed the claim in time to permit payment of the claim.ⁿ³ There is no comparable provision in chapter 13. However, there is a good argument in both chapter 7 and chapter 13 that if no objection to a tardy claim is filed under *section 502(b)(9) of the Bankruptcy Code* the claim must be allowed, since section 502(a) provides that a filed claim is allowed unless a party in interest objects to it.

PRACTICE NOTE

In chapter 7 and 13 cases, creditors who do not file any proof of claim are not entitled to participate in the distribution. This applies equally to creditors who do not receive notice or do not have actual knowledge of the case. However, if a creditor loses the right to participate in a distribution due to the

debtor's failure to list the creditor, the creditor's claim is excepted from discharge by section 523(a)(3) and in chapter 13 by section 1328(a)(2).ⁿ⁴

FOOTNOTES:

(n1)Footnote 1. *See* ch. 6 *supra*.

(n2)Footnote 2. *See* ch. 6 *supra*.

(n3)Footnote 3. *11 U.S.C. § 726(a)(2)(C)*.

(n4)Footnote 4. *See* ch. 26 *infra*.



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CHAPTER 19 Filing and Objecting to Proofs of Claims

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P 19.04 Parties Who May File Proofs of Claim or Interest

Section 501 identifies the parties who may file proofs of claim or interest in a case commenced under the Bankruptcy Code. This section is applicable to all cases filed pursuant to chapter 7, 11, 12 or 13 of the Code.ⁿ¹ Section 501(a) provides for the filing of proofs of claim by creditors and indenture trustees and the filing of a proof of interest by an equity security holder. Section 501(b) permits a codebtor, surety or guarantor of the debtor to file a proof of claim on behalf of the creditor to which he or she is liable, when such creditor has not timely filed a proof of claim. There is some question whether a servicing agent that is not the true holder of a claim is authorized to file a proof of claim, at least in its own name and without disclosing the true holder's identity.ⁿ² Section 501(c) permits the debtor or the trustee to file a proof of claim on behalf of a creditor when the creditor does not timely file its proof of claim.

[1] Filing Proofs of Claim by Prepetition Creditors

In every case, a proof of claim should be filed with the clerk of the bankruptcy court in which the bankruptcy case is pending. A proof of claim, like other documents, may be filed in person, by mail or, in most courts, electronically. It is always a good idea to obtain a time-stamped or date-stamped copy of any document filed to prove that it was filed on a particular date. If the document is filed by mail, most clerks will return a stamped copy if a copy is provided along with a stamped self-addressed envelope.

In some courts, local rules require copies of a proof of claim to be served on the trustee or the debtor. Rules requiring service on the debtor may be limited to secured and priority claims. In any event, it is important to check local rules and practice in this regard and for any other special requirements.

[a] Filing by Secured Creditors

[i] Secured Creditors Should File Proof of Claim Even If Fully Collateralized

Section 501(a) governs the filing of a proof of claim by a secured creditor, just as it applies to the filing of proofs of claim by other types of creditors. The term "secured creditor" is not defined in the Bankruptcy Code, which speaks of "claims," not "creditors." A creditor holding a secured claim should file a proof of claim even if it believes that its claim is fully collateralized, since the possibility exists that the creditor has guessed wrongly. In that case, the secured creditor who does not file a proof of claim will have lost the opportunity to participate in the bankruptcy distribution with respect to any unsecured deficiency.

PRACTICE NOTE

Federal Rule of Bankruptcy Procedure 3002(a) does not require a secured creditor to file a proof of claim. A secured creditor that fails to file a proof of claim will not normally lose its lien, and a chapter 13 plan can make payments to that creditor even if no proof of claim was filed. *Section 506(d) of the Bankruptcy Code* provides that a secured creditor's lien is not void solely because of the creditor's failure to file a proof of claim.

[ii] Preparation of Proof of Secured Claim**[A] Valuation of Collateral**

The official form for a proof of claim requires a creditor holding a secured claim to value the collateral securing the claim. If the value of the collateral is less than the amount of the debt which it secures, the creditor will file a claim which will be noted as being partially secured and partially unsecured. Thus, determining the value of the collateral is critical to the proof of claim process.

The 2005 amendments to the Bankruptcy Code.ⁿ³ specify that the valuation of personal property securing an allowed secured claim is based on replacement value without deduction for costs of sales or marketing. With respect to property acquired for household purposes, replacement value is "the price that a retail merchant would charge for property of that kind considering age and condition of the property at the time value is determined."ⁿ⁴ For personal property acquired for purposes other than household purposes, the date of valuation is the date of the petition. Despite this new more exacting language with respect to valuation, there will likely be a range of value for the property. Depending on the case, it may be to the creditor's advantage to give the collateral a higher or lower value within this range. Similarly, when valuing real estate a high value or low value may be more beneficial to the creditor.

For example, in the typical chapter 13 case, a creditor will normally place a high value on collateral, since unless that value is challenged the proof of claim will establish that value as the amount of the allowed secured claim which must be paid in full with present value interest pursuant to section 1325(a)(5)(B).ⁿ⁵

MORE INFORMATION

For a discussion of required payments to secured creditors *see* chapter 14 *supra*.

However, if the debtor will be surrendering the collateral to the creditor, the high valuation of collateral on an undersecured claim will only reduce the creditor's unsecured claim, which is likely to be paid at least in part through the plan, and provide no advantage to the creditor. Similarly, in a chapter 7 case a high valuation may simply reduce the distribution the creditor receives on the unsecured portion of its claim. A high valuation may also be damaging if the creditor must litigate a motion for relief from the stay, since it may allow the debtor or trustee to argue that the creditor's interest is adequately protected by an equity cushion.

MORE INFORMATION

For a discussion of motions for relief from the automatic stay *see* chapter 10 *supra*.

[B] Interest and Fees

If, in the creditor's proof of secured claim, it is stated that the value of the collateral exceeds the amount of the claim, section 506(b) permits the creditor to add to the amount of the claim, interest on the claim" and any reasonable fees, costs, or charges provided under the agreement under which such claim arose."ⁿ⁶ Thus, in completing the proof of a secured claim, care should be taken to include, as a part of the claim, all such items which the agreement between the

creditor and the debtor allow to the creditor. The "reasonableness" of attorneys' fees is to be governed by an independent federal standard, not by state law.ⁿ⁷

PRACTICE NOTE

Although section 506(b) addresses the "agreement" between the parties, the Supreme Court has held that the holders of oversecured nonconsensual liens, such as tax lienors, are entitled to postpetition interest even though, by definition, there is no agreement between the parties.ⁿ⁸ The Court concluded that the phrase "provided for under the agreement under which such claim arose" in section 506(b) modifies only "reasonable fees, costs, or charges," and not "interest on such claim." It could be argued, therefore, that the interest rate called for in the agreement creating a consensual lien is not the rate of interest pursuant to which postpetition interest should be calculated. The cases which have considered the issue, however, have refused to reach that conclusion.ⁿ⁹

[C] Secured Creditor Should Attach All Written Evidence Supporting Secured Claim

In preparing the proof of secured claim, the creditor should attach all evidence supporting the claim, including the security documents, proof of appropriate perfection of the security interest, and other written evidence regarding the nature and amount of the claim. This is required by *Rule 3001(c) of the Federal Rules of Bankruptcy Procedure*, which states that when a claim, or an interest in property of the debtor securing the claim, is based on a writing, the original or a duplicate shall be filed with the proof of claim. If the writing has been lost or destroyed, a statement of the circumstances of the loss or destruction shall be filed with the claim. *Rule 3001(d)* requires that, if a security interest in property of the debtor is claimed, the proof of claim shall be accompanied by evidence that the security interest has been perfected. Normally, it is safer to attach a copy rather than the original of any document to the proof of claim.

[D] Arrearage and Charges Added to Principal

Official Form 10, the proof of claim form, includes a space in which a secured creditor is to state any arrearage and other charges that are included in the claim. This information is particularly important in chapter 13 cases in which the debtor proposes to cure the arrearage under section 1322(b)(3) or (5), so that the trustee who is making payments to the creditor is aware of the amount to be paid as arrears.

Similarly, Form 10 includes a box that must be checked if the claim includes charges in addition to the principal amount of the claim. If such charges are included, the form also instructs the creditor to attach an itemized statement of all such charges. This statement permits the trustee and debtor to determine how the claim was computed and whether it is correct.

FORMS

For examples of proofs of claim by creditors see *Collier Consumer Bankruptcy Forms*, § CS8.02 (Matthew Bender).

[b] Filing by Unsecured Priority Creditors

Generally speaking, priority claims may be categorized as prepetition and postpetition claims. The matters considered here are those priority claims which arise prior to the filing of the petition initiating a case under title 11.

[i] Priority Claims Defined

Priority claims are those unsecured claims that are required to be paid before other claims. Claims are never priority claims to the extent they are allowed secured claims. In chapter 11, 12 and 13 cases, priority claims normally must be

paid in full.

Priority claims are those defined in *11 U.S.C. § 507(a)* and are as follows:

- the first priority is for domestic support obligations and certain administrative expenses related to payment of such obligations;n10
- the second and third priorities, administrative expenses, fees and charges assessed against the estate and certain unsecured claims in involuntary cases (found in section 507(a)(1) and (2)), have to do with claims which arise following the filing of a petition;n11
- the fourth and fifth priorities deal with wage and fringe benefit claims;n12
- the sixth priority pertains to unsecured claims of persons engaged in the production or raising of grain, and persons who are United States fishermen;n13
- the seventh priority is for consumer deposits;n14
- the eighth and ninth priorities are for unsecured claims of governmental units (specifically, taxes of various kinds and the FDIC and like bodies, respectively); and,
- the tenth priority relates to injury or death resulting from the operation of a motor vehicle or vessel while unlawfully intoxicated.n15

[ii] Completing the Proof of Claim Form

The same proof of claim form, Official Form 10, is used for priority claims as for other claims. However, a creditor filing a priority claim must designate the priority which it is claiming by checking the appropriate box.

[A] Claims that Are Partially Priority Claims

In some cases, a claim may be only partially a priority claim. This could occur in the case of a claim for which priority is limited to a certain dollar amount and which exceeds that amount. For example, a creditor may have a consumer deposit claim of \$5,000. The priority for such claims is limited to \$2,425,n16 so the proof of claim should reflect a priority claim for \$2,425 and a general unsecured claim for \$2,575. Similarly, a creditor such as a tax lien holder could have a claim which is partially a secured claim and partially a priority claim. In each case, the claim must be broken into its component parts of secured, priority, and general unsecured claims, as applicable, when the proof of claim form is completed.

[B] Charges Added to Principal

Official Form 10, the proof of claim form, includes a box that must be checked if the claim includes charges in addition to the principal amount of the claim. If such charges are included the form also instructs the creditor to attach an itemized statement of all such charges. This statement permits the trustee and debtor to determine how the claim was computed and whether it is correct.

[C] Creditor Should Attach All Written Evidence Supporting Claim

In preparing the proof of priority claim, the creditor should attach all evidence supporting the claim, including contracts and other written evidence regarding the nature and amount of the claim. This is required by *Bankruptcy Rule 3001(c)*, which states that when a claim, or an interest in property of the debtor securing the claim, is based on a writing, the

original or a duplicate shall be filed with the proof of claim.ⁿ¹⁷ If the writing has been lost or destroyed, a statement of the circumstances of the loss or destruction shall be filed with the claim. It is safer to attach copies of the documentation rather than the originals, in case the proof of claim is lost.

[c] General Unsecured Claims

The procedures for filing a general unsecured claim are the same as for filing a secured or priority claim, except that less information is required.

[i] Charges Added to Principal

Official Form 10 provides a box to indicate whether additional charges are included in the principal amount of the claim. If such charges are included, an itemized statement of such charges must be included. The statement allows the trustee and debtor to verify the computation and accuracy of the claim.

[ii] Creditor Should Attach All Written Evidence Supporting Claim

Federal Rule of Bankruptcy Procedure 3001(c) requires that when a claim, or an interest in property of the debtor securing the claim, is based on a writing, the original or duplicate shall be filed with the proof of claim. As stated earlier, it is better to provide copies of the written evidence in case the proof of claim is lost. In the event that the written evidence is lost or destroyed, a statement of the circumstances of the loss or destruction must be filed along with the claim.

[2] Filing Proofs of Claim On Behalf of Creditors

Section 501 of the Bankruptcy Code does not identify an exclusive list of persons who may file a proof of claim on behalf of a creditor. It does, however, mention a variety of parties who may file on behalf of the creditor, including a codebtor, surety or guarantor, debtor or trustee.

[a] Filing by Codebtor, Surety or Guarantor

Section 501(b) provides for the filing of a claim by a codebtor, surety or guarantor in the event that the primary creditor does not file a proof of claim in timely fashion. In chapter 7, 12 and 13 cases, a creditor that does not timely file a proof of claim may not participate in any distributions made by the chapter 7 trustee or under a chapter 12 or 13 plan. Thus, a codebtor, guarantor or surety that is liable on the claim with the debtor in the bankruptcy case could wind up having to pay more than might otherwise be the case if the beneficiary of the guaranty had received a distribution in the bankruptcy case. It is for this reason that section 501(b) provides for the filing of a claim by the codebtor, surety or guarantor in the event that the beneficiary of the guaranty does not timely file a proof of claim.

Federal Rule of Bankruptcy Procedure 3005(a), applicable in *all* cases under title 11, deals with the filing of proofs of claim by codebtors.ⁿ¹⁸ *Rule 3005(a)* provides that if a creditor has not filed a proof of claim pursuant to *Rule 3002* or *3003(c)*, an entity that is or may be liable with the debtor to that creditor, or who has secured that creditor, may, within 30 days after the expiration of the time for filing claims prescribed by *Rule 3002(c)* or *3003(c)*, execute and file a proof of claim in the name of the creditor, if known, or if unknown, in the entity's own name. Distribution will not be made on the claim except upon satisfactory proof that the original debt will be diminished by the amount of distribution. If a proof of claim is filed by a creditor pursuant to *Rule 3002* or *3003(c)*, the proof of claim filed by the creditor shall supersede that filed by a codebtor. *Bankruptcy Rule 3005*, as well as section 501(b), is keyed to the failure of the beneficiary of the guaranty to timely file a proof of claim.

The statute contains procedures whereby distributions cannot be made at the same time to the beneficiary of the guaranty and to the codebtor, surety or guarantor out of the estate.ⁿ¹⁹ Thus, without any detriment to the debtor or to

other creditors, the filing of a proof of claim by a codebtor, surety or guarantor can only be beneficial to the person filing the claim to insure that, if the beneficiary of the guaranty does not timely file a proof of claim, the codebtor, surety or guarantor will not have lost any benefit of a distribution from the estate. Furthermore, the filing of a proof of claim by a secondarily liable party will obviate the necessity of continually searching the claims docket in the bankruptcy case to determine if the beneficiary of the guaranty has filed a proof of claim.

PRACTICE NOTE

In preparing the proof of claim, the secondarily liable party may be operating at a disadvantage in that the amount of payments which may have been made to the beneficiary of the guaranty by the debtor on the obligation for which the secondarily liable party is obligated may not be known. This may result in the proof of claim reciting an amount which is admitted on the face of the proof of claim to be an estimation, relying upon the trustee to object to the claim in the event that the amount is overstated. Nevertheless, even in light of these difficulties, the proof of claim should always be filed for the largest amount for which the secondarily liable party may be liable to prevent distribution from being made on what may turn out to be too small a claim. Although procedures exist for amending a proof of claim, it is better to state the largest amount in the initial filing, amending the proof of claim later if information coming to the attention of the secondarily liable party reduces the amount for which a liability may exist, rather than using the amendment process for increasing the amount of the proof of claim.

FORMS

For an example of a proof of claim filed by a codebtor see *Collier Consumer Bankruptcy Forms, Form CS8.03-2* (Matthew Bender).

The other considerations for completing the proof of claim discussed above, such as attachment of writings and itemization of charges, apply equally to proofs of claim filed by a codebtor, surety or guarantor.

[b] Filing by Debtor or Trustee

Section 501(c) provides that if a creditor does not timely file a proof of its claim, the debtor or trustee may file a proof of such claim.ⁿ²⁰ A chapter 13 debtor may wish to file claims on behalf of certain types of creditors who have not filed themselves in order to protect the purposes of the plan. For example, a debtor who wants a secured or nondischargeable claim to be paid through a chapter 13 plan would file a claim on behalf of that creditor if it did not file its own claim. This may be done at the meeting of creditors or within 120 days thereafter, unless the court grants further time.ⁿ²¹

FORMS

For an example of a claim filed by the debtor see *Collier Consumer Bankruptcy Forms, Form CS8.03-1* (Matthew Bender).

The debtor may also wish to file a proof of claim if a creditor holding a nondischargeable claim fails to do so in a chapter 7 case in which there will be distributions to creditors, so that the claim will be paid at least in part by those distributions. Otherwise, if the creditor does not file, no distribution would be made on the claim, and the debtor would have a greater debt to repay after the case is closed than if the claim were paid in part or in full in the case.

[i] Time Periods Within Which Debtor May File

The debtor's time period for filing a proof of claim begins to run at the expiration of the deadline for the creditor to file a proof of claim¹ and runs until 30 days after the expiration of the creditor's bar date.

Bankruptcy Rule 3004 provides that if a creditor fails to file a proof of claim on or before the first date set for the meeting of creditors, the debtor or trustee may file a proof of claim in the name of the creditor. Such filing must be made by 30 days after expiration of the time for filing claims prescribed by *Rule 3002(c)* or *3003(c)*, whichever is applicable. The clerk shall mail notice of the filing to the creditor, the debtor and the trustee.n22

In most cases, the deadline for creditor claims is 90 days after the first date set for the meeting of creditors, so that the debtor or trustee has 120 days from that date to file a claim. A governmental unit generally has 180 days from the date of the order for relief (normally the petition date) in which to file a claim, and therefore, the debtor or trustee may file a claim on behalf of a governmental unit up to 210 days from the order for relief.n23

PRACTICE NOTE

If the debtor or trustee wishes to have a claim paid, it is good practice for the debtor or trustee to file a proof of claim without waiting for the expiration of the last date upon which a proof of claim may be timely filed. Filing will insure that the claim in question participates in any distribution made in a bankruptcy case.

[ii] Procedure for Filing

The same proof of claim form, or an adaptation of it, may be used for a claim filed by the debtor or trustee. The form should be completed in the same manner as discussed above for a creditor completing the form and filed with the clerk.

FORMS

For an example of a claim filed by the debtor see *Collier Consumer Bankruptcy Forms, Form CS8.03-1* (Matthew Bender).

[3] Filing Claims Arising After Petition Filed

[a] Filing Postpetition Claims as Prepetition Claims

Section 501(d) provides that a claim arising postpetition of the kind specified in section 502(e)(2), (f), (g), (h), or (i) may be filed under subsection (a), (b) or (c) of section 501 as if such claim had arisen against the debtor before the date of the filing of the debtor's bankruptcy petition.n24

Section 502 deals generally with the allowance or disallowance of claims. The section 502 claims specified in section 501(d) are accorded prepetition liability status even though such claims do not become fixed or arise until after the debtor's bankruptcy petition is filed. These claims may arise, for example, as the result of rejection of executory contracts or the recovery of property for the estate.

Section 501(d) provides that, notwithstanding the postpetition nature of these claims, proofs of claim relating to such claims are to be filed by a creditor under section 501(a), by a codebtor, surety or guarantor under section 501(b), or by the debtor or trustee under section 501(c), as though such claims were pending as of the date of the filing of the debtor's bankruptcy petition. The legislative history accompanying section 501(d) states, however, that these claims must be treated differently for filing purposes such as the bar date for filing proofs of claim. Also, the Federal Rules of Bankruptcy Procedure provide for later filing of claims of these kinds.n25

[4] Filing Administrative Expense Requests

Section 503(a) of the Bankruptcy Code states that an entity may timely file a request for payment of an administrative

expense, or may tardily file such request if permitted by the court for cause. Technically, a request for payment of an administrative expense is not a proof of claim or a claim, but in many districts it may be filed in the same manner as a claim.

A claim with administrative priority is generally a claim for which the estate received postpetition benefits.ⁿ²⁶ Nothing in the Bankruptcy Rules or the Bankruptcy Code, however, specifically addresses the time limitations for filing a request for payment of an administrative expense. Therefore, local rules and practices must be consulted.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 103(a)*, as amended, Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. *See Greer v. O'Dell*, 305 F.3d 1297 (11th Cir. 2002) (servicing agent could be real party in interest with standing to file a proof of claim).

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. *11 U.S.C. § 506(a)(2)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. *11 U.S.C. § 1325(a)(5)(B)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. *See 4 Collier on Bankruptcy*, P 506.03 (Matthew Bender).

(n7)Footnote 7. *Joseph F. Sanson Inv. Co. v. 268 Ltd. (In re 268 Ltd.)*, 789 F.2d 674, 14 C.B.C.2d 904 (9th Cir. 1986) .

(n8)Footnote 8. *United States v. Ron Pair Enters.*, 489 U.S. 235, 109 S. Ct. 1026, 103 L. Ed. 2d 290, 20 C.B.C.2d 267 (1989) .

(n9)Footnote 9. *See 4 Collier on Bankruptcy*, P 506.03[2] (Matthew Bender).

(n10)Footnote 10. *See 4 Collier on Bankruptcy*, P 507.02A (Matthew Bender).

(n11)Footnote 11. *See 4 Collier on Bankruptcy*, P 507.03-. 04 (Matthew Bender); *2 Collier Bankruptcy Manual*, P 507.03-. 04 (Matthew Bender).

(n12)Footnote 12. *See 4 Collier on Bankruptcy*, P 507.05-. 06 (Matthew Bender); *2 Collier Bankruptcy Manual*, P 507.05-. 06 (Matthew Bender).

(n13)Footnote 13. *See 4 Collier on Bankruptcy*, P 507.07 (Matthew Bender); *2 Collier Bankruptcy Manual*, P 507.07 (Matthew Bender).

(n14)Footnote 14. *See 4 Collier on Bankruptcy*, P 507.08 (Matthew Bender); *2 Collier Bankruptcy Manual*, P 507.08 (Matthew Bender).

(n15)Footnote 15. *11 U.S.C. § 507(a)(10)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n16)Footnote 16. Pursuant to *11 U.S.C. § 104(b)*, this amount is subject to periodic adjustment and was raised from \$2,225 to \$2,425, effective April 1, 2007. For cases commenced before April 1, 2004, the amount in effect is \$2,100. The adjustment is made every three years beginning on April 1, 1998. *See 2 Collier on Bankruptcy*, P 104.03

(Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n17)Footnote 17. See *In re Chain*, 255 B.R. 278 (Bankr. D. Conn. 2000) (failure to attach any documentation to claim resulted in creditor being denied normal presumption that claim was valid).

(n18)Footnote 18. See 9 *Collier on Bankruptcy*, ch. 3005 (Matthew Bender).

(n19)Footnote 19. 11 U.S.C. § 502(e); 11 U.S.C. § 507, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n20)Footnote 20. See 4 *Collier on Bankruptcy*, P 501.03 (Matthew Bender).

(n21)Footnote 21. *Fed. R. Bankr. P. 3002* and *3004*. In the case of a governmental creditor, the deadline is generally 210 days after the order for relief. *Id.* Unlike the deadlines for creditors to file proofs of claim in chapter 7 and chapter 13 cases, the deadline for the debtor to file a proof of claim on behalf of a creditor under *Rule 3004* may be extended by the court under *Rule 9006(b)*.

(n22)Footnote 22. [Reserved]

(n23)Footnote 23. In a chapter 13 case, a claim for taxes filed by a governmental unit with respect to a return filed under section 1308(a) is timely if filed within 60 days after the return was filed. See 11 U.S.C. § 502(b)(9), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. However, *Fed. R. Bankr. P. 3002(c)(1)*, provides that the proof of claim for a claim resulting from a tax return filed under section 1308 is timely filed if it is filed not later than 180 days after the date of the order for relief or 60 days after the date of the filing of the tax return, whichever is later. Thus, for such claims, *Rule 3002(c)(1)* provides the longer of the 60-day period and the 180-day period to file a claim on behalf of the governmental unit.

(n24)Footnote 24. See 4 *Collier on Bankruptcy*, PP 502.07-. 10 (Matthew Bender).

(n25)Footnote 25. H.R. Rep. No. 595, 95th Cong., 1st Sess. 351 (1977), reprinted in Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 61 (1978), reprinted in Vol. D *Collier on Bankruptcy*, App. Pt. 4(e)(i) (Matthew Bender). See, e.g., *Fed. R. Bankr. P. 3002(c)(4)*.

(n26)Footnote 26. 11 U.S.C. § 503(a). See 4 *Collier on Bankruptcy*, P 503 (Matthew Bender).



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CHAPTER 19 Filing and Objecting to Proofs of Claims

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P 19.05 Time for Filing Proofs of Claim

[1] General Rules for Time of Filing

The Federal Rules of Bankruptcy Procedure set forth the manner in which proofs of claims or interests must be filed, and the time requirements relating to such filings. With a view toward promoting promptness, *Bankruptcy Rule 3002(c)* requires that proofs of claim in a chapter 7, 12 or 13 case be filed within 90 days after the first date set for the meeting of creditors. However, proofs of claim filed by government entities may be filed within 180 days after the order for relief, and this period can be further extended under *Bankruptcy Rule 3002(c)(1)*.ⁿ¹ Additionally, in a chapter 13 case, a claim for taxes filed by a governmental unit with respect to a return filed under section 1308(a) is timely if filed within 60 days after the return was filed as required.ⁿ²

[2] Strict Construction of 90 Day Period

Federal Rule of Bankruptcy Procedure 9006(b)(3) makes it clear that the 90-day period may not be enlarged, except in the limited circumstances expressly allowed by *Rule 3002(c)*.

Strict construction of deadlines for filing proofs of claim is apparent under *Rule 3002(c)*.ⁿ³ The Bankruptcy Reform Act of 1994 amended section 502(b) to provide for the disallowance of claims that are not filed timely, except to the extent that such claims are tardily filed as permitted under section 726(a)(1), (2) and (3), or under the Bankruptcy Rules.

[3] Creditor Should File Proof of Claim Even if the Requisite Time Period Has Lapsed

Section 726(a) of the Bankruptcy Code provides that property of the estate in a chapter 7 case shall be distributed first to holders of priority claims, proof of which is either timely filed under *Section 501 of the Code*, or tardily filed on or before the earlier of

- ten days after the summary of the trustee's final report has been mailed to creditors; or,
- the date the trustee begins final distribution.ⁿ⁴ *Section 726(a)(2)(C)* provides that property of the estate in a chapter 7 case shall be distributed, after payment of priority claims, to holders of claims which were timely filed and to holders of claims which are tardily filed under section 501(a), if the creditor did not have notice or actual knowledge of the case in time to file a proof of claim and a proof of claim was filed in time to permit payment. *Section 726(a)(3)* provides that,

if funds remain, payment may then be made on claims that are tardily filed, in addition to those of the kind specified in paragraph (a)(2)(C).

A creditor should, therefore, still file a proof of claim even when the creditor has failed to file a proof of claim within the requisite time period. In a chapter 13 case, the claim may be allowed simply because no party chooses to object to it, in which case it may be eligible for payment through the chapter 13 plan.ⁿ⁵ Although section 726(a) is applicable only in chapter 7 cases, there is always a possibility that a case under another chapter will be converted to chapter 7, and the cost of filing a claim is low.

[4] Extended Time for Filing Government Claims

The claim of a governmental unit is timely filed if such claim is filed before 180 days after the date of the order for relief (normally the petition date) or such later time as provided under the Bankruptcy Rules. *Federal Rule of Bankruptcy Procedure 3002(c)(1)* provides that such a claim is timely if filed not later than 180 days after the order for relief. The rule also permits a governmental unit to obtain an extension of this deadline for cause upon motion filed before the deadline expires. Additionally, a claim for taxes filed by a government unit with respect to a return filed under section 1308(a) is timely if filed within 60 days after the return was filed as required.ⁿ⁶

[5] Late Filed Proof of Claim May Be Treated as Amendment of Previous Informal Proof of Claim

The harshness of the absolute bar date for most claims is tempered somewhat by decisions holding that a late filed proof of claim may be allowed as an amendment to a proof of claim if the party filing the proof of claim can establish the existence of a timely asserted informal proof of claim. The premise for the acceptance of such a proof of claim is that, based on the informal proof of claim, the trustee had notice of the creditor's intention to hold the estate liable for the debt.

A document may constitute an informal proof of claim if it states an explicit demand showing the nature and amount of the claim against the estate, and it evidences an intent to hold the estate liable.ⁿ⁷ For example, courts have recognized pleadings filed by the creditor in the bankruptcy case prior to the bar date and communications from the creditor to the debtor or the trustee as amendable informal proofs of claim. Most courts, however, require that the informal proof of claim be a paper which was filed with the bankruptcy court.

The inclusion of claims in the schedules of a chapter 7 debtor, however, does not constitute the filing of those claims, formal or informal, pursuant to section 501. Although a creditor having potential joint liability with a debtor may attempt to assert an informal proof of claim, the creditor will fail if such assertion does not meet the strict requirements for the establishment of an informal proof of claim.

[6] Extensions of 90 Day Periods

Federal Rule of Bankruptcy Procedure 3002(c) requires that proofs of claim in a chapter 7, 12 or 13 case be filed within 90 days of the first date set for the meeting of creditors required by section 341(a). However, *Rule 3002(c)* provides five exceptions to the time limit for filing proofs of claim, which are outlined below. The 90-day period for filing proofs of claim in chapter 7, 12 and 13 cases can, therefore, be extended in these limited circumstances. In addition, unlike the deadlines for creditors to file proofs of claim in chapter 7 and chapter 13 cases, the deadline for the debtor to file a proof of claim on behalf of a creditor under *Rule 3004* may be extended by the court under *Rule 9006(b)*.

[a] Government Claims

The Bankruptcy Reform Act of 1994 amended *section 502 of the Code* to give the government 180 days after the order for relief to file a claim unless the Rules provide a later time.ⁿ⁸ The 180 day period may be further extended under *Rule 3002(c)(1)*.

In light of the difficult administrative burden on taxing authorities, especially on the Internal Revenue Service, in dealing with a debtor taxpayer and the requirements for preparing and filing a tax claim, the drafters of the Bankruptcy Code anticipated that the Bankruptcy Rules should not deprive taxing authorities of an extension of the 90-day period in which to file proofs of claims.

In addition, for tax claims arising from returns filed in chapter 13 cases pursuant to section 1308(a), a government unit has 60 days from the filing date of the return to file a claim.⁹

[b] Claims of Infants and Incompetents

Federal Rule of Bankruptcy Procedure 3002(c)(2) allows the court to extend the time, otherwise prescribed by *Rule 3002*, for the filing of a proof of claim by an infant, incompetent or the representative of either. Such extension may be granted on the court's finding that the additional time is "in the interest of justice and if it will not unduly delay the administration of the case."

[c] Claims Arising from Certain Postpetition Judgments Against Claimant

Federal Rule of Bankruptcy Procedure 3002(c)(3) extends the time for filing proofs of claim arising in favor of an entity or becoming allowable because of a judgment for the recovery of money or property from that entity, or a judgment denying or avoiding an entity's interest in property. *Rule 3002(c)(3)* allows the proof of claim to be filed within 30 days after the judgment becomes final. A judgment is not final until the time within which to file an appeal has run and, if an appeal is taken, until the appeal has been resolved. *Bankruptcy Rule 8002* prescribes that, for an appeal taken to either the appellate panel or the district court, there is a 14-day period for filing the notice of appeal.

ILLUSTRATION

For example, a bankruptcy court's order avoiding a creditor's lien becomes final upon expiration of the 14-day period for filing a notice of appeal and, thus, the creditor has a total of 44 days following the entry of a judgment in which to file a proof of claim even though the normal 90-day period has expired.

Federal Rule of Bankruptcy Procedure 8002(c), however, provides that the judge may extend the time for filing a notice of appeal for a period not to exceed 21 days if a request for such extension is made before the time for filing a notice of appeal has expired. Furthermore, if the judgment or order does not authorize the sale of property, the judge may grant an extension of time to file a notice of appeal for up to 21 days, even if the 14-day period has expired before the motion requesting an extension is filed. Thus, a judgment may not be final until 35 days from the date of the entry of the judgment. Therefore, in some cases the claim resulting from such a judgment could be filed at any time within 60 days after entry of the judgment. If a notice of appeal is not filed within the appropriate number of days after the date of entry of the judgment, the judgment is final for purposes of *Rule 3002(c)(3)*. *Rule 3002(c)(3)* precludes allowance of the claim unless the claimant satisfies any liability or performs any duty required by the judgment.

Rule 3002(c)(3) clarifies the former Act by expressly covering a claim which "becomes allowable" because of a judgment avoiding a security interest. As pointed out in the 1983 Advisory Committee Note, paragraph (3) clarifies that the exception as to the time within which to file a proof of claim extends to a secured creditor whose claim arose prior to the filing of the petition, since a judgment avoiding the creditor's security interest and giving rise to an allowable unsecured claim may not have been entered until after the time for filing proofs of claim has expired. Thus, a secured creditor who did not file a secured proof of claim may nevertheless file an unsecured proof of claim within the time prescribed by *Rule 3002(c)(3)* if the creditor's security interest is avoided.

[d] Claims Arising from the Rejection of an Executory Contract or Unexpired Lease

Rule 3002(c)(4) provides that a claim arising from the rejection of an executory contract or unexpired lease of the debtor may be filed within such time as the court may direct. Typically, an order of the court approving the rejection of an executory contract pursuant to *section 365 of the Bankruptcy Code* will require claims arising from such rejection to be filed not later than 30 or 60 days from such order.

MORE INFORMATION

For discussion of rejection of executory contracts and unexpired leases *see* chapter 15 *supra*.

[e] Claims Filed After No Dividend Notice

Federal Rule of Bankruptcy Procedure 2002(e) provides that, if it appears from a chapter 7 debtor's schedules that there are no assets to provide a distribution to creditors, the clerk of the court may, in the notice of the meeting of creditors, include a statement announcing that it is unnecessary to file proofs of claim. If sufficient assets are subsequently identified or recovered to allow a dividend to creditors, paragraph (5) of *Rule 3002(c)* requires the clerk of the court to notify the creditors and to grant parties the opportunity to file proofs of claim within a period of 90 days after the mailing of the subsequent notice.

[7] Rule 3002(c) 90 Day Period Is Not Applicable to Claims of Property Ownership

The 90-day period for filing proofs of claim in a chapter 7 or 13 case pursuant to *Rule 3002(c)* does not apply to claims of ownership of property adverse to the debtor and the bankruptcy estate. Thus, claims for the restoration of specific property which, although in the possession of the trustee, actually belongs to the claimant, are not governed by *Rule 3002(c)*. Section 541, which defines the parameters of what property is considered part of the bankruptcy estate, provides that property in which the debtor does not have a legal or equitable interest does not become a part of the bankruptcy estate.ⁿ¹⁰

For example, a claim for property with respect to which the debtor was a bailee but alleged to belong to the claimant is not a claim against the debtor and, therefore, need not be filed within the statutory time period for filing proofs of claim. Such claims are, however, subject to the court's equitable power to issue bar orders. A claimant who had no notice or knowledge of the bankruptcy court's bar order, however, will not be deemed foreclosed from pursuing a remedy.

PRACTICE NOTE

It should be noted, however, that the exemption of such claims from the scope of *Rule 3002(c)* operates beneficially only when the pursuit of such claims is successful. When the claims are not upheld, the claimant who failed to file a timely proof of claim for distribution may be deemed remediless, since by the time the property claim is rejected, the period for filing an ordinary proof of claim may have elapsed. The best procedure is for the claimant to file a proof of claim within the statutory time period. In such proof of claim, the claimant should point out that proceedings to recover the property are pending and that the proof of claim is merely designed to preserve the rights that the claimant may have in the event that the property claim is defeated.

[8] No Time Limitation Provided for Administrative Expense Requests

Section 503(a) of the Bankruptcy Code states that an entity may timely file a request for payment of an administrative expense, or may tardily file such request if permitted by the court for cause. A claim with administrative priority is generally a claim for which the estate received postpetition benefits. Nothing in the Bankruptcy Rules or the Code, however, specifically addresses the time limitations for filing a request for payment of an administrative expense claim.

While the Bankruptcy Rules fail to address specifically the filing of proofs of administrative expense claims, in chapter

7, 12 and 13 cases, the court's power to fix a bar date for filing proofs of administrative expense claims would be inherent under *section 105(a) of the Bankruptcy Code*, which grants the court broad authority to issue orders. Section 105(a) provides that "[t]he court may issue any order ... that is necessary or appropriate to carry out the provisions of this title." In addition, local rules may provide for time limitations for filing administrative expense claims. Therefore, local rules and practices must be checked.

FOOTNOTES:

(n1)Footnote 1. *See 9 Collier on Bankruptcy, P 3002.03* (Matthew Bender).

(n2)Footnote 2. *11 U.S.C. § 502(b)(9)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. However, *Fed. R. Bankr. P. 3002(c)(1)*, provides that the proof of claim for a claim resulting from a tax return filed under section 1308 is timely filed if it is filed not later than 180 days after the date of the order for relief or 60 days after the date of the filing of the tax return, whichever is later. Thus, for such claims, *Rule 3002(c)(1)* provides the longer of the 60-day period and the 180-day period to file a claim on behalf of the governmental unit.

(n3)Footnote 3. *See 9 Collier on Bankruptcy, P 3002.03* (Matthew Bender).

(n4)Footnote 4. *11 U.S.C. 726(a)(1)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. *In re Miranda*, 269 B.R. 737 (Bankr. S.D. Tex. 2001) (if plan provides for payment of all unsecured claims, and does not exclude unknown or late-filed claims, late filed claim to which no objection is made should be paid under plan).

(n6)Footnote 6. *11 U.S.C. § 502(b)(9)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. However, *Fed. R. Bankr. P. 3002(c)(1)* provides that the proof of claim for a claim resulting from a tax return filed under section 1308 is timely filed if it is filed not later than 180 days after the date of the order for relief or 60 days after the date of the filing of the tax return, whichever is later. Thus, for such claims, *Rule 3002(c)(1)*, provides the longer of the 60-day period and the 180-day period to file a claim on behalf of the governmental unit.

(n7)Footnote 7. *See 4 Collier on Bankruptcy, P 501.01[7]* (Matthew Bender).

(n8)Footnote 8. *11 U.S.C. § 502(b)(9)*.

(n9)Footnote 9. *11 U.S.C. § 502(b)(9)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. However, *Fed. R. Bankr. P. 3002(c)(1)*, provides that the proof of claim for a claim resulting from a tax return filed under section 1308 is timely filed if it is filed not later than 180 days after the date of the order for relief or 60 days after the date of the filing of the tax return, whichever is later. Thus, for such claims, *Rule 3002(c)(1)* provides the longer of the 60-day period and the 180-day period to file a claim on behalf of the governmental unit.

(n10)Footnote 10. *See 5 Collier on Bankruptcy, P 541.04* (Matthew Bender).



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 19 Filing and Objecting to Proofs of Claims

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P 19.06 Determining the Amount of an Allowed Secured Claim

[1] Concept of Allowed Secured Claim

Critical to an understanding of most of the provisions dealing with secured claims is a familiarity with a key concept in the Bankruptcy Code, the "allowed secured claim." Although not defined in the definition section,ⁿ¹ the term is explained by section 506, which is applicable to cases under all chapters of the Bankruptcy Code.ⁿ² Section 506(a) provides that every claim filed which is secured by a lien on property, or subject to a setoff, is an allowed secured claim to the extent of the creditor's interest in the estate's interest in such property or in the amount subject to setoff. If the debtor (and thus the bankruptcy estate) no longer has the property which the creditor claims as collateral, because it was transferred, stolen or otherwise lost, the creditor does not have an allowed secured claim under the language of section 506.ⁿ³

However, language following section 1325(a)(9), enacted in 2005,^{n3a} provides that section 506 is not applicable to certain claims secured by purchase money security interests obtained within specified time periods. Therefore, such claims cannot be determined pursuant to section 506 and the following discussion is inapplicable to them.

Under section 506(a), to the extent that the creditor's interest, or the amount subject to setoff, is less than the total amount of the claim, the claim is an allowed unsecured claim. Put another way, a secured claim cannot be an allowed secured claim in an amount greater than the value of the collateral. An undersecured claim which is filed and allowed is therefore divided or "bifurcated" into two parts: an allowed secured claim in an amount equal to the value of the collateral, and an allowed unsecured claim as to any excess of the total claim over the value of the collateral.

ILLUSTRATION

One simple example is a debt, not otherwise subject to defenses or setoffs, in the amount of \$2,000 secured by an automobile worth \$500. With respect to that creditor's claim, the debtor could request a determination that the claim be divided into an allowed secured claim of \$500 and an allowed unsecured claim of \$1,500. Similarly, if a debtor had a bank account of \$500 during the entire 90 days prior to the filing of the petition, subject to setoff by a bank to which the debtor owed \$2,000, the court would determine that the bank had an allowed secured claim of \$500 and an allowed unsecured claim of \$1,500.

The Supreme Court limited the application of the allowed secured claim concept somewhat in *Dewsnup v. Timm*.ⁿ⁴ There, despite clear statutory language in *section 506(d) of the Bankruptcy Code* stating that a lien securing a claim that is not an allowed secured claim is void,ⁿ⁵ the Court held that a chapter 7 debtor could not have a lien declared void on the basis of that language, even though it did not secure a claim that was an allowed secured claim under *section 506(a)*. Construing the language extremely narrowly, the Court held that it rendered a lien void only if it secured a claim that was disallowed under *section 502 of the Bankruptcy Code*, such as a claim to which a valid defense existed.ⁿ⁶ Thus, bifurcation of secured claims is relevant in chapter 7 only in the context of redemption under *Code section 722*.ⁿ⁷

MORE INFORMATION

See chapter 25 *infra* for discussion of redemption of property.

Dewsnup has no applicability in chapter 13 cases. The Supreme Court implicitly recognized that most liens could be reduced to the value of their collateral ("stripped down") through a chapter 13 plan in *Nobelman v. American Savings Bank*.ⁿ⁸ In that case the Court held that a claim secured only by a home mortgage could not be stripped down in chapter 13 only because *section 1322(b)(2) of the Bankruptcy Code* provides special protection to the holders of such claims. And, even some home mortgage liens may still be stripped down through a chapter 13 plan. The Supreme Court explicitly recognized that most liens could be reduced to the value of their collateral ("stripped down") through a chapter 13 plan in *Associates Commercial Corporation v. Rash*.ⁿ⁹ However, the application of *section 506(a)* may be limited in some cases involving recently purchased personal property by language added in 2005 to the end of *section 1325(a)*.

MORE INFORMATION

See chapter 14 *supra* for discussion of chapter 13 cramdown.

[2] Procedure for Determining Amount of Allowed Secured Claim After Objection Filed

In most cases, if there is any dispute concerning the amount of the allowed secured claim, the matter will arise as an objection filed by the debtor after the creditor has filed its claim.ⁿ¹⁰ The objection, which will be filed under *Rule 3007 of the Federal Rules of Bankruptcy Procedure*, will commence an adversary proceeding because it will raise the validity and/or extent of the creditor's lien.ⁿ¹¹ Therefore, it should usually be filed in the form of a complaint.ⁿ¹² However, if the only issue is the question of valuation, a motion under *Rule 3012* is also sufficient as a way to bring the matter before the court.ⁿ¹³

FORMS

For a form of motion to determine secured status see *Collier Consumer Bankruptcy Forms, Form CS8.42-1* (Matthew Bender).

If the secured creditor fails to file a proof of claim, the debtor may file a claim on behalf of the creditor in amounts the debtor believes are secured or unsecured.ⁿ¹⁴ⁿ¹⁵ In either case, the debtor may then initiate a proceeding against the creditor, by complaint or (if valuation is the only issue) by motion, seeking a court order determining the amount of the claim. If the debtor is requesting a determination based on a claim filed by the debtor, the best practice may be to file a complaint seeking a declaratory judgment that the claim is allowable only in the amounts reflected in the debtor's proof.

PRACTICE NOTE

In some courts, valuation is determined in the context of the plan confirmation hearingⁿ¹⁶ without a separate proceeding being brought. Local practice should be checked, but if there is any doubt, a motion or complaint should be filed. In any event, specific notice to the creditor that its lien and allowed secured claim are being challenged is essential to withstand later due process challenges.

[3] Contesting and Proving Value of Claim

Assuming the matter is not settled, the issue of value will ultimately be tried and determined by the court. Since the proof of claim itself is normally *prima facie* evidence of the validity and amount of the claim,ⁿ¹⁷ creditors will argue that the debtor has the burden of proof on this issue. However, this argument should fail. While the proof of claim is *prima facie* evidence under section 502(a), once the party objecting to the claim introduces contrary evidence, the claimant must then bear the ultimate burden of proof.ⁿ¹⁸

The methods of contesting and proving value in this context will generally be the same as in the context of proceedings for relief from the automatic stay where value is an issue. Pretrial discovery related to value may in some cases shift the cost of litigating the issue. For example, a request for admission may be used to authenticate a written appraisal or other specific valuation.ⁿ¹⁹ If the valuation is not admitted, then the cost of successful testimony may be shifted to the creditor. Other creative discovery or requests for admissions as to similar sales, industry guides, etc. may also limit the expense of contesting value. Ultimately, however, the debtor may have to be prepared to prove a value different than that testified to by the creditor's witnesses, which may mean retention of an appraiser or other expert.

MORE INFORMATION

See chapter 8 *supra* for discussion of proving value in stay proceedings.

[a] The Supreme Court's *Rash* Decision.

The Supreme Court addressed the valuation issue in the context of valuing a motor vehicle for purposes of a chapter 13 cramdown in *Associates Commercial Corporation v. Rash*.ⁿ²⁰ The Court rejected the lower court's holding that the appropriate valuation would be the creditor's liquidation value and also rejected the creditor's argument that retail value was the correct figure to use. Instead, the Court held that the language of section 506(a) dictated that the debtor's cost of replacing the property be used, but made clear that this cost would not include portions of the retail price that reflect items the debtor does not receive, such as warranties, inventory storage, and reconditioning.ⁿ²¹ The Court left it up to the bankruptcy courts, as triers of fact, to ascertain the best way of determining replacement value based on the evidence presented.

[b] Valuation of Personal Property

The value of personal property securing an allowed claim is to be determined based on the replacement value of the property without deducting hypothetical costs of sale or marketing.ⁿ²² Additionally, if the property was acquired for personal, family or household purposes, replacement value is defined as the price a retail merchant would charge for property of the same age and condition at the time value is determined.

These standards replace the wholesale value standard that many courts had adopted. The standard of replacement value was intended to "clarif[y] current law to specify that the value of a claim secured by personal property is the replacement value of such property without deduction of costs of sale or marketing."ⁿ²³ However, the replacement valuation standard in amended section 506(a)(2) is not simply the retail value stated in an industry guide. Rather, amended section 506(a) incorporates the standard articulated in *Rash* ⁿ²⁴ for chapter 13 cases. That standard specifically excludes costs of items for which the debtor receives no value. Such items may include warranties, inventory storage, and reconditioning fees. Thus, the focus of the valuation process for personal property should simply be the price at which a willing buyer would pay a willing seller in the seller's trade or business to obtain property of like age and condition. Nothing in section 506(a)(2) requires the debtor to pay for extras for which they receive no benefit.

In order to prove the value of debtor's personal property, the debtor may of course present expert testimony of a seller of the same type of good, or similar witness. The debtor is also competent to give value to the debtor's property,ⁿ²⁵ but

that value will be credible only to the extent the debtor provides persuasive reasons to justify it. If the debtor has previously tried to purchase similar property that experience may be a good basis for expressing an opinion on value. Online resources, such the Kelly Blue Book (www.kbb.com), the NADA Used Card Guide (www.nadaguides.com), and even eBay (www.ebay.com), may be useful tools in determining value.^{n25a} Naturally, the cost of repairs to bring the car to average working condition should be deducted from the prices advertised.^{n25b}

It may also be possible to obtain proof of value through the discovery process via interrogatories requesting information about the price obtained for similar property and requests for admission that advertisements (newspaper or online) reflect the asking price for similar property. If a creditor denies such requests for admission, the cost of proving the truth of the statements may be shifted to the creditor. Moreover, a party responding to a request for admission may not simply deny its truth without some investigation; thus, a creditor might even be sanctioned if it denied the truth without making reasonable inquiries.ⁿ²⁶

[c] Valuation of Real Estate

Valuation of real estate presents somewhat different issues. Perhaps the easiest case is that of property which has been purchased quite recently in relation to the date of valuation. In such cases, courts have often looked simply to the price which was actually paid by a willing buyer to a willing seller, adjusted for any clear changes in the condition of the property.ⁿ²⁵ Otherwise, the valuation hearing is likely to be a battle of appraisers testifying as experts for either side. In light of the 2005 amendments to the Code that specifically dictate that the value of personal property does not exclude costs of sale or marketing, a debtor may argue that Congress's silence on the issue with respect to real property implicitly allows the debtor to deduct these costs when valuing real property. Thus, it may be possible for debtors to argue that broker's commissions, title insurance fees, recording costs, etc., should be excluded.

[d] Date as of Which Valuation Should Be Determined

A significant issue is sometimes that of the date as of which value should be determined. For personal property, other than that acquired for household purposes, section 506(a) establishes the date of valuation as the date of the petition. For personal property acquired for personal, family or household purposes value is replacement value at the time of valuation. In the context of filing a proof of claim, the date of valuation should be the date of the claim. The date as of which valuation should be determined remains unsettled. In chapter 13 cases, courts have variously held that the appropriate date for valuation is the date of the filing of the petition, the date of the plan or the date of the confirmation hearing. While there will be little difference in most cases, the issue can be significant in cases of rapidly appreciating real estate or property which has been damaged since the filing of the case.

COMMENTARY

Some courts, perhaps in the interest of simplicity, have chosen the date of filing the petition or plan in all cases, on the theory that the parties' rights are frozen as of that date in most other respects.^{n25a} There are several arguments against this approach. First, in chapter 13 cases, there is language^{n25b} that the creditor is entitled to the "value as of the effective date of the plan." While that phrase could be interpreted merely as stating a present value standard, it has been held that the amount of the claim should be evaluated as of the date of the confirmation hearing.ⁿ²⁶ Another, perhaps better, argument is that under section 506(a) the purpose of the valuation is to protect the interest the creditor has at the time of valuation, since that would be all that could be realized were the creditor to obtain the property at that time. The creditor, after all, has an opportunity to force an earlier valuation by filing a motion for relief from the stay. Some language in the legislative history suggests that the valuation under section 506 may well be different than an earlier valuation under section 362, but it is a bit unclear whether that language refers more to the different purposes of the valuations than to the different dates.ⁿ²⁷ Using some of these rationales, a number of courts have used the date of the valuation proceeding as the critical date for valuation, looking

to the value of the property as of that date.ⁿ²⁸

[e] Prior Liens on Property Must Be Subtracted

Where there are prior liens on property ahead of the lien which is to be valued, the amount of those liens must first be subtracted to determine if there is value over and above the prior liens. The value of the allowed secured claim under section 506(a) is the creditor's interest in the estate's interest and the estate's interest is reduced by any prior liens. In making this computation, it is important to remember property tax liens and municipal liens, which often are given first priority by statute. It is also critical to consider only the debtor's interest in the property if there is co-ownership with one or more nondebtors. If the prior liens equal or exceed the value of the property, then the allowed secured claim of a creditor with a lower priority lien is equal to zero.ⁿ²⁹ In some cases the estate's interest in the property securing a debt may be valueless because the property is gone. The property may have been destroyed, stolen, or lost to the debtor prior to the bankruptcy. In such a case, the allowed secured claim is zero and the entire claim is deemed an allowed unsecured claim.ⁿ³⁰

[f] Inclusion of Value of Property Exempt from Levy

An additional issue which may arise with respect to certain types of statutory liens, such as federal tax liens, is whether in assigning a value to property subject to a lien, the value of property exempt from levy should be included. (For example, the Internal Revenue Code exempts certain property from levy on tax liens.)ⁿ³¹ It has been held that all property subject to a federal tax lien must be included, even though some of it could not be seized by the Internal Revenue Service.ⁿ³² There is certainly a good argument that this holding is not correct, since the purpose of the exemption from levy is defeated if the debtors have to pay the lienholder the value of the property that is exempt from levy. Other courts have read the Internal Revenue Code exemption to exempt property not just from a levy, as the Ninth Circuit held, but also from the tax lien itself.ⁿ³³

[g] Liens on Property that Is Not Property of the Estate

Valuation issues can also arise when the property that secures a claim, or a portion of that property, is not property of the estate. For example, if the debtor is a one-half owner of a property, the allowed secured claim should be determined by comparing the claim only to the debtor's one-half ownership interest, with the full amount of prior liens deducted from the value of the one-half interest.ⁿ³⁴ If the property is owned by the entireties or by joint tenants with a right of survivorship, some courts also require calculation of the value of the survivorship interest.ⁿ³⁵ If the debt is secured in whole or in part by an ERISA pension plan, or some other property that is not property of the estate, the value of the non-estate property should not be included in the computation of the allowed secured claim.ⁿ³⁶

[4] Other Possible Grounds for Objecting to a Secured Claim

A complaint objecting to a secured claim can and should raise any and all defenses to the creditor's claim, since the claim may only be allowed to the extent it is enforceable against the debtor.ⁿ³⁷ For example, the debtor may object to the claim on the following grounds:

- that the claim is not secured at all, because the purported security interest is invalid. A creditor must attach evidence of granting and perfection of a claimed security interest to the proof of claim.ⁿ³⁸ If it fails to do so, an objection may bring out the fact that such evidence does not exist, or does not comply with Uniform Commercial Code requirements that the collateral be adequately described;
- that the agreement may also violate the requirement that the debtor's signature be reasonably legible and below the language concerning the claimed security interest.ⁿ³⁹ If the security interest language is in small print, or buried in a credit card agreement, or appears only on a sales slip, unnoticed by the consumer, courts may deem it to be an unenforceable adhesion clause not knowingly signed by the

debtor;ⁿ⁴⁰n41-44

- that creditors' methods of applying payments to particular items purchased may be suspect and the proper method is "first-in, first-out."ⁿ⁴⁵ Such a challenge, if successful, may limit the security agreement to fewer items, or may totally invalidate it;

- that the agreement does not secure all of the amounts claimed by the creditor.ⁿ⁴⁶

[5] Objections to Secured Claims in Chapter 7 Cases

If there are assets that might be distributed in a chapter 7 case, the trustee may wish to object to a secured claim in order to increase the distribution made to unsecured creditors from property subject to the secured creditor's lien. The debtor rarely has any incentive to file such an objection, unless the amount of property freed from the secured creditor's lien would be so great that it would leave a surplus for the debtor after all unsecured claims are paid.

Otherwise, there is rarely any need to object to a secured claim in a chapter 7 case. The only exception to this general statement is that there may be a need to object to a claim to prevent it from precluding later litigation. Under an erroneous Ninth Circuit decision,ⁿ⁴⁷ a failure to object to a claim can give the claim *res judicata* effect, regardless of the fact that the claim is never served on the debtor and the fact that the case is a no-asset chapter 7 case in which objecting to the claim serves no purpose in the case.

FOOTNOTES:

(n1)Footnote 1. The term "claim," however, is defined at *11 U.S.C. § 101(5)*.

(n2)Footnote 2. *11 U.S.C. § 103(a)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *In re Gilsinn*, 40 C.B.C.2d 782, 224 B.R. 710 (Bankr. E.D. Mo. 1997) .

(n4)Footnote 3a. Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005.

(n5)Footnote 4. *502 U.S. 410*, 112 S. Ct. 773, 116 L. Ed. 2d 903, 25 C.B.C.2d 1297 (1992) .

(n6)Footnote 5. *11 U.S.C. § 506(d)* so provides, with certain exceptions which were not pertinent in *Dewsnup v. Timm*.

(n7)Footnote 6. *502 U.S. 410*, 415-16, 112 S. Ct. 773, 777, 116 L. Ed. 2d 903, 910, 25 C.B.C.2d 1297, 1301 .

(n8)Footnote 7. *See 11 U.S.C. § 348(f)(1)(B)*.

(n9)Footnote 8. *508 U.S. 324*, 113 S. Ct. 2106, 124 L. Ed. 2d 228, 28 C.B.C.2d 977 (1994) .

(n10)Footnote 9. *520 U.S. 953*, 117 S. Ct. 1879, 138 L. Ed. 2d 148 (1997) .

(n11)Footnote 10. However, the prior filing of a claim is probably not an absolute prerequisite for seeking a determination of the extent to which a claim is secured. Indeed, it is not at all clear that a secured claim even need be filed to be allowed. Nonetheless, the safer practice is for the debtor to file a claim on behalf of the creditor, as discussed in *P 19.04 supra*.

(n12)Footnote 11. *Fed. R. Bankr. P. 7001*.

(n13)Footnote 12. *Fed. R. Bankr. P. 7003*.

(n14)Footnote 13. See Advisory Committee Note to *Fed. R. Bankr. P. 3012*.

(n15)Footnote 14. *Fed. R. Bankr. P. 3004*.

(n16)Footnote 15. [Reserved]

(n17)Footnote 16. See 8 *Collier on Bankruptcy*, P 1327.04[2] (Matthew Bender), 3 *Collier Bankruptcy Manual*, P 1327.04[2] (Matthew Bender) for discussion of challenges to determination of valuation without a separate proceeding.

(n18)Footnote 17. *Fed. R. Bankr. P. 3001(f)*. H.R. Rep. No. 595, 95th Cong., 1st Sess. 352 (1977), reprinted in Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender); S. Rep. No. 989, 95th Cong. 2d Sess. 62 (1978), reprinted in Vol. D *Collier on Bankruptcy*, App. Pt. 4(e)(i) (Matthew Bender).

(n19)Footnote 18. *Matter of Fidelity Holding Co.*, 837 F.2d 696 (5th Cir. 1988) ; 9 *Collier on Bankruptcy*, P 3001.05 (Matthew Bender).

(n20)Footnote 19. *Fed. R. Bankr. P. 7036*, incorporating *Fed. R. Civ. P. 36*. See *In re Sweeten*, 56 B.R. 675 (Bankr. E.D. Pa. 1986) .

(n21)Footnote 20. 520 U.S. 953, 117 S. Ct. 1879, 138 L. Ed. 2d 148, 37 C.B.C.2d 744 (1997) .

(n22)Footnote 21. 520 U.S. 953, 965 n.6, 117 S. Ct. 1879, 1886-87 n.6, 138 L. Ed. 2d 148, 37 C.B.C.2d 744, 751 n.6 (1997) .

(n23)Footnote 22. 11 U.S.C. § 506(a)(2), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n24)Footnote 23. H.R. Rep. No. 31, 109th Cong. 1st Sess., 17 (2005).

(n25)Footnote 24. 520 U.S. 953 ; 117 S. Ct. 1879 ; 138 L. Ed. 2d 148 (1997) .

(n26)Footnote 25. *Joe T. Dehmer Distributors, Inc. v. Temple*, 826 F.2d 1463 (5th Cir. 1987) .

(n27)Footnote 25a. See *In re Anda-Ramirez*, 359 B.R. 794 (B.A.P. 10th Cir. 2007) (Kelley Blue Book private party value meets the *Rash* standard).

(n28)Footnote 25b. *In re Hauser*, 2009 Bankr. LEXIS 1256 (Bankr. S.D. Fla. 2009) (value should be reduced by retail cost of repairs debtor would have to pay, rather than retailer's discounted repair costs).

(n29)Footnote 26. *Fed. R. Civ. P. 36(a)*, incorporated in *Fed. R. Bankr. P. 7036*.

(n30)Footnote 25. *In re Two S Corp.*, 875 F.2d 240 (9th Cir. 1989) (price obtained through commercially reasonable sale by trustee was conclusive proof of value); *In re Savloff*, 2 C.B.C.2d 56, 4 B.R. 285 (Bankr. E.D. Pa. 1980) ; *In re Willis, Jr.*, 6 B.R. 555 (Bankr. N.D. Ill. 1980) .

(n31)Footnote 25a. E.g., *In re Willis Jr.*, 6 B.R. 555 (Bankr. N.D. Ill. 1980) . See also *In re Hanson*, 132 B.R. 406 (Bankr. E.D. Mo. 1991) .

(n32)Footnote 25b. 11 U.S.C. § 1325(a)(5)(B)(ii).

(n33)Footnote 26. *In re McLeod*, 2 C.B.C.2d 319, 5 B.R. 520 (Bankr. N.D. Ga. 1980) . See also *In re Moreau*, 140 B.R. 943 (N.D.N.Y. 1992) (where property apparently greatly increases in value after valuation but before confirmation of chapter 13 plan, creditor was entitled to revaluation closer to confirmation date).

(n34)Footnote 27. S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender).

(n35)Footnote 28. *E.g., In re Weaver*, 2 C.B.C.2d 315, 5 B.R. 522 (Bankr. N.D. Ga. 1980) . *See also Matter of Pierce*, 2 C.B.C.2d 842, 5 B.R. 346 (Bankr. D. Neb. 1980) (value to be determined at date of section 722 redemption proceedings rather than date of petition).

(n36)Footnote 29. *In re Smith*, 92 B.R. 287 (Bankr. S.D. Ohio 1988) .

(n37)Footnote 30. *In re Gabor*, 155 B.R. 391 (Bankr. N.D.W. Va. 1993) (where debtor's wife took automobile that secured loan and debtor did not know her whereabouts or whereabouts of vehicle, estate's interest in automobile had no value).

(n38)Footnote 31. 26 U.S.C. § 6334.

(n39)Footnote 32. *United States v. Barbier*, 896 F.2d 377 (9th Cir. 1990) , *rev'g* 84 B.R. 190 (D. Nev. 1989) and 77 B.R. 799 (Bankr. D. Nev. 1987) .

(n40)Footnote 33. *In re Voelker*, 164 B.R. 308 (Bankr. W.D. Wis. 1993) ; *In re Ray*, 48 B.R. 534 (Bankr. S.D. Ohio 1985) .

(n41)Footnote 34. *In re Abruzzo*, 249 B.R. 78 (Bankr. E.D. Pa. 2000) (tenancy in common).

(n42)Footnote 35. *See In re Pletz*, 221 F.3d 1114 (9th Cir. 2000) .

(n43)Footnote 36. *I.R.S. v. Snyder*, 343 F.3d 1171 (9th Cir. 2003) (ERISA plan not included in allowed secured claim valuation). *But see In re Jones*, 206 B.R. 614 (Bankr. D. D.C. 1992) .

(n44)Footnote 37. 11 U.S.C. § 502(b)(1). It is not totally clear whether, if the creditor's claim is divided into a secured claim and an unsecured claim, the defenses of the debtor can be applied first to the secured claim rather than the unsecured claim. Certainly, a good argument can be made for this when the defense is in some way logically related to the lien in particular, rather than to the debt in general. *See In re Jablonski*, 70 B.R. 381 (Bankr. E.D. Pa. 1987) (Truth in Lending recoupment subtracted from secured portion of claim).

(n45)Footnote 38. *See P 19.04 supra*.

(n46)Footnote 39. *In re Nedeau*, 24 B.R. 1 (Bankr. S.D. Fla. 1982) .

(n47)Footnote 40. *See In re Gibson*, 234 B.R. 776 (Bankr. N.D. Cal. 1999) (cross-collateralization buried in small print was not enforceable); *Doenges-Glass, Inc.*, (W.D. Mo. 1971), . *But see In re Conte*, 206 F.3d 536 (5th Cir. 2000) .

(n48)Footnote 41-44. [Reserved]

(n49)Footnote 45. *E.g., In re Vandeusen*, 147 B.R. 9 (Bankr. E.D.N.C. 1992) . *See also In re Freeman*, 956 F.2d 252 (11th Cir. 1992) (where agreement provided no method of apportioning payments, purchase money character not preserved); *Southeast Bank of Ala., N.A. v. Borg-Warner Acceptance Corp.*, 760 F.2d 1240 (11th Cir. 1985) .

(n50)Footnote 46. *E.g., In re Stendardo*, 991 F.2d 1089 (3d Cir. 1993) (mortgage holder was not entitled to recover amounts it paid for taxes and insurance after it had obtained a judgment absent specific authority in mortgage agreement).

(n51)Footnote 47. *Siegel v. Federal Home Loan Mortgage Corp.*, 143 F.3d 525, 39 C.B.C.2d 1395 (9th Cir. 1998)



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CHAPTER 19 Filing and Objecting to Proofs of Claims

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P 19.07 Objections to Unsecured Claims

[1] Reasons for Objecting to Unsecured Claims

Debtors also may wish to object to unsecured claims, particularly priority claims which must be paid in full in a chapter 13 case.ⁿ¹ There are many grounds for objections that might be filed. In a chapter 13 case, for example, debtors may object to claims they do not want to pay if those claims have not been timely filed,ⁿ² or if they do not otherwise conform to the rules.ⁿ³

An objection to late filed tax priority claims, which otherwise would have to be paid in full in chapter 13, is particularly valuable, at least if the claim is dischargeable. For this reason, and because the IRS seems to have difficulty responding to bankruptcy filings, much of the litigation on the timeliness of claims involves tax claims in chapter 13.ⁿ⁴ In some of these cases, courts have precluded the IRS from amending a timely claim for one tax year to include claims for other types of taxes or for the same taxes due in other years.ⁿ⁵ Further, the Code provides that no claim may be allowed to the extent it is unenforceable against the debtor.ⁿ⁶ This means that any defenses and setoffs may be asserted,ⁿ⁷ as objections to claims, for resolution by the bankruptcy court, usually but not always, the bankruptcy court.

The debtor may wish to object to a claim which has been the subject of prior litigation. Where judgment has been entered by a nonbankruptcy court on a claim, normal rules of res judicata and collateral estoppel apply.ⁿ⁸ In some cases, there may be a need to object to a claim to prevent it from precluding later litigation. Under an erroneous Ninth Circuit decision,ⁿ⁹ a failure to object to a claim can give the claim res judicata effect, regardless of the fact that the claim is never served on the debtor and the fact that the case is a no-asset chapter 7 case in which objecting to the claim serves no purpose in the bankruptcy.

Although a chapter 7 debtor usually has no interest in objecting to a claim, there are cases involving distributions of nonexempt assets in which the debtor does have an interest in reducing or eliminating a claim. The most common situation is when reducing or eliminating the claim means that more money would go to unsecured claims that are nondischargeable. This could occur, for example, if the debtor owed a domestic support obligation claim and a secured creditor filed an excessive claim which would result in less property being available to pay unsecured creditors, or if an excessive priority tax claim meant that less money would be available to pay a large student loan debt. In rare cases, an objection to a claim may mean that there are nonexempt assets left over after all creditors are paid; assets that are then

distributable to the debtor.ⁿ¹⁰

[2] Procedure for Filing Objections

Unless an objection to a claim relates to matters such as the extent or validity of a lien, it will initiate a contested matter.ⁿ¹¹ Official Form 20B sets forth the form of notice of an objection to claim, though local rules may add variations to this form. A debtor or trustee should be careful to serve an objection to the claim of the federal government on all parties required to receive service under *Federal Rule of Bankruptcy Procedure 7004*, including the attorney general and U.S. Attorney, and to comply with *Rule 2002(g)* requiring service at the address listed in the proof of claim.ⁿ¹² Although a properly filed proof of claim is considered *prima facie* valid, once some evidence is produced in support of an objection, the burden of proof is usually on the creditor to substantiate its claim.ⁿ¹³ The Supreme Court has held that the burden of proof generally follows that of nonbankruptcy law, meaning that for some tax claims the party objecting to the claim will have the burden of proof.ⁿ¹⁴

In some cases a creditor will file a claim which it knows or should have known is baseless in whole or part. That conduct should be subject to sanctions under *Rule 9011*, and very likely as an unfair or deceptive practice as well. Damages and attorneys fees should be available under these theories.

The rules do not set a time limit for objections to claims. However, in chapter 13 cases some courts have set deadlines by local rule, or issue an "order on claims" soon after the deadline for filing claims has passed, and will not consider objections filed after that order. It is not clear that such deadlines are valid, especially if the resolution of the objection is not necessary to the chapter 13 plan confirmation process, since the Bankruptcy Rules do not set a deadline.ⁿ¹⁵ In any event the trustee clearly does not have the power to set a deadline.^{n15a}

In some cases, creditors will not file claims to which objections can be filed. Because no notice to the debtor of filing of a claim is required by the current rules, the only way to be certain as to whether a claim has been filed is to check the bankruptcy court file. If no claim has been filed, the debtor may file a claim for the amount the debtor believes is due on behalf of the creditor to bring the matter before the court.ⁿ¹⁶ The court then sends notice of the claim to the creditor.ⁿ¹⁷ Although superseding claims may not be filed after the bar date, a few courts have allowed creditors to amend the debtor's claim even after the bar date has passed.ⁿ¹⁸ If such an amendment is filed, the debtor may then file whatever objections are appropriate. If no amendment is filed, the claim filed by the debtor, if allowed by the court, should determine the rights of the parties thereafter.

[3] Objecting to Claims with Inadequate Documentation

Debtors or trustees may object if a proof of claim does not comply with *Bankruptcy Rule 3001*'s requirements that when a claim is based on a writing, an original or duplicate of the writing must be filed with the proof of claim, or when the proof of claim does not comply with the requirement to attach an itemized statement of all interest or additional charges. An unsubstantiated claim is facially defective and not entitled to the presumption of validity.ⁿ¹⁹ Without this presumption, a facially defective claim provides evidence to "dispute its own validity" and should be disallowed upon a general objection unless the creditor introduces evidence that proves the claim.ⁿ²⁰

With the increasing prevalence of debt buyers who buy millions of dollars of consumer credit claims for pennies on the dollar, and who often do not even possess the writings upon which the claims are based, debtors have increasingly objected to proofs of claims that do not comply with the documentation requirements. Rather than attaching cardmember agreements, promissory notes and account statements to proofs of claim, and providing itemized statements of interest and additional charges, debt buyers have attached to the claim form a one-page "Accounting Summary" that provides the debtor's name and account number and merely restates the balance owed listed in paragraph 4 on Official Form 10.ⁿ²¹ Proofs of claim are filed in this manner without any actual review of loan documents or account statements. In addition, debt buyers often fail to check the box in paragraph 4 on Official Form 10 that confirms

that the total amount claimed includes interest or other charges, even though they are undeniably seeking interest and other charges, and admit this by adding language in another section of the claim form: "Claim may include contractual interest and/or late charges." They sometimes also fail to check the most commonly used boxes in paragraph 1 on Official Form 10 for "money loaned", "service performed", or "goods sold", and instead check the "other" box, inserting the description "credit card debt." Some have even altered the instructions in paragraph 8 on Official Form 10 under "Supporting Documents" by eliminating the mandatory attachment requirement and adding a self-serving statement that copies of account statements are available upon request.

Courts have found that the purpose of *Rule 3001* is subverted by such claims, as the parties charged with policing the claims process are denied necessary information,ⁿ²² and that affording *prima facie* validity to such claims can only "lead to abuses of the claim system."ⁿ²³ Strict compliance with *Rule 3001* is necessary to ensure that an appropriate "sifting process" occurs in the evaluation of claims, otherwise "unmeritorious or excessive claims might dilute the participation of the legitimate claimants."ⁿ²⁴ In fact, objections to debt buyers' unsubstantiated claims are often followed up with amended claims at a lower amounts in which questionable fees are removed. In other cases it has been revealed that the original claims included postpetition interest, were barred by a statute of limitations, or were filed by entities that could not prove they owned the claims.

The debt buyers sometimes contend that credit card issuers and debt buyers do not have to provide documentation if they pursue claims under an "open-account" theory, ignoring the fact that open account claims are typically "founded upon contract" and require proof of the "necessary elements of a contract action." More important, the *theory* upon which a creditor asserts a claim does not determine need for compliance with *Rule 3001*'s writing and itemization requirements. *Rule 3001* does not state that writings must be attached only if the creditor's claim is based on a particular theory, nor does it provide an exception for "open-accounts" or any other theory of liability. The plain language of *Rule 3001* requires that if the claim is based on a writing, it must be filed with the proof of claim.

And there can be no question that a writing provides the contractual basis for credit card debt. In fact, the typical cardmember agreement is the controlling document that carefully delineates the rights and responsibilities between the card issuer and borrower. It specifies that use of the card is an affirmation of the contract terms contained in the written cardmember agreement (and its periodic amendments). An action on an "open-account" may be based on an express or implied contract, but if an enforceable express contract exists between the parties on the relevant subject matter, in most jurisdictions, the creditor cannot recover under an implied contract. Moreover, without the written agreement, card lenders have no legal claim to the substantial interest charges, late fees, bad check charges, over-the-limit fees and other costs included in virtually all credit card claims. In addition, prejudgment interest and costs may not be recovered in many jurisdictions on claims based on *quantum meruit* and implied contract, absent a specific statutory entitlement, because of the unliquidated nature of such claims. Thus, a claim that includes interest filed by a credit card claimant who has disavowed the cardmember agreement is self-contradictory and should be disallowed.

Some creditors and debt buyers have also argued that debtors should not be permitted to object to claims when they have listed the amount allegedly owing on their schedules and not noted it as disputed. However, the schedules are not filed for the purposes of claim allowance except in chapter 11 cases. Typically, when debtors complete their schedules they have no way of computing the amounts due under complex credit card contracts and just list the amount stated on a recent statement. However, to avoid such problems if an objection to a claim is anticipated, debtors may wish to mark debts as disputed, or to note that they have no way of verifying the amounts creditors have claimed on monthly statements. In addition, debtors usually have no way of knowing if a claim has been assigned, and often may legitimately object that they have never heard of the debt buyers filing claims in their cases, thus requiring the debt buyers to prove with competent evidence that the claims have in fact been assigned and are owing to them.

[4] Reduction of Claim for Refusal to Negotiate Repayment Schedule

Section 502(k), added in 2005,ⁿ²⁵ provides for the potential reduction of a creditor's claim, based in whole or in part on

an unsecured consumer debt, by 20% or less. However, the conditions for receiving such a reduction are so restrictive that it is unlikely that many debtors will be able to take advantage of this provision.

First, creditors may only be subject to the claim reduction if they "unreasonably" refuse to negotiate a "reasonable alternative repayment schedule proposed on behalf of the debtor by an approved nonprofit budget and credit counseling agency." Next, the offer of for a repayment schedule must have been made within 60 days prior to the filing of the petition. Third, the debt must be dischargeable. Lastly, the offer must have provided for at least 60% of the amount of the debt over the remaining term of the loan, or reasonable extension of that period.

If all the above requirements apply, the debtor may file a motion seeking a reduction of the claim. However, the debtor must then overcome the high hurdle of proving by "clear and convincing evidence" that the creditor "unreasonably refused" to consider the debtor's proposal and that the proposal was made within the 60 days prior to filing. Given all these requirements it is likely that section 502(k) will be rarely used.

FOOTNOTES:

(n1)Footnote 1. *See P 14.03[2] supra.*

(n2)Footnote 2. *See P 19.05 supra* for discussion of time limits.

(n3)Footnote 3. *See, e.g., In re Milton, Bankr. L. Rep. P73,401, 1990 Bankr. LEXIS 952 (Bankr. S.D. Cal. 1990) (IRS' claim disallowed because it did not state type of tax, tax period or amount and was therefore insufficient under Fed. R. Bankr. P. 3001).* However, in most cases, defects in form will not cause disallowance of the claim without an opportunity for the creditor to cure the defect. *Matter of Stoecker, 5 F.3d 1022, 29 C.B.C.2d 1103 (7th Cir. 1993)* (court could not disallow claim lacking required attachment of writing on which it was based without leave to amend).

(n4)Footnote 4. *E.g., In re Chavis, 47 F.3d 818 (6th Cir. 1995)* (untimely proof of IRS claim disallowed).

(n5)Footnote 5. *E.g., In re Baker, 129 B.R. 607 (E.D. Mo. 1991)* (IRS precluded from amending existing claim after bar date where supplemental claims involved tax debt for different tax year).

(n6)Footnote 6. *11 U.S.C. § 502(b)(1).*

(n7)Footnote 7. *See, e.g., In re Hamby, 19 B.R. 776 (Bankr. N.D. Ala. 1982)* (UCC repossession violations asserted as objections to claim for deficiency).

(n8)Footnote 8. *In re Laing, 945 F.2d 354 (10th Cir. 1991)* (state court judgment on note must be given preclusive effect upon objections to proof of claim). *See Matter of Brady, Texas Municipal Gas Corp., 936 F.2d 212 (5th Cir. 1991)* (state court determination concerning creditor's rights against debtor's successor in interest is entitled to full faith and credit even if erroneous).

(n9)Footnote 9. *Siegel v. Federal Home Loan Mortgage Corp., 143 F.3d 525, 39 C.B.C.2d 1395 (9th Cir. 1998)* .

(n10)Footnote 10. *11 U.S.C. § 726(a)(6).*

(n11)Footnote 11. *Fed. R. Bankr. P. 3007. Fed. R. Bankr. P. 9014* governs such proceedings.

(n12)Footnote 12. *See In re Miller, 16 F.3d 240 (8th Cir. 1994)* .

(n13)Footnote 13. *Matter of Fidelity Holding Co., Ltd., 837 F.2d 696 (5th Cir. 1988)* .

(n14)Footnote 14. *Raleigh v. Illinois Department of Revenue, 530 U.S. 15, 120 S. Ct. 1951, 147 L. Ed. 2d 13 (2000)* .

(n15)Footnote 15. See *Morton v. Morton* (*In re Morton*), 298 B.R. 301 (B.A.P. 6th Cir. 2003) ; *In re Fryer*, 172 B.R. 1020 (Bankr. S.D. Ga. 1994) (TILA objection to creditor's claim was not barred by res judicata effect of confirmed plan, since objection did not implicate validity of any plan provision).

(n16)Footnote 15a. *In re Herrera v. JPMorgan Chase Bank, N.A.*, 369 B.R. 395 (E.D. Wis. 2007) (where court had not set deadline for objections to claim, there was no deadline; trustee had no power to issue notice setting a deadline).

(n17)Footnote 16. 11 U.S.C. § 501(c).

(n18)Footnote 17. *Fed. R. Bankr. P. 3004*.

(n19)Footnote 18. *In re Kolstad*, 928 F.2d 171 (5th Cir. 1991) (court has discretion to allow IRS to amend debtor's proof of claim after the bar date); *In re Bishop*, 122 B.R. 96 (Bankr. E.D. Mo. 1990) (claim of IRS filed after debtor filed claim for IRS was effective as an amended claim, even though filed after claims bar date).

(n20)Footnote 19. See *In re Chain*, 255 B.R. 278 (Bankr. D. Conn. 2000) ; *In re Lindell Drop Forge Co.*, 111 B.R. 137 (Bankr. W.D. Mich. 1990) . See also *In re Wingerter*, 376 B.R. 221 (Bankr. N.D. Ohio 2007) (Rule 9011 requires a claim purchaser, before filing a proof of claim with a bankruptcy court, to obtain originating documents or, when such documents are not available, a clear understanding of the nature of the original dealings that support the assertion of a claim against the particular debtor).

(n21)Footnote 20. *First Nat'l Bank v. Circle J Dairy* (*In re Circle J. Dairy*), 112 B.R. 297, 300 (W.D. Ark 1989)

(n22)Footnote 21. See *In re Henry*, 311 B.R. 813 (Bankr. W.D. Wash. 2004) .

(n23)Footnote 22. *In re Trails End Lodge, Inc.*, 51 B.R. 209 (D. Vt. 1985) .

(n24)Footnote 23. *First Nat'l Bank v. Circle J Dairy* (*In re Circle J. Dairy*), 112 B.R. 297, 300 (W.D. Ark 1989) .

(n25)Footnote 24. *Gardner v. State of N.J.*, 329 U.S. 565 (1947) .

(n26)Footnote 25. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 19 Filing and Objecting to Proofs of Claims

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P 19.08 Postpetition Claims in Chapter 13 Cases

Section 1305 provides that certain postpetition claims may be filed and allowed in a chapter 13 case. It creates an exception to the basic scheme of the Bankruptcy Code, which is to affect claims arising prior to the filing of the petition under title 11. While there are exceptions to the requirement that a claim arise prior to the petition, postpetition claims are generally not allowable in title 11 cases, including chapter 13 cases.

Section 1305 supplements sections 501 and 502 in chapter 13 cases, by permitting certain postpetition claims to be treated the same as prepetition claims for purposes of proof, allowance, and distribution.ⁿ¹ Except for section 1305, postpetition claims against the chapter 13 debtor based on consumer debts could not be filed in a chapter 13 case.

[1] Filing of Postpetition Claims; § 1305(a)(1)

A proof of claim may be filed by entities holding certain types of postpetition claims against a chapter 13 debtor. Section 1305(a) is permissive.ⁿ² There is no requirement that the holder file proof of a postpetition claim under section 1305. The congressional purpose behind section 1305 is to permit the same treatment of certain postpetition credit extended to the chapter 13 debtor as for a prepetition claim for purposes of proof, allowance, and priority.ⁿ³ The holder of such a postpetition claim may refrain from filing proof of the postpetition claim, thereby waiving the right to distribution under the chapter 13 plan, in hopes of recovering against the debtor after the closing of the case. A discharge granted in a chapter 13 case would not relieve the debtor of liability on a postpetition claim, unless the debt had been provided for by the plan.ⁿ⁴

Although the Code permits certain postpetition claims to be filed by the debtor or by the trustee if the creditor does not do so,ⁿ⁵ those provisions are inapplicable to a section 1305 postpetition consumer debt claim because the holder of such a claim is neither a "creditor"ⁿ⁶ nor otherwise expressly authorized to file a claim.ⁿ⁷ The debtor cannot file a postpetition claim for such a holder.ⁿ⁸

Section 1305 does not prescribe when proof of a postpetition claim is to be filed. The former Act's deadline for filing postpetition claims with leave of court at any time during the pendency of the chapter 13 case and the legislative history strongly suggest that postpetition claims be permitted a later filing deadline than prepetition claims.ⁿ⁹

[2] Postpetition Tax Claims; § 1305(a)(1)

Any entity that holds a claim against the debtor for taxes becoming payable to a governmental unit during the pendency of the chapter 13 caseⁿ¹⁰ may elect to prove its claim against the chapter 13 estate.ⁿ¹¹ A tax on postpetition income of the debtor or of the chapter 13 estate is not a liability of the chapter 13 estate, but of the debtor only, by virtue of section 346(d).ⁿ¹² Nevertheless, the holder of a postpetition tax claim may elect to seek distribution under the chapter 13 plan by filing a proof of claim under section 1305(a)(1).ⁿ¹³ Voluntary participation in the plan by the holder of a postpetition tax claim may be beneficial to all concerned, by providing a struggling debtor with more time within which to satisfy a postpetition tax claim than would otherwise be permitted under applicable nonbankruptcy law or orders of the court dispensing relief from the automatic stay pursuant to section 362.

[3] Postpetition "Consumer Debt" Claims; § 1305(a)(2)

The holder of a claim arising out of a "consumer debt"ⁿ¹⁴ *after the commencement of the chapter 13 case*ⁿ¹⁵ for property or services necessary for the debtor's performance under the plan is entitled to file a proof of claim.ⁿ¹⁶ The debtor often encounters unforeseen circumstances which strain a marginal budget to the breaking point during the pendency of the chapter 13 plan. The only alternative to aborting the plan may be to obtain additional credit, such as for automobile repairs or hospital debts.ⁿ¹⁷ Section 1305(a)(2) permits holders of postpetition claims of this nature to share with prepetition creditors under the plan by permitting them to file proofs of claims.ⁿ¹⁸ If the debtor wishes this type of claim to be paid in full, the debtor may need to amend the chapter 13 planⁿ¹⁹ and, possibly, separately classify the postpetition claim.ⁿ²⁰

MORE INFORMATION

Classification is discussed further in chapter 14 *supra* .

[4] Advisability of Filing a Postpetition Claim

The initial decision for the holder of a section 1305 postpetition claim is whether to file a proof of claim or attempt recovery after the chapter 13 case has been closed. For a postpetition creditor, the right of the debtor to convert the case to chapter 7 at any timeⁿ²¹ and the prospects for further discharge relief following a chapter 13 dischargeⁿ²² may militate in favor of filing proof of postpetition claims, whether or not dischargeable in a chapter 7 case, as permitted by section 1305(a). However, the opportunity to share immediately in distribution of the debtor's postpetition income through the chapter 13 plan must be weighed against the possibility of the postpetition claim being discharged under section 1328(a) without full payment.

[5] Allowance of Postpetition Claims; § 1305(b)

A postpetition tax claim or consumer debt claim filed pursuant to section 1305(a) is to be allowed or disallowed under section 502(a), (b), (c), (d), or (e),ⁿ²³ as though it were a prepetition claim,ⁿ²⁴ except for certain consumer debt claims dealt with by subsection (c) of section 1305.ⁿ²⁵

[6] Disallowance of Unauthorized Consumer Debt Claims; § 1305(c)

As has been stated, it is often essential to the success of a chapter 13 plan that the debtor be allowed to acquire on credit property or services necessary to enable the debtor to continue performance under the plan. But it is equally important to the success of the plan that the chapter 13 debtor not be allowed to incur unnecessary credit, credit which cannot be repaid or credit incurred on terms prejudicial to other creditors. The chapter 13 trustee is best situated to evaluate these matters. Therefore, a postpetition consumer debt claim is to be disallowed if its holder knew or should have known that it was practicable to obtain the approval of the chapter 13 trustee before the consumer debt was incurred by the debtor and such approval was not obtained.ⁿ²⁶

[7] Postpetition Claims to Be Paid Only if Provided for by Plan

Even if a postpetition claim is filed and allowed, it is only to be paid in a chapter 13 plan and discharged by a chapter 13 discharge if it is provided for by the plan. If the initial confirmed plan or a modification of the plan approved by the court does not provide for payment of a postpetition claim, the holder of that claim has no right to be paid under the plan. Since section 1322(b)(6) permits, but does not require, a debtor to provide for postpetition claims, the debtor ultimately must choose whether to pay such claims during or after the chapter 13 case.ⁿ²⁷

Thus, a postpetition claim may be paid through a chapter 13 plan only if both the debtor and creditor agree upon that procedure. They may be paid only if the holder of the claim files a postpetition claim and only if the debtor provides in the plan for payment of that claim.

FOOTNOTES:

(n1)Footnote 1. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 427-28 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n2)Footnote 2. 11 U.S.C. § 1305(a). See H.R. Rep. No. 595, 95th Cong., 1st Sess. 427 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender). See also 8 Collier on Bankruptcy, P 1300.70[1][a] (Matthew Bender).

(n3)Footnote 3. H.R. Rep. No. 595, 95th Cong., 1st Sess. 428 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n4)Footnote 4. See 11 U.S.C. §§ 1322(b)(6) and 1328(a) and (c). See 8 Collier on Bankruptcy, P 1305.01 (Matthew Bender); 3 Collier Bankruptcy Manual, P 1305.01 (Matthew Bender). But see 11 U.S.C. § 1328(d); 8 Collier on Bankruptcy, P 1328.01 (Matthew Bender); 3 Collier Bankruptcy Manual, P 1328.01 (Matthew Bender). Section 1328(a) was amended by the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394 (enacted on October 22, 1994 and effective with respect to cases filed on or after that date), to make technical corrections and to make criminal fines nondischargeable in chapter 13 cases.

(n5)Footnote 5. See 11 U.S.C. § 501.

(n6)Footnote 6. "Creditor" is defined at 11 U.S.C. § 101 as the holder of a prepetition claim or certain specified other types of claims.

(n7)Footnote 7. See 11 U.S.C. § 501(d). The definition of "creditor" includes entities that have claims of the type specified in 11 U.S.C. §§ 348(d), 502(f), 502(g), 502(b) or 502(i).

(n8)Footnote 8. *In re Hester*, 15 C.B.C.2d 1082, 63 B.R. 607 (Bankr. E.D. Tenn. 1986) ; *In re Pritchett*, 55 B.R. 557 (Bankr. W.D. Va. 1985) .

(n9)Footnote 9. See Chapter XIII, Rule 13-305. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 352 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n10)Footnote 10. Note that the tax may have been assessed before the commencement of the case. Note also that subsection 1305(a)(1) deals with taxes becoming payable during the pendency of the chapter 13 case. Compare § 1305(a)(2).

(n11)Footnote 11. § 1305(a)(1).

(n12)Footnote 12. 11 U.S.C. § 346(d). See 15 Collier on Bankruptcy, TX12 (Matthew Bender).

(n13)Footnote 13. 11 U.S.C. § 1305(a)(1). See H.R. Rep. No. 595, 95th Cong., 1st Sess. 428 (1977), *reprinted in*

Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n14)Footnote 14. "Consumer debt" is defined at *11 U.S.C. § 101*.

(n15)Footnote 15. The consumer debt must have been incurred after the order for relief in the chapter 13 case and before performance under the plan has been completed or abandoned. *See 11 U.S.C. § 1305(a)(2). Compare § 1305(a)(1).*

(n16)Footnote 16. *11 U.S.C. § 1305(a)(2).*

(n17)Footnote 17. *See H.R. Rep. No. 595, 95th Cong., 1st Sess. 427-28 (1977), reprinted in Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).*

(n18)Footnote 18. *See H.R. Rep. No. 595, 95th Cong., 1st Sess. 427-28 (1977), reprinted in Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).*

(n19)Footnote 19. *See 11 U.S.C. § 1329; ch. 22 infra .*

(n20)Footnote 20. *See 11 U.S.C. § 1322(a)(3).*

(n21)Footnote 21. *11 U.S.C. § 1307(a).* Postpetition claims are discharged in a case converted to chapter 7. *See ch. 24 infra.*

(n22)Footnote 22. *See 11 U.S.C. § 727(a)(9).*

(n23)Footnote 23. *11 U.S.C. § 502(a)-(e). See 8 Collier on Bankruptcy, P 1300.71 (Matthew Bender).* Section 502(b) was amended by the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394 (enacted on October 22, 1994 and effective with respect to cases filed on or after that date), to clarify that a late-filed claim should be disallowed, except to the extent that such claims are entitled to distribution in chapter 7 cases pursuant to section 726(a).

(n24)Footnote 24. *11 U.S.C. § 1305(b).*

(n25)Footnote 25. *11 U.S.C. § 1305(c).*

(n26)Footnote 26. *11 U.S.C. § 1305(c). See also 11 U.S.C. § 1328(d).*

(n27)Footnote 27. *See 8 Collier on Bankruptcy, P 1305.01 (Matthew Bender); 3 Collier Bankruptcy Manual, P 1305.01 (Matthew Bender).*



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CHAPTER 19 Filing and Objecting to Proofs of Claims

1-19 Collier Consumer Bankruptcy Practice Guide P 19.09

P 19.09 Reconsideration of Claims

Both *Code section 502(j)* and *Federal Rule of Bankruptcy Procedure 3008* provide for the reconsideration of previously allowed claims. A motion for reconsideration may be needed in a number of situations. For example, a debtor may not be able to continue the chapter 13 plan payments necessary to retain a motor vehicle, leading to liquidation of the vehicle by the creditor after either a voluntary surrender of the vehicle or repossession. Such a liquidation results in a reduction in the creditor's claim and the creditor becoming unsecured with respect to any deficiency claim. Such events can be appropriate bases for reconsideration of the creditor's claim to reflect the payment by liquidation and new status as unsecured. If the claim is reconsidered, the debtor would then be able to modify the chapter 13 plan to reduce payments to that creditor¹ and, often, to the trustee.

FOOTNOTES:

(n1)Footnote 1. *See In re Zieder*, 263 B.R. 114 (Bankr. D. Ariz. 2001) .



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CHAPTER 20 Confirmation of the Chapter 13 Plan

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§ 20.syn Synopsis to Chapter 20: Confirmation of the Chapter 13 Plan

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CHAPTER 20 Confirmation of the Chapter 13 Plan

1-20 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the requirements and procedures of a chapter 13 confirmation hearing. The chapter also discusses the procedure for filing objections to confirmation and the entry of the confirmation order. In addition, the effects of confirmation, including the vesting of property, are discussed.



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CHAPTER 20 Confirmation of the Chapter 13 Plan

1-20 Collier Consumer Bankruptcy Practice Guide P 20.01

P 20.01 Introduction

A critical step in every chapter 13 case is the confirmation of the debtor's plan. The confirmation order is the court's approval of the plan, which permits the debtor to carry out the plan and ultimately obtain a discharge. The confirmation order is entered at or after a confirmation hearing, which is required in every chapter 13 case.

Creditors or the trustee may object to confirmation of the plan. These objections are determined by the court at the confirmation hearing. Other issues, such as the valuation of property, may also be considered at that hearing.

The confirmation order is binding on the debtor, creditors, and the trustee. Once the confirmation is ordered, the trustee may begin making distributions of the debtor's payments to creditors and creditors are barred from objecting to any provisions of the debtor's plan, although in certain circumstances they may move to modify the plan.

MORE INFORMATION

Postpetition modification of the plan is discussed in chapter 22 *infra*.



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CHAPTER 20 Confirmation of the Chapter 13 Plan

1-20 Collier Consumer Bankruptcy Practice Guide P 20.02

P 20.02 The Confirmation Hearing

[1] Scheduling of Hearing

A confirmation hearing must be held in every chapter 13 case.ⁿ¹ Section 1324(b), enacted in 2005,ⁿ² provides that the confirmation hearing must be held between 20 days and 45 days after the date of the section 341(a) meeting of creditors, unless the court determines it would be in the best interests of creditors and the estate to hold the hearing earlier and there is no objection to an earlier date.ⁿ³ Section 1324(b) provides that the court may schedule the confirmation hearing earlier than 20 days after the section 341(a) meeting of creditors if it determines that is in the best interests of creditors and the estate, unless there is an objection to the earlier date. This will allow continuation of the practice of some courts of holding the confirmation hearing immediately after, or within a short time after, the meeting of creditors, provided no party objects.

For cases filed prior to the effective date of the 2005 amendments, many courts found it useful to wait until after the claims deadline for nongovernmental claims passed before holding the confirmation hearing. Under the 2005 amendments, courts are not able to schedule the initial confirmation hearing after the claims deadline. However, if, for example, a plan's confirmation depends on the court's decision on objections to priority or secured claims, a court may still continue the confirmation hearing until the necessary information is available, which may not be until the claims bar date has passed. Without such a decision there may be no way to determine whether the plan pays priority or secured claims in full, as is usually required for confirmation. In such cases, it may not be possible to conclude the confirmation hearing until many months after the creditors' meeting.

MORE INFORMATION

For further discussion of objections to claims and confirmation requirements *see* chapters 19 and 14 *supra*, respectively.

[2] Notice of Hearing

Notice of the confirmation hearing must be given to the debtor, all creditors, the United States trustee and the chapter 13 trustee. *Federal Rule of Bankruptcy Procedure 2002(b)* and *(k)* provide that at least 28 days notice be given to these parties in interest.ⁿ⁴ The notice must also state the deadline for filing objections to confirmation.ⁿ⁵

Typically, the notice of the confirmation hearing is sent as part of Official Form 9I, combined with the notice of the meeting of creditors and the notice of the commencement of the case.

FORMS

Official Form 9I is reprinted in *Collier Consumer Bankruptcy Forms, Form CS10.32-5* (Matthew Bender).

[3] Procedures at Hearing

The procedures followed at the confirmation hearing vary greatly, depending on the practice in a particular judicial district or even the practice of a particular bankruptcy judge. If neither the trustee nor any creditor objects to confirmation, the hearing usually takes only a few minutes, and the court simply enters an order of confirmation finding that the plan complies with all of the provisions of chapter 13.ⁿ⁶ The debtor's attendance may not be necessary. In fact, some bankruptcy judges actively discourage counsel from bringing their clients to the confirmation hearing, so that the debtors will not lose another day's pay. Other judges do not even require that counsel be present when there is no objection; they simply sign the confirmation order in chambers. Local practice in this regard should be checked.

On the other hand, a few judges feel it necessary to conduct an evidentiary hearing about the feasibility of the debtor's plan and the debtor's disposable income. Obviously, this does not usually occur in high-volume chapter 13 districts, and the additional costs imposed by such hearings, as well as the hostility to chapter 13 they sometimes evidence, usually result in few chapter 13 cases being filed where such hearings are required.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 1324. See 8 Collier on Bankruptcy, P 1324.01* (Matthew Bender).

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. While somewhat unclear, the time periods should be interpreted as running from the conclusion of the meeting of creditors, rather than the first date set for the meeting of creditors.

(n4)Footnote 4. *See 9 Collier on Bankruptcy, P 2002.03* (Matthew Bender).

(n5)Footnote 5. *See 9 Collier on Bankruptcy, P 2002.03* (Matthew Bender).

(n6)Footnote 6. *See In re Hines*, 723 F.2d 333, 9 C.B.C.2d 1099 (3d Cir. 1983) (trustee's recommendation is sufficient basis for confirming plan); *Matter of Dues*, 98 B.R. 434 (Bankr. N.D. Ind. 1989) (absent objection, full evidentiary hearing is not required).



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CHAPTER 20 Confirmation of the Chapter 13 Plan

1-20 Collier Consumer Bankruptcy Practice Guide P 20.03

P 20.03 Objections to Confirmation

Any creditor or the trustee may file an objection to confirmation. The right to object to confirmation of the plan is usually a creditor's only opportunity to contest the debtor's treatment and possible discharge of the creditor's claim in chapter 13, since there is no possibility of objecting to discharge at any other time equivalent to that which exists in chapter 7 and chapter 11.ⁿ¹ While a creditor is entitled to rely upon compliance with the terms stated in the plan,ⁿ² if no objection to that plan is filed after proper notice of the case, the creditor is bound by the terms of the plan and has no right to later challenge the propriety of the plan.ⁿ³ However, a creditor who does not hold an allowed claim, because a claim was never filed or for some other reason, is not a party in interest with standing to object to confirmation of the plan.ⁿ⁴

Any material respect in which the plan is not in compliance with section 1325,ⁿ⁵ with any other provision of chapter 13ⁿ⁶ or with any other applicable provision of title 11,ⁿ⁷ is a sufficient basis upon which to object to its confirmation.

MORE INFORMATION

For further discussion of section 1325 and other chapter 13 plan requirements *see* chapter 14 *supra*.

An objection to confirmation must be filed and served on the debtor, the trustee, and any other entity designated by the court, as well as transmitted to the United States trustee, before confirmation of the plan.ⁿ⁸ *Rule 3015(f) of the Federal Rules of Bankruptcy Procedure* requires that the objection must be filed and served prior to confirmation of the plan, which, as a practical matter, means before the confirmation hearing. Some courts set earlier deadlines, by local rules or insertion of the deadline in the notice of the meeting of creditors,ⁿ⁹ but there is some issue regarding whether such deadlines are valid in light of *Rule 3015*, which simply requires that objections be filed before confirmation.

FORMS

For various forms of objections to confirmation *see Collier Consumer Bankruptcy Forms*, §§ CS19.31-34 (Matthew Bender).

The objection gives rise to a contested matter which is to be litigated by the parties directly involved, including the debtor and the objecting creditor or creditors. Generally, the burden of going forward with evidence and the ultimate burden of proof is borne by the party objecting to confirmation,ⁿ¹⁰ and if that party fails to prosecute the objection, the

objection should be dismissed.ⁿ¹¹ The objection is usually heard at the hearing on confirmation, but it may also be heard at a separate hearing scheduled prior to the confirmation hearing. Testimony and argument may be taken regarding the debtor's income, ability to pay, and other matters.

MORE INFORMATION

Procedures in contested matters, including service, discovery and hearing procedures are discussed in chapter 32 *infra*.

FOOTNOTES:

(n1)Footnote 1. *Compare 11 U.S.C. § 1328 with §§ 727(c) and 1141(d)(3). See 8 Collier on Bankruptcy, P 1328.01[1] (Matthew Bender).*

(n2)Footnote 2. *In re Fawcett, 758 F.2d 588, 12 C.B.C.2d 1011 (11th Cir. 1985)*

(n3)Footnote 3. *In the Matter of Gregory, 705 F.2d 1118, 8 C.B.C.2d 605 (9th Cir. 1983) ; United States on Behalf of I.R.S. v. Norton, 717 F.2d 767, 9 C.B.C.2d 336 (3d Cir. 1983) . See P 20.05 infra.*

(n4)Footnote 4. *In re Stewart, 12 C.B.C.2d 86, 46 B.R. 73 (Bankr. D. Or. 1985)*

(n5)Footnote 5. *11 U.S.C. § 1325(a)(1).*

(n6)Footnote 6. *11 U.S.C. § 1325(a)(1).*

(n7)Footnote 7. *11 U.S.C. § 1325(a)(1). See 8 Collier on Bankruptcy, P 1325.02[2] (Matthew Bender).*

(n8)Footnote 8. *See Fed. R. Bankr. P. 3015(f). See 9 Collier on Bankruptcy, P 3015.02 (Matthew Bender).*

(n9)Footnote 9. *See In re Carbone, 254 B.R. 1 (Bankr. D. Mass. 2000)* (objection not timely because it was not received by clerk within time period allowed by local rule).

(n10)Footnote 10. *In re Mendenhall, 54 B.R. 44 (Bankr. W.D. Ark. 1985); Pennsylvania v. Flick (In re Flick), 5 C.B.C.2d 494, 14 B.R. 912 (Bankr. E.D. Pa. 1981); In re Fries, 68 B.R. 676 (Bankr. E.D. Pa. 1986).*

(n11)Footnote 11. *In re Parker, 49 B.R. 61 (Bankr. E.D. Va. 985); In re Powell, 5 C.B.C.2d 775, 15 B.R. 465 (Bankr. N.D. Ga. 1981).*



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CHAPTER 20 Confirmation of the Chapter 13 Plan

1-20 Collier Consumer Bankruptcy Practice Guide P 20.04

P 20.04 Entry of Confirmation Order

In most districts, the court enters a form order confirming the plan. However, in some districts the court may require counsel to present a proposed order of confirmation, or an application for confirmation. As is required in other proceedings, inquiry should be made into local practice on these matters prior to the date of the hearing.

PRACTICE NOTE

The day of the confirmation hearing is a good time to determine what claims have been filed, especially in jurisdictions in which the deadline for filing claims has already expired. If only a few claims have been filed, the plan may provide more than enough payments to pay all filed claims in full. If that is the case, it is obviously in the debtor's interest to modify the plan to lower either the amount or the number of payments. Otherwise, because of the way some trustees' computers are programmed, the debtor may continue to make payments to the trustee even after all claims have been paid.

FORMS

For a form of order see *Collier Consumer Bankruptcy Forms, Form CS19.42-1* (Matthew Bender).



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CHAPTER 20 Confirmation of the Chapter 13 Plan

1-20 Collier Consumer Bankruptcy Practice Guide P 20.05

P 20.05 Effect of Confirmation

[1] Confirmation of Plan Binds Debtor and All Creditors

The confirmation order is binding upon the debtor and all creditors.ⁿ¹ Once the appeal period has passed, it is *res judicata* as to all issues which could have been raised in opposition to confirmation.ⁿ² After confirmation, no creditor may take actions that are inconsistent with the plan.ⁿ³ Moreover, no creditor may later challenge the plan by arguing that it did not comply with some provision of chapter 13, such as the good faith requirement.ⁿ⁴ Even if a creditor has not been provided all that it is entitled to receive under the statute, such as present value interest for a secured creditor,ⁿ⁵ the creditor that does not timely assert those rights will lose them, just as parties in other proceedings may lose rights by default. For example, a plan provision finding that a student loan was dischargeable under the undue hardship provisions of section 523(a)(8) was binding on the loan guarantee agency once the plan had been confirmed.ⁿ⁶ Since noncompliance with any provision of chapter 13 or other applicable provisions of the Bankruptcy Code may be raised as an objection to confirmation under *section 1325(a)(1) of the Bankruptcy Code*, a creditor has few if any ways to challenge a confirmed plan other than under the very narrow grounds provided for seeking revocation of confirmation.ⁿ⁷

A chapter 13 trustee is also bound by the confirmed plan, and has no authority to make distributions except as provided by the plan. If such distributions are made, the trustee is responsible for rectifying the error.ⁿ⁸

However, even a provision of a confirmed plan may not be sufficient to invalidate a claim properly filed by a creditor. Some courts have held that the only method contemplated for challenging a filed proof of claim is the process of objecting to the claim.^{n8a} Other courts have allowed the provisions of a confirmed plan to govern over an inconsistent claim.^{n8b} Still others have treated the issue as one of whether the creditor has received constitutionally sufficient notice that its property rights are in jeopardy, suggesting that if sufficient notice is given, a creditor may have its lien reduced by confirmation of a plan.^{n8c}

The binding effect of confirmation can be important in requiring creditors to abide by the terms of the plan even after it has been concluded. If a plan provides that certain payments under the plan will cure a mortgage default, thereby bringing the debtor current on the mortgage, a mortgage lender may not add extra charges or prepetition claims to the ongoing mortgage payments either during the plan or after it has been completed,ⁿ⁹ as some attempt to do. The debtor must be treated as if the default had not occurred and he or she is current on payments.

PRACTICE NOTE

Practitioners representing debtors who have cured mortgages should advise their clients to be alert to any charges added to their payments that may be related to the earlier default. If such charges are imposed, it may be necessary to enforce the terms of the confirmation order, reopening the chapter 13 case if it has already been completed. Such charges also violate the discharge injunction,ⁿ¹⁰ and in many states additional damages and attorney fees may be available because imposition of illegal charges violates state usury or unfair trade practice laws.

Although the binding effect of a confirmed plan often works in a debtor's favor, some courts have allowed creditors to use it as an argument against a debtor. For example, debtors have been prevented from claiming an exemption in the proceeds of the sale of their home when such an exemption precluded them from paying creditors the amount provided in their plan.ⁿ¹¹ It has also been held, erroneously, that confirmation fixes the amount of a claim filed prior to confirmation to which no objection has been made, and the debtor may not later argue that the claim was overstated.ⁿ¹²

[2] Property of the Estate Vests in Debtor

All property of the estateⁿ¹³ is vested in the chapter 13 debtor upon entry of the order of confirmation, unless the terms of the plan or of the order confirming the plan provide otherwise.ⁿ¹⁴ Section 1327(b) thus preserves to the debtor ownership, as well as possession,ⁿ¹⁵ of all property, whether acquired before or during the chapter 13 case, except as otherwise required to effectuate the confirmed plan.

[a] Plan or Order Confirming Plan May Provide for Different Vesting of Property

Section 1327(b) and sections 1322(b)(8) and (9) facilitate flexibility in chapter 13 plans, as well as judicial discretion, by permitting the debtor to propose a plan to satisfy all or part of one or more claims by vesting property of the debtor or property of the estate in a creditor. Section 1327(b) in no way restricts the freedom of the debtor to include a provision in the plan vesting property of the estate, including exempt property, in an entity other than the debtor. In the usual chapter 13 case, however, future earnings of the debtor required to effectuate the confirmed plan must be submitted to the control and supervision of the chapter 13 trustee.ⁿ¹⁶ When the debtor proposes to make substantial payments to certain creditors outside the plan, the bankruptcy court may retain jurisdiction over the debtor's future earnings and require their submission to the trustee, who, after disbursements for obligations under the plan, would return the balance to the debtor for distribution to holders of claims payable outside the plan.

MORE INFORMATION

See chapter 14 *supra* for further discussion of permissive plan provisions.

[b] Effect of Property Vesting in Debtor

The vesting of property of the estate in the debtor may affect the extent of the automatic stay provided by section 362(a) after confirmation. Certain creditors, such as creditors holding postpetition claimsⁿ¹⁷ or claims for domestic support obligations,ⁿ¹⁸ are stayed only from taking action against property of the estate. To the extent that property of the estate vests in the debtor upon confirmation, such creditors may be able to proceed against that property.ⁿ¹⁹ However, the Court of Appeals for the Eighth Circuit, in *Security Bank of Marshalltown, Iowa v. Neiman*,ⁿ²⁰ held that the chapter 13 estate continues to exist after property of the estate vests in the debtor.

In any case, if the plan defers the vesting of property in the debtor until some later time, the stay of acts against property of the estate clearly protects such property until that time.ⁿ²¹

[c] Protection of Secured Creditors; § 1327(c)

Section 1327(c) deems all property vesting in the debtor at confirmation by virtue of section 1327(b) "free and clear of any claim or interest of any creditor provided for by the plan," except as otherwise provided in the plan or the order confirming the plan. Section 1327(c) is similar in wording to section 1141(c),ⁿ²² from which it appears to have been derived.

The principal protection for secured creditors is their right to object to confirmation of proposed plans which do not provide for retention of their liens or plan distributions in accordance with section 1325(a)(5)(B)(iii), which was enacted in 2005.ⁿ²³ A chapter 13 plan may not be confirmed without the acceptance of the holder of an allowed secured claim provided for by the plan,ⁿ²⁴ unless the plan provides for retention of the lien securing the claimⁿ²⁵ or the debtor surrenders the collateral.ⁿ²⁶ To meet the lien retention standard the plan must permit the holder of an allowed secured claim to retain its lien until the earlier of the payment of the underlying debt determined under nonbankruptcy law or a discharge under section 1328.ⁿ²⁷ Additionally, section 1325(a)(5)(B)(iii) provides that plan distributions to the holder of an allowed secured claim must be in equal monthly payments and that such payments must provide adequate protection if the claim is secured by personal property.ⁿ²⁸ Section 1327(c) expressly excepts from its operation "claims and interests" with respect to which the plan or the order confirming the plan makes other provisions.

PRACTICE NOTE

A creditor holding an allowed secured claim provided for by the plan would be well advised to insist upon a provision in the plan formally retaining its lien during the extension period or until satisfied in full, and otherwise to object to confirmation of the chapter 13 plan.

The Court of Appeals for the Fifth Circuit has found some additional protection for a secured creditor who files a timely proof of secured claim in section 502(a), which provides that a proof of claim filed under section 501 is deemed allowed unless a party in interest objects. *In re Simmons* ^{n28a} involved a case in which a creditor filed a secured proof of claim, to which no party objected, and the creditor failed to object to the debtor's plan, which was confirmed despite the fact that it classified the claim as unsecured. The court held that the creditor was entitled to rely on its proof of claim unless an objection to that claim was filed, and that the creditor's lien survived the chapter 13 case.^{n28b} In doing so, it relied upon the decision of the Court of Appeals for the Seventh Circuit in *In the Matter of Tarnow*,^{n28c} which held that when a secured creditor did not file a timely proof of claim and was, therefore, not provided for in a chapter 11 plan, the secured creditor's lien passed through the chapter 11 case unaffected. Both courts concluded that if no party brought a proceeding specifically challenging a creditor's lien in the bankruptcy court, then that creditor could ignore the bankruptcy case without fear of losing its lien.

COMMENTARY

This latter conclusion seems overbroad, and not necessary to reach the same results in chapter 13 cases. In *Tarnow*, since the plan apparently did not provide for a secured creditor who did not file a proof of claim, section 1327(c) would not have vested property free and clear of that creditor's lien had the case been one under chapter 13. That section vests property of the estate in the debtor free of a creditor's interest only if that creditor is provided for in the plan. In *Simmons*, it would have been sufficient to hold that when a creditor had filed a timely proof of claim the debtor's plan could not alter that claim without due process notice and an opportunity for a hearing afforded to the creditor.

And in any case, when a chapter 13 plan does provide for a secured claim without altering the claim itself, it seems clear that the property securing that claim vests in the debtor subject only to the terms and conditions of the plan,^{n28d} even if the plan could have been successfully challenged at a confirmation hearing.^{n28e} One of the principal purposes of chapter 13 was to provide individual debtors with effective ways of dealing with secured creditors,ⁿ²⁹ and a secured creditor may be provided for in a plan even if it

does not file a claim.ⁿ³⁰ Therefore, a secured creditor ignores a chapter 13 case at its peril. Because all parties are entitled to rely on the *res judicata* effect of a chapter 13 confirmation order,ⁿ³¹ a confirmed chapter 13 plan is binding on all creditors.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 1327(a). See 8 *Collier on Bankruptcy*, P 1327.02 (Matthew Bender).

(n2)Footnote 2. *In re Ivory*, 70 F.3d 73 (9th Cir. 1995) (even if order confirming plan erroneously gave debtor right to redeem property after expiration of redemption period, creditor could not collaterally attack unappealed confirmation order); *Matter of Pence*, 905 F.2d 1107 (7th Cir. 1990) ; *In re Szostek*, 886 F.2d 1405 (3d Cir. 1989) ; *In re Diviney*, 225 B.R. 762 (B.A.P. 10th Cir. 1998) (unless expressly preserved by confirmed plan or order confirming plan, terms of preconfirmation agreement regarding automatic stay did not survive confirmation).

(n3)Footnote 3. *In re Talbot*, 124 F.3d 1201 (10th Cir. 1997) (IRS not permitted to demand full payment of its lien when debtors sold home because lien was to have been paid through chapter 13 plan).

(n4)Footnote 4. In the *Matter of Gregory*, 705 F.2d 1118, 8 C.B.C.2d 605 (9th Cir. 1983) . The debtor may modify the plan, however, if the modification meets the requirements of section 1329, even without a showing of cause. *In re Jourdan*, 108 B.R. 1020 (Bankr. N.D. Iowa 1989) ; *In re Moseley*, 74 B.R. 791 (Bankr. C.D. Cal. 1987) . See also *Travelers Indem. Co. v. Bailey*, 129 S. Ct. 2195 (U.S. 2009) (parties to bankruptcy case or those in privity with them could not argue court's lack of jurisdiction in challenging final chapter 11 confirmation order); *But see Matter of Escobedo*, 28 F.3d 34 (7th Cir. 1994) (distinguishing mandatory requirements of section 1322(a), and holding that a trustee could obtain dismissal of a plan not complying with section 1322(a) even after an unappealed confirmation order).

(n5)Footnote 5. *Matter of Chappell*, 984 F.2d 775, 28 C.B.C.2d 431 (7th Cir. 1993) (lien was eliminated and debt discharged upon full payment of creditor's claim for principal, without interest, pursuant to confirmed chapter 13 plan not providing for interest, to which creditor had not objected); *In re Szostek*, 886 F.2d 1405, 21 C.B.C.2d 889 (3d Cir. 1989) .

(n6)Footnote 6. *Espinosa v. United Student Aid Funds, Inc.*, 553 F.3d 1193 (9th Cir. 2008) . *But see Banks v. Sallie Mae Servicing Corp.* (*In re Banks*), 299 F.3d 296 (4th Cir. 2002) (adversary proceeding required to discharge student loan or postpetition interest on student loan; basing discharge on plan that did not provide service of process as in adversary proceeding would violate due process).

(n7)Footnote 7. 11 U.S.C. § 1330 allows revocation of confirmation to be sought only within 180 days of the confirmation order and only if the confirmation order was procured by fraud. It may be sought only by a creditor provided for in the plan. *In re Fesq*, 153 F.3d 113, 40 C.B.C.2d 768 (3d Cir. 1998) , *cert. denied*, 526 U.S. 1018, 119 S. Ct. 1253 (1999) (confirmation may not be vacated under *Rule 9024*; revocation based upon fraud is only remedy). See 8 *Collier on Bankruptcy*, P 1330.02 (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1330.02 (Matthew Bender).

(n8)Footnote 8. *In re Wilson*, 274 B.R. 4 (Bankr. D.D.C. 2001) (trustee who began distributions after confirmation but before governmental claims bar date and who made distributions to unsecured creditors of funds that should have gone to larger-than-expected governmental claims was required to recover erroneous distributions or reimburse estate).

(n9)Footnote 8a. *Cen-Pen Corp. v. Hanson*, 58 F.3d 89, 33 C.B.C.2d 1159 (4th Cir. 1995) (adversary proceeding is required to challenge validity of lien); *In re Simmons*, 765 F.2d 547 (5th Cir. 1985) . The Fifth Circuit elaborated on *Simmons* in *Matter of Howard*, 972 F.2d 639, 27 C.B.C.2d 1016 (5th Cir. 1992) . There the court held that it is simply necessary to file an objection to a secured claim before the confirmation hearing to put the creditor on notice that its lien is at risk if it does not participate in confirmation proceedings. Thereafter, a confirmed plan may modify the lien of a creditor who has filed a secured claim. See also *Universal Am. Mort. Co. v. Bateman* (*In re Bateman*), 331 F.3d 821

(11th Cir. 2003) (although mortgage creditor's claim for arrearages had to be disallowed to extent it exceeded amount provided for in confirmed plan, the arrearages disallowed would remain owing after the case because plan could not modify mortgage creditor's secured claim).

(n10)Footnote 8b. *In re Wolf*, 30 C.B.C.2d 730, 162 B.R. 98 (Bankr. D.N.J. 1993) ; *In re Tucker*, 35 B.R. 35 (Bankr. M.D. Tenn. 1983) ; *In re Russell*, 29 B.R. 332 (Bankr. E.D. N.Y. 1983) .

(n11)Footnote 8c. *In re Linkous*, 990 F.2d 160, 28 C.B.C.2d 1139 (4th Cir. 1993) (notice of confirmation hearing was not adequate to permit reduction of liens when it failed to state that court would consider valuation of security interests at confirmation hearing). See generally 8 *Collier on Bankruptcy*, P 1327.02[2] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1327.02[2] (Matthew Bender).

(n12)Footnote 9. *In re Ronemus*, 201 B.R. 458 (Bankr. N.D. Tex. 1996) (mortgage creditor assessed \$10,000 plus attorney's and accountant's fees due to improper charges on debtor's account contrary to terms of plan); *In re Rathe*, 114 B.R. 253 (Bankr. D. Idaho 1990) ; *In re Brown*, 121 B.R. 768 (Bankr. S.D. Ohio 1990) (mortgagee must treat debtor as current even where it claimed to have incorrectly computed its proof of claim).

(n13)Footnote 10. 11 U.S.C. § 524(a)(2). See ch. 29 *infra* for discussion of the discharge injunction.

(n14)Footnote 11. *In re Wolfberg*, 255 B.R. 879 (B.A.P. 9th Cir. 2000) . Compare *In re Summerville*, 361 B.R. 133 (B.A.P. 9th Cir. 2007) (plan providing only that debt would be cured with current payments outside the plan did not preclude debtor from later raising defenses in state court).

(n15)Footnote 12. *Adair v. Sherman*, 230 F.3d 890 (7th Cir. 2000) (debtor precluded from bringing action under Fair Debt Collection Practices Act alleging that proof of claim filed by creditor was excessive). Compare *In re Lewis*, 875 F.2d 53 (3rd Cir. 1989) (confirmation does not necessarily preclude challenge to proof of claim); *In re Fryer*, 172 B.R. 1020 (Bankr. S.D. Ga. 1994) (confirmation did not bar Truth in Lending objection to claim, since objection did not implicate validity of any plan provision).

(n16)Footnote 13. See 11 U.S.C. §§ 541 and 1306(a). See 8 *Collier on Bankruptcy*, P 1306.02 (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1306.02 (Matthew Bender).

(n17)Footnote 14. 11 U.S.C. § 1327(b). But see *In re Waldron*, 536 F.3d 1239 (11th Cir. 2008) (personal injury cause of action that debtor acquired after confirmation did not revest in debtor at confirmation and was property of estate; debtor had no duty to automatically amend schedules to list it, but court could require that).

(n18)Footnote 15. See 11 U.S.C. § 1306(b). See *Murray v. Board of Educ. of the City of New York*, 248 B.R. 484 (S.D. N.Y. 2000) (chapter 13 debtor had standing to bring Title VII action even though she inadvertently omitted it from schedules); 8 *Collier on Bankruptcy*, P 1306.03 (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1306 (Matthew Bender).

(n19)Footnote 16. 11 U.S.C. § 1322(a)(1).

(n20)Footnote 17. 11 U.S.C. § 362(a)(1), (2), (5), (6) and (7) apply only to prepetition debts. See ch. 8 *supra*.

(n21)Footnote 18. 11 U.S.C. § 362(b)(2)(B), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See ch. 8 *supra*.

(n22)Footnote 19. *In re Mason*, 51 B.R. 548 (D. Or. 1985) ; *In the Matter of Bernstein*, 20 B.R. 595 (Bankr. M.D. Fla. 1982) .

(n23)Footnote 20. 1 F.3d 687 (8th Cir. 1993) .

(n24)Footnote 21. *In re Denn*, 10 C.B.C.2d 279, 37 B.R. 33 (Bankr. D. Minn. 1983) .

(n25)Footnote 22. *See* 11 U.S.C. § 1141(c). *See* 8 Collier on Bankruptcy, ch. 1141 (Matthew Bender).

(n26)Footnote 23. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n27)Footnote 24. *See* 11 U.S.C. § 1325(a)(5)(A). *See* ch. 14 *supra*.

(n28)Footnote 25. *See* 11 U.S.C. § 1325(a)(5)(B)(i). *See* ch. 14 *supra*.

(n29)Footnote 26. *See* 11 U.S.C. § 1325(a)(5)(C). *See* ch. 14 *supra*.

(n30)Footnote 27. 11 U.S.C. 1325(a)(5)(B)(i), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n31)Footnote 28. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See* ch. 14 *supra*.

(n32)Footnote 28a. 765 F.2d 547 (5th Cir. 1985) .

(n33)Footnote 28b. 765 F.2d 547 (5th Cir. 1985) .

(n34)Footnote 28c. 749 F.2d 464, 12 C.B.C.2d 3 (7th Cir. 1984) .

(n35)Footnote 28d. *In re Clark*, 38 B.R. 683 (Bankr. E.D. Pa. 1984) (secured creditor bound by plan through its lien would not be paid in full); *In re Blair*, 21 B.R. 316 (Bankr. S.D. Cal. 1982).

(n36)Footnote 28e. *In re Risser*, 7 C.B.C.2d 195, 22 B.R. 868 (Bankr. S.D. Cal. 1982)

(n37)Footnote 29. H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n38)Footnote 30. A secured claim need not be filed in order to be allowed and treated in a chapter 13 plan.

(n39)Footnote 31. *See* P 20.05[1] *supra*.



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CHAPTER 21 Compensation of Professionals

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CHAPTER 21 Compensation of Professionals

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Scope

SCOPE NOTE

This chapter covers the practice and procedure to be followed by professionals seeking compensation from the bankruptcy estate. Because the most common situation in which this arises is the application of a chapter 13 debtor's counsel for fees, the chapter concentrates on such applications. The chapter first discusses what types of services and expenses can be reimbursed through the chapter 13 plan. Next, the chapter examines the procedure for obtaining payment of fees through the plan. Finally, the payment of fees as a priority claim through the plan is reviewed.



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CHAPTER 21 Compensation of Professionals

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P 21.01 Introduction

Section 330 of the Code provides that after notice and a hearing the court may award to a trustee, a professional person, or certain court-appointed, special investigators reasonable compensation for actual and necessary services, as well as reimbursement for actual and necessary expenses. Among the persons who may be awarded fees and expenses are the trustee in the case, counsel for the trustee, consumer privacy ombudsman,ⁿ¹ patient care ombudsman,ⁿ² counsel for a chapter 13 debtor and, probably, counsel for a chapter 7 debtor.

Fees are typically sought by an application to the court. (The fees of a standing chapter 13 trustee are paid in a different manner, based upon a percentage of the debtor's payments.ⁿ³ Similarly, the automatic \$60 fee to the trustee in a no asset chapter 7 case does not require an application.)ⁿ⁴ These fees are priority administrative expenses normally paid before most other unsecured claims.

This chapter focuses on fees to debtors' counsel in chapter 13. Section 330(a)(4)(B) makes clear that the court can award fees to debtor's attorneys in chapter 12 and chapter 13 cases. Fees for trustees in chapter 7, other professionals, and debtor's counsel in chapter 7ⁿ⁵ are sought through the same procedures under *Federal Rule of Bankruptcy Procedure 2016(a)*.ⁿ⁶ However, such fees, which are sought relatively rarely in consumer bankruptcy cases, are beyond the scope of this work.

FORMS

For forms relating to fees in chapter 7 cases see *Collier Consumer Bankruptcy Forms*, §§ CS11.01-11.12 (Matthew Bender).

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 332, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. 11 U.S.C. § 333, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. See 8 *Collier on Bankruptcy*, P 1302.05[1] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1302.05[1] (Matthew Bender).

(n4)Footnote 4. *11 U.S.C. § 330(b)*. See 3 *Collier on Bankruptcy*, P 330.06 (Matthew Bender).

(n5)Footnote 5. Debtor's counsel can be paid from the estate in a chapter 7 case only if there are nonexempt assets, and only if counsel has been appointed to provide services to the estate, rather than services that solely benefit the debtor. *Lamie v. United States Trustee*, 540 U.S. 526, 124 S.Ct. 1023, 157 L.Ed. 2d 1024 (2004). Fortunately, a new provision, section 330(a)(4)(B), makes clear that the court can award fees to debtors' attorneys in chapter 12 and 13.

(n6)Footnote 6. See 9 *Collier on Bankruptcy*, ch. 2016 (Matthew Bender).



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CHAPTER 21 Compensation of Professionals

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P 21.02 The Payment of Attorneys' Fees within the Chapter 13 Plan

Section 330 authorizes the court to award reasonable compensation for actual and necessary services rendered by the debtor's attorney and the reimbursement of actual and necessary expenses to be paid from property of the estate. This arrangement is common in chapter 13 cases where the fees are made payable through the plan as priority administrative claims. The opportunity for the debtor to pay all or part of the attorney's fee in installments through the trustee is often the only way a financially strapped client can pay the fee at all. And the fact that the attorney has some assurance, though hardly a complete guarantee, that the fee can be paid in this manner makes him or her more comfortable about taking the client's case without advance payment of all or most of the fee.

All attorney fees paid from estate property must be approved in advance. The debtor's attorney seeking compensation or reimbursement from the estate must submit to the court an application conforming to the requirements of *Rule 2016(a)*.

[1] Attorneys' Fees that Can Be Paid from Property of the Estate Through a Plan

[a] Legal Standard for Payment

Under *Code section 330(a)(4)(B)* services that are compensable as administrative expenses in a chapter 12 or chapter 13 case include not only services that benefit the bankruptcy estate, but also services necessary for representing the debtor's interests in connection with the bankruptcy case, based on consideration of the benefit and necessity of such services to the debtor. This language would encompass even services outside the bankruptcy proceeding if those services were necessary to successful completion of the case. For example, services provided in defending against family law litigation connected with finances may be compensable as administrative expenses.ⁿ¹

[b] Types of Services Typically Compensated

It has long been well established that virtually all of the basic services in a chapter 13 case do benefit the estate. For example:

- prefiling advice about bankruptcy;
- preparation of the initial papers and plan; and

- attendance at the creditors' meeting and confirmation hearing.

As a practical matter, courts rarely question payment of the entire basic fee as an administrative expense, although local rules often control hourly rates or the total fee charged for a chapter 13 case. Compensation for time spent may be enhanced for exceptional results, but only if the applicant produces specific evidence showing why such enhancement is necessary to make the award commensurate with nonbankruptcy compensation.ⁿ²

MORE INFORMATION

For discussion of standard fees and fees typically charged *see* chapter 5 *supra*.

It also seems quite clear that fees for other activities to preserve the estate or the functioning of the plan, such as objections to claims or modifications of the plan, warrant priority administrative expense treatment. Since a chapter 13 debtor's attorney is not limited to compensation only for services that benefit the estate, any work done in legitimate pursuit of the chapter 13 case should be compensable.

Thus, when it is necessary to defend against a motion for relief from the automatic stay, the court will normally find that such defense was necessary and for the debtor's benefit. Similarly, defense of a debtor's exemption rights or dischargeability litigation should be compensable under the test of section 330(a)(4)(B).

[c] Compensation for Time Spent Preparing the Fee Application

Sometimes courts allow attorneys' fees for the time spent on the fee application, at least if the time is substantial.ⁿ³

[d] Travel Time

Charges for time spent traveling are not favored and will be subjected to careful scrutiny.ⁿ⁴ Unless work is done while traveling, the time so spent ordinarily will not be compensable at the same rate as time spent working.

[e] Expenses

Another recurrent issue is the scope of "overhead", that is, whether compensation should be awarded for such general expenses as word processing, messenger service, taxi fares and parking, photocopying and postage, express mail services, meals, and use of electronic legal research tools, the costs of which are arguably already included in professionals' billing rates.ⁿ⁵ As a general rule, "continuous administrative or general expenses incident to the operation of a firm which cannot be attributed to a particular client" constitute overhead which is built into the fee structure and are not reimbursable expenses. On the other hand, expenses incurred on behalf of a particular client such as photocopying, long distance telephone calls, postage, travel, and computer research are reimbursable expenses if properly documented.ⁿ⁶ A court may not arbitrarily treat categories of expenses as "overhead" that are not compensable when those expenses are billed to other clients in the market.ⁿ⁷

[2] Fees Must Be Reasonable

In determining the reasonableness of compensation the court is required to consider the nature, extent and value of the services and must at least consider the specific factors provided in code section 330(a)(3):

- the time spent;
- the rates charged;ⁿ⁸
- whether nonattorney work was compensated at lawyer rates;ⁿ⁹

- whether services were necessary or beneficial;
- whether services were performed within a reasonable time; and
- the customary fees charged in non-title 11 cases by similarly skilled practitioners.

Additionally, section 330(a)(3)(E), added in 2005,ⁿ¹⁰ now permits the court to consider board certification or demonstrated skill in the bankruptcy field in determining compensation for a professional person.

WARNING

Many courts are likely to find an abuse of the system when all or almost all of the debtor's payments go toward payment of the attorney's fee. Such use of chapter 13 as simply a device for collecting fees, with little or no benefit to any creditors, may be looked upon with disfavor as little more than a disguised liquidation and akin to past abuses where the primary beneficiaries of a bankruptcy plan were the attorneys involved.ⁿ¹¹

FOOTNOTES:

(n1)Footnote 1. *See, e.g., In re Polishuk*, 258 B.R. 238 (Bankr. N.D. Okla. 2001) (fees allowed for work in domestic relations case).

(n2)Footnote 2. *In re Manoa Finance Co.*, 853 F.2d 687, 19 C.B.C.2d 574 (9th Cir. 1988) .

(n3)Footnote 3. *In re Nucorp Energy, Inc.*, 764 F.2d 655, 12 C.B.C.2d 1463 (9th Cir. 1985) . *See 3 Collier on Bankruptcy*, P 330.04[5] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 330.04[6] (Matthew Bender).

(n4)Footnote 4. *See 3 Collier on Bankruptcy*, P 330.05[3][b] (Matthew Bender).

(n5)Footnote 5. *See 3 Collier on Bankruptcy*, P 330.05[3] (Matthew Bender).

(n6)Footnote 6. *See 3 Collier on Bankruptcy*, P 330.05[3] (Matthew Bender).

(n7)Footnote 7. *In re Hillsborough Holdings Corp.*, 127 F.3d 1398 (11th Cir. 1997) .

(n8)Footnote 8. *See In re Atwell*, 148 B.R. 483 (Bankr. W.D. Ky. 1993) , for factors which may enter into the determination of a reasonable hourly rate and reasonable hours expended.

(n9)Footnote 9. *In re Clark*, 223 F.3d 859 (8th Cir. 2000) (attorney who misrepresented that he had done work that was really done by paralegal and collected flat fee designed for work done by attorneys ordered to disgorge fees). An attorney should not be compensated at lawyer's rates for work which a clerk can do more cheaply.

(n10)Footnote 10. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. *In re San Miguel*, 40 B.R. 481 (Bankr. D. Colo. 1984) .



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CHAPTER 21 Compensation of Professionals

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P 21.03 Application Procedure for Obtaining Payment of Fees Through the Plan

[1] Application Requirements

Rule 2016(a) provides that an attorney for the debtor seeking compensation for services from the estate, *i.e.*, through the plan, must file an application for those fees including a detailed statement of:

- the services rendered;
- the time and costs expended;n1
- the amounts requested;
- all payments received or promised in connection with the case;
- the source of such payments; and
- whether such payments have been or will be shared with anyone other than an attorney in the applicant's firm.

FORMS

For a form of application see *Collier Consumer Bankruptcy Forms, Form CS11.13-1* (Matthew Bender).

[2] Additional Application Information

The following elements are not required in an application, unless by local rule, but may prove helpful in obtaining approval of a fee application. Any application filed pursuant to *Rule 2016(a)* should also include a narrative description of what the representation has entailed, addressing: the problems involved, the difficulty of the problems, how each problem was resolved, and what results were achieved. However, such detail might be unnecessary in small proceedings that are routine in every respect. The application may also contain a schedule of the applicant's regular rates and may contain information respecting the applicant's qualifications.

PRACTICE NOTE

Although many courts do not require time records for the totally routine case handled for the standard fee or less, some courts require a great deal of specificity in fee applications, particularly with respect to time records. Much of the litigation arising from fee applications centers on the question of adequacy of time records. Any professional person who intends to seek compensation should keep meticulous, contemporaneous time records and such records must reveal sufficient data to allow the court to make an informed judgment regarding specific tasks and the time expended on them. Courts have expressed displeasure over lumping of several tasks in a single time entry.ⁿ² The professional who underestimates the appropriate amount of detail may do so at the risk of being denied some or all of the compensation and reimbursements requested; however, courts are often willing to afford a professional the opportunity to supplement his or her application.ⁿ³

[3] Notice and an Opportunity for a Hearing

The Code provides that compensation from the estate can be awarded only after notice and hearing.ⁿ⁴ Given the meaning of "notice and a hearing" in the Code,ⁿ⁵ this does not necessarily mean that a hearing must occur. What does seem required is at least some type of notice to all parties that fees are sought from the estate, giving them an opportunity to request a hearing to raise any questions they might have.

Rule 2016(a) specifically requires that the application be transmitted to the United States trustee. Notice to the case trustee is also normally required in every case. *Rule 2002(a)* further requires 21 days notice to the debtor, the trustee, and all creditors of an application for compensation or reimbursement of expenses in excess of \$1000.

[4] Objections to Fee Application and Court Consideration of Application

Any party may object to the relief sought in an application for compensation. If an objection is filed to an application under *Rule 2016(a)*, a contested matter is initiated.ⁿ⁶ Even absent objection, the bankruptcy court must conduct a review of each application filed.ⁿ⁷ The court must independently determine that the applicant is entitled, within the framework of the Bankruptcy Code and Rules and in accordance with applicable case law, to the payments sought. In a hearing on an application filed pursuant to *Rule 2016(a)*, the applicant has the burden of proving entitlement to the relief sought.ⁿ⁸

If the court considers awarding fees lower than those requested, it is important for the attorney to seek a hearing to make a record on fee issues and to specifically request the court to make findings of fact.ⁿ⁹ Failure to permit an attorney to present evidence in support of a fee application is probably reversible error.ⁿ¹⁰

MORE INFORMATION

For discussion of procedures in contested matters see chapter 32 *infra*.

[5] Application Process Varies from District to District

As a practical matter, these provisions mean that the debtor's attorney must apply in some way for his or her fees to be approved. In some districts the application process can be completed through a combination of the disclosure statement of fees, if it lists services rendered, and a provision in the plan to be confirmed stating that fees will be paid through the plan. If this method is followed, then notice of the plan should include notice of this plan provision.

In other jurisdictions, a separate application must be filed. Normally, the payment of fees through the plan is approved in conjunction with confirmation of the plan.

[6] Approval Process for Fees for Postconfirmation Services

Sometimes, after confirmation there are circumstances which require the debtor's attorney to do other work not originally anticipated. When this occurs, an application for additional fees may be made if the work is compensable from the estate. Indeed, since the debtor's postpetition income is normally considered property of the estate, no payment of fees from such income is proper unless an application has been approved by the court.ⁿ¹¹ In many courts, an application and proposed order approving such additional fees can be attached to the pleading filed, especially where it is a fairly simple uncontested matter such as a modification of the plan. Other courts require a supplemental application for fees.

FORMS

For a form of such application see *Collier Consumer Bankruptcy Forms, Form CS11.14-1* (Matthew Bender).

However, once the plan has been confirmed, some courts may require a motion to modify the plan if additional attorney's fees are requested to be paid through the plan.ⁿ¹²

FOOTNOTES:

(n1)Footnote 1. Costs that are reimbursable may include photocopying, postage, long distance telephone calls and travel expenses. *In re National Paragon, Corp.*, 76 B.R. 73 (E.D. Pa. 1987) .

(n2)Footnote 2. *Brake v. Tavormina*, 841 F.2d 365 (11th Cir. 1988) .

(n3)Footnote 3. See 9 *Collier on Bankruptcy*, P 2016.09[5] (Matthew Bender).

(n4)Footnote 4. 11 U.S.C. § 330(a).

(n5)Footnote 5. "After notice and a hearing" is defined at 11 U.S.C. § 102(1).

(n6)Footnote 6. *Rule 9014*.

(n7)Footnote 7. *In re Busy Beaver Bldg. Centers, Inc.*, 19 F.3d 833, 841, 30 C.B.C.2d 1264, 1271 (3d Cir. 1994) (characterizing *sua sponte* review of fee applications as "a duty which the Code does not expressly lay out but which we believe derives from the court's inherent obligation to monitor the debtor's estate and to serve the public interest").

(n8)Footnote 8. See, e.g., *In re Underground Utilities Constr. Co.*, 13 B.R. 735 (Bankr. S.D. Fla. 1981) ; *In re Werth*, 32 B.R. 442 (Bankr. D. Colo. 1983) ; *Matter of Reliable Investors Corp.*, 60 B.R. 98 (Bankr. W.D. Wis. 1986) .

(n9)Footnote 9. See *In re Boddy*, 950 F.2d 334 (6th Cir. 1991) (case remanded because lower court had not discussed how award calculated); *In re Botelho*, 3 C.B.C.2d 739, 8 B.R. 305 (B.A.P. 1st Cir. 1981) .

(n10)Footnote 10. *Thomas v. Bankr. Estate of Jones*, 360 B.R. 624 (E.D. Mich. 2007) (bankruptcy court denied due process by refusing to hold hearing before cutting fees). See also *In re Clark*, 223 F.3d 859 (8th Cir. 2000) (appellant attorney did not provide reviewing court transcript or other record that supported his contentions); *In re Pfleghaar*, 215 B.R. 394 (B.A.P. 8th Cir. 1997) (attorney entitled to evidentiary hearing before bankruptcy court denied his fee application).

(n11)Footnote 11. *In re Hanson*, 40 C.B.C.2d 918, 223 B.R. 775 (Bankr. D. Ore. 1998) .

(n12)Footnote 12. See *In re Black*, 116 B.R. 818 (Bankr. W.D. Okla. 1990) (where attorney sought fees six times higher than those provided for in confirmed plan, which would utilize all funds available to unsecured creditors, and no

motion to modify plan had been filed, attorney held bound by confirmed plan and application for additional fees denied).



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CHAPTER 21 Compensation of Professionals

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P 21.04 Payment of Fees as Priority Claim Through the Plan

Normally the attorney for the debtor classifies his or her fee among the administrative expenses entitled to priority under *11 U.S.C. § 507(a)(2)*.ⁿ¹ Not only does this mean that the fee must be paid in full for the plan to be confirmed under section 1322(a)(2), but it also usually means the fee will be paid before most other unsecured creditors receive payment.ⁿ² In addition, if fees have been approved, they may be paid by the trustee pursuant to section 1326(a)(2) even if the case is dismissed before confirmation.ⁿ³

Although the fee is to be paid, along with other administrative expenses, before the claims of other creditors, the debtor may also be obligated to make payments to provide adequate protection to secured creditors and to maintain personal property leases under section 1326(a)(1) and section 1325(a)(5)(B)(iii)(II). To the extent these payments must be made beginning early in the case, they will decrease the amount available for attorney's fees and lengthen the time needed to pay those fees.

PRACTICE NOTE

By local rule in some districts, however, attorneys' fees are customarily paid *pro rata* with other disbursements to assure the attorney's continued interest in the success of the plan.ⁿ⁴ These rules vary widely, with some permitting a fixed amount paid to the debtor's attorney before payments to creditors and installment payments of a fixed amount thereafter. Others permit the entire attorney's fee to be paid over some fixed period ranging from several months to a year or longer. To the extent these local rules and practices require unsecured creditors to be paid before administrative claims, they are of questionable validity. Also, deferring of counsel fees until later in the plan increases the risk that the fees will not be paid in full, and courts that require counsel to defer fees must recognize that it will result in higher fees being charged due to that risk.

FOOTNOTES:

(n1)Footnote 1. Formerly § 507(a)(1), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Under the 2005 amendments to the Bankruptcy Code, domestic support obligations now receive first priority, along with any administrative expenses of a trustee to administer the assets for such claims. *See 11 U.S.C. § 507(a)(1)*, as enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17. Other allowed administrative claims, including fees to debtor's attorney, are second in priority. *In re Busetta-Silvia*, 314

B.R. 218 (B.A.P. 10th Cir. 2004) (both prepetition and postpetition fees were priority administrative expenses to be paid ahead of unsecured creditors).

(n2)Footnote 2. *11 U.S.C. § 1322(a)(2); In re Shorb*, 21 C.B.C.2d 274, 101 B.R. 185 (B.A.P. 9th Cir. 1989) (fees must be paid prior to or concurrently with other claims and cannot be deferred to six months after commencement of payments to unsecured claims); *In re Parker*, 21 B.R. 692 (E.D. Tenn. 1982) , *aff'g* 5 C.B.C.2d 913, 15 B.R. 980 (Bankr. E.D. Tenn. 1981) (attorneys' fees may be paid prior to or concurrently with secured and unsecured claims); *In re Bellamy*, 379 B.R. 86 (Bankr. D. Md. 2007) (attorney's fees should be distributed by chapter 13 before creditors are paid, except to extent fees have not yet been earned).

(n3)Footnote 3. *In re Lampman*, 276 B.R. 182 (Bankr. W.D. Tex. 2002) ; *In re Oliver*, 40 C.B.C.2d 725, 222 B.R. 272 (Bankr. E.D. Va. 1998). *See also In re Lewis*, 346 B.R. 89 (Bankr. E.D. Pa. 2006) (fee motion must be filed before dismissal order).

(n4)Footnote 4. *See In re Lanigan*, 101 B.R. 530 (Bankr. N.D. Ill. 1986) (bankruptcy court had authority to order payment of fees over life of plan). *See also In re Pedersen*, 229 B.R. 445 (Bankr. E.D. Cal. 1999) (local rule required submission of a waiver of the right to receive fees before creditors, if counsel sought to receive fees under court's fee guidelines).



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CHAPTER 22 Modification of Plan After Confirmation

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CHAPTER 22 Modification of Plan After Confirmation

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Scope

SCOPE NOTE

This chapter covers motions to modify a chapter 13 plan after the plan has been confirmed by the court. It discusses the reasons for modification and the standards for approval of modifications. It details the procedure to be followed by debtors seeking to modify their plans, as well as those to be followed by creditors or trustees seeking to increase plan payments.



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CHAPTER 22 Modification of Plan After Confirmation

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P 22.01 Introduction

Chapter 13 debtors often encounter circumstances during the plan period which were unforeseen at the time of confirmation. Further persistent deterioration in a debtor's financial condition after confirmation usually leaves only four courses of action open to the debtor. The debtor may convert the case to chapter 7,ⁿ¹ apply for a hardship discharge under section 1328(b),ⁿ² dismiss the case,ⁿ³ or modify the chapter 13 plan in response to prevailing conditions.ⁿ⁴ Of these options, only plan modification preserves the broader chapter 13 discharge under *Code section 1328(a)*. A debtor is not eligible for a hardship discharge under section 1328(b) in circumstances when a postconfirmation modification of the plan is practicable.ⁿ⁵

In addition to modification requested by a debtor, the court may grant modification sought by the trustee or an unsecured creditor.ⁿ⁶ These parties may move to increase the debtor's payments if the debtor's financial circumstances improve to the extent that the debtor can afford to pay more into the plan.ⁿ⁷ However, the court may not order a particular modification of a plan on its own motion.ⁿ⁸

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 1307(a)*. See ch. 24 *infra*.

(n2)Footnote 2. See ch. 29 *infra*.

(n3)Footnote 3. *11 U.S.C. § 1307(b)*. See ch. 23 *infra*.

(n4)Footnote 4. See *11 U.S.C. § 1329(a)*. See P 22.02 *infra*.

(n5)Footnote 5. *11 U.S.C. § 1328(b)(3)*.

(n6)Footnote 6. *11 U.S.C. § 1329(a)*.

(n7)Footnote 7. See P 22.03 *infra*.

(n8)Footnote 8. *Muessel v. Pappalardo (In re Muessel)*, 292 B.R. 712 (B.A.P. 1st Cir. 2003).



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CHAPTER 22 Modification of Plan After Confirmation

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P 22.02 Modification at the Request of the Debtor

[1] Reasons for Modification

A motion to modify the plan by the debtor is usually triggered by adverse financial circumstances. The debtor may be unable to afford the plan payments originally proposed and may seek to lower those payments, perhaps at the same time extending the length of the plan. A debtor may fall behind on postpetition mortgage payments and then seek to modify the plan to provide for a cure of the postpetition default.ⁿ¹ The debtor may wish to increase the amount or number of payments in order to provide for a postpetition claim,ⁿ² or to decrease payments to a secured creditor due to a payment to the creditor outside the planⁿ³ or a surrender of collateral to the creditor which renders the creditor unsecured.ⁿ⁴ A debtor may seek to modify the plan in order to complete plan payments through a sale of property or refinancing of a mortgage. The debtor may also modify the plan under § 1329(a)(4), added in 2005,ⁿ⁵ to reduce payments in order to purchase health insurance for the debtor and any dependent who does not have health insurance. The debtor may choose not to provide for an allowed secured claim that was originally provided for in the plan, but if this is done the debtor must assume the risk of having to deal with that claim outside of bankruptcy.

Some courts have refused to permit a debtor to modify a plan in order to surrender a vehicle and treat the secured creditor's claim as unsecured.ⁿ⁶ Other courts have held to the contrary, based on a more careful and complete reading of the Code. Typically, a secured claim is in a separate class from other claims and section 1329(a)(1) specifically permits a modification to decrease the payments on claims in a particular class, i.e. to the amount already paid. Section 1329(a)(3) provides that the "amount of the distribution to a creditor" may be modified to "take into account any payment of such claim other than under the plan." Thus, a reduction of the amount owed to a creditor may be the basis for a modification that has the effect of changing the amount or classification of a claim after confirmation. Further, section 502(j) permits a court to reconsider a claim, and under *Federal Rule of Bankruptcy Procedure 3008* the court may allow or disallow a claim, increase or decrease the amount of a prior allowance, accord the claim a different priority, or enter any other appropriate order.ⁿ⁷ A claim may be altered after confirmation, a secured claim may be reclassified as unsecured, and section 1329 permits modification of the amount of payments on such a claim.ⁿ⁸ If there were no way to modify a plan to take into account such a reconsideration, the debtor could be required to make payments on a claim in excess of the amount of the claim or in excess of the percentage paid to other similar claims.

Moreover, section 1329(b) specifically makes applicable to postconfirmation modifications the provisions of section 1325(a), including section 1325(a)(5).ⁿ⁹ If there were no possibility under section 1329(a)(1) of altering the amount

paid to a secured creditor or the debtor's choice to retain the collateral, there would be no need to import the standards of section 1325(a)(5), which govern only those issues. The ability to modify under section 1329 is obviously a limited exception to the binding effect of a confirmed plan; otherwise no plan could ever be modified and section 1329 would be rendered meaningless.

MORE INFORMATION

For discussion of postpetition claims *see* chapter 19 *supra*. For discussion of allowed secured claims that are not provided for by the plan *see* chapter 14 *supra*.

[2] Modifications Permitted

The modified plan is subject to all of the standards and requirements in 1322(a) and (b) and 1325(a), including the disposable income test and the limit on the plan term, which in no case may exceed five years.ⁿ¹⁰ Subject to these strictures, almost any type of modification is permitted, including alteration of the amount or timing of the payments and alteration of distributions to particular creditors. The debtor may modify the plan to terminate at the time of modification if the modified plan meets plan confirmation requirements.

In keeping with the principle that a chapter 13 plan of the debtor is always a voluntary proposal, no cause need be shown by the debtor to modify the plan.ⁿ¹¹

[3] Procedure for Plan Modification

The procedure for plan modification after confirmation is governed by *Federal Rule of Bankruptcy Procedure 3015(g)*.ⁿ¹² A motion to modify the plan must identify the proponent of the modification and be filed together with the actual modification proposed. The clerk, or some other person directed by the court (often the debtor) must give 21 days notice of the motion and time for objecting to the modification to all creditors and the trustee.ⁿ¹³ The court may require copies of the modification, or a summary of it, to be served with the notice. Often, the motion to modify is simply served on all of these parties. However, the court may order that notice need not be given to creditors not affected by the modification.

FORMS

For forms of a motion by the debtor to modify a plan and objections to such a motion *see Collier Consumer Bankruptcy Forms*, § CS19.52 (Matthew Bender).

Any objection to the modification must be served on the debtor, the trustee and any other entity the court designates and must be transmitted to the United States trustee. The opposition to the motion creates a contested matter to be determined pursuant to *Federal Rule of Bankruptcy Procedure 9014*. The objection will normally raise issues of whether the plan as modified would comply with the standards for plan confirmation, such as the best interests of creditors test, full payment of priority claims, and treatment of allowed secured claims provided by the plan. However, an objection to modification cannot raise issues that are not connected with the proposed modification, such as issues that could have been raised at the confirmation hearing.ⁿ¹⁴

MORE INFORMATION

The procedure for contested matters is discussed in chapter 32 *infra*. Also, *see* chapter 14 *supra* for discussion of the best interests of creditors test, full payment of priority claims, and treatment of allowed secured claims provided by the plan.

If an objection to the modification is filed, 21 days notice of the hearing on the objection must be sent to these same

parties. Sometimes, depending on local practice, the date of any hearing that will take place is set forth in the initial notice. Typically, the motion to modify the plan is governed by local motion practice rules, which vary widely from district to district and must be consulted.

If no party opposes the motion to modify the plan, it is normally granted without the necessity of a hearing, although local practice may vary. In some courts, no order approving the modification is necessary and it becomes effective immediately, subject only to disapproval upon a timely objection.ⁿ¹⁵

FOOTNOTES:

(n1)Footnote 1. *E.g., Mendoza, 111 F.3d 1264 (5th Cir. 1997) ; In re Hoggle, 12 F.3d 1008 (11th Cir. 1994) . In re Johnson, 708 F.2d 865, 868 (2d Cir. 1983)*

(n2)Footnote 2. *See In the Matter of Nelson, 27 B.R. 341 (Bankr. M.D. Ga. 1983) .*

(n3)Footnote 3. *In re Tucker, 35 B.R. 35 (Bankr. M.D. Tenn. 1983) .*

(n4)Footnote 4. *In re Zieder, 263 B.R. 114 (Bankr. D. Ariz. 2001)* (debtor could modify plan to surrender vehicle to secured lender and reclassify lender's deficiency claim as unsecured); *In re Townley, 256 B.R. 697 (Bankr. D.N.J. 2000)* (same); *In re InterCat, Inc., 247 B.R. 911 (Bankr. M.D. Ga. 2000)* (same). *But see In re Nolan, 232 F.3d 528 (6th Cir. 2000)* (debtor could not modify plan to surrender automobile to secured lender and reclassify deficiency claim as unsecured).

(n5)Footnote 5. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. *See, e.g., Chrysler Financial Corp. v. Nolan (In re Nolan), 232 F.3d 528 (6th Cir. 2000) .*

(n7)Footnote 7. Advisory Committee Note to *Fed. R. Bankr. P. 3008*.

(n8)Footnote 8. *In re Zieder, 263 B.R. 114 (Bankr. D. Ariz. 2001) ; In re Townley, 256 B.R. 697 (Bankr. D.N.J. 2000) .*

(n9)Footnote 9. As amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n10)Footnote 10. *See 11 U.S.C. 1322(d) and 11 U.S.C. 1325(b)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See also Christensen v. Black (In re Black), 292 B.R. 693 (B.A.P. 10th Cir. 2003)* (debtor could not circumvent sixty month maximum plan period by modification that labeled payments made over first 28 months as "lump sum contribution"); 8 *Collier on Bankruptcy, P 1329.02, . 04, . 05, . 07* (Matthew Bender); 3 *Collier Bankruptcy Manual*, ch. 1329 (Matthew Bender).

(n11)Footnote 11. *See 8 Collier on Bankruptcy, P 1329.02* (Matthew Bender); 3 *Collier Bankruptcy Manual*, ch. 1329 (Matthew Bender).

(n12)Footnote 12. *See 9 Collier on Bankruptcy, P 3015.03* (Matthew Bender).

(n13)Footnote 13. *Fed. R. Bankr. P. 2002(a)(5)*.

(n14)Footnote 14. *See 8 Collier on Bankruptcy, P 1329.02* (Matthew Bender).

(n15)Footnote 15. *See e.g., In re Taylor, 215 B.R. 882 (Bankr. S.D. Cal. 1997) .*



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CHAPTER 22 Modification of Plan After Confirmation

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P 22.03 Modification Proposed by Creditor or Trustee

[1] Reasons for Motion to Modify Plan

Section 1329(a) of the Code provides that a modification of the plan may be sought not only by the debtor, but also by the trustee or the holder of an unsecured claim.ⁿ¹ This provision is intended to carry the ability to pay standard forward to any modifications of the plan, allowing upward or downward adjustment of plan payments in response to changes in the debtor's income or expenses which substantially affect the ability to make future payments.ⁿ² However, due to ambiguous language added by the 2005 amendments to the Bankruptcy Code³, it is not clear to what extent the trustee and unsecured creditors will be able to tap into debtor's increased income for plan payments.ⁿ⁴

In view of this congressional purpose, the right of the trustee or the holder of an unsecured claim to move for modification should be limited to situations in which there has been a substantial change in the debtor's income or expenses that was not anticipated at the time of the confirmation hearing.ⁿ⁵ As to other matters, the confirmation order should be considered *res judicata* insofar as they do not relate to a change in the debtor's ability to pay, subject only to the limited right to revocation of the order of confirmationⁿ⁶ and, of course, the debtor's right to voluntarily request modification.ⁿ⁷

MORE INFORMATION

For further discussion of the ability to pay test see chapter 14 *supra*.

[2] Types of Modification that May Be Sought

The principal type of modification likely to be sought by a trustee or creditor is an increase in the debtor's plan payments, based upon increased ability to pay. (A trustee who is following the debtor's income may, however, also move to reduce the debtor's payments if ability to pay decreases and the debtor's attorney does not make such a motion.) Neither the trustee nor a creditor should be able to seek an increase in the plan's length, since "currently monthly income," which determines the applicable commitment period, does not change as a result of post-petition increases or decreases in the debtor's income or expenses.ⁿ⁸ Any extension of the plan beyond three years for a debtor with "current monthly income" below the applicable state median income, should only be at the request of the debtor. And, if the original plan was less than the applicable commitment period and was confirmed by the court, a claim that a longer plan is required is barred by *res judicata*.ⁿ⁹ If the original plan was less than the applicable commitment period and was

confirmed by the court, a claim that a longer plan is required is barred by *res judicata*.ⁿ¹⁰

[3] Procedure for Seeking Modification

The procedure for a trustee or creditor to seek modification is basically the same as that for a debtor seeking modification. A motion to modify the plan must be filed and notice of the motion or the motion itself served on the parties named in *Rule 3015(g)*.ⁿ¹¹ The motion must also, of course, be served on the trustee, the debtor and the debtor's counsel. The court may require a copy of the proposed modification or a summary thereof to be mailed with the notice if the entire motion is not served on parties other than the debtor and trustee.

FORMS

For forms of a creditor's or trustee's motion to modify a plan after confirmation and response to such a motion, see *Collier Consumer Bankruptcy Forms*, § CS19.53 (Matthew Bender).

If the motion is opposed, a hearing will be scheduled and the proceeding treated as a contested matter under *Rule 9014*. Twenty-one days' notice of the hearing must be given pursuant to *Rule 2002(a)(5)*. The procedures for scheduling hearings and giving notice of hearing dates are normally determined by local rules, which must be consulted in this regard.

MORE INFORMATION

For discussion of procedures in contested matters see chapter 32 *infra*.

However, unlike in the situation of a debtor's proposal to modify the plan, a court may decide not to grant a modification motion filed by a trustee or creditor without a hearing, even if the motion is unopposed. In view of the fact that chapter 13 is based upon a voluntary plan by the debtor and the possibility that a debtor (especially a pro se debtor) did not understand the motion, many courts will always hold a hearing to determine whether the debtor consents to the modification and, if not, whether the modification is otherwise justified.

When a request for modification is made by the trustee or the holder of an unsecured claim, the party requesting modification must bear the burden of showing a substantial change in the debtor's ability to pay since the confirmation hearing and that the prospect of the change had not already been taken into account at the time of confirmation.ⁿ¹² A trustee or unsecured claim holder may not raise as grounds for modification under this section facts which were known and could have been raised in the original confirmation proceedings, since the order of confirmation must be considered *res judicata* as to that set of circumstances.

However, a plan may not be modified once the plan payments are completed. Section 1329(a) explicitly permits modification of the plan only before completion of payments under the plan.ⁿ¹³

FOOTNOTES:

(n1)Footnote 1. A secured creditor has no right to move for modification of the plan. See 8 *Collier on Bankruptcy*, P 1329.03 (Matthew Bender). 3 *Collier Bankruptcy Manual*, ch. 1329 (Matthew Bender).

(n2)Footnote 2. Oversight Hearings on Personal Bankruptcy Before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 97th Cong., 1st and 2nd Sess., 215, 221 (1981-82).

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. Compare 11 U.S.C. 1325(b)(2) defining disposable income with reference to "current monthly income," an amount that is fixed as of the date of filing to 11 U.S.C. 1325(b)(1)(B) calling for debtor to use "current

monthly income" in determining plan payments.

(n5)Footnote 5. *In re Murphy*, 474 F.3d 143 (4th Cir. 2007) (refinancing that exchanged debt for cash by debtors with reduced income not a substantial change, but sale of property for amount in excess of what could be anticipated at confirmation was a substantial change); *In re Arnold*, 869 F.2d 240, 20 C.B.C.2d 1168 (4th Cir. 1989) . *But see Barbosa v. Soloman*, 235 F.3d 31 (1st Cir. 2000) (plan may be modified without showing change of circumstances); *Matter of Witkowski*, 16 F.3d 739, 30 C.B.C.2d 1409 (7th Cir. 1994) ; *In re Brown*, 219 B.R. 191 (B.A.P. 6th Cir. 1998) (no substantial change of circumstances need be shown); *Max Recovery v. Than (In re Than)*, 39 C.B.C.2d 118, 215 B.R. 430 (B.A.P. 9th Cir. 1997) (no substantial and unanticipated changed circumstances required for trustee's motion to modify plan).

(n6)Footnote 6. 11 U.S.C. § 1330.

(n7)Footnote 7. *See P 22.02 supra*.

(n8)Footnote 8. *See 11 U.S.C. 101(10A) and 11 U.S.C. 1322(d)*, as enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 9. *See P 22.03[3] infra*.

(n10)Footnote 10. *See P 22.03[3] infra*.

(n11)Footnote 11. *See 9 Collier on Bankruptcy, P 3015.03* (Matthew Bender).

(n12)Footnote 12. *In re Murphy*, 474 F.3d 143 (4th Cir. 2007) (refinancing that exchanged debt for cash by debtors with reduced income not a substantial change, but sale of property for amount in excess of what could be anticipated at confirmation was a substantial change); *In re Arnold*, 869 F.2d 240, 20 C.B.C.2d 1168 (4th Cir. 1989) . *But see Barbosa v. Soloman*, 235 F.3d 31 (1st Cir. 2000) (plan may be modified without showing change of circumstances); *Matter of Witkowski*, 16 F.3d 739, 30 C.B.C.2d 1409 (7th Cir. 1994) ; *In re Brown*, 219 B.R. 191 (B.A.P. 6th Cir. 1998) (no substantial change of circumstances need be shown); *Max Recovery v. Than (In re Than)*, 39 C.B.C.2d 118, 215 B.R. 430 (B.A.P. 9th Cir. 1997) (no substantial and unanticipated changed circumstances required for trustee's motion to modify plan). *See 8 Collier on Bankruptcy, P 1329.03* (Matthew Bender).

(n13)Footnote 13. *Profit v. Savage (In re Profit)*, 283 B.R. 567 (B.A.P. 9th Cir. 2002) ; *Alpine Bank*, 293 B.R. 777 (Bankr. D. Kan. 2002) .



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CHAPTER 22 Modification of Plan After Confirmation

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P 22.04 Effect of Modification

Once the modification is approved, section 1329(b)(2) provides that the plan as modified becomes the plan. As such, it is binding on the debtor and all creditors and has the other effects of a confirmed chapter 13 plan.

MORE INFORMATION

The effects of plan confirmation are discussed in chapter 20 *supra*.



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CHAPTER 23 Dismissal of Bankruptcy Cases

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- P 23.03 Dismissal of Chapter 13 Cases

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CHAPTER 23 Dismissal of Bankruptcy Cases

1-23 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the various situations in which a bankruptcy case may be dismissed. The chapter also covers motions to dismiss chapter 7 cases based on abuse of that chapter's provisions, including discussion of the means test presumption and other types of abuse. Finally, the chapter outlines the effects of a dismissal.



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CHAPTER 23 Dismissal of Bankruptcy Cases

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P 23.01 Introduction

Bankruptcy cases may be dismissed in a variety of circumstances. In chapter 7 cases, dismissal is relatively rare and occurs most often when a debtor has not complied with duties under the Bankruptcy Code, such as filing required documents or attending the meeting of creditors.ⁿ¹ A chapter 7 case may also be dismissed, if it is an abuse of the provisions of chapter 7.ⁿ²

In chapter 13 cases, the debtor has an absolute right to dismiss the case, which is one of the debtor's options if the debtor cannot complete the plan.ⁿ³ However, if a case has been converted to chapter 13 from chapter 7, section 1307(c) provides that the case can be dismissed on the debtor's motion only if dismissal is in the best interests of the creditors and the estate.^{n3a} A chapter 13 case may also be dismissed involuntarily if the debtor fails to comply with duties under the Bankruptcy Code, such as filing required documents, filing required tax returns, attending the meeting of creditors, proposing a confirmable plan, or complying with obligations under a confirmed plan.ⁿ⁴

FOOTNOTES:

(n1)Footnote 1. *See P 23.02[2] infra.*

(n2)Footnote 2. *See P 23.02[3] infra.*

(n3)Footnote 3. *See P 23.03[1] infra.*

(n4)Footnote 3a. *In re Sobczak*, 369 B.R. 512 (B.A.P. 9th Cir. 2007).

(n5)Footnote 4. *See P 23.03[2] infra.*



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CHAPTER 23 Dismissal of Bankruptcy Cases

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P 23.02 Dismissal of Chapter 7 Cases

[1] Voluntary Dismissal

[a] Reasons Debtors May Seek Dismissal

Voluntary dismissal of a chapter 7 case is relatively rare. It is sought most often in situations in which the debtor decides after filing that the bankruptcy case is not a good idea. The debtor may reach this conclusion either because it becomes apparent that the bankruptcy case will not accomplish the ends desired or because the debtor is not able to protect all of the property of the estate through exemptions. For example, it may become clear that the debtor will not receive a discharge or that a major debt will be found nondischargeable. Another common scenario is the debtor's postpetition acquisition of property that becomes property of the estate under *section 541(a)(5) of the Bankruptcy Code*. Examples of such property include rights to an inheritance or life insurance proceeds, which cannot be exempted.

[b] Grounds for Voluntary Dismissal

A chapter 7 case may be dismissed for cause.ⁿ¹ Unfortunately for debtors, the reasons described above do not necessarily constitute cause under the statute. Some courts have held that cause may simply be that dismissal is in the best interest of the debtor and not prejudicial to creditors. The debtor's best interest lies generally in securing an effective fresh start upon discharge and in the reduction of administrative expenses, leaving resources to work out debts; for creditors, if delay is said to have prejudiced them, the court must determine whether, as section 707(a) provides, the delay has been unreasonable.ⁿ²

However, when the debtor seeks dismissal, many courts take care to assure that creditors will not be prejudiced by a dismissal. If dismissal is opposed by creditors or the trustee, debtors are not generally permitted to dismiss cases in order to refile to gain the benefit of exemptions that had been improperly claimed in the first case.ⁿ³ Some courts have not permitted debtors to obtain dismissal of a voluntary petition when the primary purpose was to file a fresh petition that would include debts incurred since the petition sought to be dismissed was filed.ⁿ⁴ Similarly, dismissal may be denied when it is sought because property has been obtained or is expected which could satisfy the debtor's debts,ⁿ⁵ to transfer the case to a different district,ⁿ⁶ to render dischargeable a previously nondischargeable debt,ⁿ⁷ to repay a favored creditor with nonexempt estate assets, or because fraud on the part of the debtor is discovered.ⁿ⁸

Creditors, thus, may wish to oppose a debtor's motion to dismiss in some cases if it appears that there are assets that will

be distributed to them. On the other hand, since those assets will often be available to executing creditors outside of bankruptcy, a creditor may also choose to allow the dismissal to occur and pursue those assets, which it would not need to share with other creditors as it would have to do in a chapter 7 case.

Other courts are more liberal, allowing dismissal in any case in which no creditor objects after notice.ⁿ⁹ At least one court has held that cause need not be shown in such cases.ⁿ¹⁰ These courts have generally conditioned dismissal on payment to the trustee of any expenses incurred,ⁿ¹¹ and at least a few have held that the trustee has no standing to object to dismissal if such expenses are paid,ⁿ¹² though others have held otherwise.ⁿ¹³ As a practical matter, there is rarely an objection in no asset cases.

Yet another possibility for obtaining dismissal of a case was created by enactment of the automatic dismissal provisions of section 521(i). But courts have not always granted debtors' motions to dismiss their cases upon finding that not all of the documents required by section 521(a)(1) have been filed within 45 days of the petition.^{n13a}

PRACTICE NOTE

If there is opposition to voluntary dismissal, an alternative in many cases is conversion to chapter 13. A conversion may render dischargeability issues moot because of the broader chapter 13 discharge and may protect nonexempt property of the debtor, which remains in the debtor's possession.ⁿ¹⁴ Of course, this strategy can only succeed if the debtor can propose and perform under a confirmable chapter 13 plan. However, the debtor may not always have the income or resources to perform under the plan.

MORE INFORMATION

Conversion of cases and the difference between the chapter 7 and chapter 13 discharges are discussed in chapters 24 and 26 *infra*, respectively.

[c] Procedure for Dismissal

Section 707(a) of the Bankruptcy Code provides that dismissal can occur only after notice and a hearing.ⁿ¹⁵ *Federal Rule of Bankruptcy Procedure 1017* amplifies the notice and hearing requirement in section 707(a) by mandating a hearing on notice as provided in *Federal Rule of Bankruptcy Procedure 2002(a)*.ⁿ¹⁶ *Rule 2002(a)* requires at least 21 days' notice by mail to the debtor, the trustee, all creditors and indenture trustees. Notice shall also be given to the United States trustee.

The mandatory notice and hearing language in *Rule 1017* may reflect an intent to place a more stringent interpretation on the term "after notice and a hearing" in section 707(a). One reason for the stringent notice and hearing requirement is undoubtedly a concern that creditors might be prejudiced by a dismissal.ⁿ¹⁷

Thus, a debtor must file a motion to dismiss a chapter 7 case and it is likely that the court will hold a hearing on the motion to determine whether dismissal is warranted, even if the motion is not opposed. If the motion is opposed, it becomes a contested matter governed by *Federal Rule of Bankruptcy Procedure 9014*.

FORMS

For a form of debtor's motion to dismiss voluntary petition see *Collier Consumer Bankruptcy Forms, Form CS10.22-1* (Matthew Bender).

MORE INFORMATION

Procedure for contested matters is discussed in chapter 32 *infra*.

In order to enable the clerk or other entity to give notice, *Federal Rule of Bankruptcy Procedure 1017* requires the debtor to file a list of all creditors and their addresses unless such a list was previously filed.ⁿ¹⁸ If the debtor fails to do so, the court may order the debtor or another entity to prepare and file the list.

[2] Involuntary Dismissal under Section 707(a)

[a] Grounds for Dismissal

Section 707(a) of the Bankruptcy Code provides three examples of "cause" that would justify dismissal of a chapter 7 case:

- unreasonable delay by the debtor that is prejudicial to creditors;
- nonpayment of any required filing fees or other charges; and
- failure of the debtor in a voluntary case to file, within 15 days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by section 521(1), but only on a motion by the United States trustee.ⁿ¹⁹

The examples are merely illustrativeⁿ²⁰ and the court may dismiss the case on other grounds when cause is found to exist, such as failure to attend the meeting of creditorsⁿ²¹ or failure to abide by a court order.ⁿ²² However, bad faith should not be considered a ground for dismissal under 707(a). The 2005 amendments to the Bankruptcy Code,ⁿ²³ make clear that bad faith is to be considered in deciding whether to dismiss a case under section 707(b), rather than section 707(a).ⁿ²⁴ Thus, a creditor who is unable to file a motion to dismiss on the basis of bad faith under 707(b) because the debtor's income is below the applicable state median income will not be able to circumvent that prohibition by bringing a motion for dismissal for bad faith under 707(a).ⁿ²⁵

The court has substantial discretion in ruling upon a motion to dismiss under section 707(a),ⁿ²⁶ and in exercising that discretion must consider any extenuating circumstances that might exist, as well as the interests of the various parties. Thus, a debtor who has failed to file papers on time or perform some other duty may oppose the motion and request that the default be excused.

Generally, death of the debtor is not, in itself, grounds for dismissal. *Bankruptcy Rule 1016* provides that the death of a chapter 7 debtor does not abate the case. Thus, the debtor's estate can receive the benefits of the bankruptcy. In chapter 13, the rule permits the case to be continued if further administration is possible and in the best interests of the parties. Often, this is not possible because the chapter 13 case relies on the deceased debtor's income. However, there are sometimes family members, or the administrator of the debtor's estate, that are in a position to carry the case to its conclusion.^{n26a}

[b] Procedure for Dismissal

[i] Usual Procedure

The procedure for involuntary dismissal is generally the same as the procedure for voluntary dismissal. Dismissal can occur only after notice and a hearing.ⁿ²⁷ *Federal Rule of Bankruptcy Procedure 1017* amplifies the notice and hearing requirement in *section 707(a) of the Bankruptcy Code* by mandating a hearing on notice as provided in *Federal Rule of Bankruptcy Procedure 2002(a)*.ⁿ²⁸ *Rule 2002(a)* requires at least 21 days' notice by mail to the debtor, the trustee, all creditors and indenture trustees. Notice shall also be given to the United States trustee.

The mandatory notice and hearing language in *Rule 1017*, which probably requires a hearing in every case, protects

debtors, such as those proceeding *pro se*, who might otherwise suffer the drastic remedy of dismissal simply because they are unfamiliar with bankruptcy procedural rules that require a request for a hearing. Although some courts have local rules or procedures providing for "automatic" dismissal if papers are not timely filed, such rules and procedures do not comply with the statute, which requires notice and a hearing before dismissal or *Rule 1017(d)*, which generally requires a contested matter for dismissal of a case.ⁿ²⁹

Thus, under section 707(a) a creditor, trustee or United States trustee must file a motion to dismiss a chapter 7 case and it is likely that the court will hold a hearing on the motion to determine whether dismissal is warranted, even if the motion is not opposed. If the motion is opposed, it becomes a contested matter governed by *Federal Rule of Bankruptcy Procedure 9014*.

FORMS

For a form of creditor's motion under section 109(g)(2) to dismiss see *Collier Consumer Bankruptcy Forms, Form CS10.24-1* (Matthew Bender).

MORE INFORMATION

Procedure for contested matters is discussed in chapter 32 *infra*.

In order to enable the clerk or other entity to give notice, *Federal Rule of Bankruptcy Procedure 1017* requires the debtor to file a list of all creditors and their addresses unless such a list was previously filed.ⁿ³⁰ If the debtor fails to do so, the court may order the debtor or another entity to prepare and file the list.

[ii] Dismissal for Failure to Pay Filing Fees

One variation of the procedure for dismissal occurs in the case of a motion to dismiss for failure to pay filing fees. If the dismissal is for failure to pay any installment of the filing fee, the court may dismiss after a hearing on notice to the debtor and the trustee.ⁿ³¹ Notice to creditors is not required because payment of the filing fee is solely the responsibility of the debtor. If the case is dismissed or closed, the installments that were paid are distributed in the same manner and proportion as if full payment had been made.ⁿ³²

Although notice of the dismissal hearing is not required when the dismissal is for failure to pay the filing fee, notice of the dismissal itself must be given within 30 days after dismissal to creditors who were listed and creditors who filed claims.ⁿ³³ This enables the creditors to protect their claims and corrects their erroneous assumption that a discharge was granted.ⁿ³⁴

Section 1930(f) of title 28, United States Code, added in 2005,ⁿ³⁵ permits the court to waive the filing fee in certain chapter 7 cases. If a debtor's application for waiver of the filing fee is denied, and the debtor does not then pay the filing fee, either in installments or otherwise, it is likely that the same dismissal procedures will be utilized.

[iii] Automatic Dismissal for Failure to File Required Information; § 521(i)

Under section 521(i), enacted by the 2005 amendments to the Bankruptcy Code,^{n35a} the failure to file the documents required by section 521(a)(1), but not the other subsections of section 521, may lead to dismissal. Under section 521(i)(1), a case is to be "automatically dismissed effective on the 46th day" if the debtor does not file the information required by section 521(a)(1) within 45 days of petition. However, section 521(i)(2) provides that in such circumstances the case is to be dismissed on request of a party of interest within 5 days of the request. This reference to court action on request of a party indicates that some order is necessary for the dismissal to be effective.^{n35b} Any other rule would leave great uncertainty about whether a case remains pending. This is especially true because it is not always easy to determine whether the debtor has filed all of the necessary information.^{n35c}

If the debtor, within 45 days of the filing, requests additional time to file documents, the court may allow up to 45 additional days for the debtor to file the required documents.^{n35d} But the provision does not address the issue of how the court will deal with a request filed shortly before the 45th day that has not been acted upon before "automatic dismissal" or a party's dismissal request. Presumably, a court will determine whether a request for extension has been filed and rule upon it before dismissing a case.

One question raised by these provisions is whether section 521(i)(1) overrides the right of United States trustee to move for dismissal before the expiration of the 45-day period for failing to file the required documents? It states that it applies "notwithstanding section 707(a)" which gives that right to the United States trustee.^{n35e} It has no similar provision allowing its operation notwithstanding section 1307(c)(9) and (10), which limit dismissal for failure to file documents required by section 521 to motions filed by the United States trustee. In any event, it certainly should override local court practices that dismiss a case earlier than the expiration of the 45-day period for not filing required documents.

Section 521(i)(4) provides that the court may also decline to dismiss the case on motion of the trustee if the motion is filed before the expiration of the time to file the documents, the court finds that the debtor attempted in good faith to file the information required by section 521(a)(1)(B)(iv) (requiring payment advices), and the best interests of creditors are served by administration of the estate. Presumably, since almost all of the documents required by subsection section 521(a)(1) must be provided only if the court does not order otherwise, the debtor could also avoid dismissal if the court entered an order that the missing documents were not required. And if a case is dismissed, the court may reopen it and reinstate it on motion of the debtor.^{n35f}

Interestingly, section 521(i) has been used affirmatively by some debtors to obtain voluntary dismissal of their cases. If a debtor has clearly not filed the required information, a court might feel constrained to dismiss the case, although it might, alternatively, find it has the power to order that the information is not required.^{n35g}

[3] Dismissal of Case for Abuse Under Section 707(b)

Section 707(b) of the Bankruptcy Code provides that the court may--on its own motion, or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest--dismiss an individual debtor's chapter 7 case after notice and a hearing if the debts are "primarily consumer debts" and the court finds that the granting of relief would be "an abuse of the provisions" of chapter 7. Because the section applies only to cases "filed" under chapter 7, it is quite arguably not applicable to a case originally filed under chapter 13 and later converted to chapter 7.^{n35h}

Section 707(b), as amended in 2005,ⁿ³⁶ sets forth a complex formula for determining whether a chapter 7 case is presumed to be an abuse and also sets forth certain other criteria to be considered when such a presumption does not arise. It is important to note that section 707(b) does not require the court to dismiss a chapter 7 case if the presumptions of abuse is not rebutted, or if abuse is otherwise found. The provision states that the court "may" dismiss the case. There may be reasons that dismissal is not appropriate, such as significant assets available to creditors or the fact that the debtor would not be required to pay creditors in a chapter 13 case.^{n36a}

[a] Dismissal Available Only Against Debtors with Primarily Consumer Debts

Dismissal under section 707(b) is available only in cases involving an individual in which the debts are "primarily consumer debts." The term "consumer debt" is defined in *section 101 of the Bankruptcy Code* to mean a "debt incurred by an individual primarily for a personal, family, or household purpose."ⁿ³⁷

The legislative history of the Bankruptcy Code states that "[A] consumer debt does not include a debt to any extent that the debt is secured by real property."ⁿ³⁸ Nevertheless, most courts have refused to follow the legislative history and

instead include home mortgages in the determination of whether a debtor has primarily consumer debts.ⁿ³⁹ While this approach has the effect of bringing within the scope of section 707(b) debtors who might otherwise have escaped the reach of that section, it seems appropriate in view of the underlying policy of preventing abuse of the bankruptcy system.

The term "consumer debt" does not necessarily encompass all nonbusiness debts. One court has indicated that, at least for purposes of determining the applicability of section 707(b), the term covers only consumer credit obligations.ⁿ⁴⁰ The court emphasized the words "incurred," "primarily," and "purpose" in finding that "the liability must have been acquired first and foremost to achieve a personal aim or objective."ⁿ⁴¹ Thus a debt arising from an automobile accident is not a consumer debt.ⁿ⁴² The history of the consumer credit amendments, which were passed in response to concern about increased credit costs resulting from misuse of the bankruptcy system,ⁿ⁴³ supports this view.ⁿ⁴⁴

Other courts, including two courts of appeals, have adopted the "profit motive" test used in several Truth in Lending cases.ⁿ⁴⁵ Under this test, a debt is not a consumer debt if it "was incurred with an eye toward profit."ⁿ⁴⁶ Most courts have held that tax debts are not consumer debts.ⁿ⁴⁷

If a debtor has some consumer debts and some other debts, a court must determine whether the debts are *primarily* consumer debts before it applies section 707(b). The term "primarily" indicates that all of the debts need not be consumer debts but that consumer debts must be a substantial component of the indebtedness. The term "primarily" would seem to imply that the debts should reflect a strong consumer orientation.ⁿ⁴⁸

[b] Presumption of Abuse

The provisions of section 707(b)(2) create a bright line test to determine whether a debtor's chapter 7 case is presumptively abusive for purposes of section 707(b). The test is applied only if the debtor's "current monthly income"ⁿ⁴⁹ is above the safe harbor amount set forth in section 707(b)(7).ⁿ⁵⁰ Debtors whose income is not within the safe harbor provision are required to perform a complicated set of calculations, in which various monthly expenses allowed by the statute are deducted from current monthly income. After deduction of those expenses, the monthly amount deemed to be remaining, is multiplied by 60. If the resulting product is either 1) greater than or equal to \$6,575 or 25% of the debtor's nonpriority unsecured debts, whichever is greater or 2) greater than or equal to \$10,950, then the case is presumed to be an abuse.ⁿ⁵¹

[i] Current Monthly Income

The first step in determining whether the means test applies is to determine the debtor's "current monthly income." The term as defined in section 101(10A) is the average of the last six months' income received from all sources by the debtor (or in a joint case, the debtor and the debtor's spouse) with certain adjustments. The six-month period is defined as the six months ending on the last day of the month before the petition is filed.ⁿ⁵² The debtor's actual income at the time of the petition may be significantly above or below the current monthly income.

PRACTICE NOTE

Because the determination of current monthly income is relative to the date of filing, waiting a few days or a few months may radically alter the amount. For example, waiting a few days until a new month begins may increase or decrease the current monthly income of a debtor with irregular income. Similarly, if a debtor has been unemployed or otherwise lost income, waiting a month or two may significantly reduce the amount. Another alternative is to seek permission to delay the filing of Schedule I. The definition of "current monthly income" permits the normal six month prepetition calculation period to be disregarded if the debtor does not file the schedule of current income required by section 521(a)(2)(B)(ii) (Schedule I) and the court determines current income as of a different date.^{n52a} Thus, several courts

have permitted debtors who have not filed Schedule I to use a later date for the calculation of current monthly income that will take into account the decrease in income.^{n52b}

Current monthly income is defined to include any amount paid by any entity "for the household expenses" of the debtor or the debtor's dependents "on a regular basis."ⁿ⁵³ Thus, it clearly does not include all income of nondebtor household members. Amounts not used for household expenses of the debtor or the debtor's dependents or not received on a regular basis are not included. Certainly, those portions of the spouse's income devoted to payment of the spouse's debts, insurance, transportation expenses, personal items, clothing, and recreation should not be included.^{n53a} To include more of a nondebtor spouse's income as available to the debtor's creditors would be the equivalent of imposing an involuntary bankruptcy on the spouse, to the detriment not only of the nondebtor spouse, but also the creditors of that spouse, who might not be paid due to diversion of the income to the debtor's creditors.^{n53b} Additionally, sole proprietors should use net, not gross, business income in calculating current monthly income.^{n53c} Capital gains are not included as income under the definitions used in computing the census' median income figures, to which the debtor's income is compared, strongly suggesting that they should not be considered income for the means test.^{n53d}

Issues can also arise regarding other possible types of income. In general, it makes sense to look to the census definition of income in considering these questions, since the median income figures used in the means test are based on those definitions. The census excludes from income capital gains and retirement account withdrawals,^{n53e} money received from the sale of an asset (unless the debtor is in the business of selling such assets), food stamps, public housing subsidies, medical care, employer contributions to benefits, money borrowed, exchange of money between relatives in a household, gifts and lump-sum inheritances, insurance payments and other lump sum receipts.^{n53f}

There are several important exclusions from current monthly income. Most notably, benefits received under the Social Security Act are excluded.ⁿ⁵⁴ This exclusion will greatly assist many elderly and disabled recipients of social security benefits by reducing the likelihood that the means test will be applicable and by immunizing such income from being considered available to pay creditors. Other types of income received pursuant to the Social Security Act are also excluded by this provision including:

- Supplemental Security Income (SSI) under Title XVI;ⁿ⁵⁵
- Welfare benefits and foster care benefits under Title IV;ⁿ⁵⁶
- Unemployment benefits provided for in Titles III and XII;ⁿ⁵⁷ and
- Benefits provided through social services block grants to states under Title XX.ⁿ⁵⁸

While many of these programs primarily benefit lower income families not affected by the means test, a debtor may receive benefits from such a program that would otherwise be counted in current monthly income.

[ii] Applicable State Median Income Threshold

"Median family income" is defined in new § 101(39A)ⁿ⁵⁹ as the median family income "both calculated and reported by the Bureau of the Census in the then most recent year." If not available for the current year, the figure may be adjusted annually using the Consumer Price Index for All Urban Consumers for the years between the most recent calculated and reported year and the current year. The Bureau of the Census has begun reporting the relevant median income numbers for each state every year.ⁿ⁶⁰

For a household of one, the relevant census figures are for a one-earner household. For households larger than four, instead of using the census figures (which go down because large families tend to be poorer) \$575 per month is added for each additional household member over four.ⁿ⁶¹ This added amount will be periodically adjusted for inflation under

section 104(b).n62

[iii] Safe-Harbor from Means Testing

Once the current monthly income has been calculated and the applicable threshold for the state median income is found, a determination can be made as to whether the safe harbor provisions of 707(b) apply. Section 707(b)(7), added in 2005,n63 provides a safe harbor that prohibits use of the means test if the current monthly income of the debtor and the debtor's spouse combined, multiplied by 12, is equal to or less than the median family income for a family the size of the debtor's household.n63a This "bright line test" of section 707(b)(7) means that no chapter 7 case should be dismissed based on the debtor's ability to pay if the debtor has an income below the safe harbor threshold.

[iv] Expenses Allowed in Means Test

If the 707(b)(7) safe harbor provision does not apply, the debtor must apply the means test formula to determine whether the presumption of abuse arises under section 707(b). Under the mean test, the debtor's current monthly income is reduced by various monthly expenses as set forth in the statute including certain expenses as specified in the collection standards of the Internal Revenue Service, certain payments on account of secured debts, and payments for priority claims.

[A] Internal Revenue Expense Standards

The first set of deductions allowed for debtors subject to the means test consists of the "applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual expenses for the categories specified as Other Necessary Expenses" issued by the Internal Revenue Service. The National and Local Standards include amounts for housing and utilities,n64 transportation,n65 food, clothing, out of pocket medical costs, and other expenses.n66 The amounts allowed for food and clothing may be adjusted upward by up to 5% if the debtor demonstrates such adjustment is reasonable and necessary.n67

The "Other Necessary Expenses" consist of a nonexclusive list of other expenses necessary for family health and welfare or production of income, including child care, court ordered payments (e.g., alimony, support and restitution payments), expenses for care of the elderly, invalid or handicapped, education for special needs children if suitable education is not available from public schools, medical and dental expenses, taxes, involuntary deductions from wages, including union dues, uniforms, etc., term life insurance premiums, mandatory pension contributions, and withholding taxes, optional telephone service,n67a and internet service. Debtors may have a variety of other expenses that are necessary to family health and welfare or production of income, such as business expenses, required homeowner association or other assessments, and burglar alarm expenses.

[I] Determining the Applicable Standard

Some of the IRS standards depend on the size of the debtor's household. The household size at the time of the petition should be used for this purpose.

Section 707(b)(2)(A) provides that the standards should be applied for the debtor, the debtor's dependents, and the spouse of the debtor in a joint case if the spouse is not otherwise a dependent. The Internal Revenue Code defines dependent broadly, to include adult children and nonrelatives in some cases.

[B] Other expenses allowed by § 707(b)

The means test specifies additional deductions that may overlap or exceed those allowed by the IRS standards. The debtor is clearly permitted to deduct reasonably necessary health insurance, disability insurance, and health savings account expenses, including such expenses for a spouse who may not be a joint debtor or a dependent who may not be

living with the debtor.n68

PRACTICE NOTE

These provisions, evidencing a clear policy that families should have such insurance, may dictate purchasing insurance prior to bankruptcy if a debtor does not already have it. This is an important step toward financial stability assures that the substantial funds necessary for such insurance are not diverted to creditors.

Other permitted expenses include:

- expenses for protection against family violence;n69
- continued contributions to the care of household or family members;n70
- charitable contributions to qualified religious or charitable entities or organizations;n71
- home energy costs in excess of the allowance specified by the IRS Local Standards.;n72
- education expenses of up to \$1,650 per year per child under 18;n73 and,
- administrative expenses of administering a chapter 13 plan not to exceed ten percent of the projected plan payments.n74

[C] Deductions for Payments on Secured or Priority Debts

Beyond the listed expenses, the means test allows deduction of amounts payable on secured and priority debts. Section 707(b)(2)(A)(ii) allows deduction of amounts payable on secured debts. The amount to be deducted from currently monthly income for secured debts is the total amount "scheduled as contractually due" to any secured creditors in the sixty months after the petition, plus any arrears necessary to maintain possession of a principal residence, motor vehicle, or other necessary property, divided by sixty. Because the payments remain scheduled as due even if a debtor surrenders property, the intent to surrender should not prevent deduction of those payments. But some courts disagree about whether these amounts can be deducted where property will be surrendered by the debtor.n74a Aside from the interrelationship with the transportation and housing allowances under the IRS standards discussed below, determining this amount is relatively straightforward in the case of most mortgage or car loans. More ambiguous, however, is the treatment of other secured claims such as tax liens, mechanics' liens or other liens with respect to which the entire amount is due immediately or secured claims involving cross-collateralized loans.

An issue that may arise is whether condominium or homeowner association fees can be deducted under this provision. Although payment of such fees is normally required by a mortgage, they are not paid to or through the mortgagee. However, the mortgage may provide that the mortgagee can advance such fees if they are unpaid, with the advance secured by the mortgage. In most states nonpayment of the fees also gives rise to a lien so they could be considered payments to a secured creditor. Alternatively, they should qualify as expenses required by special circumstances if they cannot be accommodated by the housing expense allowance.

The calculation for priority debts is somewhat less complicated, but there may be issues about which debts have priority.n75 Debtors must divide the total amount due on priority claims by sixty to obtain a monthly amount to be subtracted from current monthly income.

PRACTICE NOTE

Nonpriority tax debts formerly dischargeable in Chapter 13 are now nondischargeable,ⁿ⁷⁶ so debtors may want to arrange their bankruptcy cases to maximize the nondischargeable debt that will be priority debt. Similarly, divorce property settlements are no longer dischargeable in chapter 7 cases,ⁿ⁷⁷ so debtors may wish to argue that such debts are intended for support and therefore priority domestic support obligations, rather than property settlement debts, so that they may be deducted in the means test.

MORE INFORMATION

Dischargeability of debts is discussed further in chapter 26 *infra*.

[D] Special Issues Relating to Transportation and Housing Expenses

A literal reading of section 707(b)(2)(A) could lead to the conclusion that both the "amounts specified" for car ownership and housing allowances under the IRS standards and any secured debt payments on a car or home loan should be deducted. However, such a reading would allow double counting of some of these amounts. To avoid such double counting, the ownership allowance for a car and/or housing allowance is adjusted downward. The amount of the adjustment is determined by subtracting the average monthly paymentⁿ⁷⁸ on the secured debt from the applicable allowance amount. The difference is the amount the debtor may deduct under the IRS standards. If the difference is less than zero, the debtor may not take an additional deduction under the IRS standards.

ILLUSTRATION

Consider, for example, a debtor who lives in Boston, owns one car, and has a car loan upon which he pays \$500 and for which 36 months of scheduled payments remain. First, for the secured car loan, calculate the Average Monthly Payment, which is the total amount contractually due to the lender in the 60 months following the filing of bankruptcy case, divided by 60. In this case, Average Monthly Payment is $\$300 = [36 \text{ (number of payment contractually due in the 60 months following the filing)} \times \$500 \text{ (the amount of the payment)}] / 60$. This amount is subtracted from current monthly income pursuant to section 707(b)(2)(iii). Then calculate the amount that may be deducted under the IRS standard for the ownership allowance. To avoid double counting the secured debt payment, this amount is determined by subtracting the Average Monthly Payment from the ownership allowance. Here, \$300 is subtracted from \$471 resulting in a deductible ownership allowance of \$171.

The United States trustees have argued that if a debtor is not liable for car payments, the debtor cannot deduct the IRS ownership allowance for a vehicle owned by the debtor.^{n78a} This position ignores the language of the statute, which allows the debtor to deduct the "amount specified" for the allowance, in contrast to the way the Internal Revenue Service utilizes the standard. The better reasoned court decisions on the subject agree that the debtor may deduct the ownership allowance for each car, regardless if the debtor is making monthly payments.^{n78b} In any event, the United States trustees have adopted the Internal Revenue Service practice of allowing an additional \$200 per month in operating expenses for old cars with high mileage.

An additional issue with the IRS transportation allowance, especially in metropolitan areas, is that it assumes that debtor families who have cars do not use public transportation. For cases in which this is not true and family members commute to work or school by rail or bus, the IRS standards allow the debtor to take both the automobile and public transportation allowances.ⁿ⁷⁹ However, the IRS transportation allowance does not take into account large disparities in car insurance costs that exist within some metropolitan areas.

[v] Presumption of Abuse

After deduction of all the applicable expenses from current monthly income, the monthly amount deemed to be

remaining, is multiplied by 60. If the resulting product is either 1) greater than or equal to \$6,575 or 25% of the debtor's nonpriority unsecured debts, whichever is greater or 2) greater than or equal to \$10,950, then the case is presumed to be an abuse.ⁿ⁸⁰

[vi] Rebutting the Presumption - Adjustments for Special Circumstances

Even if the income that is deemed to remain available is above the amount that creates a presumption of abuse, the debtor may rebut the presumption by showing special circumstances that justify additional expenses or a reduction in the income figure used.ⁿ⁸¹ The test for special circumstances in section 707(b)(2)(B) is that there must be "no reasonable alternative" to the adjustment. Such special circumstances could be simply a reduction in the debtor's income below the current monthly income figure, or additional expenses, such as the moving expenses, security deposit, and other costs that would be incurred if the debtor moved to a lower rent apartment. There are many other possibilities, such as high commuting costs, the increased price of gas, security costs in dangerous neighborhoods, or the cost of infant formula and diapers. Indeed, any legitimate expense that is out of the ordinary for an average family, or that may have increased since the IRS guidelines were calculated, could be considered.

For example, a debtor who has to maintain a separate residence in another city for employment reasons may add the expenses of that residence.^{n81a} Extra housing expenses necessitated by a special needs child may be special circumstances.^{n81b} Extra auto costs necessitated by high business mileage can be special circumstances,^{n81c} as can be support payments not counted in the means test.^{n81d} And several courts have held that the need to make continued student loan payments can constitute special circumstances.^{n81e}

The debtor must itemize each adjustment to income or expenses and provide supporting documentation.ⁿ⁸² The debtor must also provide a "detailed explanation" of why the adjustment is necessary and reasonable.ⁿ⁸³ The debtor must certify "under oath" that both the itemization and explanation are accurate.ⁿ⁸⁴

[vii] Exceptions for Certain Disabled Veterans, Reservists, and National Guard Members

A complete exemption from the means test is carved out by section 707(b)(2)(D) for a disabled veteran, as defined in 38 U.S.C. § 3741(1),ⁿ⁸⁵ but only if the indebtedness occurred primarily during a period during which the veteran was on active duty, as defined by 10 U.S.C. § 101(d)(1),ⁿ⁸⁶ or performing a homeland defense activity, as defined by 32 U.S.C. § 901(1).ⁿ⁸⁷ Congress enacted the National Guard and Reservists Debt Relief Act of 2008,^{n87a} which created a similar exception for military reserve members and National Guard members who were called to active duty or homeland defense activities. Debtors who either were on active duty or performing homeland defense activities in the preceding 540 day period as members of the reserves or National Guard are exempted from dismissal based on section 707(b)(2)(A) through (C) and any other form of means testing. This provision applies only to cases filed within three years of its effective date, December 19, 2008.

[c] Abuse Other than Under Means Test Presumption

In addition to the presumption of abuse that is used for determining the debtor's ability to pay debts, section 707(b) permits a motion to dismiss based on other types of abuse including bad faith.

[i] Safe Harbor

Section 707(b)(6)ⁿ⁸⁸ provides a safe harbor from abuse motions brought by creditors, trustees, and other entities other than the court or United States trustee if the current monthly income of the debtor, or in a joint case the debtor and the debtor's spouse is equal to or less than the applicable state median family income. This safe harbor provision is distinguishable from the safe harbor provision of section 707(b)(6) because it also applies to abuse motions other than those under the means test presumption.

[ii] Other Types of Abuse

Section 707(b)(3), added in 2005,ⁿ⁸⁹ specifies two issues that the court must consider in determining whether a case is an abuse when the presumption of abuse under section 707(b)(2) does not arise or has been rebutted. The court must first consider whether the case was filed in bad faith.ⁿ⁹⁰ The second consideration of the court must be the totality of the circumstances, and whether those circumstances demonstrate abuse.ⁿ⁹¹ This consideration had been adopted almost universally as the primary standard for determining whether substantial abuse existed under section 707(b) prior to the 2005 amendments.ⁿ⁹²

[d] Dismissal on Motion of Crime Victim

Section 707(c), added by the 2005 amendments to the Bankruptcy Code,ⁿ⁹³ permits the court, on motion of a victim of a crime of violence or a drug trafficking crime, to dismiss a voluntary chapter 7 case filed by an individual if the dismissal is in the best interest of the victim.ⁿ⁹⁴ However, an exception to this provision applies if the debtor shows that the filing of a chapter 7 case is necessary to satisfy a claim for a domestic support obligation.

[e] Procedure for Dismissal**[i] Review by the United States Trustee or Bankruptcy Administrator**

The United States trustee or Bankruptcy Administrator must review the debtor's filings in a chapter 7 case and file with the court a statement, not later than 10 days after the first meeting of creditors, as to whether the case would be presumed to be an abuse under section 707(b).ⁿ⁹⁵ Several courts have held that the United States trustee may not file a motion based on the presumption of abuse if the statement is not timely filed.^{n95a} The court is then to provide a copy of the statement to all creditors.ⁿ⁹⁶ If the United States trustee or Bankruptcy Administrator determines there is a presumption of abuse in the case then within 30 days after the first statement, the United States trustee or administrator must file either a motion to dismiss or convert the case under section 707(b) or a second statement setting forth why such a motion is not appropriate.ⁿ⁹⁷

[ii] Notice and Hearing

Section 707(b) requires notice and hearing prior to dismissal (or conversion) of a case under that section. *Federal Rule of Bankruptcy Procedure 1017(e)*, which was applicable to "substantial abuse" motions under the prior version of the Bankruptcy Code requires "a hearing on notice to the debtor, the trustee, the United State trustee, and any other entities as the court directs." It is anticipated that *Rule 1017(e)* will be amended to implement the 2005 revisions to section 707(b),ⁿ⁹⁸ but it is unlikely that any revision will significantly modify the notice and hearing requirements beyond what is necessary to effectuate the 2005 amendments.

Section 102(1) indicates that "appropriate" notice and an "appropriate" hearing is necessary. Normally, if notice is properly given and no party in interest requests a hearing, no hearing is required. However, it is probable that many courts will continue to hold hearings on 707(b) motions to determine whether dismissal is warranted even if the motion is not opposed.

[iii] Time Limits for Filing Motion

Prior to the 2005 amendments to the Bankruptcy Code, *Rule 1017(e) of the Federal Rules of Bankruptcy Procedure* specified the time limits for filing "substantial abuse" motions. While the rule will need to be updated to conform to the new provision of section 707(b). As amended in 2008, *Bankruptcy Rule 1017(e)* contains the same time limits. Thus, a motion to dismiss a case on the basis of abuse must be filed not later than 60 days after the first date set for the meeting of creditors under section 341(a), unless a request to extend the time is made before the deadline expires and the courts extends the time for filing the motion. If the hearing is on the court's own motion, notice of the hearing must be served

on the debtor not later than 60 days following the first date set for the meeting of creditors. *Rule 1017(e)* requires the motion to advise the debtor of all matters to be considered at the hearing.

[iv] Procedure When Abuse is Raised *Sua Sponte*.

The correct procedural format for the initiation and conduct of the hearing remains unclear when the matter is raised *sua sponte*. Presumably the abuse issue will be raised initially by motion; however, an order to show cause may be used.ⁿ⁹⁹ *Sua sponte* motions to dismiss by the court based on the debtor's ability to pay are unlikely given the obligations of the United States trustee or Bankruptcy Administrator to review the case for the presumption of abuse and in light of the other parties that may now raise the issue. However, on the rare occasion when the court raises the issue *sua sponte*, the United States Trustee, trustee and interested creditors are likely to be permitted to defend the presumption of abuse. By contrast, the role of the trustee and creditors may be more limited in cases where the motion to dismiss is based on reasons other than the debtor's ability to pay and where the debtor's income is below the applicable state median income. In such cases, it is likely to be the United States trustee, if anyone, who assumes the burden of presenting evidence when the court raises an abuse motion not based on the means test.

[f] Attorney's Fees in Abuse Motions

Section 707(b)(4) and (5), added by the 2005 amendments,ⁿ¹⁰⁰ provide that in certain circumstances the prevailing party in a 707(b) motion may be awarded attorney's fees. The standards for awarding such fees vary depending upon which party prevailed and who brought the motion.

[i] Abuse Motion is Sustained

Under section 707(b)(4)(A), costs and attorney's fees incurred in a successful section 707(b) motion *may* be assessed against debtor's attorney, but only in certain circumstances, circumstances which would permit fees to be awarded under previous law. Fees and costs may be awarded on motion of a party in interest or on the court's own initiative, but only if the case was dismissed under section 707(b) and the debtor's attorney violated *Federal Rule of Bankruptcy Procedure 9011* in filing the bankruptcy case itself.ⁿ¹⁰¹ Moreover, the procedures of *Rule 9011* for awarding costs and fees must be followed.ⁿ¹⁰² Costs and fees may be awarded to the trustee even if the court initiates the action.

The court may also assess a civil penalty against a debtor's attorney who violates *Rule 9011*, either on motion of a party or on the court's own initiative.ⁿ¹⁰³ The penalty, unlike those assessed *sua sponte* under *Rule 9011*, may be payable to a trustee, United States trustee, or Bankruptcy Administrator.

[ii] Abuse Motion is Denied

Section 707(b)(5) contains provisions that largely parallel those of section 707(b)(4) and are applicable when a section 707(b) motion is denied. Like section 707(b)(4) it permits fees to be awarded by the court on motion of a party in interest or on its own motion, using the procedures of *Federal Rule of Bankruptcy Procedure 9011*.ⁿ¹⁰⁴ However, it is not applicable to section 707(b) motions filed by a trustee (or bankruptcy administrator, if any) or a United States trustee. Fees may be awarded under this section if the position of the party that brought the section 707(b) motion violated *Rule 9011* or the attorney, if any, who filed the motion did not comply with section 707(b)(4)(C)(I) and (ii) and that the motion was made solely to coerce the debtor into waiving a right guaranteed by title 11.ⁿ¹⁰⁵ However, section 707(b)(5)(B) carves out an exception to the general rule allowing the award of statutory fees for a small business with an aggregate claim of under \$1100.ⁿ¹⁰⁶

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 707(a). See 6 Collier on Bankruptcy, P 707.03 (Matthew Bender).

(n2)Footnote 2. *In re Schwartz*, 14 C.B.C.2d 586, 58 B.R. 923 (Bankr. S.D.N.Y. 1986) (granting debtor's request for

dismissal of his chapter 7 case after his second largest debt was held to be nondischargeable and his largest debt was subject to dischargeability litigation; dismissal appropriate because there were few assets available and debtor's fresh start was impaired by discharge litigation that could be handled more economically in state court). *See* 6 *Collier on Bankruptcy*, P 707.03[3] (Matthew Bender).

(n3)Footnote 3. *See, e.g., In re Cohara*, 324 B.R. 24 (B.A.P. 6[th] Cir. 2005) (even if debtor needed nonexempt annuity payments to pay medical expenses, that was not cause when creditors would be prejudiced by dismissal); *Gill v. Hall (In re Hall)*, 5 C.B.C.2d 1028, 15 B.R. 913 (B.A.P. 9th Cir. 1981) (debtors cannot obtain dismissal and then refile in order to rectify initial failure to secure homestead exemption if creditors would be adversely affected). *But see In re Leo*, 1 C.B.C.2d 731, 3 B.R. 329 (Bankr. E.D. Va. 1980) (petition of *pro se* debtor that failed to incorporate all the rights and benefits to which he was potentially entitled dismissed at debtor's request in decision limited to facts of case); *In re Wirick*, 1 C.B.C.2d 978, 3 B.R. 539 (Bankr. E.D. Va. 1980) (petition dismissed to permit debtor to properly claim homestead exemption and refile).

(n4)Footnote 4. *E.g., Matter of Poirier*, 5 C.B.C.2d 1332, 16 B.R. 691 (Bankr. D. Conn. 1982) ; *In re Underwood*, 3 C.B.C.2d 640, 642, 7 B.R. 936, 938 (Bankr. S.D. W. Va. 1981) ("dismissal for the purpose of a new filing does no offense to any provision of the Code, but the expectation of a discharge of debts more than once every six years is beyond the relief provided under chapter 7").

(n5)Footnote 5. *See, e.g., Smith v. Geltzer*, 507 F.3d 64 (2d Cir. 2007) (discussing factors relevant to voluntary dismissal of debtor who proposed to use nonexempt asset to pay creditors); *In re Bartee*, 317 B.R. 362 (B.A.P. 9th Cir. 2004) (debtors had not shown cause when they offered no assurance that they had binding agreement to sell business and provided no assurance that they would use proceeds to pay creditors); *Maixner v. Surratt-States (In re Maixner)*, 288 B.R. 815 (B.A.P. 8th Cir. 2003) (desire to save equity, to detriment of creditors, not cause for dismissal); *In re Higbee*, 58 B.R. 71 (Bankr. C.D. Ill. 1986) .

(n6)Footnote 6. *In re Kapsos*, 18 B.R. 88 (Bankr. S.D. Fla. 1982) .

(n7)Footnote 7. *See, e.g., In re Leach*, 130 B.R. 855 (B.A.P. 9th Cir. 1991) (tax debt). *But see In re McDaniel*, 350 B.R. 616 (Bankr. M.D. Fla. 2006) (debtor permitted to dismiss case and refile later, when tax debts became dischargeable, because attorney gave her incorrect advice).

(n8)Footnote 8. *See, e.g., In re Mathis Insurance Agency, Inc.*, 50 B.R. 482, 487 (Bankr. E.D. Ark. 1985) ("Having submitted themselves to the jurisdiction of the Court and availed themselves of the protection of the Court, debtors whose fraudulent acts are discovered may not freely dismiss their case once the fraud is discovered.").

(n9)Footnote 9. *In re Aupperle*, 352 B.R. 43 (Bankr. D.N.J. 2005) (debtor who feared loss of home could dismiss when no creditor objected and no indication of bad faith); *In re Hull*, 339 B.R. 304 (Bankr. E.D.N.Y. 2006) (creditors not prejudiced when *pro se* debtor, upon learning she might lose personal injury claim, promptly sought dismissal to work out payments with creditors and move out of district for her personal safety; debtor had not abused system, and there would be delay in trustee liquidating claim, amount of which was unknown).

(n10)Footnote 10. *In re Wirick*, 1 C.B.C.2d 978, 3 B.R. 539 (Bankr. E.D. Va. 1980) .

(n11)Footnote 11. *In re Waldman*, 5 B.R. 401 (Bankr. S.D.N.Y. 1980) .

(n12)Footnote 12. *In re Wolfe*, 4 C.B.C.2d 555, 12 B.R. 686 (Bankr. S.D. Ohio 1981) ; *In re Jackson*, 7 B.R. 616 (Bankr. E.D. Tenn. 1980) .

(n13)Footnote 13. *See, e.g., Penick v. Tice*, 732 F.2d 1211, 10 C.B.C.2d 828 (4th Cir. 1984) (trustee has standing to object on behalf of unsecured creditors).

(n14)Footnote 13a. *Segarra-Miranda v. Acosta-Rivera (In re Acosta-Rivera)*, 557 F.3d 8, 9 (1st Cir. 2009) ; *In re Warren*, 568 F.3d 1113, 1116-17 (9th Cir. 2009) .

(n15)Footnote 14. 11 U.S.C. § 1306(b). See 8 *Collier on Bankruptcy*, P 1306.03 (Matthew Bender).

(n16)Footnote 15. See 6 *Collier on Bankruptcy*, P 707.02 (Matthew Bender).

(n17)Footnote 16. See *Fed. R. Bankr. P. 2002(k)*.

(n18)Footnote 17. See 6 *Collier on Bankruptcy*, P 707.02 (Matthew Bender).

(n19)Footnote 18. See, e.g., 11 U.S.C. § 521.

(n20)Footnote 19. 11 U.S.C. § 707(a)(1), (2) and (3). Former section 521(1) was incorporated into a new section 521(a)(1) by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Section 707(a)(3) was not amended to reflect this change. The documents required are discussed in ch. 6 *supra*.

(n21)Footnote 20. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 380 (1977), *reprinted in* Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender); S. Rep. No. 95-989, 95th Cong., 2d Sess. 94 (1978), *reprinted in* Vol. D *Collier on Bankruptcy*, App. Pt. 4(e)(i) (Matthew Bender).

(n22)Footnote 21. *Davis v. Case (In re Davis)*, 275 B.R. 864 (B.A.P. 8th Cir. 2002) (bankruptcy court did not abuse its discretion in dismissing case of incarcerated debtor who made no attempt to make arrangements to conduct creditors meeting by means other than personal appearance); See 6 *Collier on Bankruptcy*, P 707.03[2] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 707.03[2] (Matthew Bender).

(n23)Footnote 22. E.g., *Howard v. Lexington Invs., Inc.*, 284 F.3d 320 (1st Cir. 2002) (failure to file past due tax returns by deadline set by court).

(n24)Footnote 23. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n25)Footnote 24. See P 23.02[3][c] *infra*.

(n26)Footnote 25. Under the prior version of the Bankruptcy Code, creditors attempted to avoid the restriction on creditor motions under 707(b) by filing motions under 707(a) alleging bad faith. See *In re Padilla*, 222 F.3d 1184 (9th Cir. 2000) (bad faith not cause to dismiss chapter 7 case).

(n27)Footnote 26. *In re Atlas Supply Corp.*, 857 F.2d 1061 (5th Cir. 1988) ; *In re Kramer*, 64 B.R. 531 (B.A.P. 9th Cir. 1986) . See also *In re Perlin*, 497 F.3d 364 (3d Cir. 2007) (ability to pay debts, by itself, should not be sufficient for a finding of bad faith).

(n28)Footnote 26a. *In re Perkins*, 381 B.R. 530 (Bankr. S.D. Ill. 2007) (denying motion to dismiss deceased debtor's chapter 13 case).

(n29)Footnote 27. See 6 *Collier on Bankruptcy*, P 707.02 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 707.02 (Matthew Bender).

(n30)Footnote 28. See *Wilson v. Reed (In re Wilson)*, 284 B.R. 109 (B.A.P. 8th Cir. 2002) (abuse of discretion to dismiss for improper venue without notice and opportunity for hearing). See *Fed. R. Bankr. P. 2002(k)*.

(n31)Footnote 29. See *Muessel v. Pappalardo (In re Muessel)*, 292 B.R. 712 (B.A.P. 1st Cir. 2003) (*sua sponte* dismissal of case on alternate grounds without notice or a meaningful opportunity for the debtor to be heard on those grounds violated the debtor's fundamental right to procedural due process and the express requirements of the

Bankruptcy Code); *Bucurescu v. 190A Realty Corp.* (*In re Bucurescu*), 282 B.R. 124 (S.D.N.Y. 2002) (reversing dismissal based upon the earlier order, without notice and a hearing regarding compliance with order); *Dinova v. Harris* (*In re Dinova*), 212 B.R. 437 (B.A.P. 2d Cir. 1997) (case could not be dismissed on ex parte order due to debtor's failure to appear at creditors' meeting even though notice of meeting warned that such dismissal would be sought, since notice and hearing not provided as required); *In re Krueger*, 88 B.R. 238 (B.A.P. 9th Cir. 1988) (dismissal of chapter 13 case without notice and hearing violates due process); *In re General Order Governing Dismissal of Cases*, 210 B.R. 941 (Bankr. M.D. Pa. 1997) ; *Dinova*, 212 B.R. 437 (B.A.P. 2d Cir. 1997) (case could not be dismissed on ex parte order due to debtor's failure to appear at creditors' meeting even though notice of meeting warned that such dismissal would be sought, because notice and hearing not provided as required).

(n32)Footnote 30. See, e.g., 11 U.S.C. § 521.

(n33)Footnote 31. *Fed. R. Bankr. P. 1017(b)*.

(n34)Footnote 32. *Fed. R. Bankr. P. 1017(b)*.

(n35)Footnote 33. *Fed. R. Bankr. P. 1017(b)*.

(n36)Footnote 34. 1983 Advisory Committee Note to *Fed. R. Bankr. P. 1017*.

(n37)Footnote 35. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n38)Footnote 35a. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n39)Footnote 35b. *CFCU Community Credit Union v. Swimelar*, 2008 U.S. Dist. LEXIS 3991 (N.D.N.Y. Jan. 18, 2008) (dismissal under § 521(i) requires a court order, either on motion of a party or, if sua sponte, subject to motion for reconsideration; otherwise due process rights would be violated); *In re Luders*, 356 B.R. 671 (Bankr. W.D. Va. 2006) ; *In re Jackson*, 348 B.R. 487 (Bankr. S.D. Iowa 2006) ; *In re Parker*, 351 B.R.790 (Bankr. N.D. Ga. 2006) .

(n40)Footnote 35c. See *In re Wojda*, 371 B.R. 656 (Bankr. W.D.N.Y. 2007) (although debtor had not filed all payment advices received in 60 day period, debtor's payment advices provided "other evidence of payment" and "information required").

(n41)Footnote 35d. 11 U.S.C. § 521(i)(3).

(n42)Footnote 35e. See P 23.02[2][a] *supra*.

(n43)Footnote 35f. *In re Weinraub*, 351 B.R. 779 (Bankr. S.D. Fla. 2006) (case reinstated under *Fed. R. Bankr. P. 9024*).

(n44)Footnote 35g. *Segarra-Miranda v. Acosta-Rivera* (*In re Acosta-Rivera*), 557 F.3d 8, 9 (1st Cir. 2009) ; *In re Warren*, 568 F.3d 1113.1116-17 (9th Cir. 2009) .

(n45)Footnote 35h. See *In re Fox*, 370 B.R. 639 (Bankr. D.N.J. 2007) . But see *In re Kellett*, 379 B.R. 332 (Bankr. D. Or. 2007) (section 707(b) applied to converted case but debtors not required to file a new means test form because same information was contained in Official Form 22C previously filed before conversion).

(n46)Footnote 36. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n47)Footnote 36a. *In re Skvorecz*, 369 B.R. 638 (Bankr. D. Colo. 2007) (debtor would not be required to pay unsecured creditors in chapter 13 so dismissal would lead to absurd result).

(n48)Footnote 37. See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender); 1 Collier Bankruptcy Manual, ch.101

(Matthew Bender).

(n49)Footnote 38. 124 Cong. Rec. H11, 909 (Sept. 28, 1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(f)(i) (Matthew Bender); S17, 406 (Oct. 6, 1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(f)(iii) (Matthew Bender).

(n50)Footnote 39. *See, e.g., In re Goodson*, 130 B.R. 897 (Bankr. N.D. Okla. 1991) ; *In re Johnson*, 115 B.R. 159 (Bankr. S.D. Ill. 1990) ; *In re Bryant*, 11 C.B.C.2d 987, 47 B.R. 21 (Bankr. W.D.N.C. 1984) . *See also* *In the Matter of Booth*, 858 F.2d 1051, 19 C.B.C.2d 1284 (5th Cir. 1988) (considering a portion of a home mortgage to be a consumer debt but excluding from consumer debt that portion of a home mortgage loan which was used in a business venture). *But see In re Restea*, 17 C.B.C.2d 132, 76 B.R. 728 (Bankr. D.S.D. 1987) .

(n51)Footnote 40. *In re White*, 12 C.B.C.2d 1245, 49 B.R. 869 (Bankr. W.D.N.C. 1985) .

(n52)Footnote 41. *In re White*, 12 C.B.C.2d 1245, 1248, 49 B.R. 869, 872 (Bankr. W.D.N.C. 1985) .

(n53)Footnote 42. *In re White*, 12 C.B.C.2d 1245, 1248, 49 B.R. 869, 872 (Bankr. W.D.N.C. 1985) ; *In re Marshalek*, 158 B.R. 704 (Bankr. N.D. Ohio 1993) .

(n54)Footnote 43. 130 Cong. Rec. H1811-12 (daily ed. Mar. 21, 1984) (Statement of Congressman Brooks); 130 Cong. Rec. H1812 (daily ed. Mar. 21, 1984) (Statement of Congressman Montgomery); 130 Cong. Rec. H7499 (daily ed. June 29, 1984) (Statement of Congressman Anderson), *reprinted in* Vol. E Collier on Bankruptcy, App. Pt. 6(c) (Matthew Bender).

(n55)Footnote 44. *Cf. In re Almendinger*, 56 B.R. 97 (Bankr. N.D. Ohio 1985) (stockbroker's \$120,000 in credit card debts incurred to raise money to reinvest in the stock market in hope that he could recoup prior losses were not "consumer debts.").

(n56)Footnote 45. *See, e.g., Baskin v. G. Fox and Co.*, 550 F. Supp. 64 (D. Conn. 1982) .

(n57)Footnote 46. *Matter of Booth*, 858 F.2d 1051, 1055, 19 C.B.C.2d 1284, 1287 (5th Cir. 1988) . *See also In re Kelly*, 841 F.2d 908, 913, 18 C.B.C.2d 560, 566 (9th Cir. 1988) .

(n58)Footnote 47. *E.g., In re Westberry*, 215 F.3d 589 (6th Cir. 2000) .

(n59)Footnote 48. *See In re Stewart*, 175 F.3d 796 (10th Cir. 1999) (alimony debts, loan from father-in-law and some student loans used for living expenses were consumer debts); *Matter of Booth*, 858 F.2d 1051, 1055, 19 C.B.C.2d 1284, 1288 (5th Cir. 1988) (stating that " 'primarily' suggests an overall ratio of consumer to nonconsumer debts of over fifty percent... .[C]onsumer debts should be evaluated not only by amount, but by their relative number."); *In re Kelly*, 841 F.2d 908, 913, 18 C.B.C.2d 560, 566 (9th Cir. 1988) (holding that when "more than half of the dollar amount owed is consumer debt, the statutory threshold is passed;" 88% of the debt was consumer debt).

(n60)Footnote 49. 11 U.S.C. § 101(10A), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See P 23.02[b][i] infra*.

(n61)Footnote 50. 11 U.S.C. § 707(b)(7), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n62)Footnote 51. 11 U.S.C. § 707(b)(2)(A)(i), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n63)Footnote 52. 11 U.S.C. § 101(10A)(A)(i).

(n64)Footnote 52a. 11 U.S.C. § 101(10a)(A)(ii).

(n65)Footnote 52b. *In re Dunford*, 2009 Bankr. LEXIS 1938 (Bankr. N.D. Ill. 2009) ; *In re Hoff*, 402 B.R. 683 (Bankr. E.D.N.C. 2009) ; *In re Montgomery*, No. 07-051781, 2008 Bankr. LEXIS 706, at *2 (Bankr. M.D.N.C. Mar. 4, 2008) .

(n66)Footnote 53. 11 U.S.C. § 101(10A)(B)

(n67)Footnote 53a. *See In re Shahan*, 367 B.R. 732 (Bankr. D. Kan. 2007) (nondebtor spouse's car and house payments on property that was not property of estate were not included in current monthly income, nor were her recreation and miscellaneous personal payments); *In re Travis*, 353 B.R. 520 (Bankr. E.D. Mich. 2006) (clothing and personal items could be included in "marital adjustment" but food and utilities could not).

(n68)Footnote 53b. *See In re Welch*, 347 B.R. 247 (Bankr. W.D. Mich. 2006) (decided under former section 707(b)).

(n69)Footnote 53c. *But see Drummond v. Wiegand (In re Wiegand)*, 386 B.R. 238 (B.A.P. 9th Cir. 2008) (gross income must be used).

(n70)Footnote 53d. http://www.census.gov/acs/www/Downloads/2004/usedata/Subject_Definitions.pdf

(n71)Footnote 53e. *See also Zahn v. Fink (In re Zahn)*, 2008 Bankr. LEXIS 2134 (B.A.P. 8th Cir. Aug. 14, 2008) (IRA withdrawals are not included in computing current monthly income).

(n72)Footnote 53f. http://www.census.gov/acs/www/Downloads/2007/usedata/Subject_Definitions.pdf. *See also In re Breeding*, 366 B.R. 21 (Bankr. E.D. Ark. 2007) (redemption of certificates of deposit did not produce income).

(n73)Footnote 54. 11 U.S.C. § 101(10A)(B).

(n74)Footnote 55. *See* 42 U.S.C. §§ 1381, *et. seq.*

(n75)Footnote 56. *See* 42 U.S.C. §§ 601, *et. seq.*

(n76)Footnote 57. *See* 42 U.S.C. §§ 501, *et. seq.*; 42 U.S.C. §§ 1321, *et seq.*

(n77)Footnote 58. *See* 42 U.S.C. 1397, *et. seq.*

(n78)Footnote 59. 11 U.S.C. § 101(39A), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n79)Footnote 60. 11 U.S.C. § 101(39A)(B).

(n80)Footnote 61. 11 U.S.C. § 707(b)(6)(C)

(n81)Footnote 62. 11 U.S.C. § 104(b)(1), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n82)Footnote 63. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n83)Footnote 63a. *See In re Ellringer*, 370 B.R. 905 (Bankr. D. Minn. 2007) (census definition of household used to determine that unrelated adult was member of debtor's household; however, the nondebtor's income was included in current monthly income only to extent paid for expenses of debtor and debtor's dependents).

(n84)Footnote 64. www.irs.gov/businesses/small/article/0,,id=104623,00.html

(n85)Footnote 65. www.irs.gov/businesses/small/article/0,,id=104696,00.html

(n86)Footnote 66. www.irs.gov/businesses/small/article/0,,id=104627,00.html

(n87)Footnote 67. 11 U.S.C. § 707(b)(2)(ii)(I).

(n88)Footnote 67a. Although basic cell phone expenses are now included in the local standards housing allowances, extraordinary expenses over and above those allowed as part of the housing allowance may be necessary. See *In re Petro*, 381 B.R. 233 (Bankr. M.D. Tenn. 2007) (\$350 monthly cell phone expense found necessary when debtor worked far from her four children's schools).

(n89)Footnote 68. 11 U.S.C. § 707(b)(2)(ii)(I).

(n90)Footnote 69. 11 U.S.C. § 707(b)(2)(A)(ii)(I). Such expenses are identified under section 309 of the Family Violence Prevention and Services Act, 42 U.S.C. § 10408, or other applicable federal law. See **[Colliers Reference]**

(n91)Footnote 70. 11 U.S.C. § 707(b)(2)(A)(ii)(II). See *Collier on Bankruptcy*, P 707.05[2][c][ii] (Matthew Bender). Because of the way this provision is worded, there is a strong argument that support for an immediate family member may be deducted even if that person is not elderly or disabled. Such a reading would permit deduction of child support payments that are not ordered by a court or payments for support of adult children who are not in the debtor's household.

(n92)Footnote 71. 11 U.S.C. § 707(b)(1). See *Collier on Bankruptcy*, P 707.05[2][c][ii] (Matthew Bender).

(n93)Footnote 72. 11 U.S.C. § 707(b)(2)(A)(ii)(V). See *Collier on Bankruptcy*, P 707.05[2][c][ii] (Matthew Bender).

(n94)Footnote 73. 11 U.S.C. § 707(b)(2)(A)(ii)(IV). To take this deduction, the debtor must supply detailed documentation of such expenses and of why they are reasonable and necessary and why they are not already accounted for under IRS standards. See *Collier on Bankruptcy*, P 707.05[2][c][ii] (Matthew Bender).

(n95)Footnote 74. 11 U.S.C. 707(b)(2)(A)(ii)(III). See *Collier on Bankruptcy*, P 707.05[2][c][ii] (Matthew Bender).

(n96)Footnote 74a. Compare *Morse v. Rudler (In re Rudler)*, 576 F.3d 37 (1st Cir. 2009) (debtor can deduct payments for property to be surrendered) with *In re Turner*, 2009 U.S. App. LEXIS 15942 (7th Cir. 2009) (debtor could not deduct secured debt payments on property to be surrendered); *In re Thomas*, 2008 Bankr. LEXIS 3664 (B.A.P. 6th Cir. 2008) (same). Courts permit deduction of such amounts regardless of whether the lien will be reduced or eliminated in the case. *In re Roberts*, 2008 U.S. Dist. LEXIS 108640 (D. Nev. 2008) ; *In re Marshall*, 2009 Bankr. LEXIS 1928 (Bankr. D. Mass. 2009) .

(n97)Footnote 75. 11 U.S.C. § 707(b)(2)(A)(iv).

(n98)Footnote 76. 11 U.S.C. § 1328(a)(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n99)Footnote 77. 11 U.S.C. § 523(a)(15), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n100)Footnote 78. The average monthly payment is the total amount "scheduled as contractually due" to the secured creditor in the sixty months after the petition divided by sixty. See 11 U.S.C. 707(b)(2)(A)(iii). With respect to home mortgages, items deducted elsewhere as Other Necessary Expenses such as taxes and insurance are not included in the calculation of average monthly payment.

(n101)Footnote 78a. *E.g., In re Fowler*, 349 B.R. 414 (Bankr. D. Del. 2006) (discussing statute and conflicting case law).

(n102)Footnote 78b. *eCAST Settlement Corp. v. Washburn (In re Washburn)*, 2009 U.S. App. LEXIS 19400 (8th Cir. Aug. 28, 2009) ; *Tate v. Bolen (In re Tate)*, 571 F.3d 423 (5th Cir. 2009) ; *Morse v. Rudler (In re Rudler)*, 576 F.3d 37 (1st Cir. 2009) ; *Ross-Tousey v. Neary (In re Ross-Tousey)*, 549 F.3d 1148 (7th Cir. 2008). *Contra Ransom v. MBNA Am. Bank, N.A. (In re Ransom)*, 577 F.3d 1026 (9th Cir. 2009) .

(n103)Footnote 79. 11 U.S.C. § 707(b)(2)(B), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n104)Footnote 80. 11 U.S.C. § 707(b)(2)(A)(i), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n105)Footnote 81. 11 U.S.C. § 707(b)(2)(B), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n106)Footnote 81a. *In re Graham*, 363 B.R. 844 (Bankr. S.D. Ohio 2007) .

(n107)Footnote 81b. *In re Scarafiotti*, 375 B.R. 618 (Bankr. D. Colo. 2007) .

(n108)Footnote 81c. *In re Turner*, 376 B.R. 370 (Bankr. D.N.H. 2007)

(n109)Footnote 81d. *In re Littman*, 370 B.R. 820 (Bankr. D. Id. 2007).

(n110)Footnote 81e. *In re Martin*, 371 B.R. 347 (Bankr. C.D. Ill. 2007) ; *In re Delbecq*, 368 B.R. 754 (Bankr. S.D. Ind. 2007) ; *In re Haman*, 366 B.R. 307 (Bankr. D. Del. 2007) ; *In re Templeton*, 365 B.R. 213 (Bankr.W.D. Okla. 2007) .

(n111)Footnote 82. 11 U.S.C. § 707(b)(2)(B)(ii)(I), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n112)Footnote 83. 11 U.S.C. § 707(b)(2)(B)(ii)(II)

(n113)Footnote 84. 11 U.S.C. § 707(b)(2)(B)(iii)

(n114)Footnote 85. Under 38 U.S.C. § 3741(1), the term "disabled veteran" means (A) a veteran who is entitled to compensation under laws administered by the Secretary for a disability rated at 30 percent or more, or (B) a veteran whose discharge or release from active duty was for a disability incurred or aggravated in line of duty.

(n115)Footnote 86. Under 10 U.S.C. § 101(d)(1), the term "active duty" means full-time duty in the active military service of the United States. Such term includes full-time training duty, annual training duty, and attendance, while in the active military service, at a school designated as a service school by law or by the Secretary of the military department concerned. Such term does not include full-time National Guard duty.

(n116)Footnote 87. Under 32 U.S.C. § 901(1), the term "homeland defense activity" means an activity undertaken for the military protection of the territory or domestic population of the United States, or of infrastructure or other assets of the United States determined by the Secretary of Defense as being critical to national security, from a threat or aggression against the United States.

(n117)Footnote 87a. Pub. L. No. 110-438 (2008), effective December 19, 2008, *reprinted at Vol. F Collier on Bankruptcy, App. Pt. 41* (Matthew Bender).

(n118)Footnote 88. 11 U.S.C. § 707(b)(6), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n119)Footnote 89. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n120)Footnote 90. 11 U.S.C. § 707(b)(3)(A).

(n121)Footnote 91. 11 U.S.C. § 707(b)(3)(B).

(n122)Footnote 92. *In re Green*, 934 F.2d 568, 24 C.B.C.2d 1911(4[th] Cir. 1991)

(n123)Footnote 93. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n124)Footnote 94. "Crime of violence" and drug trafficking crime" are defined to have the meanings they have under 18 U.S.C. § 16, § 924(c)(2)

(n125)Footnote 95. 11 U.S.C. 704(b)(1), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n126)Footnote 95a. *In re Perrotta*, 378 B.R. 434 (Bankr. D.N.H. 2007) ; *In re Robertson*, 370 B.R. 804 (Bankr. D. Minn. 2007) . See also *In re Byrne*, 376 B.R. 700 (Bankr. W.D. Ark. 2007) (although § 704(b)(1) statement is prerequisite to motion based on presumption of abuse, it is not required for motion under § 707(b)(3) where presumption does not arise or is rebutted).

(n127)Footnote 96. 11 U.S.C. § 704(b)(1), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See 11 U.S.C. § 707(b)(2), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n128)Footnote 97. 11 U.S.C. 704(b)(2), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n129)Footnote 98. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *Federal Rule of Bankruptcy Procedure 1017(e)* governs the procedure for 707(b) dismissal motions.

(n130)Footnote 99. See, e.g., *In re Edwards*, 13 13 C.B.C.2d 255, 50 B.R. 933 (Bankr. S.D.N.Y. 1985) ; *In re White*, 12 C.B.C.2d 1245, 49 B.R. 869 (Bankr. W.D.N.C. 1985) . *Federal Rule of Bankruptcy Procedure 1017(e)* governs the procedure for 707(b) dismissal motions.

(n131)Footnote 100. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n132)Footnote 101. 11 U.S.C. § 707(b)(4)(A).

(n133)Footnote 102. *Id.*

(n134)Footnote 103. 11 U.S.C. § 707(b)(4)(B).

(n135)Footnote 104. 11 U.S.C. § 707(b)(5)(A).

(n136)Footnote 105. 11 U.S.C. § 707(b)(5)(ii).

(n137)Footnote 106. "Small business" is defined in section 707(b)(5)(C), for purposes of this paragraph only, as an unincorporated business, partnership, corporation, association, or organization that has fewer than 25 full time employees when the motion is filed and is engaged in commercial or business activity. However, the protection does not extend to the attorney for the small business.



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CHAPTER 23 Dismissal of Bankruptcy Cases

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P 23.03 Dismissal of Chapter 13 Cases

[1] Voluntary Dismissal

Dismissal of chapter 13 cases commonly result when debtors cannot comply with the terms of their chapter 13 plans. In such circumstances, the trustee typically files a motion requesting that the case be dismissed by the court.

However, the debtor in some cases may voluntarily dismiss the case. If a chapter 13 plan is failing, dismissal is one of several options open to the debtor. If modification of the plan is possible, that option is often preferable. Similarly, the debtor may do better by converting the case to chapter 7 or seeking a hardship discharge. However, in some cases, modification is impossible, the debtor is ineligible for a hardship discharge, and conversion to chapter 7 may risk adverse consequences, such as the liquidation of nonexempt property. In such cases, dismissal, which more or less restores the status quo prior to bankruptcy, may be the debtor's best available option.

MORE INFORMATION

For a detailed discussion of plan modification after confirmation *see* chapter 22 *supra*. For an examination of conversion and the hardship discharge *see* chapters 24 and 29 *infra*, respectively.

[a] Grounds for Voluntary Dismissal

In a case originally commenced under chapter 13, as distinguished from a case converted to chapter 13 from another chapter, the debtor is entitled, as a matter of right, to obtain a dismissal of the chapter 13 case, at any time.ⁿ¹ In keeping with Congressional intent that chapter 13 be completely voluntary, the right to a dismissal of the chapter 13 case cannot be waived by the debtor.ⁿ² Nor may it be denied or delayed by the court, even where other parties oppose the dismissal or seek to have the court convert the case to another chapter,ⁿ³ since to do so would force a debtor to remain in chapter 13 involuntarily.

There is no absolute right on the part of the debtor to obtain a dismissal of a case converted to chapter 13 from another chapter. Instead the debtor may request dismissal of the chapter 13 case pursuant to *section 1307(c) of the Bankruptcy Code*, which provides that the case may be dismissed for cause. The cause, most typically, will be simply that the debtor is unable to complete the plan. The court, after notice and a hearing, may grant the motion, which will usually be unopposed. However, if a debtor has significant nonexempt assets, there is always a possibility that the trustee or a

creditor will successfully argue that the case should be converted to chapter 7 rather than dismissed.

MORE INFORMATION

Conversion is discussed further in chapter 24 *infra*.

[b] Procedure for Dismissal

The procedure for dismissal as a matter of right under section 1307(b) is provided for in *Federal Rule of Bankruptcy Procedure 1017(f)(2)*.ⁿ⁴ The debtor effectuates the dismissal by motion, but because there is no right to contest the dismissal,^{n4a} the procedures of *Bankruptcy Rule 9013*, rather than *Bankruptcy Rule 9014*, are followed. The court's participation is required only to verify that the case was commenced as a chapter 13 case, since otherwise there would not be an absolute right to dismissal. Unless the court has reason to believe that the case was not originally commenced under chapter 13, and therefore is not subject to the absolute right to dismiss, the court should enter the dismissal order immediately upon filing of the motion. In cases in which there is doubt as to the right to dismiss, the court may schedule a hearing.ⁿ⁵

FORMS

For a form of a debtor's motion to dismiss as a matter of right, see *Collier Consumer Bankruptcy Forms, Form 10.27-1* (Matthew Bender).

If the debtor does not have an absolute right to dismiss the case, the procedure to be followed is the same procedure as for any other party seeking a dismissal. The debtor must file a motion pursuant to *Federal Rule of Bankruptcy Procedure 1017(f)(1)*.ⁿ⁶ The motion should be served on the chapter 13 trustee and transmitted to the United States trustee. *Federal Rule of Bankruptcy Procedure 2002(a)(4)* does not require, as it does in cases under other chapters, that the motion be served on all creditors, although local rules may have such a requirement or notice to creditors may be ordered by the court.

[2] Involuntary Dismissal

Dismissal may also be ordered pursuant to *sections 1307(c) or (e) of the Bankruptcy Code* on request of a creditor, the chapter 13 trustee, or the United States trustee if dismissal is in the best interests of creditors and the estate.ⁿ⁷ The court may act under these sections only on the request of a party in interest or the United States trustee and "after notice and a hearing,"ⁿ⁸ for causeⁿ⁹ or for failure to file tax returns required by section 1308.

Section 105(a) of the Bankruptcy Code gives the court the power to *sua sponte* take any action necessary to enforce or implement court orders or rules, or to prevent an abuse of process, and that section, as amended, presumably would give the court the power to dismiss a case *sua sponte*. However, with the presence of the chapter 13 trustee, as well as the the United States trustee, whose duty it is to monitor such matters and make appropriate motions to dismiss, this extraordinary power of the court should rarely be exercised. In such cases in which the court does consider *sua sponte* dismissal, the principles underlying section 1307 dictate that all parties in interest should be given notice and an opportunity for a hearing.

[a] Grounds for Dismissal for cause

Section 1307(c) of the Bankruptcy Code enumerates 11 specific occurrences which constitute sufficient cause for the dismissal or conversion to chapter 7 of a chapter 13 case.ⁿ¹⁰ These include nonpayment of required fees and charges, failure to pay post-petition domestic support obligations, failure to file a plan on time, denial of plan confirmation and of time to propose an amended plan and, only upon motion of the United States trustee, failure to file required statements and schedules. However, the most common ground for dismissal is the failure to make required plan

payments, either before or after confirmation. The grounds enumerated in sections 1307(c)(1) through (11) are not exhaustive.ⁿ¹¹ For example, the court also has the power to dismiss the case if the debtor is not eligible to be a debtor under chapter 13 because of failure to meet the requirements of *section 109(a), (e), (g) or (h) of the Bankruptcy Code*.ⁿ¹²

[b] Opposing Dismissal

The debtor may, of course, oppose a motion to dismiss the case. It is clear that dismissal, for cause under section 1307(c) even for the enumerated reasons, is discretionary rather than mandatory. For example, if a plan is filed late, but is filed in time to be reviewed by creditors without delaying other steps in the case, and no creditor is prejudiced by the delay, dismissal is rarely appropriate.ⁿ¹³ A failure to timely commence payments may be quickly cured. Similarly, if there are extenuating circumstances, or if the reason for the default can be cured by a permissible modification of the plan, to lower the payments for example, the debtor should normally be given a second chance. Usually, the trustee will settle a motion in such situations if there is a reasonable chance that the plan can succeed.

Serious and repeated defaults, of course, may very well warrant dismissal, particularly if it appears that the plan is unworkable or the case has been filed with no bona fide intention of proceeding. In such cases, it is also appropriate to examine the debtor's payment of his or her attorney,ⁿ¹⁴ since an attorney who knowingly submits a plan which has no chance of succeeding should not be compensated for those actions. For this reason, some courts routinely order a hearing on attorneys' fees after a plan is dismissed under such circumstances.

[c] Procedure for Dismissal

The procedure for a motion seeking involuntary dismissal of a chapter 13 case is governed by *Federal Rule of Bankruptcy Procedure 1017*. The Rule requires a hearing on notice in all such cases.ⁿ¹⁵ Unless the debtor has already filed a list of creditors, the debtor must provide the court with the names and addresses of all creditors so notice of the dismissal may be given to them pursuant to *Federal Rule of Bankruptcy Procedure 2002*.

A motion to dismiss a case, other than one filed by the debtor as a matter of right, is treated by the Rules as a contested matter under *Federal Rule of Bankruptcy Procedure 9014*,ⁿ¹⁶ which incorporates many of the rules governing adversary proceedings, providing for discovery and other procedures.ⁿ¹⁷

MORE INFORMATION

For a detailed discussion of the procedure for contested matters see chapter 32 *infra*.

However, especially with respect to the chapter 13 debt limitations of section 109(e),ⁿ¹⁸ the courts have differed as to the extent of the hearing which should be held to consider the motion. The Court of Appeals for the Sixth Circuit has held that the court should rely solely on the debtor's representations in the Chapter 13 Statement, as long as they are made in good faith.ⁿ¹⁹ This conclusion seems logical, since the hearing might otherwise require the resolution of numerous disputed claims at the very outset of the case and an inquiry into good faith should expose those cases in which debtors are clearly ineligible for relief. It is also in accord, as the Sixth Circuit court pointed out, with the procedure for disputes as to other monetary jurisdictional requirements in the federal courts.ⁿ²⁰ However, other courts have demanded a more searching inquiry into the amount of claims against the debtor to determine initial eligibility under chapter 13.ⁿ²¹

[d] Dismissal for Failure to File Required Tax Returns

Section 1308(a), enacted by the 2005 amendments to the Bankruptcy Code,ⁿ²² requires the debtor to file with the applicable taxing authorities all tax returns which the debtor was required to file for all taxable periods ending during the four years before the petition is filed. The enforcement mechanism for section 1308(a) is the right of a party in

interest or the United States trustee to move for dismissal under section 1307(e), also enacted in 2005,ⁿ²³ if the required returns are not filed. Section 521(j) provides for conversion or dismissal of a case for failure to file postpetition tax returns.ⁿ²⁴ Section 1307(e), like section 1307(c), requires notice and hearing in all such cases. It has been held that the court must dismiss the case if the required returns are not timely filed and no extension of time has been granted.ⁿ²⁵

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 1307(b)*. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 428 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender). See also *In re Nash*, 765 F.2d 1410, 13 C.B.C.2d 209 (9th Cir. 1985) .

(n2)Footnote 2. *11 U.S.C. § 1307(b)*.

(n3)Footnote 3. *In re Barbieri*, 199 F.3d 616, 43 C.B.C.2d 410 (2d Cir. 1999) (court must dismiss and could not convert case to chapter 7 when debtor had moved to dismiss); *In re Eddis*, 37 B.R. 217 (E.D. Pa. 1984) ; *In re Gillion*, 36 B.R. 901 (E.D. Ark. 1983) . But see *In re Molitor*, 76 F.3d 218 (8th Cir. 1996) (debtor who did not deny filing multiple bankruptcy cases in bad faith could not respond to conversion motion by dismissing chapter 13 case voluntarily).

(n4)Footnote 4. Prior to the 1999 Amendments to the Federal Rules of Bankruptcy Procedure this procedure was set forth in *Fed. R. Bankr. P. 1017(d)*.

(n5)Footnote 4a. *In re Barbieri*, 199 F.3d 616 (2d Cir. 1999) . But see *Rosson v. Fitzgerald (In re Rosson)*, 545 F.3d 764 (9th Cir. 2008) (dismissal as of right is subject to bad faith exception).

(n6)Footnote 5. See 1987 Advisory Committee Note to *Bankruptcy Rule 1017*.

(n7)Footnote 6. Prior to the 1999 Amendments to the Federal Rules of Bankruptcy Procedure this procedure was set forth in *Fed. R. Bankr. P. 1017(d)*.

(n8)Footnote 7. See 1987 Advisory Committee Note to *Bankruptcy Rule 1017*. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 428 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n9)Footnote 8. See *11 U.S.C. § 102(1)*. See 2 *Collier on Bankruptcy*, P 102.02 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 102.02 (Matthew Bender).

(n10)Footnote 9. See 8 *Collier on Bankruptcy*, P 1307.04[1]-[9] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1307.04[1]-[9] (Matthew Bender).

(n11)Footnote 10. See *11 U.S.C. § 1307(e)(1)-(11)*, Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n12)Footnote 11. See, e.g., *In re Leavitt*, 171 F.3d 1219, 41 C.B.C.2d 1035 (9th Cir. 1999) (bad faith can be cause for dismissal of chapter 13 case with prejudice); *In re Lilley*, 91 F.3d 491 (3d Cir. 1996) (lack of good faith can be cause for dismissal of chapter 13 case). Note the use of the term "including." See 2 *Collier on Bankruptcy*, P 102.04 (Matthew Bender). 1 *Collier Bankruptcy Manual*, ch. 102 (Matthew Bender).

(n13)Footnote 12. *11 U.S.C. § 109(a), (e) and (g)*. See ch. 4 *supra* for discussion of debt limits. See also 2 *Collier on Bankruptcy*, P 109 (Matthew Bender). 1 *Collier Bankruptcy Manual*, ch. 109 (Matthew Bender).

(n14)Footnote 13. *In re McConnell*, 60 B.R. 310 (Bankr. W.D. Va. 1986) .

(n15)Footnote 14. See *11 U.S.C. § 329(b)* (court may examine debtor's transactions with attorneys).

(n16)Footnote 15. *Bankruptcy Rule 1017(a)*.

(n17)Footnote 16. *Fed. R. Bankr. P. 1017(f)(1)*, formerly *Fed. R. Bankr. P. 1017(d)* prior to the 1999 Amendments to the Federal Rules of Bankruptcy Procedure.

(n18)Footnote 17. See 10 Collier on Bankruptcy, ch. 9014 (Matthew Bender).

(n19)Footnote 18. *11 U.S.C. § 109(e)*. See 2 Collier on Bankruptcy, P 109.06 (Matthew Bender).

(n20)Footnote 19. In the *Matter of Pearson*, 773 F.2d 751, 13 C.B.C.2d 749 (6th Cir. 1985) Accord, *In re Lybrook*, 951 F.2d 136 (7th Cir. 1991) ;

(n21)Footnote 20. In the *Matter of Pearson*, 773 F.2d 751, 13 C.B.C.2d 749 (6th Cir. 1985) .

(n22)Footnote 21. See, e.g., *In re Sylvester*, 6 C.B.C.2d 586, 19 B.R. 671 (B.A.P. 9th Cir. 1982) .

(n23)Footnote 22. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n24)Footnote 23. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n25)Footnote 24. *11 U.S.C. § 521(j)*, also enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n26)Footnote 25. *In re Cushing*, 401 B.R. 528 (1st Cir. B.A.P. 2009) .



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CHAPTER 23 Dismissal of Bankruptcy Cases

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P 23.04 Effect of Dismissal

The effect of dismissal is governed by *section 349 of the Bankruptcy Code*. In general, the dismissal of a case, prior to discharge, is without prejudice and the debtor is not barred from receiving a discharge in a subsequent case of those debts that were dischargeable in the dismissed case. The language of section 349(a), however, gives the court discretion, when there is cause, to deny the debtor the benefits of the general rule, *i.e.*, to dismiss the case with prejudice thereby preventing the debtor from obtaining a discharge with regard to the debts existing at the time of the dismissed case, at least for some period of time.ⁿ¹ Additionally, under amended section 362, dismissal may affect the applicability of the automatic stay in a subsequent case.ⁿ²

MORE INFORMATION

The automatic stay is discussed further in chapter 8 *infra* .

Section 349(b) states that the dismissal of a title 11 case reinstates those proceedings and custodianships that were superseded by the commencement of the case, as well as avoided transfers and voided liens.ⁿ³ The section also specifies that the dismissal vacates any order, judgment, or transfer ordered as a result of the avoidance of a transfer, and that the property of the estate is revested in the entity in which such property was vested when the case was initiated.

The objective of section 349(b) is to undo the title 11 case, insofar as is practicable, and to restore all property rights to the position they occupied at the beginning of such case.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 349(a)*. See *In re Tomlin*, 105 F.3d 933, 37 C.B.C.2d 654 (4th Cir. 1997) (although court used words "with prejudice," it intended only to prohibit refiling for 180 days). See 3 *Collier on Bankruptcy*, P 349.02 (Matthew Bender). 1 *Collier Bankruptcy Manual*, ch. 349 (Matthew Bender).

(n2)Footnote 2. *11 U.S.C. § 362*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *11 U.S.C. § 349(b)*. See 3 *Collier on Bankruptcy*, P 349.03 (Matthew Bender). 1 *Collier Bankruptcy Manual*, ch. 349 (Matthew Bender).



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CHAPTER 24 Conversion of Cases from One Chapter to Another

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§ 24.syn Synopsis to Chapter 24: Conversion of Cases from One Chapter to Another

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CHAPTER 24 Conversion of Cases from One Chapter to Another

1-24 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the conversion of cases from chapter 13 to chapter 7 and from chapter 7 to chapter 13. It discusses when the debtor has the absolute right to convert and when the court may permit conversion for cause, either at the request of the debtor or at the request of a creditor or trustee. The chapter also explains the procedures involved in converting a case and the effects of conversion on creditors and the bankruptcy estate.



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CHAPTER 24 Conversion of Cases from One Chapter to Another

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P 24.01 Introduction

The Bankruptcy Code has several provisions governing conversion of a case from one chapter to another. In the consumer context, these provisions give debtors who have commenced a case in chapter 7 an absolute right to convert the case to chapter 13 if the case has not previously been converted.ⁿ¹ Moreover, any chapter 13 debtor has the absolute right to convert a case to chapter 7.ⁿ² Any other conversion, either at the request of the debtor, a creditor, or the trustee, must be approved by the court after notice and a hearing. However, a case cannot be involuntarily converted to chapter 13, and a case in which the debtor is a farmer may not be involuntarily converted from chapter 13 to another chapter.ⁿ³

Once a case is converted, it generally proceeds as if it had been commenced under the chapter to which it was converted. However, special rules govern the treatment of property acquired and debts incurred after the bankruptcy petition was filed but before the conversion.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 706(a). See P 24.03 infra.*

(n2)Footnote 2. *11 U.S.C. § 1307(a).*

(n3)Footnote 3. *11 U.S.C. § 1307(f), formerly § 1307(e), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.*



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CHAPTER 24 Conversion of Cases from One Chapter to Another

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P 24.02 Conversion from Chapter 13 to Chapter 7

[1] Voluntary Conversion

[a] Reasons for Conversion

Conversion to chapter 7 is one of several options available to a debtor who cannot complete a chapter 13 plan. The other options are modification of the plan, which is usually preferable if it is feasible, a hardship discharge, if the debtor qualifies for one, and dismissal of the case.

One advantage of conversion is that it allows postpetition debts arising before conversion to be treated as if they arose prepetition.ⁿ¹ These debts may thus be discharged if they are dischargeable under chapter 7. This may make conversion an attractive option if the debtor has significant unsecured postpetition debts.

MORE INFORMATION

Postconfirmation modification of plans and dismissal are examined in chapter 22 and chapter 23 *supra*, respectively. A detailed discussion of the hardship discharge can be found in chapter 29 *infra*. For a discussion of which debts are dischargeable in chapter 7 *see* chapter 26 *infra*.

PRACTICE NOTE

Conversion of the case does not create a new automatic stay when stay relief has been previously granted.ⁿ² It may sometimes be possible, however, to move to have a stay reimposed if the debtor can ensure that the creditor's rights will be protected.ⁿ³ However, if this does not appear likely and the debtor needs a new stay to prevent an imminent event such as foreclosure, an involuntary dismissal at the trustee's request and refiling under chapter 13 may be preferable, assuming the debtor is again in a position to propose and carry out a confirmable plan. Section 109(g) would not preclude such a refiling as long as the dismissal was not voluntary or brought about by the debtor's willful failure to follow court orders or prosecute the case.ⁿ⁴

The debtor may wish to convert if the reasons for the initial choice of chapter 13 no longer apply. For example, the debtor may have chosen chapter 13 to protect property, such as an automobile, from repossession. If that property is

later destroyed or is no longer of value to the debtor, chapter 13 may no longer be necessary.

MORE INFORMATION

The use of chapter 13 in dealing with secured creditors is examined in chapter 14 *supra*.

Conversion may also be advantageous when the debtor is unable to complete his or her plan and is ineligible for a hardship discharge, yet wishes to obtain a discharge of unsecured debts or to preserve the effect of lien avoidance or other orders obtained under chapter 13.ⁿ⁵ If a case is voluntarily or involuntarily dismissed, rather than converted, liens avoided in the bankruptcy are reinstated.ⁿ⁶

WARNING

The major disadvantage of conversion is that if there is nonexempt property in the estate, it is liquidated regardless of what the unsecured creditors have already received under the plan (at least to the extent necessary to pay all creditors in full with interest). Therefore, in cases in which the debtor has nonexempt assets and can meet the requirements, a hardship discharge is often preferable to conversion.

[b] Debtor's Absolute Right to Convert

The debtor may convert a chapter 13 case to a chapter 7 liquidation case, at any time.ⁿ⁷ The right to convert to chapter 7 is unqualified and may not be waived.ⁿ⁸

Unlike section 1307(b), which states that the *court* shall dismiss a case upon request of the debtor, section 1307(a) provides that the *debtor* may convert a case to chapter 7. There is no need for the court to review the propriety of the conversion, since there are no preconditions on the right to convert similar to the limitation of the debtor's absolute right to dismiss to only those cases originally commenced under chapter 13.ⁿ⁹ Once the debtor files a notice of conversion, the conversion is automatic and immediate; it cannot be delayed by the court.ⁿ¹⁰

However, a debtor converting from chapter 13 to chapter 7 by right may still be subject to the means-test formula of section 707(b) if his or her current monthly income at the time of filing the chapter 13 exceeded the applicable state median income.ⁿ¹¹ If after applying the mean test a presumption of abuse arises, the debtor may rebut the presumption by showing special circumstances.ⁿ¹² For the debtor that legitimately is unable to carry out a confirmable chapter 13 plan, this hurdle should not be insurmountable.

[c] Procedure for Conversion by Debtor

The procedure for conversion by the debtor is governed by *Federal Rule of Bankruptcy Procedure 1017(f)*.ⁿ¹³ Recognizing that the statute provides for conversion by the debtor to chapter 7 without a motion or court order, the Rule requires only a notice of conversion to be filed by the debtor.ⁿ¹⁴ *Rule 1017(f)(3)* provides that the date of filing of the notice of conversion shall be deemed the date of the conversion order for purposes of applying *Rule 1019* and *section 348(c) of the Bankruptcy Code*, which refers to the "conversion order." It also requires that the clerk forward a copy of the conversion notice to the United States trustee.ⁿ¹⁵

FORMS

For a form of a debtor's notice of conversion from chapter 13 to chapter 7 see *Collier Consumer Bankruptcy Forms, Form CS12.12-1* (Matthew Bender).

Once the case has been converted, proceedings in the converted case are governed by *Federal Rule of Bankruptcy Procedure 1019*. Although that Rule does not require new schedules to be filed in the converted case unless the court so

directs,ⁿ¹⁶ the debtor must file a supplemental schedule of debts which have arisen since the chapter 13 case was filed, since such debts are dischargeable in the converted case.ⁿ¹⁷ A statement of intention under section 521(a)(2) must also be filed. Courts disagree about whether a chapter 7 means test form, Official Form 22A, must be filed after conversion.^{n17a}

If the conversion order is entered after confirmation of a plan, the debtor must file a list of property which has been acquired after the filing of the petition and before the conversion order, a schedule of unpaid debts incurred after confirmation and before the conversion order, and a schedule of executory contracts entered into or assumed after the petition and before the conversion order.ⁿ¹⁸ The clerk is then required to transmit copies of all such schedules to the United States trustee.ⁿ¹⁹

New time periods for filing claims, dischargeability complaints and objections to discharge come into being, although claims actually filed in the chapter 13 case are deemed filed in the chapter 7 case.ⁿ²⁰ The chapter 13 trustee must turn over to the chapter 7 trustee all records of the estate and nonexempt property,ⁿ²¹ at least if the chapter 7 trustee desires possession. (If the amounts of property are nominal, the chapter 7 trustee may not wish to take possession, since chapter 7 trustees are encouraged to abandon property in nominal asset cases.)ⁿ²² And the chapter 13 trustee must transmit to the United States trustee a final report and account.ⁿ²³

MORE INFORMATION

Abandonment of property is discussed in chapter 28 *infra*.

[2] Involuntary Conversion

[a] Reasons for Conversion

A conversion to a chapter 7 can be ordered against a debtor's will pursuant to section 1307(c) or 1307(e) upon motion of a party in interest, such as a creditor or the trustee, or the United States trustee. Section 1307(c) permits conversion "for cause" and section 1307(e), added in 2005,ⁿ²⁴ allows for conversion if the debtor fails to file a tax return under section 1308. In order for a case to be involuntarily converted to chapter 7, both sections require that such conversion be in the best interest of creditors and the estate.

Section 1307(c) of the Bankruptcy Code enumerates 11 specific occurrences which constitute sufficient cause for conversion, including failure to file necessary papers and failure to make plan payments. In most cases, however, conversion is not in the best interests of creditors unless there are significant nonexempt assets that would be liquidated for the benefit of creditors in a chapter 7 case. In most places, involuntary conversions are relatively rare.

If such assets do exist, it may be a good strategy for a creditor to move to convert the debtor's case to chapter 7, especially if there are few other creditors with whom they would be shared. On the other hand, it may be preferable to pursue those assets outside of bankruptcy after the case is dismissed, so that they would not have to be shared with other creditors.

However, the case of a debtor who is a farmer may not be converted involuntarily.ⁿ²⁵ Moreover, a debtor who is faced with a conversion motion may exercise the right to dismiss the case voluntarily before the motion is decided, pursuant to section 1307(b).

MORE INFORMATION

For a discussion of a debtor's absolute right to dismiss a chapter 13 case that has not been converted from another chapter *see* chapter 23 *supra*.

[b] Procedure for Requesting Conversion

The procedure for a motion to convert a case to chapter 7 is governed by *Federal Rule of Bankruptcy Procedure 1017(f)(1)*.ⁿ²⁶ Such a motion must be served on the debtor and the trustee and initiates a contested matter governed by *Federal Rule of Bankruptcy Procedure 9014*. The burden is on the moving party to demonstrate cause for the conversion.

MORE INFORMATION

For a discussion of procedures in contested matters see chapter 32 *infra*.

Once the case is converted, the procedures are the same as they are if the debtor converts to chapter 7 voluntarily.

[3] Effect of Conversion

Section 348(a) provides that while conversion of a case from one chapter to another constitutes an order for relief, this does not affect the dates of the filing of the petition, the commencement of the case, or the order for relief, except as provided in subsections (b) and (c). This means that (with the exceptions listed in subsections (b) and (c) of section 348) those sections of the Bankruptcy Code that are keyed to the dates of filing of the petition, commencement of the case or entry of the order for relief are unaffected by conversion. Section 348(a) thus operates in conjunction with many other Code provisions.

[a] Property of the Estate After Conversion

Section 348(f)(1)(A) provides that "property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion." Therefore, property that the debtor has acquired since the filing of the chapter 13 case does not come into the chapter 7 estate.

However, an exception to the general rule about property of the estate after conversion from chapter 13 to chapter 7 exists if the conversion is "in bad faith." In that case, property of the chapter 7 estate is the property of the estate as of the date of conversion.ⁿ²⁷

It is unclear what would constitute "bad faith" triggering this exception. One situation in which bad faith might be found would be if the debtor never really intended to proceed with a chapter 13 and had filed a chapter 13 case simply to protect assets the debtor knew would soon be acquired. Courts clearly should not find bad faith if the debtor is unable to complete a plan due to a change in circumstances or financial hardship.

On a related matter, some cases have held that creditors had a vested right to payment as to funds paid into the chapter 13 estate when a plan has been confirmed and funds were paid to the trustee but not yet distributed to creditors at the time of conversion.ⁿ²⁸ These cases were overruled by enactment of section 348(f)(1). In accordance with section 348(f)(1), postpetition wages in the hands of the chapter 13 trustee should be returned to the debtors because they were not a part of the chapter 7 estate.ⁿ²⁹ Moreover, *Federal Rule of Bankruptcy Procedure 1019(4)* requires the chapter 13 trustee to turn over all property of the estate in his or her possession to the chapter 7 trustee, so it is doubtful that the cases were correct even when decided. After conversion, the chapter 13 plan is no longer in effect and, pursuant to section 522(b), the debtor has the right to exempt from property of the estate any property that falls within the limitations of section 522.

[b] Valuation of Property and Allowed Secured Claim After Conversion

The 2005 amendments to section 348(f)ⁿ³⁰ added a new paragraph 348(f)(1)(C), applicable to conversions from chapter

13. Additionally, the amendments make section 348(f)(1)(B) inapplicable in a case converted from chapter 13 to chapter 7.

Section 348(f)(1)(C)(i), added in 2005,ⁿ³¹ provides that with respect to cases converted from chapter 13, the claim of any creditor holding securityⁿ³² shall continue to be secured by that security unless the full amount of such claim determined under applicable nonbankruptcy law has been paid in full as of the date of conversion, notwithstanding any valuation or determination of the amount of the allowed secured claim made for purposes of the case under chapter 13. While paragraphs (1)(B) and (1)(C) specifically limit the use of valuations of property and allowed secured claims made in the chapter 13 case prior to conversion, nothing in the amended language dictates how property should be valued in the chapter 7 case. Thus, courts will have to look to other sources to decide the amount of the allowed secured claim in the converted case.

PRACTICE NOTE

The inapplicability of previous determinations of value in a case converted from chapter 13 to chapter 7 may be advantageous to debtors where their property's value has gone down during the pendency of the chapter 13 case.ⁿ³³

Similarly, the provision of section 348(f)(1)(B) which allowed secured claims to be reduced to the extent they were paid in chapter 13 no longer applies to cases converted from chapter 13 to chapter 7.ⁿ³⁴ The new language, however, does not describe how any reduction in the amount of the creditor's secured claim is to be determined in such cases. Certainly, the amendment should not be read as creating a negative implication that the allowed secured claim should not be reduced by payments in a chapter 13 plan, because Congress clearly could have stated that rule if it had desired that result. Rather, the provisions of section 348(f)(1)(B) and 1(C) can best be reconciled by reasoning that even if a creditor continues to be secured by its security, a chapter 7 debtor may still redeem the property by paying the remainder of the allowed secured claim.

[c] Cure of Prebankruptcy Defaults

Paragraph 348(f)(1)(C)(ii), added in 2005,ⁿ³⁵ provides that unless a prebankruptcy default has been fully cured under a chapter 13 plan at the time of conversion, in any proceeding under title 11 or otherwise, the default will have the effect it has under applicable nonbankruptcy law. The provision seems to make no significant change, except perhaps to clarify that a cure under a chapter 13 plan continues to be effective even if the plan is not completed.

[d] Effect on Preconversion Claims

Section 348(d) provides for special treatment of claims that arose during a case under chapter 13 before the case was converted to chapter 7. When a claim arises after the order for relief in a chapter 13 case but before conversion of the case under section 1307, such claim "shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition."ⁿ³⁶

By treating a preconversion claim that arises after the order for relief as if it had arisen immediately before the date the petition was filed, section 348(d) renders such claims subject to discharge in the converted case. Once these claims are treated as arising before the order for relief, they are within the ambit of *section 727(b) of the Bankruptcy Code*, which provides that a discharge in chapter 7 discharges the debtor "from all debts that arose before the date of the order for relief."ⁿ³⁷ The applicability of section 727(b) to these debts is further elucidated by section 348(b), which provides that, unless the court for cause orders otherwise, "the order for relief" for purposes of section 727(b) in the converted case means the conversion date.

Claims for administrative expenses as specified by section 503(b),ⁿ³⁸ however, are expressly excepted from the

operation of section 348(d), to the extent that such administrative expense claims continue to have priority in distribution as specified by section 507(a). These claims, although classified as administrative claims under section 507(a)(2), are subordinated to the administrative claims arising in the case after conversion by section 726(b).n39

The exception to the general rule in section 348(d) applies only to priority status, giving different treatment to preconversion administrative claims by granting them administrative priority that they would not have had had they arisen prior to the order for relief in a nonconverted case. It has nothing to do with dischargeability of those claims,n40 and therefore does not alter the application of section 727(b), via 348(b), to them.n41

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 348(d). See 3 Collier on Bankruptcy, P 348.05[3]* (Matthew Bender 15th Ed. Revised).

(n2)Footnote 2. *See generally In re State Airlines, 873 F.2d 264 (11th Cir. 1989)* (conversion from chapter 11 to chapter 7 does not trigger new stay).

(n3)Footnote 3. A stay may be available under section 105 particularly as to property which might be liquidated for the benefit of unsecured creditors. This may allow a debtor facing foreclosure to obtain the benefit of an applicable homestead exemption in the liquidation process.

(n4)Footnote 4. *See 2 Collier on Bankruptcy, P 109.08* (Matthew Bender 15th Ed. Revised).

(n5)Footnote 5. *11 U.S.C. § 348(f)(1)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. The language of new section 348(f)(1)(C), added in 2005, is unlikely to require debtors who convert to chapter 7 to bring a second motion of avoid a lien that was avoided in the chapter 13 case prior to conversion. *See also In re Tluscik, 122 B.R. 728 (Bankr. W.D. Mo. 1991)* (debtor may redeem property at the amount of unpaid balance of secured claim determined in chapter 13 case after conversion to chapter 7); *In re Hargis, 103 B.R. 912 (Bankr. E.D. Tenn. 1989)* (effect of lien avoidance won in chapter 13 preserved after conversion to chapter 7).

(n6)Footnote 6. *11 U.S.C. § 349. See In re Sadler, 935 F.2d 918, 24 C.B.C.2d 2017 (7th Cir. 1991)*.

(n7)Footnote 7. *11 U.S.C. § 1307(a)*.

(n8)Footnote 8. *11 U.S.C. § 1307(a). See H.R. Rep. No. 595, 95th, Cong. 1st Sess. 428 (1977), reprinted in Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i)* (Matthew Bender 15th Ed. Revised).

(n9)Footnote 9. *Compare 11 U.S.C. § 1307(a) with 11 U.S.C. § 1307(b). See also ch. 23 supra.*

(n10)Footnote 10. *In re McFadden, 37 B.R. 520 (Bankr. M.D. Pa. 1984)* ; *In re Perkins, 10 C.B.C.2d 963, 36 B.R. 618 (Bankr. M.D. Tenn. 1983)* *In re McFadden, 37 B.R. 520 (Bankr. M.D. Pa. 1984)* *In re Perkins, 10 C.B.C.2d 963, 36 B.R. 618 (Bankr. M.D. Tenn. 1983)*

(n11)Footnote 11. *See P 23.03[3] supra.*

(n12)Footnote 12. *See P 23.03[3][b][vi] supra.*

(n13)Footnote 13. *Fed. R. Bankr. P. 1017(f)*.

(n14)Footnote 14. *Fed. R. Bankr. P. 1017(f)(3)*.

(n15)Footnote 15. *Id.*

(n16)Footnote 16. *Fed. R. Bankr. P. 1019(1)(A)*.

(n17)Footnote 17. *Fed. R. Bankr. P. 1019(5); 11 U.S.C. § 348(b) and (d).*

(n18)Footnote 17a. *See In re Fox*, 370 B.R. 639 (Bankr. D.N.J. 2007) (new Form 22 not required after conversion); *In re Kellett*, 379 B.R. 332 (Bankr. D. Or. 2007) (new Form 22 required, may be waived upon motion); *In re Edwards*, 367 B.R. 921 (Bankr. S.D. Ga. 2007) (new Form 22 not required for below-median income debtors because information would be unchanged from original Form 22C).

(n19)Footnote 18. *Fed. R. Bankr. P. 1019(5); 11 U.S.C. § 348(b) and (d).*

(n20)Footnote 19. *Fed. R. Bankr. P. 1019(5); 11 U.S.C. § 348(b) and (d).*

(n21)Footnote 20. *Fed. R. Bankr. P. 1019(2) and (3).*

(n22)Footnote 21. *Fed. R. Bankr. P. 1019(4).*

(n23)Footnote 22. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 93 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender) 15th Ed. Revised).

(n24)Footnote 23. *Fed. R. Bankr. P. 1019(5).*

(n25)Footnote 24. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n26)Footnote 25. *11 U.S.C. § 1307(e).*

(n27)Footnote 26. *Fed. R. Bankr. P. 1017(f)(1)*, formerly *Fed. R. Bankr. P. 1017(d)* prior to the 1999 Amendments to the Federal Rules of Bankruptcy Procedure.

(n28)Footnote 27. *11 U.S.C. § 348(f)(2).*

(n29)Footnote 28. *In re Milledge*, 20 C.B.C.2d 366, 94 B.R. 218 (Bankr. M.D. Ga. 1988) *Ledford v. Burns (In the Matter of Burns)*, 19 C.B.C.2d 900, 90 B.R. 301 (Bankr. S.D. Ohio 1988)

(n30)Footnote 29. *Stamm v. Morton (In re Stamm)*, 222 F.3d 216 (5th Cir. 2000) .

(n31)Footnote 30. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n32)Footnote 31. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n33)Footnote 32. "Security" is defined in section 101; *see* ch.101 *supra*. In light of the definition of security, it is not clear what claims would be affected by the new language.

(n34)Footnote 33. *See also* § 506(a)(2), which provides that with respect to property acquired for personal, family, or household purposes replacement value shall be determined *considering the age and condition of the property at the time value is determined*. [emphasis supplied]

(n35)Footnote 34. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n36)Footnote 35. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n37)Footnote 36. *11 U.S.C. § 348(d).*

(n38)Footnote 37. *11 U.S.C. § 727(b)*. *See* 6 Collier on Bankruptcy, P 727.13 (Matthew Bender 15th Ed. Revised).

(n39)Footnote 38. *11 U.S.C. § 503(b)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases

filed on or after October 17, 2005. *See* 4 *Collier on Bankruptcy*, P 503.05 (Matthew Bender 15th Ed. Revised).

(n40)Footnote 39. 11 U.S.C. § 726(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See* 6 *Collier on Bankruptcy*, P 726.03 (Matthew Bender 15th Ed. Revised).

(n41)Footnote 40. *Matter of Pavlovich*, 952 F.2d 114, 118, 26 C.B.C.2d 542, 549 (5th Cir. 1992) .

(n42)Footnote 41. *In re Ramaker*, 23 C.B.C.2d 936, 117 B.R. 959 (Bankr. N.D. Iowa 1990) ; *In re Deiter*, 33 B.R. 547 (Bankr. W.D. Wis. 1983) . *In re Ramaker*, 23 C.B.C.2d 936, 117 B.R. 959 (Bankr. N.D. Iowa 1990)



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CHAPTER 24 Conversion of Cases from One Chapter to Another

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P 24.03 Conversion from Chapter 7 to Chapter 13

Conversion from chapter 7 to chapter 13 is far more infrequent than conversion from chapter 13 to chapter 7. Usually it is the result of a change in the debtor's circumstances, which makes it possible for the debtor to propose a plan to save property from foreclosure or repossession that might not have been feasible when the case was commenced. However, such a change does not normally occur during the short life-span of a chapter 7 case. More often, such a change may result in a new chapter 13 case being filed after the chapter 7 case is completed.

In some cases, a debtor may wish to convert if it becomes apparent that the discharge of a significant debt will be challenged and the debtor does not wish to litigate or is not confident about the outcome of the proceeding. In these cases, the debtor may convert to take advantage of the broader chapter 13 discharge, which may render the dischargeability proceeding moot. Similarly, a debtor may convert or consent to conversion if faced with a motion under section 707(b) which has been successful or is likely to be successful.ⁿ¹

MORE INFORMATION

For a discussion of the differences between the chapter 7 discharge and the chapter 13 discharge *see* chapter 26 *infra*. For a discussion of dismissal under section 707(b) *see* chapter 23 *supra*.

Because chapter 13 is entirely voluntary, there can be no involuntary conversion of a case to chapter 13.

[1] Debtor's Ability to Convert to Chapter 13

[a] When Case Has Not been Converted Previously.

Section 706(a) of the Bankruptcy Code Normally permits the debtor to convert from chapter 7 to chapter 13, provided the case has not previously been converted.

The Supreme Court, in *Marrama v. Citizens Bank* ⁿ², held that a debtor's right to convert a chapter 7 case to another chapter is not absolute. The court ruled that a debtor who in bad faith had concealed significant assets, and whose case under chapter 13 would be subject to immediate dismissal under section 1307(c), did not have the right to convert to chapter 13 in the first instance. Such a debtor, the court held, comes within the description in section 706(d) of debtors

who do not have a right to convert because the debtor is not someone who "may be a debtor under such chapter."³

The court emphasized that denial of the right to convert to chapter 13 should be limited to "extraordinary cases" of bad faith and should not apply to other cases.^{3a} It also suggested that the showing of bad faith necessary to deny conversion should be very clear, and more than might be required for denial of plan confirmation under section 1325(a)(3).^{3b}

In any event, it is unlikely that the decision will have much effect in practice. A court that denies conversion based on the debtors bad faith would almost certainly have either promptly dismissed a chapter 13 case or denied confirmation based on that same bad faith, so the ultimate result will be the same as if the court had ruled the other way.

[b] Case that Was Converted Previously.

A few courts have read this section, and the absence of a specific authorization for a motion to convert to chapter 12 or chapter 13 when there to preclude reconversion to chapter 12 or chapter 13 after a case has been converted from one of those chapters to chapter 7.⁴ However, had Congress meant to bar such reconversions completely, it would not have used the language it used. Unlike section 706(a), which speaks of the debtor converting a case when the debtor has an absolute right to convert, subsection 706(c), like subsection 706(b), speaks of the court converting the case. Both sections 706(b) and 706(c) refer to a decision of the court, in its discretion, to permit conversion at the request of a party. Section 706(c) serves simply to limit who may request conversion to chapter 12 or chapter 13, permitting only the debtor to make such a request. If the court were not authorized to convert a case to chapter 13 in the first place, there would be no need for section 706(c). Therefore, the power of the court to convert a case to chapter 13 is implicit in section 706(c), which limits that power.

Most courts have recognized that it would make little sense to deny the debtor any opportunity to convert back to chapter 12 or chapter 13 if the debtor decides an earlier conversion to chapter 7 was a mistake.⁵ While Congress did not give debtors an absolute right to reconvert, so that debtors cannot frustrate creditors by continually converting and reconverting, it did generally want to give debtors every opportunity to repay their debts if they chose.⁶

Of course, a debtor may convert to chapter 13 only if the debtor is eligible to be a chapter 13 debtor under section 109(e).⁷ In *In re Bobroff*,⁸ the Court of Appeals for the Third Circuit held that when a debtor attempted to convert a case as a matter of right to chapter 13 under section 706(a), but was concededly ineligible for relief under that chapter, the conversion attempt, which was never ratified by an order of the court or other court action, was void.^{8a} In that case, after a creditor had brought the ineligibility to the attention of the bankruptcy court, the court held that the debtor could not proceed under chapter 13. However, if a bankruptcy court enters an unappealed order converting a case to chapter 13, or if a chapter 13 plan is confirmed and not appealed after a debtor has asserted a right to convert under section 706(a), any eligibility challenges thereafter would be barred by *res judicata*.⁹

MORE INFORMATION

The effects of confirmation are outlined in chapter 20 *supra* .

[2] Procedure for Conversion

Conversion by the debtor under section 706(a) is accomplished, pursuant to *Federal Rule of Bankruptcy Procedure 1017(f)(2)*^{9a} by the debtor filing a motion to convert. The motion should be served on the trustee and the United States trustee. Since the debtor usually has an absolute right to convert if the case has not previously been converted, the only issues are whether there was a prior conversion, whether the conversion is sought in bad faith, and whether the debtor is eligible for relief under chapter 13, which will usually be apparent from the record. Therefore, there is normally no hearing on the motion before a conversion order is entered unless such an issue arises and the court so directs.

FORMS

For a form of a motion to convert a case under chapter 7 to a case under chapter 13 without prior conversions *see Collier Consumer Bankruptcy Forms, Form CS12.02-1* (Matthew Bender).

If the debtor has previously converted the case, the same procedure is followed, except that the proceeding will be deemed a contested matter under *Rule 9014*. Depending on local motion practice, this may mean that a hearing is scheduled or it may mean that a hearing is scheduled only if the motion is opposed. Therefore, the local rules for motion practice must be consulted.

Once the case is converted, the service of the chapter 7 trustee is terminated.ⁿ¹⁰ Since the debtor has the right to possession of all property of the estate,ⁿ¹¹ the trustee should turn over to the debtor any property in his or her possession. The debtor must file a chapter 13 plan within 15 days, unless the court grants additional time for cause shown and on notice as the court may direct.ⁿ¹² Any other schedules and statements not previously filed must also be filed. Thereafter, the case proceeds like any other case under chapter 13, with new notice of a new meeting of creditors and confirmation hearing.

MORE INFORMATION

For an outline of the procedure to be followed in contested matters *see* chapter 32 *infra*. For an overview of procedures in chapter 13 cases *see* chapter 2 *supra*.

[3] Effect of Conversion

Although the Bankruptcy Code is not as explicit concerning postpetition claims arising before conversion to chapter 13 as it is for such claims arising before conversion to chapter 7,ⁿ¹³ such claims should be treated as prepetition claims. Under *section 348(b) of the Bankruptcy Code*, the order for relief in the converted case is the conversion order for purposes of section 1305(a), which defines a postpetition claim in chapter 13. This strongly suggests that claims arising before the conversion order should be treated as prepetition claims, since otherwise there would be no indication in the Bankruptcy Code regarding how they should be treated. Property of the estate is governed by section 1306(a), which in all chapter 13 cases includes property acquired after the petition is filed.ⁿ¹⁴

FOOTNOTES:

(n1)Footnote 1. *See 11 U.S.C. § 707(b)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. *127 S. Ct. 1105 ; 166 L. Ed. 2d 956 (2007) .*

(n3)Footnote 3. *127 S. Ct. 1105 ; 166 L. Ed. 2d 956, 964-66 (2007) .*

(n4)Footnote 3a. *127 S. Ct. 1105 ; 166 L. Ed. 2d 956, 966 n.11 (2007) .*

(n5)Footnote 3b. *Id.*

(n6)Footnote 4. *In re Carter*, 84 B.R. 744 (D. Kan. 1988) ; *In re Ghosh*, 38 B.R. 600 (Bankr. E.D.N.Y. 1984) *In re Carter*, 84 B.R. 744 (D. Kan. 1988) *In re Ghosh*, 38 B.R. 600 (Bankr. E.D.N.Y. 1984)

(n7)Footnote 5. *In re Hollar*, 70 B.R. 337 (Bankr. E.D. Tenn. 1987) ; *In re Walker*, 77 B.R. 803 (Bankr. D. Nev. 1987) ; *In re Sensibaugh*, 9 B.R. 45 (Bankr. E.D. Va. 1981)

(n8)Footnote 6. S. Rep. No. 989, 95th Cong., 2d Sess. 94 (1978) *reprinted in* Vol D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender 15th Ed. Revised); H.R. Rep. No. 595, 95th Cong. 1st Sess. 380 (1977), *reprinted in* Vol. C

Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender 15th Ed. Revised).

(n9)Footnote 7. *See* 2 *Collier on Bankruptcy*, P 109.06 (Matthew Bender 15th Ed. Revised).

(n10)Footnote 8. 766 F.2d 797, 12 C.B.C.2d 1491 (3d Cir. 1985) .

(n11)Footnote 8a. 766 F.2d 797, 803, 12 C.B.C.2d 1491, 1498 .

(n12)Footnote 9. 11 U.S.C. § 1327(a).

(n13)Footnote 9a. *Fed. R. Bankr. P. 1017(f)(2)*, formerly *Fed. R. Bankr. P. 1017(d)* prior to the 1999 Amendments to the Federal Rules of Bankruptcy Procedure.

(n14)Footnote 10. *See* 6 *Collier on Bankruptcy*, P 706.06 (Matthew Bender 15th Ed. Revised). 2 *Collier Bankruptcy Manual*, ch. 706 (Matthew Bender).

(n15)Footnote 11. 11 U.S.C. § 1306(b). *See* 8 *Collier on Bankruptcy*, P 1306.03 (Matthew Bender 15th Ed. Revised). 3 *Collier Bankruptcy Manual*, ch. 1306 (Matthew Bender).

(n16)Footnote 12. *Fed. R. Bankr. P. 3015(b)*.

(n17)Footnote 13. *See* P 24.02[3] *supra*.

(n18)Footnote 14. *See* 8 *Collier on Bankruptcy*, P 1306.02 (Matthew Bender 15th Ed. Revised).



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CHAPTER 25 Redemption of Property in Chapter 7 Cases

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CHAPTER 25 Redemption of Property in Chapter 7 Cases

1-25 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the right of the debtor to redeem certain types of property in a chapter 7 case. The chapter begins by discussing the types of property that can be redeemed. The chapter also explains the relationship of section 722 to section 506(a)'s determination of allowed secured claim and details the procedures to be followed in redeeming property. Next, the chapter examines whether redemption is the best alternative for the debtor and suggests strategies for the use of redemption. The chapter ends with a discussion of the strategies that a creditor may employ.



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CHAPTER 25 Redemption of Property in Chapter 7 Cases

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P 25.01 Introduction

Section 722 of the Bankruptcy Code provides that an individual debtor may redeem consumer goods from a lien securing a dischargeable consumer debt, if the property is exempted under *section 522 of the Bankruptcy Code* or has been abandoned under section 554, by paying the lienholder the amount of the allowed claim secured by the lien, *i.e.*, the value of the lienholder's collateral if the creditor is undersecured.ⁿ¹ The right to redeem amounts to a right of first refusal for the debtor to purchase consumer goods that might otherwise be repossessed.ⁿ² The right allows the debtor to retain the necessary property and avoid the high replacement cost that might be required if the secured creditor took the collateral.

MORE INFORMATION

For a discussion of exempting property and determining the allowed secured claim *see* chapter 10 and 19 *supra*, respectively. Abandonment of property is discussed in chapter 28 *infra*.

The purpose of this section, like that of *section 506 of the Bankruptcy Code*, is to prevent secured creditors from getting an unfair advantage out of proportion to the value of their security. Section 722, however, is aimed solely at preventing an unfair advantage over the debtor, rather than over the other creditors. Under prior law, a secured creditor had the right to demand full payment or to obtain a reaffirmation of a secured debt after bankruptcy, and to repossess or otherwise recover the collateral if such payment or reaffirmation did not occur. This often allowed the creditor to collect far more than the market value of the collateral due to the fact that the debtor could not easily replace the property securing the debt. Congress felt it was unfair for a creditor holding a security interest in some necessity like a refrigerator to demand payment of a debt of several hundred dollars when the collateral was worth only \$50 on the market, simply because the item was irreplaceable for a financially strapped debtor who could not afford to purchase a new one.ⁿ³

Property meeting the requirements set forth in section 722 may be redeemed from a lien securing a dischargeable consumer debt. "Lien" is defined in section 101 as a "charge against or interest in property to secure payment of a debt or performance of an obligation."ⁿ⁴ Redemption may be from a purchase money security interest as well as a nonpurchase money security interest,ⁿ⁵ although in light of the debtor's right to invalidate certain nonpurchase money security interests in household items under section 522(f)(2), the application of this section to that fact situation will be limited. Possessory security interests are also subject to the right of redemption.

In some cases, the court may have to determine whether a contract denominated as a lease is in reality a credit sale with a security interest. This issue frequently arises with respect to consumer "rent-to-own" or "rental-purchase" contracts. Typically, these contracts provide that the consumer will become the owner of an appliance or other property after making a certain number of "rental" payments. Most bankruptcy courts have had little difficulty in finding such contracts to be disguised installment sales with security agreements.ⁿ⁶ If that is the case, then the property involved may be redeemed under section 722.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 506(a)*.

(n2)Footnote 2. H.R. Rep. No. 595, 95th Cong., 1st Sess. 380-381 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n3)Footnote 3. H.R. Rep. No. 595, 95th Cong., 1st Sess. 127-28 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n4)Footnote 4. *See* 2 Collier on Bankruptcy, ch. 101 (Matthew Bender); 1 Collier Bankruptcy Manual, ch. 101 (Matthew Bender).

(n5)Footnote 5. The express exception of purchase money agreements from the right to redeem in section 722, as it would have been enacted in S. 2266, 95th Cong., 2d Sess., was not included in the final Act.

(n6)Footnote 6. *Matter of Rose*, 94 B.R. 103 (Bankr. S.D. Ohio 1988) ; *In re Armstrong*, 84 B.R. 94 (Bankr. W.D. Tex. 1988) ; *In re Fogelson*, 88 B.R. 194 (Bankr. C.D. Ill. 1988) ; *In re Brown*, 82 B.R. 68 (Bankr. W.D. Ark. 1987) ; *In re Puckett*, 60 B.R. 223 (Bankr. M.D. Tenn. 1986) .



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CHAPTER 25 Redemption of Property in Chapter 7 Cases

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P 25.02 Property that May Be Redeemed

[1] Only Tangible Personal Property May Be Redeemed

The property to be redeemed must be tangible personal property.ⁿ¹ It cannot be intangibles like an account or stock. Although some courts of appeals had previously held that a chapter 7 debtor could use *section 506(d) of the Bankruptcy Code* to seek a declaration that the undersecured portion of a lien on other types of property was void, the United States Supreme Court overruled those cases in *Dewsnup v. Timm*.ⁿ² In that case, the Court held that since there was no legislative history indicating Congressional intent to allow elimination of undersecured liens on property not subject to the redemption provisions in chapter 7 cases, section 506(d) could not be read to provide relief similar to section 722 for property not included within the ambit of section 722.ⁿ³ Hence, section 722 provides the only relief available in chapter 7 to reduce or eliminate liens not avoidable under the debtor's or the trustee's avoiding powers.ⁿ⁴

MORE INFORMATION

The debtor's and trustee's avoiding powers are discussed in chapters 17 and 18 *supra*.

[2] Only Consumer Goods May Be Redeemed

The property redeemed must be intended primarily for "personal, family, or household" use. This language is also found in *section 101 of the Bankruptcy Code* defining "consumer debt."ⁿ⁵ Thus, the right of redemption is intended for property that constitutes consumer goods.ⁿ⁶

[3] Debtor Must Have an Interest in the Property

The property also must be property in which the debtor has an interest, but the debtor need not have been the original purchaser of the property or the obligee on the debt secured by the lien on the property.ⁿ⁷ However, the right to redeem extends to the whole of the property, and not just to the debtor's interest in it.ⁿ⁸

ILLUSTRATIONS

For example, if a debtor owns an automobile valued at \$4,000, subject to a \$2,400 lien, the debtor may exempt a \$1,600 interest in the car. Section 522(d)(2) permits a maximum exemption of \$3,225ⁿ⁹ in a

motor vehicle¹⁰ unless state law, as provided under section 522(b)(1), specifically does not allow the debtor to utilize the federal bankruptcy exemptions. If the debtor claims property exempt under state law, the applicable state exemption provisions determine the property that can be exempted. In either case, section 722 permits a debtor claiming the property as exempt to pay the lienholder \$2,400, the amount of the allowed claim secured by the lien, and redeem the entire car, not just the remaining amount of the statutorily permitted exemption.¹¹

The more common case is that of property which is worth less than the amount of the creditor's lien. If a vehicle is worth \$5,000 and the creditor's lien secures a debt of \$8,000, a debtor who exempts his or her interest in the property (an interest with no monetary value) can redeem the property by paying the creditor \$5,000.

[4] Property Must Have Been Exempted or Abandoned

Property may be redeemed only if it has been exempted or abandoned. In most cases, since the lien is typically greater than the value of the property, the debtor has exempted his or her (valueless) interest in the property. However, if the property is of a type that cannot be exempted under the exemption scheme utilized by the debtor, redemption must await the point in time when the property is abandoned. The debtor may seek such abandonment by motion, and such a motion presumably can be combined with a motion to redeem.

MORE INFORMATION

Motions for abandonment are examined in detail in chapter 28 *infra*.

[5] Debt Must Be a Dischargeable Consumer Debt

The debt secured by the lien must be a consumer debt.¹² Section 101 defines "consumer debt" to mean a debt incurred by an individual primarily for a personal, family, or household purpose.¹³

The debt secured by the lien must also be dischargeable. The exceptions to discharge in chapter 7 cases are set forth in *section 523 of the Bankruptcy Code*.

MORE INFORMATION

For a detailed outline of the exceptions to discharge see chapter 26 *infra*.

FOOTNOTES:

(n1)Footnote 1. *In re Hall*, 11 B.R. 3 (Bankr. W.D. Mo. 1980).

(n2)Footnote 2. *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773, 116 L. Ed. 2d 903, 25 C.B.C.2d 1297 (1992).

(n3)Footnote 3. 502 U.S. 410, 417, 112 S. Ct. 773, 778, 116 L. Ed. 2d 903, 911, 25 C.B.C.2d 1297, 1303.

(n4)Footnote 4. See 11 U.S.C. §§ 522(f) and (h), 544, 545, 547, 548, 549, 553 and 724(a).

(n5)Footnote 5. See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender); 1 Collier Bankruptcy Manual, ch. 101 (Matthew Bender).

(n6)Footnote 6. See *In re Runski*, 102 F.3d 744, 37 C.B.C.2d 230 (4th Cir. 1996) (office equipment used for business purposes could not be redeemed because it was not intended primarily for personal, family, or household use). See also H.R. Rep. No. 595, 95th Cong., 1st Sess. 381 (1977), reprinted in Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 95 (1978), reprinted in Vol. D Collier on Bankruptcy,

App. Pt. 4(e)(i) (Matthew Bender).

(n7)Footnote 7. *In re Tluscik*, 122 B.R. 728 (Bankr. W.D. Mo. 1991)

(n8)Footnote 8. *In re Fitzgerald*, 20 B.R. 27 (Bankr. N.D.N.Y. 1982)

(n9)Footnote 9. Pursuant to 11 U.S.C. § 104(b), this amount is subject to periodic adjustment and was raised from \$2,950 to \$3,225, effective April 1, 2007. For cases commenced before April 1, 2004, the amounts in effect are \$2,775. The adjustment is made every three years beginning on April 1, 1998. See 2 *Collier on Bankruptcy*, P 104.03 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 104.03 (Matthew Bender).

(n10)Footnote 10. See ch. 13 *supra*.

(n11)Footnote 11. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 381 (1977), reprinted in Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender).

(n12)Footnote 12. *Boitnott v. United Virginia Bank (In re Boitnott)*, 2 C.B.C.2d 25, 4 B.R. 122 (Bankr. W.D. Va. 1980) (consolidation loan was a consumer debt, even though original consumer loans had been combined with corporate debt, where collateral was always used for personal family use; section should be construed liberally in favor of the debtor).

(n13)Footnote 13. See 2 *Collier on Bankruptcy*, ch. 101 (Matthew Bender); 1 *Collier Bankruptcy Manual*, ch. 101 (Matthew Bender).



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CHAPTER 25 Redemption of Property in Chapter 7 Cases

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P 25.03 Procedure for Redemption

Redemption under section 722 is accomplished by the debtor paying the lienholder the amount of the allowed claim secured by the lien. Under section 506(a), the amount of the allowed secured claim of an undersecured creditor is the value of the secured party's collateral.ⁿ¹ When the debtor and the secured creditor agree on the amount of the allowed secured claim, redemption may be accomplished by the debtor simply paying that amount to the creditor in exchange for release or satisfaction of the lien. Neither a motion to redeem nor a hearing before the court to obtain court approval of the redemption agreement is necessary, notwithstanding *Rule 6008*.ⁿ²

[1] Debtor's Motion to Redeem

When there is a dispute regarding some issue regarding redemption, the procedure is governed by *Rule 6008 of the Federal Rules of Bankruptcy Procedure*, which provides that authorization for redemption may be obtained by a motion, which initiates a contested matter.ⁿ³ This motion should generally be filed within 30 days of the first date set for the first meeting of creditors under 341(a).ⁿ⁴ For purchase money security interests in personal property, motions should be filed within 45 days of the conclusion of the first meeting of creditors.ⁿ⁵ However, these time periods are not absolute deadlines for redemption. Under section 521(a)(2)(B) and section 521(a)(6), failure to redeem property within the specified time periods may result in termination of the automatic stay with respect to that property, but should not otherwise alter the substantive rights of the debtor under the Bankruptcy Code or state law. As a result, courts may continue to allow redemption at later timesⁿ⁶ or even after the debtor's discharge.ⁿ⁷

FORMS

For forms of a motion to redeem see *Collier Consumer Bankruptcy Forms*, §§ CS21.02 and CS21.03 (Matthew Bender).

MORE INFORMATION

Procedures in contested matters are outlined in chapter 32 *infra*.

[2] Lienholder's Response to Motion

Rule 9014 does not require a response to a motion but local rules and practices vary with respect to whether a response

to a motion is required in a contested matter. However, a lienholder who opposes the debtor's proposed redemption should take the steps necessary to oppose the motion. Usually a response to the motion should be filed, detailing the issues to be raised in opposition, such as valuation, whether the debt is dischargeable, or whether the property is of the type that can be redeemed. A hearing should be requested if that is required by local rules or practice.

FORMS

For a form of response to a motion for redemption see *Collier Consumer Bankruptcy Forms, Form CS21.03-2* (Matthew Bender).

[3] Valuation of Property to be Redeemed

When there is a dispute as to value, the court must hear evidence on that issue.ⁿ⁸ Section 506(a) was amended in 2005ⁿ⁹ to further specify how certain allowed secured claims are determined. If the chapter 7 debtor is an individual, the value of personal property securing an allowed claim is to be determined based on the replacement value of the property as of the petition date, without deducting hypothetical costs of sale or marketing.ⁿ¹⁰ Section 506(a)(2) also provides that if the property was acquired for personal, family or household purposes, replacement value is defined as the price a retail merchant would charge for property of the same age and condition at the time value is determined.

These standards replace the wholesale value standard that many courts had adopted. The standard of replacement value was intended to "clarif[y] current law to specify that the value of a claim secured by personal property is the replacement value of such property without deduction of costs of sale or marketing."ⁿ¹¹ However, the replacement valuation standard in amended section 506(a)(2) is not simply the retail value stated in an industry guide. Rather, amended section 506(a) adopts the standard articulated by the Supreme Court in *Associates Commercial Corporation v. Rash* ⁿ¹² for chapter 13 cases. The Court in that case, while denying any reduction in the value for costs of sale or marketing, made clear that replacement value is not always the equivalent of the retail price one would pay, because the creditor should not receive portions of the retail price that reflect the value of items the debtor does not receive when he retains his property such as warranties, inventory storage, and reconditioning. The second sentence of section 506(a)(2), which refers to the age and condition of the property, reinforces this conclusion. Because courts have been applying the *Rash* standard in chapter 13 for a number of years since the decision, the case law under *Rash* will be instructive for future cases under section 722.

[4] Payment of Redemption Amount in Lump Sum or Installments

Once the redemption amount has been determined, section 722, as amended in 2005,ⁿ¹³ provides that redemption is to be accomplished by paying the holder of the allowed secured claim in full at the time of redemption. However, section 521(a)(2)(B) continues to give the court discretion to provide the debtor more time to pay. The two provisions can be reconciled by recognizing that the court may give the debtor additional time to accumulate the redemption amount, but it must ultimately be paid in one full payment to the creditor.

PRACTICE NOTE

An option for a debtor who cannot afford to redeem in a lump sum is to obtain financing of the lump sum. If the property is worth significantly less than the amount due on the debt, or if the debtor is delinquent on the debt, financing a redemption may be advantageous. Financing a redemption may cost less to the debtor than continuing to pay the original loan, obtaining another vehicle with a high interest loan (if credit is available), or filing a chapter 13 case, which could require payments to other creditors as well as additional fees and costs.

FOOTNOTES:

(n1)Footnote 1. S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt.

4(e)(i) (Matthew Bender); see H.R. Rep. No. 595, 95th Cong., 1st Sess. 356 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender). See ch. 19 *supra* for discussion of allowed secured claim determination.

(n2)Footnote 2. *But see In re White*, 231 B.R. 551 (Bankr. D. Vt. 1999) (upholding local General Order requiring redemption agreements to be filed); *In re Spivey*, 230 BR 484 (Bankr. E.D.N.Y. 1999) (redemption agreement must be presented to court by motion for approval under Fed. R. Bankr. P. 6008); *In re Lopez*, 40 C.B.C.2d 944, 224 BR 439 (Bankr. C.D. Cal. 1998) (same)

(n3)Footnote 3. Contested matters are governed by *Bankruptcy Rule 9014*.

(n4)Footnote 4. See 11 U.S.C. § 521(a)(2)(B), as amended and redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. See 11 U.S.C. 521(a)(6), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. *In re Eagle*, 13 C.B.C.2d 659, 51 B.R. 959 (Bankr. N.D. Ohio 1985) .

(n7)Footnote 7. *In re Hawkins*, 136 B.R. 649 (Bankr. W.D. Va. 1991) ; *In re Cassell*, 12 C.B.C.2d 769 (Bankr. E.D. Va. 1984) .

(n8)Footnote 8. *In re Van Holt*, 28 B.R. 577 (Bankr. W.D. Mo. 1983) .

(n9)Footnote 9. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n10)Footnote 10. 11 U.S.C. § 506(a)(2), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. H.R. Rep. No. 31, 109th Cong. 1st Sess., 17 (2005).

(n12)Footnote 12. 520 U.S. 953 ; 117 S. Ct. 1879 ; 138 L. Ed. 2d 148 (1997) .

(n13)Footnote 13. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 25 Redemption of Property in Chapter 7 Cases

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P 25.04 Strategies for Debtors

[1] Avoidance of Lien if Possible

When a debtor's property secures a lien, the debtor's attorney must first determine whether the lien is avoidable by the debtor. If the lien is avoidable, that is the best step for the debtor, since no money will normally have to be paid toward satisfying the lien. If the lien is not avoidable, counsel for the debtor must determine whether redemption is permitted, whether the debtor has the funds necessary to redeem, and whether redemption is the best alternative.

MORE INFORMATION

The debtor's avoiding powers are examined in chapter 18 *supra* .

[2] Redemption through Negotiation or Litigation, with or without Reaffirmation

Whether redemption is permitted is determined by applying the statutory rules discussed earlier in this chapter. If redemption is permitted, the debtor may choose to pay the allowed secured claim to free the property from the lien. In some cases, however, this may entail negotiation with the creditor about value and perhaps about payment terms.

PRACTICE NOTE

If the debt cannot be paid in a lump sum, the debtor should seek a negotiated resolution that allows installment payments and a bar on repossession as long as those installments are paid. The creditor, however, may demand reaffirmation in return for concessions on valuation or payment terms, especially if the debt is in default. In other cases, redemption may require litigation and the attendant costs if disputes cannot be resolved.

[3] Continued Payments without Reaffirmation or Redemption

Another alternative for the debtor is to simply keep paying the secured debt. This alternative may avoid the necessity of reaffirmation or chapter 13 when the debtor cannot pay the allowed secured claim in a lump sum. However, it deprives the debtor of the right to reduce the lien to the value of the collateral under section 722, so it may not be a good alternative if the property is worth far less than the debt amount.

Even when the secured creditor does not specifically agree to refrain from repossessing if payments are made, many courts held under pre-2005 law that attempts to take possession of the property after the bankruptcy petition are prohibited as long as the debtor is current in payments on the obligation.ⁿ¹ These decisions have been premised on several different grounds. Some hold that clauses creating a contractual default upon filing of a bankruptcy petition are void as contrary to the fresh start policy of the Bankruptcy Code.ⁿ² Others held that attempts to repossess are actions to coerce reaffirmation or payment of discharged debts, in violation of the automatic stay of section 362ⁿ³ or the discharge injunction of section 524.ⁿ⁴ Some of these arguments may not be available in certain cases under the 2005 amendments to sections 362 and 521.ⁿ⁵ However, many debtors may still be able to continue making payments on a secured debt without reaffirming and retain the collateral. Many creditors agree to such arrangements because they would rather have the payment stream than the vehicle, even without reaffirmation. A creditor may waive the *ipso facto* clause and its right to repossess if payments are accepted after the bankruptcy, or state law may prohibit repossessing from a debtor who is current. For example, when the debtor is current in contractual payments, there would also be possible grounds for finding the creditor in violation of the good faith requirement of the Uniform Commercial Codeⁿ⁶ or a state unfair and deceptive practices statute, especially if the creditor has arguably waived the default by accepting payments after the bankruptcy. Also, if a debtor executes a reaffirmation agreement, but it does not become effective because of creditor delay or the court's refusal to approve it, the debtor should have the right to retain the property if the debtor continues to make payments.^{n6a}

PRACTICE NOTE

If such arguments are not effective, the debtor can usually obtain relief by converting the case to a chapter 13, if the case is still pending, or by commencing a new chapter 13 case after the chapter 7 case is closed.ⁿ⁷ Once the debtor is in chapter 13, there are effective restraints on the secured creditor, as discussed elsewhere in this guide.

However, if the debtor cannot convert to chapter 13, or file a chapter 13 case, the debtor may have few practical alternatives to reaffirming the debt. In such cases, the debtor's counsel should at a minimum resist a reaffirmation for more than the current value of the collateral and should not agree to any additional charges, such as attorney's fees, being added to the debt. Alternatively, if the creditor refuses to accept a reaffirmation in the amount that the property is worth, the debtor may choose to obtain financing to pay the redemption amount. Sometimes, especially if the debtor's loan is already at a high interest rate, the most advantageous option is to retain the car for several months during the chapter 7 case, not making payments while attempting to negotiate a favorable redemption or reaffirmation and, if that fails, to buy another used vehicle at a similarly high interest rate. It may even be possible to have friends or family of the debtor go to the auction of the debtor's vehicle and purchase it for the low price at which such cars are typically sold. If the debtor insists on reaffirmation, the attorney must consider whether he or she can sign the certification that must accompany the reaffirmation.^{n7a} If the attorney does not negotiate the reaffirmation or certify that it will not be an undue hardship, and if the debtor's budget does not accommodate the reaffirmation agreement, there is a good chance the agreement will not be approved by the court. In such a case where the debtor has executed a reaffirmation agreement, as discussed above, the argument that the debtor can retain the property are stronger.

[4] Assuming the Risk of Creditor Action to Regain Collateral

A final approach, especially for appliances and items of personal property with relatively little value, is to ignore the security interest entirely and wait to see if the creditor takes postbankruptcy action to repossess. Many creditors take no such action because repossession and resale is not economical. Thus, the debtor would not pay even the redemption amount to retain the property, albeit subject to the creditor's nonenforced lien.

Moreover, debtors can be advised not to allow repossessing agents into their homes. The creditor cannot breach the peace in order to repossess. Usually, creditors who cannot achieve repossession of collateral simply give up, rather than incur the expense necessary to pursue in rem actions, like replevin, that are required in most states to force the debtor to surrender personal property. Even if the creditor institutes legal action after bankruptcy, the debtor could normally settle the matter at that time by paying the value of the property, or even reopen the bankruptcy case to redeem the property.

MORE INFORMATION

The reopening of a case is discussed in chapter 31 *infra*.

In jurisdictions in which it has been held that the debtor must either reaffirm, redeem or surrender the property under the previous version of section 521(2),ⁿ⁸, this option should still be available. Section 521(a)(2)(C) and section 521(a)(6) make clear that failure to reaffirm, redeem, or surrender may result in the termination of the automatic stay, but does not otherwise affect the debtor's substantive rights vis-à-vis the creditor.ⁿ⁹ Thus, a debtor who states an intention to surrender property is stating simply that the creditor has the right to repossess it. Nothing in the Bankruptcy Code requires the debtor to deliver the collateral to a creditor.

FOOTNOTES:

(n1)Footnote 1. *E.g.*, *Price v. Del. State Police Fed. Credit Union (In re Price)*, 370 F.3d 362 (3d Cir. 2004) ; *In re Parker*, 139 F.3d 668 (9th Cir. 1998) , *cert. denied* 119 S. Ct. 592, 142 L. Ed. 2d 535 (1998) ; *Capital Communications Fed. Cred. Union v. Boodrow*, 126 F.3d 43, 38 C.B.C.2d 1397 (2d Cir. 1997) , *cert. denied*, 522 U.S. 1117, 118 S. Ct. 1055, 140 L. Ed. 2d 118 (1998) ; *In re Belanger*, 962 F.2d 345, 36 C.B.C.2d 1429 (4th Cir. 1992) ; *Lowry Federal Credit Union v. West*, 882 F.2d 1543 (10th Cir. 1989) ; *Riggs National Bank of Washington D.C. v. Perry*, 729 F.2d 982, 10 C.B.C.2d 701 (4th Cir. 1984) . *But see In re Burr*, 160 F.3d 843, 41 C.B.C.2d 42 (1st Cir. 1998) ; *In re Taylor*, 3 F.3d 1512 (11th Cir. 1993) *Matter of Edwards*, 901 F.2d 1383, 23 C.B.C.2d 488 (7th Cir. 1990)

(n2)Footnote 2. *Riggs National Bank of Washington, D.C. v. Perry*, 729 F.2d 982, 10 C.B.C.2d 701 (4th Cir. 1984)

(n3)Footnote 3. 11 U.S.C. § 362(a). *See* ch. 8 *supra*.

(n4)Footnote 4. 11 U.S.C. § 524(a)(2). *In re Winters*, 16 C.B.C.2d 405, 69 B.R. 145 (Bankr. D. Or. 1986) ; *In re Corona*, 1 C.B.C.2d 899 (Bankr. C.D. Cal. 1986) . *See also Houghton v. Foremost Financial Services*, 724 F.2d 112 (10th Cir. 1983) (construing Bankruptcy Act; whether true purpose of replevin action is to repossess personalty or collect on a discharged debt is a question of fact precluding summary judgment).

(n5)Footnote 5. 11 U.S.C. §§ 362(h); 521(a)(2), (6), (d), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. *Uniform Commercial Code* §§ 1-203, 2-302.

(n7)Footnote 6a. *See In re Baker*, 390 B.R. 524 (Bankr. D. Del. 2008), *aff'd.*, 400 B.R. 136 (D. Del. 2009); *In re Hinson*, 352 B.R. 48 (Bankr. E.D.N.C. 2006) (stay did not terminate when debtor offered to reaffirm on original terms and creditor insisted on including attorney's fees in reaffirmation); *In re Quintero*, 2006 Bankr. LEXIS 906 (Bankr. N.D. Cal. 2006) (stay did not terminate because debtor entered into reaffirmation agreement that court later disapproved based on creditor's failure to provide required disclosures).

(n8)Footnote 7. Under section 1328(f), enacted in 2005, a discharge will not be granted in a chapter 13 case if the debtor received a discharge in a chapter 7 within the four years prior to the date of filing. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. However, the amended section 1328 does not prevent the debtor from filing a chapter 13 within four years of a chapter 7 discharge and obtaining the benefits of the automatic

stay and the ability to cure arrearages on secured claims over time.

(n9)Footnote 7a. *See P 27.02[5][a] infra*

(n10)Footnote 8. Section 521(2) was amended and redesignated § 521(a)(2) by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 9. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 25 Redemption of Property in Chapter 7 Cases

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P 25.05 Strategies for Creditors

The strategy for a creditor depends to a large degree on the value of the collateral. Realistically, if that value is small, it would not justify the costs of either litigation or repossession after bankruptcy. In that event, the creditor is fortunate to receive any amount the debtor pays on the debt. If the value is large, the creditor should take action to assure that the value will be realized.

[1] Collateral of Limited Value

Since the creditor will not normally seek to repossess collateral of minimal value, there is little the creditor can or should do with respect to debts secured by that collateral. A threat of repossession, when that threat will not be carried out, is deceptive and could be considered an unfair or deceptive practice. Since the collateral is worth little, the costs of any litigation would not be justified.

If the debtor has stated an intention to redeem or reaffirm the debt, or seeks to negotiate a redemption or reaffirmation, the creditor's attorney should obviously negotiate for the highest possible amount, and attempt to obtain a reaffirmation if the debt is to be paid in installments. The debtor's counsel may also be contacted to determine the debtor's intent if a statement of intention has not been filed. In some cases, the debtor may have been unaware of the existence of the security interest. Again, in view of the costs of litigation, it is rarely worth actually litigating about the issue of value.

[2] Motor Vehicles and Other Valuable Items

With respect to more valuable property, such as vehicles, of course, the strategy must be different. If the debtor is not complying with the terms of the contract, including payments and maintenance of any required insurance, a motion for relief from the automatic stay should be filed to obtain permission to repossess the property. Often this will lead to a settlement in which the default is cured. If the debtor is given time to cure the default or some other concession a reaffirmation of the debt can often be obtained in exchange.

The creditor may be able to threaten repossession after bankruptcy if the debt is not reaffirmed, even if the payments are current. However, this threat should not be made unless the creditor intends to carry it out, since making threats of actions that are not intended is considered a deceptive collection tactic. In many cases, especially if the loan is undersecured, the creditor is much better off continuing to receive payments on the loan than repossessing and liquidating the collateral.

In any event, it is important to determine the debtor's intentions. Usually, they are stated on the statement of intention filed with the court, which is also served on the secured creditor. If the debtor's intentions are not clear, the debtor's attorney should be contacted.



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CHAPTER 26 Dischargeability of Debts

1-26 Collier Consumer Bankruptcy Practice Guide 26.syn

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CHAPTER 26 Dischargeability of Debts

1-26 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the various exceptions to the discharge of debts in chapter 7 and chapter 13. First, the chapter discusses the differences between a chapter 7 discharge and a chapter 13 discharge. Next, there is a detailed examination of the particular exemptions applicable to each chapter. The chapter also outlines the options available to creditors in challenging the dischargeability of debts, and the procedures to be followed by a debtor who wishes to litigate the issue of dischargeability. In addition, *res judicata* and collateral estoppel effects in dischargeability cases are reviewed.



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CHAPTER 26 Dischargeability of Debts

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P 26.01 Exceptions to Discharge in Chapter 7 and Chapter 13

When an individual debtor receives a discharge in a chapter 7 or chapter 13 case, certain debts are not eliminated by that discharge. These exceptions to the discharge remain due and owing, to whatever extent they were due and owing prior to the bankruptcy case, as personal liabilities of the debtor. The general rule is that a prepetition debt is discharged unless a specific exception to the discharge provides otherwise.ⁿ¹

[1] Differences Between Chapter 7 Discharge and Chapter 13 "Full Compliance" Discharge

Prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act")^{n1a} the enhanced discharge available in a chapter 13 case after the completion of payments under the plan, sometimes known as a "superdischarge," made chapter 13 an attractive option for debtors who might otherwise have nondischargeable debts. The 2005 amendments to the Bankruptcy Code have eliminated many, though not all, of the differences between a chapter 7 discharge and a "full compliance" chapter 13 discharge. In addition to those debts described in section 523(a)(5), (8) and (9), debts that meet the requirements of section 507(a)(8)(C) or section 523(a)(1)(B), (1)(C), (2), (3), or (4) are no longer dischargeable in chapter 13 cases. Further, section 1328(a)(4), added in 2005, provides that restitution or damages awarded in a civil action as a result of willful and malicious injury by the debtor that caused personal injury to or the death of an individual are not dischargeable in chapter 13 cases.ⁿ² Long-term debts provided for under section 1322(b)(5) cure provisions and which have a final payment that is due after the last payment of the plan is due remain nondischargeable in chapter 13.ⁿ³ Additionally, as a practical matter, almost all priority debts are not dischargeable through a normal chapter 13 discharge because a plan cannot be confirmed unless it proposes to pay all priority claims in full (except when the creditor agrees otherwise or, in certain cases, the claim is a domestic support obligation owed to a governmental unit.)

Despite the new broader scope of the exceptions to discharge in a chapter 13, the differences in the dischargeability of certain debts can still be an important factor in choosing a chapter 13 rather than a chapter 7, or in a decision to convert from chapter 7 to chapter 13.ⁿ⁴

MORE INFORMATION

See chapter 4 *supra* for a discussion of the choice between chapter 7 and chapter 13.

[2] Chapter 13 Hardship Discharge

This difference between chapter 7 and chapter 13 does not exist if the debtor obtains a chapter 13 hardship discharge under *section 1328(b) of the Bankruptcy Code*. In such cases, the exceptions to discharge are the same as in chapter 7.ⁿ⁵ When a hardship discharge is obtained, however, the debtor is excused from the requirement, not present in chapter 7, that all priority debts be paid.

MORE INFORMATION

For an extensive discussion of the steps involved in obtaining a hardship discharge *see* chapter 29 *infra*.

FOOTNOTES:

(n1)Footnote 1. *But see In re Laizure*, 548 F.3d 693 (9th Cir. 2008) (when debtor's repayment of an embezzlement debt was avoided as a preference, compensating claim resulting from section 502(h) revived nondischargeability of prior debt).

(n2)Footnote 1a. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 2. The new section 1328(a)(4) category of nondischargeability in chapter 13 encompasses some, but not all of the debts that are nondischargeable in chapter 7 cases under section 523(a)(6).

(n4)Footnote 3. 11 U.S.C. § 1328(a)(1). *See P 14.04[5] supra*.

(n5)Footnote 4. *See P 4.05 supra*

(n6)Footnote 5. 11 U.S.C. § 1328(b). The hardship discharge also does not eliminate long-term debts which were to be cured under the debtor's plan. *Id.*



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CHAPTER 26 Dischargeability of Debts

1-26 Collier Consumer Bankruptcy Practice Guide P 26.02

P 26.02 Where Exceptions to Discharge Are Litigated

[1] Exceptions that May Be Raised During or After the Bankruptcy Case

The Bankruptcy Code makes an important distinction between two categories of exceptions to discharge. The first category consists of debts that are excepted from the discharge regardless of whether the issue is raised during the bankruptcy case. The exceptions falling into this category, each of which is discussed below, are those covered by subsections (a)(1), (a)(3), (a)(5), and (a)(7)-(a)(19) of *section 523 of the Bankruptcy Code*. These subsections include exceptions for taxes, debts not listed by the debtor, domestic support obligations, fines and penalties, student loans, certain debts incurred through operation of a motor vehicle, vessel or aircraft while unlawfully intoxicated, debts where a discharge was denied or waived in a prior bankruptcy, debts incurred to pay certain taxes, fines or penalties, marital property settlement debts, debts for certain condominium, cooperative or homeowner association assessments, court costs owed by prisoners, certain pension loan debts and debts arising from securities fraud. Creditors that hold claims covered by these exceptions are free to assert them against the debtor after the bankruptcy, without the permission of the bankruptcy court.ⁿ¹

[2] Exceptions that May Be Raised Only During the Bankruptcy Case

The second category of exceptions consists of debts that are excluded from the discharge only if their nondischargeability is raised and determined during the bankruptcy case. The debts that fall into this category are those specified in subsections (a)(2), (a)(4) and (a)(6) of section 523.ⁿ² These subsections deal with debts incurred by fraud, false pretenses or false financial statements, debts for fraud on the part of fiduciaries and debts for willful and malicious injuries.

FOOTNOTES:

(n1)Footnote 1. However, property claimed as exempt in the bankruptcy may not be reached by such creditors, except those who hold claims for taxes, alimony, and support. *11 U.S.C. § 522(c)*.

(n2)Footnote 2. *11 U.S.C. § 523(c)*. This provision contains an exception applicable only to agencies regulating federal depository institutions which do not have the ability to "reasonably comply" with the requirement of a timely filed complaint to determine dischargeability.



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CHAPTER 26 Dischargeability of Debts

1-26 Collier Consumer Bankruptcy Practice Guide P 26.03

P 26.03 Procedures for Creditors to Challenge Dischargeability of Debts

[1] Adversary Proceeding Required

The Rules require that a creditor raise nondischargeability issues by commencing an adversary proceeding by filing a summons and complaint.ⁿ¹ This means that the adversary proceeding rules, Rules 7001 *et seq.*, are applicable. If, for example, the summons and complaint are not served within 120 days as required by *Rule 4(j) of the Federal Rules of Civil Procedure* (made applicable by *Rule 7004(a)*) and no good cause is shown, then the complaint must be dismissed.ⁿ²

In view of the inapplicability of many of the exceptions to discharge in chapter 13, courts have ruled that there is no purpose to complaints challenging dischargeability on those inapplicable grounds in chapter 13 cases and have dismissed such complaints.ⁿ³ However, some courts have taken the presence of debts that are allegedly nondischargeable under chapter 7 into consideration in ruling upon whether the plan has been filed in good faith.ⁿ⁴

MORE INFORMATION

For a detailed discussion of procedures in adversary proceedings *see* chapter 32 *infra*.

[2] Deadline for Filing Proceeding

If the complaint raises grounds for nondischargeability that are within the exclusive jurisdiction of the bankruptcy court,ⁿ⁵ the deadline for commencing such a proceeding is 60 days after the first date set for the section 341 meeting of creditors.ⁿ⁶ The fact that the meeting of creditors is postponed has no effect on this deadline, which runs from the first date set for the meeting.ⁿ⁷ This deadline is not jurisdictional and may be waived by a failure to object to an untimely complaint.ⁿ⁸ If a case has been converted to chapter 7 from another chapter, a new time period for filing a complaint commences, unless the case had previously been a chapter 7 case and the time period had expired before conversion from chapter 7 to another chapter.ⁿ⁹

The complaint must be properly filed by the deadline.^{n9a} Mere mailing by the deadline is not sufficient.^{n9b} Nor, perhaps, is filing without paying the necessary filing fee sufficient.^{n9c}

The court gives at least 30 days' notice of this deadline, normally combined with the notice of the meeting of

creditors.ⁿ¹⁰ The deadline may be extended upon motion for cause only if such a motion is filed before the deadline passes.ⁿ¹¹ Only a creditor, and not the trustee, is a party in interest entitled to request an extension of the deadline.ⁿ¹² Such a request must set forth a specific and satisfactory explanation why the creditor is unable to file a timely complaint,ⁿ¹³ and when additional time is granted, the extension of the deadline applies only to the creditor who requested the extension.ⁿ¹⁴ The court has no discretion to extend the time limit once the deadline has passed.ⁿ¹⁵

FORMS

For Official Form 9 and a sample form of a motion to extend time for filing complaint for determination of dischargeability *see Collier Consumer Bankruptcy Forms*, § CS10.32 and Form CS13.02-1 (Matthew Bender), respectively.

If a creditor does not file a complaint alleging nondischargeability of its claim before the deadline, or any extension, and the claim is within the categories of exceptions to which the deadline applies under *section 523(c) of the Bankruptcy Code*, then the claim is permanently discharged. The debtor may then raise the deadline as a complete defense to any later dischargeability action. Even if the creditor did not receive proper notice of the deadline, it is strictly applied by the courts if the creditor had timely notice of the bankruptcy case.ⁿ¹⁶ The creditor's filing of a motion for relief from the stay or other pleading is not sufficient to put the debtor on notice of issues concerning dischargeability; therefore, the subsequent filing of a dischargeability complaint does not relate back to the date such pleading was filed.ⁿ¹⁷ Similarly, once the deadline has run, a creditor may not amend an existing complaint to raise an entirely new ground for nondischargeability.ⁿ¹⁸ Upon conversion to chapter 7, however, a new period arises for filing complaints.ⁿ¹⁹

[3] Creditor's Complaint

Like every complaint in an adversary proceeding, the creditor's dischargeability complaint must state the court's jurisdiction. Since dischargeability is a core proceeding,ⁿ²⁰ the complaint should so state. The rules of federal civil pleading generally apply, including Rule 9, incorporated in *Federal Rule of Bankruptcy Procedure 7009*, which requires fraud to be pleaded with particularity. Under that Rule, however, malice, intent, knowledge or other conditions of mind may be averred generally.

MORE INFORMATION

For a detailed discussion of complaints in adversary proceedings *see* chapter 32 *infra*.

PRACTICE NOTE

A complaint may state more than one cause of action either cumulatively or in the alternative.ⁿ²¹ A creditor should be careful, therefore, to allege every exception to discharge that might be applicable. If an exception is not raised in the original complaint, most courts will not permit it to be raised after the deadline by way of an amendment.ⁿ²²

FORMS

For sample forms of dischargeability complaints *see Collier Consumer Bankruptcy Forms*, § CS13.12 (Matthew Bender).

If there has been a prior judgment or finding of fraud, or of some other element of the discharge exception, that fact should be pleaded because there may be collateral estoppel effect.ⁿ²³

[4] Debtor's Response to Complaint

If the creditor does file a dischargeability complaint, the debtor must respond or a default judgment may be entered.ⁿ²⁴ However, a court will often require a creditor to introduce evidence before granting judgment against the debtor, even if no response has been filed.

The debtor may respond to the complaint by filing either an answer or a motion to dismiss. If the latter is filed, the debtor may argue, for example, that the creditor has not stated a cause of action, or that fraud has not been pleaded with particularity as required by *Rule 7009*.

If the debtor files an answer, the pleading rules are the same as those of the Federal Rules of Civil Procedure, which are incorporated in *Federal Rule of Bankruptcy Procedure 7008*. Denials of allegations may be general denials, but if only part of an allegation is denied, the denial should so specify and admit the remainder. Affirmative defenses must be pleaded and counterclaims may be asserted against the plaintiff. If the debtor seeks attorney's fees in the proceeding, a claim for those fees should be made.

[5] Pretrial Proceedings

Other pretrial proceedings are identical to those which would occur in a civil action in the federal district court, although some bankruptcy courts move on a faster timetable. The court may hold a pretrial conference under *Federal Rule of Bankruptcy Procedure 7016*. A motion for judgment on the pleadings or for summary judgment may be filed if appropriate.

MORE INFORMATION

Chapter 32 *infra* outlines the procedures in adversary proceedings.

PRACTICE NOTE

Discovery is also governed by the Federal Rules of Civil Procedure as incorporated in the Federal Rules of Bankruptcy Procedure.ⁿ²⁵ Discovery is often necessary to obtain all of the documents and records in the proceeding, and also to determine what witnesses exist and the substance of their likely testimony. In cases alleging fraud, depositions are often useful, because credibility is often an issue.

[6] Trial and Burden of Proof

The burden of proof at trial of an alleged exception to discharge is usually on the party seeking the exception. However, in some cases, such as the determination of undue hardship with respect to student loans, courts have allocated the burden of proof differently.ⁿ²⁶ The party with the burden of proof must meet that burden by a preponderance of the evidence.ⁿ²⁷

[7] Settlement of a Dischargeability Proceeding

Like most types of litigation, dischargeability proceedings are often resolved by compromise settlements. The debtor and creditor may agree on a part of the debt being nondischargeable and so stipulate to end the proceeding. However, a few courts have held that such a stipulation constitutes a reaffirmation of the debt and have required that the reaffirmation requirements be met.ⁿ²⁸ Because of creditor overreaching in dischargeability cases, other courts require a hearing at which some basis for a finding of nondischargeability is demonstrated before they will approve a stipulated settlement, especially in the cases of *pro se* debtors.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 7001* Although the bankruptcy court probably has jurisdiction to also enter a money judgment in such a proceeding, *Sasson v. Sokoloff*, 424 F.3d 864 (9th Cir. 2005), it usually will not do so.

(n2)Footnote 2. *In re Kirkland*, 86 F.3d 172, 36 C.B.C.2d 314 (10th Cir. 1996) (when creditor filed timely dischargeability complaint but failed to make timely service of complaint, complaint was dismissed); *In re Heinz*, 131 B.R. 38 (Bankr. D. Md. 1991) .

(n3)Footnote 3. *E.g.*, *In re Lewis*, 5 B.R. 575 (Bankr. N.D. Ga. 1980)

(n4)Footnote 4. *See P 14.06 supra* for discussion of the "good faith" question.

(n5)Footnote 5. *See P 26.02[2] supra*.

(n6)Footnote 6. *Fed. R. Bankr. P. 4007(c)*. In chapter 13 cases in which the debtor seeks a hardship discharge, a different deadline is set by the court pursuant to *Fed. R. Bankr. P. 4007(d)*. *See 9 Collier on Bankruptcy, P 4007.04* (Matthew Bender).

(n7)Footnote 7. *In re Bowman*, 800 F.2d 520, 15 C.B.C.2d 723 (5th Cir. 1986) .

(n8)Footnote 8. *Kontrick v. Ryan*, 540 U.S. 443, 124 S. Ct. 906, 157 L. Ed. 2d 867 (2004) (deadline is not jurisdictional and debtor may waive right to object to untimely complaint by failing to object to judge's order extending deadline).

(n9)Footnote 9. *Fed. R. Bankr. P. 1019(2)*.

(n10)Footnote 9a. *See In re Ryan*, 408 B.R. 143 (Bankr. N.D. Ill. 2009) (dismissal of earlier timely complaint without prejudice did not permit later untimely complaint).

(n11)Footnote 9b. *See In re Strickland*, 50 B.R. 16 (Bankr. M.D. Ala. 1985) . *But see In re Coggin*, 30 F.3d 1443 (11th Cir. 1994) (disagreeing with cases holding that motion for extension of deadline must be filed and also served by deadline); *In re Toler*, 999 F.2d 140 (6th Cir. 1993) (complaint filed before deadline was timely despite the fact that it was not accompanied by summons as required by local rules).

(n12)Footnote 9c. *See In re Smolen*, 48 B.R. 633 (Bankr. N.D. Ill. 1985) .

(n13)Footnote 10. *See 9 Collier on Bankruptcy, P 4007.04[2]* (Matthew Bender).

(n14)Footnote 11. *Fed. R. Bankr. P. 4007(c)*; *Nardei v. Maughan (In re Maughan)*, 268 B.R. 128 (B.A.P. 6th Cir. 2001) (denying extension request filed 3 days after deadline as untimely). *But see In re Kontrick*, 295 F.3d 724 (7th Cir. 2002) , *cert. granted*, *Kontrick v. Ryan*, 123 S. Ct. 1899, 155 L. Ed. 2d 824, 2003 U.S. LEXIS 3247 (U.S. 2003) (deadline subject to equitable tolling).

(n15)Footnote 12. *See 9 Collier on Bankruptcy, P 4007.04[3]* (Matthew Bender). *But see In re Brady*, 101 F.3d 1165, 37 C.B.C.2d 218 (6th Cir. 1996) (trustee had standing to seek extension of dischargeability complaint deadline on behalf of creditors).

(n16)Footnote 13. *See 9 Collier on Bankruptcy, P 4007.04[3]* (Matthew Bender).

(n17)Footnote 14. *Matter of Ichinose*, 946 F.2d 1169, 25 C.B.C.2d 1709 (5th Cir. 1991) (order extending time as to one creditor is not implicit extension of deadline as to other creditors). *But see In re Demos*, 57 F.3d 1037, 33 C.B.C.2d 1774 (creditor could rely on extension of deadline granted to trustee when extension order erroneously purported to grant extension for all creditors).

(n18)Footnote 15. *Palmer v. Nordin (In re Nordin)*, 299 B.R. 915 (B.A.P. 8th Cir. 2003) (court has no authority to grant motion to extend time if filed after deadline); *In re Hill*, 811 F.2d 484 (9th Cir. 1987) . *But see Nardei v. Maughan (In re Maughan)*, 340 F.3d 337 (6th Cir. 2003) (wrongly holding that deadline may be equitably tolled based on

debtor's behavior).

(n19)Footnote 16. *In re Moss*, 289 F.3d 540 (8th Cir. 2002) (untimely complaint accepted because untimeliness was caused by court's error); *In re Williamson*, 15 F.3d 1037 (11th Cir. 1994) (creditor did not need to receive specific notice of deadline if it had timely notice of case). *But see In re Isaacman*, 26 F.3d 629, 31 C.B.C.2d 199 (6th Cir. 1994) (creditor could file late dischargeability complaint that was within time period stated in erroneous notice from court reasonably relied upon by creditor).

(n20)Footnote 17. *Markus v. Gschwend (In re Markus)*, 313 F.3d 1146 (9th Cir. 2002) (pro se motion objecting to discharge filed within time limits did not constitute complaint because it did not meet pleading requirements); *In re Kennerley*, 995 F.2d 145 (9th Cir. 1993) (motion for relief could not be considered equivalent of dischargeability complaint or motion to extend time for filing dischargeability complaint); *Matter of McGuirt*, 879 F.2d 182 (5th Cir. 1989) (objection to dischargeability does not relate back to date of filing motion for relief).

(n21)Footnote 18. *Matter of Bercier*, 934 F.2d 689, 24 C.B.C.2d 2022 (5th Cir. 1991) .

(n22)Footnote 19. *Fed. R. Bankr. P. 1019(2)*. See 9 Collier on Bankruptcy, P 4007.04[1][b] (Matthew Bender).

(n23)Footnote 20. 28 U.S.C. 157(b)(2)(I).

(n24)Footnote 21. *Fed. R. Bankr. P. 7008*, incorporating *Fed. R. Civ. P. 8(e)*.

(n25)Footnote 22. See 9 Collier on Bankruptcy, P 4007.04[1][a], (Matthew Bender).

(n26)Footnote 23. See P 26.05 *infra*.

(n27)Footnote 24. *In re Lee*, 186 B.R. 695 (B.A.P. 9th Cir. 1995) . The court retains its usual discretion to vacate a default judgment on motion. See *In re Emmerling*, 223 B.R. 860 (B.A.P. 2d Cir. 1997) .

(n28)Footnote 25. *Fed. R. Bankr. P. 7026-7037*.

(n29)Footnote 26. See ch. 26.13 *infra* .

(n30)Footnote 27. *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755 (1991) .

(n31)Footnote 28. See ch. 27 *infra*.



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CHAPTER 26 Dischargeability of Debts

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P 26.04 Debtor's Complaint to Determine Dischargeability

[1] Cases in Which Debtor May Wish to File Dischargeability Proceeding

The Federal Rules of Bankruptcy Procedure also permit the debtor or any creditor to file a complaint to determine dischargeability of a debt.ⁿ¹ For the types of discharge exceptions that a creditor need not raise during the bankruptcy case, the debtor may file an adversary proceeding in order to have dischargeability issues settled during the bankruptcy case. The debtor may prefer to resolve dischargeability questions in the bankruptcy court, which is often a more sympathetic forum than the one later chosen by the creditor. (The debtor may also remove a later case brought by the creditor to the bankruptcy forum.)ⁿ² An action may be brought by the debtor seeking a declaratory judgment that a particular debt is dischargeable and an injunction against it being collected. Such a complaint would not be governed by the deadline discussed above, which is applicable only to those dischargeability complaints that must be filed in the bankruptcy court under *section 523(c) of the Bankruptcy Code*. A dischargeability complaint against a state is not barred by the *Eleventh Amendment* because it is within the bankruptcy court's *in rem* jurisdiction.ⁿ³

For some situations in which dischargeability under the Bankruptcy Code is relatively clear (such as certain tax debts to which a time period applies), such a complaint may not be necessary. The debtor may be able to agree with the creditor that the debt is dischargeable so that problems do not arise after the close of the case. An exchange of letters, a stipulation, or a consent order can be useful tools to create a record that will resolve future questions.

Another possibility is to defer the question of dischargeability and to have it resolved later if collection activity is commenced. The discharge can then be interposed as a defense to repayment in the non-bankruptcy forum (or the bankruptcy case can be reopened to address the issue). One advantage of this strategy is that it avoids unnecessary litigation when the creditor is unlikely to commence future collection activities. On the other hand, failure to resolve questions about dischargeability during the bankruptcy creates uncertainty about the scope of the discharge which can seriously undermine the effectiveness of the debtor's fresh start.

[2] Procedure on Debtor's Complaint

Like a creditor's dischargeability complaint, a proceeding filed by a debtor to determine dischargeability must be filed as an adversary proceeding. The procedures to be followed are the same as those followed when a creditor files a dischargeability complaint.ⁿ⁴

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 4007(a)*. See 9 *Collier on Bankruptcy*, P 4007.02 (Matthew Bender).

(n2)Footnote 2. See 1 *Collier on Bankruptcy*, P 3.07 (Matthew Bender), 1 *Collier Bankruptcy Manual*, P 3.07 (Matthew Bender) for discussion of removing matters within the federal courts' bankruptcy jurisdiction.

(n3)Footnote 3. *Tenn. Student Assistance Corp. v. Hood*, 124 S. Ct. 1905, 158 L. Ed. 2d 764, 2004 U.S. LEXIS 3387 (2004) .

(n4)Footnote 4. See P 26.03 *supra*.



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CHAPTER 26 Dischargeability of Debts

1-26 Collier Consumer Bankruptcy Practice Guide P 26.05

P 26.05 *Res Judicata* and Collateral Estoppel in Dischargeability Cases.

One of the more disputed issues in dischargeability litigation has been the extent to which prior state court judgments are binding upon the parties in bankruptcy court through *res judicata* or collateral estoppel.ⁿ¹ At least some of the questions repeatedly raised in this area have been addressed by the Supreme Court.

[1] Prior Judgment with No Finding on Issue Central to Dischargeability

In *Brown v. Felsen*,ⁿ² the debtor had entered into a judgment by stipulation in state court, and thereafter filed a bankruptcy case. The creditor then alleged that the debt was incurred through fraud, deceit, and malicious conversion, which would make it nondischargeable. The lower courts, following the rule in the Tenth Circuit, held that the state court stipulation and judgment did not mention fraud and that the bankruptcy court could not go beyond that state court record. Therefore, they held the debt was dischargeable.

The Supreme Court reversed, stating that a creditor should not be required to litigate issues of possible fraud in every state court collection suit just to guard against discharge in a possible later bankruptcy. The Court found that this would frustrate Congressional policy which intended the bankruptcy court to handle dischargeability issues, and held that when the debtor adds the new element of bankruptcy to a dispute, the creditor should then have an opportunity to respond by raising dischargeability. Thus, the bankruptcy court was instructed to go outside the state court record to hear evidence on the issue of dischargeability.

Brown v. Felsen thereby resolved the question of what to do when a fraud claim had been raised, but not actually litigated or resolved, in prior state litigation. Bankruptcy courts have since had little problem following its holding in that situation.ⁿ³

[2] Default Judgment on Issue Central to Dischargeability

Slightly different than *Brown* is the case in which the creditor pleaded all of the elements that would give rise to nondischargeability and then obtained a default judgment in state court. Does *res judicata* apply in this situation? The courts have held it does not, based upon *Brown v. Felsen*.ⁿ⁴ *Res judicata* is inapplicable because the dischargeability cause of action is separate and distinct from any state law cause of action.ⁿ⁵ Moreover, Congress intended the dischargeability cause of action to be decided (for certain types of nondischargeability complaints) only in the bankruptcy courts.ⁿ⁶

Nor does a default judgment normally give rise to collateral estoppel (sometimes known as "issue preclusion") on issues pleaded in the plaintiff's complaint. Most courts hold that collateral estoppel has no applicability if the fraud issue was not actually litigated, *i.e.*, if a default judgment was obtained.ⁿ⁷ However, the effect of a prior judgment has generally been held to depend on the law of the state in which it was entered. Thus, some courts have given collateral estoppel effect to the facts necessary to a default judgment,ⁿ⁸ or to a judgment entered as a discovery sanction.ⁿ⁹

[3] Facts Actually Litigated in Prior Action

The final possibility is the case in which the factual issues necessary to establish a nondischargeable debt were raised, actually litigated and determined in the state court. There the question is whether collateral estoppel, which normally precludes relitigation of factual issues actually litigated and necessarily decided in a prior case, should be applicable to dischargeability cases.

A unanimous Supreme Court answered this question in *Grogan v. Garner*,ⁿ¹⁰ holding that collateral estoppel can be applied to permit creditors, who have successfully reduced fraud claims to judgment, to exempt those claims from discharge.ⁿ¹¹ Consequently, collateral estoppel applies when a creditor can produce a record from a nonbankruptcy court proceeding establishing fraud or willful and malicious injury.ⁿ¹² Similarly, collateral estoppel can apply against a creditor when an issue such as the debtor's malice has been actually litigated and decided in the debtor's favor.ⁿ¹³

The party seeking collateral estoppel has the burden of making an evidentiary record sufficient to establish that collateral estoppel applies.ⁿ¹⁴ This normally requires filing the relevant aspects of the non-bankruptcy court record with the bankruptcy court, generally by attaching certified copies to the dischargeability complaint or to a motion for summary judgment. Moreover, for a prior judgment to preclude litigation of dischargeability, all of the elements necessary to the nondischargeability cause of action must have also been necessary to the prior cause of action. If the prior proceeding did not require proof of all of the elements necessary to obtain a judgment that a debt is nondischargeable, the creditor must prove those elements in the court deciding the dischargeability proceeding.ⁿ¹⁵

It is not clear whether stipulated facts can even be the basis for collateral estoppel. To the extent such facts are incorporated in a judgment, courts may deem them to be the equivalent of litigated findings of fact. However, a bankruptcy court (or other court deciding issues of dischargeability) is not bound by a stipulation made prior to the commencement of a case under the Bankruptcy Code that a debt will not be dischargeable in bankruptcy.ⁿ¹⁶

[4] New Cause of Action Based upon Facts Supporting Previously Litigated Claim

Whether a creditor can bring a claim based on a whole new cause of action on the same facts supporting a previously litigated dischargeable claim is unclear. That claim is probably barred by *res judicata* when it arises from a common nucleus of operative facts as the actually litigated claims.ⁿ¹⁷

[5] Cases in Which Underlying Liability Is Disputed

A different problem sometimes arises in cases in which the creditor has not yet obtained a judgment on the alleged claim. Obviously, if the claim is not valid in the first place, then the courts need not reach the dischargeability issue. Generally, this means that the court must first decide whether the debt exists, and then determine whether it is dischargeable. While it is clear that bankruptcy courts have jurisdiction to do this, they will occasionally let previously filed proceedings in other courts proceed to their conclusion (at least if they are not removed to bankruptcy court).ⁿ¹⁸

Although *Grogan v. Garner*ⁿ¹⁹ holds that the preponderance of the evidence standard is applicable to determine nondischargeability in bankruptcy, presumably if a higher evidentiary standard is applicable under state law to establish the debt, *e.g.*, a debt for fraud, that higher standard is also applicable to that question if it arises in bankruptcy court. If

the case is tried in the bankruptcy court, any right to jury trial the debtor has on the issue of liability is preserved and a jury may be demanded in that court.ⁿ²⁰

[6] Prior Determination of Dischargeability

Finally, res judicata principles apply when a court has made a postpetition determination of whether a debt was discharged in a case under the Bankruptcy Code. Except for debts made nondischargeable by sections 523(a)(2), (4) and (6), state courts have concurrent jurisdiction to make dischargeability determinations after a Code case has been commenced. Once a state court has found a debt to be dischargeable or nondischargeable, that judgment cannot be challenged in the bankruptcy court.ⁿ²¹ Therefore, if a debtor is concerned that the state court may not fully comprehend the nuances of bankruptcy law, the debtor may wish to remove the proceeding to the bankruptcy court before a judgment is entered.ⁿ²²

[7] Prebankruptcy Settlement Agreement on Claim

The Supreme Court has held, in *Archer v. Warner*, that ordinarily a settlement of a fraud case that substitutes a new contractual obligation does not eliminate the ability to claim the underlying debt is nondischargeable due to fraud.ⁿ²³ The Court did leave open the possibility that a creditor could be precluded from bringing such a claim if the settlement included a promise that the creditor would not make a claim of nondischargeability for fraud.ⁿ²⁴ The principles of *Archer* are likely to be applied to other types of dischargeability actions as well, so that debtors and creditors should pay close attention to the language of agreements settling potentially nondischargeable debts, and debtors should bear in mind the possibility that any debt under the settlement agreement may well be nondischargeable if the original debt was nondischargeable.

FOOTNOTES:

(n1)Footnote 1. See 4 *Collier on Bankruptcy*, P 523.06 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.05 (Matthew Bender).

(n2)Footnote 2. 442 U.S. 127, 99 S. Ct. 2205, 60 L. Ed. 2d 767 (1979) .

(n3)Footnote 3. See, e.g., *In re Daley*, 776 F.2d 834, 13 C.B.C.2d 927 (9th Cir. 1985) , cert. denied, 476 U.S. 1159, 106 S. Ct. 2279, 90 L. Ed. 2d 721 (1986) (a stipulated dismissal of state court fraud claims did not bar dischargeability action).

(n4)Footnote 4. See, e.g., *In re Eskenazi*, 3 C.B.C.2d 20, 22, 6 B.R. 366, 368 (B.A.P. 9th Cir. 1980) .

(n5)Footnote 5. *In re Rahm*, 641 F.2d 755 (9th Cir. 1981) ; *In re McKenna*, 4 B.R. 160 (Bankr. N.D. Ill. 1980) ; *In re Richards*, 7 B.R. 711 (Bankr. S.D. Fla. 1980) . See also *In re Gibbs*, 107 B.R. 492 (Bankr. D.N.J. 1989) (consent judgment entered in district court prior to bankruptcy which included provision that debt would be nondischargeable is not res judicata, because district court lacked subject matter jurisdiction over bankruptcy issue before bankruptcy was filed).

(n6)Footnote 6. *In re Shuler*, 722 F.2d 1253, 10 C.B.C.2d 101 (5th Cir. 1984) .

(n7)Footnote 7. See 4 *Collier on Bankruptcy*, P 523.06 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.05 (Matthew Bender). See also *Sartin v. Macik*, 535 F.3d 284 (4th Cir. 2008) (default judgment does not have collateral estoppel effect under North Carolina law); *In re Palmer*, 207 F.3d 566 (9th Cir. 2000) (finding in adverse judgment of tax court based on facts deemed admitted because debtor did not respond to allegations that did not have preclusive effect).

(n8)Footnote 8. *In re Catt*, 368 F.3d 789 (7th Cir. 2004) (default judgment had collateral estoppel effect under Indiana law); *In re Nourbakhsh*, 67 F.3d 798 (9th Cir. 1995) . See also *Garner*, 56 F.3d 677, 33 C.B.C.2d 1449 (5th

Cir. 1995) (defendant answered complaint but failed to appear for trial).

(n9)Footnote 9. *In re Daily*, 47 F.3d 365, 32 C.B.C.2d 2023 (9th Cir. 1995) ; *In re Bush*, 62 F.3d 1319, 34 C.B.C.2d 243 (11th Cir. 1995) .

(n10)Footnote 10. 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755, 24 C.B.C.2d 1 (1991) .

(n11)Footnote 11. *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755, 24 C.B.C.2d 1 (1991) .

(n12)Footnote 12. *E.g.*, *Siemer v. Nangle* (*In re Nangle*), 274 F.3d 481 (8th Cir. 2001) (prior court orders and jury verdict could only be interpreted as having found debtor's acts to be willful and malicious); *In re McNallen*, 62 F.3d 619 (4th Cir. 1995) ; *In re Lacy*, 947 F.2d 1276 (5th Cir. 1991) (debtor's misrepresentations established in state court proceedings).

(n13)Footnote 13. *E.g.*, *Recoverededge L.P. v. Pentecost*, 44 F.3d 1284 (5th Cir. 1995) (creditor could not assert under section 523(a)(2) that debtor committed fraud after judgment in earlier action that had been entered on all of creditor's claims except fraud claim).

(n14)Footnote 14. *See In re Baylis*, 217 F.3d 66 (1st Cir. 2000) (state court judgment did not have preclusive effect on issue of bad faith because under Massachusetts law a finding must have been essential to a judgment to have preclusive effect, and alternative grounds for judgment not ruled upon in final appellate review were not essential to judgment); *Pancake*, 106 F.3d 1242 (5th Cir. 1997) (collateral estoppel did not apply because creditor failed to present evidence that the state court held a hearing to determine facts upon entering uncontested judgment).

(n15)Footnote 15. *See Miller*, 156 F.3d 598 (5th Cir. 1998) (state court judgment did not have collateral estoppel effect in dischargeability action for embezzlement or willful and malicious injury because state cause of action required fewer elements to be proved; conversely, state court verdict for debtor on issue of fiduciary fraud precluded proceeding claiming fraud as a fiduciary, since elements of dischargeability claim were more demanding than state court claim).

(n16)Footnote 16. *In re Cole*, 40 C.B.C.2d 1482, 226 B.R. 647 (Bankr. 9th Cir. 1998) . *But see Saler v. Saler*, 217 B.R. 166 (E.D.Pa. 1998) (stipulation in earlier chapter 7 case that debt was not dischargeable given preclusive effect in later chapter 7 case).

(n17)Footnote 17. *But see In re Keller*, 106 B.R. 639 (B.A.P. 9th Cir. 1989) (creditor not precluded from arguing that debt was based on willful and malicious conduct where only negligence was pleaded and tried in state court proceeding).

(n18)Footnote 18. *In re Harris*, 3 C.B.C.2d 189, 7 B.R. 284 (Bankr. S.D. Fla. 1980) . *See also In re Wardrobe*, 559 F.3d 932 (9th Cir. 2009) (relief from stay order only permitted creditor to pursue claims pending at time relief was granted, so judgment on fraud claim added after relief from stay was granted was not valid and did not have preclusive effect on dischargeability issue).

(n19)Footnote 19. 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755 (1991) .

(n20)Footnote 20. 28 U.S.C. § 1411. However, any jury trial may have to be conducted in the district court. *See 1 Collier on Bankruptcy*, P 3.08 (Matthew Bender); *1 Collier Bankruptcy Manual*, P 3.08 (Matthew Bender).

(n21)Footnote 21. *Swate*, 99 F.3d 1282 (5th Cir. 1996) (state court determination that support debt was nondischargeable after debtor's first bankruptcy case given res judicata effect in second bankruptcy case). *See also In re Goetzman*, 91 F.3d 1173 (9th Cir. 1996) (Rooker-Feldman doctrine prevents relitigation of questions related to discharge resolved by state court foreclosure judgment).

(n22)Footnote 22. For discussion of removal procedures *see 1 Collier Bankruptcy Manual* P 3.07 (Matthew

Bender).

(n23)Footnote 23. 538 U.S. 314, 123 S. Ct. 1462, 155 L. Ed. 2d 454 (2003) . See also *Giaimo v. DeTrano* (*In re Detrano*), 326 F.3d 319 (2d Cir. 2003) .

(n24)Footnote 24. *Id.* at 123 S. Ct. 1462, 155 L. Ed. 2d 454 .



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CHAPTER 26 Dischargeability of Debts

1-26 Collier Consumer Bankruptcy Practice Guide P 26.06

P 26.06 Exception to Discharge for Taxes; § 523(a)(1), § 1328(a)(2)

[1] Taxes that Cannot Be Discharged

Taxes are the debts that are most frequently nondischargeable in bankruptcy cases. However, it is important to realize that not all taxes are nondischargeable. It is also important to remember that, as with any other debt, even if a tax is discharged, liens based on the underlying debt may remain legally enforceable *in rem* claims.ⁿ¹

FORMS

For forms of a complaint and answer in a tax dischargeability proceeding see *Collier Consumer Bankruptcy Forms*, § CS13.12 (Matthew Bender).

A rather complicated series of cross-references within the Bankruptcy Code² can be followed to the conclusion that, basically,ⁿ³ only the types of taxes listed below are not discharged in consumer cases:ⁿ⁴

- any tax for which a return, equivalent report or notice if required, was not filed,ⁿ⁵ for which a fraudulent return was filed, or for which the debtor attempted to evade;ⁿ⁶
- any tax with respect to which a late return notice, or report was filed or given within two years before the date of filing of the bankruptcy;ⁿ⁷
- taxes on income or gross receipts
 - (a) for which a return, if required, was last due within three years of the filing of the bankruptcy,ⁿ⁸ or
 - (b) assessed within 240 days before filing of the bankruptcy,ⁿ⁹ or

- (c) not yet assessed, but assessable after filing of the bankruptcy;ⁿ¹⁰
 - property taxes incurred before commencement of the case and last payable without penalty less than one year before filing of the bankruptcy;ⁿ¹¹
 - excise taxesⁿ¹²
-
- (a) on transactions as to which a return was required and last due less than three years before the bankruptcy, or
 - (b) on transactions, as to which no return was required, which occurred less than three years before the bankruptcy;
 - taxes required to be collected or withheld by the debtor, such as employment "trust fund" taxes (income taxes and FICA withholding) or sales taxes.ⁿ¹³

Erroneous refunds of nondischargeable taxes are similarly nondischargeable.ⁿ¹⁴ And in limited situations, a party who has paid the tax claim of the debtor may become subrogated to the claim and eligible for the same priority and treatment related to dischargeability.ⁿ¹⁵

Of course, the debtor may challenge the initial assessment of a tax and argue that the tax that is claimed is not owed. There may be issues regarding whether the debtor is a "responsible person" subject to the penalty for a business' failure to remit taxes withheld from employee wages or the debtor may claim the status of an "innocent spouse" who was unaware of deficiencies in a joint return.

[a] Penalties and Interest on Nondischargeable Taxes

Any penalties related to the taxes listed above are also nondischargeable, unless the penalty is solely punitive in nature or relates to a transaction that occurred more than three years before the filing of the petition.ⁿ¹⁶ The treatment of interest is not as clear, but some courts have held that it is dischargeable.ⁿ¹⁷ However, postpetition interest on nondischargeable tax debts is clearly nondischargeable.ⁿ¹⁸

[b] Is the Debt a Tax?

Occasionally, it is not altogether clear whether a particular debt to a governmental entity is a tax subject to these provisions. Courts consider the debt's inherent characteristics, especially whether, or how closely, it is related to a debtor's voluntary use of a service, rather than assessed regardless of the debtor's actions. Thus, when a charge is assessed only when services are used, in proportion to their use, that charge is not a tax.ⁿ¹⁹ Similarly, if the charge is exacted as punishment for an unlawful act or omission, such as early withdrawal of IRA funds, it is a penalty and not a tax.ⁿ²⁰ On the other hand, revenue collected on an *ad valorem* basis from all property holders or for a purpose that confers no particular benefit on the payer would be considered a tax.ⁿ²¹

In addition, even if a tax is an excise tax, it must be an excise tax "on a transaction" to fall under *section 507(a)(8)(E) of the Bankruptcy Code*. Thus, an occupation tax is dischargeable despite the fact that it may be an excise tax, because it is not a tax on a transaction.ⁿ²²

[2] Analyzing Tax Debts to Determine Dischargeability

In view of the relative intricacy of these provisions, it is always wise to check each particular fact situation against the Bankruptcy Code itself. In some cases, when significant amounts of money are involved, it may pay to delay filing until one or more of the time periods listed above has expired. For the purpose of calculating time limits under the various provisions, taxes are found to be payable from the date the relevant tax return is due rather than the date on which quarterly estimated payments are required.ⁿ²³ It should also be remembered that, since taxes in many of the categories listed above are priority claims, a chapter 13 plan must normally provide for their full payment.ⁿ²⁴

PRACTICE NOTE

In analyzing federal income tax debts, it is important to have all the facts, including precise dates, so that the relevant time periods can be calculated accurately. The procedure for obtaining tax information from the Internal Revenue Service is discussed earlier in this guide.ⁿ²⁵ Once counsel obtains the necessary information, the claim for each tax year must be separately analyzed.

[a] Is Tax Claim a Secured Claim?

First, is there a lien securing the claim? If so, to the extent that the lien is not undersecured and is properly recorded, the tax claim (including interest and penalties) is an allowed secured claim.ⁿ²⁶ The lien will probably not be eliminated in chapter 7, even if the tax is dischargeable,ⁿ²⁷ although a lien for penalties may be avoidable under section 724(a).

MORE INFORMATION

The avoidance of tax liens is examined in chapters 17 and 18 *supra*.

In chapter 13, a tax claim is not a priority claim to the extent it is an allowed secured claim. Therefore, a tax claim is not subject to the requirement of section 1322(a)(2) of payment in full. However, if the plan provides for the claim, the taxing authority is entitled to demand the present value of its allowed secured claim under section 1325(a)(5)(B)(ii).ⁿ²⁸ If the plan does not provide for the secured claim, the taxing authority may seek relief from the automatic stay.ⁿ²⁹

[b] Income Tax Dischargeability

If the debtor filed a tax return, the debt is dischargeable in chapter 7 if all of the following are true:

- the return was filed on time, or the return was filed late, but more than two years before the bankruptcy;
- the tax is not a priority claim (see below); and
- the debtor did not willfully evade taxes.

An unsecured tax claim for which a return has not been filed is never dischargeable in chapter 7. Similarly, tax debts for which a return was not filed, for which a late return was filed within two years before the date of filing the bankruptcy, or with respect to which the debtor made a fraudulent return or attempted to evade such tax are not dischargeable in chapter 13.ⁿ³⁰ However, some priority tax debts described in section 507(a)(8) remain dischargeable in chapter 13.ⁿ³¹

[c] Determining Priority Status

Whether the claim is a priority claim depends upon when the debtor's tax return was last due and when the tax was last assessable.

The tax debt is a priority claim if the tax return was last due less than three years before the date of the petition. The due date of the return is normally April 15 (but occasionally the 16th or 17th if the 15th is on a weekend) of the year after the tax year. However, if the debtor obtained an extension, the due date would be the extended deadline. Also, the time period is tolled during the pendency of any type of legally mandated collection stay under bankruptcy or nonbankruptcy law, plus an additional 90 days.ⁿ³²

A tax debt also is a priority debt if it was assessed within 240 days before the petition, or is assessable after the commencement of the case. Federal income tax is assessed on the date the IRS notifies the taxpayer of a tax claim, or perhaps, on the earlier date that an assessment officer signs a summary record of assessment (Form 23-C).ⁿ³³ The date of the assessment is normally stated on the IRS transcript and when a return is timely filed it is normally around the time of the return. An assessment may be made within three yearsⁿ³⁴ of when a return is filed or of the last day the return was due, whichever was later.

PRACTICE NOTE

If an amended tax return is filed, a new 240 period begins to run for additional taxes assessed. Therefore, if a tax is not otherwise a priority tax, and is dischargeable, no return or amended return should be filed before the bankruptcy case is filed, since it will trigger a new assessment period.

On the other hand, if the tax is nondischargeable, perhaps because no return was previously filed, it may make sense to file a return before filing the bankruptcy petition to trigger an assessment period making the tax a priority claim. It then can be paid before other unsecured claims in the chapter 13 case, allowing the debtor to devote postpetition funds to paying off a debt that would not be discharged.

The assessment time period does not begin to run when a substitute return is filed by the IRS. The 240 days is extended by the time during which an offer in compromise made after the assessmentⁿ³⁵ is pending or in effect during that 240-day period, plus 30 days.ⁿ³⁶ If the debtor was in a prior bankruptcy case, it is also extended by the time that case was pending, assuming the automatic stay was in effect for that period.ⁿ³⁷

[d] Categorizing the Claims

Once each year's taxes, interest and penalties are analyzed, they may be categorized as allowed secured claims, unsecured priority claims, nondischargeable claims (which overlap with priority claims), and unsecured claims that are dischargeable in chapter 7. The debtor's counsel can then compute the amounts that would not be discharged in chapter 7 or chapter 13 and the amounts that would have to be paid in a chapter 13 case, in order to decide which chapter offers the greatest benefit.

FOOTNOTES:

(n1)Footnote 1. *In re Isom*, 901 F.2d 744 (9th Cir. 1990) .

(n2)Footnote 2. Section 523(a)(1) refers to section 507(a)(3) and 507(a)(8), the former of which refers in turn to section 502(f).

(n3)Footnote 3. Not included in the list are some "gap" tax claims arising in involuntary cases, which are provided for in 11 U.S.C. § 502(f). There are special provisions dealing with cases where there has been an offer of compromise (11 U.S.C. § 507(a)(8)(A)(ii)) taxes to be withheld by employers or paid by employers on priority wages (11 U.S.C. §

507(a)(8)(C), (D)), and certain unpaid customs duties (11 U.S.C. § 507(a)(8)(F)). Also not included are sales taxes which are to be collected by some business debtors. *See In re Shank*, 792 F.2d 829 (9th Cir. 1986).

(n4)Footnote 4. For detailed discussion of taxes that are not dischargeable *See* 15 Collier on Bankruptcy, TX4.02 (Matthew Bender).

(n5)Footnote 5. Under the 2005 amendments to the Bankruptcy Code, the dischargeability of a debtor's tax liability based upon substitute returns prepared by the IRS (or state or local taxing authority) may depend on the process which resulted in the filing of the returns. *See* 11 U.S.C. § 523(a), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. For example, if the debtor discloses all necessary information to the IRS and then executes a return prepared by the IRS, such a return satisfies the requirements for a "return." *See* 26 U.S.C. § 6020(a). However, if the debtor fails to make a return and the IRS creates a return based upon its knowledge and other information obtained, such a substitute return is not considered a "return" for purposes of section 523. *See* 26 U.S.C. § 6020(b).

(n6)Footnote 6. 11 U.S.C. § 523(a)(1)(B)(i),(C). *Cassidy v. C.I.R.*, 814 F.2d 477 (7th Cir. 1987). *See generally In re Griffith*, 206 F.3d 1389 (11th Cir. 2000) (en banc), cert. denied, 531 U.S. 826, 121 S. Ct. 73, 148 L. Ed. 2d 37 (2000) (exception applies where the debtor engaged in affirmative acts seeking to evade or defeat collection of taxes); *but see United States*, 118 F.3d 979, 38 C.B.C.2d 451 (3d Cir. 1997) (debtor who knew he had duty to file returns, had the wherewithal to pay the taxes due, and intentionally failed to do so, held to have evaded taxes)

(n7)Footnote 7. 11 U.S.C. § 523(a)(1)(B)(ii), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 8. The tolling principle established by the Supreme Court in *Young v. United States*, 535 U.S. 43, 122 S. Ct. 1036, 152 L. Ed. 2d 79 (2002) has been codified and expanded by the 2005 amendments to the Bankruptcy Code. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Section 507(a)(8) provides that priority lookback time period in section 507(a)(8) is statutorily tolled during the pendency of any type of legally mandated collection stay under bankruptcy or nonbankruptcy law, plus an additional 90 days. Similarly, section 507(a)(8)(A)(ii) expressly provides that the 240-day period is tolled during the pendency of a stay of collection during a prior bankruptcy case plus an additional 90 days. *See* 2 Collier on Bankruptcy, P 108.04[3] (Matthew Bender); 1 Collier Bankruptcy Manual, P 108.04[3] (Matthew Bender).

(n9)Footnote 9. *See In re O'Connell*, 246 B.R. 332 (B.A.P. 8th Cir. 2000) (state law definition of assessment was not dispositive of when tax was assessed under section 507(a)(8)(A)); *In re King*, 122 B.R. 383 (B.A.P. 9th Cir. 1991) (date of assessment depends on specific tax code and practices involved).

(n10)Footnote 10. 11 U.S.C. § 523(a)(1)(A), incorporating 11 U.S.C. § 507(a)(8)(A), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. 11 U.S.C. § 523(a)(1)(A), incorporating 11 U.S.C. § 507(a)(8)(B), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Some property taxes may acquire lien status. When they do, they no longer constitute priority debts, nor are they nondischargeable under section 523(a)(1). However, the lien associated with the debt, if unpaid or unavowed, will pass through the bankruptcy unaffected. The penalty necessary to place a tax outside this exception need not be solely a monetary one. *In re South Shore Vending, Inc.*, 25 B.R. 111 (Bankr. D. Mass. 1982) (issuance of a warrant to sell property constitutes a penalty).

(n12)Footnote 12. 11 U.S.C. § 523(a)(1)(A), incorporating 11 U.S.C. § 507(a)(8)(E). A tax may be an excise tax in some circumstances even if it is measured by gross receipts. *In re Groetken*, 843 F.2d 1007 (7th Cir. 1988) (Illinois retailer's occupation tax). *See also In re Grynberg*, 986 F.2d 367 (10th Cir. 1993) (gift taxes were excise taxes). *In re Marcucci*, 256 B.R. 685 (D.N.J. 2000) (New Jersey vehicle insurance discharge debt was not an excise tax).

(n13)Footnote 13. 11 U.S.C. § 523(a)(1)(A), incorporating 11 U.S.C. § 507(a)(8)(C). Although such taxes are usually owed by businesses, consumers who have employed others, or who were previously in business may have liabilities for such taxes. A debtor may request that the bankruptcy court determine whether there is a liability for withholding taxes as a "responsible person" with respect to a business with which the debtor has been affiliated. See, e.g., *Adams v. Coveney*, 162 F.3d 23 (1st Cir. 1998) .

(n14)Footnote 14. *Bleak v. United States*, 817 F.2d 1368 (9th Cir. 1987) .

(n15)Footnote 15. See *Matter of Fields*, 926 F.2d 501 (5th Cir. 1991) ; *Western Surety Co. v. Waite*, 698 F.2d 1177, 8 C.B.C.2d 619 (11th Cir. 1983) .

(n16)Footnote 16. 11 U.S.C. § 523(a)(1)(A), incorporating 11 U.S.C. § 507(a)(8)(G); 11 U.S.C. § 726(a)(4). *Cassidy v. C.I.R.*, 814 F.2d 477 (7th Cir. 1987) . See also *McKay v. United States*, 957 F.2d 689 (9th Cir. 1992) (penalties relating to transactions more than three years old are dischargeable even if underlying taxes are not). See 15 Collier on Bankruptcy, TX4.05-4.06 (Matthew Bender).

(n17)Footnote 17. Compare *In re Razorback Ready-Mix Concrete Co.*, 12 C.B.C.2d 221, 45 B.R. 917 (Bankr. E.D. Ark. 1984) with *In re Reich*, 15 C.B.C.2d 1055, 66 B.R. 554 (Bankr. D. Colo. 1986) . The Seventh Circuit has concluded, however, that prepetition interest on a nondischargeable tax liability is nondischargeable. *In re Larson*, 862 F.2d 112 (7th Cir. 1988) .

(n18)Footnote 18. *In re Fullmer*, 962 F.2d 1463, 27 C.B.C.2d 92 (10th Cir. 1992) ; *In re Burns*, 887 F.2d 1541, 21 C.B.C.2d 1237 (11th Cir. 1989) ; *In re Hanna*, 872 F.2d 829 (8th Cir. 1989) ; *In re Irvin*, 129 B.R. 187 (W.D. Mo. 1990) (liability for postpetition interest survives bankruptcy even though prepetition claim was fully paid by estate). See also *Bruning v. United States*, 376 U.S. 358 (1964) .

(n19)Footnote 19. *In re Jenny Lynn Mining Co.*, 780 F.2d 585 (6th Cir. 1986) ; *In re Lorber Industries of California*, 675 F.2d 1062 (9th Cir. 1982) .

(n20)Footnote 20. *United States v. Reorganized CF&I Fabricators*, 518 U.S. 2106, 518 U.S. 213, 116 S. Ct. 2106, 135 L. Ed. 2d 506 (1996) (exaction imposed upon employer that fails to correct pension plan deficiency was a penalty, not an excise tax); *In re Cespedes*, 393 B.R. 403 (Bankr. E.D.N.C. 2008) (penalty on early IRA withdrawal was not an excise tax).

(n21)Footnote 21. E.g., *In re Dietz*, 914 F.2d 161, 23 C.B.C.2d 1006 (9th Cir. 1990) (assessment imposed by Virginia on individuals for operating uninsured vehicle is involuntary pecuniary burden and thus nondischargeable, excise tax; however, a separate service fee was intended to defray administrative costs and was not excluded from discharge).

(n22)Footnote 22. *In re Templar*, 170 B.R. 562 (Bankr. M.D. Pa. 1994) .

(n23)Footnote 23. *In re Ripley*, 926 F.2d 440 (5th Cir. 1991) . But see *In re Joye*, 2009 U.S. App. LEXIS 18841 (9th Cir. Aug. 21, 2009) (taxes incurred before petition were claims that were dischargeable even if they were not payable until after petition).

(n24)Footnote 24. 11 U.S.C. § 1322(a)(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See P 14.07 *supra*. The holders of such tax claims may agree to different treatment. Also, full payment is not required if the claim is not filed by the creditor. *Id.*

(n25)Footnote 25. See ch. 3 *supra*.

(n26)Footnote 26. See 15 Collier on Bankruptcy, TX4.04[5] (Matthew Bender).

(n27)Footnote 27. If the tax is dischargeable, the lien cannot attach to after-acquired property, however. *Dishong*, 35 C.B.C.2d 223, 188 B.R. 51 (Bankr. M.D. Fla. 1995) .

(n28)Footnote 28. See ch. 14 *supra*.

(n29)Footnote 29. See ch. 14 *supra*

(n30)Footnote 30. 11 U.S.C. § 1328(a)(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n31)Footnote 31. Of the priority tax debts provided for in section 507(8)(C), section 1328(a)(2) only makes those debts of the kind specified in 507(a)(8)(C) nondischargeable in chapter 13.

(n32)Footnote 32. 11 U.S.C. § 507(a)(8), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n33)Footnote 33. IRS Reg. 301.6203-1.

(n34)Footnote 34. The period is six years if the return omits over 25% of reportable gross income.

(n35)Footnote 35. *U.S. v. Aberl*, 175 B.R. 915 (N.D. Ohio 1994) (language in section 507(a)(8) only extends period for offers in compromise made during the 240 day period).

(n36)Footnote 36. 11 U.S.C. § 507(a)(8)(A)(ii), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See 4 *Collier on Bankruptcy*, P 523.08 (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 523.07 (Matthew Bender).

(n37)Footnote 37. *Young v. United States*, 535 U.S. 43, 122 S. Ct. 1036, 152 L. Ed. 2d 79 (2002) .



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 26 Dischargeability of Debts

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P 26.07 Debts Incurred through False Pretenses, Fraud or False Financial Statements; § 523(a)(2), § 1328(a)(2)

While the exception to discharge for taxes is the exception most commonly applicable in consumer cases, the exception dealing with false pretenses, fraud and false financial statementsⁿ¹ is the one which has given rise to the most litigation. Generally speaking, the Bankruptcy Code upholds a creditor's timely-filed complaint seeking a determination that a debt is nondischargeable if the debt is for obtaining money, property, services, or an extension, renewal, or refinancing of credit, by false pretenses, a false representation, fraud, or a false financial statement.

FORMS

For various forms of pleadings in dischargeability proceedings based upon fraud, false pretenses or false financial statements *see* Collier Consumer Bankruptcy Forms, §§ CS 13.21-.25 (Matthew Bender).

However, for a time, litigation concerning this exception has decreased in consumer cases for two reasons. First, prior to the 2005 amendments to the Bankruptcy Code,ⁿ² fraudulently incurred debts that were not dischargeable in chapter 7 could be discharged in chapter 13.ⁿ³ And second, creditors who file nondischargeability complaints based upon this subsection and lose are often required to pay attorney's fees to the debtor's counsel, as discussed below.

Subsequently, however, there has been a surge in claims of fraud by creditors in consumer cases. For the most part, this is due to a concerted effort by the credit card industry to establish that consumers who use a credit card when they do not have a present ability to make substantial payments have committed fraud. The basis for these cases is the creditor's claim that a consumer using a credit card makes an implied representation about ability to pay. As will be discussed in more detail below, the vast majority of these cases involve consumers who intend to repay and who believe that they will be able to do so. No misrepresentation is involved. Additionally, because the Supreme Court has made clear that justifiable reliance by the creditor on representations by the debtor is a prerequisite to a claim of fraud,ⁿ⁴ and since there is no such reliance in a credit card transaction, credit card nondischargeability cases brought on this basis should fail.ⁿ⁵

[1] Elements Which Must Be Proved by Creditor in Cases of Alleged False Financial Statements

To prevail on a complaint alleging nondischargeability under *section 523(a)(2)(B) of the Bankruptcy Code*, a creditor must prove that the transaction met every element set out in that subsection. All of the exceptions to discharge are to be

construed narrowly.ⁿ⁶

[a] Debtor Obtained Money, Property, Services, or an Extension, Renewal, or Refinancing of Credit

The first element that the creditor must allege and prove is that the debtor obtained money, property, services, or an extension, renewal, or refinancing of credit through the use of the allegedly false statement. Thus, if the creditor has given up nothing in the transaction, the exception to discharge is not applicable.ⁿ⁷

Moreover, the exception applies only to the extent the debtor obtained money or property as a result of the fraudulent act.ⁿ⁸ It remains unclear, as it was under the prior Act, whether a transaction is covered by this provision when the money, property, *etc.* is obtained by the debtor for another.ⁿ⁹ It is also unclear to what extent a debtor can be held responsible for actions of a spouse or an agent that were fraudulent.ⁿ¹⁰

[i] Refinancing Transactions

The most important aspect of this element is its applicability to refinancing transactions, which are very common in the world of consumer credit. By adding the words "extension, renewal, or refinancing of credit, to the extent obtained," Congress intended to include the entire refinanced debt in some, but not all, refinancing transactions. This marked a change in the law that had prevailed in many bankruptcy courts; previously, only the amount of the refinanced loan that was "fresh cash" had been held nondischargeable.

COMMENTARY

The apparent intent of the provision as now worded is to make the entire refinanced loan nondischargeable only in cases in which the creditor agreed to refinance because of detrimental reliance on the false financial statement.ⁿ¹¹ Thus, there is still room in most cases for the argument that the creditor lost nothing, or even gained something, from refinancing.ⁿ¹² Using repeated refinancing as a method of business keeps the customer "on the book," over a long period of time, and often results in greater payments of interest, application of the "hidden penalty" in the Rule of 78's,ⁿ¹³ and additional loan servicing charges. Thus, especially in cases in which the refinancing was initially suggested by the creditor,ⁿ¹⁴ or was required by state law when new funds were advanced,ⁿ¹⁵ a strong argument may be made that the refinancing itself was not detrimental to the creditorⁿ¹⁶ and was not obtained by the consumer as a result of any alleged falsehoods.ⁿ¹⁷

A refinancing may also extinguish a nondischargeable debt arising out of the refinanced transaction. If the refinancing is intended to eliminate the liability on the preexisting note, the debtor may be able to argue that all claims arising from that note are also extinguished.ⁿ¹⁸ However, the Supreme Court has held that, ordinarily, a settlement of a fraud case that substitutes a new contractual obligation does not eliminate the ability to claim that the underlying debt is non-dischargeable due to fraud.ⁿ¹⁹ The Court did leave open the possibility that a creditor could be precluded from bringing such a claim if the settlement included a promise that the creditor would not make a claim of non-dischargeability for fraud.ⁿ²⁰

[ii] Debt Nondischargeable Only to Extent Debtor Received Value

The "fresh cash" argument received a substantial boost from the 1984 amendments to the Bankruptcy Code. Section 523(a)(2) was amended by the addition of the words "to the extent obtained" as part of the description of those obligations which are nondischargeable. This seemingly made clear that to the extent that credit had already been obtained previously without fraud or a false financial statement, such obligations were not covered by the exception.

A number of courts have adopted these arguments in holding only the "new money" or "fresh cash" nondischargeable.ⁿ²¹ When there has been some payment on a loan that is partially nondischargeable, the payment

may, at least in some cases, be apportioned *pro rata* by the court between the nondischargeable and dischargeable portions.ⁿ²²

The exception applies to the extent that the debt arises from a fraudulent act of the debtor whereby the debtor obtained money or property. Thus, the Supreme Court has held that punitive or multiple damages which arise from such fraud are also nondischargeable.ⁿ²³ However, if the debtor did not obtain any money or property, the exception should not apply.ⁿ²⁴

[b] Statement Was Materially False and in Writing

The creditor cannot prevail simply by proving that a debtor's financial statement was false. The false statements must be in writingⁿ²⁵ and these statements must be *materially* false. Small omissions are usually insufficient to meet this test. Similarly, a false statement that is irrelevant to the decision about whether to grant credit is not material.ⁿ²⁶ Thus, a debtor contesting this element should be entitled to conduct discovery into the creditor's application evaluation process and credit scoring systems and methods to determine the actual effect of the falsehood.

[c] Statement Concerned the Financial Condition of the Debtor or an Insider

This requirement is similar to the last. The statement must concern the debtor's financial condition. A recital of false information in a deed or contract is insufficient.ⁿ²⁷ A statement having no bearing on the debtor's finances or an insider'sⁿ²⁸ finances is not sufficient to bar dischargeability of the debt, no matter how false or distorted.

[d] Creditor Reasonably Relied Upon the False Statement

Creditors often cannot meet the test requiring a showing that they reasonably relied on the false statement. In reality this test encompasses two elements that the creditor must prove--that the creditor in fact relied on the statement, and that such reliance was reasonable. Whether a creditor reasonably relied on a statement depends on all of the circumstances of the case.ⁿ²⁹

[i] Actual Reliance

Thus, when a creditor relies on the consumer's past record of dealing with the creditor or on other information,ⁿ³⁰ this standard is not met. If a loan or refinancing is offered and agreed to before the false financial statement is executed, no reliance can be shown.ⁿ³¹ Often, other information possessed by the creditor, such as a credit report, indicates that the financial statement is false, and if the creditor had reason to believe that the financial statement was false, it could not have relied upon it.ⁿ³² Similarly, if the financial statement was perfunctorily completed for the file and the creditor made no real reference to it in granting credit, no reliance can be shown.ⁿ³³ This may be the case in some situations in which a lien is taken and the creditor relies on the value of the property subject to the lien rather than on the debtor's ability to make payment.

[ii] Reasonableness of Reliance

Even if the creditor shows that it relied on the statement, that reliance may not have been reasonable. The reasonableness test requires consideration of whether the creditor followed its standard practices in evaluating creditworthiness, whether the creditor followed the standards or customs of the creditor's industry by conducting a commercially reasonable investigation, whether there was a "red flag" that would have alerted a prudent lender to the possibility that the debtor's statement was inaccurate, and whether even minimal investigation would have revealed the debtor's misrepresentations.ⁿ³⁴

If the creditor did not obtain a credit report, or check any information given by the debtor, its reliance may not have met this standard.ⁿ³⁵ And if the creditor told the debtor not to worry about listing every single debt owed on the financial

statement, it could not have reasonably relied on that statement. Some courts have even held that a creditor may not reasonably rely on a list of debts unless it includes the statement that all debts have been included.ⁿ³⁶

PLANNING NOTE

In litigating a false financial statement case it is important to obtain discovery with respect to all of the persons involved in the transaction on behalf of the creditor, and what information they did and did not obtain elsewhere. Obviously, if such witnesses are no longer employed by the creditor, it will be more difficult for it to prove its case.

[e] Debtor's Intent to Deceive

Finally, the creditor must prove that the debtor had an actual intent to deceive the creditor through the use of the false financial statement.ⁿ³⁷ If the debtor's false disclosure was innocently or negligently made, the debt is dischargeable, although some courts have considered a "reckless indifference" to the truth to be equivalent to intentional falsehood.ⁿ³⁸ Thus, debtors who failed to list debts because they thought a spouse or relative was responsible for paying them have been found to be without intent to deceive.ⁿ³⁹ Similarly, debtors who made a good faith effort, but omitted debts such as taxes in answering ambiguous questions, were entitled to discharge of the debts involved.ⁿ⁴⁰ Given good faith, even seriously inaccurate estimates of assets or liabilities do not constitute intentional deception.ⁿ⁴¹ The debtor may also have simply assumed that the creditor knew of debts from prior statements or other sources. However, it has been held that an intent to deceive can be inferred from the circumstances.ⁿ⁴²

Probably the most common defense on the question of intent arises out of the practices of creditors who mislead debtors about the purpose of the financial statement. It is well known, and indeed it was noted in the legislative history of the Bankruptcy Code,ⁿ⁴³ that some finance companies require a financial statement for future use in bankruptcy proceedings rather than for making the decision to grant credit. These creditors typically provide a form that has very little space for listing debts and they orally advise the debtor not to worry if the list is not complete. Some creditors describe the form as a mere formality or as a list of credit references. Such companies then retain the form for use in a bankruptcy case, in which they challenge the dischargeability of the debt,ⁿ⁴⁴ hoping that the debtor will reaffirm rather than pay an attorney to litigate the matter.

In cases in which such conduct can be shown, of course, there is no intent to deceive on the part of the debtor,ⁿ⁴⁵ nor is there reasonable reliance on the part of the creditor.

PLANNING NOTE

A debtor may seek to conduct discovery into the company's practices, and particularly the number of cases in which it has filed complaints seeking to have debts ruled nondischargeable. Finding more than a very few such cases is usually fatal to the creditor's complaint.

[2] Debts Incurred Through False Pretenses or Fraud

Very similar to cases dealing with false financial statements are complaints challenging dischargeability on the basis of false pretenses, false representations, or actual fraud.ⁿ⁴⁶ These complaints are usually based upon information conveyed by the debtor, orally, in writing, or by conduct, but not in a written financial statement.ⁿ⁴⁷

Indeed, it is questionable whether any statement concerning the debtor's financial condition renders a debt nondischargeable under this provision, because there is a separate provision, section 523(a)(2)(B), that covers only a written financial statement.^{n47a} To include oral or written financial statements in section 523(a)(2)(A) would render section 523(a)(2)(B) meaningless. For this reason, some courts have interpreted the phrase "respecting the debtor's financial condition" in section 523(a)(2)(B) narrowly.^{n47b}

A debtor will be denied the discharge of a particular debt under this section if it is shown that the creditor provided money, property, services, or an extension, renewal, or refinancing of credit due to an intentionally and materially false statement by the debtor⁴⁸ upon which the creditor justifiably relied.⁴⁹ This standard is basically the standard for fraud at common law. However, the fraud must be actual, and not constructive or implied by law.

Just as with false financial statements, all of the elements of the exception to discharge must be proved in each case. The creditor must prove both intent on the part of the debtor and justifiable reliance on the part of the person who was allegedly deceived.⁵⁰

[a] Intentional False Representations Which Creditor Relied

Thus, debtors who have obtained money in their businesses through deliberate misrepresentations about security interests, or about the use that would be made of the funds, have been denied discharge on those debts.⁵¹ Loans obtained through knowing misrepresentations about other intended activities may also be nondischargeable.⁵² In addition, an intentional failure to disclose a material fact may constitute false pretenses. Debtors who fail to disclose significant facts about a transaction, or about unrecorded mortgages on real estate, have been denied discharges of debts incurred in that fashion.⁵³ The fact that a representation or promise later turns out to be one that the debtor does not fulfill is not sufficient to show intent.⁵⁴ Otherwise, almost every debt would be nondischargeable under this exception.

[b] Justifiable Reliance

PRACTICE NOTE

The requirement of justifiable reliance, which was enunciated by the Supreme Court in *Field v. Mans*, *Field v. Mans*⁵⁵ is slightly different than the test for reasonable reliance used with respect to false financial statements. The requirement of justifiable reliance judges whether the creditor's reliance on the debtor's false pretenses or false statement was justifiable based upon "the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case."⁵⁶ It differs from reasonable reliance, which is an objective standard applicable to all creditors based on community norms.⁵⁷ It differs from reasonable reliance, which is an objective standard applicable to all creditors based on community norms.

Justifiable reliance may also be challenged based upon the credit granting investigation and standards used in a particular case. If the creditor knew the debtor had no income at the time the card was granted, or never even asked the debtor's income, a court is unlikely to find justifiable reliance.⁵⁸ If the debtor immediately begins to use the card primarily for gambling, or to make late payments, and the creditor continues to extend credit, justifiable reliance may be difficult for the creditor to prove. Thus, it is important to determine the information that the creditor had when the credit was granted as well as during the time the credit card was used.

[c] Dishonored Checks

Applying these principles, it is not sufficient to show simply that the debtor wrote a bad check. That the check induced the transfer of money, property, or credit must also be shown. If the check was given in payment of an antecedent debt, no false pretenses exist. Furthermore, the intent requirement is not satisfied unless the debtor knew at the time the check was issued that it would not be honored.⁵⁹ In fact, the Seventh Circuit Court of Appeals has held that a check, by itself, is not even a statement and, therefore, a bad check cannot be a false statement that gives rise to a nondischargeable claim.⁶⁰ In cases in which bad checks are involved, therefore, a creditor must prove some other false pretenses besides the check itself.

[d] Credit Cards and Other Credit Use with No Intent to Pay

The most common allegation of false pretenses is that the debtor obtained money, goods, or services on credit with no intent to pay. As distinguished from debts that the debtor later finds himself or herself unable or unwilling to pay, debts incurred through false pretenses were incurred through an intentionally false representation that they would be paid. Because many courts have held that such a representation may be found to have been implied,ⁿ⁶¹ rather than expressed, it is not surprising that difficult problems of proof can arise as to intent and as to exactly when the debtor decided that the debt would not be paid.

In consumer cases, these issues arise most frequently when credit cards are involved, particularly if there is evidence of an unusual "buying spree" shortly before the bankruptcy. It is not uncommon for creditors to allege that such use of credit constitutes a knowing misrepresentation, upon which they justifiably relied, that the debt could and would be paid.

[i] "Loading Up" Presumption

Since the creditor has the burden of proof in such cases, it must produce evidence which proves these allegations.^{n61a} The 1984, 1994 and 2005 amendments to the Bankruptcy Code made this burden far easier for creditors to meet in certain specified circumstances when a debtor allegedly "loaded up" prior to bankruptcy. In any case in which a debtor incurred consumer debtsⁿ⁶² in excess of \$550 to a single creditor for luxury goods or services within 90 days prior to filing a bankruptcy, or cash advancesⁿ⁶³ of over \$825 within 70 days prior to a filing,ⁿ⁶⁴ there is a presumption that the debts were incurred through false pretenses.ⁿ⁶⁵

"Luxury goods or services" are defined in this subsection as goods and services that are not reasonably acquired for the support or maintenance of the debtor or the debtor's dependents.ⁿ⁶⁶ Therefore, the presumption would not arise if the debtor purchased more than \$550, worth of ordinary clothing or a necessary major appliance.ⁿ⁶⁷ Similarly, when a debt is incurred to refinance an earlier debt within 90 days prior to bankruptcy, the presumption does not arise, even if the earlier debt was to purchase luxury goods or services, since those goods and services were not obtained during the 90-day period.ⁿ⁶⁸

Even when the subsection's standards are met, the presumption is rebuttable. The presumption may be overcome if the debtor can show a sudden change in circumstances after the transaction or that bankruptcy had not been contemplated until after the transaction when the debtor consulted counsel. Indeed, it should be overcome in any case in which the court is convinced that the debtor honestly intended to pay the debt.ⁿ⁶⁹ Once the debtor introduces evidence meeting this burden of going forward, the burden of proof reverts to the creditor.ⁿ⁷⁰

The presumption is also not operative unless the creditor files a timely dischargeability complaint. *Section 523(c) of the Bankruptcy Code* which, as discussed above,ⁿ⁷¹ provides that a claim of nondischargeability under section 523(a)(2) is lost if not raised during the bankruptcy case.

PRACTICE NOTE

Obviously, any anticipated problems that might be caused by the presumption may be avoided by a debtor in most cases by delaying a bankruptcy until after the applicable time period has passed. However, the time period is only relevant to the automatic presumption. Debts incurred prior to that period may still be found nondischargeable for fraud or false pretenses. Eliminating the presumption means simply that the creditor has the burden of going forward on all elements of the cause of action in such cases.

[ii] Types of Evidence Creditors May Use to Show Intent

To show fraudulent intent, it is not sufficient to prove simply that the debt was incurred and not paid, since that much is true of all dischargeable debts. Usually, absent an admission on the part of the debtor, it is almost impossible to prove the debtor's intent through direct evidence or statements that the debtor has made. These difficulties have led courts to look to circumstantial evidence.

The courts have considered several indicia as strong evidence of fraudulent intent.ⁿ⁷² The first of these is a surge of credit use shortly before the bankruptcy. When a debtor suddenly resigned from her job and left home to travel extensively on credit, without notifying anyone of her whereabouts, it was not hard for the court to infer intent, despite a defense that such activities were the result of mental illness.ⁿ⁷³ Similarly, a debtor who made approximately \$1,000 worth of credit purchases, most of which were gift certificates used not for others but for himself, the court found such behavior more than a little suspicious.ⁿ⁷⁴ A debtor who shortly before bankruptcy charged more than \$60,000 in luxury items on a trip to France, which was more than his annual income, and who had no assets other than a home that was subject to foreclosure, was found to have had no intent to repay the debt.ⁿ⁷⁵

A second indication of fraudulent intent is the use of the credit card after it is no longer permitted by the credit contract, either because the credit limit has been exceeded or because the creditor has instructed the debtor to destroy, return, or cease using the card.ⁿ⁷⁶ The evidence of fraud has been found stronger for a debtor who ceased to make purchases in excess of \$50, the amount at which merchants customarily called for credit approval. And, of course, proof that the debtor consulted an attorney or other evidence that bankruptcy was contemplated at the time of the credit use is quite helpful to the creditor's cause.ⁿ⁷⁷ But most courts have held that use of the card at a time when the debtor was unable to pay, by itself is not sufficient to show that the debtor lacked the intent to pay.ⁿ⁷⁸ One of the primary purposes of credit use is to purchase items that the debtor could not otherwise then afford to purchase. Normally, debtors who use credit when they have little income expect their circumstances to improve so they will be able to repay. The key issue is whether the debtor had a subjective intent, even if unrealistic, to repay. If the debtor intended to repay, the debt should be found dischargeable.ⁿ⁷⁹

[iii] Debtor Defenses

A debtor may raise a number of arguments in defense against such claims. Most courts have held that exceeding the credit limit, without more, is not sufficient to constitute false pretenses.ⁿ⁸⁰ Especially if the creditor has acquiesced in such use of a credit card over a period of months, the creditor should be estopped from later challenging it, or it should be found that the contract was changed by the parties' conduct.ⁿ⁸¹ Indeed, the Eleventh Circuit Court of Appeals has held that debts incurred through credit card use cannot be excepted from discharge unless the use occurs after an unequivocal revocation of credit card privileges.ⁿ⁸² A debtor's honest belief that he or she could and would pay, even if that belief is ill-founded, negates any fraudulent intent. An absence of fraudulent intent is also evidenced in many cases by return of the credit cards when requested. In addition, a debtor can fairly argue that there was no reliance at the time of the card transaction because the creditor was relying on the express agreement to repay that had occurred when the card was issued, along with its investigation at that time, and because the debtor never communicated with the creditor at the time of the transaction.ⁿ⁸³

There are other factual issues related to credit card dischargeability which can be brought out by a debtor through thorough discovery. For example, did the creditor have a practice of encouraging consumers with large balances to make additional purchases by increasing their credit limits or by advertising products or services in their billing statements? These practices undermine a creditor's claim that it justifiably relied on the debtor's implied representations about ability to pay, particularly if an increased credit limit is typically granted without a review of the debtor's recent credit record or current income.ⁿ⁸⁴ Similarly, a creditor's practices with respect to accepting minimum payments should be reviewed. If a debtor had the ability to make anticipated minimum payments in the short term, that fact undermines circumstantial evidence which tends to establish that the debtor had no intent to repay.

[iv] Proving Intent at Trial

When cases go to trial, it is important to make a record regarding the debtor's intent at the time of the purchase usually through the debtor's testimony. For example, if the debtor was unemployed at the time of the purchase, did the debtor expect to be reemployed shortly? Was there a reasonable belief that financial difficulties would be temporary? Were the purchases within the debtor's credit limit? Did the debtor have the ability and intent to continue to make the minimum monthly payments despite financial difficulties? Had the debtor had prior financial problems from which he or she recovered which led to a reasonable assumption that these financial difficulties would also be resolved? Had the debtor consulted a bankruptcy attorney before making the purchases? Did the debtor continue to offer partial payments to creditors which were rejected so that bankruptcy became the only realistic option?

Virtually all debtors have had some financial problems before they file bankruptcy. Many people who use credit cards fully expect that their debts can be repaid. It is thus insufficient to use past financial difficulties alone as evidence of fraudulent intent.ⁿ⁸⁵ The creditor must add at least some other element if it expects to convince the court that the debtor knew the debt would not be paid.

[e] Public Benefits Overpayments

Another type of fraud problem that may arise in the case of low-income or elderly debtors involves past overpayments of social security, unemployment, welfare, or other benefits. In many cases involving such overpayments, the amount that was erroneously paid is deducted from future benefits, often causing considerable hardship.

In determining whether debts for such overpayments should be discharged, the bankruptcy court applies the same standards as in other cases under section 523(a)(2). These standards may be quite different from those applied by the agency that administers the benefits; many such agencies, including the Social Security Administration, may decide to recoup erroneous payments even if the debtor was not at fault or may use a fault standard far less favorable to the debtor than that used in bankruptcy.ⁿ⁸⁶

Clearly, any overpayment that is the result of an administrative error should be discharged under the bankruptcy standard. No exception to discharge applies solely because the debt is owed to a government agency. Nor would recoupment after bankruptcy be a setoff permitted under section 553, since it would not meet the mutuality requirement, which prohibits a prepetition debt of the debtor from being setoff against monies that become due to the debtor only after the bankruptcy.ⁿ⁸⁷ Following these principles, courts have consistently held social security overpayments to be dischargeable unless a successful dischargeability challenge is made under section 523.ⁿ⁸⁸

However, debtors who fraudulently obtain benefits by intentionally and falsely representing that they are unemployed will usually be denied a discharge of overpayment if a complaint is filed.ⁿ⁸⁹ Courts are likely to extend this rule to those who do not report new employment, at least if it can be shown that they were aware of their duty to do so, under the theory that such failure constitutes a continuing misrepresentation.ⁿ⁹⁰ Of course, other intentional falsehoods in the application regarding eligibility questions can also lead to an exception of the overpayment from discharge.ⁿ⁹¹

[3] Tactics for Debtors Defending Against Abusive Dischargeability Cases

Some creditors continue to file complaints alleging nondischargeability because of a false financial statement, false pretenses, or fraud, in hopes that they can obtain a settlement reaffirming all or part of a debt because some debtors do not defend against such cases. It is important for a debtor's attorney to quickly disabuse a creditor/plaintiff of such notions by making it known that the case will be vigorously defended, quite possibly at the creditor's expense.

The debtor's attorney would be well advised to litigate and negotiate aggressively. That the creditor must plead and prove every element of the case (except when the section 523(a)(2)(C) presumption applies, in which case the creditor

has the burden of proof only if the presumption is rebutted.) should be remembered. Further, the Rules require fraud to be pleaded with particularity.ⁿ⁹² If these requirements are not met, the debtor may move for dismissal. Similarly, there may be issues regarding whether the plaintiff has standing to assert rights as a creditor.ⁿ⁹³

PRACTICE NOTE

The debtor may raise counterclaims as well as defenses in answering the complaint. If the debt itself is not owed because the debtor's rights under consumer credit laws were violated, or for some other reason, dischargeability becomes a moot point.^{n93a} Such challenges to the existence of the debt can also be useful in settling for a lower amount, if that is later desired.

Discovery should be fully pursued. The creditor's practices with respect to obtaining credit reports, granting unsolicited credit, credit scoring, filing other dischargeability complaints, and frequently refinancing, encouraging or making a profit from refinancing, may all be relevant. Operations manuals, standardized forms, and other internal documents setting out these practices should be sought if any of them are relevant or could lead to the discovery of relevant information. These inquiries may well serve to put the creditor on the defensive, forcing it to explain why it granted credit in the first place, why it did not obtain a credit report or did not rely on one, why it increased the debtor's credit, why it encourages refinancings and why it challenges dischargeability more than other creditors. The practitioner may also be able to find other consumers who will back up the debtor's assertion as to the creditor's practices in closing loans. Exposure of unethical practices and bad publicity are usually the last things a creditor wants.

FORMS

For sample discovery materials in credit card nondischargeability cases *see* Collier Consumer Bankruptcy Forms §§ CS 13.22-3-13.22-5 (Matthew Bender).

In some cases, the creditor may be seeking a determination of nondischargeability for a debt that is not limited to the debt incurred by fraud. Issues concerning refinancings are discussed above.ⁿ⁹⁴ Moreover, if the debt obtained by fraud has been replaced by a newer obligation not obtained through fraud, the newer obligation may well be dischargeable.ⁿ⁹⁵

[4] Award of Attorney's Fees When Complaint Not Substantially Justified

Creditors contemplating dischargeability complaints should be mindful of *section 523(d) of the Bankruptcy Code*, which requires a creditor to pay attorney's fees to the debtor if the latter prevails and the creditor's complaint was not "substantially justified."ⁿ⁹⁶ The purpose of this provision is to prevent a creditor from bringing a questionable case to exploit the debtor's need to pay a lawyer to assert a meritorious defense to a dischargeability complaint; thus, whenever a creditor does not have significant evidence to support its claim, the creditor should be obliged to pay the debtor's attorney. Otherwise, the debtor will have lost money even when the case is won.

The "substantially justified" standard was adopted from the Equal Access to Justice Act, 28 U.S.C. § 2412(d). Under that Act, courts have held that a losing party must make a strong showing of justification for its claims.ⁿ⁹⁷ There is no requirement that the prevailing debtor demonstrate the losing party's bad faith.ⁿ⁹⁸ The same is true of section 523(d); Congress clearly rejected creditor proposals to award fees only when bad faith could be demonstrated.ⁿ⁹⁹ It is the creditor's burden to show that fees should not be awarded.ⁿ¹⁰⁰

Indeed, the fact that a creditor failed to diligently investigate the debtor's credit prior to extending credit has been held to be an important factor in deciding that fees should be awarded.ⁿ¹⁰¹ Thus, it is important for creditors to attend the

meeting of creditors and perhaps schedule a *Rule 2004* examination of the debtor in order to investigate the dischargeability issue prior to filing a complaint. However, absent some evidence that suggests a colorable argument for nondischargeability, a creditor does not have an unlimited right to conduct a *Rule 2004* examination, which could be used to harass the debtor,ⁿ¹⁰² especially in view of the right to examine the debtor at the section 341(a) meeting of creditors.

PRACTICE NOTE

For the debtor, one useful tactic, especially if the creditor has sent a letter threatening a dischargeability complaint, is to immediately inform the creditor of the facts supporting the debtor's defense. A better argument can then be made that the creditor's proceeding was not substantially justified in light of the facts available to it either before the case was filed or before significant attorney's fees had been incurred.

The fact that the debtor is represented by a legal services or *pro bono* program should not be a factor in a fees determination, because the courts have consistently held such parties to be entitled to statutory attorney's fees on the same basis as all others.ⁿ¹⁰³ Nor should the fact that the case was dismissed or dropped by the creditor short of a final judgment after full trial on the merits excuse liability for attorney's fees.ⁿ¹⁰⁴ Fees should be awarded not only for defending the action, but also for the time necessary to litigate the attorney's fee issue.^{n104a} Otherwise, creditors could render the fees insufficient simply by causing a good deal of work to obtain them. However, fees awardable against certain governmental units may be limited by the provisions of *section 106(a)(3) of the Bankruptcy Code*.ⁿ¹⁰⁵

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 523(a)(2)*.

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. This is no longer the case under amended section 1328(a)(2), which makes nondischargeable the debts described in section 523(a)(2).

(n4)Footnote 4. *Field v. Mans*, 516 U.S. 59, 116 S. Ct. 437, 133 L. Ed. 2d 351, 33 C.B.C.2d 1323 (1995) .

(n5)Footnote 5. *See, e.g., In re Alvi*, 191 B.R. 724 (Bankr. N.D. Ill. 1996) ; *In re Willis*, 190 B.R. 866 (Bankr. W.D. Mo. 1996) .

(n6)Footnote 6. *See, e.g., Gleason v. Thaw*, 236 U.S. 558, 562, 35 S. Ct. 287, 289, 59 L. Ed. 717, 719 (1915) ("exceptions to discharge ... should be confined to those plainly expressed"); *In re Ward*, 857 F.2d 1082 (6th Cir. 1988) .

(n7)Footnote 7. *See, e.g., In re Harlan*, 7 B.R. 83 (Bankr. D. Ariz. 1980) (forbearance in suing a comaker is not property). *But see In re Campbell*, 159 F.3d 963 (6th Cir. 1998) (agreement to forbear from collection was an extension of credit); *Field v. Mans*, 157 F.3d 35 (1st Cir. 1998) (fraudulent concealment of sale of property that would have permitted acceleration of mortgage induced nonacceleration which was deemed an extension of credit).

(n8)Footnote 8. *See, e.g., In re Aboukhater*, 165 B.R. 904 (B.A.P. 9th Cir. 1994) (debt did not fall within exception if alleged fraudulent acts occurred after the transaction through which money or property was obtained). *See also In re Johannessen*, 76 F.3d 347, 35 C.B.C.2d 583 (11th Cir. 1996) (debt arising from settlement agreement could be nondischargeable if original obligation that was subject of agreement arose from fraudulent conduct). Certiorari was denied in the *McFarland* case at 519 U.S. 931, 117 S. Ct. 302, 136 L. Ed. 2d 220 (1996) .

(n9)Footnote 9. *See In re Arm*, 87 F.3d 1046, 36 C.B.C.2d 293 (9th Cir. 1996) (indirect benefit to debtor from fraud gives grounds for discharge exception); *In re Bilzerian*, 100 F.3d 886, 37 C.B.C.2d 234 (11th Cir. 1996) (exception to discharge applied to debtor whose fraud induced investment in partnership in which debtor had indirect

interest); 4 *Collier on Bankruptcy*, P 523.08[1][a] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.07[1][a] (Matthew Bender).

(n10)Footnote 10. See *In re Bonnanzio*, 91 F.3d 296 (2d Cir. 1996) (debtor responsible only if debtor knew or should have known of fraud and knowingly retained benefit from fraud).

(n11)Footnote 11. See *In re Siriani*, 967 F.2d 302, 26 C.B.C.2d 1845 (9th Cir. 1992) (creditor who renewed bond had to show that it relied to its detriment on false representations by giving up valuable collection remedies).

(n12)Footnote 12. But see *Matter of McFarland*, 84 F.3d 943, 947, 36 C.B.C.2d 137, 142 (7th Cir. 1996) , cert. denied, 519 U.S. 931, 117 S. Ct. 302, 136 L. Ed. 2d 220 (1996) (entire debt nondischargeable based on false financial statement related to refinancing); *In re Goodrich*, 999 F.2d 22, 29 C.B.C.2d 554, 560 (1st Cir. 1993) (entire amount of loan, not just amount extended after false financial statement, was nondischargeable).

(n13)Footnote 13. See Hunt, *The Rule of 78: Hidden Penalty in Consumer Credit Transactions*, 55 B.U. L. Rev. 331 (1975).

(n14)Footnote 14. See, e.g., *In re Archangeli*, 2 C.B.C.2d 1209, 6 B.R. 50 (Bankr. D. Me. 1980) (bank desired consolidation because of its belief that debtor would be better able to make payments to it).

(n15)Footnote 15. *In re Danns*, 558 F.2d 114 (2d Cir. 1977) .

(n16)Footnote 16. See *In re Gadberry*, 10 C.B.C.2d 1034, 37 B.R. 752 (Bankr. C.D. Ill. 1984) .

(n17)Footnote 17. See 4 *Collier on Bankruptcy*, P 523.08[2][f] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.07[2][f] (Matthew Bender).

(n18)Footnote 18. See, *In re Fischer*, 116 F.3d 388 (9th Cir. 1997) (agreement that was novation of prior contract eliminated any nondischargeability claims arising out of prior contract); *In re West*, 22 F.3d 775 (7th Cir. 1994) (general release included a release of a claim nondischargeable under the Code, because even if the obligation arising from debtor's embezzlement would have been nondischargeable due to its fraudulent nature, no allegations of fraud surround the subsequent note, and the note substituted a contractual obligation for a tortious one). But see *United States v. Spicer*, 57 F.3d 1152 (D.C. Cir. 1995) (settlement of fraud claim did not extinguish nondischargeability claim).

(n19)Footnote 19. *Archer v. Warner*, 538 U.S. 314, 123 S. Ct. 1462, 155 L. Ed. 2d 454 (2003) . See also *Giaimo v. DeTrano* (*In re Detrano*), 326 F.3d 319 (2d Cir. 2003) .

(n20)Footnote 20. *Archer v. Warner*, 538 U.S. 314, 123 S. Ct. 1462, 1468 155 L. Ed. 2d 454 (2003) .

(n21)Footnote 21. *In re Greenidge*, 75 B.R. 245 (Bankr. M.D. Ga. 1987) ; *In re Ojeda*, 51 B.R. 91 (Bankr. D.N.M. 1985) . But see *Matter of McFarland*, 84 F.3d 943, 947 (7th Cir. 1996) ; *In re Kim*, 62 F.3d 1511 (9th Cir. 1995) , aff'g 163 B.R. 161 (B.A.P. 9th Cir. 1994) (creditor must show only that it had valuable collection remedies that it lost during the loan renewal period).

(n22)Footnote 22. *In re Hunter*, 771 F.2d 1126, 13 C.B.C.2d 412 (8th Cir. 1985) .

(n23)Footnote 23. *Cohen v. De La Cruz*, 523 U.S. 213, 118 S. Ct. 1212, 140 L. Ed. 2d 341, 38 C.B.C.2d 1891 (1998) .

(n24)Footnote 24. See 4 *Collier on Bankruptcy*, P 523.08[4] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.07[4] (Matthew Bender).

(n25)Footnote 25. *Matter of Kaspar*, 125 F.3d 1358 (10th Cir. 1997) (credit card application taken over telephone

not in writing, even though lender later transferred debtor's answers to a document); *Blackwell v. Dabney*, 702 F.2d 490, 8 C.B.C.2d 1009 (4th Cir. 1983) .

(n26)Footnote 26. *Matter of Bogstad*, 779 F.2d 370, 13 C.B.C.2d 1282 (7th Cir. 1985) (if lender would have made loan regardless of misrepresentation, then the misrepresentation was not material).

(n27)Footnote 27. *In re Phillips*, 804 F.2d 930 (6th Cir. 1986) (misstatement of acreage in a deed is not a false written statement of debtor's financial condition).

(n28)Footnote 28. "Insider" is defined at 11 U.S.C. § 101(31) and includes relatives of the debtor.

(n29)Footnote 29. *Matter of Coston*, 987 F.2d 1096 (5th Cir. 1992) (trial court's finding of reasonable reliance based on circumstances would not be overturned unless clearly erroneous). At least one appellate court has held that when a debt is assigned the assignee may assert reliance by the assignor, even though it is the creditor and it never relied on the debtor's statement. *In re Boyajian*, 564 F.3d 1088 (9th Cir. 2009) .

(n30)Footnote 30. *In re Savich*, 82 B.R. 1011 (Bankr. W.D. Mo. 1988) (bank's course of dealing with borrower established that bank ignored the debtor's financial statements which contained misrepresentations).

(n31)Footnote 31. *Matter of Greene*, 65 B.R. 266 (Bankr. M.D. Fla. 1986) .

(n32)Footnote 32. *In re Morris*, 223 F.3d 548 (7th Cir. 2000) (when creditor, based on past experience, had doubts about debtor's statements, reliance without further investigation was not reasonable).

(n33)Footnote 33. *In re Jones*, 1 C.B.C.2d 676, 3 B.R. 410 (Bankr. W.D. Va. 1980) .

(n34)Footnote 34. *In re Cohn*, 54 F.3d 1108, 33 C.B.C.2d 849 (3d Cir. 1995) .

(n35)Footnote 35. *E.g.*, *In re Jones*, 31 F.3d 659, 31 C.B.C.2d 1349 (8th Cir. 1994) (reliance not reasonable where "red flags" should have alerted creditor to investigate further); *In re Kirsh*, 973 F.2d 1454, 27 C.B.C.2d 942 (9th Cir. 1992) (attorney creditor did not show required justifiable reliance in believing debtor's representations regarding liens on property without ordering a title report).

(n36)Footnote 36. *See Dial Finance v. Duthu*, 188 So. 2d 151 (La. Ct. App. 1966) .

(n37)Footnote 37. *See* 4 Collier on Bankruptcy, P 523.08[2][e] (Matthew Bender); 2 Collier Bankruptcy Manual, P 523.07[2][e] (Matthew Bender).

(n38)Footnote 38. *Knoxville Teachers Credit Union v. Parkey*, 790 F.2d 490 (6th Cir. 1986) (misrepresentation of liabilities by \$4,300 was grossly reckless and satisfied the element of intentional deception); *Birmingham Trust Nat'l Bank v. Case*, 755 F.2d 1474, 12 C.B.C.2d 630 (11th Cir. 1985) .

(n39)Footnote 39. *E.g.*, *In re Mosley*, 2 C.B.C.2d 146, 4 B.R. 177 (Bankr. S.D. Fla. 1980) .

(n40)Footnote 40. *E.g.*, *In re Miller*, 39 F.3d 301, 32 C.B.C.2d 854 (11th Cir. 1994) (based upon totality of circumstances, bankruptcy court correctly held that there was no intent to deceive when assets were valued on net basis and real estate values were in flux).

(n41)Footnote 41. *In re Rosel*, 63 B.R. 603 (Bankr. W.D. Ky. 1986) .

(n42)Footnote 42. *Matter of Young*, 995 F.2d 547 (5th Cir. 1993) .

(n43)Footnote 43. H.R. Rep. No. 595, 95th Cong., 1st Sess. 130 (1977), *reprinted in* Vol. C Collier on Bankruptcy,

App. Pt. 4(d)(i) (Matthew Bender).

(n44)Footnote 44. *See, e.g., All State Credit Plan, Halihan v. Anderson*, 250 So. 2d 806 (La. Ct. App. 1971) .

(n45)Footnote 45. *See, e.g., In re Rosia*, 4 B.R. 701 (Bankr. S.D. Fla. 1980) (debtor instructed to state falsely that she owned a home).

(n46)Footnote 46. 11 U.S.C. § 523(a)(2)(A).

(n47)Footnote 47. *See 4 Collier on Bankruptcy*, P 523.08[1] (Matthew Bender); *2 Collier Bankruptcy Manual*, P 523.07[1] (Matthew Bender).

(n48)Footnote 47a. *See In re Gulevsky*, 362 F.3d 961 (7[th] Cir. 2004) (writing requirement could not be circumvented by proceeding under section 523(a)(6)).

(n49)Footnote 47b. *See In re Joelson*, 427 F.3d 700 (10[th] Cir. 2005) .

(n50)Footnote 48. *See 4 Collier on Bankruptcy*, P 523.08[3] (Matthew Bender); *2 Collier Bankruptcy Manual*, P 523.07[3] (Matthew Bender). The debtor may commit fraud through the agency of another person only if the debtor knew or should have known of the fraud. *Matter of Allison*, 960 F.2d 481 (5th Cir. 1992) (debt that was nondischargeable with respect to husband held dischargeable with respect to wife who did not participate in transaction). *But see In re M.M. Winkler & Assocs.*, 239 F.3d 746 (5th Cir. 2001) (fraud may be imputed to innocent partner regardless of whether partner receives any monetary benefit).

(n51)Footnote 49. *Field v. Mans*, 516 U.S. 59, 116 S. Ct. 437, 133 L. Ed. 2d 351, 33 C.B.C.2d 1323 (1995) .

(n52)Footnote 50. *See, e.g., In re Rubin*, 875 F.2d 755 (9th Cir. 1989) (claimants were entitled to rely on the debtor/real estate agent's misrepresentations based on his position and apparent experience).

(n53)Footnote 51. *E.g., In re Miller*, 5 B.R. 424 (Bankr. W.D. La. 1980) .

(n54)Footnote 52. *E.g., In re Milbank*, 1 B.R. 150 (Bankr. S.D.N.Y. 1979) (debtor obtained loan from wife and her father upon representation that he would try to strengthen marriage; loan found nondischargeable upon proof that he was at same time engaged in affair with wife of next door neighbor).

(n55)Footnote 53. *E.g., In re Quintana*, 2 C.B.C.2d 293, 4 B.R. 508 (Bankr. S.D. Fla. 1980) .

(n56)Footnote 54. *In re Ashley*, 2 C.B.C.2d 949, 5 B.R. 262 (Bankr. E.D. Tenn. 1980) (no false representation simply because goods sold proved defective); *In re Brooks*, 2 C.B.C.2d 312, 4 B.R. 237 (Bankr. S.D. Fla. 1980) (no showing that debtor's implied representation that note would be paid was known to be false at time note was executed).

(n57)Footnote 55. 516 U.S. 59, 116 S. Ct. 437, 133 L. Ed. 2d 351, 33 C.B.C.2d 1323 (1995) .

(n58)Footnote 56. 516 U.S. 59, 70-71 ; 116 S. Ct. 437, 444, 133 L. Ed. 2d 351, 358, 33 C.B.C.2d 1323, 1330 . *See Sanford Inst. for Savings v. Gallo*, 156 F.3d 71 (1st Cir. 1998) (due to circumstances of case, creditor justifiable relied on debtor's representations even though it failed to conduct title search which would have revealed fraud).

(n59)Footnote 57. 516 U.S. 59, 70-71 ; 116 S. Ct. 437, 444, 133 L. Ed. 2d 351, 358, 33 C.B.C.2d 1323, 1330 .

(n60)Footnote 58. *In re Cacciatore*, 38 C.B.C.2d 186, 209 B.R. 609 (Bankr. E.D.N.Y. 1997) (debtor was a 21-year-old student who listed no employer or any business telephone number but, notwithstanding this information, and without further inquiry as to whether defendant was employed or had any resources that might enable him to repay, creditor gave debtor a \$5,000 pre-approved line of credit based on the absence of prior bankruptcies, assumed names

and the like in his history).

(n61)Footnote 59. *See, e.g., In re Davis*, 246 B.R. 646 (B.A.P. 10th Cir. 2000) (debtor expected to deposit funds in account to pay check); *In re Burgstaler*, 58 B.R. 508 (Bankr. D. Minn. 1985) (even if the debtor knew there were insufficient funds to cover the check, no intent may be present if the debtor expected to be able to deposit money in the account before the check was honored).

(n62)Footnote 60. *Matter of Scarlata*, 979 F.2d 521, 27 C.B.C.2d 1494 (7th Cir. 1992) . *See also In re Coatney*, 185 B.R. 546 (Bankr. N.D. Ohio 1995) .

(n63)Footnote 61. *But see, e.g., In re Alvi*, 191 B.R. 724 (Bankr. N.D. Ill. 1996) (use of credit card did not involve any representation, either express or implied).

(n64)Footnote 61a. *See In re McGee*, 359 B.R. 764 (B.A.P. 9th Cir. 2006) (affirming refusal to enter default judgment when creditor introduced no evidence and 190% interest rate undercut creditor claim of reliance); *In re Vee Vinhnee*, 336 B.R. 437 (B.A.P. 9th Cir. 2005) (affirming refusal to enter default judgment when creditor produced no admissible evidence and offered only electronic records without proper evidentiary foundation).

(n65)Footnote 62. "Consumer debt" is defined at 11 U.S.C. § 101(8). *See* 2 Collier on Bankruptcy, ch. 101 (Matthew Bender); 1 Collier Bankruptcy Manual, ch. 101 (Matthew Bender).

(n66)Footnote 63. Convenience checks and balance transfers are not normally considered cash advances. *See Nat'l City Bank v. Manning (In re Manning)*, 280 B.R. 171 (Bankr. S.D. Ohio 2002) (balance transfer is not a cash advance); *In re Welch*, 208 B.R. 107 (S.D.N.Y. 1997) (cash advance is ATM withdrawal or a check written to cash).

(n67)Footnote 64. Pursuant to 11 U.S.C. § 104(b), these amounts are subject to periodic adjustment. For cases commenced before April 1, 2004, the amount in effect is \$1,150, and for cases commenced between April 1, 2004 and October 16, 2005, the dollar amount in effect is \$1,225. For cases commenced between October 17, 2005 and April 1, 2007, the amounts were \$550 for luxury goods and \$750 for cash advances. The adjustment is made every three years beginning on April 1, 1998. *See* 2 Collier on Bankruptcy, P 104.03 (Matthew Bender); 1 Collier Bankruptcy Manual, P 104.03 (Matthew Bender).

(n68)Footnote 65. 11 U.S.C. § 523(a)(2)(C), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See In re Poor*, 39 C.B.C.2d 1354, 219 B.R. 332 (Bankr. D.Me. 1998) (balance transfer was not a "cash advance" under this section); *In re Cameron*, 219 B.R. 531 (Bankr. W.D.Mo. 1998) (same); 4 Collier on Bankruptcy, P 523.08[5] (Matthew Bender); 2 Collier Bankruptcy Manual, P 523.07[5] (Matthew Bender).

(n69)Footnote 66. 11 U.S.C. § 523(a)(2)(C), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n70)Footnote 67. *In re Larisey*, 34 C.B.C.2d 962, 185 B.R. 877 (Bankr. M.D. Fla. 1995) (air conditioner repair and carpet were not luxury goods or services).

(n71)Footnote 68. *In re Shurbier*, 134 B.R. 922 (Bankr. W.D. Mo. 1991) (loan to repay earlier debt for goods and services did not give rise to presumption).

(n72)Footnote 69. *See, e.g., Sears, Roebuck & Co.*, 160 B.R. 328 (Bankr. W.D. Wis. 1993) (presumption overcome because debtor did not know, when she bought collector edition dolls, that her husband planned to file bankruptcy case and that his attorney would advise joint petition, and debtor had intended to pay for dolls even though she did not have money immediately available).

(n73)Footnote 70. *Sears, Roebuck & Co. v. Cline (In re Cline)*, 282 B.R. 490 (Bankr. W.D. Wash. 2002) (because

debtor used her account for necessities, and always planned to repay, the presumption of fraud burst and burden of proof reverted to creditor).

(n74)Footnote 71. *See P 26.03 supra.*

(n75)Footnote 72. *See generally In re Dougherty*, 18 C.B.C.2d 471, 84 B.R. 653 (B.A.P. 9th Cir 1988) .

(n76)Footnote 73. *In re Banasiak*, 8 B.R. 171 (Bankr. M.D. Fla. 1981) .

(n77)Footnote 74. *Matter of Ratajczak*, 5 B.R. 583 (Bankr. M.D. Fla. 1980) .

(n78)Footnote 75. *In re Hashemi*, 104 F.3d 1122, 37 C.B.C.2d 342 (9th Cir. 1996) , *cert. denied*, 520 U.S. 1230, 117 S. Ct. 1824, 137 L. Ed. 2d 1031 (1997) .

(n79)Footnote 76. *In re Brewster*, 5 B.C.D. 783 (Bankr. E.D. Va. 1979) .

(n80)Footnote 77. *But see In re Cacho*, 137 B.R. 864 (Bankr. N.D. Fla. 1991) (fact that debtor consulted attorney concerning possible bankruptcy before cash advance was not sufficient to show fraud where debtor made numerous payments of debts after that and did not file until two months later).

(n81)Footnote 78. *In re Anastas*, 94 F.3d 1280, 36 C.B.C.2d 814 (9th Cir. 1996) (nondischargeability determination may not be based solely upon fact that at time debts were incurred debtor was not likely to be able to repay them; additional evidence of fraudulent intent is required).

(n82)Footnote 79. *In re Ettell*, 188 F.3d 1141 (9th Cir. 1999) (debtor had intent to repay, even if it was objectively unlikely he would be able to do so); *In re Rembert*, 141 F.3d 277 (6th Cir.) , *cert. denied*, 119 S. Ct. 438 (1998) (debtor had intent to repay when she took cash advances for gambling).

(n83)Footnote 80. *In re Lyon*, 3 C.B.C.2d 644, 8 B.R. 152 (Bankr. D. Me. 1981) and cases cited therein.

(n84)Footnote 81. *In re Lyon*, 3 C.B.C.2d 644, 8 B.R. 152 (Bankr. D. Me. 1981) and cases cited therein.

(n85)Footnote 82. *First Nat'l Bank of Mobile v. Roddenberry*, 701 F.2d 927 (11th Cir. 1983) . This holding may be called into question to some extent by the 1984 addition of section 523(a)(2)(C) to the Bankruptcy Code.

(n86)Footnote 83. *In re Alvi*, 191 B.R. 724 (Bankr. N.D. Ill. 1996) (credit card issuer failed to show actual or justifiable reliance when it passively extended credit on card; it had willingly undergone risk of nonpayment by factoring risk into finance charges). *But see In re Mercer*, 246 F.3d 391 (5th Cir. 2001) (en banc) (each use of card is a new contract and representation of intent to pay and company could justifiably rely on that representation absent red flags or actual knowledge that it was untrue, essentially reducing dischargeability of credit cards to issue of whether debtor had intent to deceive and whether creditor was aware of red flags, thus rewarding creditors who do not investigate a debtor's credit and therefore do not discover red flags).

(n87)Footnote 84. *But see In re Mercer*, 246 F.3d 391 (5th Cir. 2001) (en banc) (each use of card is a new contract and representation of intent to pay, and company could justifiable rely on that representation absent red flags or actual knowledge that it was untrue, essentially reducing dischargeability of credit cards to issue of whether debtor had intent to deceive and whether creditor was aware of red flags, thus rewarding creditors who do not investigate a debtor's credit); *In re Cacciatore*, 38 C.B.C.2d 186, 209 B.R. 609 (Bankr. E.D.N.Y. 1997) (debtor was a 21-year-old student who listed no employer or any business telephone number, but notwithstanding this information, and without further inquiry as to whether debtor was employed or had any resources that might enable him to repay, creditor gave debtor a \$5,000 pre-approved line of credit).

(n88)Footnote 85. *See In re Mercer*, 246 F.3d 391 (5th Cir. 2001) (en banc); *In re Anastas*, 94 F.3d 1280 (9th Cir.

1996) ; *In re Cox*, 182 B.R. 626 (Bankr. D. Mass. 1995) (all debtors have history of financial problems which cannot alone establish intent); *FCC Bank v. Dobbins*, 151 B.R. 509 (W.D. Mo. 1992) (debtor's insolvency at time of credit card use, without more, was not sufficient to render complaint substantially justified).

(n89)Footnote 86. See *In re Chen*, 227 B.R. 614 (D.N.J. 1998) (fraud standard used in state unemployment compensation proceeding was less demanding than that of section 523(a)(2) so finding in such proceeding not entitled to preclusive effect).

(n90)Footnote 87. See ch. 17 *supra*.

(n91)Footnote 88. *Rowan v. Morgan*, 747 F.2d 1052, 11 C.B.C.2d 721 (6th Cir. 1984) ; *Lee v. Schweiker*, 739 F.2d 870, 11 C.B.C.2d 834 (3d Cir. 1984) ; *In re Neavear*, 674 F.2d 1201, 6 C.B.C.2d 367 (7th Cir. 1982) .

(n92)Footnote 89. *In re Kaliff*, 2 B.R. 465 (Bankr. D. Ariz. 1979) .

(n93)Footnote 90. *In re Kaliff*, 2 B.R. 465 (Bankr. D. Ariz. 1979) ; *In re Berry*, 3 B.R. 430 (Bankr. D. Or. 1980) .

(n94)Footnote 91. *In re Forcier*, 7 B.R. 31 (Bankr. D. Ariz. 1980) (student status concealed).

(n95)Footnote 92. See P 26.03 *supra*.

(n96)Footnote 93. See *In re Pittard*, 358 B.R. 457 (Bankr. N.D. Ga. 2006) (dismissing section 523(a)(2) claim because fraud claim not assignable under Georgia law); *In re Wilson*, 311 B.R. 566 (B.A.P. 9th Cir. 2004) , *aff'd*, 185 Fed. Appx. 696 (9th Cir. 2006) (plaintiff did not have standing because it had not registered as collection agent on assigned debt).

(n97)Footnote 93a. See, e.g., *In re Wilder*, 178 B.R. 174 (Bankr. E.D. Mo. 1995) (debt that was barred by statute of limitations was not a claim and could not be nondischargeable).

(n98)Footnote 94. See P 26.07[1][a][i] *supra*.

(n99)Footnote 95. See *Matter of West*, 22 F.3d 775 (7th Cir. 1995) (when debtor had executed note to employer to repay embezzled funds and employer had agreed not to sue debtor on any obligation other than note, § 523(a)(4) was inapplicable). But see *U.S. v. Spicer*, 57 F.3d 1152 (D.C. Cir. 1995) (debt that originated through debtor's fraud remained nondischargeable even though there was settlement agreement, regardless of whether agreement included release or waiver of fraud claim).

(n100)Footnote 96. See 4 *Collier on Bankruptcy*, P 523.08[8] (Matthew Bender).

(n101)Footnote 97. *Natural Resources Defense Council v. United States Environmental Protection Agency*, 703 F.2d 700 (3d Cir. 1983) .

(n102)Footnote 98. *In re Carmen*, 723 F.2d 16, 9 C.B.C.2d 953 (6th Cir. 1983) .

(n103)Footnote 99. See H.R. 4786, 97th Cong. 1st Sess. § 9(b) (1981), the creditors' proposed bill which would have allowed fees only if bad faith were shown. Cases decided prior to the 1984 amendments also rejected a bad faith requirement.

(n104)Footnote 100. *First Card v. Hunt* (*In re Hunt*), 238 F.3d 1098 (9th Cir. 2001) (creditor that presented virtually no evidence of debtor intent to commit fraud failed to meet burden of proof for avoiding fee award); *In re McCarthy*, 43 C.B.C.2d 1101, 243 B.R. 203 (B.A.P. 1st Cir. 2000) .

(n105)Footnote 101. *In re Stine*, 254 B.R. 244 (B.A.P. 9th Cir. 2000) (alleged inaccuracies in schedules which were

irrelevant to dischargeability case were not substantial justification, nor were the inaccuracies or the fact that debtor was represented by pro bono counsel special circumstances warranting denial of fees); *In re Sales*, 41 C.B.C.2d 793, 228 B.R. 748 (B.A.P. 10th Cir. 1999) (credit card issuer which failed to investigate prior to filing complaint and whose only basis for filing complaint was a high balance on account was not substantially justified in filing complaint); *In re Leonard*, 29 C.B.C.2d 859, 158 B.R. 839 (Bankr. D. Colo. 1993) ; *Manufacturers Hanover Trust Co.*, 153 B.R. 352 (Bankr. M.D. Fla. 1993) .

(n106)Footnote 102. *In re Strecker*, 251 B.R. 878 (Bankr. D. Colo. 2000) .

(n107)Footnote 103. *See e.g., Blum v. Stenson*, 465 U.S. 886, 104 S. Ct. 1541, 79 L. Ed. 2d 891 (1984) ; *Rodriguez v. Taylor*, 569 F.2d 1231 (3d Cir. 1977) , *cert. denied*, 436 U.S. 913, 98 S. Ct. 2254, 56 L. Ed. 2d 414 (1978) ; *First Card v. Hunt* (*In re Hunt*), 238 F.3d 1098 (9th Cir. 2001) ; *Sellers v. Wollman*, 510 F.2d 119 (5th Cir. 1977) ; *In re Stine*, 254 B.R. 244 (B.A.P. 9th Cir. 2000) .

(n108)Footnote 104. *See e.g., In re Mull*, 122 B.R. 763 (Bankr. W.D. Okla. 1991) .

(n109)Footnote 104a. *In re Dayton*, 306 B.R. 322 (Bankr. N.D. Cal. 2004) .

(n110)Footnote 105. *See 2 Collier on Bankruptcy*, P 106.04[1] (Matthew Bender); *1 Collier Bankruptcy Manual*, P 106.04[1] (Matthew Bender).



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CHAPTER 26 Dischargeability of Debts

1-26 Collier Consumer Bankruptcy Practice Guide P 26.08

P 26.08 Creditors Not Listed or Scheduled by the Debtor; § 523(a)(3), § 1328(a)(2)

Debts owed to some creditors that are not listed or scheduled in the bankruptcy case are excepted from the discharge.ⁿ¹ This exception underscores the importance of filing a complete and accurate list of a client's debts in every case. As a result of the 2005 amendments to the Bankruptcy Code, this section, previously applicable only in chapter 7 cases, is now also applicable in chapter 13 cases.ⁿ² Creditors who are never listed and are thus not informed of the bankruptcy need not file a complaint during the bankruptcy case to raise this ground for nondischargeability. These creditors may raise the issue in either the bankruptcy court or a nonbankruptcy court having jurisdiction after the bankruptcy case is concluded.

FORMS

For forms of pleadings in proceedings under section 523(a)(3) see *Collier Consumer Bankruptcy Forms*, §§ CS13.32-. 34 (Matthew Bender).

[1] Exception Not Applicable If Creditor Receives Timely Notice of Case

However, there are a number of exceptions to this exception. The debt is discharged, even though not listed, if the creditor receives actual notice, either from the debtor or from some other source, that the bankruptcy has been filed,ⁿ³ and receives that notice in time to file a proof of claim or, if the claim is nondischargeable and a dischargeability complaint is required, in time to file such a complaint.ⁿ⁴ Since the deadline for claims is presently 90 days after the first date set for the meeting of creditors (or later), and in many cases there is no deadline under the Rules,ⁿ⁵ most creditors can still be notified of the case even if their claims are not discovered until well after the case is filed. Indeed, because under section 726(a)(2)(C) a creditor without notice can receive distributions even if the claim is not filed before the claims bar date, as long as the claim is filed in time to permit payment of the claim,ⁿ⁶ the appropriate deadline for notice, when there is a bar date for claims, is the last day a claim could be filed in time to receive a distribution. While there is no comparable provision in chapter 13, a good argument can be made that if no objection to a tardy claim is filed, the claim must be allowed.ⁿ⁷

Creditors that claim they were not informed of the time limit for filing a nondischargeability complaint must prove not only that they did not have timely notice, but also that their claims are in fact nondischargeable under one of the listed exceptions.ⁿ⁸ If the debt is nondischargeable under one of those exceptions, section 523(a)(3) permits the creditor without timely notice to bring its dischargeability action at any time.ⁿ⁹

PRACTICE NOTE

This exception to the exception applies if the creditor receives actual notice of the case even though the debt is not duly scheduled. Sometimes, but not always, notice is imputed if an agent, for example a collection agent or attorney, receives notice.ⁿ¹⁰ It is safest, therefore, to list the creditor itself in the bankruptcy schedules, though the agent or attorney may also be listed.

[a] Giving Notice to Creditor Omitted from Schedules

If a creditor is not scheduled at the outset of a case, the schedules should be amended and the debtor's counsel should be sure to send a copy of the notice of the meeting of creditors to the creditor, by certified mail, to ensure actual notice. If a discharge has already been granted, the debtor may still file an amendment up to the time the case is closed,ⁿ¹¹ or even afterward.ⁿ¹² Even if the schedules are not amended, actual notice sent and received within the time limits should be sufficient under the wording of section 523(a)(3).

If such notice is sent, it is a good idea to provide accurate information about the debtor's address and taxpayer identification number, as well as an account number, if possible, to avoid a later dispute about whether sufficient information was provided for effective notice.

[2] Deadlines in No-Asset Cases

In no-asset chapter 7 cases in which creditors are sent the typical notice that they should not file claims, courts have held that all otherwise dischargeable claims are discharged even if they are not listed in the debtor's schedules.ⁿ¹³ The rationale is that the only notice these unscheduled creditors miss is a notice not to file a proof of claim and a notice of a deadline for dischargeability objections which the creditors do not have. They therefore are not within the terms of section 523(a)(3) and suffer no prejudice from the lack of notice. Many of these courts have held that in such cases there is no need to amend the schedules to add the omitted creditor since the debt is already discharged by operation of law.ⁿ¹⁴ On the other hand, if a creditor could have filed a valid dischargeability complaint under one of the sections listed in section 523(c), the debt is nondischargeable after the deadline for such complaints passes, regardless of whether the schedules are amended.

FORMS

Official Form 9A is reprinted in *Collier Consumer Bankruptcy Forms, Form CS10.32-1* (Matthew Bender).

In other words, under the language of the statute, a creditor in a no asset case is never denied the right to file a timely proof of claim because there is no deadline. Similar logic would suggest that when an otherwise dischargeable debt is not listed in a case involving only partial payments to unsecured creditors, the debt should be nondischargeable only to the extent of that creditor's unpaid *pro rata* share of the total amount distributed to unsecured creditors, because that is the only harm suffered by the creditor.ⁿ¹⁵

[3] What Constitutes Proper Scheduling

If the creditor is duly scheduled, it is irrelevant whether or not it receives notice. The courts have held that minor irregularities, such as misspellings or incorrect amounts listed as due, do not render improper the listing of a particular creditor.ⁿ¹⁶ Generally, it has been held that if the creditor's identity can be reasonably ascertained, the listing is sufficient.ⁿ¹⁷ However, listing a creditor's address as that of its attorney, or in care of its attorney, may in some cases be sufficient.ⁿ¹⁸ Moreover, if the debtor knows that the debt has been assigned, the assignee must be listed as the creditor. And if the debtor lists an incorrect address, the court may inquire whether the debtor exercised reasonable diligence in completing the schedules.ⁿ¹⁹ If the debtor does not know and cannot, with reasonable diligence, determine²⁰ a

creditor's name or address, the unknown information need not be listed.ⁿ²¹ However, the fact of the debt and whatever information the debtor does know must be listed, along with a statement that the supplied information is the extent of the debtor's knowledge, and perhaps a description of efforts taken to obtain the missing information.

[4] Postbankruptcy Litigation

Usually, issues under this exception arise in state courts, which have concurrent jurisdiction to decide them, because the creditor without notice will simply sue to collect its debt. The action may be removed to bankruptcy court, however, once the affirmative defense of the discharge is raised.ⁿ²² Even if a default judgment is obtained by the creditor, the debtor should be able to litigate the dischargeability issue in bankruptcy court;ⁿ²³ if the debtor is correct in asserting that the debt was discharged, the creditor's judgment would be void under section 524(a).ⁿ²⁴

Of course, a claim which is not discharged solely because it was not listed in a chapter 7 case may be included and discharged in a subsequent bankruptcy.ⁿ²⁵

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. 523(a)*. See 4 *Collier on Bankruptcy*, P 523.09 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.08 (Matthew Bender).

(n2)Footnote 2. *11 U.S.C. § 1328(a)(2)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *Matter of Barnes*, 969 F.2d 526 (7th Cir. 1992) (creditor received actual notice when debtor orally informed him of bankruptcy and debt discharged even though debtor at same time had promised to repay it).

(n4)Footnote 4. *In re Medaglia*, 52 F.3d 451, 33 C.B.C.2d 548 (2d Cir. 1995) (creditor had timely actual notice of case even though it did not have notice of deadlines).

(n5)Footnote 5. *Fed. R. Bankr. P. 3002(c)*.

(n6)Footnote 6. *In re Ricks*, 253 B.R. 734 (Bankr. M.D. La. 2000) .

(n7)Footnote 7. See *11 U.S.C. § 502(a), (b)(9)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 8. *In re Lochrie*, 78 B.R. 257 (B.A.P. 9th Cir. 1987) .

(n9)Footnote 9. *In re Santiago*, 175 B.R. 48 (B.A.P. 9th Cir. 1994) . But see *Beaty v. Selinger (In re Beaty)*, 306 F.3d 914 (9th Cir. 2002) (laches may be available to debtor as defense if there is undue and prejudicial delay in raising nondischargeability of debt). See also *Staffer v. Predovich (In re Staffer)*, 306 F.3d 967 (9th Cir. 2002) (motion to reopen bankruptcy case was not a prerequisite to creditor complaint under § 523(a)(3)).

(n10)Footnote 10. See *In re Land*, 215 B.R. 398 (B.A.P. 8th Cir. 1997) (notice to attorney for creditor imputed to creditor because attorney was agent of creditor); *In re Price*, 17 C.B.C.2d 999, 79 B.R. 888 (B.A.P. 9th Cir. 1988) ; 4 *Collier on Bankruptcy*, P 523.09[4][a] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.08[4] (Matthew Bender).

(n11)Footnote 11. *Fed. R. Bankr. P. 1009*.

(n12)Footnote 12. *In re Soult*, 894 F.2d 815 (6th Cir. 1990) (debtor entitled to reopen case to add omitted creditor after bar date passed); *In re Rosinski*, 759 F.2d 539, 12 C.B.C.2d 923 (6th Cir. 1985) ; *In re Stark*, 717 F.2d 322, 9 C.B.C.2d 319 (7th Cir. 1983) .

(n13)Footnote 13. *Watson v. Parker (In re Parker)*, 313 F.3d 1267 (10th Cir. 2002) (debtor's intent in failing to list is irrelevant); *In re Madaj*, 149 F.3d 467 (6th Cir. 1998) ; *Judd v. Wolfe*, 78 F.3d 110, 35 C.B.C.2d 698 (3d Cir. 1996) ; *In re Beezley*, 994 F.2d 1433 (9th Cir. 1993) .

(n14)Footnote 14. *E.g., In re Beezley*, 994 F.2d 1433 (9th Cir. 1993) .

(n15)Footnote 15. *In re Ladnier*, 130 B.R. 335 (Bankr. S.D. Ala. 1991) .

(n16)Footnote 16. *Kreitlein v. Ferger*, 238 U.S. 21, 35 S. Ct. 685 (1915) ; 4 *Collier on Bankruptcy*, P 523.09[1], [2] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.08[1], [2] (Matthew Bender).

(n17)Footnote 17. 4 *Collier on Bankruptcy*, P 523.09[2] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.08[2] (Matthew Bender).

(n18)Footnote 18. *See Chanute Prod. Credit Ass'n v. Schicke (In re Schicke)*, 290 B.R. 792 (B.A.P. 10th Cir. 2003) (judgment creditor was properly scheduled in care of attorney who obtained judgment).

(n19)Footnote 19. *See In re Fauchier*, 71 B.R. 212 (B.A.P. 9th Cir. 1987) (use of addresses that were two years old).

(n20)Footnote 20. *See In re Gelman*, 5 B.R. 230 (Bankr. S.D. Fla. 1980) .

(n21)Footnote 21. *See General Collections, Inc. v. Steward*, 539 N.E.2d 981 (Ind. Ct. App. 1989) (where creditor dissolved and reformed under new name and at new address without notice to debtor, listing old name and address was sufficient and debt is discharged).

(n22)Footnote 22. *See* 1 *Collier on Bankruptcy*, P 3.07 (Matthew Bender), 1 *Collier Bankruptcy Manual*, P 3.07 (Matthew Bender) for a discussion of removal to bankruptcy court.

(n23)Footnote 23. *See McGhan v. Rutz (In re McGhan)*, 288 F.3d 1172 (9th Cir. 2002) (bankruptcy court abused its discretion in refusing to reopen case to decide whether debt was nondischargeable under § 523(a)(3) and whether discharge injunction was violated; state court's order that debt was not discharged improperly modified bankruptcy court's discharge order).

(n24)Footnote 24. *See* ch. 29 *infra*.

(n25)Footnote 25. *See In re Dye*, 108 B.R. 135 (Bankr. W.D. Tex. 1989) .



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CHAPTER 26 Dischargeability of Debts

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P 26.09 Fraud as a Fiduciary, Embezzlement or Larceny; § 523(a)(4), § 1328(a)(2)

Another exception to discharge involves fraud or defalcation while acting in a fiduciary capacity, or embezzlement or larceny while not in a fiduciary capacity.ⁿ¹ The 2005 amendments to the Bankruptcy Code,ⁿ² make this section applicable in both chapter 7 and chapter 13 cases. However, the exception based on fraud or defalcation is rarely invoked in cases involving consumers, since few consumers have acted as fiduciaries. The most common application in consumer cases may be to guardians for elderly persons and executors of estates.ⁿ³

[1] Defalcation of a Fiduciary

Defalcation has been defined as failure by a trustee to properly account for funds placed in his or her trust.ⁿ⁴ It seems clear that for this exception to apply the trust relationship involved must be an express or technical trust, and not a constructive trust implied by law in some cases of wrongful conduct.ⁿ⁵ A sales employee who has misappropriated funds is thus not a fiduciary, though a consignee may be one.ⁿ⁶ When a true fiduciary relationship is created by statute, there is little doubt that the section applies.ⁿ⁷ Courts have disagreed, however, regarding whether there must be some element of culpability for a defalcation to be nondischargeable or whether all defalcations by fiduciaries are nondischargeable.ⁿ⁸

FORMS

For a form of complaint alleging fraud as a fiduciary, see *Collier Consumer Bankruptcy Forms, Form CS13.42-1* (Matthew Bender).

[2] Larceny and Embezzlement

The terms larceny and embezzlement are also included in this exception in the Bankruptcy Code and are applicable to nonfiduciaries as well as fiduciaries. "Larceny" is not necessarily defined in bankruptcy in the same way it is defined in state law.ⁿ⁹ Larceny is defined as a matter of federal common law as taking property from its rightful owner willfully and with fraudulent intent.ⁿ¹⁰ Embezzlement is the fraudulent appropriation of property belonging to another by a person in lawful possession of that property.ⁿ¹¹

FORMS

For a form of complaint alleging larceny, see *Collier Consumer Bankruptcy Forms, Form CS13.43-1* (Matthew Bender).

As under section 523(a)(2), it is the creditor's burden to show actual fraudulent intent in order to prove embezzlement.ⁿ¹² If the debt in question was not actually incurred with such intent, even if it replaced a debt that would have met the tests for fraud, the debt is not excepted from the discharge.ⁿ¹³

PRACTICE NOTE

In any case, for this exception to apply, a complaint must be filed during the bankruptcy case within the time limits set by the Bankruptcy Rules.ⁿ¹⁴ The amount excepted from discharge is equal to the amount misappropriated, rather than any greater amount that may be owed to the creditor.ⁿ¹⁵

FOOTNOTES:

(n1)Footnote 1. See 4 *Collier on Bankruptcy*, P 523.10 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.09 (Matthew Bender).

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. *E.g.*, *In re Messineo*, 192 B.R. 597 (Bankr. D.N.H. 1996) (son breached fiduciary duties when, as co-guardian of his elderly mother's estate, he misappropriated her funds and property for his own use).

(n4)Footnote 4. See, *e.g.*, *In re Niles*, 106 F.3d 1456, 37 C.B.C.2d 644 (9th Cir. 1997) (real estate broker who handled client's funds for sales, rentals and loans was a fiduciary); *Matter of Moreno*, 892 F.2d 417 (5th Cir. 1990) (where debtor, while officer of debtor corporation, directed transfer of \$200,000 to himself and companies in which he owned at least 50% interest he acted in fiduciary capacity).

(n5)Footnote 5. *Matter of Nicholas*, 956 F.2d 110 (5th Cir. 1992) (debtor was not a fiduciary under Texas statute that deemed contractor to be "trustee" of funds due to subcontractors absent intent to defraud); *In re Teichman*, 774 F.2d 1395, 13 C.B.C.2d 1077 (9th Cir. 1985) ; *In re Schoen*, 407 B.R. 420 (Bankr. W.D. Okla. 2009) (debtor who received health insurance benefits that were supposed to be paid to hospital was not a fiduciary based on agreement with hospital). See 4 *Collier on Bankruptcy*, P 523.10[1][c] (Matthew Bender).

(n6)Footnote 6. See 4 *Collier on Bankruptcy*, P 523.10[1][c] (Matthew Bender).

(n7)Footnote 7. *E.g.*, *In re McGee*, 353 F.3d 537 (7th Cir. 2003) (city ordinance requiring landlord to place tenant's security deposit in segregated account created a fiduciary relationship); *In re Interstate Agency Inc.*, 760 F.2d 121 (6th Cir. 1985) ; *In re Thomas*, 729 F.2d 502 (7th Cir. 1984) .

(n8)Footnote 8. Compare *In re Hyman*, 502 F.3d 61 (2d Cir. 2007) (defalcation under § 523(a)(4) requires a showing of conscious misbehavior or extreme recklessness--a showing akin to the showing required for scienter in the securities law context); *Rutanen v. Baylis* (*In re Baylis*), 313 F.3d 9 (1st Cir. 2002) (defalcation requires some degree of fault, closer to fraud, without necessity of meeting a strict specific intent requirement); with *Republic of Rwanda v. Uwimana* (*In re Uwimana*), 274 F.3d 806 (4th Cir. 2001) (defalcation includes negligence or innocent mistake).

(n9)Footnote 9. See *In re Lane*, 115 B.R. 81 (Bankr. E.D. Va. 1990) (debt arising from conduct which constituted larceny under Virginia law was nevertheless dischargeable).

(n10)Footnote 10. *Werner v. Hofmann*, 5 F.3d 1170 (8th Cir. 1993) (no larceny found with respect to failure to return creditor's property when debtor's initial possession of property was lawful); *Matter of Rose*, 934 F.2d 901 (7th Cir. 1991) (debtor took husband's funds from safe deposit box).

(n11)Footnote 11. *Werner v. Hofmann*, 5 F.3d 1170 (8th Cir. 1993) (no embezzlement found with respect to failure to return creditor's property when debtor did not improperly use creditor's property that was lawfully in debtor's possession).

(n12)Footnote 12. *See, e.g., Matter of Weber*, 892 F.2d 534 (7th Cir. 1989) .

(n13)Footnote 13. *Matter of West*, 22 F.3d 775 (7th Cir. 1995) (when debtor had executed note to employer to repay embezzled funds and employer had agreed not to sue debtor on any obligation other than note, section 523(a)(4) was inapplicable). *But see Archer v. Warner*, 538 U.S. 314, 123 S. Ct. 1462, 155 L. Ed. 2d 454 (2003) .

(n14)Footnote 14. 11 U.S.C. § 523(c); *Fed. R. Bankr. P. 4007(c)*. *See P 26.03 supra*.

(n15)Footnote 15. *Matter of Bennett*, 989 F.2d 779 (5th Cir. 1993) . *But see In re Bugna*, 33 F.3d 1054, 31 C.B.C.2d 927 (9th Cir. 1994) (punitive damages also not discharged).



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CHAPTER 26 Dischargeability of Debts

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P 26.10 Domestic Support Obligations; § 523(a)(5), § 1328(a)(2)

The Bankruptcy Code excepts from discharge, both in chapter 7 and chapter 13,ⁿ¹ domestic support obligations. The term "domestic support obligation" is a new term, added in 2005,ⁿ² that encompasses what was considered alimony, maintenance or support under previous section 523(a)(5), but is broader in several respects. First, the new definition expands the persons and entities to whom such debts may be payable and includes both prepetition and postpetition obligations. Second, the term includes interest that accrues on such debt under applicable nonbankruptcy law. Last, the definition now includes obligations "established or subject to establishment before, on, or after the date of the order for relief."

For debts falling within the definition of domestic support obligations, the most a bankruptcy can do is provide protection during a reasonable payment plan under chapter 13. This protection, however, can be very valuable in areas where overzealous prosecutors and judges harass and even incarcerate those who, because of unemployment or other problems, have allowed their dependents to become public charges.

[1] Payee of the Obligation

The exception to dischargeability applies only to debts owed or recoverable by a spouse,ⁿ³ former spouse, child of debtorⁿ⁴ or such child's parent, legal guardian, responsible relative, or a government unit. It also includes obligations assigned to nongovernmental units if voluntarily assigned for purposes of collection. The definition does not include debts for alimony, maintenance, or support owed to most other entities, even if they have been assigned by the spouse or child or by operation of law. Thus, debts owed under "palimony" decision, to persons who were never validly married to the debtor, are not excepted from discharge, nor are debts to putative spouses, e.g., spouses in a void marriage. Similarly, debts assigned to other entities, such as a former spouse's estate after the former spouse's death, are not included in the exception.

FORMS

For forms of pleadings in complaints by ex-spouse under sections 523(a)(5),(15) *see Collier Consumer Bankruptcy Forms*, §§ CS13.52-. 53 (Matthew Bender).

In some cases, such as divorce decrees that give the nondebtor spouse a right to pension benefits, courts have ruled that

no debt is owed in the first place because the divorce decree granted a vested interest in property to that spouse.ⁿ⁵

[a] Support Debts Owed to Governmental Units

The definition of a domestic support obligation specifically includes all debts in the nature of alimony or support owed to or recoverable by a governmental unit.ⁿ⁶ Thus, such debts that have been assigned to governmental units remain nondischargeable under section 523(a)(5), which incorporates the definition of domestic support obligation from section 101(14A).ⁿ⁷ Similarly, such debts owed to a governmental unit, including those that were nondischargeable under section 523(a)(18), are nondischargeable pursuant to section 523(a)(5) and section 101(14A).ⁿ⁸

A few courts have expanded the definition of "domestic support obligation" beyond its obvious intent, to include other debts determined by an administrative agency to be owed to governmental units that have no relation to support orders or support obligations of debtors. These courts have held that if a debtor is determined to have received an overpayment of funds intended to support dependents the obligation to repay the overpayment is a domestic support obligation.^{n8a} In so doing, they ignore the fact that the reference to administrative determinations was originally added to the Code in order to encompass non-court adjudications of family support obligations, not every decision made by any governmental agency. By the reasoning of these courts, all sorts of debts owed to the government, if arguably they were intended for support, could be classed as non-dischargeable domestic support obligations.

[2] Determination of Whether Debt Is in the Nature of Alimony, Maintenance, or Support

The term "domestic support obligation" expressly includes within its definition the requirement that the debt be "in the nature of alimony, maintenance, or support ... without regard to whether such debt is expressly so designated."ⁿ⁹ In this respect, the scope of the exception to discharge under section 523(a)(5) remains the same as under the prior version of the Code.ⁿ¹⁰

Since its enactment, the Code has drawn a distinction between an obligation that is in the nature of alimony, maintenance and support and other types obligations arising out of a marital relationship, more specifically, a debt arising in the course of a divorce or separation or in connection with a separation agreement or divorce decree. The latter type of debt is commonly referred to as a property settlement obligation. However, it is not always simple to distinguish whether an obligation is alimony, maintenance or support as opposed to a property settlement. Many of the disputes under the previous version of section 523(a)(5) concerned the classification of debts into one of these two categories. However, as a result of the 2005 amendments to the Bankruptcy Code, for purposes of determining dischargeability, the distinction between domestic support obligations and other types of obligations arising out of a marital relationship is no longer of practical consequence in a no-asset chapter 7 case.^{n10a} However, the difference is likely to remain important for chapter 13 cases in which debts covered by section 523(a)(5) are not dischargeable while debts encompassed by section 523(a)(15) are dischargeable.

The legislative history makes clear that the question of whether a debt is in the nature of alimony, maintenance, or support or is a property settlement obligation is a matter of federal bankruptcy law, and not state law.ⁿ¹¹ The designation of a debt as alimony or property settlement by a state court decree or agreement is not binding in the dischargeability determination; a court can look behind such language to determine the real nature of the debt.ⁿ¹² However, since state courts have concurrent jurisdiction with respect to dischargeability of such debts, a decision by a state court on a section 523(a)(5) dischargeability issue is probably binding, at least if the issue is actually litigated.ⁿ¹³

[a] Factors Considered by Courts

In deciding whether an obligation is in the nature of support, the overriding issue is whether the obligation was intended to serve the function of support, as opposed to dividing property and debts. The main indicators that courts will look to in determining whether the debt is in the nature of a support payment rather than a property settlement are:

- whether the payments terminate upon death or remarriage of the spouse receiving them;ⁿ¹⁴
- whether payments are contingent on future earning abilities;
- whether payments are to be periodic over a long period of time rather than in a lump sum; and
- whether the payments are designated as being for purposes such as medical care, mortgage, or other needs of the spouse receiving them.

Each of these factors indicates that support, based upon the needs of the obligee spouse, is intended, rather than a property settlement. The existence of those needs at the time of the agreement, by itself, is often sufficient for a finding that an obligation was intended for the purpose of support.ⁿ¹⁵ While labels in a divorce decree or settlement are not binding on the court, at least some deference may be given to how the various obligations are labeled in the agreement.ⁿ¹⁶ Another factor that courts may find relevant is the parties' tax treatment of the payments. A spouse who has taken the benefit of treatment of marital obligations as alimony may be estopped from later contending the obligation was a property settlement.ⁿ¹⁷ Similarly, an obligee who did not report past payments as alimony income, may be estopped from later claiming the debt is in the nature of alimony.

If the intent of an agreement is to provide support, it is irrelevant whether such support is required under state law.ⁿ¹⁸ If the court finds, on the other hand, that payments are to compensate for a spouse's property interest, they will be designated as in the nature of a property settlement. Normally, a trial court's findings on such issues will not be disturbed on appeal if the proper legal standards are applied.ⁿ¹⁹

[b] Hold Harmless Agreements

Spouses or former spouses often disagree about the nature of a "hold harmless" agreement in which one spouse agrees to pay marital debts and then later claims that they were discharged in a bankruptcy. Whether the responsibility for these debts is more in the nature of a support payment or a property settlement is determined using similar criteria. For these debts to be determined nondischargeable, most courts have held that payment of them must be necessary to support the nondebtor spouse at the time of the agreement or order. If the debtor spouse has agreed to pay current mortgage, utility, insurance, and tax payments, for example, such payments are normally deemed to be support.ⁿ²⁰ This conclusion is bolstered if the nondebtor spouse is unemployed or if the agreement provides for payment through the court, with noncompliance punishable by contempt. Other cases in which courts have found an intent to provide support have involved such debts as payments for life insurance policies that name the debtor's spouse and children as beneficiaries,ⁿ²¹ payments for medical treatment after the divorce,ⁿ²² and debts for furniture used by the former spouse and children, when the intent was to relieve the spouse from the burden of paying them, and the spouse waived the right to periodic alimony payments.ⁿ²³

[i] Minority View of Sixth Circuit Regarding Current Needs

The Sixth Circuit Court of Appeals mandated a several step analysis to determine the dischargeability of a hold harmless obligation under the previous version of section 523(a)(5).ⁿ²⁴ Under this test, the bankruptcy court must look to the intent of the family law court or the intent of the parties themselves as to each loan obligation. If payments were intended as support, the bankruptcy court must decide whether the payments have the effect of providing support and whether that support is necessary for the daily needs of the spouse and children.ⁿ²⁵ If these factors are present, the court must finally decide whether the payments are within the criteria for ability to pay that would normally be applied to support orders. If the amounts are unreasonably excessive, they are dischargeable.

All other circuits that have addressed the issue have rejected the Sixth Circuit approach to the extent that the approach

looks to current need and the amounts of payments ordered.ⁿ²⁶ These courts have generally held that the bankruptcy court has the duty only to determine whether the payments due were originally intended to be in the nature of support rather than a property settlement. Once the debt is determined to be one for support, no further inquiry is to be made and the debt must be declared totally nondischargeable.ⁿ²⁷

[c] Debts with Intent to Divide Property Not Nondischargeable Under Section 523(a)(5)

When the intent of the parties was simply to divide assets and previous liabilities, the debt is not nondischargeable as a domestic support obligation under section 523(a)(5), especially if there is no apparent benefit intended for the other spouse. Courts have generally ruled that business debtsⁿ²⁸ and debts incurred during the marriage for medical expenses,ⁿ²⁹ furniture and other household items and transportation are dischargeable.ⁿ³⁰ However, such debts are nondischargeable in chapter 7, 11 and 12 cases under section 523(a)(15). If such debts are discharged in a chapter 13 case, any action to collect them is enjoined under *section 524 of the Bankruptcy Code*.ⁿ³¹

[d] Obligations to Pay Attorney's Fees

One type of divorce debt that has usually been found to be in the nature of support and thus nondischargeable consists of attorney's fees payable by one spouse to the other's attorney, at least when the first spouse has been awarded alimony or support. In some courts, the attorney's fees are generally deemed to rise or fall with the determination on the primary debt.ⁿ³² But most courts have reasoned that the award of fees is based upon the need of one spouseⁿ³³ or the duty of one spouse to support the other.

Courts have also struggled with whether attorney's fees incurred in custody proceedings, including fees of attorneys appointed to represent children, are dischargeable. Most courts have found this issue to turn on whether the representation was necessary for the welfare of the child; in such cases the fees have been found nondischargeable.ⁿ³⁴ Most of these courts have not addressed, however, the issue of whether the fees are owed to a spouse or child of the debtor, as is also required by section 523(a)(5).ⁿ³⁵

PLANNING NOTE

Naturally, bankruptcy debtors and potential debtors, as well as their spouses, will want to keep these principles in mind when negotiating marital settlements. Obtaining a large property settlement in return for reduced alimony may be a short-lived victory if obligations under the former are discharged in bankruptcy soon afterwards. Although some state courts have found discharge of property settlement obligations in bankruptcy to be changed circumstances justifying modification of alimony awards,ⁿ³⁶ these cases may contravene the Bankruptcy Code's "fresh start" policy.ⁿ³⁷

[3] Obligation in Connection with Separation Agreement, Divorce Decree or Court Order

To be nondischargeable under section 523(a)(5), a debt must have been established or be subject to establishment before, on or after the commencement of the case through the provisions of a separation agreement, property settlement agreement, divorce decree, other order of a court of record or a determination made in accordance with State or territorial law by a governmental unit.ⁿ³⁸ The language "subject to establishment" expands the scope of the discharge exception to include cases where a court has not yet entered an order creating an obligation in the nature of alimony or support, but where such an order "is subject" to being entered.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 523(a)(5), 1328(a)(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. 11 U.S.C. § 101(14A), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on

or after October 17, 2005.

(n3)Footnote 3. A same-sex spouse, however, will have to confront arguments that he or she is not within the ambit of the statute due to the federal Defense of Marriage Act, which defines "spouse" as only a person of the opposite sex who is a husband or a wife. 1 U.S.C. § 7. See *In re Kandu*, 315 B.R. 123 (Bankr. W.D. Wash. 2004) (same sex couple not eligible to file joint bankruptcy case due to Defense of Marriage Act).

(n4)Footnote 4. The child need not be a minor and "support" probably includes educational expenses. See *In re Harrell*, 754 F.2d 902, 12 C.B.C.2d 340 (11th Cir. 1985). Additionally, support order obligations to a child born outside of a marriage, such as those arising in paternity cases, are also not dischargeable. See *Falk & Siemer, LLP v. Maddigan* (*In re Maddigan*), 312 F.3d 589 (2d. Cir. 2002).

(n5)Footnote 5. *In re Gendreau*, 122 F.3d 815 (9th Cir. 1997) ; *In re Chandler*, 805 F.2d 555 (5th Cir. 1986) . *Bush v. Taylor*, 912 F.2d 989, 23 C.B.C.2d 1294 (8th Cir. 1990) (en banc). See 4 Collier on Bankruptcy, P 523.11[7] (Matthew Bender). But see *In re Reines*, 142 F.3d 970 (7th Cir. 1998) (city pension could not be divided by family court and obligation to pay benefits to former spouse found to be dischargeable).

(n6)Footnote 6. 11 U.S.C. § 101(14A), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n7)Footnote 7. Prior to the 2005 Act, section 523(a)(5) provided that debts assigned pursuant to section 408(a)(3) of the Social Security Act, 42 U.S.C. § 608(a)(3), or any debt assigned to the federal government or to a state or a political subdivision of a state were not dischargeable.

(n8)Footnote 8. The 2005 amendments to the Code deleted section 523(a)(18) related to support obligations owed to government units apparently because Congress believed the section was no longer necessary in light of the new definition of domestic support obligations. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 8a. *Wis. Dep't of Workforce Dev. v. Ratliff*, 390 B.R. 607, 616 (E.D. Wis. 2008) (food stamp benefits were intended to support debtor's children so overpayment was nondischargeable). Compare *In re Tinnell*, 2009 Bankr. LEXIS 1604 (Bankr. D. Neb. June 12, 2009) (no evidence that an administrative determination based on evidence had ever been made).

(n10)Footnote 9. 11 U.S.C. § 101(14A), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 10. Former section 523(a)(B) expressed the same principle through a convoluted, double negative which excluded debts designated as alimony, maintenance, or support "unless such liability is actually in the nature of alimony, maintenance, or support."

(n12)Footnote 10a. If there are assets, the distinction will determine whether the debt will be a first priority debt under section 507(a)(1) entitled to payment before other unsecured creditors.

(n13)Footnote 11. S. Rep. No. 989, 95th Cong., 2d Sess. 79 (1978), reprinted in Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender); H.R. Rep. No. 595, 95th Cong., 1st Sess. 364 (1977) reprinted in Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n14)Footnote 12. 11 U.S.C. § 523(a)(5)(B). *In re Goin*, 808 F.2d 1391 (10th Cir. 1987).

(n15)Footnote 13. *Goss*, 722 F.2d 599 (10th Cir. 1983).

(n16)Footnote 14. See *In re Morel*, 983 F.2d 104 (8th Cir. 1992) (when one portion of award was payable until

death or remarriage and other portion was not, the portion not conditioned on the obligee continuing to live as a single person was a dischargeable property settlement).

(n17)Footnote 15. *In re Benich*, 811 F.2d 943 (5th Cir. 1987) (wife needed support); *In re Shaver*, 736 F.2d 1314 (9th Cir. 1984) ("property settlement" found in nature of support where wife needed support and divorce decree had no explicit provision for support of wife).

(n18)Footnote 16. *See Tilley v. Jessee*, 789 F.2d 1074 (4th Cir. 1986) (settlement agreement structured so as to divide property settlement from alimony given great weight in determining that debt is dischargeable).

(n19)Footnote 17. *E.g., Matter of Davidson*, 947 F.2d 1294 (5th Cir. 1991) . Such decisions are probably erroneous in looking to this single factor, since the requirements for federal tax deductibility are not exactly the same as the indicia of support under federal bankruptcy law.

(n20)Footnote 18. *Matter of Biggs*, 907 F.2d 503 (5th Cir. 1990) (debtor's divorce decree obligation to former wife was nondischargeable alimony, even though Texas law did not provide for alimony awards).

(n21)Footnote 19. *In re Brody*, 3 F.3d 35 (2d Cir. 1993) (listing factors trial court found showed parties' intent to provide support).

(n22)Footnote 20. *In re Gianakas*, 917 F.2d 759, 23 C.B.C.2d 1510 (3d Cir. 1990) ; *Sylvester v. Sylvester*, 865 F.2d 1164 (10th Cir. 1989) . *But see Richardson v. Edwards*, 127 F.3d 97 (D.C. Cir. 1997) (obligation to assume second mortgage not intended as a means of providing support).

(n23)Footnote 21. *In re Evans*, 4 B.R. 232 (Bankr. S.D. Ala. 1980) .

(n24)Footnote 22. *In re Breaux*, 3 C.B.C.2d 604, 8 B.R. 218 (Bankr. W.D. La. 1981) .

(n25)Footnote 23. *Matter of Coil*, 680 F.2d 1170, 6 C.B.C.2d 955 (7th Cir. 1982) .

(n26)Footnote 24. *In re Calhoun*, 715 F.2d 1103, 9 C.B.C.2d 290 (6th Cir. 1983) .

(n27)Footnote 25. The Sixth Circuit has since held that in determining the court's intent, once it is shown that there is a direct payment obligation labeled as maintenance, terminable on death remarriage or receipt of social security, there is a conclusive presumption that it is intended as support. *In re Sorah*, 163 F.3d 397 (6th Cir. 1998) .

(n28)Footnote 26. *E.g., Sylvester v. Sylvester*, 865 F.2d 1164 (10th Cir. 1989) ; *Forsdick v. Turgeon*, 812 F.2d 801, 16 C.B.C.2d 452 (2d Cir. 1987) ; *Draper v. Draper*, 790 F.2d 52 (8th Cir. 1986) ; *In re Harrell*, 754 F.2d 902, 12 C.B.C.2d 340 (11th Cir. 1985) .

(n29)Footnote 27. *E.g., Sylvester v. Sylvester*, 865 F.2d 1164 (10th Cir. 1989) ; *Forsdick v. Turgeon*, 812 F.2d 801, 16 C.B.C.2d 452 (2d Cir. 1987) ; *Draper v. Draper*, 790 F.2d 52 (8th Cir. 1986) ; *In re Harrell*, 754 F.2d 902, 12 C.B.C.2d 340 (11th Cir. 1985) .

(n30)Footnote 28. *Stout v. Prussel*, 691 F.2d 859, 7 C.B.C.2d 6 (9th Cir. 1982) (Small Business Administration loan).

(n31)Footnote 29. *See 11 U.S.C. § 101(14A)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005; *see also In re Linn*, 10 C.B.C.2d 1049, 38 B.R. 762 (B.A.P. 9th Cir. 1984) (fees for court appointed attorney and psychiatrist that wife was not obligated to pay discharged in husband's bankruptcy).

(n32)Footnote 30. *In re Daiker*, 2 C.B.C.2d 916, 5 B.R. 348 (Bankr. D. Minn. 1980) .

(n33)Footnote 31. *In re Jones*, 38 B.R. 690 (N.D. Ohio 1983) (state proceedings to collect on discharged property settlement debt enjoined by bankruptcy court); *In re Marriage of Williams*, 203 Cal. Rptr. 909 (Ct. App. 1984) (attempted setoff of discharged debt).

(n34)Footnote 32. *In re Bell*, 5 B.R. 653 (Bankr. W.D. Okla. 1980) ; *Lynn v. Lynn*, 91 N.J. 510, 453 A.2d 539 (1982) .

(n35)Footnote 33. *In re Joseph*, 16 F.3d 86 (5th Cir. 1994) .

(n36)Footnote 34. *Falk & Siemer, LLP v. Maddigan (In re Maddigan)*, 312 F.3d 589 (2d Cir. 2002) (attorney's fees awarded to out of wedlock mother in custody case were nondischargeable support); *In re Chang*, 163 F.3d 1138 (9th Cir. 1998) (debts for professional fees in child custody case owed to father and guardian ad litem were nondischargeable); *Miller v. Gentry*, 55 F.3d 1487, 33 C.B.C.2d 1044 (10th Cir.) , cert. denied, 516 U.S. 916, 116 S. Ct. 305, 133 L. Ed. 2d 210 (1995) ; *In re Jones*, 9 F.3d 878, 30 C.B.C.2d 206 (10th Cir. 1994) (fees were incurred on behalf of child). Cf. *Lowther v. Lowther (In re Lowther)*, 321 F.3d 946 (10th Cir. 2002) (attorney fee award that would impair debtor's ability to support children presented unusual circumstances calling for exception to usual rule that fees in custody cases are nondischargeable); *Adams v. Zentz*, 963 F.2d 197 (8th Cir. 1992) (case primarily concerned mother's efforts to frustrate father's relationship with child).

(n37)Footnote 35. See generally Sommer & McGarity, *Collier Family Law and the Bankruptcy Code*, P 6.03[4] (Matthew Bender).

(n38)Footnote 36. *In re Myers*, 773 P.2d 118 (Wash. Ct. App. 1989) ; *Eckert v. Eckert*, 424 N.W.2d 759 (Wis. Ct. App. 1988) .

(n39)Footnote 37. Modification issues are discussed in Sommer & McGarity, *Collier Family Law and the Bankruptcy Code*, P 6.10 (Matthew Bender).

(n40)Footnote 38. 11 U.S.C. § 101(14A)(C).



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 26 Dischargeability of Debts

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P 26.11 Willful and Malicious Injury; § 523(a)(6)

The sixth category of debts excepted from discharge consists of debts for willful and malicious injury by the debtor to another entity or the property of another entity.ⁿ¹ This exception encompasses a narrow class of tort liabilities, in which the debtor's conduct was both intentional and such that it intended to harm an entity or its property. If the creditor does not have an enforceable claim against the debtor based on the alleged injury, the exception does not apply.ⁿ² Some courts have held that if a contractual obligation, such as a settlement agreement, has been substituted for the original alleged tort debt, the exception does not apply.ⁿ³

FORMS

For forms of complaints under section 523(a)(6) see *Collier Consumer Bankruptcy Forms*, §§ CS13.62-.63 (Matthew Bender).

[1] Meaning of Willful and Malicious

Most of the litigation under this exception has focused on whether specific conduct was willful and malicious. It is clear, at one end of the spectrum, that assault and battery is willful and malicious.ⁿ⁴ At the other end, negligence, even gross negligence, is not.ⁿ⁵ Thus, few liabilities that arise out of automobile accidents are excepted from discharge under this subsection, regardless of whether the debtor was driving while intoxicated,ⁿ⁶ driving without insurance,ⁿ⁷ or violating various traffic laws.ⁿ⁸ Even a reckless disregard for the safety of others is not sufficient to except the debt from discharge.ⁿ⁹

Although the case law indicates that a case-by-case analysis must be made to determine whether conduct was willful and malicious, proof of an intentional tort is not always enough. The ultimate outcome usually depends on the nature of the act. The intentional setting of a fire is obviously sufficient,ⁿ¹⁰ but breaches of contractual rights, even if intentional, generally fall short of the standard.ⁿ¹¹ The Supreme Court clarified this issue in *Kawaauhau v. Geiger*.ⁿ¹² The court held that medical malpractice could not be willful and malicious injury under this section because the word "willful" modified "injury," thus requiring that the actor intended the harmful consequences of the act in question, knowing that they would occur.

[2] Conversion of Collateral

Perhaps the most common attempts to use this exception in consumer cases arise from alleged conversions of a creditor's collateral. It was probably the common use of such allegations in cases in which consumers innocently disposed of such property that led to the requirement that the willful and malicious exception be raised during the bankruptcy case, if it is to be raised at all.ⁿ¹³

It is clear, though, that the willful and malicious standard is applicable to conversion cases.ⁿ¹⁴ Although a technical conversion may occur whenever a debtor disposes of collateral, no matter how small its value, more is required to bring the discharge exception into play.ⁿ¹⁵ The debt is not excepted from discharge unless the debtor understood that a security interest existedⁿ¹⁶ and acted with a specific intent to harm or defraud the creditor.ⁿ¹⁷ The debt is also not excepted if the creditor was aware of the debtor's actions and failed to object to them.ⁿ¹⁸ This is especially true for retailers who know that their credit cards will often be used to purchase gifts and who fail to discourage (and in some cases encourage) that practice.ⁿ¹⁹ Moreover, if the debt is excepted, it should be nondischargeable only to the extent of the value of the collateral converted, if that value is less than the debt.ⁿ²⁰

[3] Punitive Damages

Prior to 1998, courts disagreed regarding whether punitive damages are also nondischargeable under section 523(a)(6). In light of the Supreme Court's decision about punitive damages under section 523(a)(2),ⁿ²¹ there is little doubt that any punitive and multiple damages included in a debt for willful and malicious injury that is not discharged will also be nondischargeable.

[4] Acts of Persons Other than the Debtor

Finally, it is clear under the Bankruptcy Code that only willful and malicious acts of the debtor, and not those of agents, children, or others, can lead to a finding of nondischargeability.ⁿ²² This changes the law from what had developed under the prior Bankruptcy Act, which in some cases denied the discharge of debts for willful and malicious acts of partners, children, and others for whom the debtor was legally responsible under state law.ⁿ²³

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 523(a)(6). See 4 Collier on Bankruptcy, P 523.12* (Matthew Bender).

(n2)Footnote 2. *In re Zelis*, 66 F.3d 205 (9th Cir. 1995) (creditor that had settled with joint tort-feasor had no claim against debtor and could not have claim held nondischargeable)

(n3)Footnote 3. *But see Archer v. Warner*, 538 U.S. 314, 123 S. Ct. 1462, 155 L. Ed. 2d 454 (2003) .

(n4)Footnote 4. *In re Miera*, 926 F.2d 741, 24 C.B.C.2d 961 (8th Cir. 1991) (debtor judge could not discharge award of compensatory and punitive damages to court reporter for battery consisting of kissing court reporter on mouth without his consent); *In the Matter of Dardar*, 620 F.2d 39 (5th Cir. 1980) .

(n5)Footnote 5. *In re Kelly*, 140 B.R. 291 (Bankr. N.D. Okla. 1992) (debt for negligent shooting held dischargeable).

(n6)Footnote 6. *Cassidy v. Minihan*, 794 F.2d 340 (8th Cir. 1986) . However, many of these debts are now nondischargeable under *11 U.S.C. § 523(a)(9)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See P 26.14 infra*.

(n7)Footnote 7. *Pechar v. Moore*, 98 B.R. 488 (D. Neb. 1988) .

(n8)Footnote 8. *Oregon Ford, Inc. v. Claburn*, 89 B.R. 629 (N.D. Ohio 1987) (debtor had driven rented vehicle in excess of lawful speed limit).

(n9)Footnote 9. H.R. Rep. No. 595, 95th Cong., 1st Sess. 363 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 77-79 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender); *In re Duncan*, 448 F.3d 725 (4th Cir. 2006) (state court judgment based on reckless indifference did not establish facts necessary for exception to apply); *In re Quezada*, 718 F.2d 121, 9 C.B.C.2d 695 (5th Cir. 1983) .

(n10)Footnote 10. *In re Galanis*, (Bankr. D.N.J. 1980), .

(n11)Footnote 11. *In re Riso*, 978 F.2d 1151 (9th Cir. 1992) (contract giving right of first refusal with respect to sale of property did not give rise to security interest that would constitute property; intentional breach of contract not within exception unless accompanied by willful and malicious tortious conduct).

(n12)Footnote 12. 523 U.S. 57, 118 S. Ct. 974, 140 L. Ed. 2d 90, 38 C.B.C.2d 1629 (1998) . *See also In re Delaney*, 97 F.3d 800 (5th Cir. 1996) (accidental firing of gun that debtor tapped on car window was not willful and malicious, even though debtor intentionally tapped on window).

(n13)Footnote 13. 11 U.S.C. § 523(c), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n14)Footnote 14. *Vulcan Coals, Inc. v. Howard*, 946 F.2d 1226 (6th Cir. 1991) (allegation of conversion of collateral is sufficient to make out a case under section 523(a)(6)).

(n15)Footnote 15. *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 55 S. Ct. 151, 79 L. Ed. 393 (1934) .

(n16)Footnote 16. *In re Posta*, 866 F.2d 364, 20 C.B.C.2d 937 (10th Cir. 1989) (evidence that debtors were inexperienced in business matters, had never read security agreement and intended to fulfill their loan obligation was sufficient to establish that conversion of collateral was not willful or malicious).

(n17)Footnote 17. *In re Littleton*, 942 F.2d 551 (9th Cir. 1991) (conversion of collateral not willful where debtors were struggling to keep business going and there was no evidence that debtors personally benefitted from the sale); *In re Phillips*, 882 F.2d 302 (8th Cir. 1989) ; *In re Posta*, 866 F.2d 364, 20 C.B.C.2d 937 (10th Cir. 1989) ; *In re Cecchini*, 780 F.2d 1440, 14 C.B.C.2d 91 (9th Cir. 1986) (substituted opinion on denial of rehearing) (debtor acted under mistaken belief in converting checks of another); *In re Long*, 774 F.2d 875, 13 C.B.C.2d 1036 (8th Cir. 1985) ; *St. Paul Fire & Marine Ins. Co. v. Vaughn*, 779 F.2d 1003, 14 C.B.C.2d 133 (4th Cir. 1985) . *But see In re Foust*, 52 F.3d 766 (8th Cir. 1995) (debt found due to willful and malicious conversion when debtor converted crops securing loans, sold them in distant market, keeping proceeds, and fabricated reports of grain thefts to cover up scheme).

(n18)Footnote 18. *In re Wolfson*, 56 F.3d 52 (11th Cir. 1995) (debtor's belief that creditor acquiesced in his actions, engendered by course of dealing with creditor, was reasonable and supported conclusion that conversion was not willful or malicious).

(n19)Footnote 19. *In re Goycochea*, 192 B.R. 847 (Bankr. D. Md. 1996) (Sears could not claim conversion of collateral when debtor gave goods purchased to others, since Sears had knowledge that goods purchased are often given as gifts and therefore, impliedly consented to transfer); *In re Hodges*, 83 B.R. 25 (Bankr. N.D. Cal. 1988) (creditor required to prove that giving away collateral as a gift is an intentional violation of the security agreement).

(n20)Footnote 20. *See In re Modicue*, 926 F.2d 452 (8th Cir. 1991) (conversion of collateral renders debt nondischargeable to the extent of the value of the collateral at the time of sale).

(n21)Footnote 21. *Cohen v. De La Cruz*, 523 U.S. 213, 118 S. Ct. 1212, 140 L. Ed. 2d 341, 38 C.B.C.2d 1891 (1998) .

(n22)Footnote 22. *But see In re Cecchini*, 780 F.2d 1440, 14 C.B.C.2d 91 (9th Cir. 1986) (partner's acts imputed to debtor).

(n23)Footnote 23. *In re Eggers*, 51 B.R. 452 (Bankr. E.D. Tenn. 1985) .



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CHAPTER 26 Dischargeability of Debts

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P 26.12 Fines and Penalties; §§ 523(a)(7), 1328(a)(3)

One of the less frequently applicable exceptions is the exception for fines and penalties owed to governmental units and for their benefit.ⁿ¹ The debt must be owed to a governmental unit to be nondischargeable under this provision.ⁿ² However, section 523(a)(13), makes federal criminal restitution orders nondischargeable in chapter 7, regardless of whether the obligee is a governmental unit.ⁿ³

FORMS

For a form of complaint seeking a dischargeability determination under this section *see Collier Consumer Bankruptcy Forms, Form CS13.72-1* (Matthew Bender).

[1] Only Punitive Fines and Penalties Included

By its terms, this exception is limited to purely punitive, as opposed to compensatory, assessments. However, the Supreme Court in *Kelly v. Robinson*,ⁿ⁴ has held that a restitution order in a welfare fraud case constitutes a nondischargeable fine or penalty within the meaning of this section. Some courts, following *Kelly*, have found state criminal restitution debts dischargeable even if they are forwarded to a private victim.^{n4a} Similar reasoning has led courts to hold that a compensatory assessment of costs is nondischargeable.ⁿ⁵ This exception may extend to fines imposed by administrative agencies as well as by courts.ⁿ⁶ But an examination of the circumstances of other judicial and administrative restitution awards may turn up grounds for distinguishing *Kelly*.ⁿ⁷

[2] Fines and Penalties in Chapter 13 Cases

In a chapter 13 case, many penalties and fines are dischargeable. In the past, arguments were frequently raised about whether court-imposed payments are debts within the meaning of the Bankruptcy Code. The United States Supreme Court has laid most of those arguments to rest by holding that restitution orders imposed as a condition of probation in a criminal proceeding are debts dischargeable in chapter 13.ⁿ⁸ Shortly after it was rendered, this decision was partially overruled by Congress through an amendment creating *section 1328(a)(3) of the Bankruptcy Code*, which makes nondischargeable restitution debts or criminal fines included in a sentence on the debtor's conviction of a crime.ⁿ⁹ Thus, an adjudication in a juvenile proceeding is not within the scope of this provision.^{n9a} Other restitution debts, such as those imposed in pretrial diversion programs, remain dischargeable in chapter 13. Certain fines, other than federal criminal fines,ⁿ¹⁰ also remain dischargeable in chapter 13. For example, civil penalties are clearly not within the scope

of section 1328(a)(3).

Whether parking tickets or traffic tickets are dischargeable may depend on whether parking or traffic violations are deemed "crimes" under state law. In many states they probably are not, especially if there is state law defining crimes as including only misdemeanors and felonies. In such cases, there may also be issues regarding whether a "conviction" has occurred, or whether there has been a "sentence."¹¹

In any case, there is no doubt that a debtor may provide for such debts in a chapter 13 plan even if they are nondischargeable. If the debtor does so, the automatic stay should bar collection efforts, such as attempts to revoke the debtor's driver's license or to incarcerate the debtor due to nonpayment. There may be issues regarding whether the debtor can separately classify such debts, similar to issues that now arise with respect to nondischargeable student loans.¹² Also, the debtor may have to file a claim on behalf of the creditor to ensure that the debt is paid.¹³

[3] Tax Penalties

Not included in either the chapter 7 exception or the chapter 13 exception are two specific kinds of tax penalties. Those penalties relating to a tax which is dischargeable are also dischargeable, as are any tax penalties relating to a transaction or event that occurred more than three years before the filing of the petition.¹⁴ Also not included in either exception are civil awards for multiple and punitive damages.¹⁵ However, such awards may be nondischargeable if the underlying debt is nondischargeable under another provision of section 523(a).¹⁶

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 523(a)(7). See 4 Collier on Bankruptcy, P 523.13 (Matthew Bender); 2 Collier Bankruptcy Manual, P 523.12 (Matthew Bender).

(n2)Footnote 2. *In re Rashid*, 210 F.3d 201 (3d Cir. 2000) (federal restitution payable to private victims not within discharge exception); *Matter of Towers*, 162 F.3d 952 (7th Cir. 1998), cert. denied, 527 U.S. 1004, 119 S. Ct. 2340 (1999) (restitution order payable to attorney general for benefit of fraud victims was not for benefit of a governmental unit and, therefore, was dischargeable, but separate \$50,000 penalty was nondischargeable); *In re Strutz*, 154 B.R. 508 (Bankr. N.D. Ind. 1993) (attorney's fees awarded as sanctions were dischargeable).

(n3)Footnote 3. See P 26.17 *infra*.

(n4)Footnote 4. 479 U.S. 36, 107 S. Ct. 353, 93 L. Ed. 2d 216, 15 C.B.C.2d 890 (1986).

(n5)Footnote 4a. *In re Troff*, 479 F.3d 1213 (10th Cir. 2007); *In re Verola*, 446 F.3d 1206 (11th Cir. 2006); *In re Thompson*, 418 F.3d 362 (3d Cir. 2005) (distinguishing from civil restitution orders).

(n6)Footnote 5. *Thompson v. Virginia*, 16 F.3d 576 (4th Cir.), cert. denied, 512 U.S. 1221, 114 S. Ct. 2709, 129 L. Ed. 2d 836 (1994) (fact that punishment was contingent on costs rendered costs nondischargeable as fines, penalties or forfeitures).

(n7)Footnote 6. See *Hickman v. Texas* (*In re Hickman*), 260 F.3d 400 (5th Cir. 2001); *In re Collins*, 173 F.3d 924 (4th Cir. 1999), cert. denied, 528 U.S. 1073, 120 S.Ct. 785 (2000) (exception covers only fines that are penal in nature; liability of surety on forfeited bail bonds was dischargeable); *In re Poule*, 19 C.B.C.2d 1059, 91 B.R. 83 (B.A.P. 9th Cir. 1988) (civil penalties imposed for debtor's violation of contractor licensing law are nondischargeable fines). But see *City of Philadelphia v. Nam* (*In re Nam*), 273 F.3d 281 (3d Cir. 2001) (bail bond forfeiture judgment against individual who was not a professional bail bondsman nondischargeable).

(n8)Footnote 7. E.g., *Williams v. Motley*, 925 F.2d 741, 24 C.B.C.2d 1188 (4th Cir. 1991) (service fee imposed on uninsured motorists to defray administrative expenses found dischargeable).

(n9)Footnote 8. *Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 110 S. Ct. 2126, 109 L. Ed. 2d 588, 22 C.B.C.2d 1067 (1990) .

(n10)Footnote 9. *See Bova v. St. Vincent De Paul Corp.* (*In re Bova*), 326 F.3d 300 (1st Cir. 2003) (fact that injured party sought civil judgment to enforce restitution order did not alter character of debt that arose from criminal restitution order and was nondischargeable in chapter 13).

(n11)Footnote 9a. *In re Sweeney*, 2007 U.S. App. LEXIS 16405 (10[th] Cir. 2007) .

(n12)Footnote 10. *See* 18 U.S.C. § 3613(f).

(n13)Footnote 11. *See In re Wilson*, 252 B.R. 739 (B.A.P. 8th Cir. 2000) (plea of guilty with deferred sentence of probation was conviction, as determined under federal law).

(n14)Footnote 12. *See* ch. 14 *supra*. *See also* 8 *Collier on Bankruptcy*, P 1322.05[2] (Matthew Bender); 3 *Collier Bankruptcy Manual*, P 1322.05[2] (Matthew Bender).

(n15)Footnote 13. *See* ch. 19 *supra*.

(n16)Footnote 14. 11 U.S.C. § 523(a)(7)(A), (B). *McKay v. United States*, 957 F.2d 689 (9th Cir. 1992) (penalties relating to transactions more than three years old are dischargeable even if underlying taxes are not). *See* P 26.05 *supra*.

(n17)Footnote 15. *In re Marvin*, 139 B.R. 202 (Bankr. E.D. Wis. 1992) .

(n18)Footnote 16. *See Cohen v. De La Cruz*, 523 U.S. 213, 118 S. Ct. 1212, 140 L. Ed. 2d 341 (1998) .



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CHAPTER 26 Dischargeability of Debts

1-26 Collier Consumer Bankruptcy Practice Guide P 26.13

P 26.13 Student Loans; § 523(a)(8), § 1328(a)(2)

The exception to discharge for student loans resulted from publicity over a supposed flood of bankruptcies in the early 1970s filed by students who were just finishing their education with the purpose of discharging their student loans before they started earning money. The exception has had several different wordings and, as last amended, covers an "educational benefit, overpayment or loan" which is "made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or a nonprofit institution," for "an obligation to repay funds received as an educational benefit, scholarship or stipend," or "any other educational loan that is a qualified loan, as defined by section 221(d)(1) of the Internal Revenue Service Code of 1986..."ⁿ¹ This language covers most, if not all, student loans made by nonprofit institutions or governmental units,ⁿ² at least when the debtor is the student loan recipient rather than a co-signer.ⁿ³ Additionally, the 2005 Act broadened the exception further by including any education loan that is qualified for a tax deduction regardless of whether the loan is made, insured or guaranteed by a governmental unit or made under a program funded by a governmental unit or nonprofit institution.

[1] Types of Obligations Included

The statutory language includes loans from a trust fund administered by a state university.ⁿ⁴ It also includes "scholarships" under the public health service's health professions scholarship program where the student does not fulfill his or her obligation of active duty service.ⁿ⁵ Courts have disagreed whether loans from a nonprofit credit union are within the scope of the exception.ⁿ⁶ However, for such loans that are tax deductible, they will now be nondischargeable under section 523(a)(8)(B). Other debts related to education that do not come within the specific terms of the exception are dischargeable.ⁿ⁷

Generally, if a student loan debt is nondischargeable, postpetition interest on the debt is also not discharged.ⁿ⁸ Some courts have held, however, that contractually imposed liquidated damages for nonpayment of student loans are dischargeable, because the penalties are not debts for an "educational loan."ⁿ⁹

[2] Student Loan Dischargeability Tests

Currently, the sole exception to the nondischargeability of student loans is available when excepting the debt from discharge would cause the debtor or the debtor's dependents "undue hardship."ⁿ¹⁰ However, prior to October 7, 1998, section 523(a)(8) also provided for the dischargeability of student loan debt if the loan first came due more than seven years prior to the filing of the bankruptcy petition.

[a] Undue Hardship Test

Courts have long struggled to define the term undue hardship. Although most of the published opinions on the subject agree that "undue" means more than the "garden variety" hardship that arises from the expense of future payments,ⁿ¹¹ each judge seems to bring a unique set of values to the process of defining and implementing the applicable standard.

Several circuit courts of appeals have adopted a definition of undue hardship that employs a three-part test.ⁿ¹² Under this test, undue hardship exists if:

- the debtor cannot maintain, based on current income and expenses, a minimal standard of living for the debtor and the debtor's dependents if forced to repay the loans;
- additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans;^{n12a} and
- the debtor has made good faith efforts to repay the loans.

In general, low-income debtors are most likely to obtain a discharge under this test, but debtors need not be at the poverty level to demonstrate undue hardship.ⁿ¹³ Most courts have found debtors with incomes lower than \$25,000 (or more for large families) to be at a minimal standard of living. Most debtors who have been denied an undue hardship discharge had incomes several times greater than the poverty level.ⁿ¹⁴ They should seek to have the court focus on their income and expenses as the basis for a determination of undue hardship. Certainly, any debtor who can demonstrate some personalized misfortune, disability or unique underprivilege should bring that factor to the attention of the court.ⁿ¹⁵ Similarly, every effort should be made to establish lack of job skills, lack of available jobs, disabilities and other factors which make it improbable that a low-income debtor will have better prospects in the future.ⁿ¹⁶ A debtor must demonstrate that he or she is not likely to earn significantly more in the future, or the discharge of the loans is likely to be denied.ⁿ¹⁷ The test requiring a good faith effort to pay the loan does not require that repayment actually occurred, although it may require some effort to deal with the loan prior to bankruptcy.ⁿ¹⁸

[i] Trade School Loans

In evaluating student loans that were incurred for vocational school education, two additional considerations related to discharge are appropriate. First, the student's undue hardship argument may be strengthened if the student loan arose from a private vocational school that closed down or defrauded the student. Not only do courts sense the unfairness involved in making a student repay a loan for a valueless education, but also the absence of acquired skills makes it less likely that the debtor will be able to obtain employment that could make possible future loan repayment.ⁿ¹⁹ In fact, under recent legislation, the debtor may be excused from paying the loan, even without a bankruptcy case or may have a defense to liability on the loan.

Evidence that a student obtained no benefit from a trade school education is relevant to the issue of whether the debtor will be able to pay in the future, because it suggests lack of skills necessary to obtain income for repayment.ⁿ²⁰ It is also relevant to the debtor's payment history, because the debtor may not have had the ability to make any payments and because a valueless vocational school education is outside the Congressional concern about highly skilled professionals shedding loan obligations prior to a lucrative career.ⁿ²¹

A further argument related to the dischargeability of trade school loans is that, absent discharge, the debtor may be ineligible for future government educational loans. If a discharge is not granted, a low-income student will not be able to go back to school, and will not be able to obtain a decent paying job, making repayment now or in the future an undue hardship.

[ii] Courts' Attempts at Compromise Solutions

Sometimes, even in fairly strong hardship cases, student loan creditors offer to take very low payments. While it could be argued that the court should only look to the payments actually due under the terms of the note, such offers of low payments can make it more difficult to assert that the loan, as modified by the creditor, presents a hardship. Perhaps not surprisingly, courts have been attracted to this method of compromising on the outcome of the case, sometimes finding no hardship solely because of the reduced-payments offer. In fact, a few courts have even devised other solutions, short of complete nondischargeability in difficult cases, by reducing the term and/or amount of the loan.ⁿ²² The Sixth Circuit Court of Appeals approved a bankruptcy court's order ruling that a debtor's loans were dischargeable, but staying enforcement of its order for 18 months to see if the debtor's situation improved.ⁿ²³ The authority for such actions without the creditor's consent is dubious.

Some student loan creditors have argued that no undue hardship discharge is necessary because the debtor may participate in an income-contingent repayment program with very low or even no payments in years when the debtor has a low income. Such arguments would, if carried to their logical conclusion, mean that no debtor could obtain an undue hardship discharge, which is clearly not Congress' intent since it has not repealed the undue hardship discharge provision, and has even amended it since the repayment programs were instituted. Courts have also noted that placing a debtor in a 25 year repayment plan that is not likely to eliminate, or sometimes even reduce, the loan does not mitigate the undue hardship the loan would cause.ⁿ²⁴ Such programs require payments if the debtor's income is even slightly above poverty level, which still does not afford a minimal standard of living. Moreover, such programs actually permit the loan balance to go up, with capitalization of some interest, and do not prevent the discharge of a remaining balance after 25 years from being deemed taxable income to the debtor.

[b] Former Seven Year Test**WARNING**

The Higher Education Amendments of 1998,ⁿ²⁵ deleted section 523(a)(8)(A) from the Code, leaving "undue hardship" as the sole basis for discharging a student loan. However, the "seven year test," and the discussion that follows, is still applicable in cases commenced on or prior to October 7, 1998.

The plain language of former section 523(a)(8)(A) provides that a debt which came due more than seven years prior to the debtor's bankruptcy filing, excluding any suspension of the repayment period, is dischargeable.ⁿ²⁶

[i] Exclusion of Deferment and Suspension Periods

Although student loans usually first become due shortly after graduation,ⁿ²⁷ extensions and consolidations can, on occasion, cause confusion as to whether the seven years has yet passed. Generally, the first date that payments became due is the critical point of reference.ⁿ²⁸ Later consolidations have been held to start the running of a new seven year period from the date of the first payment on the consolidated loan.ⁿ²⁹ On the other hand, a creditor's unilateral changes in the payment schedule,ⁿ³⁰ or deferments that are retroactive and not permitted by state regulations,ⁿ³¹ do not change the first payment due date, nor do payment agreements that do not involve cessation of payments.ⁿ³² However, courts have suspended the running of the time period when payment has been deferred by re-enrollment after the initial period has begun to run.ⁿ³³

[ii] Bankruptcy Cases within the Seven Year Period

There is also some disagreement about whether the seven year period continues to run during a bankruptcy case when collection of the loan may be stayed.ⁿ³⁴ Department of Education regulations offer a useful clarification on this issue, providing that the Department will not consider the time a debtor is in bankruptcy to be a suspension of the repayment

period if the debtor makes payments during the case sufficient to meet the amount owed under the debtor's repayment schedule.ⁿ³⁵ Thus, a debtor who has student loans that cannot be discharged, and who may have to file a bankruptcy case for other reasons, should be able to enter into an affordable payment agreement with the holder of the student loanⁿ³⁶ and continue those payments during the case, thereby avoiding any interruption in the running of the seven year dischargeability period.

[iii] Seeking Resolution of Dischargeability Issues

Whether or not there is confusion on the debtor's part about passage of the requisite seven years, it is essential to achieve clarity on this issue with the applicable creditors. In some cases, there will be no dispute because all parties will agree that the loan was dischargeable since it was undeniably more than seven years old. In that event, a stipulation, letter or other confirmation of an agreement is essential since the lending institution, guarantee agency or some other creditor may not keep adequate records reflecting the discharge and therefore seek to collect at some point in the future.

PRACTICE NOTE

If there is any dispute about whether the seven years had passed, then a strategic decision must be made about whether to seek a declaratory judgment on dischargeability in the bankruptcy court. The debtor's other potential course of action is to wait and see if the creditor recommences collection efforts following bankruptcy and then raise the discharge defensively in the applicable state or federal forum.ⁿ³⁷

If a bankruptcy court determination is desired, there is no time limit to commence an adversary proceeding to resolve the dischargeability issues. In fact, the applicable Rule even speaks of allowing cases to be reopened in order to obtain determinations on issues related to dischargeability.ⁿ³⁸

[3] Procedure for Dischargeability Determination

A proceeding to determine dischargeability of a student loan may be brought at any time.ⁿ³⁹ It must be commenced by a complaint pursuant to the adversary proceeding Rules.ⁿ⁴⁰ A state student loan creditor is not immune from suit under the *Eleventh Amendment*.ⁿ⁴¹ Often, the student loan creditor will serve discovery on the debtor to determine the debtor's circumstances and whether it wishes to settle the case.

FORMS

For sample discovery materials in student loan dischargeability cases, see Collier Consumer Bankruptcy Forms §§ CS 13.82-3, 13.82-4 (Matthew Bender).

The debtor has at least the burden of going forward with proof in such a case, but courts have differed regarding whether the debtor has the ultimate burden of proof, since in other dischargeability proceedings the creditor bears that burden.ⁿ⁴² Alternatively, at least if the student loan creditor does not object, the dischargeability of a student loan may be determined by a provision in the debtor's chapter 13 plan which, if the plan is confirmed, becomes binding upon the creditor.ⁿ⁴³

PRACTICE NOTE

Although a debtor has the option of seeking a determination related to dischargeability in a nonbankruptcy forum after the bankruptcy is completed,ⁿ⁴⁴ some state or nonbankruptcy federal courts may be unwilling to make a decision on what they perceive to be a bankruptcy issue especially if the open question is "undue hardship."ⁿ⁴⁵ If the facts are favorable during the bankruptcy case, the better practice is to seek to have the issue decided in bankruptcy court prior to discharge. If an unfavorable decision is received and circumstances subsequently change for the worse, dischargeability of student

loan obligations generally may be relitigated by reopening a prior complaint or bringing a new proceeding even if the debtor's bankruptcy case has been closed.ⁿ⁴⁶

[4] Raising Defenses to Student Loan Debts

If it is not likely that a student loan debt will be found dischargeable (and especially in chapter 13 if payments on the debt are going to be made), the debtor should consider whether there are defenses to the debt, particularly if there was a close relationship between the school and the lender. If possible, the debtor should consider bringing school-related defenses (*e.g.*, breach of contract, warranty, fraud or unfair trade practice) to the proof of claim filed by the originating lender or guarantee agency.ⁿ⁴⁷ A decision disallowing the claim based on a valid defense is as good or better than a decision that the loan is dischargeable.

To the extent the claim is disallowed, the debtor would have a binding judgment that the debt is not owed. Additionally, the creditor would not be entitled to any dividend available from the estate. Finally, attorneys fees might be available to counsel to the extent that a determination is based on unfair and deceptive acts or practices or another statute involving fee shifting.

[5] Special Issues Regarding Student Loans in Chapter 13

Student loans that are nondischargeable in chapter 7 under section 523(a)(8) are also nondischargeable in chapter 13 under section 1328(a)(2), which incorporates by reference section 523(a)(8). However, in some cases a chapter 13 plan may still provide advantages during the term of the plan, even if the debt is ultimately nondischargeable. Additionally, student loans issues continue to arise in chapter 13 cases that are filed for other reasons.

[a] Undue Hardship in Chapter 13

Given that *section 1328(a) of the Bankruptcy Code* simply incorporates section 523(a)(8), issues of dischargeability of student loans in chapter 13 cases should be treated almost identically to those arising in chapter 7 cases. For example, one court addressing dischargeability in chapter 13 determined undue hardship just as if the case had proceeded under chapter 7.ⁿ⁴⁸ The mere fact that the debtor can afford chapter 13 plan payments should not be dispositive of the ability to pay a student loan.ⁿ⁴⁹ In many cases those payments go almost entirely to secured creditors to ensure a debtor continued shelter, transportation to work or other necessities, or are made at great sacrifices that cannot be sustained beyond the plan period.

As in chapter 7, the debtor must affirmatively request a finding of undue hardship for the debt to be found dischargeable during the bankruptcy case. Although a plan provision might provide that confirmation of the plan will constitute a finding that undue hardship exists,ⁿ⁵⁰ such provisions will probably be disfavored if a party objects.ⁿ⁵¹ A few courts have even sanctioned counsel for placing such provisions in plans,ⁿ⁵² although such decisions are contrary to both the concept of the chapter 13 plan as a proposal by the debtor which can include any provision not contrary to title 11,ⁿ⁵³ and the case law which has held that such provisions can be approved and binding.ⁿ⁵⁴ As discussed above, the procedure used in most cases for resolving questions related to dischargeability in bankruptcy is set out in *Rule 4007 of the Federal Rules of Bankruptcy Procedure*, which provides for an adversary proceeding.

Since most chapter 13 cases continue for the three to five-year length of the plan and because the nondischargeability of student loans can be raised at any time,^{n54a} careful considerations of timing should be brought to bear in order to ensure that the issues are heard when the debtor faces maximum financial pressures. However, some courts may take the position that no determination on dischargeability can be made until the end of the case.ⁿ⁵⁵

[b] Payment of Student Loan through Chapter 13 Plan

In a few districts, the chapter 13 standing trustee has taken the position that nondischargeable student loan debts must be

fully paid in a chapter 13 bankruptcy plan. That position is incorrect. Even if a student loan is not dischargeable, it nevertheless remains an unsecured claim during the bankruptcy case (unless the creditor holds a nonavoided judgment lien), subject to those provisions of the Bankruptcy Code applicable to unsecured debts. For most cases, this means that during the bankruptcy plan, the student loan creditor is entitled to the greater of what it would receive under the best interests of the creditors testⁿ⁵⁶ or the disposable income test,ⁿ⁵⁷ just like any other unsecured creditor.ⁿ⁵⁸

PRACTICE NOTE

Thus, the debtor can propose treatment of a student loan creditor during a bankruptcy plan that is no different than treatment of any other unsecured creditor. The student loan creditor will not be entitled to additional regular payments outside the plan prior to the debtor's discharge.

[c] Separate Classification of Student Loan

However, if the student loan is nondischargeable, it is in the debtor's interest to make sure that as much of the loan as possible is paid during the bankruptcy. Frequently this means that the debtor wishes to propose a plan to separately classify the student loan and have it paid at a higher percentage than other unsecured debts.ⁿ⁵⁹ Several judicial decisions have explicitly held that a separate classification in favor of a student loan creditor does not "discriminate unfairly" within the meaning of *section 1322(b)(1) of the Bankruptcy Code*.ⁿ⁶⁰ At least one court has held that there is a reasonable basis for the separate classification both because the debt is nondischargeable and because absent payment the debtor may be unable to return to school to obtain a degree.ⁿ⁶¹ And even if separate classification is not permitted, the debtor has the absolute right to provide in the plan for a cure of all defaulted payments and maintenance of current payments under *section 1322(b)(5) of the Bankruptcy Code* if the loan's last payment is after the plan's last payment.ⁿ⁶²

MORE INFORMATION

For an extensive discussion of classification of claims see chapter 14 *supra*.

[6] Health Education Assistance Loans and Other Special Loan Programs

Congress created an additional student loan exception to discharge for certain student loans in the Omnibus Budget Reconciliation Act of 1981. *Section 292f(g) of title 42, United States Code*,ⁿ⁶³ provides that no bankruptcy discharge may be granted as to a Health Education Assistance Loan ("HEAL") within seven years after the date repayment is to begin. During this seven year period no hardship discharge is available for such loans. Even after the seven years, the loan is dischargeable only if the bankruptcy court finds that denial of a discharge would be unconscionable.ⁿ⁶⁴ This nondischargeability provision has been held to apply in chapter 13 as well as in chapter 7.ⁿ⁶⁵

Because the provision contains language making discharge available after seven years based on unconscionability, a discharge should be possible in a chapter 13 case that is filed within seven years of the first repayment due date, if the discharge is not entered until after the seven-year period has expired.ⁿ⁶⁶ Several courts have held that in the context of a chapter 13 plan, the student loan creditor can be treated like other unsecured creditors and that a determination as to discharge can only be made at the conclusion of the plan.ⁿ⁶⁷ Moreover, based on the language of *section 523(b) of the Bankruptcy Code*, HEAL loans may be dischargeable in a second bankruptcy filing under the more lenient standards of *section 523(a)*, if the prior case resulted in a discharge.ⁿ⁶⁸

As with *section 523(a)(8)*, the provision making HEAL debts nondischargeable is self-executing. The burden is on the debtor to request and establish grounds for a court to find the loan dischargeable.ⁿ⁶⁹ Courts have held that nondischarge of the loan would be unconscionable if it was "excessive, exorbitant," "lying outside the limits of what is reasonable or acceptable," "shockingly unfair, harsh, or unjust" or "outrageous."ⁿ⁷⁰

Several other health education programs have similar provisions which make debts arising in those programs

nondischargeable.ⁿ⁷¹ Generally the operation of these provisions is similar to that of the HEAL provisions. It has been held that the fact that a loan may be dischargeable under one of these specialized provisions does not exempt it from nondischargeability under section 523(a)(8).^{n71a}

[7] Effect of Student Loan Discharge

If a student loan is discharged, the lender should not accept any further payments on the loan, such as payments the lender may receive through a tax intercept program, or even money voluntarily paid by the debtor.ⁿ⁷² Department of Education regulations provide that if a guaranty agency receives any payments on a discharged loan on which the Department of Education previously paid a claim to the agency, the agency must return 100% of those payments to the sender and notify the borrower that there is no obligation to pay the loan.ⁿ⁷³

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 523(a)(8)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. *Murphy v. Pa. Higher Educ. Assistance Agency (In re Murphy)*, 282 F.3d 868 (5th Cir. 2002) (entire student loan nondischargeable, including portion meant for living expenses); *Burks v. Louisiana (In re Burks)*, 244 F.3d 1245 (11th Cir. 2001) (repayment requirement of stipend due to failure to complete obligation to teach in "other race" institution after receiving degree was within scope of § 523(a)(8)).

(n3)Footnote 3. *See In re Behr*, 80 B.R. 124 (Bankr. N.D. Iowa 1987) (exception not applicable to nonstudent codebtor). *Cf.* H.R. Rep. No. 595, 95th Cong., 1st Sess. 134 (1977), reprinted in Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender). ("The proponents of an exception to discharge have argued that educational loans are different from most loans, they...[rely] for repayment solely on the debtor's future increased income resulting from the education"). *But see In re Pelkowski*, 990 F.2d 737, 28 C.B.C.2d 1023 (3d Cir. 1993) (language of statute does not limit exception to discharge to exclude parent cosigners).

(n4)Footnote 4. *In re Shore*, 707 F.2d 1337, 8 C.B.C.2d 1007 (11th Cir. 1983) .

(n5)Footnote 5. *U.S. Dept. of Health & Human Services v. Smith*, 807 F.2d 122, 15 C.B.C.2d 1405 (8th Cir. 1986)

(n6)Footnote 6. *Compare T I Federal Credit Union v. Delbonis*, 72 F.3d 921 (1st Cir. 1995) (loan from nonprofit federal credit union nondischargeable; federal credit union was instrumentality of United States) *with In re Simmons*, 175 B.R. 624 (Bankr. E.D. Va. 1994) (credit union was not a nonprofit institution and loan was not made pursuant to a program within meaning of section 523(a)(8)).

(n7)Footnote 7. *In re Hawkins*, 469 F.3d 1316 (9th Cir. 2006), *aff'g* 317 B.R. 104 (B.A.P. 9th Cir. 2004) (debt for tuition subsidy that arose when debtor did not fulfill terms of subsidy was not educational loan); *In re Chambers*, 348 F.3d 650 (7th Cir. 2003) (open account for unpaid tuition and fees not a loan); *Boston Univ. v. Mehta (In re Mehta)*, 310 F.3d 308 (3d Cir. 2002) (tuition debt not a loan); *In re Renshaw*, 222 F.3d 82 (2d Cir. 2000) (tuition debt not a loan); *In re Segal*, 57 F.3d 342, 33 C.B.C.2d 1496 (3d Cir. 1995) (when nonprofit hospital paid off debtor's student loan, replacing it with new loans, those new loans were not nondischargeable under this section because they were not made under a "program" of giving educational loans); *Scott v. Midwestern Training Ctr., Inc. (In re Scott)*, 287 B.R. 470 (Bankr. E.D. Mo. 2002) (loan from for-profit truck driving school was dischargeable). *Cf. In re DePasquale*, 225 B.R. 830 (B.A.P. 1st Cir. 1998) (payment agreement for overdue tuition constituted "loan"); *In re Johnson*, 218 B.R. 449 (B.A.P. 8th Cir. 1998) (debtor who signed promissory note to college for unpaid tuition had student loan). *In re Nelson*, 188 B.R. 32 (D.S.D. 1995) (debts for tuition, room and board to university was not a loan).

(n8)Footnote 8. *In re Woods*, 233 F.3d 324 (5th Cir. 2000) ; *Leeper v. Pennsylvania Higher Education Assistance*

Agency, 49 F.3d 98, 32 C.B.C.2d 1833 (3d Cir. 1995) (postpetition interest not discharged, even after debtor paid prepetition debt in full through chapter 13 plan).

(n9)Footnote 9. *E.g., In re Lipps*, 79 B.R. 67 (Bankr. M.D. Fla. 1987) .

(n10)Footnote 10. 11 U.S.C. § 523(a)(8), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. *E.g., Brunner v. New York State Higher Education Services*, 831 F.2d 395 (2d Cir. 1987) .

(n12)Footnote 12. *Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302 (10th Cir. 2004) (test does not require certainty of hopelessness for second prong; good faith prong should not allow imposition of court's values on debtor's life choices); *Hemar Ins. Corp. of Am. v. Cox (In re Cox)*, 338 F.3d 1238 (11th Cir. 2003) ; *In re Pena*, 155 F.3d 1108 (9th Cir. 1998) ; *In re Faish*, 72 F.3d 298, 34 C.B.C.2d 1312 (3d Cir. 1995) , *cert denied*, 518 U.S. 1009, 116 S. Ct. 2532, 135 L. Ed. 2d 1055 (1996) ; *Matter of Roberson*, 999 F.2d 1132, 29 C.B.C.2d 561 (7th Cir. 1993) ; *Cheesman v. Tennessee Student Assistance Corp.*, 25 F.3d 356, 31 C.B.C.2d 140 (6th Cir. 1994) , *cert. denied*, 513 U.S. 1081, 115 S. Ct. 731, 130 L. Ed. 2d 634 (1995) ; *Brunner v. New York State Higher Education Services*, 831 F.2d 395 (2d Cir. 1987) .

(n13)Footnote 12a. To meet this prong of the test the debtor must simply prove that the inability to pay will continue for a substantial portion of the loan repayment period. No evidence of exceptional facts beyond that is necessary. *In re Nys*, 446 F.3d 938 (9th Cir. 2006) .

(n14)Footnote 13. *See In re Pena*, 155 F.3d 1108 (9th Cir. 1998) (discharge granted to childless couple with income of \$20,976); *In re Cline*, 248 B.R. 347 (B.A.P. 8th Cir. 2000) (single woman in good health who earned \$25,000 and is unlikely to earn more granted discharge); *In re Nary*, 253 B.R. 752 (N.D. Tex. 2000) (income of \$48,000 for family of five, though 2.2 times poverty standard, would justify discharge based on family expenses if it could not be increased); *In re Coulson*, 253 B.R. 174 (W.D.N.C. 2000) (mother and two children with income of \$23,975 could not repay loans); *In re Turreto*, 255 B.R. 884 (Bankr. N.D. Cal. 2000) (debtor with one child in her care could not repay loans with income of over \$25,000).

(n15)Footnote 14. *E.g., In re Roberson*, 999 F.2d 1132 (7th Cir. 1993) (court found debtor could earn over \$30,000).

(n16)Footnote 15. *See, e.g., In re Hornsby*, 144 F.3d 433 (6th Cir. 1998) (debtors did not need to be at poverty level to show undue hardship); *In re Johnson*, 121 B.R. 91 (Bankr. N.D. Okla. 1990) (single mother of two not receiving support); *In re Reilly*, 24 C.B.C.2d 361, 118 B.R. 38 (Bankr. D. Md. 1990) (debtor was divorced mother of three whose ex-husband was incurably ill and therefore not contributing support).

(n17)Footnote 16. *E.g., In re Price*, 25 B.R. 256, 258 (Bankr. W.D. Mo. 1982) (relevant considerations include "whether the education enabled or would enable the debtor to obtain substantially higher income"); *Matter of Powelson*, 25 B.R. 274 (Bankr. D. Neb. 1982) (vocational degree in hairstyling did not enhance debtor's job skills or employability).

(n18)Footnote 17. *See Rifino v. United States (In re Rifino)*, 245 F.3d 1083 (9th Cir. 2001) (debtor with masters degree was earning over \$27,000 with future increases likely); *Brightful v. Pa. Higher Educ. Assistance Agency (In re Brightful)*, 267 F.3d 324 (3d Cir. 2001) (debtor who did not introduce evidence showing why she could not use her skills as a legal secretary to earn more income denied student loan discharge).

(n19)Footnote 18. *Innes v. Kansas (In re Innes)*, 284 B.R. 496 (D. Kan. 2002) ; *In re Brown*, 239 B.R. 204, 209 (S.D. Cal. 1999) .

(n20)Footnote 19. *See, e.g., In re Law*, 29 C.B.C.2d 1603, 159 B.R. 287 (Bankr. D.S.D. 1993) (repayment of \$20,000 student loan for two and a half weeks of useless flight training would be undue hardship); *In re Evans*, 131 B.R. 372 (Bankr. S.D. Ohio 1991) (trade school education in word-processing did not put debtor in a position to repay her student loans).

(n21)Footnote 20. *E.g., Matter of Powelson*, 25 B.R. 274 (Bankr. D. Neb. 1982) .

(n22)Footnote 21. *In re Evans*, 131 B.R. 372 (Bankr. S.D. Ohio 1991) .

(n23)Footnote 22. *Saxman v. Educ. Credit Mgmt. BJR Corp.* (*In re Saxman*), 325 F.3d 1168 (9th Cir. 2003) (partial discharge order is permissible); *In re Hornsby*, 144 F.3d 433 (6th Cir. 1998) (partial discharge is permitted under court's equitable powers).

(n24)Footnote 23. *In re Cheesman*, 25 F.3d 356, 31 C.B.C.2d 140 (6th Cir. 1994) , *cert. denied*, 513 U.S. 1081, 115 S. Ct. 731, 130 L. Ed. 2d 634 (1995) .

(n25)Footnote 24. *Long v. Educ. Credit Mgmt. Corp.* (*In re Long*), 271 B.R. 322 (B.A.P. 8th Cir. 2002) .

(n26)Footnote 25. Pub. L. No. 105-244, § 971 (1998), *reprinted in* Vol. F Collier on Bankruptcy, App. Pt. 41(o)(iii) (Matthew Bender).

(n27)Footnote 26. *See 4 Collier on Bankruptcy*, P 523.14[3] (Matthew Bender); *2 Collier Bankruptcy Manual*, P 523.13 (Matthew Bender).

(n28)Footnote 27. *See In re Woodcock*, 45 F.3d 363, 32 C.B.C.2d 1341 (10th Cir.) , *cert. denied*, 516 U.S. 828, 116 S. Ct. 97, 133 L. Ed. 2d 52 (1995) (based upon language of note, debtor's payments first came due nine months after debtor ceased to be matriculated in a program leading to a degree, even though debtor continued to take courses after that).

(n29)Footnote 28. *In re Scott*, 147 F.3d 788 (8th Cir. 1998) .

(n30)Footnote 29. *Hiatt v. Indiana State Student Assistance Comm'n*, 36 F.3d 21, 31 C.B.C.2d 1520 (7th Cir. 1994) , *cert. denied*, 513 U.S. 1154, 115 S. Ct. 1109, 130 L. Ed. 2d 1074 (1995) (seven years runs from date on which first payment was due on consolidation loan).

(n31)Footnote 30. *In re Woodcock*, 45 F.3d 363, 32 C.B.C.2d 1341 (10th Cir.) , *cert denied*, 516 U.S. 828, 116 S. Ct. 97, 133 L. Ed. 2d 52 (1995) (creditor could not unilaterally change the due date of first payment).

(n32)Footnote 31. *Flynn*, 190 B.R. 139 (Bankr. D.N.H. 1995) .

(n33)Footnote 32. *In re Marlewski*, 168 B.R. 378 (Bankr. E.D. Wis. 1994) .

(n34)Footnote 33. *In re Kaufman*, 4 C.B.C.2d 109, 9 B.R. 755 (Bankr. E.D. Pa. 1981) . *See also In re Woodcock*, 45 F.3d 363, 32 C.B.C.2d 1341 (10th Cir.) *cert. denied*, 516 U.S. 528, 116 S. Ct. 97, 133 L. Ed. 2d 52 (1995) (loans became due when debtor ceased to be matriculated due to graduation, even though debtor was part-time student after that, so loans became due nine months after graduation).

(n35)Footnote 34. *In re Gibson*, 34 C.B.C.2d 998, 184 B.R. 716 (E.D. Va. 1995) (period during which lender was stayed from taking action excluded in computing seven year period).

(n36)Footnote 35. 34 C.F.R. § 682.402(m)(5).

(n37)Footnote 36. Student loan regulations require holders of student loans to enter into reasonable and affordable

payment agreements with debtors. 34 C.F.R. § 682.200.

(n38)Footnote 37. *See, e.g., Indiana Univ. v. Canganeli*, 501 N.E.2d 299 (Ill. App. Ct. 1986) (discharge can be raised as a defense to collection of student loans in postbankruptcy state court proceedings).

(n39)Footnote 38. *Fed. R. Bankr. P. 4007(b)*.

(n40)Footnote 39. *Fed. R. Bankr. P. 4007(b)*.

(n41)Footnote 40. *Fed. R. Bankr. P. 7001 et seq.*

(n42)Footnote 41. *Tennessee Student Assistance Corporation v. Hood*, 124 S. Ct. 1905, 158 L. Ed. 2d 764 (2004) .

(n43)Footnote 42. *In re Fox*, 163 B.R. 975 (Bankr. M.D. Pa. 1993) (debtor has burden of going forward but not burden of proof); *In re Alliger*, 78 B.R. 96 (Bankr. E.D. Pa. 1987) . *But see Tennessee Student Assistance Corporation v. Hood*, 124 S. Ct. 1905, 158 L. Ed. 2d 764 (2004) (student loans "presumptively" nondischargeable).

(n44)Footnote 43. *In re Andersen*, 215 B.R. 792 (B.A.P. 10th Cir. 1998) , *aff'd*, 179 F.3d 1253 (10th Cir. Kan. 1999) (holding confirmed plan declaring undue hardship and dischargeability of student loan binding on creditor). *But see In re Galey*, 230 B.R. 898 (Bankr. S.D. Ga. 1999) (finding dischargeability of student loan must be determined through adversary proceeding and denying confirmation of plan that sought to discharge student loan).

(n45)Footnote 44. 11 U.S.C. § 523(c), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See Standifer v. State*, 3 P.3d 925 (Alaska 2000) (debtor could move to vacate postbankruptcy default judgment on student loan to obtain determination of undue hardship dischargeability).

(n46)Footnote 45. *See Massachusetts Higher Education Assistance Corp. v. Taylor*, 390 Mass. 755, 459 N.E.2d 807(1984) (implying that if undue hardship claim not raised in bankruptcy court it is waived).

(n47)Footnote 46. 11 U.S.C. § 350; *Fed. R. Bankr. P. 4007(b)*; *In re Fisher*, 223 B.R. 377 (Bankr. M.D. Fla. 1997) (debtor who had not sought discharge of student loan during bankruptcy could reopen case to seek undue hardship discharge in light of postbankruptcy accident which reduced her ability to repay). *In re Sobh*, 61 B.R. 576 (E.D. Mich. 1986) .

(n48)Footnote 47. *See Tipton v. Secretary of Education*, 768 F. Supp. 540 (S.D.W. Va. 1991) .

(n49)Footnote 48. *In re Evans*, 131 B.R. 372 (Bankr. S.D. Ohio 1991) .

(n50)Footnote 49. *In re Goranson*, 183 B.R. 52 (Bankr. W.D.N.Y. 1995) (income used for plan payments would not be available at end of plan, since major portion of payments was for car payments and other expenses that would continue after the plan).

(n51)Footnote 50. *Espinosa v. United Student Aid Funds, Inc.*, 553 F.3d 1193 (9th Cir. 2008) , *cert. granted*, *United Student Aid Funds, Inc. v. Espinosa*, 129 S. Ct. 2791, 174 L. Ed. 2d 289, 2009 U.S. LEXIS 4361 (2009) . (creditor bound by confirmed plan provision discharging postpetition interest on student loan). *But see In re Ransom*, 336 B.R. 790 (B.A.P. 9th Cir. 2005) (creditor not bound by plan discharging interest due to insufficient notice and ambiguity of plan). Other courts have held that an undue hardship determination can be obtained only through an adversary proceeding. *E.g., Whelton v. Educ. Mgmt. Corp.*, 432 F.3d 150 (2d Cir. 2005) ; *In re Ruehle*, 412 F.3d 679 (6th Cir. 2005) .

(n52)Footnote 51. *Matter of Key*, 128 B.R. 742 (Bankr. S.D. Ohio 1991) .

(n53)Footnote 52. *E.g., In re Evans*, 43 C.B.C.2d 435, 242 B.R. 407 (Bankr. S.D. Ohio 1999) .

(n54)Footnote 53. 11 U.S.C. § 1322(b)(11), formerly § 1322(b)(10), as redesignated by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n55)Footnote 54. See *In re Wright*, 279 B.R. 886 (D. Kan. 2002) (sanctions not appropriate unless there was no good faith basis for claim that repayment of student loans would be undue hardship).

(n56)Footnote 54a. *Educational Credit Mgmt. Corp. v. Coleman (In re Coleman)*, 2008 U.S. App. LEXIS 16424 (9th Cir. Aug. 1, 2008) ;

(n57)Footnote 55. See, e.g., *Ekenasi v. Educ. Res. Inst. (In re Ekenasi)*, 325 F.3d 541 (4th Cir. 2003) (ordinarily dischargeability proceeding should not be brought until end of chapter 13 case, unless there are circumstances where the Brunner factors could be predicted with sufficient certainty earlier in case); *In re Raisor*, 180 B.R. 163 (Bankr. E.D. Tex. 1995) (dischargeability based upon undue hardship cannot be determined until end of plan).

(n58)Footnote 56. 11 U.S.C. § 1325(a)(4). See ch. 14 *supra*.

(n59)Footnote 57. 11 U.S.C. § 1325(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. See ch. 14 *supra*.

(n60)Footnote 58. See *In re Owens*, 82 B.R. 960 (Bankr. N.D. Ill. 1988) (potentially nondischargeable HEAL loan may be treated like other unsecured debts during chapter 13).

(n61)Footnote 59. See generally ch. 14 *supra*.

(n62)Footnote 60. *In re Cox*, 34 C.B.C.2d 591, 186 B.R. 744 (Bankr. N.D. Fla. 1995) ; *In re Boggan*, 125 B.R. 533 (Bankr. N.D. Ill. 1991) ; *In re Freshley*, 69 B.R. 96 (Bankr. N.D. Ga. 1987) . But see *In re Groves*, 39 F.3d 212 (8th Cir. 1994) (affirming bankruptcy court's refusal to permit separate classification).

(n63)Footnote 61. *In re Freshley*, 69 B.R. 96 (Bankr. N.D. Ga. 1987) .

(n64)Footnote 62. *In re Benner*, 29 C.B.C.2d 762, 156 B.R. 631 (Bankr. D. Minn. 1993) .

(n65)Footnote 63. This section replaces the former applicable provision, 42 U.S.C. § 294f(g).

(n66)Footnote 64. 42 U.S.C. § 292f(g).

(n67)Footnote 65. *Matter of Johnson*, 787 F.2d 1179, 14 C.B.C.2d 1223 (7th Cir. 1986) .

(n68)Footnote 66. *In re Nelson*, 183 B.R. 972 (Bankr. S.D. Fla. 1995) (also holding that, under HEAL provision, the time period was not tolled during forbearance periods).

(n69)Footnote 67. *United States v. Lee*, 89 B.R. 250 (N.D. Ga. 1987) (debt is conditionally dischargeable during pendency of chapter 13 plan); *In re Cleveland*, 19 C.B.C.2d 654, 89 B.R. 69 (B.A.P. 9th Cir. 1988) (upon completion of chapter 13 plan, issue would be whether nondischarge of loan would be unconscionable).

(n70)Footnote 68. *In re Tanski*, 195 B.R. 408 (Bankr. E.D. Wis. 1996) .

(n71)Footnote 69. *United States v. Wood*, 925 F.2d 1580 (7th Cir. 1991) .

(n72)Footnote 70. E.g., *United States HHS v. Smitley*, 347 F.3d 109 (4th Cir. 2003) (court should determine dischargeability of nonHEAL loans first and then apply HEAL standard to remainder; repayment not unconscionable when debtor could repay in 25 year plan); *Matthews v. Pineo*, 19 F.3d 121 (3d Cir.) , cert. denied, 513 U.S. 820, 115 S. Ct. 82, 130 L. Ed. 2d 35 (1994) (nondischarge not unconscionable when debtor chose to move to a small town and earn

less than she could elsewhere as physician, rather than fulfill requirement of service in medically underserved area).

(n73)Footnote 71. *In re Brown*, 79 B.R. 789 (Bankr. N.D. Ill. 1987) (National Health Services Corp. Scholarship Program- 42 U.S.C. § 254o(d)). *See also* 37 U.S.C. § 302g(e) (pertaining to refund obligations of military reservist physicians who receive special pay and who terminate their service early). Unlike HEAL loans, these provisions have not been amended to change the five year absolute bar on discharge to seven years.

(n74)Footnote 71a. *In re Udell*, 454 F.3d 180 (3d Cir. 2006) .

(n75)Footnote 72. The protections of the discharge injunction apply. 11 U.S.C. § 524(a)(2). *See* ch. 29 *infra*.

(n76)Footnote 73. 34 C.F.R. § 682.402(l).



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CHAPTER 26 Dischargeability of Debts

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P 26.14 Debts Incurred Through Operation of Motor Vehicle, Vessel or Aircraft While Unlawfully Intoxicated; § 523(a)(9), § 1328(a)(2)

As a result of increased public concern about the social problem of drunk drivers, the 1984 amendments added an exception to the chapter 7 discharge for debts incurred through drunk driving.ⁿ¹ A 1990 amendment to the statute made the exception to discharge applicable in chapter 13 cases as well.ⁿ² The same amendment broadened the exception to include unlawful driving while under the influence of a drug or other substance, but also narrowed it to include only debts for death or personal injury. Thus, debts for property damage are not nondischargeable under *section 523(a)(9) of the Bankruptcy Code*.ⁿ³ The 2005 Act extended the exception beyond debts arising from the operation of a motor vehicle while unlawfully intoxicated to include debts arising from the operation of a vessel or aircraft while unlawfully intoxicated.ⁿ⁴

The specific terms of this subsection narrow its scope somewhat. Section 523(a)(9) applies only if the debtor operated a motor vehicle, vessel or aircraft and the operation was unlawful due to intoxication. The statute does not cover vicarious liability.ⁿ⁵ Courts have disagreed about whether a motorboat is a motor vehicle within the meaning of the exception.ⁿ⁶

FORMS

For a form of complaint to determine dischargeability of debt arising from motor vehicle injury caused by intoxicated defendant *see Collier Consumer Bankruptcy Forms, Form CS13.92-1* (Matthew Bender).

At a minimum, the language of the subsection also presumably requires that the debtor meet the legal standard for intoxication in the jurisdiction where the accident occurred. These standards vary and may not even exist in every jurisdiction. Where they do exist, there may be disputes about how the standard is to be applied, especially if it is not labelled "intoxication."ⁿ⁷ In many cases, a judgment or consent decree does not specify whether or not the standard was met, and there is then a question of whether this issue may later be separately litigated to determine dischargeability under this provision.ⁿ⁸ The state courts have concurrent jurisdiction with the bankruptcy forum over any such disputes.

This subsection closes the hole which case law created in the willful and malicious injury exception of section 523(a)(6). The subsection makes clear that drunk driving, boating or flying debts do not fall within the section 523(a)(6) exception, because Congress saw fit to establish a new subsection to deal with them.ⁿ⁹ If such debts do not fall within the terms of section 523(a)(9), they should be dischargeable. Thus, a criminal restitution debt for injuries arising out of

judgment based on the debtor operating a vehicle while intoxicated was found nondischargeable under this section.ⁿ¹⁰ Additionally, one court of appeals has held that an insurance surcharge imposed by a state as a result of a drunk driving conviction is also nondischargeable under section 523(a)(9).ⁿ¹¹ It is doubtful whether the latter decision is still good law after section 523(a)(9) was amended to include only debts for death or personal injury.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 523(a)(9). See 4 *Collier on Bankruptcy*, P 523.15 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 522.14 (Matthew Bender).

(n2)Footnote 2. 11 U.S.C. § 1328(a)(2).

(n3)Footnote 3. *In re Wiggins*, 180 B.R. 676 (M.D. Ala. 1995) .

(n4)Footnote 4. This amendment resolves conflicting court decisions about whether a motorboat was a "motor vehicle" within the meaning of the exception. Compare *Boyce*, 71 F.3d 1177 (5th Cir.) , cert. denied, 517 U.S. 1244, 116 S. Ct. 2499, 135 L. Ed. 2d 191 (1996) (motorboat is not a motor vehicle) with *Willison v. Race*, 192 B.R. (W.D. Mo. 1996)(motorboat is a vehicle within scope of exception).

(n5)Footnote 5. *In re Lewis*, 17 C.B.C.2d 768, 77 B.R. 972 (Bankr. S.D. Fla. 1987) (debt dischargeable where debtor's daughter drove car).

(n6)Footnote 6. Compare *Boyce*, 71 F.3d 1177 (5th Cir.) , cert. denied, 517 U.S. 1244, 116 S. Ct. 2499, 135 L. Ed. 2d 191 (1996) (motorboat is not a motor vehicle) with *Willison v. Race*, 192 B.R. 949 (W.D. Mo. 1996) (motorboat is a motor vehicle within scope of exception).

(n7)Footnote 7. See, e.g., *Whitson v. Middleton*, 898 F.2d 950, 22 C.B.C.2d 258 (4th Cir. 1990) (evidence as a whole showed intoxication even though no drunk driving charge was made and no breath test administered); *In re Tuzzolino*, 70 B.R. 373 (Bankr. N.D.N.Y. 1987) (various degrees of intoxication are all "legal intoxication" under section 523(a)(9)). See also *Boone v. Barnes* (*In re Barnes*), 266 B.R. 397 (B.A.P. 8th Cir. 2001) (discussing evidence of intoxication).

(n8)Footnote 8. *Matter of Pahule*, 78 B.R. 210 (E.D. Wis. 1987) (bankruptcy court could look to underlying facts of debtor's criminal conviction for driving under influence to find civil judgment within scope of section 523(a)(9)), *aff'd*, 849 F.2d 1056 (7th Cir. 1988) . See also *In re Caffey*, 248 B.R. 920 (Bankr. N.D. Ga. 2000) (debt could be found nondischargeable under this section even if debtor was acquitted in criminal DUI case, since burden of proof was only a preponderance of evidence in bankruptcy proceeding).

(n9)Footnote 9. See *Cassidy v. Minihan*, 794 F.2d 340 (8th Cir. 1986) ; *In re Wright*, 66 B.R. 403 (Bankr. S.D. Ind. 1986) . But see *In re Adams*, 761 F.2d 1422, 12 C.B.C.2d 1220 (9th Cir. 1985) .

(n10)Footnote 10. See *In re Steiger*, 29 C.B.C.2d 1637, 159 B.R. 907 (B.A.P. 9th Cir. 1993) (amount of nondischargeable restitution obligation was set in criminal process based on ascertainable damages for vehicular homicide).

(n11)Footnote 11. *Lugo v. Paulsen*, 886 F.2d 602, 21 C.B.C.2d 1121 (3d Cir. 1989) .



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CHAPTER 26 Dischargeability of Debts

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P 26.15 Debts Not Discharged in Prior Bankruptcy Case - 11 U.S.C. § 523(a)(10), (b).

Section 523(a)(10) of the Bankruptcy Code contains an exception to discharge which is rarely invoked. It is relevant only if the debtor has been denied a discharge in a prior bankruptcy case, which rarely occurs in consumer cases.ⁿ¹ If the debtor has been denied a discharge, any debt that existed when the prior bankruptcy was filed may not be discharged in a later bankruptcy.

This exception does not apply, however, if discharge was denied in the prior case only because of a time bar to consecutive bankruptciesⁿ² or because of failure to pay filing fees.ⁿ³ Nor does it apply when a debt was reaffirmed in a prior bankruptcy case.ⁿ⁴ The sections which concerned these latter two bars to discharge under both the Act and the Code are conspicuously omitted from the list in section 523(a)(10), designating causes for prior denial of discharge which trigger this exception.

This exception also does not apply when a previous case was dismissed, with or without prejudice, if a discharge was not waived or denied in that case.ⁿ⁵

In addition to the exception to discharge for cases in which a discharge was denied or waived, a separate provision preserves the result of dischargeability determinations in a prior case for most debts in subsequent cases. Section 523(b) provides that if a debt was excepted from a discharge in a prior case under certain subsections of section 523(a), it is not excepted from discharge in a later case unless the debt is nondischargeable under the terms of section 523(a). Thus, if a debt not discharged in a prior case such as a tax debt has become dischargeable due to the passage of time, it can be discharged in the later case. It is unclear whether a new dischargeability complaint must be filed for the types of debts that would ordinarily require them under section 523(c) or whether such debts are remain nondischarged under principles of *res judicata*.ⁿ⁶

FOOTNOTES:

(n1)Footnote 1. See 4 *Collier on Bankruptcy*, P 523.16 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.15 (Matthew Bender). This section has also been applied in a case where discharge was revoked in a prior case. *In re Klapp*, 706 F.2d 998, 8 C.B.C.2d 725 (9th Cir. 1983) .

(n2)Footnote 2. See 11 U.S.C. § 727(a)(8), as amended by Pub. L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005 (barring discharge if debtor granted discharge under chapter 7 in case commenced eight

years before filing petition); 11 U.S.C. § 727(a)(9) (barring discharge if debtor granted discharge under chapter 13 in case commenced six years before filing petition).

(n3)Footnote 3. See ch. 29 *infra*.

(n4)Footnote 4. *In re Johnson*, 255 B.R. 696 (Bankr. E.D. Mich. 2000) (debt reaffirmed in prior bankruptcy in settlement of dischargeability dispute was not nondischargeable under section 523(a)(10) unless written waiver of discharge approved by court in prior case provided that debt would be nondischargeable in future bankruptcy cases); *In re Lones*, 13 C.B.C.2d 464, 50 B.R. 801 (Bankr. W.D. Ky. 1985) .

(n5)Footnote 5. *In re Samora*, 23 C.B.C.2d 1085, 117 B.R. 660 (Bankr. D.N.M. 1990) . See also *In re Logan*, 145 B.R. 324 (Bankr. D. Kan. 1992) (order dismissing prior case and denying a discharge for failure to attend creditors' meeting was not a denial of discharge for cause under section 727 that gave rise to an exception to discharge in later case).

(n6)Footnote 6. See *In re Moncur*, 328 B.R. 183 (B.A.P. 9th Cir. 2005) (claim preclusion principles render debt nondischargeable in later case even without timely adversary proceeding).



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CHAPTER 26 Dischargeability of Debts

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P 26.16 Debts Emerging From Responsibilities to Federal Depository Institutions; § 523(a)(11) and (12)

The two exceptions to discharge in *section 523(a)(11) and (12) of the Bankruptcy Code* are rarely, if ever, applicable in consumer cases. They were added to the Code as part of the Congressional response to the savings and loan crisis in order to help the Federal Deposit Insurance Corporation (FDIC) and other regulators recover assets to pay the cost of the bailout.

Section 523(a)(11) excepts from discharge debts that emerged from fraud or defalcation in a fiduciary capacity related to the debtor's responsibility to a depository institution or credit union when that debt is memorialized in a "final judgment, unreviewable order, consent order, decree or ... settlement agreement."ⁿ¹ Section 523(a)(12) excepts debts for malicious or reckless failure to maintain the capital of insured depository institutions, unless such responsibility has been terminated by an act of the applicable regulatory agency.ⁿ²

Section 523(c) extends the deadline for regulatory agencies in some cases under sections 523(a)(2),(4) and (6).ⁿ³ The deadline was also purportedly extended for actions to determine nondischargeability under section 523(a)(11), although by its terms that section is not referenced in section 523(c)(1), so it is not clear that a deadline applies.

FOOTNOTES:

(n1)Footnote 1. *See 4 Collier on Bankruptcy, P 523.17* (Matthew Bender); *2 Collier Bankruptcy Manual, P 523.16* (Matthew Bender).

(n2)Footnote 2. *See 4 Collier on Bankruptcy, P 523.18* (Matthew Bender); *2 Collier Bankruptcy Manual, P 523.17* (Matthew Bender).

(n3)Footnote 3. *11 U.S.C. § 523(c)(2)*. For further discussion of the procedure for determining nondischargeability of various debts *see P 26.03 supra*.



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P 26.17 Federal Criminal Restitution; § 523(a)(13)

Section 523(a)(13) of the Bankruptcy Code excepts from discharge any order of restitution issued under title 18 of the United States Code, the federal criminal code.ⁿ¹ Since the Supreme Court had already held that criminal restitution generally came within the scope of section 523(a)(7)'s exception for noncompensatory fines, penalties and forfeitures payable to or for the benefit of a governmental unit,ⁿ² this section appears to make only a few additional types of debts nondischargeable. If the federal criminal restitution debt is not payable to or for the benefit of a governmental unit, this section would make it nondischargeable nonetheless. Similarly, if the restitution were found to be compensation for actual pecuniary loss, this section would prevent it from being discharged. However, nonfederal criminal restitution debts which do not fall within section 523(a)(7) are not affected by section 523(a)(13).

Section 523(a)(13) of the Bankruptcy Code is not applicable when the debtor receives a full chapter 13 discharge under *section 1328(a) of the Bankruptcy Code*.ⁿ³ But, oddly, the exception to that discharge is in some ways broader than the exceptions to discharge in chapter 7. The chapter 13 exception in section 1328(a)(3) includes all criminal restitution debts, whether state or federal, imposed in a sentence upon conviction of a crime. However, as discussed elsewhere in this guide,ⁿ⁴ the chapter 13 exception may permit discharge of some restitution debts not dischargeable in chapter 7 if they are not imposed in a sentence upon conviction of a crime.

FOOTNOTES:

(n1)Footnote 1. *See* 4 *Collier on Bankruptcy*, P 523.19 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 523.18 (Matthew Bender).

(n2)Footnote 2. *See* P 26.12 *supra*.

(n3)Footnote 3. *Compare* 11 U.S.C. § 1328(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005, to which § 523(a)(13) is applicable.

(n4)Footnote 4. *See* P 26.12 *supra*.



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P 26.18 Debts Incurred to Pay Nondischargeable Taxes and Federal Election Law Fines; § 523(1)(14), (14A), and (14B)

Sections 523(14), (14A), and (14B) generally serve to except from discharge certain debts incurred to pay other nondischargeable obligations. Specifically, section 523(14) provides that debt incurred to pay a federal tax that would have been nondischargeable under section 523(a)(1) is nondischargeable to the same extent as the tax debt would have been.ⁿ¹

Similarly, paragraph (14A), added in 2005,ⁿ² extends the exception to debts incurred to pay a tax to a governmental unit other than the United States. Finally, section 523(14B) adds to the category of nondischargeable debts, fines or penalties imposed under federal election law. Also enacted in 2005,ⁿ³ this exception to discharge overlaps the exception to discharge under section 523(a)(7). However, it is more expansive in that, unlike section 523(a)(7), it includes fines or penalties imposed as compensation for actual pecuniary loss.

Section 523(a)(14), originally enacted in 1994 and applicable only to federal taxes, was supposedly needed to prevent debtors anticipating a bankruptcy from using a credit card to pay nondischargeable taxes and then discharging the credit card debt.

FORMS

For a form of complaint alleging nondischargeability under this section *see Collier Consumer Bankruptcy Forms, Form CS13.142-1* (Matthew Bender).

Although the provision was intended to facilitate the payment of taxes by credit card, it is not limited to credit card payments. Any loan that a lender could show was used to pay taxes probably would be within its scope. However, lenders may not know, in many cases, whether a loan was used to pay taxes, unless the loan proceeds check is made out to the tax creditor, for example to pay off a tax lien, or the debtor uses a credit card convenience check made out to the tax creditor.

The provisions also create difficult tracing problems. If taxes are paid by credit card, how are payments on the account after that to be apportioned? In view of the amendment's proponents' arguments that this provision was only to protect against debtors evading the nondischargeability of taxes by borrowing money to pay them, all payments after the credit

was incurred to pay taxes should be allocated to the tax charges until those charges are paid. However, creditors undoubtedly will argue for other methods of allocating payments, such as FIFO (first-in, first-out) or pro-rating them. The issue could become even more confused if the debtor accepted one of the frequent solicitations by credit card companies to pay off the balance on one card using a new card.

Unfortunately, the amendment does little to deter its intended targets, while harming others who are innocent of any intent to manipulate the Bankruptcy Code. Debtors who plan their bankruptcy cases and are intent on evading the tax discharge exception can simply obtain cash advances or incur debts to pay other expenses so they can pay their taxes with cash. Alternatively, some may seek to cover their tracks by incurring debt to pay their taxes and then incurring debt from another creditor to pay off the first debt. Since the second lender or credit card issuer will rarely be aware that the debt it paid off was used to pay nondischargeable taxes, the debtor will have achieved the precise result that the Bankruptcy Code attempts to prevent. The only debtors likely to be hurt by the provision are those who genuinely want to pay their taxes, incur debts to do so, and later run into financial problems before those debts are paid.

FOOTNOTES:

(n1)Footnote 1. *See 4 Collier on Bankruptcy*, P 523.20 (Matthew Bender); *2 Collier Bankruptcy Manual*, P 523.19 (Matthew Bender).

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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P 26.19 Marital Property Settlement Debts; § 523(a)(15)

Subsection 523(a)(15) provides for the nondischargeability of property settlement debts, other than domestic support obligations, that arise during the course of a divorce or separation or in connection with a divorce decree, separation agreement or other court order or determination made by a governmental unit. Generally, section 523(a)(15) governs the dischargeability of property settlement debts as opposed to support obligations. This exception to discharge was originally added by the Bankruptcy Reform Act of 1994 and most recently amended in 2005.ⁿ¹

As originally enacted, section 523(a)(15) provided that debts that are not support obligations but which were incurred in the course of a divorce or separation are nondischargeable unless either (1) the debtor lacks the ability to pay the debt or (2) discharging the debt would result in a benefit to the debtor that outweighs the detrimental consequences to the spouse, former spouse or child of the debtor.ⁿ² Also, simultaneously with the enactment of paragraph (15), Congress amended 11 U.S.C. § 523(c)(1) to add debts referred to in paragraph (15) to the list of debts that will be automatically discharged unless a creditor files an adversary proceeding in the bankruptcy court to have the debt declared nondischargeable.

As part of the the 2005 Act,ⁿ³ the balancing test governing the dischargeability of debts falling under section 523(a)(15) previously set forth in former subsections (A) and (B) of the provision was deleted. Section 523(a)(15) now provides, unqualifiedly, that a property settlement obligation encompassed by section 523(a)(15) is nondischargeable. Thus, in individual chapter 7 cases the distinction between a domestic support obligation and other types of obligations arising out of a marital relationship is of no practical consequence in determining the dischargeability of the debt. However, in chapter 13, debts covered by section 523(a)(5) are not dischargeable, while debts encompassed by section 523(a)(15) are dischargeable.ⁿ⁴ The distinction between domestic support obligations and other types of marital or family-related debt also remains significant in other contexts under the Code.ⁿ⁵ In addition, the reference to section 523(a)(15) was deleted from section 523(c)(1) by the 2005 amendments to the Code.ⁿ⁶ Therefore, debts falling under section 523(a)(15) are no longer included in the category of debts that are discharged automatically if a party does not obtain a determination of nondischargeability from the bankruptcy court.

FORMS

For a form of a complaint by creditor to determine dischargeability of debt arising from divorce or separation proceeding see *Collier Consumer Bankruptcy Forms, Form CS13.153-1* (Matthew Bender).

[1] Ability to Pay Test and Balancing Test of Former § 523(a)(15)**WARNING**

The 2005 Act,ⁿ⁷ eliminated the provisions that required the court in determining the dischargeability of marital property settlements to consider the debtor's ability to pay and to balance the benefit to the debtor against the harm to the obligee. However, these provisions are still ⁰²applicable to cases filed before October 17, 2005.

[a] Ability of Debtor to Pay

Under the former version of § 523(a)(15), applicable to cases filed before October 17, 2005, a marital property settlement debt is dischargeable if the debtor does not have the ability to pay it after providing support for dependents. The language used in the section is identical to that in former *section 1325(b) of the Bankruptcy Code*, the ability to pay test in chapter 13.ⁿ⁸ Courts therefore will probably apply similar standards, raising all of the questions that they have dealt with it in chapter 13. However, they may also take notice of the circumstances of the obligee spouse, and be more likely to find that the debtor can cut expenses if the obligee spouse has a lower standard of living than the debtor. And courts will take into account the fact that the debtor no longer has to pay other debts which are being discharged in the bankruptcy case.ⁿ⁹

Unlike a determination of nondischargeability under former section 523(a)(5), which was based upon the parties' finances at the time of the divorce, the court under section 523(a)(15) looks to the current and likely future income and expenses of the debtor,ⁿ¹⁰ which may involve consideration of the debtor's needs in light of a later marriage or live-in companion.ⁿ¹¹ In any event, if the debtor does not have the ability to pay, the analysis is ended and the court never reaches the other prong of the dischargeability test.

[b] Balancing Benefit to Debtor Against Harm to Obligee

Former section 523(a)(15), applicable to cases filed before October 17, 2005, also made property settlement debts dischargeable if the benefit to the debtor of discharge outweighs the detriment to the nondebtor obligee. This would include situations in which the debt is for an obligation which the nondebtor does not have to pay. The legislative history also mentions that it would include situations in which the nondebtor could easily pay the debt.ⁿ¹² One tendency that emerged in the cases was the desire of the court to equalize the living standards of the parties, much as a family court would do.ⁿ¹³ Finally, some courts have held that the availability of chapter 7 to the obligee may lessen the detriment of discharging the property settlement debt.ⁿ¹⁴

[c] Burden of Proof

Generally, the party asserting an exception to discharge has the burden of proof, and some courts have applied this principle.ⁿ¹⁵ Most, noting the language of the section stating the debt is not dischargeable unless one of the two tests is met and may, as they have with similar language in the student loan exception, put the burden of going forward or the burden of proof on the debtor, at least with respect to proving that one of the two exceptions to the exception are met.ⁿ¹⁶ Still others have placed the burden of pleading and proving the "affirmative defense" of inability to pay the debt on the debtor and the burden of proving that the detrimental consequences of the discharge to the creditor outweigh the benefit to the debtor on the creditor.ⁿ¹⁷

Courts not wanting to hold the entire debt dischargeable may also seek to achieve compromise results as a few have under the student loan discharge exception.ⁿ¹⁸ Despite the fact that, unlike many other Bankruptcy Code provisions, former section 523(a)(15) did not say that debts are nondischargeable "to the extent that" the debtor can afford to pay them, some courts may try to "split the baby" and discharge part but not all of the debt.ⁿ¹⁹

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. 523(a)(15). See 4 Collier on Bankruptcy, P 523.21 (Matthew Bender); 2 Collier Bankruptcy Manual, P 523.20 (Matthew Bender). This exception to discharge is discussed at length at Sommer and McGarity, *Collier Family Law and the Bankruptcy Code*, P 6.07A (Matthew Bender).

(n2)Footnote 2. Former 11 U.S.C. § 523(a)(15)(A), (B), repealed by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. See 11 U.S.C. § 1328(a), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n5)Footnote 5. See, e.g., 11 U.S.C. §§ 507(a)(1), 547(c)(7), 707(c)(3), 1112(p), 1129(a)(14), 1208(c)(10), 1225(a)(7), 1228(a), 1307(b)(11), 1325(a)(8), 1325(b)(2), 1328(a).

(n6)Footnote 6. Pub L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n7)Footnote 7. Pub L. No. 109-8 (2005), effective in cases commenced on or after October 17, 2005.

(n8)Footnote 8. See ch. 14 *supra*.

(n9)Footnote 9. *In re Schmitt*, 197 B.R. 312 (Bankr. W.D. Ark. 1996) .

(n10)Footnote 10. *In re Florio*, 187 B.R. 654 (Bankr. W.D. Mo. 1995) .

(n11)Footnote 11. *In re Short*, 232 F.3d 1018 (9th Cir. 2000) (companion's income may be considered when debtor and companion are financially interdependent or form single economic unit); *Matter of Crosswhite*, 148 F.3d 879 (7th Cir. 1998) ; *In re Adams*, 200 B.R. 630 (N.D. Ill. 1996) ; *Matter of Cleveland*, 36 C.B.C.2d 450, 198 B.R. 394 (Bankr. N.D. Ga. 1996) .

(n12)Footnote 12. H.R. Rep. No. 835, 103d Cong., 2d Sess. 54 (1994).

(n13)Footnote 13. E.g., *In re Smither*, 35 C.B.C.2d 1239, 194 B.R. 102 (Bankr. W.D. Ky. 1996) (if nondischargeability will cause debtor's living standard to fall materially below that of nondebtor, debt will be discharged).

(n14)Footnote 14. E.g., *In re Hill*, 34 C.B.C.2d 368, 184 B.R. 750 (Bankr. N.D. Ill 1995) .

(n15)Footnote 15. E.g., *In re Butler*, 186 B.R. 371 (Bankr. D. Vt. 1995) .

(n16)Footnote 16. E.g., *Matter of Crosswhite*, 148 F.3d 879 (7th Cir. 1998) (after nondebtor spouse showed debt was incurred in connection with divorce, debtor had burden of proving inability to pay and detriment to debtor greater than benefit to creditor); *Matter of Gamble*, 143 F.3d 223 (5th Cir. 1998) (same); *In re Moeder*, 220 B.R. 52 (B.A.P. 8th Cir. 1998) (same); *In re Jodoin*, 209 B.R. 132 (B.A.P. 9th Cir. 1997) ; *In re Hill*, 34 C.B.C.2d 368, 184 B.R. 750 (Bankr. N.D. Ill. 1995) (debtor has burden of proof); *In re Silvers*, 187 B.R. 648 (Bankr. W.D. Mo. 1995) (debtor has burden of going forward, but not burden of proof).

(n17)Footnote 17. *In re Hesson*, 35 C.B.C.2d 11, 190 B.R. 229 (Bankr. D. Md. 1995) .

(n18)Footnote 18. See P 26.13 *supra*.

(n19)Footnote 19. *In re Myrvang*, 232 F.3d 1116 (9th Cir. 2000) (court could enter partial discharge and set

payment schedule for remainder of debt, but exceeded its equitable powers by providing for large penalty if debtor failed to make payments).



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P 26.20 Debts for Certain Property Association Fees; § 523(a)(16)

Section 523(a)(16), as amended in 2005,ⁿ¹ makes nondischargeable membership association fees with respect to debtor's 1) interest in a condominium unit, 2) share of a cooperative corporation, and 3) interest in a lot in a homeowners association. These fees are nondischargeable for as long as the debtor has legal, equitable, or possessory ownership interest in the property.

This section was originally enacted to resolve the conflict as to whether association fees accruing after the commencement of a chapter 7 case were discharged because the contract establishing those fees was entered into before the commencement of the case.ⁿ² Prior to 2005, the exception applied only for the period the debtor physically occupied the unit or received rent from a tenant that occupied the unit. The 2005 amendments broadened the scope of the exception to discharge by eliminating the occupancy and receipt of rent requirements.ⁿ³ Instead, amended section 523(a)(16) only applies for the time period during which the debtor has an ownership interest in the property. Thus, such fees or assessments should become dischargeable after the debtor has sold, or otherwise disposed of his ownership interest, in the property.

FOOTNOTES:

(n1)Footnote 1. Pub L. No. 109-8, (2005), effective in cases commenced on or after October 17, 2005.

(n2)Footnote 2. Compare *In re Rosteck*, 899 F.2d 694 (7th Cir. 1990) (fees dischargeable) with *River Place E. Hous. Corp. v. Rosenfeld* (*In re Rosenfeld*), 23 F.3d 833 (4th Cir. 1994) (postpetition fees not discharged).

(n3)Footnote 3. Pub L. No. 109-8, (2005), effective in cases commenced on or after October 17, 2005.



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P 26.21 Costs and Fees in Prisoner Litigation; § 523(a)(17)

Yet another exception to the chapter 7 discharge, not applicable in chapter 13, was added by the Prisoner Litigation Reform Act, part of an omnibus budget bill enacted in 1996.ⁿ¹ The exception is limited to costs and fees that are imposed upon prisoners who seek to file actions *in forma pauperis* in federal courts.

Initially, section 523(a)(17) was not clearly drafted and could have been read to refer to the filing fees or costs and expenses incurred in civil actions or appeals by any debtor, not only debtors who are prisoners. The courts uniformly rejected the overbroad interpretation, recognizing that the provision was enacted as part of a legislative reform of a specific subject: prisoner *in forma pauperis* litigation.ⁿ² Nevertheless, the section was amended in 2005 to eliminate any ambiguity.ⁿ³

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 104-134 (1996).

(n2)Footnote 2. *See In re Hough*, 42 C.B.C.2d 1631, 329 B.R. 412 (B.A.P. 9th Cir. 1999) ; *In re Tuttle*, 224 B.R. 606 (Bankr. W.D. Mich. 1998) .

(n3)Footnote 3. Pub L. No. 109-8, (2005), effective in cases commenced on or after October 17, 2005.



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P 26.22 Discharge Exception for Repayment of Certain Retirement Plan Loans; § 523(a)(18)n1

In 2005, Congress replaced the existing version of section 523(a)(18) with a different category of debt excepted from discharge under chapter 7.ⁿ² Section 523(a)(18) now excepts from discharge any debt owed to a pension, profit-sharing, stock bonus or other plan established under specified sections of the Internal Revenue Code of 1986ⁿ³ for a loan authorized under specified provisions of the Employee Retirement Income Security Act of 1974,ⁿ⁴ the Internal Revenue Code,ⁿ⁵ and the Federal Employees' Retirement System Act of 1986.ⁿ⁶ Section 523(a)(18) also provides that the statutory exception to discharge for certain qualified loansⁿ⁷ may not be construed to mean that the debtor's obligation to repay the loans "constitutes a claim or a debt under this title."

Before the enactment of section 523(a)(18), there was some judicial debate, usually arising in the context of objections to confirmations of chapter 13 plans in which debtors proposed to continue to repay monies borrowed from retirement plans or accounts, as to whether "loans" from retirement plans and accounts constitute debts within the meaning of the Bankruptcy Code. Almost all of the courts have held that such obligations are not bankruptcy debts subject to discharge, primarily based on the rationale that the monies "borrowed" are merely advances from the debtor's own retirement fund which will be deducted from the fund if the debtor does not replace the funds.ⁿ⁸ In enacting section 523(a)(18), Congress has not unequivocally settled the conceptual issue but, instead, has taken a functional approach. Regardless of whether a debtor's obligation to repay a loan from the covered retirement plans or accounts is a debt within in the meaning of the Code, the obligation is not dischargeable.

FOOTNOTES:

(n1)Footnote 1. As part of the 2005 Act, the exception to discharge for certain support obligations was repealed and replaced with an entirely unrelated category of debt excepted from discharge under chapter 7. Pub L. No. 109-8, (2005), effective in cases commenced on or after October 17, 2005. There is no explanation in the legislative history for the repeal of former section 523(a)(18). However, it can be inferred that Congress was satisfied that the provision became unnecessary due to the expansion of the scope of the exception to discharge set forth in section 523(a)(5).

(n2)Footnote 2. Pub L. No. 109-8, (2005), effective in cases commenced on or after October 17, 2005.

(n3)Footnote 3. 26 U.S.C. §§ 401, 403, 408, 408A, 414, 457, 501(c).

(n4)Footnote 4. 29 U.S.C. § 1108(b)(1).

(n5)Footnote 5. 26 U.S.C. § 72(p).

(n6)Footnote 6. 5 U.S.C. § 8433(g).

(n7)Footnote 7. Section 523(a)(18) refers to loans made pursuant to a government plan as defined in 28 U.S.C. § 414(d) or a contract or account under 28 U.S.C. § 403(b).

(n8)Footnote 8. See *In re Villarie*, 648 F.2d 810 ; *In re Johnson*, 241 B.R. 394 (Bankr. E.D. Tex. 1999) ; (collecting cases); *In re Goewey*, 185 B.R. 444 (Bankr. N.D.N.Y. 1995) ; *In re Scott*, 142 B.R. 126 (Bankr. E.D. Va. 1992) . But see *In re Buchferer*, 216 B.R. 332 (Bankr. E.D.N.Y. 1997) .



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P 26.23 Debts Arising from Securities Fraud; § 523(a)(19)

Section 523(a)(19), enacted as part of the Corporate and Criminal Fraud Accountability Act of 2002,ⁿ¹ makes nondischargeable various claims relating to violation of securities laws or fraud in connection with the purchase or sale of a security, but only if there is a judgment, order, decree, settlement agreement or other official determination of the debtor's liability.ⁿ² As initially enacted, section 523(a)(19) may have required that the judgment, order, consent order or decree be entered in a judicial or administrative proceeding prior to the filing of the debtor's bankruptcy case. In the 2005 amendments, additional language was added providing that the liability result from a determination in the judicial or administrative proceeding "before, on, or after the date which the petition was filed."ⁿ³ This exception is unlikely to be utilized in many cases, especially consumer bankruptcy cases.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 107-204 (2002).

(n2)Footnote 2. See 4 Collier on Bankruptcy, P 523 (Matthew Bender); 2 Collier Bankruptcy Manual, P 523 (Matthew Bender).

(n3)Footnote 3. Pub L. No. 109-8, (2005), effective in cases commenced on or after October 17, 2005.



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CHAPTER 26 Dischargeability of Debts

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P 26.24 Debts Nondischargeable Only in Chapter 13

Section 1328(a), as amended in 2005,ⁿ¹ excepts two kinds of debt from discharge in chapter 13 which do not apply in chapter 7 cases.

[1] Long Term Debts; § 1328(a)(1)

Section 1322(b)(5) permits the debtor to include a provision in the chapter 13 plan proposing to cure any default and to maintain payments during the pendency of the chapter 13 case on any claim, secured or unsecured, on which the last payment is due after the due date of the final payment under the plan.ⁿ² A long-term debt dealt with by the chapter 13 plan in the manner authorized under section 1322(b)(5) is excepted from any discharge granted under section 1328(a)(1).

[2] Debts for Restitution or Damages Awarded for Willful or Malicious Injury or Death; § 1328(a)(3), (4)

For a debt to be nondischargeable under section 1328(a)(4) it must be for damages or restitution awarded in a civil action. Thus, criminal restitution is not included, though many criminal restitution debts are within the scope of section 1328(a)(3).ⁿ³ In addition, the debt must be a result of willful or malicious injury. This is a lower standard than section 523(a)(6), which requires the debt to be the result of a willful *and* malicious injury. However, unlike section 523(a)(6), injuries to property are not included. The injury must be a personal injury to an individual or the death of an individual. In addition, the statute requires that there be an actual award of damages or restitution, not just a claim.

Unlike section 523(a)(6), section 1328(a)(4) need not be asserted during the bankruptcy case. A creditor holding a claim that is nondischargeable under section 1328(a)(4) may litigate the dischargeability of any unpaid portion of that claim after the chapter 13 discharge in a nonbankruptcy court.

FOOTNOTES:

(n1)Footnote 1. Pub L. No. 109-8, (2005), effective in cases commenced on or after October 17, 2005.

(n2)Footnote 2. This section is primarily concerned with relatively long-term debt, such as a security interest or mortgage debt on the residence of the debtor. *See* ch. 14 *supra*.

(n3)Footnote 3. *See* P 26.12 *supra*.



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P 26.25 Debts Made Nondischargeable by Other Statutes

Congress has passed several other statutory provisions which may make debts nondischargeable in bankruptcy under either chapter 7 or 13. Two statutes making student loan debts nondischargeable in some circumstances outside *section 523(a)(8) of the Bankruptcy Code* are discussed above.ⁿ¹ Similarly, certain obligations arising from retention bonuses or continuation pay paid to military personnel were made nondischargeable when the discharge is entered less than five years from the date the retention or continuation agreement is terminated.ⁿ² To the extent that these provisions contain language making them applicable when a discharge is entered within five years, they will not apply in a chapter 13 case which is filed within five years, but where the discharge is not entered until after the five-year period has expired.

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. § 292f(g) (Health Education Assistance Loans-"HEAL"); 42 U.S.C. § 254o(d)(3) (National Health Services Scholarship Program). See P 26.13[6] *supra*.

(n2)Footnote 2. 37 U.S.C. § 301d(c)(3). See also, e.g., 37 U.S.C. § 302f (obligation of reserve health specialists who fail to honor agreement to serve in armed forces to refund special bonus pay not dischargeable in bankruptcy with no exceptions); 37 U.S.C. § 317(f)(3) (five year nondischargeable provision related to obligation to refund retention bonuses of military officers who terminate agreement); 37 U.S.C. § 302g(e) (refund obligations of military reservist physicians who receive special pay and who terminate their service early not dischargeable if less than 5 years after termination).



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CHAPTER 26 Dischargeability of Debts

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P 26.26 Debts that were Nondischargeable in a Previous Bankruptcy Case; § 523(b)

Section 523(b) provides that certain debts not discharged in a prior bankruptcy case may be discharged in a later case if they are dischargeable under section 523(a) in the later case. These debts include debts that were previously found nondischargeable under section 523(a)(1), (a)(3), and (a)(8). What these debts have in common (or at least had in common when section 523(b) was enacted)ⁿ¹ is that they all turn on time periods that may have changed in the later bankruptcy case. For example, section 523(a)(1) looks to whether a return for a prior tax year was filed more than two years before the bankruptcy petition.ⁿ² While that may not have been true in the first case, it may be true in the later case. Similarly, section 523(a)(3) looks to whether certain debts were scheduled in a case or whether the creditor otherwise had notice in time to participate. If a debt was not dischargeable due to lack of timely scheduling or notice in the first case, it may still be scheduled and therefore be dischargeable in the second case.

However, other debts that were nondischargeable in a prior case cannot be discharged in a later case, except for a case in which a debtor receives a discharge under section 1328(a).ⁿ³ In this respect, section 523(b) applies principles of *res judicata*.ⁿ⁴

Section 523(b) may well allow a debtor with a HEAL loan that was nondischargeable in an earlier case under both section 523(a)(8) and 42 U.S.C. § 292f(g)ⁿ⁵ to seek an undue hardship discharge of that loan under section 523(a)(8) without meeting the stricter requirements for discharge of a HEAL loan. The debtor can argue that the plain language of section 523(b) provides that the loan, which meets the description of that subsection, is dischargeable if the loan is not nondischargeable under section 523(a)(8) in the second case.ⁿ⁶

FOOTNOTES:

(n1)Footnote 1. Earlier versions of § 523(a)(8) permitted discharge of student loans if the first payment was due more than five (or later seven) years before the petition.

(n2)Footnote 2. *Cates v. Arkansas Dep't of Finance & Admin.* (*In re Cates*), 289 B.R. 389 (Bankr. E.D. Ark. 2003)

(n3)Footnote 3. Section 1328(a) discharges all debts provided for by the plan, with certain exceptions. Section 1328(b) discharges all debts provided for in the plan except those provided for under section 1322(b)(5) and those that are nondischargeable under section 523(a). It does not mention section 523(b).

(n4)Footnote 4. *Paine v. Griffin (In re Paine)*, 283 B.R. 33 (B.A.P. 9th Cir. 2002) .

(n5)Footnote 5. *See P 26.24 supra.*

(n6)Footnote 6. *Tanski v. United States (In re Tanski)*, 195 B.R. 408 (Bankr. E.D. Wis. 1996) .



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CHAPTER 27 Reaffirmation of Debts

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CHAPTER 27 Reaffirmation of Debts

1-27 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers agreements to reaffirm debts that would otherwise be discharged in bankruptcy. It details the requirements for an enforceable reaffirmation agreement including the determination of whether the agreement will pose an undue hardship to the debtor. It also discusses alternatives to reaffirmation and strategies for both debtors and creditors in connection with reaffirmation agreements.



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CHAPTER 27 Reaffirmation of Debts

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P 27.01 Introduction

Some of the most persistent problems under the Bankruptcy Code, as well as under the previous Bankruptcy Act, have been those arising through the reaffirmation of debts by consumer debtors. By using a variety of coercive levers, such as threats of repossession, collection activities directed at cosigners, and refusal to lend more money without reaffirmation, creditors have routinely lured debtors into giving up the protections of their bankruptcy discharges by making new and binding promises to pay debts that had been discharged.

This problem was recognized by both the Bankruptcy Commission in 1973, which proposed a total bar against reaffirmation agreements,ⁿ¹ and Congress.ⁿ² Although the Code does not completely bar reaffirmation agreements, it does restrict them significantly under the theory that reaffirmation is rarely a wise step for the debtor. A reaffirmation agreement is valid only if it complies with a series of specific requirements set forth in the Code.ⁿ³

The most common purposes for reaffirmation agreements are to enable the debtor to keep property which is secured by liens, to settle complaints regarding the nondischargeability of certain debts, and to otherwise assist guarantors, sureties and other co-obligors who have a special relationship with the debtor. Creditors who seek reaffirmation agreements must be careful not to overstep the bounds on their activities set forth in the Code and attorneys for debtors must consider carefully whether reaffirmation agreements are in the best interests of their clients.

A reaffirmation agreement, as its name implies, is a contract between the debtor and the creditor. Both the debtor and creditor must assent to the agreement. The debtor cannot reaffirm a debt unilaterally.ⁿ⁴

FOOTNOTES:

(n1)Footnote 1. Report of the Bankruptcy Commission, Part I at 177 , Part II at 130 .

(n2)Footnote 2. H.R. Rep. No. 595, 95th Cong., 1st Sess. 162-164 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n3)Footnote 3. *See P 27.02 infra.*

(n4)Footnote 4. *Matter of Turner*, 156 F. 3d 713, 40 C.B.C.2d 1105 (7th Cir. 1998) (reaffirmation agreements not valid without creditors' signatures).



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CHAPTER 27 Reaffirmation of Debts

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P 27.02 Requirements for an Enforceable Reaffirmation Agreement

Section 524(c) and (d),ⁿ¹ except under very limited circumstances, make reaffirmation agreements based upon dischargeable debts unenforceable. Additionally, Section 524(k), enacted in 2005,ⁿ² contains requirements for lengthy disclosures, a form agreement, a form motion for court approval, and a form court order to be used with respect to reaffirmation agreements. The debtor must receive the disclosures specified in section 524(k) at or before the time the debtor signs the reaffirmation agreement.

[1] Timing

In order to be enforceable, a reaffirmation must be made before the granting of a discharge.ⁿ³ Once the discharge has been granted, no reaffirmation is possible,ⁿ⁴ and the discharge may not be revoked to provide for one.ⁿ⁵ However *Federal Rule of Bankruptcy Procedure 4004(c)* provides that on motion of the debtor, the court may defer the entry of an order granting a discharge for 30 days and, on motion within such period, the court may further defer entry of the order to a date certain. The purpose of this rule is to give the debtor the opportunity to obtain automatically an additional 30 days to conclude a reaffirmation agreement.ⁿ⁶ In explaining the provision, the 1983 Advisory Committee Note to *Bankruptcy Rule 4004* states in part:

The last sentence of subdivision (c) takes cognizance of § 524(c) of the Code which authorizes a debtor to enter into enforceable reaffirmation agreements only prior to entry of the order of discharge. Immediate entry of that order after expiration of the time fixed for filing complaints objecting to discharge may render it more difficult for a debtor to settle pending litigation to determine the dischargeability of a debt and execute a reaffirmation agreement as part of a settlement.

[2] Rescission Requirements

The debtor may rescind a reaffirmation agreement at any time up to 60 days after the agreement is filed in court or before the discharge is granted, whichever is later. Thus, an agreement cannot be enforced if it has been rescinded by the debtor.

[3] Required Disclosures, Statements and Forms

The disclosures that must be given in connection with a reaffirmation agreement are set forth in section 524(k), enacted

by the 2005 amendments.ⁿ⁷ The disclosures consist of a combination of the disclosure statement described in section 524(k)(3) and the agreement, statement, declaration, motion and order described in section 524(k)(4) - (8). Section 524(k)(2) requires the disclosures to be made clearly and conspicuously and in writing. Further, the required disclosures must be made in good faith.ⁿ⁸

Section 524(k)(3) describes the specific contents of the disclosure statement. The disclosure requirements are in some ways similar to those required for consumer credit transactions under the Truth in Lending Act, and incorporate certain concepts from that law.ⁿ⁹ They require the use of particular terms and phrases, including "Amount Reaffirmed" and "Annual Percentage Rate," as well as standard statements.ⁿ¹⁰ The required disclosures are far more lengthy and confusing than the form promulgated by the Administrative Office of the Courts that was previously used in many courts. It is likely that many debtors, and even some creditors, will not understand them, potentially giving rise to much litigation.

The form of the reaffirmation agreement is dictated by section 524(k)(4). It must include a brief description of the credit agreement, a task that may not be easy in light of the complicated agreements utilized by consumer creditors. The creditor and the debtor(s) must both sign and date the agreement.

Under section 524(k)(6) the debtor must also sign a form statement that requires the debtor to compute whether the debtor has sufficient disposable income to make the payments required under the reaffirmation agreement and, if not, to explain how the debtor can afford to make the payments.ⁿ¹¹ Under *Interim Bankruptcy Rule 4008*, the statement must be accompanied by a statement of the total income and expense amounts on Schedules I and J, along with an explanation of any differences. If the debtor's budget does not demonstrate adequate income to make the payments required by the reaffirmation agreement, unless the creditor is a credit union, a presumption arises that the reaffirmation agreement is an undue hardship. If the presumption is not rebutted, the court "may" disapprove the agreement after notice to the debtor and creditor and a hearing concluded before the discharge unless the creditor is a credit union.ⁿ¹²

Section 524(k)(7) sets forth the form motion that may be used to obtain court approval of a reaffirmation agreement. Unless the debt is secured by real property, such approval is necessary if the debtor is not represented by an attorney with respect to the reaffirmation. Section 524(k)(8) sets out a form of order that may be used to grant court approval of a reaffirmation agreement.

The reaffirmation agreement must be accompanied by a Reaffirmation Agreement Cover Sheet.^{n12a} The Cover Sheet, Official Bankruptcy Form 27, requires information, such as the value of the collateral, the repayment terms, and a comparison of the debtor's current budget with the amounts listed on Schedules I and J. This information is intended to help the bankruptcy judge determine whether the reaffirmation would pose an undue hardship for the debtor or the debtor's dependents.

FORMS

For forms of reaffirmation agreements containing these disclosures, including a form promulgated by the Administrative Office of United States Courts, see *Collier Consumer Bankruptcy Forms*, §§ CS20.13, CS 20.13-7, CS20.22 (Matthew Bender).

[4] Filing Requirement

The agreement must be filed with the court within 60 days after the first date set for the section 341(a) creditors meeting, unless that deadline is extended by the court.^{n12b} If it is not filed with the court it is not enforceable. In addition, the time period for rescission does not begin to run until the agreement is filed.ⁿ¹³ Normally, the agreement should be filed before the discharge is entered. Most courts close cases, other than chapter 7 cases in which assets will be distributed to creditors, very soon after the discharge and the case files are then transferred to a storage facility, so

that after the case is closed the clerk has nowhere to file the agreement. In addition, local rules may require filing before the discharge order is entered so the court can decide whether a discharge hearing is to be held. A clerk may even refuse to accept a filing after the case has been closed, although such refusal might be improper.ⁿ¹⁴

One matter that came to light was that many creditors had a longstanding practice of obtaining reaffirmation agreements without filing them with the court.ⁿ¹⁵ This practice renders the reaffirmations invalid because the agreements fail to meet the requirements of section 524(c)(3).ⁿ¹⁶ Collection based on those agreements violates the discharge injunction.ⁿ¹⁷ Other statutory remedies may be available as well.ⁿ¹⁸

[5] Attorney Affidavit or Court Approval

Except to the extent that a debt is secured by real property, an additional requirement is that either the filed agreement be accompanied by an affidavit of the attorney that negotiated the agreement, as described below, or that the court approve the agreement after a discharge hearing attended by the debtor.

PRACTICE NOTE

Since the language of the Code states that these requirements are not applicable only *to the extent* a debt is secured by real property, they presumably apply to the excess of a debt over the value of the real estate interest which secures it. Therefore, the safest course for a creditor is to obtain an attorney affidavit or court approval in every case in which there is any chance the debt is undersecured.

[a] Affidavit of Debtor's Attorney

If the debtor was represented by an attorney in negotiating the reaffirmation agreement, the agreement must be accompanied by a declaration or affidavit of the attorney who represented the debtor which states that the agreement represents a fully informed and voluntary agreement by the debtor and does not impose a hardship on the debtor or a dependent of the debtor.ⁿ¹⁹ The declaration or affidavit must also state that the attorney fully advised the debtor of the legal effect and consequences of the reaffirmation agreement and of any default under that agreement.ⁿ²⁰ And, if the debtor's statement under 524(k)(6) does not demonstrate adequate income to make the payments required by the reaffirmation agreement, the declaration must also state that in the attorney's opinion the debtor is able to make those payments.ⁿ²¹

[b] Court Approval Required for Certain Reaffirmation Agreements

[i] Discharge Hearing

If the debtor is an individual who was not represented by an attorney in the course of negotiating a reaffirmation agreement, the agreement is valid under section 524(c)(6) only if it is approved by the court. Only the debtor may request court approval of the agreement.ⁿ²² Section 524(d) requires the court to hold a discharge hearing, which the debtor must attend, at which the court must explain reaffirmation to the debtor.

If a discharge hearing is required and the court does not hold a discharge hearing at which the debtor receives the admonitions described in section 524(d), the language of section 524(c) leaves no doubt that the reaffirmation agreement is not enforceable. Section 524(c)(5) requires compliance with section 524(d) and section 524(d) requires the court to hold a hearing in certain specified cases at which the debtor shall appear in person. Therefore, in *Arnhold v. Kyrus*,ⁿ²³ a case in which the debtor failed to bring a reaffirmation agreement to the attention of the court and therefore never received the admonitions concerning reaffirmation, the Court of Appeals for the Fourth Circuit held that the reaffirmation agreement was invalid.ⁿ²⁴

Most courts do not hold discharge hearings in cases in which there are no reaffirmation agreements. However,

bankruptcy courts may still wish to exercise their discretion to hold discharge hearings in all cases in which the debtor agrees to reaffirm a debt. Many courts have found that even debtors who have been represented by counsel have made unwise reaffirmation agreements and benefit greatly from an explanation of the risks of such agreements.

In cases in which the court does hold a discharge hearing, the court is required to inform the debtor that a discharge has been granted, that a reaffirmation agreement is not required by any applicable law, and of the legal consequences and effects of such an agreement and of a default under such agreement.ⁿ²⁵

Federal Rule of Bankruptcy Procedure 4008 provides that the discharge hearing shall be held not more than 30 days following the entry of an order granting or denying a discharge, or confirming a plan in a chapter 11 reorganization case concerning an individual debtor, and on not less than 10 days notice to the debtor and trustee. Under that rule, the notice of the section 524(d) hearing may be combined with the notice of the meeting of creditors or entered as a separate order. The rule also provides that a motion by the debtor for approval of a reaffirmation agreement must be filed before or at the hearing.ⁿ²⁶

[ii] Presumption of Undue Hardship

Section 524(m)(1), enacted to accompany the other 2005 changes,ⁿ²⁷ creates a presumption that a reaffirmation is an undue hardship on the debtor if the debtor's income is not sufficient to make the payments required by the reaffirmation agreement.ⁿ²⁸ The court is required to review the presumption, which may be rebutted by a written explanation of how the needed funds would be obtained. If the presumption is not rebutted to the court's satisfaction, the court may disapprove the agreement, after notice and a hearing to the debtor and creditor. For cases in which a presumption of undue hardship arises under section 524(m)(1), courts will likely look to the provisions of § 524(c)(6)(A) and apply similar considerations in determining whether an agreement will pose an undue hardship for the debtor.

However the provisions creating a presumption of undue hardship do not apply if the creditor is a credit union.

[iii] Standard for Approval When Court Approval Required

When court approval is required, section 524(c)(6)(A) requires the court to determine whether the agreement imposes an undue hardship on the debtor or a dependent of the debtor and whether it is in the best interest of the debtor. In cases in which court approval has been required, courts have looked to a number of factors to decide whether to approve a reaffirmation agreement including the debtor's ability to pay, the value of collateral underlying a secured debt, whether the debtor is current in payments, alternatives to reaffirmation, and creditor's conduct. Official Form 27, the Reaffirmation Agreement Cover Sheet, gives the court information needed to help make that determination.ⁿ²⁹

If an agreement is intended to prevent repossession of property subject to a nonavoidable lien, and the debtor could better accomplish the purpose of the agreement in some other manner, the agreement is unlikely to win court approval.ⁿ³⁰ Similarly, if the agreement purports to be one entered into to avoid dischargeability litigation, and the creditor has not timely filed such litigation, the agreement will not be approved.ⁿ³¹ Some courts refuse to permit reaffirmation of secured debt in an amount in excess of the value of the collateral.ⁿ³² Creditors' threats of costly foreclosure proceedings or of criminal charges have been found insufficient to justify approval of reaffirmation agreements that otherwise were not in the debtors' best interest.ⁿ³³ Courts have also held that property securing a discharged debt cannot be repossessed as long as the debtor remains current in payments on the debt, so that in those courts it is unnecessary to reaffirm a secured debt to retain the property if the debtor is current on payments.ⁿ³⁴ It is unclear what, if any, effect newly added section 521(a)(6) will have on debtor's ability to reaffirm debts for personal property subject to a purchase money security interest and for which the debtor's payments remain current. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

PRACTICE NOTE

Reaffirmation should rarely, if ever, be recommended by an attorney or approved by the court if the sole reason for it is the debtor's desire to pay the discharged debt,ⁿ³⁵ since the debtor already has the absolute right to pay the debt without giving up the protections of the discharge.ⁿ³⁶

FOOTNOTES:

(n1)Footnote 1. As amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. 11 U.S.C. § 524(c)(1). *Bankr. Receivables Mgmt. v. Lopez* (*In re Lopez*), 345 F.3d 701 (9th Cir. 2003) ("asset retention agreement" debtors in which debtors agreed to pay discharged debt was invalid reaffirmation); *In re Brown*, 220 B.R. 101 (Bankr. C.D. Cal. 1998) (debtor's postbankruptcy agreement to pay creditor in return for forbearance in repossessing necklace was prohibited reaffirmation); *Matter of Arnold*, 206 B.R. 560 (Bankr. N.D. Ala. 1997) (debtor's postbankruptcy agreement to pay debt in exchange for promise not to garnish wife's wages was not enforceable even though there was consideration for agreement). *In re Brinkman*, 123 B.R. 611 (Bankr. N.D. Ind. 1991)

(n4)Footnote 4. *In re Coots*, 2 C.B.C.2d 233, 4 B.R. 281 (Bankr. S.D. Ohio 1980) .

(n5)Footnote 5. *In re McQuality*, 2 C.B.C.2d 723, 5 B.R. 302 (Bankr. S.D. Ohio 1980) . But see *In re Eccleston*, 70 B.R. 210 (Bankr. N.D.N.Y. 1986) (discharge would be vacated only upon showing of explanation for failure to obtain approval of reaffirmation prior to discharge); *In re Solomon*, 5 C.B.C.2d 613, 15 B.R. 105 (Bankr. E.D. Pa. 1981) (in light of special equities raised, discharge vacated to allow reaffirmation three days after discharge hearing).

(n6)Footnote 6. *In re Long*, 6 C.B.C.2d 1370, 1373, 22 B.R. 152, 154 (Bankr. D. Me. 1982)

(n7)Footnote 7. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n8)Footnote 8. Section 524(l)(3) provides that the disclosure requirements of section 524(c)(2) and (k) are satisfied if the required disclosures are made in good faith. This provision appears to be a limitation on creditors' actions to undermine the reaffirmation requirements. If the required disclosures are made, but are not made in good faith, perhaps because the creditor has added excessive charges to the agreement or plans to change the credit terms immediately, the disclosure requirements would not be satisfied. The provision does not excuse a creditor from making the required disclosures simply because the creditor has acted in good faith.

(n9)Footnote 9. 15 U.S.C. §§ 1601 *et. seq.*

(n10)Footnote 10. The terms "Amount Reaffirmed" "and Annual Percentage Rate" must be disclosed more conspicuously than other terms or information, except that the phrases "Before agreeing to reaffirm a debt, review these important disclosures" and "Summary of Reaffirmation Agreement" may be equally conspicuous. 11 U.S.C. 524(k)(2), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 11. This computation and explanation is not required if the debtor is represented by an attorney and the creditor is a credit union.

(n12)Footnote 12. 11 U.S.C. § 524(m), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n13)Footnote 12a. *Fed. R. Bankr. P. 4008(a)*.

(n14)Footnote 12b. *Fed. R. Bankr. P. 4008(a)*.

(n15)Footnote 13. *11 U.S.C. § 524(c)(4)*.

(n16)Footnote 14. *See Fed. R. Bankr. P. 5005(a)* (clerk may not refuse to accept paper solely because it is not in proper form).

(n17)Footnote 15. *See In re Latanowich*, 207 B.R. 326, 336 (Bankr. D. Mass. 1997) .

(n18)Footnote 16. *In re Gardner*, 57 B.R. 609 (Bankr. D. Me. 1986) ("An agreement to reaffirm an otherwise dischargeable debt will be binding only if it is made in compliance with section 524(c) and (d)."); *In re Hovestadt*, 193 B.R. 382, 386 (Bankr. D. Mass. 1996) . *Accord, In re Daily*, 47 F.3d 365, 369, 32 C.B.C.2d 2023, 2029 (9th Cir. 1995) ; *In re Getzoff*, 33 C.B.C.2d 1281, 1284-86, 180 B.R. 572, 574-75 (B.A.P. 9th Cir. 1995) ; *In re Bowling*, 116 B.R. 659, 664 (Bankr. S.D. Ind. 1990) .

(n19)Footnote 17. *In re Latanowich*, 207 B.R. 326, 336 (Bankr. D. Mass. 1997) ; *In re Bowling*, 116 B.R. 659, 664 (Bankr. S.D. Ind. 1990) .

(n20)Footnote 18. *See, e.g., Miele v. Sid Bailey, Inc.*, 192 B.R. 611 (S.D.N.Y. 1996) (one thousand dollars in damages under federal Fair Debt Collection Practices Act and \$60,000 in damages under state tort law awarded against debt collector who repeatedly attempted to collect discharged debt).

(n21)Footnote 19. *11 U.S.C. § 524(c)(3)*.

(n22)Footnote 20. *11 U.S.C. 524(c)(3)*.

(n23)Footnote 21. *11 U.S.C. § 524(k)(5)(B)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. This statement is not required if the creditor is a credit union exempted from the presumption of undue hardship provision by § 524(m)(2), enacted by the same legislation.

(n24)Footnote 22. *In re Carlos*, 215 B.R. 52 (Bankr. C.D. Cal. 1997) . *See also In re Parker*, 193 B.R. 525 (B.A.P. 9th Cir. 1996) (creditor did not have standing to appeal bankruptcy court's disapproval of reaffirmation agreement).

(n25)Footnote 23. *851 F.2d 738 (4th Cir. 1988)* .

(n26)Footnote 24. *See also In re Roth*, 12 C.B.C.2d 53, 43 B.R. 484 (N.D. Ill. 1984), *aff'g* 10 C.B.C.2d 708, 38 B.R. 531 (Bankr. N.D. Ill. 1984); *In re Hunt*, 124 B.R. 200 (Bankr. N.D. Tex. 1991) . *But see In re Sweet*, 954 F.2d 610 (10th Cir. 1992) (debtor's failure to attend reaffirmation hearing did not render reaffirmation agreement unenforceable). *Compare In re Mensch*, 7 B.R. 804 (Bankr. S.D.N.Y. 1980) (debtor may be excused from attending discharge hearing if there is good cause presented at time of hearing).

(n27)Footnote 25. *See In re Garber*, 2 C.B.C.2d 390, 4 B.R. 684 (Bankr. C.D. Cal. 1980); and *In re Keefe*, 3 C.B.C.2d 385, 7 B.R. 270 (Bankr. E.D. Va. 1980).

(n28)Footnote 26. *See 9 Collier on Bankruptcy*, P 4008.03, .05 (Matthew Bender).

(n29)Footnote 27. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n30)Footnote 28. *11 U.S.C. § 524(m)(2)*, enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n31)Footnote 29. [Reserved]

(n32)Footnote 30. *In re Sampson*, 51 B.R. 13 (Bankr. D.D.C. 1984) (debtor might have better options through converting case or redeeming property).

(n33)Footnote 31. *In re Hirte*, 71 B.R. 249 (Bankr. D. Or. 1986).

(n34)Footnote 32. *In re Delano*, 7 B.R. 72 (Bankr. D. Me. 1980) ; *In re Jenkins*, 2 C.B.C.2d 307, 4 B.R. 651 (Bankr. E.D. Va. 1980)

(n35)Footnote 33. *In re Farmer*, 4.B.C.2d 1461, 13 B.R. 319 (Bankr. M.D. Fla. 1981) ("it is essential that creditors not be permitted to use their superior economic leverage to coerce reaffirmation of debts where such reaffirmation is not in the best interest of the debtor"); *American Express Co. V. Griffin* (*In re Griffin*), 4 C.B.C.2d 1507, 13 B.R. 591 (Bankr. S.D. Ohio 1981) (finding post-discharge "criminal process" to collect debt violation of debtor's discharge rights).

(n36)Footnote 34. *In re Parker*, 139 F.3d 668 (9th Cir. 1998) ; *In re Belanger*, 962 F.2d 345 (4[th] Cir. 1992) . *But see In re Taylor*, 3 F.3d 1512 (11th Cir. 1993) ; *Matter of Edwards*, 901 F.2d 1383 (7th Cir. 1990) .

(n37)Footnote 35. *In re Berkich*, 7 B.R. 483 (Bankr. E.D. Pa. 1980); *In re Long*, 2 C.B.C.2d 23, 3 B.R. 656 (Bankr. E.D. Va. 1980).

(n38)Footnote 36. 11 U.S.C. § 524(f). See 4 *Collier on Bankruptcy*, P 524.07 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 524.07 (Matthew Bender).



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CHAPTER 27 Reaffirmation of Debts

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P 27.03 Procedure for Reaffirmation

The procedure for reaffirmation is dictated by the requirements of the Code. Once an agreement has been reached and signed by the debtor, it must be filed. If the debtor was not represented by an attorney who has filed an affidavit in support of the agreement, a motion for approval of the agreement must also be filed.ⁿ¹

FORMS

For a form of such a motion see Collier Consumer Bankruptcy Forms, CS20.22-1 (Matthew Bender).

Depending upon whether a hearing is required or otherwise scheduled by the court, there may be a discharge hearing scheduled thereafter. If there is a discharge hearing, the court will provide the debtor with the necessary warnings about reaffirmationⁿ² and question the debtor regarding the debtor's circumstances and why the debtor desires to reaffirm. If court approval of the agreement is required, the court will make a determination about approval and, normally, announce it at the hearing.

FOOTNOTES:

(n1)Footnote 1. Section 524(k)(7) sets forth the form motion that is to be used to obtain court approval of a reaffirmation agreement. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. See P 27.02[5] *supra*.



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CHAPTER 27 Reaffirmation of Debts

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P 27.04 Acceptance of Payments in Connection with Reaffirmation Agreement

Section 524(l), added by the 2005 amendments to the Bankruptcy Code,ⁿ¹ permits creditors to accept payments made by debtors in connection with reaffirmation agreements. A creditor may accept a voluntary payment by the debtor either before or after the filing of a reaffirmation agreement with the court.ⁿ² However, the authorization to accept payments is limited to an agreement that a creditor believes in good faith to be effective.ⁿ³ Thus, for example, if the creditor knows, or should with reasonable diligence know, that the agreement does not meet requirements for a valid reaffirmation, the creditor is not permitted to accept payments.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. *11 U.S.C. § 524(l)(1)*.

(n3)Footnote 3. *11 U.S.C. § 524(l)(2)*.



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CHAPTER 27 Reaffirmation of Debts

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P 27.05 Considerations for Debtors' Attorneys

WARNING

Attorneys should be extremely cautious in negotiating and validating reaffirmation agreements by signing affidavits that the agreements will not cause hardship to the debtor and the debtor's dependents. There are serious problems of possible malpractice liability if such an agreement later causes harm to the debtor, *e.g.*, through the debtor's loss of property if the debtor does not later pay the reaffirmed debt.ⁿ¹ There is no question that prior to 1979 many debtors entered into ill-advised reaffirmations; the numerous cases in which courts have disapproved reaffirmations since then suggest that attorneys have not always been as wary of reaffirmations as the courts.

It is usually better practice to avoid reaffirmations if at all possible. Very often the debtor can obtain the result desired by simply maintaining voluntary payments on a debt without reassuming the legal obligation. For example, a creditor cannot pursue a codebtor if the debtor's payments remain current. And some courts have held that property subject to a security interest may not be repossessed if payments are up to date. If there is any doubt on this issue, a chapter 13 filing should be considered to deal with the secured claim, rather than a reaffirmation.

Some creditors offer additional credit to debtors if they reaffirm. The debtor's attorney should explain to the debtor that the reaffirmed debt is effectively a finance charge of hundreds of percent on the amount of new credit offered. Attorneys can also inform debtors that, while there are obviously no guarantees, debtors with more than minimal income usually are able to obtain new credit within a year or two after bankruptcy without reaffirming.

Other creditors may suggest that they will repossess household appliances based upon alleged purchase money security interests in them. Or, they may allege purchase money security interests in debtors' personal property and seek reaffirmation of the underlying debt pursuant to section 521(a)(6).ⁿ² However, debtors' attorneys should not necessarily be so quick to recommend reaffirmation agreements with such creditors. First, it applies only to "allowed claims" and in order for a claim to be allowed it must be filed in accordance with section 501.ⁿ³ Few creditors file proofs of claim in chapter 7 no asset cases. Second, the applicability of section 521(a)(6) extends only to purchase money security interests. The debtor's attorney should request copies of the security documents, which often do not exist or are of questionable validity.ⁿ⁴ Finally, the consequences of not reaffirming (or redeeming) is termination of the automatic stay with respect to the property. The provision does not authorize the creditor to repossess. Creditors must still comply with

state law with respect to repossession. In the unlikely event that the creditor files a replevin action to recover the property, there would be an opportunity to settle the matter at that time. Therefore, it may continue to be better practice to avoid reaffirmation in these circumstances. If a debt must for some reason be reaffirmed in these circumstances, it should be reaffirmed only in the amount of the value of the collateral, which is usually far less than the creditor claims it is.

A variation of this practice is the attempted use of cross-collateralization (spreader) clauses in contracts such as automobile loan contracts or mortgages which purport to make the property involved security for future advances, such as those on credit cards. There are a variety of arguments against such claims, such as arguments based on whether the debtor knew and intended to create such a security interest, especially when the original contract (which is later assigned) was entered into with a dealer who the debtor would have no reason to believe would make any future advances.ⁿ⁵

MORE INFORMATION

For discussion of alternatives to reaffirmation and redemption *see* chapter 25 *supra*.

In the case of motor vehicles, which creditors can and do repossess, the situation is different. In most jurisdictions, the debtor may simply keep paying on the debt to prevent repossession. In some places, however, courts have ruled that a debtor must reaffirm or the creditor can repossess the vehicle after the bankruptcy case is completed. If this is the case, the debtor should still negotiate to limit reaffirmation to the value of the collateral or to keep paying on the (usually higher) full balance without reaffirming. The threat of conversion to chapter 13, under which the creditor would receive payment more slowly and often in a smaller amount, is an effective device to give the debtor leverage.

One way out for an attorney unsure about a possible reaffirmation, perhaps one fervently desired by a client, is to leave the question to the court. If the attorney does not negotiate the reaffirmation agreement, then the procedure for court approval must be followed,ⁿ⁶ relieving the attorney of responsibility for the decision.ⁿ⁷ There is also a strong argument that if the debtor executes a reaffirmation agreement and the payments are current the creditor cannot repossess after bankruptcy even if the court disapproves the agreement, because by their terms sections 362(h), 521(a)(6), and 521(d) only apply if a debtor has not executed a reaffirmation agreement.ⁿ⁸

FOOTNOTES:

(n1)Footnote 1. *See In re Bruzzese*, 214 B.R. 444 (Bankr. E.D.N.Y. 1997) (attorney found to have violated *Rule 9011* and ethical obligations by signing reaffirmation agreement declaration that was not accurate and did not investigate or explain facts to client); *In re Izzo*, 197 B.R. 11 (Bankr. D.R.I. 1996) (debtor's attorney ordered to show cause why reaffirmation should not be declared void when debtor's expenses exceeded his income even without car payment provided for in agreement).

(n2)Footnote 2. Section 521(a)(6), added in 2005, provides that a chapter 7 individual debtor is not to retain possession of certain personal property if the debtor does not enter into a reaffirmation agreement or redeem the property within 45 days after the first meeting of creditors. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n3)Footnote 3. 11 U.S.C. § 502(a).

(n4)Footnote 4. *In re Immerfall*, 216 B.R. 269 (Bankr. D. Minn. 1998) (Sears charge slips, without underlying credit agreement they purported to incorporate, did not prove security interest; description of some items also inadequate); *In re Carlos*, 215 B.R. 52 (Bankr. C. D. Cal. 1997) (property in which Sears' alleged security interest was inadequately described in the charge slip).

(n5)Footnote 5. *In re Gibson*, 234 B.R. 776 (Bankr. N.D. Cal. 1999) (dragnet clause which was not clear and

unambiguous not enforceable between parties of unequal bargaining power under Illinois law); *In re Cushing*, 41 C.B.C.2d 1190, 230 B.R. 639 (Bankr. W.D. Pa. 1999) (mortgage note dragnet clause, under which lender argued that credit card debt was secured by mortgage, was invalid). *But see In re Conte*, 206 F.3d 536 (5th Cir. 2000) (upholding cross-collateral clause).

(n6)Footnote 6. 11 U.S.C. § 524(c)(6). *See In re James*, 120 B.R. 582 (Bankr. W.D. Okla. 1990) (court would not approve reaffirmation agreement where creditor held unsecured, unliquidated claim; debtor could not bifurcate claim so as to reaffirm it only to the extent it was secured by debtor's automobile and attorney had not certified, without qualification, that reaffirmation would impose no undue hardship on debtor).

(n7)Footnote 7. *But see Jamo v. Katahdin Fed. Credit Union (In re Jamo)*, 283 F.3d 392 (1st Cir. 2002) (counsel's approval required for a represented debtor to reaffirm).

(n8)Footnote 8. *In re Baker*, 390 B.R. 524 (Bankr. D. Del. 2008), *aff'd.*, 400 B.R. 136 (D. Del. 2009); *In re Quintero*, 2006 Bankr. LEXIS 906 (Bankr. N.D. Cal. May 17, 2006) (section 521(a)(6) does not require reaffirmation agreement to be approved).



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CHAPTER 27 Reaffirmation of Debts

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P 27.06 Considerations for Creditors

Creditors must be careful in attempting to obtain reaffirmation agreements. First, although some case law permits it,ⁿ¹ other courtsⁿ² have held that pursuing a reaffirmation can be a violation of the stay against any act to collect a prepetition debt.ⁿ³ The strongest case for a creditor is when the creditor sends a letter to follow up on a debtor's statement in the statement of intention that the debtor intends to reaffirm a debt. If a letter is sent it should be only in the form of an offer to reaffirm, with no threat, implied or express, of any adverse action. Neither the letter nor a copy of it should be sent to a debtor who is represented by an attorney. It is considered unethical for an attorney to communicate with a represented individual, and it is an unfair collection practice under many state laws for a creditor or collection agency to do so.ⁿ⁴

MORE INFORMATION

See chapter 6 supra for discussion of the debtor's statement of intention with respect to property securing debts.

In light of the stiff penalties that have been imposed on creditors who attempted to collect debts based upon invalid reaffirmation agreements,ⁿ⁵ it obviously behooves creditors who wish to rely upon a reaffirmation agreement to make sure that all steps necessary for the agreement's validity are scrupulously followed, including filing of the agreement and, if necessary, obtaining court approval of the agreement.ⁿ⁶

Because of the debtor's right to rescind a reaffirmation agreement, creditors who have raised issues concerning discharge or dischargeability must take care to protect themselves against the possibility of a discharge in the interim between execution of the reaffirmation agreement and expiration of the 60-day period (or the discharge hearing) whichever comes later. Thus, to the extent complaints objecting to discharge or dischargeability are to be settled based on reaffirmation of certain debts, the complaints should be timely filed and left open until the reaffirmation is finally approved and the rescission period has expired. Similarly, to the extent that motions for relief from automatic stay are settled in a manner which is dependent upon a reaffirmation agreement, the agreements should contain protection for the secured creditor in the event the reaffirmation agreement is either rescinded or disapproved by the court. Creditors who do not protect themselves against these contingencies have found little success in the alternatives to reaffirmation discussed above.

Obviously, creditors who obtain reaffirmation agreements must be diligent in assuring that all of the Code's requirements for reaffirmation are met. Otherwise, the agreement will be unenforceable and attempts to collect it could be considered unfair and deceptive in that no debt is actually owed.

Finally, creditors must decide whether they really want to repossess property, rather than receive continued payments, from debtors who do not reaffirm. A creditor can only threaten repossession if it has an intent to carry out the threat. Otherwise the threat is deceptive. Many creditors have decided they would rather receive continued payments, even in the absence of continued personal liability, rather than a return of the collateral.

FOOTNOTES:

(n1)Footnote 1. *In re Duke*, 79 F.3d 43, 35 C.B.C.2d 686 (7th Cir. 1996) (noncoercive letter may be sent to debtor and debtor's attorney).

(n2)Footnote 2. *See, e.g., Green*, 5 C.B.C.2d 733, 15 B.R. 75 (Bankr. S.D. Ohio 1981) .

(n3)Footnote 3. 11 U.S.C. § 362(a)(6). *See* ch. 8 *supra*.

(n4)Footnote 4. *Sears, Roebuck & Co. v. O'Brien*, 178 F. 3d 962 (8th Cir. 1999) (bankruptcy law does not preempt state consumer protection laws); *Greenwood Trust Co. v. Smith*, 212 B.R. 599 (B.A.P. 8th Cir. 1997) (creditor's direct communication seeking reaffirmation of debt, while debtor represented by attorney, violated state consumer credit laws). *But see Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502 (9th Cir. 2002) (Bankruptcy Code remedies preempt state consumer protection laws).

(n5)Footnote 5. *In re Vazquez*, 221 B.R. 222 (Bankr. N.D. Ill. 1998) (creditor and attorney for creditor sanctioned for collection actions on debt for which reaffirmation agreement never filed); *In re Latanowich*, 207 B.R. 326, 336 (Bankr. D. Mass. 1997) .

(n6)Footnote 6. Creditors should not read the language of newly enacted section 524(l)(3) to excuse a creditor from making required disclosures. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. Rather, that section operates as a further limitation on creditors' actions to undermine the reaffirmation requirements.



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CHAPTER 28 Abandonment of Property

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§ 28.syn Synopsis to Chapter 28: Abandonment of Property

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CHAPTER 28 Abandonment of Property

1-28 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the abandonment of property of the bankruptcy estate. It discusses abandonment by the trustee, abandonment on motion of a party in interest, and abandonment by operation of law at the end of a case. It also details the procedure for a motion to abandon property.



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CHAPTER 28 Abandonment of Property

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P 28.01 Introduction

The bankruptcy trustee may abandon property if it is not needed by the estate and its retention serves no purpose in effectuating the goals of the Bankruptcy Code. Section 554 sets a standard for determining property that may be abandoned; property may be abandoned if it is burdensome to the estate or of inconsequential value and benefit to the estate.ⁿ¹ It also provides procedural safeguards that must be met prior to abandonment. Abandonment during the case can occur only after notice and a hearing,ⁿ² which assures that interested parties have an opportunity to object to a proposed abandonment.

Section 554 also provides for automatic abandonment of scheduled property that has not been administered by the close of the case. Such property is deemed abandoned to the debtor unless the court orders otherwise.ⁿ³ However, all property of the estate that is not abandoned, either after notice and a hearing or at the close of the case, remains property of the estate.ⁿ⁴

Typically, abandonment of property of the estate pursuant to section 554 is initiated by the trustee, although other parties may move to have the trustee abandon property. Since unadministered property is automatically abandoned at the close of the case in any event, the impetus for the trustee's abandonment before that time is most often expense to estate caused by particular property. Such expense may include such items as the costs of maintaining or insuring the property. The trustee should not, however, abandon property, that is necessary for the debtor's fresh start or other bankruptcy purposes.ⁿ⁵

In consumer bankruptcy, abandonment is a chapter 7 phenomenon. In chapter 13, the debtor retains possession of all property of the estate and the trustee has no reason to abandon property.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 554(a). See 5 *Collier on Bankruptcy*, P 554.02[1] (Matthew Bender). 2 *Collier Bankruptcy Manual*, ch. 554 (Matthew Bender).

(n2)Footnote 2. 11 U.S.C. § 554(b). See 5 *Collier on Bankruptcy*, P 554.02[4] (Matthew Bender). 2 *Collier Bankruptcy Manual*, ch. 554 (Matthew Bender).

(n3)Footnote 3. 11 U.S.C. § 554(c). See 5 *Collier on Bankruptcy*, P 554.02[5] (Matthew Bender).

(n4)Footnote 4. *11 U.S.C. § 554(d). See 5 Collier on Bankruptcy, P 554.03* (Matthew Bender).

(n5)Footnote 5. *See In re Hawkins, 8 B.R. 637 (Bankr. N.D. Ga. 1981)* (denying request for abandonment of property that debtor might seek to redeem).



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CHAPTER 28 Abandonment of Property

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P 28.02 Abandonment Initiated by Trustee

Abandonment initiated by the trustee can occur only after notice and a hearing. *Federal Rule of Bankruptcy Procedure 6007* governs the procedure for abandonment. *Rule 6007(a)* requires the trustee to give notice of a proposed abandonment to the United States trustee, all creditors, indenture trustees, and committees elected pursuant to section 705 unless otherwise ordered by the court. Thus, the court may limit notice, perhaps eliminating the need to serve all creditors, if it deems that appropriate. It would rarely, if ever, be appropriate, however, to permit abandonment without notice to the key parties in the case, including the debtor and the debtor's attorney.

FORMS

For a form of proposal by the trustee to abandon property *see Collier Consumer Bankruptcy Forms, Form CS1.02-1* (Matthew Bender).

Any party in interest may file and serve an objection to the abandonment within 14 days of the mailing of the notice, or such other time as is fixed by the court.ⁿ¹ If an objection is made, the court must schedule a hearing to consider the objection and order notice of the hearing to the United States trustee and other interested parties. However, if there is no objection to the proposed abandonment after notice, the court may dispense with a hearing and a court order is not necessary.ⁿ²

FORMS

For a form of an objection to proposed abandonment of property *see Collier Consumer Bankruptcy Forms, Form CS1.02-2* (Matthew Bender).

The Code does not specify the time in which the trustee must act to abandon, nor does *Federal Rule of Bankruptcy Procedure 6007*.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 6007(a)*.

(n2)Footnote 2. 124 Cong. Rec. H11,090 (daily ed. Sept. 28, 1978); S17,407 (daily ed. Oct. 6, 1978). *See In the Matter of Trim-X, Inc.*, 695 F.2d 296, 7 C.B.C.2d 955 (7th Cir. 1982) .



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CHAPTER 28 Abandonment of Property

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P 28.03 Abandonment Initiated by Another Party

Subsections (a) and (b) of section 554 provide not only that the trustee may abandon property but also that a party in interest may request the court to order abandonment of particular property. There is a filing fee of \$150 for a motion to abandon property unless the motion is brought by the debtor.ⁿ¹

Neither the statute nor *Federal Rule of Bankruptcy Procedure 6007* specifies those entitled to request an abandonment. However, the statute distinguishes between abandonment on the trustee's initiative and abandonment at the request of some other party. If the trustee proposes to abandon property under subsection (a), the property may be abandoned after notice and a hearing, unless a timely objection is made, without a court order.ⁿ²

On the other hand, if another party requests abandonment, that request must be made by motion.ⁿ³ Although a hearing is not always required if the motion is unopposed,ⁿ⁴ the abandonment can occur only after a court order granting the motion.

FORMS

For a sample motion and order for abandonment see *Collier Consumer Bankruptcy Forms, Form CS1.12-1* and *Form CS1.12-2* (Matthew Bender).

A request for abandonment should not, however, be considered a substitute for a motion for relief from the automatic stay. Although the automatic stay with respect to acts against property of the estate would end with respect to the property abandoned, the automatic stay would otherwise remain in place, including the stay against actions and proceedings on prepetition claims,ⁿ⁵ the stay against enforcement of prepetition judgments against the debtor,ⁿ⁶ the stay against acts to enforce or perfect liens securing prepetition claims against property of the debtor,ⁿ⁷ and the stay against any other act to collect or recover a prepetition claim against the debtor.ⁿ⁸ Therefore, abandonment of property of the estate does not normally remove the stay's prohibition of a creditor's actions to recover that property.ⁿ⁹

Occasionally, the debtor may find it necessary to move for an order requiring the trustee to abandon property. In real estate markets where values are increasing rapidly, trustees have been known to hold cases open for a year or more in hopes that appreciation will create equity above the exemption levels. Although the debtor's exemptions should be determined as of the petition date, a few courts apparently allow this practice and, if the debtor has a small amount of

nonexempt equity as of the petition date there is an argument that the appreciation of this nonexempt equity is property of the estate. For this reason, a debtor may have to promptly file a motion to compel the abandonment of property so the trustee cannot simply sit and wait to see if there is appreciation.

FOOTNOTES:

(n1)Footnote 1. *See* Federal Judicial Conference Bankruptcy Court Miscellaneous Fee Schedule, Item 20, *reprinted in* 1 Collier on Bankruptcy, Ch. App. 9 (Matthew Bender).

(n2)Footnote 2. *In the Matter of Trim-X, Inc.*, 695 F.2d 296, 7 C.B.C.2d 955 (7th Cir. 1982) ; *Hickman v. First State Bank (In re Motley)*, 4 C.B.C.2d 36, 10 B.R. 141 (Bankr. M.D. Ga. 1981) .

(n3)Footnote 3. *Fed. R. Bankr. P. 6007(b)*.

(n4)Footnote 4. 1993 Advisory Committee Note to *Fed. R. Bankr. P. 6007*.

(n5)Footnote 5. 11 U.S.C. § 362(a)(1).

(n6)Footnote 6. 11 U.S.C. § 362(a)(2).

(n7)Footnote 7. 11 U.S.C. § 362(a)(5).

(n8)Footnote 8. 11 U.S.C. § 362(a)(6).

(n9)Footnote 9. *In re Crueturner*, 8 B.R. 581 (Bankr. D. Utah 1981) ; *In re Motley*, 10 B.R. 141 (Bankr. M.D. Ga. 1981) . *See* ch. 8 *supra* for discussion of the automatic stay.



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CHAPTER 28 Abandonment of Property

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P 28.04 Abandonment of Property by Operation of Law

When there is no court order directing abandonment, the language of subsection (c) of 554 deems abandoned to the debtor any scheduled property of the estate that is unadministered at the close of the case unless the court orders otherwise.ⁿ¹ This type of abandonment most often occurs in cases in which the debtor has nominal nonexempt assets. In such cases, the trustee has no reason to move for abandonment before the end of the case because the assets are typically in the debtor's possession and are no burden to the trustee. The easiest course of action for the trustee is simply to allow them to be automatically abandoned at the end of the case. However, property which has not been scheduled is not deemed abandoned and the trustee may reopen the case to administer such property if it is later discovered. Rights to such property therefore may not revert in the debtor at the closing of the case.^{n1a}

Congress has encouraged the abandonment of nominal assets. The legislative history of the Code specifically condemned the practices of some trustees under the former Bankruptcy Act who liquidated assets that were sufficient only to pay the fees of the trustee and other professionals.ⁿ² It made clear the view of Congress that it was improper for trustees to sell assets to pay themselves when there would be no significant distributions to creditors.ⁿ³ The amount of assets considered nominal will vary depending on local practice and the ease of liquidating particular types of assets. However, trustees will rarely liquidate assets of less than \$1,000 to \$2,000. If it appears that a trustee plans to liquidate nominal assets of the debtor, the debtor may wish to file a motion seeking an order that those assets be abandoned.

Property abandoned by operation of law "is abandoned to the debtor."ⁿ⁴ Because this presumption of abandonment is subject to court order to the contrary, however, it is likely that only burdensome or property of limited value will be abandoned in this manner.

However, abandonment presupposes knowledge. There can, as a rule, be no abandonment by mere operation of law of property that was not listed in the debtor's schedules or otherwise disclosed to the creditors,ⁿ⁵ a fact recognized by section 554(d). That subsection provides that, unless the court orders otherwise, property of the estate that is neither abandoned nor administered in the case remains property of the estate.

Thus, if property was not properly scheduled by the debtor, so that it was concealed from the trustee and creditors and not administered, it is not automatically abandoned at the end of the case.ⁿ⁶ Section 554(c) provides for automatic abandonment only for property that was "scheduled under section 521(1)."^{n6a} Even after the case is closed, the estate continues to retain its interest in such property. One consequence of section 554(c) is that the debtor may be unable to

assert a cause of action after the bankruptcy if the cause of action was not scheduled.ⁿ⁷

If the property is later discovered and is valuable, the court may reopen the case;ⁿ⁸ if it is not, the court may order the property to be abandoned without reopening the case and without incurring additional expense.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 554(c) as amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, *reprinted in* Vol. E Collier on Bankruptcy, App. Pt. 6(a) (Matthew Bender), and the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, *reprinted in* Vol. E Collier on Bankruptcy, App. Pt. 7(a) (Matthew Bender).

(n2)Footnote 1a. *See Matter of Baudoin*, 981 F.2d 736 (5th Cir. 1993) (lender liability claim scheduled as "any possible claim against creditor for actions taken against debtor," with value listed as "undetermined," was not properly scheduled and, therefore, was not deemed abandoned at end of case); *Vreugdenhill v. Navistar Int'l Transp. Corp.*, 950 F.2d 524 (8th Cir. 1991) .

(n3)Footnote 2. H.R. Rep. No. 595, 95th Cong., 1st Sess. 93-95 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender).

(n4)Footnote 3. H.R. Rep. No. 595, 95th Cong., 1st Sess. 93-95 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender). *In re Kusler*, 224 B.R. 180 (Bankr. N.D. Okla. 1998)

(n5)Footnote 4. H.R. Rep. No. 595, 95th Cong., 1st Sess. 377 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 92 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender).

(n6)Footnote 5. *See Tavormina v. Harris (In re Harris)*, 32 B.R. 125 (Bankr. S.D. Fla. 1983) (when through honest error debtor failed to schedule his interests in certain mortgages the debtor's interests were not deemed abandoned and remained property of the estate).

(n7)Footnote 6. *Vreugdenhill v. Navistar Int'l Transport Corp.*, 950 F.2d 524 (8th Cir. 1991) .

(n8)Footnote 6a. Section 521(1) was amended and redesignated as 521(a)(1) by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n9)Footnote 7. *See Matter of Baudoin*, 981 F.2d 736 (5th Cir. 1993) (lender liability claim listed simply as "any possible claim against creditor for actions taken against debtor" with "undetermined" value was not properly scheduled); *Krank v. Utica Mutual Ins. Co.*, 109 B.R. 668 (E.D. Pa. 1990) , *aff'd*, 908 F.2d 962 (3d Cir. 1990) (debtor not permitted to enforce prepetition cause of action not listed in schedules without reopening bankruptcy case and giving trustee opportunity to enforce or abandon cause of action). *See also In re Coastal Plains, Inc.*, 179 F.3d 197 (5th Cir. 1999) ; *Wolfork v. Tackett*, 273 Ga. 328, 540 S.E.2d 611 (Ga. 2001) (failure to list tort claim that arose during pendency of chapter 13 case judicially estopped debtor from pursuing claim in state court).

(n10)Footnote 8. *Matter of Shondel*, 950 F.2d 1301, 26 C.B.C.2d 193 (7th Cir. 1991) (case reopened due to debtor's failure to list liability policy as an asset). *See* ch. 31 *infra* for discussion of reopening of cases.



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CHAPTER 28 Abandonment of Property

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P 28.05 Effect of Abandonment

Upon abandonment under section 554, the trustee is simply divested of control of the property because it is no longer part of the estate. Thus, abandonment constitutes a divestiture of all of the estate's interests in the property abandoned. Although section 554 does not specify to whom property is abandoned, property may be abandoned by the trustee to any party with a possessory interest in it.ⁿ¹ Normally, the debtor is the party with a possessory interest, but in some cases it may be some other party, such as a secured creditor that has repossessed the property.

Abandonment is also not a judicial sale of the property abandoned. Therefore when property is subject to a security interest, abandonment does not take the place of a proper foreclosure sale. Even if the secured party is given possession, it still must comply with any nonbankruptcy law requirements for sale. Abandonment also should not be considered to divest the court of jurisdiction to enforce the rights of a debtor to claim an exemption under section 522.ⁿ²

Abandonment, once accomplished, is irrevocable, regardless of any subsequent discovery that the property had greater value than previously believed.ⁿ³

FOOTNOTES:

(n1)Footnote 1. H.R. Rep. No. 595, 95th Cong., 1st Sess. 377 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender); S. Rep No. 989, 95th Cong., 2d Sess. 92 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender).

(n2)Footnote 2. *In re Bennett*, 4 C.B.C.2d 1317, 13 B.R. 643 (Bankr. W.D. Mich. 1981) .

(n3)Footnote 3. *In re Bryson*, 13 B.C.D. 715 (Bankr. M.D. Tenn. 1985) (creditor's motion to reopen a no-asset chapter 7 case to proceed against a security interest in monies obtained by the debtor in settlement of a lawsuit denied; lawsuit had been properly scheduled and trustee knowingly abandoned the asset without objection from the creditor so abandonment was irrevocable); *Wallace v. Enriquez (In the Matter of Enriquez)*, 7 C.B.C.2d 263, 22 B.R. 934 (Bankr. D. Neb. 1982) ; *In re Sutton*, 8 B.C.D. 21 (Bankr. E.D. Va. 1981) . *See also* *Meyers v. Josephson*, 124 F. 734 (5th Cir. 1903) (insurance policy, becoming valuable through debtor's death). *But see In re Woods*, 173 F.3d 770 (10th Cir.) , *cert. denied*, 528 U.S. 878, 120 S. Ct. 187, 145 L. Ed. 2d 157 (1999) (court may revoke deemed abandonment under section 554(c) pursuant to *Fed. R. Bankr. P. 9024*). *In re Sutton*, 8 B.C.D. 21 (Bankr. E.D. Va. 1981) *Meyers v. Josephson*, 124 F. 734 (5th Cir. 1903)



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CHAPTER 29 Obtaining a Discharge

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CHAPTER 29 Obtaining a Discharge

1-29 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

After explaining the basic requirements for obtaining chapter 7 and chapter 13 discharges, the chapter reviews the legal grounds for objecting to a chapter 7 discharge and how they typically might apply in consumer cases. Among the grounds for objections are concealment or transfer of property, dishonesty in connection with the case, refusal to obey court orders, and the obtaining of a discharge in a recent previous case. The chapter then describes how the objection complaint is drafted and the procedure at trial. Next the chapter reviews what should happen when the discharge is granted, including the sending of the notice of discharge and the other steps that should be taken immediately. The legal effect of chapter 7 and 13 discharges is described as well as what should be done to enforce them. Finally, the chapter reviews the grounds and procedures for revoking a discharge.



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P 29.01 Grant of a Chapter 7 Discharge

Section 727 of the Bankruptcy Code provides that the court must grant a discharge to a chapter 7 debtor unless one or more of the specific grounds for denial of discharge enumerated in section 727(a)(1) - (12) is proven to exist.ⁿ¹

Ordinarily, if no objection to discharge has been filed by the deadline of 60 days after the first date set for the section 341 meeting,ⁿ² the court enters the chapter 7 discharge order as a matter of course shortly after that deadline.ⁿ³ However, if the debtor has not completed a personal financial management instructional course, the court may close the case without entering a discharge.^{n3a} Ordinarily, a certificate evidencing completion of the course^{n3b} must be filed within 45 days of the first date set for the meeting of creditors,^{n3c} although this time can be extended by the court under *Federal Rule of Bankruptcy Procedure 9006(b)*.

The discharge order is mailed by the clerk to the debtor, the trustee, counsel for the trustee (if any), counsel for the debtor, and all creditors.ⁿ⁴ Unless there is nonexempt property of the estate to be administered by the trustee, or some other proceeding is still pending before the court, the bankruptcy case is normally closed at this time as well. Thereafter, any action by the debtor, a creditor, or the trustee will probably require a motion to reopen the case.

FORMS

For the form of the chapter 7 Discharge Order in particular types of cases, see *Collier Consumer Bankruptcy Forms*, § CS14.02 (Matthew Bender).

MORE INFORMATION

Reopening of cases is discussed at chapter 31 *infra*.

Pursuant to section 727(b), the discharge under section 727 discharges the debtor from all debtsⁿ⁵ that arose before the date of the chapter 7 order for relief, and any liability on a claim that is determined under section 502 as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501, and whether or not a claim based on any such debt or liability is allowed under section 502, *provided* that the debts are not excepted from discharge under section 523 or some other statute.ⁿ⁶

FOOTNOTES:

(n1)Footnote 1. The grounds for denial of discharge are discussed below at *P 29.05 infra*.

(n2)Footnote 2. *Fed. R. Bankr. P. 4004(a)*. See 9 *Collier on Bankruptcy*, P 4004.02[1] (Matthew Bender).

(n3)Footnote 3. *Fed. R. Bankr. P. 4004(c)*. This rule states several other circumstances which can delay entry of the discharge, such as the pendency of a motion to dismiss or a motion for an extension of time to file an objection to discharge or a motion to dismiss.

(n4)Footnote 3a. See *P 29.05[11] infra*.

(n5)Footnote 3b. Official Form 23.

(n6)Footnote 3c. *Fed. R. Bankr. P. 1007(c)*.

(n7)Footnote 4. *Fed. R. Bankr. P. 4004(g)*. See *P 29.08 infra* for further discussion of notice of the discharge order.

(n8)Footnote 5. "Debt" is defined in 11 U.S.C. § 101(12) as "liability on a claim." For discussion of which debts are discharged, see 6 *Collier on Bankruptcy*, P 727.13 (Matthew Bender).

(n9)Footnote 6. See discussion of exceptions to discharge at ch. 26 *supra* .



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P 29.02 Grant of a Chapter 13 Discharge After Compliance with Plan

Section 1328(a) of the Bankruptcy Code directs the court to grant the debtor a discharge as soon as practicable after the completion of all payments under the plan, unless an exception applies or the discharge has been waived. Even if the original proposed time period for the plan has not elapsed because the debtor has completed payments early, the debtor is entitled to a discharge, and no party may move to have the plan modified to require additional payments.ⁿ¹ There is no requirement that the debtor apply for a discharge. The chapter 13 trustee is best situated to determine when payments under the plan have been completed and should initiate the process for the granting of a discharge for full compliance, which in turn should prompt the scheduling of the discharge hearing required under section 524(d), if the court determines that one is to be held.

[1] Limitations on Grant of "Full Compliance" Chapter 13 Discharge

A chapter 13 discharge after compliance with the plan is now subject to several conditions as a result of the 2005 amendments to the Bankruptcy Code.ⁿ²

[a] Certification of Payment of Domestic Support Obligations

Section 1328(a) was amended in 2005ⁿ³ to require that, if applicable, debtors certify payment of certain domestic support obligations in order to receive a discharge. If the debtor was required to pay a domestic support obligationⁿ⁴ during the case, the debtor must certify that all amounts payable on such obligation that were due on or before the date of the certification have been paid with the exception of any prepetition arrears that were not provided for by the plan.

[b] Chapter 13 Discharge After Discharge In a Prior Case

[i] Discharge After Prior Discharge in Chapter 7, 11 or 12 Case; § 1328(f)(1)

Section 1328(f)(1), enacted in 2005,ⁿ⁵ provides that if the debtor received a discharge in a chapter 7, 11, or 12 case that was filed during the four years prior to the date of the order for relief in a subsequent chapter 13 case, which is the date of the petition,ⁿ⁶ the debtor may not receive a chapter 13 discharge. This provision will preclude a debtor from receiving a discharge in a chapter 13 case filed soon after a chapter 7 case, a practice sometimes referred to as a chapter 20ⁿ⁷ because it adds 13 to 7.

However, it is important to note that section 1328(f) does not prevent a debtor from filing a chapter 13 case after a chapter 7 case; it only prevents such a debtor from receiving a discharge in that chapter 13 case if it is filed within four years of the earlier petition. There may be occasions in which a debtor will find it advantageous to file a chapter 13 case even if a discharge is not available, in order to cure a default through a plan, or simply to seek protection of the bankruptcy court and the automatic stay while paying debts in an orderly fashion through a plan.

[ii] Discharge After Prior Discharge in Chapter 13 Case; § 1328(f)(2)

Section 1328(f)(2), also added in 2005,ⁿ⁷ prohibits the entry of a discharge in a chapter 13 case filed within two years of the filing of a prior chapter 13 case in which a discharge was granted. This provision should rarely be applicable, because most chapter 13 cases in which discharges are granted last for three to five years. Additionally, Section 1328(f)(2) also has no applicability if the prior chapter 13 case was dismissed, although other Code provisions may limit the debtor's rights in a subsequent chapter 13 case after a prior case is dismissed.ⁿ⁸

Again, it is important to note that section 1328(f)(2) does not preclude filing a chapter 13 case after a prior case in which a discharge was received, but only the receipt of a discharge if the second case is filed within the stated time period after the first case. A debtor may still file a chapter 13 case and utilize the tools in chapter 13 to cure a mortgage, deal with other secured debts, or simply pay debts under a plan with the protection of the automatic stay.

[c] Failure to Complete a Personal Financial Management Course; § 1328(g)

Section 1328(g), added by the 2005 amendments to the Bankruptcy Code,ⁿ⁹ requires that before the debtor receive a discharge in chapter 13 the debtor must complete a personal financial management instructional course as described in section 111. *Bankruptcy Rule 1007(c)* requires the debtor to file a certificate evidencing completion of the course no later than the time of the last plan payment,^{n9a} although this time can be extended by the court under *Federal Rule of Bankruptcy Procedure 9006(b)*. There are two exceptions to this requirement. The debtor need not complete such a course if the United States trustee or Bankruptcy Administrator¹⁰ for the district determines that the approved courses that are available are not sufficient to service the "additional individuals" who would be required to take the course.ⁿ¹¹ The second exception is for those individuals described in section 109(h)(4), which excuses from the credit counseling requirement individuals who the court finds to be unable to comply with the requirement because of incapacity, disability, or active military duty in a combat zone.ⁿ¹²

[d] Delay of Discharge Because of Possible Exemption Objection Under Section 522(q); § 1328(h)

Section 1328(h), added by the 2005 amendments to the Bankruptcy Code,ⁿ¹³ prohibits the granting of a chapter 13 discharge unless there has been notice and an opportunity for a hearing with respect to the issue of whether section 522(q)(1) may be applicable to the debtor and whether a proceeding that may implicate section 522(q) is pending. The prohibition is intended to help effectuate section 522(q), which limits a debtor's state homestead exemption in certain cases. *Federal Rule of Bankruptcy Procedure 1007(b)* requires a debtor who has claimed a state homestead exemption in an amount higher than the amount specified in section 522(q)(1) (currently \$136,875) to file a statement as to whether there is any proceeding pending in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or found liable for a debt of the kind described in section 522(q)(1)(B). This statement must be filed no earlier than the date of the last payment made under the plan or the filing of a motion for a hardship discharge.ⁿ¹⁴

PRACTICE NOTE

However, in some jurisdictions the debtor is required to initiate the process. This usually involves filing an application, motion, or similar document with the court or trustee stating that payments are complete and requesting that a discharge be entered. In these districts, creditors or the trustee may then be given time to dispute whether payments under the plan have been completed. Local rules often provide the

details of such procedures.

FOOTNOTES:

(n1)Footnote 1. *Sunahara v. Burchard* (*In re Sunahara*), 326 B.R. 768, 2005 Bankr. LEXIS 1270 (B.A.P. 9th Cir. 2005) (holding debtor may modify plan to complete in fewer than 36 months without having to pay unsecured claims in full); *In re Pancurak*, 316 B.R. 173 (Bankr. W.D. Pa. 2004) (holding debtor entitled to discharge after making lump sum payment to complete plan payments); *Bayshore Nat. Bank of La Porte v. Smith*, 252 B.R. 107 (E.D. Tex. 2000) , *aff'd* 252 F.3d 1357 (5th Cir. 2001) (stating that once payments are complete, even if completed early, debtor entitled to discharge).

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. Domestic support obligation is defined in 11 U.S.C. § 101.

(n5)Footnote 5. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005

(n6)Footnote 6. 11 U.S.C. § 301(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005; § 348(a).

(n7)Footnote 7. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005

(n8)Footnote 8. *See, e.g.*, 11 U.S.C. §§ 109(g), 362(c)(3),(4).

(n9)Footnote 9. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n10)Footnote 9a. *Fed. R. Bankr. P. 1007(c)*.

(n11)Footnote 10. The Bankruptcy Administrator performs most of the functions of the United States trustee in judicial districts in Alabama and North Carolina, where the United States trustee program is not operational.

(n12)Footnote 11. 11 U.S.C. § 109(h)(4), § 1328(g)(2).

(n13)Footnote 12. *Id.*

(n14)Footnote 13. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n15)Footnote 14. *Fed. R. Bankr. P. 1007(c)*.



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P 29.03 Chapter 13 Hardship Discharge

[1] When Hardship Discharge May Be Obtained

A chapter 13 debtor who has not completed payments under the plan may obtain a hardship discharge under *section 1328(b) of the Bankruptcy Code at any time after confirmation* of the plan, after notice and a hearing,ⁿ¹ provided unsecured creditors have received as much as they would have received in a chapter 7 liquidation.ⁿ² Certification by the debtor that all post-petition support and all support required to be paid by the plan has been paid is not required for a hardship discharge.ⁿ³ However, sections 1328(f), (g), and (h), added in 2005,ⁿ⁴ apply equally to hardship discharges under section 1328(b) as to discharges after completion of all plan payments under section 1328(a).ⁿ⁵ *Bankruptcy Rule 1007(c)* requires the debtor to file a certificate evidencing completion of the course no later than the time of motion for a hardship discharge,^{n5a} although this time can be extended by the court under *Federal Rule of Bankruptcy Procedure 9006(b)*.

[2] Procedure for Obtaining Hardship Discharge

On motion by the debtor for a discharge under section 1328(b), the court sends a notice of the motion to all creditors and the trustee, so that they have the opportunity to oppose the motion. A motion for a hardship discharge initiates a contested matter under *Rule 9014 of the Federal Rules of Bankruptcy Procedure*.

In addition, since the chapter 7 exception to discharge for debts arising from willful and malicious injuries by the debtors^{n5b} is applicable when a hardship discharge is granted,ⁿ⁶ under *Federal Rule of Bankruptcy Procedure 4007(d)*, the court enters an order fixing a time for the filing of any complaint to determine dischargeability pursuant to section 523(a)(6) and giving at least 30 days notice of that deadline to all creditors.ⁿ⁷ The deadline may be extended on motion of any party in interest made prior to the original expiration date. The filing of a complaint to determine dischargeability initiates an adversary proceeding governed by Part VII of the Bankruptcy Rules.ⁿ⁸

MORE INFORMATION

Procedure in contested matters and adversary proceedings is discussed in chapter 32 *infra*.

If the motion for a hardship discharge is opposed by any party and, in some courts, even if it is not, the court will hold a hearing to determine if the criteria for a hardship discharge are met.

[3] Criteria for Allowance of Hardship Discharge

A hardship discharge may be granted, at any time after confirmation, to a debtor who is unable to complete a plan. There are three essential criteria for the allowance of a hardship discharge under section 1328(b).

[a] Circumstances for Which Debtor Not Justly Accountable

The court must find that the failure to complete payments under the plan was due to circumstances for which the debtor should not justly be held accountable.ⁿ⁹ A hardship discharge has been granted under circumstances such as the death of the debtor or the serious deterioration of the debtor's financial circumstances.ⁿ¹⁰ Such circumstances need not be catastrophic; they need only be circumstances that make it impossible for the debtor to complete the plan.ⁿ¹¹

[b] Best Interests Test

The court must apply yet another variation of the best interests test as a prerequisite to the granting of a hardship discharge under section 1328(b). The court must find that the value, as of the effective date of the plan, of property actually distributed under the plan on account of each allowed unsecured claim at least equals the amount which would have been paid on each allowed unsecured claim had the estate of the debtor been liquidated under chapter 7 on the effective date of the plan.ⁿ¹² However, unlike the requirements for confirmation of a chapter 13 plan, the criteria for a hardship discharge do not include full payment of all priority claims.

[c] Modification of Plan Not Practicable

Although the debtor was not justly accountable for the failure to complete payments under the plan and the holder of each allowed unsecured claim has received its liquidation value, the court may not grant a hardship discharge under section 1328(b)(3) unless the circumstances of the debtor at the time of the hearing on the hardship discharge motion make it impracticable to propose and obtain approval of a modified plan in accordance with section 1329.ⁿ¹³

Typically, the debtor's income has dropped and it is apparent that there is not sufficient income to fund a confirmable plan. If the debtor does propose a modification of the plan, but holders of allowed secured claims whose acceptances are required refuse to accept the plan,ⁿ¹⁴ or approval of the modification cannot be had for any other reason, modification of the plan is impracticable and the requirements of section 1328(b)(3) are met.

PRACTICE NOTE

Modification of the plan is thus a solution to the debtor's problems which is preferred by the Bankruptcy Code. It should be attempted whenever it is feasible for the debtor, who could thereby preserve the normal chapter 13 discharge. In addition to modification or a hardship discharge, a debtor who encounters problems also has the option of converting the case to chapter 7ⁿ¹⁵ or dismissing the case voluntarily.ⁿ¹⁶

FOOTNOTES:

(n1)Footnote 1. See 11 U.S.C. § 102(1) for the meaning of notice and a hearing. See also 2 Collier on Bankruptcy, P 102.02 (Matthew Bender).

(n2)Footnote 2. 11 U.S.C. § 1328(b). See 8 Collier on Bankruptcy, P 1328.03 (Matthew Bender).

(n3)Footnote 3. Compare 11 U.S.C. § 1328(a) to 11 U.S.C. § 1328(b); See P 29.03[1] *supra*.

(n4)Footnote 4. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005

(n5)Footnote 5. See P 29.02[1]

(n6)Footnote 5a. *Fed. R. Bankr. P. 1007(c)*.

(n7)Footnote 5b. *11 U.S.C. § 523(a)(6)*.

(n8)Footnote 6. See P 29.12 *infra*.

(n9)Footnote 7. See 9 *Collier on Bankruptcy*, P 4007.05 (Matthew Bender).

(n10)Footnote 8. *Fed. R. Bankr. P. 4007(e)*.

(n11)Footnote 9. *11 U.S.C. § 1328(b)(1)*.

(n12)Footnote 10. See 8 *Collier on Bankruptcy*, P 1328.03[2][a] (Matthew Bender).

(n13)Footnote 11. *In re Bandilli*, 41 C.B.C.2d 1356, 231 B.R. 836 (B.A.P. 1st Cir. 1999) (circumstances need not be catastrophic, but temporary relapse of medical condition which did not affect income was insufficient for hardship discharge); *In re Edwards*, 207 B.R. 728 (Bankr. N.D. Fla. 1997) .

(n14)Footnote 12. *11 U.S.C. § 1328(b)(2)*. See 8 *Collier on Bankruptcy*, P 1328.03[2][b] (Matthew Bender).

(n15)Footnote 13. See 8 *Collier on Bankruptcy*, P 1328.03[2][c] (Matthew Bender). See also *Roberts v. Boyajian* (*In re Roberts*), 279 F.3d 91 (1st Cir. 2002) (no abuse of discretion in denying hardship discharge to debtor who made no attempt to modify the plan or to sever her case from her husband's, actions that in all likelihood would have been allowed by the bankruptcy court and might have permitted her to obtain a discharge).

(n16)Footnote 14. *11 U.S.C. § 1325(a)(5)(A)* and *1329(b)(1)*.

(n17)Footnote 15. *11 U.S.C. § 1307(a)*. See ch. 24 *supra*.

(n18)Footnote 16. *11 U.S.C. § 1307(b)*. See ch. 23 *supra*.



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P 29.04 Objections to Discharge in Chapter 7 Cases

[1] Objections to Discharge and their Effect

As discussed above,ⁿ¹ the procedure for obtaining a discharge is normally quite simple. In a chapter 7 case, as provided by *Rule 4004(c) of the Federal Rules of Bankruptcy Procedure*, a discharge order is usually entered a little over 60 days after the first date set for the meeting of creditors, assuming no objection to discharge has been filed by that time.ⁿ² In a chapter 13, case the discharge is granted after completion of payments under a confirmed plan and, if applicable, certification that domestic support obligations have been paid or upon application of a debtor for a hardship discharge, and that credit education has been completed.ⁿ³ In both chapters, the court may choose to hold a discharge hearing, but is not required to do so unless the debtor chooses to reaffirm a debt and the debtor was not represented by an attorney in negotiating the reaffirmation agreement.ⁿ⁴

In a chapter 7 case, an objection to discharge may be raised based on the grounds for denial listed in section 727.ⁿ⁵ Note that the grounds for denial of discharge listed in section 727 do not apply in chapter 13 cases.ⁿ⁶ This may be a good reason to start a case under chapter 13 in some instances, or convert to chapter 13 if problems arise. This is not to say, however, that a chapter 13 discharge could not be opposed on the grounds that the plan has not been completed or that a hardship discharge is not warranted. And, of course, creditors may object earlier to confirmation of the plan.

MORE INFORMATION

See chapter 20 *supra* for discussion of objections to confirmation of a chapter 13 plan.

WARNING

A serious obstacle may arise from an objection to the discharge. If a discharge is denied in a chapter 7 case, the effect is quite serious. Although the debtor would lose any nonexempt property to creditors, those creditors, if not paid in full, could still pursue the debtor after the bankruptcy for the remaining amounts due to them. While property claimed as exempt by the debtor could not be taken to satisfy these creditorsⁿ⁷ (which might well protect all of the debtor's property), any property acquired after the bankruptcy could be subjected to process.ⁿ⁸

[2] Procedure for Raising Objections to Discharge

[a] Objections Must Be Raised by Adversary Proceeding

Objections must be raised in a complaint, initiating an adversary proceeding,ⁿ⁹ filed by the United States Trustee, the trustee or a creditor.ⁿ¹⁰ The complaint must be filed within 60 days of the first date set for the meeting of creditors under section 341(a) unless the court, upon a motion filed within that time period and for cause, extends the deadline.ⁿ¹¹ Once the deadline has passed, the court has no power to extend it.ⁿ¹²

FORMS

For forms of complaints raising objections to discharge *see* Collier Consumer Bankruptcy Forms, § CS14.41 *et. seq.* (Matthew Bender).

MORE INFORMATION

For discussion of procedure in adversary proceedings *see* chapter 32 *infra*.

[b] Court May Be Able to Deny Discharge *Sua Sponte*.

In view of the wording of section 727(a), it may be possible for the court, *sua sponte*, to deny a discharge, if it knows of facts which would bar the debtor from that relief.ⁿ¹³ However, this almost never happens, since such an active partisanship of the court in a case is out of keeping with its role under the Bankruptcy Code, as a neutral arbiter of disputes brought before it rather than a participant. While the Bankruptcy Rules are clear that the objector to a discharge has the burden of proof,ⁿ¹⁴ how would that burden be carried if the court itself raised the objection? Presumably, the court would instead direct the trustee to initiate and litigate an objection to discharge.

[3] Burden of Proving Objections to Discharge

Most courts have concluded that objections to discharge, particularly those involving fraud, must be proved by "clear and convincing" evidence,ⁿ¹⁵ but those holdings have been called into question by the Supreme Court's decision in *Grogan v. Garner*.ⁿ¹⁶ At a minimum, the reasons for denying a discharge must be real and substantial and not merely technical and conjectural.ⁿ¹⁷ And, since *Grogan*, it has been held that the provisions on objections to discharge should be construed liberally in favor of the debtor.ⁿ¹⁸ Although proof of actual intent to defraud is necessary to prove most objections to discharge, courts have generally held that such proof may be made by circumstantial evidence.ⁿ¹⁹

FOOTNOTES:

(n1)Footnote 1. *See PP 29.01 and 29.02 supra* .

(n2)Footnote 2. Under section 727(a)(12), enacted in 2005 and effective immediately, the entry of discharge may be delayed until the applicability of section 522(q), also newly enacted, can be made. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after April 20, 2005. *Fed. R. Bankr. P. 4004(c)*, also states several other circumstances which can delay entry of the discharge, such as the pendency of a motion to dismiss or a motion for an extension of time to file an objection to discharge or a motion to dismiss.

(n3)Footnote 3. *See 11 U.S.C. § 1328. See P 29.03 supra*.

(n4)Footnote 4. *See 11 U.S.C. § 524(d). See P 29.07 infra* for discussion of the discharge hearing.

(n5)Footnote 5. *See P 29.05 infra* for discussion of grounds for objections to discharge.

(n6)Footnote 6. *11 U.S.C. § 103(b)*.

(n7)Footnote 7. *11 U.S.C. § 522(c)*. Of course, the exemptions would not defeat valid nonavoidable liens.

(n8)Footnote 8. That property, though, could conceivably be protected under state exemption laws.

(n9)Footnote 9. *Fed. R. Bankr. P. 7001. See Markus v. Gschwend (In re Markus), 313 F.3d 1146 (9th Cir. 2002) (pro se motion objecting to discharge filed within time limits did not constitute complaint because it did not meet pleading requirements).*

(n10)Footnote 10. *11 U.S.C. § 727(c)(1).* A party whose claim has been disallowed is not a creditor entitled to object to discharge. *In re Vahlsing, 829 F.2d 565, 17 C.B.C.2d 937 (5th Cir. 1987)* . Similarly, one court has held that a party which purchases a claim from a creditor is not itself a creditor entitled to object to discharge. *In re Beugen, 99 B.R. 961 (B.A.P. 9th Cir. 1989)* .

(n11)Footnote 11. *Fed. R. Bankr. P. 4004(a).* If a case has been converted to chapter 7 from another chapter, a new time period for filing a complaint commences, unless the case had previously been a chapter 7 case and the time period had expired before conversion from chapter 7 to another chapter. *Fed. R. Bankr. P. 1019(2). See P 29.06[1]* for discussion of time limits.

(n12)Footnote 12. *In re Dombroff, 192 B.R. 615 (S.D.N.Y. 1996)* .

(n13)Footnote 13. *11 U.S.C. § 727(c)* states that only the trustee or a creditor may object, with the court seemingly limited to acting on request of a party.

(n14)Footnote 14. *Fed. R. Bankr. P. 4005. But cf. Matter of Freedman, 693 F.2d 50 (8th Cir. 1982)* (once creditor raises reasonable grounds to support a finding that the debtor committed proscribed acts, debtor has the burden of proving that he or she did not do so or did not have requisite intent).

(n15)Footnote 15. *E.g., In re Mayo, 20 C.B.C.2d 641, 94 B.R. 315 (Bankr. D. Vt. 1988) ; In re Garcia, 88 B.R. 695 (Bankr. E.D. Pa. 1988)* . *But see, e.g., In re Riso, 74 B.R. 750 (Bankr. D.N.H. 1987)* (preponderance of the evidence).

(n16)Footnote 16. *498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755, 24 C.B.C.2d 1 (1991)* (preponderance of the evidence standard applies to exception to dischargeability under section 523(a)). Following *Grogan*, it may still be possible to argue that the clear and convincing standard should apply under section 727, because the consequences of denial of discharge are more severe than those of making a single debt nondischargeable. But such arguments have been largely unsuccessful. *In re Scott, 172 F.3d 959, 41 C.B.C.2d 1610 (7th Cir. 1999) ; In re Adams, 31 F.3d 389, 31 C.B.C.2d 865 (6th Cir. 1994)* (proof by preponderance of evidence); *Farouki v. Emirates Bank Int'l, Ltd., 14 F.3d 244 (4th Cir. 1994)* (same); *In re Serafini, 938 F.2d 1156, 25 C.B.C.2d 489 (10th Cir. 1991)* (extending preponderance standard to section 727 based on *Grogan*).

(n17)Footnote 17. *In re Burgess, 955 F.2d 134 (1st Cir. 1992)* .

(n18)Footnote 18. *Rosen v. Bezner, 996 F.2d 1527, 29 C.B.C.2d 93 (3d Cir. 1993)* .

(n19)Footnote 19. *E.g., Matter of Chastant, 873 F.2d 89 (5th Cir. 1989)* .



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Collier Consumer Bankruptcy Practice Guide

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CHAPTER 29 Obtaining a Discharge

1-29 Collier Consumer Bankruptcy Practice Guide P 29.05

P 29.05 Grounds for Creditor to Object to Discharge

[1] Discharge Granted to Individuals Only; § 727(a)(1)

Section 727(a)(1) provides that unless the debtor is an individual, he or she shall not be granted a discharge in a liquidation case under chapter 7.

This provision, which is not applicable in consumer cases, is meant simply to deny a discharge to corporations and partnerships in liquidation cases.ⁿ¹ After such an entity has been liquidated, if a dissolution of such a corporation or partnership is desired, it must be effectuated under state law.

The prohibition on nonindividuals, however, does not apply when the debtor has died after the filing of a bankruptcy case. The estate of the deceased debtor is entitled to the benefits of that debtor's discharge.ⁿ²ⁿ³

[2] Intentional Concealment, Transfer or Destruction of Property; § 727(a)(2)

Probably the most common objection to discharge is that the debtor has intentionally transferredⁿ⁴ or concealed assetsⁿ⁵ in order to prevent creditors from obtaining access to them in bankruptcy.ⁿ⁶ This blatant type of fraudulent conduct goes to the very heart of the bankruptcy law, defeating its purpose of distributing nonexempt property to creditors.ⁿ⁷

[a] Limitations of this Ground

Several limitations to this bar to discharge are both explicitly and implicitly present in the statute.

[i] Debtor Must Have Actual Intent to Hinder, Delay or Defraud

First, the debtor must have committed the act with actual intent to hinder, delay, or defraud a creditor or officer of the estate.ⁿ⁸ Thus, the standard for objection is stricter than that contained in many types of fraudulent conveyance provisions under which a constructive intent can be presumed simply on the basis of the debtor's financial condition. Without this very specific intent, a discharge will not be barred.ⁿ⁹

[ii] Determination Whether Prebankruptcy Conversion Was with Intent to Defraud Creditors

Some cases under this provision have examined the debtor's prebankruptcy conversion of nonexempt assets into assets that are exempt in bankruptcy. Several of the decisions turn on whether the exemption planning was done with intent to defraud creditors.ⁿ¹⁰ Given that the debtor has control over the timing of a voluntary bankruptcy, it would appear to be unfair to require that the debtor maintain nonexempt assets to satisfy creditors' claims in bankruptcy when the debtor could protect those assets under state or federal law by making them exempt prepetition. The courts have taken a fairly subjective approach to this issue, depending on the amount of money shielded from creditors, with a good deal of discretion afforded to the trial court.ⁿ¹¹

MORE INFORMATION

For a further discussion of exemption planning see chapter 13 *supra*.

[iii] Exemption Planning Distinguished from Transfer of Assets Out of Estate

Exemption planning obviously must be distinguished from the transfer of assets completely out of the bankruptcy estate for little or no consideration, particularly if the debtor has some access to or full use of those assets.

PRACTICE NOTE

The courts have denied a discharge when there has been an obvious dissipation of assets in contemplation of bankruptcy,ⁿ¹² or a suspicious transfer to relatives for little or no consideration.ⁿ¹³ They have even denied a discharge when money was "transferred" from a debtor's bank account to the debtor, when it was shown that the transfer was an attempt to avoid attachment of the account and thus hinder creditors.ⁿ¹⁴ However, if the debtor has recovered substantially all of the property transferred before the bankruptcy is filed and truthfully discloses the transfers, the debtor should not be denied a discharge under this subsection.ⁿ¹⁵

[iv] Transfer Must Occur Either within One Year Prior to Petition or After Petition was Filed

Additionally, the challenged action must have taken place within one year prior to the bankruptcy or after the bankruptcy was filed.ⁿ¹⁶ And it must have involved property that would have been available to creditors. If the debtor had no equity in the property, then the bar to discharge is usually not considered applicable.ⁿ¹⁷ The same result would probably be reached with respect to property that the debtor could claim as exempt.ⁿ¹⁸

[3] Unjustified Failure to Keep Books or Records as to Finances; § 727(a)(3)

The Bankruptcy Code provides for denial of discharge if the debtor has "concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information" concerning the debtor's finances, but only if such act or failure to act was not justified under all the circumstances.ⁿ¹⁹

The section should only come into play if the consumer's records are so deficient the court and the parties cannot ascertain an accurate picture of the debtor's financial affairs.^{n19a}

[a] Inapplicable to Most Consumer Debtors

COMMENTARY

The exception to the general rule, which excuses the failure to keep records if it was "justified," has prevented the application of this subsection in most consumer cases. Most consumers, of course, do not keep books and records in the conventional sense. What they have, at most, is a collection of receipts,

bills, canceled checks, loan documents, and payment books. Certainly, a consumer debtor who has any of these documents may honestly say that books or records have been kept. And, since this provision is really directed at independent businesses,ⁿ²⁰ and perhaps gamblers,ⁿ²¹ even a total lack of records has been excused in the cases of wage-earners and other low-income people.ⁿ²² Since this subsection is basically unchanged from the prior Bankruptcy Act (except for wording), case law interpreting that Act should still be applicable. So long as the debtor did not have any particular reason to anticipate the need for records, and there are other ways to ascertain the debtor's financial affairs, this provision should present few problems in consumer cases.

If the court does find that the debtor was required to keep books and records but failed to do so, the debtor may have the burden of showing that the failure was justified.ⁿ²³ The court may find that the failure was justified in some cases if the debtor relied upon another to keep the records.ⁿ²⁴

[4] Dishonesty in Connection with the Bankruptcy Case; § 727(a)(4)

Debtors who attempt to perpetrate a fraud upon the bankruptcy court are not treated kindly by the Bankruptcy Code. Those who make a false oath (commit perjury), present false claims, give or take bribes, or withhold records are denied a discharge.ⁿ²⁵ This provision clearly extends to the bankruptcy statements and schedules, which are submitted under oath.

[a] False Oath Objection Limited to More Serious Cases

Like many of the other bars to discharge, the false oath objection is limited by its terms and by case law to the more serious types of cases. The false oath must be in regard to a matter material to the proceedings, which could have some real effect on creditors and the estate.ⁿ²⁶ The false oath must be intentional; false answers resulting from carelessness or ignorance will not bar a debtor's discharge.ⁿ²⁷ And the false oath must be in connection with administration of the case itself; fraudulent conduct in connection with a particular debt can be grounds only for an exception to the discharge of that debt. It may be the debtor's burden to show lack of intent once there is proof of a false oath as to a material fact.ⁿ²⁸

MORE INFORMATION

The dischargeability exception for individual debts incurred through false pretenses, fraud or false financial statements is examined in chapter 26 *supra* .

[b] False Oath in Case of Joint Debtors

A finding that one debtor in a joint case made a false oath does not necessarily bar the other debtor from receiving a discharge.ⁿ²⁹ If the joint debtor had no interest in property omitted from the schedules or no knowledge of the facts which were falsely stated, that debtor remains entitled to a discharge.ⁿ³⁰

[5] Failure to Explain Loss or Deficiency of Assets; § 727(a)(5)

This provision barring discharge is often grouped with the previous two (unjustified failure to keep books or records and dishonesty in connection with the bankruptcy case), as going to the debtor's honesty with regard to the bankruptcy case. The debtor is not entitled to a discharge if the debtor has failed satisfactorily to explain a loss of assets or deficiency of assets necessary to meet liabilities.ⁿ³¹ Once the creditor carries its burden of establishing that an asset is lost or dissipated, this section places the burden on the debtor to explain the loss or dissipation.ⁿ³²

COMMENTARY

Courts interpreting this section have been concerned primarily with debtors who previously had large amounts of property or money, a situation which, unfortunately, few consumer debtors have ever experienced. In most consumer cases, the obvious use of any diminishing assets was for basic living expenses. Even if this was not the case, this subsection is not intended as a vehicle through which the court may pass judgment on the wisdom of the debtor's expenditures.ⁿ³³ And an innocent failure of a spouse who took no part in her husband's business to explain a loss of assets will not bar that spouse's discharge.ⁿ³⁴

[6] Refusal to Obey Court Orders or to Testify; § 727(a)(6)

If the debtor has refused to comply with direct court orders or to testify (except when the privilege against self-incrimination has been invoked and immunity has not been granted), the debtor's discharge may be denied.ⁿ³⁵ However, not every failure to comply with a court order warrants a denial of discharge.ⁿ³⁶

[a] Debtor's Refusal to Turn Over Estate Property

Most often, this unusual situation will arise when a debtor has been ordered to turn over property which he or she expected to keep in the bankruptcy, and which the debtor may no longer even possess.

WARNING

For example, debtors who are poorly advised sometimes spend nonexempt tax refunds received after the filing of their cases. Like other property that is not exempt, those refunds constitute property of the estate which the court may order turned over to the trustee. If the debtor is unable to deliver that amount of money within a reasonable time, the discharge could be denied.^{n36a}

[b] Debtor's Refusal to Testify; Invocation of Privileges

Debtors who refuse to testify may also be denied a discharge. However, if a debtor properly invokes the privilege against self-incrimination, discharge cannot be denied unless immunity has first been offered with respect to the matter concerning which the privilege was invoked.ⁿ³⁷ Presumably, debtors will also not be ordered to answer questions as to which other privileges are properly invoked.

[7] Commission of Prohibited Acts in Connection with Another Bankruptcy Case Concerning an Insider; § 727(a)(7)

Debtors who have committed any of the fraudulent acts listed in the previous sections, within a year previous to the filing of their cases, or after the filing of their cases, are barred from discharge if such acts were committed in connection with another case concerning an "insider."ⁿ³⁸ The Bankruptcy Code defines "insider" to include relatives and partners, as well as partnerships and corporations of which the debtor is a director, officer, or person in control.ⁿ³⁹

Although this section is undoubtedly directed principally at debtors who have been involved in bankrupt corporations and partnerships,ⁿ⁴⁰ it could also be applied to occasional consumer cases. These would most likely involve a husband and wife or other related persons committing the specified fraudulent acts.

[8] Prior Discharge in Chapter 7 or Chapter 11, or their Predecessors; § 727(a)(8)

Section 727(a)(8) of the Bankruptcy Code contains a eight-year bar against successive bankruptcy discharges.ⁿ⁴¹ It is important to note, first of all, that it applies only to prior cases in which a discharge was granted. If a prior bankruptcy case was terminated without a discharge, for example by a dismissal, this objection to discharge may not be raised. However, if a case is dismissed with prejudice, the debts owed at the time the first case was filed may not be included in

the discharge in a later case.ⁿ⁴² It should be noted that the eight-year period runs from the date the earlier bankruptcy was commenced, not from the date of the discharge.ⁿ⁴³

Unlike other provisions of the Code that take into account a prior bankruptcy filing that did not result in a discharge,^{n43a} section 727(a)(8) and (9) do not consider cases in which a discharge was not granted and there is no equitable tolling of the time periods in those provisions.^{n43b}

Lastly, as with all the provisions of section 727(a), this section has no applicability to cases in which the debtor seeks a chapter 13 discharge.ⁿ⁴⁴

[9] Prior Discharge under Chapter 12, Chapter 13 or Former Chapter XIII; § 727(a)(9)

The Bankruptcy Code also bars a chapter 7 discharge in many cases in which a debtor has received a discharge under chapter 12, chapter 13 or its predecessor in a case commenced within the previous six years.ⁿ⁴⁵ Again, this subsection applies only if the earlier case proceeded to a discharge.

[a] Exception for Certain Cases in which there Were Substantial Payments to Unsecured Creditors

A significant exception to this general rule allows a chapter 7 discharge if the previous case wholly or in large part paid unsecured debts. Thus, if 100% of the allowed unsecured claims in the previous case were paid, this subsection is not applicable. Similarly, if the actual payments under the previous chapter 13 plan comprised at least 70% of the allowed unsecured claims in that case, and the court finds that the plan was proposed by the debtor in good faith and was the debtor's "best effort," a subsequent chapter 7 discharge within six years is not barred. The drafters of the Bankruptcy Code anticipated that a debtor would be able to get this "best effort" determination at the time the original chapter 13 plan was confirmed.ⁿ⁴⁶

[10] Written Waiver of Discharge; § 727(a)(10)

The court may deny a discharge based upon a court-approved written waiver of discharge executed after the order for relief.ⁿ⁴⁷ Obviously, this section has no applicability to purported waivers of bankruptcy rights obtained by creditors in granting loans. Given the strict standards set forth for the reaffirmation of even a single debt, it is highly unlikely that many waivers of discharge will be approved.ⁿ⁴⁸

FORMS

For forms involved in waiver of discharge *see Collier Consumer Bankruptcy Forms, § CS14.62* (Matthew Bender).

MORE INFORMATION

For discussion of reaffirmation *see* chapter 27 *supra*.

Probably, the court will approve a waiver of discharge only in cases in which it seems likely no discharge could be granted anyway. Thus, it may be a method of settling a complaint objecting to discharge that will prevent the disclosure of damaging or embarrassing facts about the debtor. Even in such cases, a debtor may be able to obtain a better settlement, excepting only debts to particular creditors from the discharge or compromising the amounts owed.

[11] Failure to Complete Personal Financial Management Instructional Course; § 727(a)(11)

Under section 727(a)(11), enacted by the 2005 amendments to the Bankruptcy Code,ⁿ⁴⁹ a chapter 7 discharge may be denied if the debtor does not complete a personal financial management instructional course. However, there are several

exceptions to this requirement. The requirement does not apply to those individuals described in section 109(h)(4), which excuses a debtor from obtaining prepetition budget and credit counseling if the debtor is unable to complete the requirement because of incapacity, disability, or active military duty in a military combat zone.ⁿ⁵⁰ In addition, a debtor need not attend a financial management course if the United States trustee, or Bankruptcy Administrator,ⁿ⁵¹ if any, has determined that the courses approved under section 111 are not adequate to serve all of the individuals who would be required to complete such courses.

It should be noted that section 727(a)(11) does not require the court to deny a discharge if the debtor has not attended the required course. The provision simply makes inapplicable the introductory language of section 727 that gives the debtor an entitlement to a discharge absent grounds for an objection.

Generally, if the debtor fails to attend the required course, the court will close the case without entering a discharge order. Normally, courts will reopen the case and grant a discharge if the debtor subsequently takes the course, but the current bankruptcy court fee schedule requires the debtor to pay a filing fee to reopen the case for this reason.^{n51a}

[12] Delay of Discharge Due to Possible Proceeding Under § 522(q); § 727(a)(12)

A chapter 7 debtor is not entitled to receive discharge if the court, after notice and a hearing and not more than ten days before the order granting a discharge finds reasonable cause to believe that section 522(q)(1) may be applicable to the debtor and that there is a pending proceeding in which the debtor may be found guilty of a felony or liable for a debt described in section 522(q)(1)(B).ⁿ⁵² Section 522(q) serves to limit the homestead exemption available to debtors who have engaged in or owe a debt because of certain bad conduct. The limitation on the homestead exemption in such cases was presumably meant to prevent a debtor from sheltering very substantial assets from the victims of such acts, and section 727(a)(12) serves the purpose of allowing a court to delay the discharge while it is determined whether the debtor's exemption should be limited under section 522(q).

[13] Nonpayment of Filing Fees Not a Basis for Denial of Discharge

Under the prior Bankruptcy Act, an additional ground for denial of discharge was the failure to pay filing fees. This provision was eliminated under the Bankruptcy Code and *Rule 4004(c)(1)(G) of the Federal Rules of Bankruptcy Procedure* provides an exception to the general rule requiring prompt entry of discharge for cases in which the filing fee has not been paid. Presumably such a delay will give the debtor an opportunity to pay the filing fee and obtain a discharge. For cases filed on or after October 17, 2005, debtors may also be eligible to proceed in bankruptcy *in forma pauperis*, thus eliminating the need to pay the filing fee.ⁿ⁵³

MORE INFORMATION

For a further discussion of in forma pauperis proceedings see chapter 32 *infra*.

FOOTNOTES:

(n1)Footnote 1. The policy behind this provision is the prevention of trafficking in corporate shells and bankrupt partnerships. *See, e.g., N.L.R.B. v. Better Bldg. Supply Corp.*, 837 F.2d 377 (9th Cir. 1988) .

(n2)Footnote 2. H.R. Rep. No. 595, 95th Cong., 1st Sess. 368(1977), reprinted in Vol. C. Collier on Bankruptcy, App. Pt. 4(e)(i) (Mathew Bender 15th Ed. Revised).

(n3)Footnote 3. *See, e.g., N.L.R.B. v. Better Bldg. Supply Corp.*, 837 F.2d 377 (9th Cir. 1988) .

(n4)Footnote 4. "Transfer" is very broadly defined at 11 U.S.C. § 101(54).

(n5)Footnote 5. The "transfer" must be of the debtor's own property. *In re Thurman*, 901 F.2d 839 (10th Cir.

1990).

(n6)Footnote 6. See, e.g., *In re Kaiser*, 722 F.2d 1574, 9 C.B.C.2d 910 (2d Cir. 1983); *In re Adams*, 31 F.3d 389, 31 C.B.C.2d 865 (6th Cir. 1994) (debtors used and made unauthorized postpetition transfers of accounts receivable which were cash collateral); *Matter of Perez*, 954 F.2d 1026 (5th Cir. 1992) (debtor transferred 50% of tax refund attributable to his business to his wife).

(n7)Footnote 7. For detailed discussion of this ground see 6 *Collier on Bankruptcy*, P 727.02 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.02 (Matthew Bender).

(n8)Footnote 8. See 6 *Collier on Bankruptcy*, P 727.02[3] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.02[3] (Matthew Bender).

(n9)Footnote 9. See, e.g., *Robertson v. Dennis* (*In re Dennis*), 330 F.3d 696 (5th Cir. 2003) (affirming decision finding that minimal amounts of transfers to minor child showed no intent); *In re Miller*, 39 F.3d 301, 32 C.B.C.2d 854 (11th Cir. 1994) (motivation for transfer was not fraudulent when debtors were trying to keep business alive and satisfy their largest creditor, who was transferee); *Rosen v. Bezner*, 996 F.2d 1527, 29 C.B.C.2d 93 (3d Cir. 1993) (remand for further findings on intent); *Matter of Moreno*, 892 F.2d 417 (5th Cir. 1990); *In re Johnson*, 18 C.B.C.2d 51, 80 B.R. 953 (Bankr. D. Minn. 1987), *aff'd*, 880 F.2d 78, 21 C.B.C.2d 78 (8th Cir. 1989) (debtor's intent to prevent creditors from "depriving him of wealth" not fraudulent). See also *Swift*, 3 F.3d 929, 29 C.B.C.2d 1070 (5th Cir. 1993) (trial court's findings on intent upheld unless clearly erroneous); *McCormick v. Security State Bank*, 822 F.2d 806 (8th Cir. 1987) (debtor concealed assets from creditor prior to bankruptcy and purchased a house in name of himself and his wife in clandestine manner).

(n10)Footnote 10. E.g., *Matter of Bowyer*, 932 F.2d 1100 (5th Cir. 1991) (using savings to pay down mortgage was without requisite intent to defraud creditors); *In re Johnson*, 880 F.2d 78, 21 C.B.C.2d 498 (8th Cir. 1989) (conversion of property to make use of homestead exemption does not in itself establish fraud absent proof of actual intent to defraud); *In re Smiley*, 864 F.2d 562 (7th Cir. 1989) (conversion of nonexempt assets to exempt assets not in itself fraudulent, absent specific intent to hinder or delay creditors shown by concealment or misrepresentation); *Ford v. Poston*, 773 F.2d 52, 13 C.B.C.2d 632 (4th Cir. 1985) (conversion of nonexempt property to exempt property is normally permissible, but a court may find extrinsic elements of fraud). See also section 522(o), enacted in 2005, which limits debtor's homestead exemption in cases where nonexempt property has been converted into exempt homestead property with fraudulent intent. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after April 20, 2005.

(n11)Footnote 11. See Koger & Reynolds, *Is Prefiling Engineering Prudent Planning or Section 727 Fraud? (Or, When does a Pig Become a Hog?)*, 93 *Comm. L.J.* 465 (1988).

(n12)Footnote 12. *Matter of Bowyer*, 916 F.2d 1056, 24 C.B.C.2d 238 (5th Cir. 1990) (debtor's spending \$18,000 on travel and exempt assets just before bankruptcy and voluntarily satisfying homestead mortgage 15 days before filing case warranted denial of discharge, even though debtor may not have had actual intent to defraud creditor); *In re Marcus*, 45 B.R. 338 (S.D.N.Y. 1984) (debtor sold property for far less than it was worth).

(n13)Footnote 13. *Cohen v. Bucci*, 905 F.2d 1111 (7th Cir. 1990) (denial of discharge where debtor had transferred assets to wife and son); *Matter of Chastant*, 873 F.2d 89 (5th Cir. 1989) (trust gratuitously created for children suggests fraudulent motive); *In re Olivier*, 819 F.2d 550, 16 C.B.C.2d 1330 (5th Cir. 1987) (debtors concealed beneficial interest they retained in home they transferred to parent immediately after automobile accident seven years earlier); *Ford v. Poston*, 773 F.2d 52, 13 C.B.C.2d 632 (4th Cir. 1985) (debtor transferred real estate to himself and his wife and extrinsic evidence indicated fraudulent purpose).

(n14)Footnote 14. *In re Bernard*, 96 F.3d 1279, 36 C.B.C.2d 1585 (9th Cir. 1996) (relying on broad definition of "transfer" to include deposits and withdrawals from bank account).

(n15)Footnote 15. *In re Adeeb*, 787 F.2d 1339, 14 C.B.C.2d 740 (9th Cir. 1986) . But see *In re Davis*, 911 F.2d 560 (11th Cir. 1990) (discharge denied where debtor transferred interest in marital home to wife within one year of filing petition even though he retransferred property to himself day before bankruptcy was filed).

(n16)Footnote 16. 11 U.S.C. § 727(a)(2)(A). See *In re Roosevelt*, 87 F.3d 311, 36 C.B.C.2d 118 (9th Cir. 1996) , amended, 98 F.3d 1169 (1996) , cert. denied, 520 U.S. 1209, 117 S. Ct. 1691, 137 L. Ed. 2d 818 (1997) (marital agreement transferring debtor's community property interest was effective upon signing and therefore beyond one year limit). But see *Rosen v. Bezner*, 996 F.2d 1527, 29 C.B.C.2d 93 (3d Cir. 1993) (continuing concealment could bring transfer that was more than one year prior to petition within scope of section); *In re Olivier*, 819 F.2d 550, 16 C.B.C.2d 1330 (5th Cir. 1987) (same); *In re Kauffman*, 675 F.2d 127 (7th Cir. 1981) (finding continuing concealment of assets more than one year after formal transfer of property where debtor continued to use property as his own).

(n17)Footnote 17. See, e.g., *In re J. J. Bradley & Co.*, 2 C.B.C.2d 1245, 6 B.R. 529 (Bankr. M.D. Tenn. 1980) and cases cited therein.

(n18)Footnote 18. See, e.g., *In re Lippow*, 92 F.2d 619 (7th Cir. 1937) (decided under similar language in prior Bankruptcy Act).

(n19)Footnote 19. 11 U.S.C. § 727(a)(3). See 6 *Collier on Bankruptcy*, P 727.03 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.03 (Matthew Bender).

(n20)Footnote 19a. *In re French*, 499 F.3d 345 (4th Cir. 2007) .

(n21)Footnote 20. See, e.g., *Matter of Juzwiak*, 89 F.3d 424, 36 C.B.C.2d 306 (7th Cir. 1996) (owner of trucking business did not keep records that allowed meaningful reconstruction of debtor's transactions); *Meridian Bank v. Alten*, 958 F.2d 1226, 26 C.B.C.2d 846 (3d Cir. 1992) (debtor, a sophisticated business person, held to a high level of accountability in record keeping; neither small legal practice nor fear of execution by creditors constitutes adequate justification for failure to keep adequate records).

(n22)Footnote 21. See *In re Dolin*, 799 F.2d 251 (6th Cir. 1986) (debtor's chemical dependency and compulsive gambling did not excuse failure to keep records).

(n23)Footnote 22. See, e.g., *In re Humphries*, 469 F.2d 643 (5th Cir. 1972) ; *Morris Plan Indus. Bank v. Henderson*, 131 F.2d 975 (2d Cir. 1942) . See also *In re Cox*, 41 F.3d 1294, 32 C.B.C.2d 745 (9th Cir. 1994) (factors to be considered in deciding if failure to keep records is justified by reliance on spouse are debtor's intelligence and education, debtor's experience in business, extent of debtor's involvement in businesses with respect to which debts arose, debtor's reliance on spouse to keep records, including what debtor saw or was told, nature of marital relationship, and any record keeping or inquiry duties debtor had under state law).

(n24)Footnote 23. See *Meridian Bank v. Alten*, 958 F.2d 1226, 26 C.B.C.2d 846 (3d Cir. 1992) (debtor has burden of establishing adequate justification).

(n25)Footnote 24. See *In re Cox*, 904 F.2d 1399, 22 C.B.C.2d 1754 (9th Cir. 1990) (bankruptcy court must consider debtor wife's reliance on husband in determining whether her failure to keep records was justified under all the circumstances).

(n26)Footnote 25. 11 U.S.C. § 727(a)(4). *In re Keeney*, 227 F.3d 679 (6th Cir. 2000) (failure to schedule debtor's secret interest in property purportedly transferred prior to bankruptcy); *Farouki v. Emirates Bank Int'l., Ltd.*, 14 F.3d 244 (4th Cir. 1994) (debtor falsely denied ownership interest in family-owned business); *In re Calder*, 907 F.2d 953 (10th Cir. 1990) (failure to disclose substantial assets in schedules warranted denial of discharge); *Williamson v. Fireman's Fund Ins.*, 828 F.2d 249 (4th Cir. 1987) (false oaths concealed pattern of gratuitous transfers); *In re Tully*, 818 F.2d 106 (1st Cir. 1987) (failing to list assets). See generally 6 *Collier on Bankruptcy*, P 727.04 (Matthew Bender);

2 *Collier Bankruptcy Manual*, P 727.04 (Matthew Bender).

(n27)Footnote 26. Compare *Matter of Beaubouef*, 966 F.2d 174 (5th Cir. 1992) (failure to disclose interest in corporation with intent to deceive warranted denial of discharge); *Swicegood v. Ginn*, 924 F.2d 230, 24 C.B.C.2d 1245 (11th Cir. 1991) (omission from schedules of watch and set of silverware worth \$1,400 was material even though debts to be discharged totalled \$861,778.19); *In re Olson*, 916 F.2d 481 (8th Cir. 1990) (debtor's failure to list interest in dinner theater of questionable value and nominally owned by wife was material misrepresentation); *In re Chalik*, 748 F.2d 616, 11 C.B.C.2d 1159 (11th Cir. 1984) (debtor omitted any reference in statement of affairs to 12 corporations with assets of \$2.1 million in which he had been involved) with *Matter of Agnew*, 818 F.2d 1284 (7th Cir. 1987) (failure to disclose property not subject to claims of creditors did not bar discharge). But see *Mertz v. Rott*, 955 F.2d 596 (8th Cir. 1992) (failure to disclose anticipated estate tax refund, on three separate occasions, justified denial of discharge even though refund was found by lower court to be exempt).

(n28)Footnote 27. *In re Brown*, 108 F.3d 1290 (10th Cir. 1997) (no inference of fraudulent intent when debtor promptly brings mistake to trustee's or court's attention); *In re Espino*, 806 F.2d 1001 (11th Cir. 1986) (failure to list contingent obligation did not bar discharge where no intent to defraud creditors); See also 6 *Collier on Bankruptcy* P 727.04[1][a] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.04[1][a] (Matthew Bender).

(n29)Footnote 28. See *In re Tully*, 818 F.2d 106 (1st Cir. 1987) . See also *In re Varrasso*, 37 F.3d 760 (7th Cir. 1994) (circumstantial evidence of intent would rarely be sufficient to grant summary judgment denying discharge).

(n30)Footnote 29. E.g., *In re Montgomery*, 86 B.R. 948 (Bankr. N.D. Ind. 1988) .

(n31)Footnote 30. *Gannett v. Carp* (*In re Carp*), 340 F.3d 15 (1st Cir. 2003) (wife not automatically an agent of husband or responsible for husband's failure to disclose property; her knowledge and fraudulent intent must be proved).

(n32)Footnote 31. See 6 *Collier on Bankruptcy*, P 727.08 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.08 (Matthew Bender).

(n33)Footnote 32. *Matter of D'Agnese*, 86 F.3d 732, 36 C.B.C.2d 101 (7th Cir. 1996) (debtor's vague and uncorroborated explanation of what happened to jewelry, crystal and silver worth over \$300,000 was inadequate); *In re Hawley*, 51 F.3d 246, 33 C.B.C.2d 781 (11th Cir. 1995) (debtor with no documentation and vague explanations failed to explain satisfactorily loss of \$13 million in assets); *In re Hughes*, 873 F.2d 262 (11th Cir. 1989) (case remanded to allow debtor an opportunity to explain loss of assets); *In re Chalik*, 748 F.2d 616, 11 C.B.C.2d 1159 (11th Cir. 1984) ; *In re Martin*, 698 F.2d 883, 8 C.B.C.2d 152 (7th Cir. 1983) (although creditor had ultimate burden of proof in proceeding, once evidence of loss or deficiency of assets is presented, debtor has burden of going forward with evidence to explain loss; debtor also could be denied discharge for concealment of such assets where no explanation provided).

(n34)Footnote 33. *In re Nye*, 64 B.R. 759 (Bankr. E.D.N.C. 1986) (requirement of satisfactory explanation required only that debtor explain loss and not that explanation be meritorious). However, the court may require an explanation showing good faith and businesslike conduct. See 6 *Collier on Bankruptcy*, P 727.08 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.08 (Matthew Bender). See also *In re Dolin*, 799 F.2d 251 (6th Cir. 1986) (debtor's drug addiction and compulsive gambling were not satisfactory explanations for deficiency of assets).

(n35)Footnote 34. *In re Suttles*, 819 F.2d 764 (7th Cir. 1987) ; *In re MacPherson*, 101 B.R. 324 (Bankr. M.D. Fla. 1989) .

(n36)Footnote 35. 11 U.S.C. § 727(a)(6). See 6 *Collier on Bankruptcy*, P 727.09 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.09 (Matthew Bender).

(n37)Footnote 36. *In re Burgess*, 955 F.2d 134 (1st Cir. 1992) (failure to file statements and schedules by date set by court did not warrant denial of discharge when there was no evidence of harm to creditors or contumacy).

(n38)Footnote 36a. *See, e.g., In re Klages*, 381 B.R. 550 (B.A.P. 8th Cir. 2008) (debtor's discharge revoked for failing to turn over tax refund after being advised orally and in writing to turn over refund, even if it was received after discharge).

(n39)Footnote 37. 11 U.S.C. § 727(a)(6)(B). *See* 6 *Collier on Bankruptcy*, P 727.09[2] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.09[2] (Matthew Bender).

(n40)Footnote 38. *See* 6 *Collier on Bankruptcy*, P 727.10 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.10 (Matthew Bender).

(n41)Footnote 39. 11 U.S.C. § 101(31). *See* 2 *Collier on Bankruptcy*, ch. 101 (Matthew Bender); 1 *Collier Bankruptcy Manual*, ch. 101 (Matthew Bender).

(n42)Footnote 40. *E.g., Groman v. Watman (In re Watman)*, 301 F.3d 3 (1st Cir. 2002) (dental practice was insider of debtor); *In re Krehl*, 86 F.3d 737 (7th Cir. 1996) (debtor destroyed records of corporation of which he had previously been president).

(n43)Footnote 41. *See* 6 *Collier on Bankruptcy*, P 727.11[1][a] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.11[1][a] (Matthew Bender).

(n44)Footnote 42. *See* 3 *Collier on Bankruptcy*, P 349.02[3] (Matthew Bender); 1 *Collier Bankruptcy Manual*, P 349.02[3] (Matthew Bender).

(n45)Footnote 43. *See* 6 *Collier on Bankruptcy*, P 727.11[2] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.11[2] (Matthew Bender).

(n46)Footnote 43a. *E.g., 11 U.S.C. §§ 109(g) and 507(a)(8)(ii)(II).*

(n47)Footnote 43b. *Tidewater Fin. Co. v. Williams*, 498 F.3d 249 (4th Cir. 2007) .

(n48)Footnote 44. *See* P 29.02[1] *infra* for a discussion of when prior discharges bar a subsequent discharge in chapter 13.

(n49)Footnote 45. 11 U.S.C. § 727(a)(9). *See* 6 *Collier on Bankruptcy*, P 727.11[1][b] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.11[1][b] (Matthew Bender).

(n50)Footnote 46. 124 Cong. Rec. S17,415 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini), *reprinted in* Vol. D *Collier on Bankruptcy*, App. Pt. 4(f)(iii) (Matthew Bender). *See* 6 *Collier on Bankruptcy*, P 727.11[1][b] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.11[1][b] (Matthew Bender).

(n51)Footnote 47. 11 U.S.C. § 727(a)(10). *See* 6 *Collier on Bankruptcy*, P 727.12 (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.12 (Matthew Bender). In a voluntary case, the order for relief occurs as of the filing of the petition. 11 U.S.C. § 301.

(n52)Footnote 48. *See In re Martin*, 211 B.R. 23 (Bankr. E.D. Ark. 1997) (waiver not approved because debtor did not understand its legal effect).

(n53)Footnote 49. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n54)Footnote 50. 11 U.S.C. § 109(h), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005

(n55)Footnote 51. The Bankruptcy Administrator performs most of the functions of the United States trustee in

judicial districts in Alabama and North Carolina, where the United States trustee program is not operational.

(n56)Footnote 51a. Bankruptcy Court Miscellaneous Fee Schedule, Item 11.

(n57)Footnote 52. 11 U.S.C. § 727(a)(12), enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17.

(n58)Footnote 53. 28 U.S.C. 1930(f), enacted by enacted by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. However, proceeding *in forma pauperis* is only available for Chapter 7 filings.



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CHAPTER 29 Obtaining a Discharge

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P 29.06 Procedure for Complaint Objecting to Discharge

[1] Deadline for Filing Objections

An objection to discharge must be filed within 60 days after the first date set for the meeting of creditors.ⁿ¹ Even if the meeting does not take place on that date, or is not concluded on that date, the 60 day clock begins to run. If the deadline cannot be met, the court is empowered to grant an extension, but only for cause.ⁿ² Therefore, every effort should be made to acquire the information necessary to file an objection prior to the deadline through the mechanisms described below.ⁿ³

[2] Obtaining Information Necessary to File a Complaint

It is often necessary to obtain discovery of facts before filing a complaint, in order to know whether there is a good faith basis for filing an objection to discharge and whether the likelihood of success justifies the time and expense involved. There are two principal means of obtaining information.

The first method is by questioning the debtor at the section 341(a) meeting of creditors. Notice of this meeting is given to all creditors and any creditor has a right to question the debtor at the meeting. Creditors should take advantage of this opportunity if there is any contemplation of an objection to discharge.

However, questioning at the meeting may sometimes be curtailed by the trustee or other officer conducting the meeting, or it may not be possible to obtain all necessary information for some other reason, such as the unavailability of documents or the fact that important questions arise only after the meeting. It may also be necessary to examine someone other than the debtor. In such cases, the potential plaintiff can file a motion that the court order an examination or several examinations under *Federal Rule of Bankruptcy Procedure 2004*. Such a motion is almost always granted and the rule permits a wide-ranging examination of the debtor and the debtor's finances.ⁿ⁴ The subpoena to a *Rule 2004* examination may compel the debtor, or any other person the court orders examined, to bring books and records to the examination.ⁿ⁵

[3] Drafting the Complaint

A proceeding objecting to discharge, as an adversary proceeding, must be initiated by a complaint.ⁿ⁶ The general rules of pleading for federal civil proceedings apply.

DRAFTING NOTE

Of particular note is *Federal Rule of Bankruptcy Procedure 7009*, which requires that fraud be pleaded with particularity. Malice, intent, knowledge or other condition of mind, however, may be averred generally.ⁿ⁷ It is important to plead sufficient facts to withstand a motion to dismiss, although amendments relating to the same fact situation are usually allowed if necessary.

A complaint may state more than one cause of action either cumulatively or in the alternative.ⁿ⁸ A plaintiff should also be careful to allege each and every objection to discharge that might be possible based upon the facts that are known, as well as any exception to discharge that the plaintiff wishes to raise. If an objection or dischargeability issue is not raised by the applicable deadline, it will often be impossible to later amend the complaint to add it after the deadline has run.ⁿ⁹

FORMS

For forms of complaints objecting to discharge, see *Collier Consumer Bankruptcy Forms*, § CS14.41 *et. seq.* (Matthew Bender).

If there has been a prior judgment or finding of fraud, or of some other element of the discharge objection, that fact should normally be pleaded, since there may be collateral estoppel effect.

[4] Debtor's Response to the Complaint

The debtor must file a timely response to the complaint or risk a default in which all facts alleged are deemed admitted and a default judgment is possible.ⁿ¹⁰ However, a court will often require evidence before denying a debtor's discharge even in a default situation.

The debtor may respond by a motion to dismiss, when it can be argued that the complaint does not plead sufficient facts to support a denial of discharge. Such a motion may also raise the plaintiff's failure to plead fraud with particularity as required by *Federal Rule of Bankruptcy Procedure 7009*.

If the debtor files an answer, the pleading rules are the same as those applicable in the district court. Denials of allegations may be general denials, but if only part of an allegation is denied, the denial should so specify and admit the remainder.ⁿ¹¹ Affirmative defenses must be pleaded and counterclaims may be asserted against the plaintiff.

[5] Pretrial Proceedings

Other pretrial proceedings are identical to those which would occur in any federal civil action. The court may hold a pretrial conference under *Federal Rule of Bankruptcy Procedure 7016*. A motion for judgment on the pleadings or for summary judgment may be filed if appropriate.ⁿ¹²

Discovery in adversary proceedings is governed by the Federal Rules of Civil Procedure.ⁿ¹³ Discovery is often necessary to obtain all of the documents and records in the case, and also to determine what documents and witnesses exist. In cases involving alleged fraud, depositions are often useful, because credibility is often an issue.

[6] Trial and Burden of Proof

The burden of proof at trial for an objection to discharge is generally on the plaintiff, the party objecting to the discharge. However, with respect to certain objections, many courts have held that the burden shifts once certain elements are proved. For example, once a plaintiff has a substantial unexplained loss of assets under *section 727(a)(5) of the Bankruptcy Code*, the burden shifts to the debtor to provide a reasonable explanation for that loss.ⁿ¹⁴

Some courts have held that the objection must be proved by clear and convincing evidence rather than by a preponderance of evidence, but many courts have held otherwise.ⁿ¹⁵

[7] Settlement of an Objection to Discharge

If the facts are such that the debtor seems unlikely to prevail, the debtor may attempt to settle the objection to discharge. The debtor may seek to avoid disclosure of embarrassing or damaging facts by agreeing to waive the discharge under section 727(a)(10). Other settlements are also possible; often the objector is really more concerned about the dischargeability of its particular debt and the addition of the objection was an afterthought or makeweight to the complaint. In such cases, reaffirmation of the debt in whole or in part may settle the case.

WARNING

However, unlike in most other types of proceedings, the court has an interest in assuring that the objector is not "bought off" in a situation in which a discharge is truly not appropriate. Therefore, *Federal Rule of Bankruptcy Procedure 7041* provides that a complaint objecting to discharge may not be voluntarily dismissed, except on notice to the trustee, the United States trustee, and such other persons as the court may direct, and may be dismissed only on order of the court containing such terms and conditions as the court deems proper.ⁿ¹⁶ This permits other parties to intervene or question the dismissal of the objection if they believe the debtor is not entitled to a discharge.

FOOTNOTES:

(n1)Footnote 1. If a case has been converted to chapter 7 from another chapter, a new time period for filing a complaint commences, unless the case had previously been a chapter 7 case and the time period had expired before conversion from chapter 7 to another chapter. *Fed. R. Bankr. P. 1019(2)*. See 9 *Collier on Bankruptcy*, P 4004.02 (Matthew Bender).

(n2)Footnote 2. *Fed. R. Bankr. P. 4004(b)*.

(n3)Footnote 3. See P 29.06[2] *infra*.

(n4)Footnote 4. See 3 *Collier on Bankruptcy*, P 343.03 -. 06 (Matthew Bender).

(n5)Footnote 5. See 3 *Collier on Bankruptcy*, P 343.06 (Matthew Bender).

(n6)Footnote 6. *Fed. R. Bankr. P. 7003*. See ch. 32 *infra* for general discussion of procedures in adversary proceedings.

(n7)Footnote 7. *Fed. R. Bankr. P. 7009*, incorporating *Fed. R. Civ. P. 9(b)*.

(n8)Footnote 8. *Fed. R. Bankr. P. 7008*, incorporating *Fed. R. Civ. P. 8(e)*.

(n9)Footnote 9. See 9 *Collier on Bankruptcy*, P 4004.02[3], 4007.04[1][a] (Matthew Bender).

(n10)Footnote 10. *Fed. R. Bankr. P. 7008*, incorporating *Fed. R. Civ. P. 7008(d)*; *Fed. R. Bankr. P. 7055*.

(n11)Footnote 11. *Fed. R. Bankr. P. 7008*, incorporating *Fed. R. Civ. P. 8(b)*.

(n12)Footnote 12. *Fed. R. Bankr. P. 7012*, incorporating *Fed. R. Civ. P. 12(c)*; *Fed. R. Bankr. P. 7056*.

(n13)Footnote 13. *Fed. R. Bankr. P. 7026-7037*.

(n14)Footnote 14. *See P 29.05[5] supra.*

(n15)Footnote 15. *See P 29.04[3] supra.*

(n16)Footnote 16. *See 10 Collier on Bankruptcy, P 7041.01 (Matthew Bender).*



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CHAPTER 29 Obtaining a Discharge

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P 29.07 The Discharge Hearing

[1] No Discharge Hearing in Most Cases

Originally, the Bankruptcy Code provided that a discharge hearing be held in every individual bankruptcy case. Since the 1986 amendments to the Bankruptcy Code, most courts have ceased conducting discharge hearings in cases in which there is no reaffirmation of debts. After the 1994 amendments, many courts have stopped holding such hearings even in most cases in which there is a reaffirmation, since a hearing is usually not required by the statute.

[a] Discretionary with the Court; Required for Reaffirmation of Debt Not Negotiated By an Attorney

The 1986 amendments to the Bankruptcy Code eliminated the requirement that the court hold a discharge hearing in every case, and the 1994 amendments further limited the requirement. Under the amended section 524(d), a discharge hearing is required only when the debtor desires to reaffirm a debt and the reaffirmation was not negotiated by an attorney. Otherwise, it is discretionary with the court and few courts hold discharge hearings when there is no reaffirmation. However, many courts do hold discharge hearings when the debtor's reaffirmation raises a presumption of undue hardship under section 524(m).

[b] Debtor Required to Attend Discharge Hearing

If a discharge hearing is held, the Bankruptcy Code clearly provides that the debtor must attend the hearing.ⁿ¹ Although there is no apparent necessity for such attendance in most cases when debts are not being reaffirmed, the mandatory appearance provision was probably included, in part, to impress the debtor with the solemnity and importance of the bankruptcy. The discharge hearing may be the first and only time most debtors see a judge in their bankruptcy cases.

[i] Debtor Attendance at Hearing May Be Waived

When no reaffirmation is being proposed and attendance at the hearing would cause real hardship, it should be possible to convince a court to conduct a telephonic hearing or, otherwise, waive the required appearance of the debtor. Indeed, several decisions have announced that Congress did not really mean what it said, and that the debtor need not attend in all cases.ⁿ²

[2] Purpose of Discharge Hearing

[a] Advise Debtor of Rights, Particularly Regarding Reaffirmation of Debts

The principal stated purpose of the discharge hearing is to advise debtors of their rights, especially with regard to reaffirmation of debts. In a well-handled case, this should already have been done by the debtor's counsel before the discharge hearing.

MORE INFORMATION

For discussion of reaffirmation *see* chapter 27 *supra*.

[b] Duty of Judge to Advise Debtor of Dangers of Reaffirmation

The discharge hearing can serve an important purpose in the situation in which the debtor is inappropriately advised by counsel about reaffirmation. The judge's main duty is to advise debtors of the dangers of reaffirmation, of the fact that reaffirmation is not required, and of the debtor's right to rescind the reaffirmation within 60 days after it is filed with the court or, if later, up to the date of the discharge.ⁿ³ If court approval is required, the agreement normally becomes effective only when that is granted. Otherwise, unless the agreement provides otherwise, the effective date is the date of filing with the court.ⁿ⁴ After discharge or the passage of 60 days from the date the reaffirmation agreement is filed, whichever occurs later, it is normally impossible to rescind a reaffirmation agreement.

[3] Procedures at the Discharge Hearing

[a] Simplicity of Discharge Hearing Held without Reaffirmation of Debts

In those few courts that have a discharge hearing even though there will be no reaffirmations of debts, the discharge hearing is usually a very brief affair, with nothing to be said by the debtor or the debtor's counsel. In fact, in many jurisdictions, debtors' counsel are not required to attend the hearing in such cases. The court usually gives a warning about creditors trying to collect their debts or obtain reaffirmations in the future, and lets the debtor know that bankruptcy is a serious business. Generally, the court will then advise prudence in future credit transactions and wish the debtor good luck. Given the potential for mind-numbing repetition, some judges give this message to all the debtors scheduled on a particular day *en masse*. Others give it once, to the first debtor to appear, and then simply ask the ones appearing later whether they heard what was said to the first debtor, saying that the same applies to them. Some judges do, however, repeat the message, with slight variations, for each debtor who appears.

[b] Discharge Hearing Held with Reaffirmation Proposed for Approval

If a reaffirmation is proposed for approval, most courts require prehearing filing, or the filing at the hearing, of a motion and a proposed order.ⁿ⁵ The court may (and should) then examine the debtor closely to determine if he or she understands what reaffirmation means and whether the reaffirmation is really in the debtor's best interest. If it is not, the reaffirmation will not be approved.

FORMS

For examples of forms used in obtaining approval of the reaffirmation agreement *see Collier Consumer Bankruptcy Forms*, § CS20.22 *et. seq.* (Matthew Bender).

MORE INFORMATION

For an examination of the standards for approval of reaffirmation *see* chapter 27 *supra*.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. § 524(d).

(n2)Footnote 2. See *In re Killett*, 1 C.B.C.2d 328, 2 B.R. 273 (Bankr. E.D. Va. 1980) (debtor in England serving in U.S. Air Force); *In re Mensch*, 7 B.R. 804 (Bankr. S.D.N.Y. 1980) (debtor suffered disabling stroke); *In re Garber*, 2 C.B.C.2d 390, 4 B.R. 684 (Bankr. C.D. Cal. 1980) (use of "shall" in section 524 is directory, not mandatory); *In re Keefe*, 3 C.B.C.2d 385, 7 B.R. 270 (Bankr. E.D. Va. 1980) (debtor suffered mental breakdown).

(n3)Footnote 3. 11 U.S.C. § 524(c)(4).

(n4)Footnote 4. 11 U.S.C. § 524(c)(3).

(n5)Footnote 5. *Federal Rule of Bankruptcy Procedure 4008(a)* requires a motion for approval of reaffirmation to be filed within 60 days of the first date set for the § 341(a) meeting of creditors, unless the court extends that time. Section 524(k)(7), added in 2005, sets forth a form motion to be used by debtors not represented by and attorney, and section 524(k)(8), also added in 2005, provides a model order for approval of a reaffirmation agreement. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *Rule 4008(a)* requires these forms to be accompanied by Official Form 27, the Reaffirmation Agreement Cover Sheet.



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CHAPTER 29 Obtaining a Discharge

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P 29.08 Notice of the Order of Discharge

Federal Rule of Bankruptcy Procedure 4004(g) states that a copy of the final order of discharge should be promptly mailed by the clerk to the persons specified in *Bankruptcy Rule 4004(a)*. The persons specified in *Bankruptcy Rule 4004(a)* are all creditors, the United States trustee, the trustee and the trustee's attorney, if any. The debtor and the debtor's attorney also should receive copies.

[1] If Notice of Discharge Is Not Mailed to Creditors, Discharge Still Effective

Because the order of discharge operates affirmatively and, perhaps independently, and may serve as the basis for a contempt proceeding, a copy of the order itself must be mailed to creditors. Until the notice is mailed, the discharge, as a practical matter, remains ineffective.ⁿ¹

However, failure to promptly send copies of the order of discharge within the time required does not affect, in any way, the validity of the order granting the discharge; it merely postpones the time when creditors are to be deemed to know about the discharge and to know that they are not to begin lawsuits or attempt to collect on discharged debts.

If any creditor has actual knowledge of the order and its contents, such knowledge would substitute for the formal mailing of the order. Any other creditor who had received the initial notice of the bankruptcy filing would presumably be under the impression that the section 362(a) automatic stay was still in effect, unless that creditor had obtained relief from the stay.

[2] Notice to Creditors Holding Discharged Debts Not to Attempt Collection

The notice required by *Rule 4004(g) of the Federal Rules of Bankruptcy Procedure* serves to inform creditors holding discharged debts not to attempt collection through the use of judicial process in a non-bankruptcy forum or through other means. Any such use could subject them to proceedings for contempt and open the door to appropriate sanctions. But these restrictions apply only to those creditors holding discharged debts. If a debt has been determined to be nondischargeable by the bankruptcy court, that court may also have entered judgment on it and no additional suit may be necessary. Otherwise, the creditor may proceed on a nondischargeable debt once the automatic stay has ended.

[3] Notice Does Not Need to Include the Debts Determined to Be Nondischargeable

Federal Rule of Bankruptcy Procedure 4004(g) sensibly omits the requirement that notice be given of the specific debts that are nondischargeable and the debts as to which proceedings to determine dischargeability are pending. The debtor and every creditor whose debt is the subject matter of any proceeding to determine dischargeability will otherwise have had notice of its pendency or disposition. Parties other than the debtor and the creditor whose debt is involved have no sufficient need of notice of the pendency or determination of such proceedings to warrant inclusion of this information in the notice of discharge. The debts to be specified in the notice could not in any event purport to be a complete list of the debts that may be nondischargeable.

[4] Finality of Order of Discharge Depends upon Whether an Appeal Is Taken

Finality of the order of discharge depends upon whether or not an appeal is taken from the order. If a notice of appeal is not filed, and no application to extend the appeal period is filed, the order becomes final at the expiration of that appeal period.

MORE INFORMATION

Appeals are discussed in more detail in chapter 33 *infra*.

FOOTNOTES:

(n1)Footnote 1. See 4 *Collier on Bankruptcy*, P 524.03, 9 *Collier on Bankruptcy*, P 4004.08 (Matthew Bender) for further discussion of notice of the order of discharge.



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P 29.09 Steps to Be Taken Immediately After Discharge

Once the discharge has been granted and all related litigation has ended, a few steps normally remain to be taken in representing the debtor. These final details may be quite important in particular cases and should not be neglected.

[1] Warnings to Be Conveyed to Client Immediately After Discharge

In order to inform clients about their post-discharge situation, the attorney must communicate a few important warnings to the client. Preprinted materials or a form letter may save time and assure that the warnings described below are clearly conveyed. Whatever method is used (interview, letter, or both), it is appropriate to assure the client that there are no new or undiscovered legal problems and to give the client a clear understanding of the new postbankruptcy situation.

FORMS

A sample letter to clients appears in *Collier Consumer Bankruptcy Forms, Form CS14.14-1* (Matthew Bender).

[a] Clients Made Fully Aware of the Meaning of the Discharge

PRACTICE NOTE

Very important advice needs to be given to clients: they should be made fully aware of the meaning of their discharge so they are not misled into paying discharged debts. Debtors should be encouraged to keep a copy of the discharge order, as well as a list of creditors scheduled in the bankruptcy, in a safe place in case issues later arise about the disposition of the case.

They should be told to report any contacts by creditors so that advice can be given and steps taken against those creditors if necessary. Many creditors have become more aggressive in testing the limits of the discharge, including attempts to obtain reaffirmations after the case is closed or to enforce invalid reaffirmation agreements never known to the debtor's counsel and never filed with the court. Clients should also be advised of the other protections arising from their discharge, particularly against any governmental and employer discrimination.

Clients should also be advised to check credit reports thirty to sixty days after discharge to verify whether creditors are properly reporting information about discharged debts as required by the Fair Credit Reporting Act. Debts discharged in the bankruptcy case should show a zero balance and be noted as having been included in the bankruptcy. If the client's credit reports still show balances owed on discharged debts, clients should be advised to send letters demanding correction of the report, with letters sent to both the creditor furnishers of information and the credit reporting agencies. If the report is not corrected, it may be necessary to initiate litigation to enforce the debtor's rights under the Fair Credit Reporting Act.

MORE INFORMATION

The requisites of a valid reaffirmation agreement and discrimination protections are discussed in chapters 27 and 30 *infra*, respectively.

[b] Clients Must Not Ignore Legal Actions Brought Against Them After Bankruptcy

[i] Even Illegal Actions By Creditors Need to Be Addressed By Counsel

WARNING

Most importantly, clients must be told not to ignore legal actions brought against them after bankruptcy. Many clients are under the impression that the bankruptcy makes any further action to protect their interests unnecessary. While this may be technically true with respect to some debts, as a general rule it is advisable to seek the advice of counsel if sued by a creditor after discharge. Some creditors may wrongfully institute legal actions to collect a discharged debt and, while this type of action can usually be rectified, early intervention and raising of the bankruptcy discharge can prevent later complications such as harm caused by a wrongful execution.ⁿ¹

[ii] Counsel Must Advise if Creditors Seek to Foreclose on Valid Liens or Collect on Nondischargeable Debts

Other creditors may seek to foreclose on a lien, to repossess property, or to collect a debt they argue was not discharged, such as a student loan. In these cases, counsel for the debtor is needed as much as ever. The answer may be a new chapter 13 bankruptcyⁿ² or any one of numerous other defensive strategies. These strategies include challenging the existence of the lien under state law and the possible reopening of the bankruptcy case to seek a determination of whether a debt was discharged in the case.

MORE INFORMATION

Dischargeability of particular debts, including debts not listed in the schedules, is discussed in more detail in chapter 26 *supra*.

[2] Public Records Should Be Modified to Reflect Discharge and other Bankruptcy Orders

Public records often should be modified to reflect what has occurred in the bankruptcy. For example, liens may no longer exist or may have been modified; debtor's counsel should be sure that any record of such liens has been corrected. Normally, this is done as part of the lien avoidance process, but it is important in closing a case to check the records.

MORE INFORMATION

Lien avoidance is discussed further in chapter 17 *supra*.

[3] Local Practice May Dictate that Courts Be Notified of Discharge

In some jurisdictions, it is a matter of practice to notify courts where proceedings have been pending that the discharge has been granted or that certain judgments are void. Technically, this is not necessary, since the effect of the discharge is automatic, but local practice or the dictates of court etiquette may make it advisable in particular areas.

FOOTNOTES:

(n1)Footnote 1. *See P 29.13 infra* for discussion of enforcing the discharge.

(n2)Footnote 2. However, new section 1328(f), enacted in 2005, prohibits a court from entering a subsequent chapter 13 discharge if the debtor received a discharge in a case filed under chapter 7 case during the 4-year period preceding the date of the order for relief in the chapter 13 case. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See P 29.05[8] supra*



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CHAPTER 29 Obtaining a Discharge

1-29 Collier Consumer Bankruptcy Practice Guide P 29.10

P 29.10 Effect of Discharge Generally

[1] Discharge Voids any Judgment with Respect to Discharged Debt

Section 524(a) of the Bankruptcy Code provides that a discharge granted to a debtor under sections 727, 944, 1141, 1228, or 1328 of title 11 voids any judgment obtained at any time with respect to any debt discharged under the abovementioned sections of the Bankruptcy Code to the extent that such a judgment is a determination of the personal liability of the debtor.ⁿ¹ It further specifies that such judgments are avoided whether or not the debtor has waived discharge of the particular debt involved. Thus, no action need be taken to eliminate a judgment that has been entered before bankruptcy. It is void as a determination of personal liability.

This provision does not, however, void a judgment to the extent that it constitutes a lien on property. Often, such a judgment lien may be voided under section 522(f), which gives the debtor the power to avoid judicial liens that impair the debtor's exemptions, but the debtor must affirmatively file a motion to obtain an order specifically avoiding the lien.ⁿ² A motion to avoid a judicial lien should ordinarily be brought during the life of the bankruptcy case. If the motion is not brought within that period, the bankruptcy court will usually allow the case to be reopened for that purpose.

MORE INFORMATION

For an examination of reopening a case *see* chapter 31 *infra*.

Section 524(a) voids a judgment on a discharged debt as a personal liability whenever it is obtained, and therefore it also avoids a judgment entered after the bankruptcy case has been filed. Nonetheless, it is unwise to rely on the judgment's voidness when a postpetition judgment is entered. A creditor may seek to execute on wages or property based upon that judgment, causing damages and hardship that, while illegal, are all too real to the debtor. If the creditor does not agree to vacate its judgment, a proceeding to enforce the discharge injunction should be brought.ⁿ³

[2] Discharge as an Injunction Against Commencement or Continuation of an Action

Section 524(a)(2) specifies that a discharge granted a debtor under sections 727, 944, 1141, 1228, or 1328 also operates as an injunction against the commencement or continuation of an action, the employment of process, or any act, including telephone calls, letters, and personal contacts to collect, recover or offset any discharged debt as a personal

liability of the debtor, whether or not discharge of the particular debt has been waived by the debtor.

[a] Discharge Protects Debtor from Subsequent State Court Suits by Creditor with Discharged Claim

In order to insure that a discharge will be completely effective, section 524(a)(2) provides that it operates as an injunction against the commencement or continuation of an action or the employment of process to collect or recover a debt as a personal liability of the debtor. Thus it protects the debtor from a subsequent suit in a state court by a creditor whose claim (debt) had been discharged in the title 11 case, as well as from continuation of an earlier suit.ⁿ⁴

[b] Creditor Who Attempts to Recover Discharged Claim May Be in Contempt

Section 524(a) also enjoins the creditor from engaging in any act to collect a discharged debt, which includes such acts as dunning by telephone or letter, harassment, and threats of repossession. The discharge injunction thus goes beyond mere initiation of legal proceedings and covers a wide range of acts intended to cause repayment of a debt.ⁿ⁵ A number of courts have held that continuing to report a discharged debt to credit reporting agencies without noting that it was included in a bankruptcy and is no longer owed has a coercive effect and can violate the discharge injunction, the FDCPA, or the Fair Credit Reporting Act.^{n5a} Creditors must maintain procedures to insure that such activities do not take place, or else they risk sanctions by the court.

Because the debtor is free to pay any discharged debt voluntarily, even if it has not been reaffirmed, issues occasionally arise regarding whether the debtor's postbankruptcy payments to a creditor were truly voluntary. If the payments were coerced by some creditor action or threat of action, courts usually find that they were not voluntary repayments and impose sanctions on the creditors involved.ⁿ⁶ In any event, there can be no binding agreement to repay debts that were discharged and not reaffirmed.

A creditor is in contempt of the bankruptcy court order if it takes any action to collect a discharged debt from the debtor.ⁿ⁷

[3] Effect of Discharge on Reaffirmed Debts

[a] Reaffirmation Waives Protections of Discharge

A reaffirmation agreement, assuming it is enforceable and not rescinded, essentially waives the protections of the discharge for the particular debt involved. However, even a creditor whose debt has been reaffirmed cannot proceed against property that was exempted in the bankruptcy case.ⁿ⁸

[b] Enforceability of Reaffirmation Agreements Dependent On Several Factors

Section 524(c), (d), and (k) of the Bankruptcy Code,ⁿ⁹ dealing with reaffirmation agreements provides that for a reaffirmation agreement to be enforceable, it must have been entered into prior to discharge, it must be filed with the court, and it must not have been rescinded prior to discharge or within 60 days after the agreement is filed with the court. Additionally, the disclosure and other requirements of section 524(k) must be satisfied. Unless, and except to the extent, a debt is secured by real property, the filed agreement must be accompanied with an affidavit of the attorney that negotiated the agreement.ⁿ¹⁰ The affidavit should conform to the provisions of section 524(c)(3) and section 524(k)(5).ⁿ¹¹ If a debtor is not represented by an attorney in negotiating a reaffirmation agreement, court approval is required.ⁿ¹²

MORE INFORMATION

For further discussion of reaffirmation agreements *see* chapter 27 *supra*.

[4] Special Rules for Debtors with Community Property

For debtors with interests in community property, the discharge is even broader; it covers creditors' prebankruptcy claims against any after-acquired community property that would have been included in the bankruptcy estate, even if only one spouse has filed a bankruptcy petition.ⁿ¹³ Generally, section 541(a)(2) provides that community property comes into the bankruptcy estate, even if only one spouse files, if it is under the sole, equal, or joint management and control of the debtor, or to the extent it is liable for a claim against the debtor or both a claim against the debtor and a claim against the debtor's spouse. This means all community property in Arizona, Idaho and New Mexico.ⁿ¹⁴

PRACTICE NOTE

The only exceptions to this broad rule are claims excepted from discharge in the debtor spouse's case and claims which would not have been discharged if the nondebtor spouse had filed.ⁿ¹⁵ A determination that an objection to the discharge of a nondebtor spouse would have been sustained must be sought by the creditor within the time limits for objecting to the debtor spouse's discharge, unless the nondebtor spouse has previously been denied a discharge within six years.ⁿ¹⁶ Of course, these provisions also mean that all creditors of both spouses should be listed in the schedules to prevent nondischargeability problems under section 523(a)(3), which pertains to unlisted creditors.ⁿ¹⁷

[5] Discharge Does Not Eliminate Valid Unavoided Liens

The discharge operates to eliminate the personal liability of the debtor. It does not eliminate valid liens against the debtor's property that have not been avoided, paid, or modified during the bankruptcy.ⁿ¹⁸ Thus, a mortgage continues to be valid after a chapter 7 case, though the creditor can no longer obtain a deficiency judgment against the debtor if the property fails to satisfy the debt. Similarly, a Uniform Commercial Code security interest in a car or other property remains in existence.

In Chapter 13, the new language of section 1325(a)(5)(B)(1) provides that a lien remains valid until the earlier of the payment of the underlying debt determined under nonbankruptcy law or a discharge under section 1328.ⁿ¹⁹ This amendment is apparently an attempt to overrule the results of cases under the prior language that required elimination of the creditor's lien when the allowed secured claim had been paid.

FOOTNOTES:

(n1)Footnote 1. See 4 *Collier on Bankruptcy*, P 524.02[1] (Matthew Bender).

(n2)Footnote 2. See ch. 18 *supra*.

(n3)Footnote 3. See *McGhan v. Rutz (In re McGhan)*, 288 F.3d 1172 (9th Cir. 2002) (bankruptcy court abused its discretion in refusing to reopen case to decide whether debt was nondischargeable under § 523(a)(3) and whether discharge injunction was violated; state court's order that debt was not discharged improperly modified bankruptcy court's discharge order); P 29.10[2][a] *infra* .

(n4)Footnote 4. See 4 *Collier on Bankruptcy*, P 524.02[2][a] (Matthew Bender).

(n5)Footnote 5. See 4 *Collier on Bankruptcy*, P 524.02[2][b] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 524.02[2][b] (Matthew Bender). See *In re Pratt*, 462 F.3d 14 (1st Cir. 2006) (refusal to release lien on junked vehicle that lender refused to repossess unless debtors agreed to pay debt was coercive); *In re Simon*, 153 F.3d 991 (9th Cir. 1998) (injunction applied to acts to collect from debtor's nonestate property in a foreign country).

(n6)Footnote 5a. See *Carriere v. Federal Credit Union*, 2004 U.S. Dist. LEXIS 14095, at 20-23 (W.D. La. July 12, 2004) ; *In re Torres*, 367 B.R. 478 (Bankr. S.D.N.Y. 2007) (reporting could violate discharge injunction; erroneous

holding that bankruptcy court did not have jurisdiction to consider FCRA or defamation claims); *In re Sommersdorf*, 139 B.R. 700, 701 (Bankr. S.D. Ohio 1992) .

(n7)Footnote 6. *See, e.g., Matter of Arnold*, 206 B.R. 560 (Bankr. N.D. Ala. 1997) (payments made pursuant to debtor's postbankruptcy agreement to pay debt in exchange for promise not to garnish wife's wages were not voluntary payments).

(n8)Footnote 7. *In re Hardy*, 97 F.3d 1384, 36 C.B.C.2d 1596 (11th Cir. 1996) (IRS violation of discharge injunction would be contempt and debtor could seek damages and fees, but damages and fees were limited by § 106(a)); H.R. Rep. No. 595, 95th Cong., 1st Sess. 365 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 80 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender). *See* 4 Collier on Bankruptcy, P 524.02[2][c] (Matthew Bender); 2 Collier Bankruptcy Manual, P 524.02[2][c] (Matthew Bender).

(n9)Footnote 8. 11 U.S.C. § 522(c).

(n10)Footnote 9. As amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n11)Footnote 10. *See* P 27.02(5)(a) *supra*.

(n12)Footnote 11. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n13)Footnote 12. *See* P 27.02(5)(b) *supra*.

(n14)Footnote 13. 11 U.S.C. 524(a).

(n15)Footnote 14. *See generally* Sommer & McGarity, Collier Family Law and the Bankruptcy Code, ch. 4 (Matthew Bender).

(n16)Footnote 15. 11 U.S.C. § 524(a)(3), (b).

(n17)Footnote 16. 11 U.S.C. § 524(a)(3), (b).

(n18)Footnote 17. *See* ch. 26 *supra*.

(n19)Footnote 18. *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773, 116 L. Ed. 2d 903, 25 C.B.C.2d 1297 (1992) ; *Chandler Bank of Lyons v. Ray*, 804 F.2d 577 (10th Cir. 1986) . *See Johnson v. Home State Bank*, 501 U.S. 78, 111 S. Ct. 2150, 115 L. Ed. 2d 66, 24 C.B.C.2d 1171 (1991) .

(n20)Footnote 19. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 29 Obtaining a Discharge

1-29 Collier Consumer Bankruptcy Practice Guide P 29.11

P 29.11 Effect of Chapter 13 Discharge

The 2005 amendments to the Bankruptcy Code¹ significantly enlarged the types of debt that are nondischargeable in chapter 13. However, the chapter 13 discharge, in cases in which the debtor completes a plan, remains broader than the discharge in chapter 7. In chapter 13, the normal discharge covers all "debts," "provided for in the plan," excepting only:

- domestic support obligations;²
- certain tax debts;³
- student loans;⁴
- some debts connected with operation of motor vehicles, vessels, or aircraft while unlawfully intoxicated;⁵
- debts incurred through fraud;⁶
- debts incurred through fraud as a fiduciary; embezzlement, or larceny;⁷
- certain debts not listed or scheduled by the debtor;⁸
- fines or restitution included in a sentence on the debtor's conviction of a crime;⁹
- debts for restitution or damages awarded for willful or malicious injury or death to an individual;¹⁰ and
- long-term debts provided for in the plan on which the last payment is due after the last payment under the plan is due.¹¹

Many of the new exceptions to discharge were added by incorporating the relevant subsections of section 523. For these types of debt, it is likely that they will be interpreted in chapter 13 in the same way as they have been interpreted in other chapters. The effect of the discharge on those debts that are discharged in chapter 13 is the same effect of a

chapter 7 discharge.ⁿ¹²

Although it is fairly clear that an unsecured debt is "provided for" even if no payment on that debt is possible in the plan,ⁿ¹³ it is still probably a good idea to include at least a nominal amount for all unsecured creditors in every chapter 13 plan. Occasionally, there may be disputes as to what is a "debt."ⁿ¹⁴ The Supreme Court has ruled that a restitution order in a criminal case is a "debt,"ⁿ¹⁵ although Congress thereafter made most restitution debts nondischargeable by creating section 1328(a)(3).

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. 11 U.S.C. § 523(a)(5), § 1328(a)(2).

(n3)Footnote 3. 11 U.S.C. § 507(a)(8)(C), 523(a)(1)(b), § 523(a)(1)(C), § 1328(a)(2).

(n4)Footnote 4. 11 U.S.C. § 523(a)(8), § 1328(a)(2).

(n5)Footnote 5. 11 U.S.C. § 523(a)(9), § 1328(a)(2).

(n6)Footnote 6. 11 U.S.C. § 523(a)(2), § 1328(a)(2).

(n7)Footnote 7. 11 U.S.C. § 523(a)(4), § 1328(a)(2).

(n8)Footnote 8. 11 U.S.C. § 523(a)(3), § 1328(a)(2).

(n9)Footnote 9. 11 U.S.C. § 1328(a)(3).

(n10)Footnote 10. 11 U.S.C. § 1328(a)(4)

(n11)Footnote 11. 11 U.S.C. § 1322(b)(5), § 1328(a)(1).

(n12)Footnote 12. See P 29.10

(n13)Footnote 13. At least one court of appeals has held that even a plan proposing to pay nothing to unsecured creditors has "provided for" those creditors, since they have notice of the possible discharge of their debts. In the *Matter of Gregory*, 705 F.2d 1118, 8 C.B.C.2d 605 (9th Cir. 1983). Moreover, the Supreme Court has held that a debt is "provided for" if it is simply referred to or mentioned in a plan. *Rake v. Wade*, 508 U.S. 464, 473, 113 S. Ct. 2187, 2193, 124 L. Ed. 2d 424, 434-35, 28 C.B.C.2d 983, 990 (1993).

(n14)Footnote 14. See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender), 1 Collier Bankruptcy Manual, ch. 101 (Matthew Bender) for discussion of the definitions of "debt" and "claim."

(n15)Footnote 15. *Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 110 S. Ct. 2126, 109 L. Ed. 2d 588, 22 C.B.C.2d 1067 (1990). See also *In re Hardenberg*, 42 F.3d 986, 32 C.B.C.2d 520 (6th Cir. 1994) (criminal fines and court costs were debts).



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CHAPTER 29 Obtaining a Discharge

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P 29.12 Effect of Chapter 13 Hardship Discharge

A hardship discharge granted under *section 1328(b) of the Bankruptcy Code* is in most respects the same as the effect of a chapter 7 discharge.ⁿ¹ It relieves the debtor of liability for all *unsecured* debts provided for by the planⁿ² as well as all unsecured debts disallowed under section 502, except for debts that are listed in section 523(a) and long term debts which were to be cured under section 1322(b)(5).

[1] Hardship Discharge Does Not Discharge Debts Not Dischargeable Under Section 523(a)

The biggest difference between a hardship discharge and a full compliance discharge is that a hardship discharge granted under section 1328(b) does not discharge any debts listed in section 523(a).ⁿ³ All debts of the kind specified in section 523(a) are nondischargeable under section 1328(b) by virtue of section 1328(c)(2). The breadth of the hardship discharge, therefore, is very similar to that of the chapter 7 discharge.

[2] Special Provisions Made for Long-Term Debts

Section 1322(b)(5) of the Bankruptcy Code permits the debtor to make special provision in the chapter 13 plan for curing any default and maintaining payments on any secured or unsecured claim on which the last contract payment becomes due after the final payment required under the plan.ⁿ⁴ Since it would be inequitable to provide for the payment of long-term debts, such as mortgages, in accordance with an installment payment schedule extending beyond the term of the plan, and still discharge those debts upon completion of payments under the plan, section 1328(c)(1) excepts from a hardship discharge long-term debts provided for in accordance with section 1322(b)(5),ⁿ⁵ just as section 1328(a)(1) excepts them from a full compliance chapter 13 discharge.

Section 524(i), enacted in 2005,^{n5a} gives debtors a private right of action against creditors who willfully fail to properly credit plan payments on secured or other long term debts if that failure causes material injury. This provision allows debtors to challenge the misallocation of payments, especially on mortgages, to unauthorized or illegal charges.

[3] Effect on Secured Debts

The 2005 amendments to the Bankruptcy Codeⁿ⁶ added new language to section 1325(a)(5)(B)(I), providing the plan must permit the holder of an allowed secured claim to retain its lien until the earlier of the payment of the underlying debt determined under nonbankruptcy law or a discharge under section 1328. The new language also states that the plan

must provide that if the case is dismissed or converted without completion of the plan, the lien will also be retained to the extent recognized by applicable nonbankruptcy law. The effect of this new language is to prohibit the elimination of the creditor's lien when the allowed secured claim has been paid. However, for debtors who cannot complete a plan but who have completely paid an allowed secured claim, the amendments make more attractive the options of a hardship discharge (or a modification that allows plan completion) so that a discharge is entered and the lien can be eliminated.

FOOTNOTES:

(n1)Footnote 1. *See P 29.10 supra* for discussion of effects of chapter 7 discharge.

(n2)Footnote 2. *11 U.S.C. § 1328(c). Compare 11 U.S.C. § 1328(a). See 8 Collier on Bankruptcy, P 1328.03 (Matthew Bender); 3 Collier Bankruptcy Manual, P 1328.03 (Matthew Bender).*

(n3)Footnote 3. *11 U.S.C. § 1328(c)(2). See P 29.03 supra; 8 Collier on Bankruptcy, P 1328.03[3][b] (Matthew Bender); 3 Collier Bankruptcy Manual, P 1328.03[3][b] (Matthew Bender).*

(n4)Footnote 4. *11 U.S.C. § 1328(b)(5). See 8 Collier on Bankruptcy, P 1322.09 (Matthew Bender); 3 Collier Bankruptcy Manual, P 1322.09 (Matthew Bender).*

(n5)Footnote 5. *11 U.S.C. § 1328(c)(1).*

(n6)Footnote 5a. Pub. L. No. 109-8 (2005), effective in cases filed on or after October 17, 2005.

(n7)Footnote 6. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 29 Obtaining a Discharge

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P 29.13 Enforcing the Discharge

PRACTICE NOTE

In almost every case in which the debtor's discharge rights are being violated, it is wise to take some type of protective action. Even though a judgment obtained on a discharged debt is void,ⁿ¹ that judgment could also cause illegal but harmful garnishment of the debtor's wages or seizure of the debtor's property. Thus, it is good practice to assert the protections of discharge as early as possible.

[1] Choice of Forum

The first decision that arises in such cases is where to enforce the debtor's rights. Although they could be raised in the state forum in which a proceeding is already pending, it is usually preferable to go to the bankruptcy court, which is likely to be more sympathetic to the debtor's concerns. The bankruptcy court clearly has jurisdiction over any proceeding relating to the debtor's bankruptcy, and in many cases a state court proceeding may be removed to the bankruptcy court.ⁿ² If the debtor litigates the issue in the nonbankruptcy court, there is a substantial risk that any attempt to seek relief from the challenged actions in the bankruptcy court thereafter would be barred.ⁿ³

[2] Remedies Available

Several remedies may be possible in the bankruptcy forum (in addition to simply defending a removed action). The most common remedy is for violators of the section 524(a) injunction to be held in contempt of court.ⁿ⁴ It may not be necessary to reopen the bankruptcy case to seek remedies for a discharge violation,ⁿ⁵ though local practice varies. The remedies for civil contempt can include both damages and attorney's fees, even if the contempt is not willful.ⁿ⁶ The federal court may also issue a writ of habeas corpus to release a debtor incarcerated in state proceedings.

The debtor may also assert an implied private right of action under section 524 and seek equitable relief under *section 105 of the Bankruptcy Code*. Under the principles set forth by the Supreme Court in *Cort v. Ash*, there is every reason to find that Congress intended that such a right of action exists. First, the enforcement of the bankruptcy discharge is not a matter typically left to state law. Second, the debtors who receive discharge are clearly the specific intended beneficiaries of section 524, not mere incidental beneficiaries. Third, there is evidence of Congressional intent that there be implied remedies: The statute provides for rescission of invalid reaffirmations, for example, and such rescission logically gives right to actions for enforcing the rescission and restitution. The mere fact that there is an explicit private

right of action for violations of section 362, enacted by a later Congress, has no bearing on remedies for violations of section 524, since Congress might have already assumed such a remedy existed based on the rescission remedies available. Indeed, the Supreme Court has held that the availability of statutory injunctive relief does not limit the corollary equitable powers to order rescission and restitution.ⁿ⁷ To restrict those remedies would be inconsistent with the Congressional intent of broad discharge protection for bankruptcy debtors found in the legislative history. For the same reason, there is no basis for finding that Congress intended to preempt state consumer protection laws as they apply to bankruptcy debtors.ⁿ⁸

Some courts have held that there is no private right of action that allows a class of debtors to pursue relief for violations of the discharge order.ⁿ⁹ Some courts have also held that the discharge injunction is the only remedy for violations of the discharge and preempts state law remedies.ⁿ¹⁰ As discussed above, these cases are clearly wrong given that the discharge injunction is a creation of statute. Unlike other contempt claims, this uniform order need not be enforced by a contempt proceeding in the court that issued it, because debtors are enforcing a statutory right rather than a unique order that requires interpretation by its maker. Moreover, there is ample authority to enforce the discharge injunction by requiring disgorgement and other equitable remedies under *11 U.S.C. § 105(a)*.ⁿ¹¹

Attorneys fees should be available in any action against state or local officials under section 524, but they may be limited in some cases by section 106(a)(3).

Reopening of the bankruptcy case may be required to address post-discharge issues, although not all courts require it as a prerequisite to enforcing the discharge. Reopening should be liberally granted when necessary to afford relief for the debtor.ⁿ¹²

[3] Procedure for Seeking Relief

Injunctive relief, which is most often necessary when the discharge protections are violated, must be sought by an adversary proceeding initiated by a complaint.ⁿ¹³ Other relief, such as damages and attorney's fees for contempt of court may also be requested in the complaint. An action to enforce the discharge is a core proceeding.ⁿ¹⁴

FORMS

For a complaint seeking contempt remedies for violation of the automatic stay *see Collier Consumer Bankruptcy Forms, Form CS14.80-1* (Matthew Bender).

It may also be possible to seek punitive or multiple damages under other consumer protection statutes, such as laws prohibiting abusive collection practices or unfair or deceptive acts. However, such claims are more likely to be considered non-core proceedings.

If local practice so requires, the complaint should be accompanied by a motion to reopen the case if the case has been closed. Under the adversary proceeding rules, a temporary restraining order or preliminary injunction may be sought if necessary.

MORE INFORMATION

For discussion of procedures in adversary proceedings *see* chapter 32 *infra*.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 524(a)(1)*. But *see Federal Deposit Insurance Corp. v. Gulf Life Ins. Co.*, 737 F.2d 1513 (11th Cir. 1984) (bankruptcy defense rejected where it was pleaded but not proved).

(n2)Footnote 2. *28 U.S.C. §§ 1334(b), 1452*. *See In re Myers*, 6 C.B.C.2d 347, 18 B.R. 362 (Bankr. E.D. Va. 1982)

(bankruptcy case reopened and creditor fined \$10,000 for willful violation of discharge injunction).

(n3)Footnote 3. *In re Ferren*, 227 B.R. 279 (B.A.P. 8th Cir. 1998) (bankruptcy court lacked jurisdiction over debtor's attack on state court order disbursing foreclosure sale proceeds to judicial lienholders due to *Rooker-Feldman* doctrine).

(n4)Footnote 4. See 4 *Collier on Bankruptcy*, P 524.02[2][c] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 524.02[2][c] (Matthew Bender).

(n5)Footnote 5. See *Singleton v. Wells Fargo Bank, N.A. (In re Singleton)*, 269 B.R. 270 (Bankr. D.R.I. 2001) (citing cases).

(n6)Footnote 6. See 4 *Collier on Bankruptcy*, P 524.02[2][c] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 524.02[2][c] (Matthew Bender); *Matter of Rosteck*, 899 F.2d 694 (7th Cir. 1990) (sanctions imposed against condominium association that had attempted to collect postpetition condominium assessments which were discharged). But see 26 U.S.C. § 7433(e), which appears to limit damages for violations of the discharge injunction by the Internal Revenue Service to willful violations.

(n7)Footnote 7. See *California v. American Stores*, 495 U.S. 271, 110 S.Ct. 1853, 109 L.Ed.2d 240 (1990) (injunctive relief available under Clayton Act creates power to order other equitable relief including divestiture of acquired assets); *Porter v. Warner Holding Co.*, 328 U.S. 395, 66 S.Ct. 1086, 90 L.Ed. 1332 (1946) (grant of specific equitable powers by statute did not restrict other equitable powers unless statute explicitly so stated).

(n8)Footnote 8. *Sears Roebuck and Co. v. O'Brien*, 178 F.3d 962 (8th Cir. 1999) .

(n9)Footnote 9. E.g., *Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502 (9th Cir. 2002) ; *Cox v. Zale Del., Inc.*, 239 F.3d 910 (7th Cir. 2001) ; *Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417 (7th Cir. 2000) .

(n10)Footnote 10. E.g., *Walls v. Wells Fargo Bank, N.A.*, 276 F.3d 502 (9th Cir. 2002) ; *Cox v. Zale Del., Inc.*, 239 F.3d 910 (7th Cir. 2001) ; *Pertuso v. Ford Motor Credit Co.*, 233 F.3d 417 (7th Cir. 2000) .

(n11)Footnote 11. *Bessette v. Avco Financial Servs., Inc.* 230 F.3d 439 (1st Cir. 2000) , cert. denied sub nom. *Textron Funding Corp. v. Bessette*, 532 U.S. 1048, 121 S. Ct. 2016, 149 L. Ed. 2d 1018 (2001) (discharge injunction may be enforced in class action since statutory injunction under section 524 is a uniform order in every bankruptcy case); *Malone v. Norwest Financial California*, 245 B.R. 389 (E.D. Cal. 2000) ; *Rogers v. Nationscredit Financial Services Corp.*, 233 B.R. 98 (N.D. Cal. 1999) (finding private right of action to enforce discharge injunction in part under § 105); *In re Mickens*, 41 C.B.C.2d 618, 229 B.R. 114 (Bankr. W.D. Va. 1999) ; *In re Vazquez*, 221 B.R. 222 (Bankr. N.D. Ill. 1998) (actual and punitive damages awarded pursuant to § 105).

(n12)Footnote 12. See *Fed. R. Bankr. P. 5010*. No filing fee is required to reopen a case if the reopening is for actions related to the debtor's discharge. See Judicial Conference Bankruptcy Court Miscellaneous Fee Schedule, Item 9, reprinted in 1 *Collier on Bankruptcy*, Ch. App. 9 (Matthew Bender).

(n13)Footnote 13. *Fed. R. Bankr. P. 7001*.

(n14)Footnote 14. See discussion of core and noncore proceedings at P 32.03[2] *infra* .



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CHAPTER 29 Obtaining a Discharge

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P 29.14 Revocation of Discharge

Although it occurs only rarely, a creditor, trustee or United States trustee may seek revocation of the debtor's discharge in a chapter 7 case under *section 727(d) of the Bankruptcy Code* or in a chapter 13 case under *section 1328(e)*.

Generally, a complaint seeking revocation of a discharge under 727(d) must be filed within relatively short time limits and must allege the existence of one of the limited sets of circumstances that allow revocation.

[1] Grounds for Revoking Discharge

The discharge may be revoked only in limited types of cases. In both chapter 7 and chapter 13, the discharge may be revoked if it was obtained through fraud of the debtor, of which the requesting party was unaware until after the discharge, and the revocation proceeding is brought within one year of the discharge.ⁿ¹

In a chapter 7 case, the discharge may also be revoked if the debtor committed an act described in *section 727(d)(2)*, *i.e.*, knowingly and fraudulently failed to report the acquisition of property that would be property of the estate.ⁿ² It may be revoked in chapter 7 if the debtor committed an act described in *section 727(a)(6)*, *i.e.*, failed to obey an order of the court. The most frequent use of this last subsection is in cases in which the debtor does not surrender nonexempt property demanded by the trustee. Lastly, *section 727(d)(4)*, enacted in 2005,ⁿ³ allows revocation of a chapter 7 discharge if the debtor fails to satisfactorily explain a material misstatement in an audit referred to in *section 586(f)* of title 28 or a failure to make available for inspection all necessary papers, things and property requested for such audit.

The provisions permitting revocation of a bankruptcy discharge found in the Bankruptcy Code are exclusive and may not be supplemented by other factors which might in other contexts warrant relief from a judgment.ⁿ⁴

Moreover, to obtain revocation of a discharge for fraud, it is not sufficient to show that the debtor's fraud rendered a particular debt nondischargeable; the plaintiff must show that the bankruptcy discharge itself would not have been granted but for the fraud.ⁿ⁵ In addition, the party requesting revocation of discharge must not have learned of the fraud before the discharge was entered.ⁿ⁶

[2] Procedure for Seeking Revocation of Discharge

The procedure for seeking revocation of a discharge is essentially the same as that for objecting to discharge.ⁿ⁷ The

revocation must be sought by an adversary proceeding initiated by a complaint.ⁿ⁸ However, if the case has been closed most courts require a motion to reopen the case to be filed either with or prior to the complaint seeking revocation of discharge.

FORMS

For form of complaint used in revocation of discharge see *Collier Consumer Bankruptcy Forms*, § CS14.71 (Matthew Bender).

MORE INFORMATION

The reopening of a case is discussed in detail in chapter 31 *infra*.

Under the language of section 727(d), a complaint raising any of the grounds for revocation of discharge under subsections (1), (2) or (3) must be filed within one year of the discharge unless the case is closed after the one year has passed, in which case the grounds described in section 727(d)(2) and section 727(a)(6) as set forth aboveⁿ⁹ may be raised until the date the case is closed.ⁿ¹⁰ However, courts have also permitted such complaints to be filed if knowledge of the debtor's fraud first came to the plaintiff during the "gap" period before the discharge was granted but after the deadline for objections to discharge.ⁿ¹¹ No time limit is specified with respect to proceedings to revoke a chapter 7 discharge under section 727(d)(4).

Although section 727 does not apply to chapter 13 cases, a creditor or trustee may also move to revoke a chapter 13 discharge within one year of when it was granted if the discharge was obtained by fraud and that fraud was not known by the requesting party until after the discharge was granted.ⁿ¹²

The plaintiff must follow the general rules of pleading in federal civil proceedings, which require that a party must allege fraud with particularity, including the time, place and contents of any false representation, as well as its consequences.ⁿ¹³

Once the complaint has been filed, the procedures to be followed are identical to those in cases involving an objection to discharge.

FOOTNOTES:

(n1)Footnote 1. 11 U.S.C. §§ 727(d)(1), (e)(1), 1328(e).

(n2)Footnote 2. See 6 *Collier on Bankruptcy*, P 727.15[2] (Matthew Bender); 2 *Collier Bankruptcy Manual*, P 727.15[2] (Matthew Bender). See, e.g., *Matter of Yonikus*, 974 F.2d 901 (7th Cir. 1992) (debtor's failure to report prepetition personal injury claim warranted revocation of discharge even if it could be claimed as exempt).

(n3)Footnote 3. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n4)Footnote 4. See *In re Zimmerman*, 869 F.2d 1126 (8th Cir. 1989) . But see *Midkiff v. Stewart* (*In re Midkiff*), 342 F.3d 1194 (10th Cir. 2003) (discharge temporarily vacated under Rule 9024 so trustee could collect debtor's tax refund and distribute it to creditors in accordance with plan); *In re Cisneros*, 994 F.2d 1462 (9th Cir. 1993) (despite limitations in section 727(d), court could enter order vacating discharge on grounds set forth in *Fed. R. Bankr. P. 9024*).

(n5)Footnote 5. *In re Edmonds*, 924 F.2d 176 (10th Cir. 1991) .

(n6)Footnote 6. *Mid-Tech Consulting v. Swendra*, 938 F.2d 885 (8th Cir. 1991) (creditor knew of omission from schedules before discharge was entered and failed to timely investigate it).

(n7)Footnote 7. *See P 29.06 supra* for procedure in objections to discharge.

(n8)Footnote 8. *Fed. R. Bankr. P. 7001*.

(n9)Footnote 9. *See P 29.14[1] supra*.

(n10)Footnote 10. *11 U.S.C. § 727(e)*. *See 6 Collier on Bankruptcy, P 727.16* (Matthew Bender); *2 Collier Bankruptcy Manual, P 727.16* (Matthew Bender).

(n11)Footnote 11. *In re Emery*, 132 F.3d 892, 39 C.B.C.2d 263 (2d Cir. 1998) ; *In re Dietz*, 914 F.2d 161 (9th Cir. 1990) (court allowed request for revocation of discharge even though discharge had not yet been formally entered where discharge order should have been entered by time of complaint). *But see Zedan v. Habash*, 529 F.3d 398 (7th Cir. 2007) (creditor could not seek revocation of discharge that had not yet been entered; it should have sought an extension of deadline if it suspected fraud and instead had simply tried to take advantage of trustee's fortuitous discovery).

(n12)Footnote 12. *11 U.S.C. § 1328(e)*.

(n13)Footnote 13. *In re Edmonds*, 924 F.2d 176 (10th Cir. 1991) .



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CHAPTER 29 Obtaining a Discharge

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P 29.15 Tax Consequences of the Discharge

The law is clear that, generally speaking, the discharge of a debt in bankruptcy, unlike most other types of discharge of indebtedness without payment, is excludable from gross income for tax purposes.ⁿ¹ Nonetheless, some creditors believe that they are required to send a bankruptcy debtor a 1099 Form when a debt is discharged in bankruptcy.ⁿ² Although this problem may eventually disappear as a result of clarifying tax regulations,ⁿ³ and the fact that the current version of Form 1099-C states on its reverse side that "debts canceled in bankruptcy are not includable in your income," it is likely to persist for some time.

These forms cause considerable confusion and harm to debtors. All too often, an unskilled tax preparer will see one of these forms, assume the debtor had taxable income, and list the amount stated on the form as income on the debtor's tax return. It is also possible, but unlikely, that the Internal Revenue Service will incorrectly seek payment of taxes which are not owed based on a filed 1099.ⁿ⁴ A debtor could thus pay taxes that are not owed, often losing a needed tax refund.

A related problem which occasionally arises involves a debt which was forgiven by the creditor prior to the bankruptcy. The most common example is a deficiency obligation which is forgiven in exchange for a deed in lieu of foreclosure or another type of foreclosure workout. Such issues can also arise when there is a foreclosure on a mortgage that was a refinancing or other nonpurchase-money mortgage for more than the tax basis of the property. Although the prepetition forgiveness of debt is technically a taxable event separate from the bankruptcy discharge,ⁿ⁵ it is generally not taxable in the event that the debtor was insolvent.ⁿ⁶ In any event, the increase to \$500,000 of the exemption from capital gains tax for sale of a principal residence will make it a rare case in which any tax would be due after such a transaction.

In view of the fact that these problems have become more common, attorneys should always advise debtors that the discharge of indebtedness in bankruptcy and most types of forgiveness of debt are not taxable. It is also helpful to recommend that a tax preparer with a question about the law on this issue should be referred to the attorney.

FOOTNOTES:

(n1)Footnote 1. Internal Revenue Code, 26 U.S.C. § 108(a)(1)(A). See 1 *Collier on Bankruptcy*, P 13.03 (Matthew Bender).

(n2)Footnote 2. Some confusion is possible because there may be tax consequences of prepetition debt forgiveness, for example, if a deficiency obligation is forgiven in connection with a deed in lieu of foreclosure. The prepetition event

may create a tax liability which is then a separate nondischargeable prepetition obligation of the debtor, though there may be no liability for forgiven debt if the debtor can establish insolvency as of the date on which the debt is forgiven. Internal Revenue Code, 26 U.S.C. § 108(a)(1)(B).

(n3)Footnote 3. 26 C.F.R. §§ 1.6050P-0, 1.65050P-1 (indebtedness discharged in bankruptcy required to be reported only if creditor knows that the debt was incurred for business or investment purposes).

(n4)Footnote 4. This would obviously be an IRS error subject to dispute by the debtor.

(n5)Footnote 5. 26 U.S.C. § 61(a)(12).

(n6)Footnote 6. 26 U.S.C. § 108(a)(1)(B).



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CHAPTER 30 Protections From Discrimination Against Bankruptcy Debtors

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CHAPTER 30 Protections From Discrimination Against Bankruptcy Debtors

1-30 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the various protections provided by the Bankruptcy Code from discrimination against bankruptcy debtors during and after the bankruptcy case. It details the provisions prohibiting discrimination by governmental units, private employers, and the providers of student loans and grants. It also discusses the procedure for enforcement of the antidiscrimination provisions.



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CHAPTER 30 Protections From Discrimination Against Bankruptcy Debtors

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P 30.01 Introduction

Section 525 of the Code protects bankruptcy debtors from various forms of discrimination based upon the filing a bankruptcy case, insolvency prior to a bankruptcy case, or nonpayment of a debt that was discharged in a bankruptcy case. It also protects other persons with whom a bankruptcy debtor has been associated.

Section 525(a) protects a person who has been a debtor under the Code, or someone who has been associated with a debtor, from discriminatory treatment by a governmental unit.ⁿ¹ This section, which is a codification and expansion of *Perez v. Campbell*,ⁿ² permits further development of prohibitions against discriminatory treatment by quasi-governmental organizations that perform licensing types of functions.ⁿ³ The enumeration in this section of various forms of discrimination against debtors, therefore, is not exhaustive and is not intended to permit other forms of discrimination not listed therein.ⁿ⁴

Section 525(b) protects an individual debtor, or an individual associated with the debtor, from discriminatory treatment by a private employer. A debtor or someone associated with the debtor may not have employment terminated or be discriminated against with respect to employment by reason of commencing a case under the Code or for other insolvency related reasons listed in section 525(b).ⁿ⁵

Section 525(c) protects debtors, and those associated with them, from discrimination in the administration of student loan and grant programs. Debtors, and persons with whom they have been associated, cannot be denied student loans or grants based upon a prior bankruptcy or upon nonpayment of debts dischargeable in their bankruptcy cases.ⁿ⁶

FOOTNOTES:

(n1)Footnote 1. "Governmental unit" is defined in *11 U.S.C. § 101*. See 2 Collier on Bankruptcy, ch. 101 (Matthew Bender).

(n2)Footnote 2. *402 U.S. 637, 91 S. Ct. 1704, 29 L. Ed. 2d 233 (1971)* .

(n3)Footnote 3. See *P 30.02 infra*.

(n4)Footnote 4. H.R. Rep. No. 595, 95th Cong., 1st Sess. 366-7 (1977), *reprinted in* Vol. B Collier on Bankruptcy, App. Pt. 4(d) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 81 (1978), *reprinted in* Vol D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender).

(n5)Footnote 5. *See P 30.03 infra.*

(n6)Footnote 6. *See P 30.04 infra.*



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CHAPTER 30 Protections From Discrimination Against Bankruptcy Debtors

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P 30.02 Discrimination by Governmental Units

Section 525(a) is designed to prevent governmental units from frustrating the fresh start policy of the Code by discriminating against persons who have been debtors under the Code or bankrupts or debtors under the prior Act.ⁿ¹ In *Perez v. Campbell*,ⁿ² the Supreme Court held that a state may not refuse to renew the driver's license of a debtor whose tort judgment, resulting from an automobile collision, was discharged. Relying on the *Supremacy Clause of the Constitution*, the court held that such discriminatory treatment resulting from an unpaid debt that was discharged in bankruptcy would conflict with the fresh start policy of the Act.

Section 525(a) codifies and expands upon *Perez* by prohibiting a governmental unit from denying, revoking, suspending, or refusing to renew a license, permit, charter franchise, or other similar grant to, from conditioning such a grant to, from discrimination with respect to such a grant against, denying employment to, terminating the employment of, or discriminating with respect to employment against any person who has been a debtor or bankrupt. In short, a governmental unit may not discriminate against a person in ways that will frustrate the fresh start policies of the Code. Section 525 applies to debtors filing under all chapters of the Code.ⁿ³

The legislative history to section 525 makes clear that the list of prohibited types of discrimination does not prohibit consideration of other factors, such as future financial responsibility or ability, and does not prohibit imposition of requirements such as net capital rules, if applied nondiscriminatorily.ⁿ⁴ Therefore, if there is a *bona fide* nondiscriminatory examination of future financial responsibility in a particular licensing process, applicable to all persons regardless of the existence of prior debts or any bankruptcy filings, section 525 is not applicable. In addition, section 525 does not bar discrimination based upon nonpayment of a debt which is *not* dischargeable.ⁿ⁵

The prohibition against discriminatory treatment protects persons with whom the debtor was associated as well. It is applicable to any discrimination which occurs during the case or after the case.ⁿ⁶

The list of discriminatory acts that is included in section 525(a) is not meant to be exhaustive. Legislative history indicates that further development by the courts is permitted in order to prohibit discriminatory treatment by quasi governmental organizations that perform licensing functions, such as state bar associations and medical societies, or other organizations, such as unions, capable of seriously affecting the debtor's livelihood or fresh start.ⁿ⁷

[1] Discrimination Based Upon Commencement of Bankruptcy Case

Perhaps the clearest and most easily detectable type of discrimination prohibited by section 525 is discrimination based upon the commencement of the bankruptcy case itself. Such discrimination obviously frustrates the purpose of Congress to make the fresh start or reorganization benefits provided by the Code freely available to debtors who may need them. Discrimination against debtors may deter individuals, or others who need to file bankruptcy petitions to deal with problems unrelated to the entity which is discriminating, from making use of the bankruptcy remedies Congress meant them to have.

Hence, such discrimination has been remedied by courts, both under the *Perez* doctrine and, after its enactment, under section 525. It has been found unlawful for the Small Business Administration to discriminate in renewing procurement contracts based upon the filing of a bankruptcy petition;ⁿ⁸ for a state to deny a liquor license due to a bankruptcy filing;ⁿ⁹ for employers to fire debtors due to their bankruptcy filings;ⁿ¹⁰ for a governmental agency to reject a contract bid solely because of the bidder's chapter 11 status;ⁿ¹¹ for a state agency to revoke a debtor's workers' compensation certificate of self-insurance solely due to the debtor's bankruptcy or insolvency;ⁿ¹² for employers to transfer employees or change the terms of their employment due to their filing bankruptcy cases;ⁿ¹³ and for state assistance programs to deny benefits, to which debtors would otherwise be entitled, because those debtors had filed bankruptcy petitions.ⁿ¹⁴

The prohibition against discrimination based upon the filing of a bankruptcy case necessarily extends to discrimination based upon automatic or likely consequences of such filing. Thus, a state mortgage assistance agency could not claim that it was not the bankruptcy, but rather the effects of the automatic stay, which formed the basis of its discrimination, since allowing such a claim would have the same result as allowing the disqualification of all bankruptcy debtors.ⁿ¹⁵ Similarly, an employer could not take disciplinary action against an employee due to court ordered payments by the employer to a chapter 13 trustee.ⁿ¹⁶

[2] Discrimination Based Upon Prebankruptcy Debts

Section 525 also prohibits discrimination based upon certain aspects of the debtor's financial condition prior to and during a bankruptcy case. Specifically, it prohibits discrimination because a debtor has been insolvent before the commencement of the case, or during the case before a discharge is granted or denied, and it prohibits discrimination based upon the fact that a debtor has not paid a debt that is dischargeable or has been discharged in a bankruptcy case.

These provisions are intended to promote the debtor's fresh start by insuring that prior debts dischargeable in the debtor's case are not used as the basis for the prohibited types of discrimination. This portion of section 525 has not always been easy for courts to interpret, in part due to the legislative history providing that section 525 is not intended to bar legitimate inquiry into the debtor's *future* financial responsibility or ability, to the extent that inquiry is conducted nondiscriminatorily.ⁿ¹⁷

The prohibition of discrimination based upon dischargeable debts has been applied in a variety of contexts. It includes, of course, the situation in *Perez v. Campbell*,ⁿ¹⁸ in which a driver's license was denied due to the existence of an unpaid debt which had been discharged. It extends to other types of discrimination based upon unpaid tort judgments which have been discharged, such as the requirement of special insurance, as a condition of granting a driver's license.ⁿ¹⁹ It also includes the denial of a driver's license based upon the existence of traffic fines which are dischargeable in the debtor's bankruptcy.ⁿ²⁰

The Supreme Court has interpreted the prohibition of discrimination based on discharged debts in section 525(a) broadly. In *F.C.C. v. NextWave Personal Communications, Inc.*, the court held that a court must look behind the alternative alleged motives of a government agency that denies a license.ⁿ²¹ It is not sufficient for the government to say that a license was denied for some other reason if the proximate cause for the denial was the failure to pay a dischargeable debt.ⁿ²² The fact that licenses are also revoked for nonbankruptcy debtors who fail to pay similar debts does not change this fact.ⁿ²³ The Court specifically rejected the argument, raised in the dissent, that there must be

discrimination based upon the debtor's bankruptcy filing, rather than simply nonpayment of a dischargeable debt, which is contrary to the clear meaning of the statutory language.ⁿ²⁴

Beyond the area of licenses, debtors are protected from denial of continued occupancy in public housing based upon dischargeable debts for past rent,ⁿ²⁵ from denial of student transcripts based upon dischargeable tuition or student loan debts,ⁿ²⁶ and from the denial of a contractor's license,ⁿ²⁷ a real estate license,ⁿ²⁸ a liquor license,ⁿ²⁹ a license to practice law,ⁿ³⁰ or an insurance agent license,ⁿ³¹ if any such denial is based solely upon past or present nonpayment of a dischargeable debt.

Prior to *Nextwave*, some courts failed to distinguish the prohibition against discrimination based upon nonpayment of dischargeable debts from the separate prohibition of discrimination based upon the bankruptcy filing itself, and have thus concluded that discrimination based upon a dischargeable debt is permissible if discrimination based upon unpaid debts also is applicable to debtors who have not filed bankruptcy cases. In *Duffey v. Dollison*,ⁿ³² the Court of Appeals for the Sixth Circuit permitted a state to require bankruptcy debtors with dischargeable motor vehicle tort judgments to post proof of financial responsibility not required of any drivers except those who had not timely paid such judgments because such proof was not required only of debtors who had filed bankruptcy cases. After the *Nextwave* decision, *Duffey* should not be considered good law.

In order to come within the exception which allows consideration of future financial responsibility, the test applied to the debtor must be a *bona fide* test applied to all individuals, designed to determine future ability to pay debts. The test may, for example, look at the assets of all persons to whom it is applied, or to their income, or to a variety of factors taken together, including assets, income, payment of past debts, character, and other things normally examined in determining creditworthiness.ⁿ³³ Similarly, a state may require insurance of all who apply for a particular license or charter, or of all who do not have assets or income above a certain level sufficient to provide self-insurance.

The test, however, cannot look solely to past payment of debts, because that would allow discrimination based solely upon past insolvency. Such a test would not be a *bona fide* consideration of future financial responsibility, since it would not take into account other factors such as current income or assets. Nor can it look solely at whether a debtor has paid a particular dischargeable debt or type of debt, since that would allow prohibited discrimination based solely upon nonpayment of a dischargeable debt. Put another way, with respect to any particular dischargeable debt, the debtor cannot be discriminated against solely because the debt was not paid when due. The debtor must be treated in the same manner as a person who had never had that unpaid debt.ⁿ³⁴

[3] Discrimination by Governmental Units with Respect to Employment

One of the key purposes of section 525 is to protect the debtor's means of earning a livelihood. In many areas of the public sector, the filing of a petition under title 11 had been grounds for termination of employment. Under section 525(a), such discriminatory treatment in employment by the public sector is clearly a violation of the prohibition against discrimination.

The prohibition of employment discrimination has been applied when a quasi governmental transit authority disciplined a debtor employee whose wages were to be paid by the employer to the chapter 13 trustee pursuant to an order of the bankruptcy court.ⁿ³⁵ It has also been read broadly to include contracts to provide services to governmental units.ⁿ³⁶

[4] Scope of the Phrase "License, Permit, Charter, Franchise, or Other Similar Grant."

It is sometimes not clear whether a particular government program or benefit falls within the scope of the phrase "license, permit, charter, franchise, or other similar grant" that appears in section 525(a). While this language clearly includes such things as drivers' licenses and other licenses, its outer limits are less well-defined. The legislative history suggests that this section be interpreted broadly.ⁿ³⁷

Courts have had little trouble finding a variety of governmental subsidy programs to be within this language. A public housing tenant may not be denied the continued right to live in his or her apartment, and thus denied the subsidy inherent in public housing, because of unpaid rent which is discharged or dischargeable or because a bankruptcy has been filed, even if the bankruptcy has the effect of causing rejection of the preexisting lease.ⁿ³⁸ A state program offering mortgage assistance cannot deny benefits based upon the filing of bankruptcy or upon the automatic stay provided by a bankruptcy filing.ⁿ³⁹

The Court of Appeals for the Fifth Circuit, in *Exquisito Services, Inc. v. U.S.A.*,ⁿ⁴⁰ held that participation in a Small Business Administration Program under which a debtor receives various types of assistance constitutes a franchise. The court adopted the definition of "franchise" in *Black's Law Dictionary* ⁿ⁴¹ as a special privilege conferred by government on an individual or corporation, which does not belong to citizens generally of common right. That same source defines "license" as the authority or liberty given to do or forbear any act, permission by some competent authority to do some act which, without such permission, would be illegal.

Section 525(a) is applicable to a variety of other benefits, privileges, and services as well. For example, schools that are governmental units are not permitted to deny students the right to receive their transcripts based upon dischargeable debts for tuition or student loans.ⁿ⁴²

Notwithstanding the legislative history, some courts have read the language of section 525 more narrowly. The Court of Appeals for the Second Circuit has held that the right to have the state guarantee a student loan was not within its scope, because section 525 was not intended to reach decisions regarding the extension of credit.ⁿ⁴³ Similarly, the Court of Appeals for the Third Circuit has held that a state subsidized mortgage assistance program, in which the applicant agrees to repay the assistance on a deferred basis at below-market interest, is an extension of credit outside the scope of section 525.ⁿ⁴⁴ While the conclusion that section 525 does not apply to extensions of credit may be generally correct, the courts did not adequately consider whether the state programs involved were in fact more in the nature of benefits conferred upon needy applicants, without regard to their creditworthiness, and therefore more similar to a franchise or similar grant, rather than an extension of credit.

The decision of the Court of Appeals for the Second Circuit in *In re Goldrich* ⁿ⁴⁵ with respect to student loans was specifically overruled by Congress when it enacted section 525(c) as part of the Bankruptcy Reform Act of 1994.ⁿ⁴⁶ In the legislative history of that section the House Judiciary Committee stated that the court in that case had given "an unduly narrow interpretation to *Code section 525*."ⁿ⁴⁷ Thus, not only decisions permitting discrimination with respect to student loans, but also decisions permitting discrimination in other loan-related benefit programs, must be questioned anew in light of this clear statement of Congressional intent. The reference in section 525(c) to cases filed under the Bankruptcy Act, as well as to those filed under the Code, strongly bolsters the argument that Congress intended the amendment to clarify existing law applicable to past and pending cases as well as to cases filed after its enactment.

FOOTNOTES:

(n1)Footnote 1. *Henry v. Heyison*, 1 C.B.C.2d 552, 4 B.R. 437 (E.D. Pa. 1980) ; *Rose v. Connecticut Housing Fin. Authority (In the Matter of Rose)*, 7 C.B.C.2d 909, 23 B.R. 662 (Bankr. D. Conn. 1982) .

(n2)Footnote 2. 402 U.S. 637, 91 S. Ct. 1704, 29 L. Ed. 2d 233 (1971) .

(n3)Footnote 3. 11 U.S.C. § 103(a). See *In the Matter of Heath*, 3 B.R. 351, 354 (Bankr. N.D. Ill. 1980).

(n4)Footnote 4. H.R. Rep. No. 595, 95th Cong., 1st Sess. 367 (1977), reprinted in Vol. B Collier on Bankruptcy, App. Pt. 4(d) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 81 (1978), reprinted in Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender).

(n5)Footnote 5. *Johnson v. Edinboro State College*, 728 F.2d 163, 10 C.B.C.2d 231 (3d Cir. 1984) .

(n6)Footnote 6. *See, e.g., ; In the Matter of Heath*, 1 C.B.C.2d 736, 3 B.R. 351 (Bankr. N.D. Ill. 1980) (section 525 violated when a state university refused to furnish a chapter 13 debtor his transcript until the debtor's prepetition loan was paid in full; refusal occurred after confirmation of his plan but before he could obtain discharge through compliance with the plan). *In re Briner*, 4 C.B.C.2d 539, 10 B.R. 850 (Bankr. D. Colo. 1981) ; *In the Matter of Heath*, 1 C.B.C.2d 736, 3 B.R. 351 (Bankr. N.D. Ill. 1980)

(n7)Footnote 7. H.R. Rep. No. 595, 95th Cong., 1st Sess. 366-7 (1977), *reprinted in* Vol. B Collier on Bankruptcy, App. Pt. 4(d) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 81 (1978), *reprinted in* Vol. D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender). This legislative history was reaffirmed in the legislative history of the amendments to section 525 effected by the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394 (enacted on October 22, 1994 and effective with respect to cases filed on or after that date), *reprinted in* Vol. E Collier on Bankruptcy, App. Pt. 9(a) (Matthew Bender). *See* 140 Cong. Rec. H10,771 (daily ed. Oct. 4, 1994) (remarks of Rep. Jack Brooks).

(n8)Footnote 8. *Exquisito Servs., Inc. v. United States (In re Exquisito Servs., Inc.)*, 823 F.2d 151, 17 C.B.C.2d 324 (5th Cir. 1987) .

(n9)Footnote 9. *In re Maley*, 4 C.B.C.2d 292, 9 B.R. 832 (Bankr. W.D. N.Y. 1981)

(n10)Footnote 10. *Rutledge v. City of Shreveport*, 387 F. Supp. 1277 (W.D. La. 1975) ; *In re Hopkins*, 16 C.B.C.2d 186, 66 B.R. 828 (Bankr. W.D. Ark. 1986)

(n11)Footnote 11. *Matter of Son-Shine Grading, Inc.*, 27 B.R. 693 (Bankr. E.D.N.C. 1983) ; *In re Marine Electric Railway Products Div., Inc.*, 6 C.B.C.2d 29, 17 B.R. 845 (Bankr. E.D. N.Y. 1982) ; *In re Coleman Am. Moving Servs., Inc.*, 8 B.R. 379 (Bankr. D. Kan. 1980)

(n12)Footnote 12. *In re Blue Diamond Coal Co.*, 145 B.R. 895 (Bankr. E.D. Tenn. 1992)

(n13)Footnote 13. *Matter of McNeely*, 18 C.B.C.2d 1273, 82 B.R. 628 (Bankr. S.D. Ga. 1987) ; *Hicks v. First Nat'l Bank of Harrison (In re Hicks)*, 15 C.B.C.2d 1097, 65 B.R. 980 (Bankr. W.D. Ark. 1986) .

(n14)Footnote 14. *Rose v. Connecticut Housing Fin. Authority (In the Matter of Rose)*, 7 C.B.C.2d 909, 23 B.R. 662 (Bankr. D. Conn. 1982) ; *but see Watts v. Pennsylvania Hous. Fin. Agency*, 876 F.2d 1090, 21 C.B.C.2d 521 (3d Cir. 1989) (state mortgage assistance program involved loans rather than grants and was therefore outside scope of section 525).

(n15)Footnote 15. *In re Watts*, 76 B.R. 390 (Bankr. E.D. Pa. 1987) , *aff'd*, 93 B.R. 350 (E.D. Pa. 1988) , *rev'd on other grounds*, 876 F.2d 1090, 21 C.B.C.2d 521 (3d Cir. 1989)

(n16)Footnote 16. *In re Latchaw*, 24 B.R. 457 (Bankr. N.D. Ohio 1982)

(n17)Footnote 17. *See* n.4 *supra* and accompanying text.

(n18)Footnote 18. *See* n.2 *supra* and accompanying text.

(n19)Footnote 19. *Henry v. Heyison*, 1 C.B.C.2d 552, 4 B.R. 437 (E.D. Pa. 1980) ; *Matter of Layfield*, 12 B.R. 846 (Bankr. N.D. Ala. 1981) .

(n20)Footnote 20. *Smith v. Pennsylvania Dep't of Transp.*, 66 B.R. 244 (E.D. Pa. 1986) ; *In re Young*, 3 C.B.C.2d 145, 10 B.R. 17 (Bankr. S.D. Cal. 1980) . *Traffic fines, although they are not dischargeable in chapter 7 due to the operation of section 523(a)(7), are often dischargeable in chapter 13. See* ch. 26 *supra*. *In re Young*, 3 C.B.C.2d 145, 10 B.R. 17 (Bankr. S.D. Cal. 1980)

(n21)Footnote 21. 537 U.S. 293, 301-302, 123 S. Ct. 832, 839, 154 L. Ed. 2d 863, 874 (2003) .

(n22)Footnote 22. 537 U.S. 293, 301-302, 123 S. Ct. 832, 839, 154 L. Ed. 2d 863, 874-875 (2003) .

(n23)Footnote 23. 537 U.S. 293, 306-307, 123 S. Ct. 832, 841-2, 154 L. Ed. 2d 863, 877-8 (2003) .

(n24)Footnote 24. *Id.*

(n25)Footnote 25. *Gibbs v. Housing Authority of City of New Haven*, 76 B.R. 257 (D. Conn. 1983) ; *In re Szymecki*, 87 B.R. 14 (Bankr. W.D. Pa. 1988) ; *In re Sudler*, 71 B.R. 780 (Bankr. E.D. Pa. 1987) *In re Szymecki*, 87 B.R. 14 (Bankr. W.D. Pa. 1988) *In re Sudler*, 71 B.R. 780 (Bankr. E.D. Pa. 1987)

(n26)Footnote 26. *Lee v. Board of Higher Ed. in the City of New York*, 1 B.R. 781 (S.D. N.Y. 1979) ; *In re Dembek*, 15 C.B.C.2d 611, 64 B.R. 745 (Bankr. N.D. Ohio 1986) *Board of Trustees of the University of Alabama v. Howren* (*In re Howren*), 4 C.B.C.2d 153, 10 B.R. 303 (Bankr. D. Kan. 1980) *In the Matter of Heath*, 1 C.B.C.2d 736, 3 B.R. 351 (Bankr. N.D. Ill. 1980)

(n27)Footnote 27. *In re Walker*, 64 B.R. 751 (Bankr. S.D. Ohio 1986) ; *In re Lambillotte*, 8 C.B.C.2d 430, 25 B.R. 392 (Bankr. M.D. Fla. 1982) *In re Walker*, 64 B.R. 751 (Bankr. S.D. Ohio 1986) *In re Lambillotte*, 8 C.B.C.2d 430, 25 B.R. 392 (Bankr. M.D. Fla. 1982)

(n28)Footnote 28. *In re Walker*, 927 F.2d 1138, 1141, 24 C.B.C.2d 1517, 1522, (10th Cir. 1991) ; *In re Harris*, 85 B.R. 858 (Bankr. D. Colo. 1988) *In re Walker*, 927 F.2d 1138, 1141, 24 C.B.C.2d 1517, 1522, (10th Cir. 1991) *In re Harris*, 85 B.R. 858 (Bankr. D. Colo. 1988)

(n29)Footnote 29. *Tell v. State of Ill. Liquor Control Comm'n* (*In re Tell*), 11 C.B.C.2d 235, 38 B.R. 327 (N.D. Ill. 1983) .

(n30)Footnote 30. *In re Williams*, 158 B.R. 493 (Bankr. D. Id. 1993)

(n31)Footnote 31. *In re Jacobs*, 28 C.B.C.2d 556, 149 B.R. 983 (Bankr. N.D. Okla. 1993)

(n32)Footnote 32. 734 F.2d 265, 10 C.B.C.2d 1394 (6th Cir. 1984) .

(n33)Footnote 33. *In re Christmas*, 102 B.R. 447 (Bankr. D. Md. 1989) *Rose v. Connecticut Housing Fin. Authority* (*In the Matter of Rose*), 7 C.B.C.2d 909, 23 B.R. 662 (Bankr. D. Conn. 1982)

(n34)Footnote 34. *Henry v. Heyison*, 1 C.B.C.2d 552, 4 B.R. 437 (E.D. Pa. 1980) ; *Matter of Layfield*, 12 B.R. 846 (Bankr. N.D. Ala. 1981) . See also 140 Cong. Rec. H 10,771 (daily ed. Oct. 4, 1994) (remarks of Rep. Jack Brooks); H.R. Rep. No. 835, 103d Cong., 2d Sess. 58 (1994).

(n35)Footnote 35. *In re Latchaw*, 24 B.R. 457 (Bankr. N.D. Ohio 1982)

(n36)Footnote 36. *Matter of Son-Shine Grading, Inc.*, 27 B.R. 693 (Bankr. E.D.N.C. 1983) ; *In re Marine Electric Railway Products Div., Inc.*, 6 C.B.C.2d 29, 17 B.R. 845 (Bankr. E.D. N.Y. 1982) ; *In re Coleman Am. Moving Servs., Inc.*, 3 C.B.C.2d 609, 8 B.R. 379 (Bankr. D. Kan. 1980)

(n37)Footnote 37. H.R. Rep. No. 595, 95th Cong., 1st Sess. 366-7 (1977), *reprinted in* Vol. B Collier on Bankruptcy, App. Pt. 4(d) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 81 (1978), *reprinted in* Vol D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender)

(n38)Footnote 38. *Stoltz v. Brattleboro Housing Auth.* (*In re Stoltz*), 315 F.3d 80 (2d Cir. 2002) (section 525 trumps any contrary language in section 365). *In re Curry*, 148 B.R. 966 (S.D. Fla. 1992) ; *Gibbs v. Housing Authority of City of New Haven*, 76 B.R. 257 (D. Conn. 1983) ; *In re Szymecki*, 87 B.R. 14 (Bankr. W.D. Pa. 1988) ; *In re Sudler*, 71 B.R. 780 (Bankr. E.D. Pa. 1987). But see *Smith v. St. Louis Hous. Auth.* (*In re Smith*), 259 B.R. 901 (B.A.P. 8th Cir.

2001) (§ 525 not applicable when public housing lease terminated due to debtor's fraud; dictum stating § 525 not applicable even if nonpayment of rent was reason for termination). *In re Sudler*, 71 B.R. 780 (Bankr. E.D. Pa. 1987) *Smith v. St. Louis Hous. Auth.* (*In re Smith*), 259 B.R. 901 (B.A.P. 8th Cir. 2001) *In re Szymecski*, 87 B.R. 14 (Bankr. W.D. Pa. 1988) *In re Sudler*, 71 B.R. 780 (Bankr. E.D. Pa. 1987) *Smith v. St. Louis Hous. Auth.* (*In re Smith*), 259 B.R. 901 (B.A.P. 8th Cir. 2001) *In re Curry*, 148 B.R. 966 (S.D. Fla. 1992) *Gibbs v. Housing Authority of City of New Haven*, 76 B.R. 257 (D. Conn. 1983) *In re Szymecski*, 87 B.R. 14 (Bankr. W.D. Pa. 1988) *In re Sudler*, 71 B.R. 780 (Bankr. E.D. Pa. 1987) *Smith v. St. Louis Hous. Auth.* (*In re Smith*), 259 B.R. 901 (B.A.P. 8th Cir. 2001)

(n39)Footnote 39. *Rose v. Connecticut Housing Fin. Authority* (*In the Matter of Rose*), 7 C.B.C.2d 909, 23 B.R. 662 (Bankr. D. Conn. 1982) ; but see *Watts v. Pennsylvania Hous. Fin. Agency*, 876 F.2d 1090, 21 C.B.C.2d 521 (3d Cir. 1989) (state mortgage assistance program involved loans rather than grants and was therefore outside scope of section 525).

(n40)Footnote 40. 823 F.2d 151, 154, 17 C.B.C.2d 324, 328 (5th Cir. 1987) .

(n41)Footnote 41. (5th ed. 1979).

(n42)Footnote 42. *Lee v. Board of Higher Ed. in the City of New York*, 1 B.R. 781 (S.D. N.Y. 1979) ; *In re Dembek*, 15 C.B.C.2d 611, 64 B.R. 745 (Bankr. N.D. Ohio 1986) *Board of Trustees of the University of Alabama v. Howren* (*In re Howren*), 4 C.B.C.2d 153, 10 B.R. 303 (Bankr. D. Kan. 1980) *In the Matter of Heath*, 1 C.B.C.2d 736, 3 B.R. 351 (Bankr. N.D. Ill. 1980)

(n43)Footnote 43. *In re Goldrich*, 771 F.2d 28, 13 C.B.C.2d 468 (2d Cir. 1985) *In re Richardson*, 5 C.B.C.2d 429, 15 B.R. 925 (Bankr. E.D. Pa. 1981) , rev'd on other grounds, 8 C.B.C.2d 79, 27 B.R. 560 (E.D. Pa. 1982) *In re Goldrich*, 771 F.2d 28, 13 C.B.C.2d 468 (2d Cir. 1985) *In re Richardson*, 5 C.B.C.2d 429, 15 B.R. 925 (Bankr. E.D. Pa. 1981) , rev'd on other grounds, 8 C.B.C.2d 79, 27 B.R. 560 (E.D. Pa. 1982)

(n44)Footnote 44. *Watts v. Pennsylvania Hous. Fin. Agency*, 876 F.2d 1090, 21 C.B.C.2d 521 (3d Cir. 1989) . See also *Toth v. Mich. State Housing Development Authority*, 136 F.3d 477 (6th Cir.) , cert. denied, 524 U.S. 954, 118 S. Ct. 2371, 141 L. Ed. 2d 739 (1998) (§ 525 did not extend to denial of credit in stae home improvement loan program).

(n45)Footnote 45. See n.41 *supra*.

(n46)Footnote 46. Pub. L. No. 103-394 (enacted on October 22, 1994 and effective with respect to cases filed on or after that date), reprinted in Vol. E Collier on Bankruptcy, App. Pt. 9(a) (Matthew Bender).

(n47)Footnote 47. 140 Cong. Rec. H 10,771 (daily ed. Oct. 4, 1994) (remarks of Rep. Jack Brooks); H.R. Rep. No. 835, 103d Cong., 2d Sess. 58 (1994).



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CHAPTER 30 Protections From Discrimination Against Bankruptcy Debtors

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P 30.03 Discrimination by Private Employers

Section 525(b) extends the prohibition against discriminatory treatment to private employers. Other private entities are not included within the scope of section 525, except as provided in section 525(c),ⁿ¹ but the application of section 524 serves to prevent discriminatory treatment by private entities in some cases.ⁿ²

Section 525(b) states that no private employer may terminate the employment of, or discriminate with respect to employment against, a debtor. This protection applies to an individual who is or has been a debtor under the Bankruptcy Code or debtor or bankrupt under the prior Bankruptcy Act. This protection also extends to an individual associated with the debtor or bankrupt.

Under the law prior to 1984, it had been held that the firing of an employee by a power and light company for having received a discharge in bankruptcy, as a matter of company policy, was not prohibited.ⁿ³ Such conduct by private employer would now be clearly prohibited by section 525(b). In view of the specific mention of unions in the legislative history of section 525,ⁿ⁴ it is also likely that such action by a union or other organization affecting the debtor's livelihood would now violate section 525(a).

A private employer is prohibited, by subsection (b), from discriminating against a debtor or bankrupt solely because such individual is or has been a debtor under the Code or a debtor or bankrupt under the prior Bankruptcy Act;ⁿ⁵ has been insolvent before the commencement of a case or during the case but before a discharge is granted or denied;ⁿ⁶ or has not paid a dischargeable debt in a case under the Code or that was discharged under the prior Bankruptcy Act.ⁿ⁷

Under this provision, a bank could not terminate an employee from her position simply because she had filed a chapter 13 petition and the bank had fears of what public opinion might be.ⁿ⁸ Nor could a bank change an employee's duties based upon a bankruptcy filing, even when there were no adverse economic consequences to the employee.ⁿ⁹ An employer is similarly not permitted to deny a debtor participation in an advancement program based upon the debtor having filed a bankruptcy case.ⁿ¹⁰ Section 525(b) could also prohibit discrimination in hiring,ⁿ¹¹ though some courts have held otherwise.ⁿ¹²

In *In re Patterson*,ⁿ¹³ the Court of Appeals for the Eleventh Circuit held that the term "employer" should be given a broad reading and the protections of section 525(b) extended to actions taken by an employee credit union that was affiliated with the debtor's employer. The court held that the credit union's actions of freezing the debtor's accounts,

refusing deposits, and returning checks after they filed a bankruptcy case violated the prohibition of discrimination by employers.ⁿ¹⁴

Several courts have noted that section 525(b) prohibits discriminatory action only if it is based "solely" upon the factors enumerated in the subsection, and that if there are other reasons for discharge, the section may not be utilized. In *Laracuente v. Chase Manhattan Bank*,ⁿ¹⁵ the court held that the debtor was not protected by section 525(b) because there had been other reasons for her termination, including her participation in improper loans. And in *Comeaux v. Brown & Williamson Tobacco Co.*,ⁿ¹⁶ because the debtor alleged only that he had been terminated due to his filing a bankruptcy case and the evidence showed that the decision to terminate had been made prior to the filing, the court found that the termination could not have been due solely to the bankruptcy filing. Because the debtor had not alleged discrimination based upon failure to pay dischargeable debts, the court did not reach the issue of whether the employer discriminated on that basis.ⁿ¹⁷

PRACTICE NOTE

However, the debtor may argue that other reasons given by an employer as a basis for actions against the debtor would not have been sufficient grounds for those actions, *i.e.*, that the employer would not have taken the actions if they were not based in part on grounds prohibited by section 525(b). It may also be necessary to determine whether the stated separate grounds for an employer's actions are merely pretexts and not the actual reasons for those actions.ⁿ¹⁸

FOOTNOTES:

(n1)Footnote 1. Added by the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394 (enacted on October 22, 1994 and effective with respect to cases filed on or after that date), *reprinted in* Vol. E Collier on Bankruptcy, App. Pt. 9(a) (Matthew Bender. *See 4 Collier on Bankruptcy*, P 525.05 (Matthew Bender). 2 Collier Bankruptcy Manual, ch. 525 (Matthew Bender).

(n2)Footnote 2. *See* ch. 29 *supra* for discussion of the protections of the discharge injunction.

(n3)Footnote 3. *McLellan v. Mississippi Power & Light Co.*, 545 F.2d 919 (5th Cir. 1977) .

(n4)Footnote 4. H.R. Rep. No. 595, 95th Cong., 1st Sess. 366-7 (1977), *reprinted in* Vol. B Collier on Bankruptcy, App. Pt. 4(d) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 81 (1978), *reprinted in* Vol D Collier on Bankruptcy, App. Pt. 4(e)(i) (Matthew Bender).

(n5)Footnote 5. 11 U.S.C. § 525(b)(1). *But see Majewski v. St. Rose Dominican Hospital (In re Majewski)*, 310 F.3d 653 (9th Cir. 2002) (section 525(b) inapplicable when debtor fired before bankruptcy case was filed, even if cause was debtor's intention to file bankruptcy case).

(n6)Footnote 6. 11 U.S.C. § 525(b)(2).

(n7)Footnote 7. 11 U.S.C. § 525(b)(3).

(n8)Footnote 8. *In re Hopkins*, 16 C.B.C.2d 186, 66 B.R. 828 (Bankr. W.D. Ark. 1986)

(n9)Footnote 9. *Hicks v. First Nat'l Bank of Harrison (In re Hicks)*, 15 C.B.C.2d 1097, 65 B.R. 980 (W.D. Ark. 1986) .

(n10)Footnote 10. *In re Vaughter*, 109 B.R. 229 (Bankr. W.D. Tex. 1989)

(n11)Footnote 11. *Leary v. Warnaco*, 251 B.R. 656 (Bankr. S.D.N.Y. 2000) (provision applied both to the current employees and to hiring of new employees).

(n12)Footnote 12. *E.g., Fiorani v. Caci*, 192 B.R. 401 (E.D. Va. 1996) .

(n13)Footnote 13. 967 F.2d 505, 27 C.B.C.2d 475 (11th Cir. 1992) .

(n14)Footnote 14. 967 F.2d 505, 514, 27 C.B.C.2d 475, 486 (11th Cir. 1992) .

(n15)Footnote 15. 891 F.2d 17 (1st Cir. 1989) .

(n16)Footnote 16. 915 F.2d 1264 (9th Cir. 1990) .

(n17)Footnote 17. 915 F.2d 1264, 1269, n.6 .

(n18)Footnote 18. *In re Sweeney*, 113 B.R. 359 (Bankr. N.D. Ohio 1990)



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CHAPTER 30 Protections From Discrimination Against Bankruptcy Debtors

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P 30.04 Discrimination in Treatment of Applicants for Student Loans or Grants

Section 525(c), added by the Bankruptcy Reform Act of 1994,ⁿ¹ clarifies the law with respect to discrimination against applicants for student loans or grants. Prior to its enactment, some courts, such as the Court of Appeals for the Second Circuit in *In re Goldrich* ⁿ² had held that section 525(a) did not extend to discrimination in student loan programs, since such programs did not involve a "license, permit, charter, franchise, or other similar grant." These courts ignored the fact that these programs, though structured as loans, are in fact designed to confer grants upon student beneficiaries through subsidized interest rates and government guarantees. Typically, they have no credit requirements, since the applicants are usually young persons with no credit history.

Section 525(c) reinforces and makes explicit Congressional intent that a prior bankruptcy or nonpayment of a debt that is dischargeable in a debtor's bankruptcy case may not be a basis for denial of a student loan or grant. The legislative history states that the *Goldrich* decision is overruled and that it "gave an unduly narrow interpretation to *Code section 525*."ⁿ³ Section 525(c)(2) defines "student loan program" broadly. The term includes any program operated under title IV of the Higher Education Act of 1965ⁿ⁴ and similar programs operated under state or local law.ⁿ⁵

Because student loans are sometimes granted by private entities (which typically are involved in governmental programs that guarantee such loans), the subsection is not limited to governmental units. It includes any "personⁿ⁶ engaged in a business that includes the making of loans guaranteed or insured under a student loan program."ⁿ⁷ The fact that the section is not explicitly limited to discrimination based *solely* on bankruptcy or nonpayment of a dischargeable debt, as are subsections (a) and (b) of section 525, was not meant to preclude consideration of future financial responsibility, or discrimination that is based upon other generally applicable factors.

In light of the subsection's broad provisions, as well as its legislative history, there should be no doubt that discrimination with respect to all student loan programs based upon prior bankruptcy cases or nonpayment of dischargeable debts is unlawful, regardless of when the applicant's bankruptcy case was filed. The reference in section 525(c) to cases filed under the Bankruptcy Act, as well as to those filed under the Code, strongly bolsters the argument that Congress intended the amendment to clarify existing law applicable to past and pending cases as well as to cases filed after its enactment.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 103-394 (enacted on October 22, 1994 and effective with respect to cases filed on or after

that date), *reprinted in* Vol. E Collier on Bankruptcy, App. Pt. 9(a) (Matthew Bender).

(n2)Footnote 2. 771 F.2d 28, 13 C.B.C.2d 465 (2d Cir. 1985) *rev'g* 12 C.B.C.2d 8, 45 B.R. 514 (Bankr. E.D. N.Y. 1984). *In re Richardson*, 5 C.B.C.2d 429, 15 B.R. 925 (Bankr. E.D. Pa. 1981) , *rev'd on other grounds*, 8 C.B.C.2d 79, 27 B.R. 560 (E.D. Pa. 1982)

(n3)Footnote 3. 140 Cong. Rec. H 10,771 (daily ed. Oct. 4, 1994) (remarks of Rep. Jack Brooks); H.R. Rep. No. 835, 103d Cong., 2d Sess. 58 (1994).

(n4)Footnote 4. 20 U.S.C. §§ 1070, *et. seq.*

(n5)Footnote 5. 11 U.S.C. § 525(c)(2), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n6)Footnote 6. "Person" is defined at 11 U.S.C. § 101. *See* 2 Collier on Bankruptcy, ch. 101 (Matthew Bender).

(n7)Footnote 7. 11 U.S.C. § 525(c)(1).



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CHAPTER 30 Protections From Discrimination Against Bankruptcy Debtors

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P 30.05 Particular Problems of Discrimination

[1] Drivers' Licenses

One of the more common uses of bankruptcy by low-income clients is to prevent the loss of or to regain a driver's license that is jeopardized by state financial responsibility laws such as that dealt with in *Perez v. Campbell*.ⁿ¹ Typically, such statutes provide that an operator's license, and sometimes vehicle registration, is suspended until a tort judgment arising out of a motor vehicle accident is paid. The Supreme Court held in *Perez* that, if the debt is discharged in bankruptcy, the license can no longer be denied.

Following *Perez*, courts have more recently held that any other discrimination based upon a discharged debt, such as a requirement that special insurance or a bond be purchased before a license can be granted, is also prohibited under the *Supremacy Clause* since it too would tend to frustrate the Congressional purpose of giving debtors a fresh start.ⁿ² Similarly, a license cannot be withheld on the basis of nonpayment of traffic tickets which are dischargeable in chapter 13 cases or of other dischargeable debts arising from driving infractions.ⁿ³ In such situations, section 525 has been read to mean that the debtor involved should be treated as if the discharged debt never existed.ⁿ⁴ However, if the license has been suspended or revoked for some reason other than simply the nonpayment of money, such as points assessed after traffic violations, bankruptcy will not resolve that problem.

PRACTICE NOTE

Thus, for a client who needs a driver's license, but cannot pay a judgment or fines, bankruptcy can be an ideal solution. Especially in areas where use of an automobile is a necessity of life, such a bankruptcy can be a vital service.

[2] Student Loans and College Transcripts

One of the persistent problems under the prior Bankruptcy Act concerned college students and graduates who were refused transcripts from educational institutions because of discharged student loans. Assuming that a transcript can fit within the "license, permit, charter, franchise, or other grant" language, section 525(a) codifies the result of those cases holding a public institution could not deny a transcript.ⁿ⁵ Similarly, the denial of further student loans by such a public entity based upon the bankruptcy is barred.ⁿ⁶

And, to the extent that pre-Code cases had held that withholding a transcript was a valid means for a private party to induce payment of a debt,ⁿ⁷ those cases are clearly no longer good law due to the prohibition in section 524 of "any act" to collect a debt after discharge.ⁿ⁸ Indeed, as soon as a bankruptcy case is filed, such acts to collect a debt are prohibited by the automatic stay of section 362.ⁿ⁹

MORE INFORMATION

For discussion of the automatic stay *see* chapter 8 *supra*.

One additional argument a debtor might face from a private college withholding a transcript is that the school is not trying to coerce payment of the debt, but rather is simply exercising its right to refuse to enter into new transactions, such as providing a transcript, with the debtor. This argument could be attacked directly under *Perez*, as discussed above, by attempting to convince a court to extend the *Perez* doctrine to private entities.ⁿ¹⁰ It may also be shown to be a pretext to cover up an actual intent to coerce payment. Unlike a creditor who decides not to extend further credit or services, the college puts nothing new at risk in releasing a transcript. The transcript fee is normally paid in advance, and there is no chance whatsoever of creditor harm.ⁿ¹¹ Finally, the debtor might argue that the right to a transcript is a property right that is received in conjunction with the degree or with enrollment.ⁿ¹² If this is the case, and the debtor claims this right is exempt under section 522, then a good argument exists that a creditor may not withhold such property, which is also property of the estate, from the debtor.

MORE INFORMATION

For a discussion of exemptions *see* chapter 10 *supra*.

Thus, debtors are afforded significant protections with respect to college transcripts under the Code. Since its enactment the courts have largely made this problem a thing of the past.

[3] Public Housing

Many of the issues that arise with respect to student loans are also involved in disputes concerning the right to remain in public housing after discharge. A strong argument can be made that the right to remain in public housing is in essence a grant of the subsidy which makes possible lower rents. Further, it is well established in case law and HUD regulations that tenants may be evicted from public housing only for valid cause.ⁿ¹³ Thus, it is not surprising that section 525 has been found applicable to bar eviction of public housing tenants who discharged rent arrearages through bankruptcy.ⁿ¹⁴ In a case in which continued occupancy is conditioned upon payment of the arrearages, a valid claim may also exist that there are violations of section 524(a).ⁿ¹⁵

Section 362(a)(3), added in 2005,ⁿ¹⁶ provides that eviction proceedings are not stayed where the landlord has obtained a judgment for possession prior to the filing of the bankruptcy petition unless the debtor meets certain obligations. However, this amendment should not be read to limit the applicability of § 525 in the context of public housing. The relief from stay provided in § 362(a)(3) only permits the lessor of public housing to take actions that could otherwise be taken; it does not confer any rights upon the landlord to discriminate in violation of § 525.^{n16a}

[4] Social Security, Welfare and Other Governmental Benefits

In many instances, debtors have debts to local, state or federal governmental agencies, that arise out of various public benefit programs and that they wish to discharge. These debts may arise out of a general duty to reimburse for such benefits, which exists under some state laws, or out of an overpayment which the debtor is required to repay.

In most cases these debts are clearly dischargeable since, absent certain kinds of fraud, they do not fall within any of the exceptions to discharge.ⁿ¹⁷ It seems clear that any future denial or recoupment of benefits because of the discharge

would fall squarely within the prohibitions of sections 525(a) and/or 524(a).ⁿ¹⁸

[5] Criminal Proceedings, Fines, and Incarceration

In some cases, the tricky problem of dealing with criminal or quasi-criminal proceedings during or after bankruptcy may be encountered. During the bankruptcy, such problems may sometimes be dealt with through use of the automatic stay.ⁿ¹⁹ Both during and after the case, section 525(a) may also be applicable. Assuming that the right to be free from incarceration is a "license,"ⁿ²⁰ then the state cannot incarcerate a debtor due to a debt that was discharged.ⁿ²¹ Similarly, driver's license suspensions, based on dischargeable unpaid traffic fines should be found to violate section 525(a).ⁿ²² To the extent that it can be shown that a criminal or contempt proceeding is for the purpose of collecting a discharged debt,ⁿ²³ such proceedings are in violation of section 524(a) or (b).ⁿ²⁴

However, as discussed elsewhere in this guide, the court must first find that the fine or restitution order is a dischargeable debt. The Supreme Court has held that at least some restitution debts are not dischargeable in a chapter 7 case.ⁿ²⁵ Similarly, fines are not generally dischargeable in chapter 7. Section 1328(a)(3) specifically makes restitution or a criminal fine, included in a sentence for conviction of a crime, nondischargeable in chapter 13.ⁿ²⁶

MORE INFORMATION

See ch. 26 *supra* for further discussion of dischargeability.

FOOTNOTES:

(n1)Footnote 1. 402 U.S. 637, 91 S. Ct. 1704, 29 L. Ed. 2d 233 (1971) .

(n2)Footnote 2. *Henry v. Heyison*, 1 C.B.C.2d 552, 4 B.R. 437 (E.D. Pa. 1980) . See also *In re Young*, 3 C.B.C.2d 145, 10 B.R. 17 (Bankr. S.D. Cal. 1980) (license could not be denied due to nonpayment of dischargeable fines). But see *Duffey v. Dollison*, 734 F.2d 265, 10 C.B.C.2d 1394 (6th Cir. 1984) (upholding requirement of financial responsibility insurance based upon debt discharged in bankruptcy). The *Duffy* holding is probably no longer good law after the Supreme Court's decision in *FCC v. NextWave Pers. Communs., Inc.*, 537 U.S. 293, 123 S. Ct. 832, 154 L. Ed. 2d 863 (2003) .

(n3)Footnote 3. *Smith v. Pennsylvania Dept. of Transportation*, 66 B.R. 244 (E.D. Pa. 1986) ; *In re Colon*, 21 C.B.C.2d 282, 102 B.R. 421 (Bankr. E.D. Pa. 1989) (attempts to collect prepetition traffic fines by postpetition license suspension violate the automatic stay and nondiscrimination provision); *In re Young*, 3 C.B.C.2d 145, 10 B.R. 17 (Bankr. S.D. Cal. 1980) . See also *In re Kish*, 238 B.R. 271 (Bankr. D.N.J. 1999) (license could not be denied due to nonpayment of discharged insurance "surcharges"); *In re Bill*, 19 C.B.C.2d 1046, 90 B.R. 651 (Bankr. D.N.J. 1989) (suspension of driver's license for failure to pay dischargeable traffic violation insurance surcharges violates the Bankruptcy Code). However, not all fines are dischargeable, even in chapter 13. See ch. 26 *supra*.

(n4)Footnote 4. *Henry v. Heyison*, 1 C.B.C.2d 552, 4 B.R. 437 (E.D. Pa. 1980) . See also *In re Young*, 3 C.B.C.2d 145, 10 B.R. 17 (Bankr. S.D. Cal. 1980) (license could not be denied due to nonpayment of dischargeable fines). But see *Duffey v. Dollison*, 734 F.2d 265, 10 C.B.C.2d 1394 (6th Cir. 1984) (upholding requirement of financial responsibility insurance based upon debt discharged in bankruptcy); *In re Geiger*, 143 B.R. 30 (E.D. Pa. 1992) , *aff'd*, 993 F.2d 224 (3d Cir. 1993) (restoration of license could be conditioned on payment of \$25 restoration fee, which was held nondiscriminatory since it was charged whenever a license was restored to a driver).

(n5)Footnote 5. See *In re Howren*, 4 C.B.C.2d 153, 10 B.R. 303 (Bankr. D. Kan. 1980) ; *In re Heath*, 1 C.B.C.2d 736, 3 B.R. 351 (Bankr. N.D. Ill. 1980) ; *Lee v. Board of Higher Ed. in the City of New York*, 1 B.R. 781 (Bankr. S.D. N.Y. 1979) .

(n6)Footnote 6. See P 30.04 *supra*.

(n7)Footnote 7. *See Girardier v. Webster College*, 563 F.2d 1267 (8th Cir. 1977) .

(n8)Footnote 8. *Matter of Kuehn*, 563 F.3d 289 (7th Cir. 2009) (withholding transcript violated stay and discharge injunction); *Parraway v. Andrews University*, 50 B.R. 316 (W.D. Mich. 1984) . *See* Op. N.Y. Att'y Gen., reprinted in Pov. L. Rep. (CCH) P 31,093 (Jun. 9, 1980). *But cf. Johnson v. Edinboro State College*, 728 F.2d 163, 10 C.B.C.2d 231 (3d Cir. 1984) (transcript may be denied where student loan debt is not discharged).

(n9)Footnote 9. *In re Parham*, 56 B.R. 531 (Bankr. E.D. Pa. 1986) ; *In re Howren*, 10 B.R. 303 (Bankr. D. Kan. 1980) ; *In the Matter of Heath*, 1 C.B.C.2d 736, 3 B.R. 351 (Bankr. N.D. Ill. 1980) .

(n10)Footnote 10. This argument was urged, with respect to both private and public colleges under the Act, in *Girardier v. Webster College*, 563 F.2d 1267, 1277 (8th Cir. 1977) (Bright, J. concurring).

(n11)Footnote 11. *See In the Matter of Heath*, 1 C.B.C.2d 736, 3 B.R. 351 (Bankr. N.D. Ill. 1980) ; Comment, *Postdischarge Coercion of Bankrupts by Private Creditors*, 91 Harv. L. Revised 1336, 1344 (1979).

(n12)Footnote 12. *See Chesapeake Bay Foundation, Inc. v. United States*, 445 F. Supp. 1349 (D. N.J. 1978) .

(n13)Footnote 13. 24 C.F.R. § 866.4(l)(1); *see, e.g., Tyson v. N.Y. City Housing Authority*, 369 F. Supp. 513 (S.D. N.Y. 1974) . *See also In re Adams*, 94 B.R. 838 (Bankr. E.D. Pa. 1989) (household members remaining after lessee vacated public housing unit are entitled to the rights of public housing tenants).

(n14)Footnote 14. *Stoltz v. Brattleboro Hous. Auth.*, 315 F.3d 80 (2d Cir. 2002) ; *In re Curry*, 148 B.R. 966 (S.D. Fla. 1992) ; *Gibbs v. Housing Authority of City of New Haven*, 76 B.R. 257 (D. Conn. 1983) , *aff'd*, 4 C.B.C.2d 161, 9 B.R. 758 (Bankr. D. Conn. 1981) ; *In re Szymecki*, 87 B.R. 14 (Bankr. W.D. Pa. 1988) ; *In re Sudler*, 71 B.R. 780 (Bankr. E.D. Pa. 1986) . *But see In re Robinson*, 54 F.3d 316, 33 C.B.C.2d 603 (7th Cir. 1995) (if public housing lease was terminated prior to tenant's bankruptcy, lessor was not required by § 525 to renew lease); *Smith v. St. Louis Hous. Auth.* (*In re Smith*), 259 B.R. 901 (B.A.P. 8th Cir. 2001) (§ 525 not applicable when public housing lease terminated due to debtor's fraud; dictum stating § 525 not applicable even if nonpayment of rent was reason for termination); *In re Lutz*, 18 C.B.C.2d 378, 82 B.R. 699 (Bankr. M.D. Pa. 1988) (landlord who receives subsidy from HUD toward debtor's rental is not a public entity subject to the Code's antidiscrimination provision).

(n15)Footnote 15. *See* ch. 29 *supra*.

(n16)Footnote 16. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n17)Footnote 16a. *In re Kelly*, 356 B.R. 899 (Bankr. S.D. Fla. 2006) .

(n18)Footnote 17. *Lee v. Schweiker*, 739 F.2d 870, 11 C.B.C.2d 834 (3d Cir. 1984) (social security overpayment); *In re Neavear*, 674 F.2d 1201, 6 C.B.C.2d 367 (7th Cir. 1982) (social security overpayments).

(n19)Footnote 18. *In re Cost*, 161 B.R. 856 (Bankr. S.D. Fla. 1993) (attorney's fees and costs awarded as sanctions to remedy Social Security Administration's recovery of discharged overpayment through withholding from benefits).

(n20)Footnote 19. *See* ch. 8 *supra* for a discussion of related issues. *See generally In re Poule*, 19 C.B.C.2d 1059, 91 B.R. 83 (B.A.P. 9th Cir. 1988) (comparison of application of automatic stay for restitution with application for fine).

(n21)Footnote 20. "License" has been defined as the "authority or liberty given to do or forbear any act," the "leave to do a thing which the licensor could prevent," and "permission to do something which without the license would not be allowable." *See Black's Law Dictionary* 1067 (Revised 4th ed. 1968).

(n22)Footnote 21. *See generally Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 110 S. Ct. 2126, 109 L. Ed. 2d 588, 22 C.B.C.2d 1067 (1990) . The *Davenport* decision does not fully address whether a judge

could have someone imprisoned for the probation violation inherent in not paying a dischargeable restitution order. However, the court's dicta, taken together with common sense, strongly suggests that a discharge and/or the automatic stay and/or the confirmed plan must preclude the debtor's incarceration for failure to pay restitution after a chapter 13 case has been filed. *But see Hucke v. State of Oregon*, 992 F.2d 950, 28 C.B.C.2d 1485 (9th Cir.) , *cert. denied*, 114 S. Ct. 178 (1993) (revocation of probation after nonpayment of restitution did not violate the automatic stay as attempt to collect debt because state court judge canceled restitution obligation when probation was revoked).

(n23)Footnote 22. *See In re Colon*, 21 C.B.C.2d 282, 102 B.R. 421 (Bankr. E.D. Pa. 1989) (prepetition traffic fines are dischargeable in chapter 13; attempts to collect them by postpetition license suspension violate the automatic stay); *In re Young*, 3 C.B.C.2d 145, 10 B.R. 17, 6 B.C.D. 1213 (Bankr. S.D. Cal. 1980) (state could not deny drivers license due to fine which would be discharged in chapter 13).

(n24)Footnote 23. *See In re Kaping*, 4 C.B.C.2d 1529, 13 B.R. 621 (Bankr. D. Or. 1981) (prosecution of criminal nonsupport charge enjoined where principal motivation was to obtain restitution of discharged debts).

(n25)Footnote 24. *See In re Lenke*, 249 B.R. 1 (Bankr. D. Ariz. 2000) (bankruptcy court had authority to enjoin prosecution if it was disguised effort to collect debt); *In re Gilliam*, 67 B.R. 83 (Bankr. M.D. Tenn. 1986) . *But see In re Daulton*, 966 F.2d 1025 (6th Cir. 1992) (where creditors did not seek restitution, their signing of criminal complaint against debtor alleging fraudulent sale of collateral does not violate discharge injunction).

(n26)Footnote 25. *Kelly v. Robinson*, 479 U.S. 36, 107 S. Ct. 353, 93 L. Ed. 2d 216, 15 C.B.C.2d 890 (1986) .

(n27)Footnote 26. 11 U.S.C. 1328(a)(3).



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CHAPTER 30 Protections From Discrimination Against Bankruptcy Debtors

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P 30.06 Enforcement of Protections Against Discrimination

[1] Bankruptcy Court Remedies Available

Discrimination prohibited by section 525 may occur during or after the bankruptcy case. In either situation the bankruptcy court has jurisdiction to determine whether the statute has been violated, since a proceeding brought to enforce the protections of section 525 would be a proceeding arising under title 11.ⁿ¹ In *Matter of Bradley*,ⁿ² the Court of Appeals for the Fifth Circuit held that a bankruptcy court may not refuse to hear a complaint under section 525 simply because the debtor's bankruptcy case had already been closed. Noting that most violations of section 525 will occur after a bankruptcy case is over, the court held that a proceeding to remedy such a violation is clearly within the jurisdiction to hear proceedings "arising under" title 11 that is granted by *section 1334(b) of title 28 of the United States Code*.ⁿ³

Bankruptcy courts have the power to remedy discrimination prohibited by section 525 under section 105(a), which gives them the power to issue any order or judgment necessary or appropriate to carry out the provisions of title 11.ⁿ⁴ Under that section courts have granted both injunctive relief and damages to debtors who have been subject to unlawful treatment.ⁿ⁵ A bankruptcy court need not stay its determination under section 525 to permit arbitration of the matter pursuant to a contractual arbitration clause.ⁿ⁶

In cases in which discrimination is the result of action by state or local governmental officials, the debtor also has a remedy available under *42 U.S.C. § 1983*, which is applicable to cases in which there is action under color of state or local law depriving any person or rights secured by the laws of the United States.ⁿ⁷ Because the Bankruptcy Code is a law of the United States, state action in violation of the Code should give rise to a cause of action under section 1983.ⁿ⁸ One important consequence of this additional cause of action is the availability of statutory attorney's fees to a successful plaintiff.ⁿ⁹

In addition, a debtor may be able to obtain monetary damages in such a suit, notwithstanding any claim of sovereign immunity by a governmental unit. Section 106(a)ⁿ¹⁰ of the Code, as amended by the Bankruptcy Reform Act of 1994,ⁿ¹¹ abrogates sovereign immunity with respect to section 525 and permits monetary damages, but not punitive damages, to be awarded against the state or federal government. The legislative history states that amended section 106 is intended to overrule *Hoffman v. Connecticut Department of Income Maintenance* ⁿ¹² and *United States v. Nordic Village, Inc.*,ⁿ¹³ in which the Supreme Court had held that a prior version of section 106 was not sufficient to overcome

federal sovereign immunity or state *Eleventh Amendment* immunity. However, the right to damages from a state government was again thrown into doubt by the supreme Court's decision in *Seminole Tribe of Florida v. Florida*,ⁿ¹⁴ which may bar suits against a state for damages based upon the Bankruptcy Code.ⁿ¹⁵

[2] Procedure for Enforcing Section 525

A proceeding to enforce section 525 will normally seek injunctive relief and possibly damages. Therefore, under *Federal Rule of Bankruptcy Procedure 7001* it must be brought as an adversary proceeding and commenced by a complaint. If it is brought after the bankruptcy case is concluded, the bankruptcy case may have to be reopened. After the complaint is filed, the action will proceed, under the adversary proceeding rules, in a manner similar to a federal district court civil action.

FORMS

For forms of such complaints see *Collier Consumer Bankruptcy Forms*, §§ CS15.02-. 06 (Matthew Bender).

MORE INFORMATION

For discussion of reopening bankruptcy cases see chapter 31 *infra*. For discussion of procedure in adversary proceedings see chapter 32 *infra*.

There are sometimes difficult problems of proof with respect to whether a particular course of conduct is discriminatory. As in cases of racial discrimination, the court must look at the practical effects of the conduct. The court must determine whether the asserted reason for the acts the debtor complains of is in fact the actual reason or only a pretext for prohibited discrimination.ⁿ¹⁶ If a test or requirement has the effect of excluding a bankruptcy debtor solely because of past insolvency or solely because of past nonpayment of dischargeable debts, it discriminates in a manner prohibited by section 525.

FOOTNOTES:

(n1)Footnote 1. 28 U.S.C. § 1334(a). See 1 *Collier on Bankruptcy*, P 3.01[1][c] (Matthew Bender).

(n2)Footnote 2. 989 F.2d 802 (5th Cir. 1993) .

(n3)Footnote 3. 989 F.2d 802, 804 (5th Cir. 1993) .

(n4)Footnote 4. 11 U.S.C. § 105(a). See 2 *Collier on Bankruptcy*, P 105.02-. 04 (Matthew Bender).

(n5)Footnote 5. *In re Exquisito Servs., Inc.*, 823 F.2d 151, 17 C.B.C.2d 324 (5th Cir. 1987) *Matter of McNeely*, 82 B.R. 628 (Bankr. S.D. Ga. 1987)

(n6)Footnote 6. *In re Arentson*, 126 B.R. 236 (Bankr. N.D. Miss. 1991)

(n7)Footnote 7. *Wright v. Roanoke Redevelopment and Hous. Auth.*, 479 U.S. 418, 107 S. Ct. 766, 93 L. Ed. 2d 781 (1987) ; *Maine v. Thiboutot*, 448 U.S. 1, 100 S. Ct. 2502, 65 L. Ed. 2d 555 (1980) .

(n8)Footnote 8. *In re Watts*, 93 B.R. 350 (E.D. Pa. 1988) , rev'd on other grounds, 876 F.2d 1090, 21 C.B.C.2d 521 (3d Cir. 1989) ; *Higgins v. Philadelphia Gas Works*, 54 B.R. 928 (E.D. Pa. 1985) ; *Gibbs v. Housing Authority of City of New Haven*, 76 B.R. 257 (D. Conn. 1983) ; *In re Maya*, 3 C.B.C.2d 561, 8 B.R. 202 (Bankr. E.D. Pa. 1981) *In re Watts*, 93 B.R. 350 (E.D. Pa. 1988) , rev'd on other grounds, 876 F.2d 1090, 21 C.B.C.2d 521 (3d Cir. 1989) *Higgins v. Philadelphia Gas Works*, 54 B.R. 928 (E.D. Pa. 1985) *Gibbs v. Housing Authority of City of New Haven*, 76 B.R. 257 (D. Conn. 1983) *In re Maya*, 3 C.B.C.2d 561, 8 B.R. 202 (Bankr. E.D. Pa. 1981)

(n9)Footnote 9. 42 U.S.C. § 1988. However, attorney's fees may be limited, at least with respect to the federal government, by 11 U.S.C. § 106(a)(4), which states that an award of fees must be consistent with the provisions and limitations of 28 U.S.C. § 2412(d)(2)(A), which contains rate limitations on fees awarded against the federal government.

(n10)Footnote 10. 11 U.S.C. § 106(a). See 2 Collier on Bankruptcy, ch. 106 (Matthew Bender).

(n11)Footnote 11. Pub. L. No. 103-394 (enacted on October 22, 1994 and effective with respect to cases filed before, on or after that date), *reprinted in* Vol. E Collier on Bankruptcy, App. Pt. 9(a) (Matthew Bender).

(n12)Footnote 12. 492 U.S. 96, 109 S. Ct. 2818, 106 L. Ed. 2d 76, 20 C.B.C.2d 1204 (1989) .

(n13)Footnote 13. 503 U.S. 30, 112 S. Ct. 1011, 117 L. Ed. 2d 181, 26 C.B.C.2d 9 (1992) .

(n14)Footnote 14. 517 U.S. 44, 116 S. Ct. 1114, 134 L. Ed 2d 252, 34 C.B.C.2d 1199 (1996).

(n15)Footnote 15. See 2 Collier on Bankruptcy, P 106.02[1] (Matthew Bender).

(n16)Footnote 16. *Matter of McNeely*, 18 C.B.C.2d 1273, 82 B.R. 628 (Bankr. S.D. Ga. 1987) ; *In re Rath Packing Co.*, 9 C.B.C.2d 1295, 35 B.R. 615 (Bankr. N.D. Iowa 1983)



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CHAPTER 31 Reopening Bankruptcy Cases

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CHAPTER 31 Reopening Bankruptcy Cases

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Scope

SCOPE NOTE

This chapter discusses reopening of bankruptcy cases. It explains some of the reasons that parties seek to reopen cases and the standard for reopening. It also details the procedure for seeking the reopening of a case.



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CHAPTER 31 Reopening Bankruptcy Cases

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P 31.01 Introduction

At the end of a bankruptcy case the case is closed.ⁿ¹ In no asset chapter 7 cases and in chapter 13 cases, this occurs simultaneously with or shortly after the discharge order. In a chapter 7 case in which there are assets, it occurs when after the trustee's final account has been filed, the estate has been certified as fully administered and 30 days have passed without objection.ⁿ² A case may also be closed without a discharge if the debtor fails to file evidence of completing a personal financial management course.^{n2a}

For various reasons, parties may later seek to reopen a case. New assets may be discovered for the trustee to administer, the debtor may seek to amend schedules or seek other relief such as avoidance of a lien or enforcement of the discharge protections. The bankruptcy court has jurisdiction to hear these matters, and to the extent that they do not involve administration of the bankruptcy case itself it is not clear that reopening is necessary for that jurisdiction to be exercised.ⁿ³ However, in many jurisdictions the court will refuse to hear a proceeding related to a bankruptcy case unless a motion to reopen the case is filed. In some cases, courts require that a motion to reopen be filed simply to provide a mechanism to instruct the clerk to retrieve a case file from storage.

Section 350(b) of the Bankruptcy Code affords the court broad discretion with respect to the reopening of a case.

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 350(a)*. See 3 *Collier on Bankruptcy*, P 350.02 (Matthew Bender).

(n2)Footnote 2. *Fed. R. Bankr. P. 5009*. See 9 *Collier on Bankruptcy*, P 5009.02 (Matthew Bender).

(n3)Footnote 2a. See 2008 Advisory Committee Note to *Federal Rule of Bankruptcy Procedure* 4006.

(n4)Footnote 3. See *Staffer v. Predovich (In re Staffer)*, 306 F.3d 967 (9th Cir. 2002) (motion to reopen bankruptcy case was not a prerequisite to creditor complaint under § 523(a)(3)).



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CHAPTER 31 Reopening Bankruptcy Cases

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P 31.02 Reasons for Reopening a Case

[1] Administration of Assets

Pursuant to section 350(b) and *Rule 5010*, the discovery of unadministered assets is a sufficient reason for the court to exercise its power to reopen. However, the assets must be assets that were not known at the time the case was closed. The administration of assets would not normally be grounds for reopening if the assets had been properly scheduled by the debtor. It is the trustee's duty to investigate properly scheduled assets, and the fact that the debtor does not volunteer information about changes in the value of such assets, when information is not requested by the trustee, does not justify reopening the case after the trustee discovers such changes.ⁿ¹ For example, in *Miller v. Shallowford Community Hospital*,ⁿ² a lawsuit properly abandoned by the trustee did not constitute "unadministered asset" for purposes of section 350(b). However some courts have held that an inadvertent technical abandonment of assets by a trustee could be cause for reopening the case pursuant to *Federal Rule of Bankruptcy Procedure 9024*, which incorporates *Federal Rule of Civil Procedure Rule 60*.ⁿ³ Other courts have held that *Rule 9024* cannot be used to overcome the abandonment resulting from application of the statutory provisions of section 554.ⁿ⁴ Assets may come into the estate for the first time after the case is closed under section 541(a)(5), which includes in the estate inheritances, property settlements and life insurance proceeds acquired within 180 days after the petition.ⁿ⁵

[2] Amendment of Schedules

Motions to reopen are often filed by debtors seeking to amend schedules to list an additional creditor. Such motions are generally liberally granted.ⁿ⁶ The courts have held that no prejudice will accrue to the creditor in a no asset case when notice to creditors has been given pursuant to *Rule 2002(e)* that it is not necessary to file a claim. In such a case, the omitted creditor is not prejudiced if the case is reopened and the creditor scheduled because the creditor would not have received a distribution in any event, and the time for filing proofs of claim has not passed. If additional assets are subsequently found, the creditor has not lost its opportunity to file a claim; if that were to occur, all creditors would be notified and granted reasonable time to file their claims pursuant to *Rule 3002(c)(5)*.ⁿ⁷

Motions to reopen for the purpose of adding creditors to the schedules are often filed by debtors in the mistaken belief that adding the creditor to the schedules is necessary for the debt to be discharged. In fact, as explained by the Court of Appeals for the Third Circuit in *Judd v. Wolfe*,ⁿ⁸ the belated scheduling of a creditor after the case has been closed has no effect on whether the debt is discharged. Under section 523(a)(3), a nonscheduled debt is excepted from the discharge only if the failure to schedule resulted in the creditor not having knowledge of the case in time to file a proof

of claim or, if the creditor holds a claim that would have been found nondischargeable under section 523(a)(2), (4), or (6), in time to file a dischargeability complaint.ⁿ⁹ If the debt falls within this exception, reopening the case to schedule the debt does not render it dischargeable. If it does not fall within the exception, the debt is discharged regardless of whether it is ever scheduled.

Moreover, nowhere in section 523(a)(3) is the reason why a debt was not scheduled made relevant to the discharge of the debt.ⁿ¹⁰ As the *Judd* court held, the plain language of section 523(a)(3) represents a choice by Congress that the discharge of a debt omitted from the schedules does not depend on the debtor's good faith in making the omission.ⁿ¹¹ Therefore, the court held, it was not an abuse of discretion to refuse the debtor's motion to reopen a case that was filed as an attempt to affect the dischargeability of a debt.

Recognizing that a reopening of the case would not affect whether the debt was discharged, the court of appeals in *Judd* went on to consider whether the case should be reopened for the limited purpose of adding a creditor's name to the list of creditors. The debtor asserted that this was important in her attempts to acquire new credit. The court remanded the case for a determination of whether reopening the case would serve this or any other purpose, such as assuring the creditor would be notified if assets were later discovered.ⁿ¹²

Some courts have conditioned permission to reopen for the purpose of scheduling an additional creditor on the debtor's payment of the reasonable attorney's fees the creditor expended in pursuing its claim prior to discovery that a debtor had filed a bankruptcy petition from which that creditor was omitted.ⁿ¹³ Like those courts which condition reopening on a finding that the debtor's omission of a creditor on the schedules was unintentional and nonfraudulent,ⁿ¹⁴ many of these courts incorrectly assume that the debt will not be discharged if the schedules are not amended. As discussed above, reopening a case and adding a creditor to the schedules does not affect whether a debt is discharged. While a court may choose not to reopen a case to permit amendment of the schedules because the debtor has not acted in good faith, the debtor's inability to amend the schedules does not affect the dischargeability of the nonscheduled debt.

[3] Filing Lien Avoidance Motion

Additional grounds for reopening include the debtor's desire to file a motion to avoid a lien pursuant to *section 522(f) of the Code*. The majority of courts hold that a debtor may reopen a bankruptcy case in order to file a lien avoidance action unless the creditor has been unduly prejudiced by delay on the debtor's part.ⁿ¹⁵ Unlike other provisions in the Code and Rules,ⁿ¹⁶ neither section 522(f) nor *Federal Rule of Bankruptcy Procedure 4003(d)*, both governing lien avoidance motions, sets a deadline for the filing of such motions. Indeed, since the power to avoid a lien is a personal right of the debtor, which has no bearing on the administration of the bankruptcy case, it is doubtful that the case has to be reopened at all to hear such a motion, which is clearly within the jurisdiction of the court.ⁿ¹⁷

A key factor in deciding a motion to reopen to allow late avoidance of a lien is therefore whether the creditor is sufficiently prejudiced so that it would be inequitable to grant the motion.ⁿ¹⁸ Laches, a long delay in reopening the case, may be an equitable defense to a motion by the debtor to reopen to pursue its section 522(f) remedy.ⁿ¹⁹ Some courts have conditioned a debtor's right to file a postdischarge lien avoidance action on the debtor's reimbursing the creditor for costs and attorney's fees incurred in enforcing its judicial lien in state court, which eliminates any prejudice to the creditor due to unreasonable delay by the debtor.ⁿ²⁰

Most cases have held that there is no time limit in the Code within which a motion for lien avoidance must be filed, as long as the creditor has not been prejudiced by the delay.ⁿ²¹

[4] Granting a Discharge or Other Relief to the Debtor

The court may reopen a case to grant the debtor a discharge if the case has been closed before a discharge is granted. Thus, a case that has been closed without a discharge or dismissed may be reopened. The most common such situation

is that of a debtor who does not timely complete the personal financial management instructional course. Courts should reopen the case and grant a discharge if the debtor files a motion to reopen with a certificate attached that evidences completion of the course.^{n21a} However, such relief may not be extended to a debtor whose discharge has been denied under other provisions of sections 727, 1141(d)(3)(C), 1228n22 or 1328 of the Code.

Also common is the situation in which postpetition events give rise to a motion to reopen. The debtor may seek to reopen the case to enforce the discharge injunction of section 524(a) after a creditor has attempted to collect a discharged debt. Similarly, a debtor may be subjected to discrimination prohibited by section 525, and seek enforcement of rights guaranteed by that section in the bankruptcy court. In these situations, which do not concern administration of the case, a motion to reopen may not be necessary for the court to render a decision on issues that are clearly within its jurisdiction under section 1334 of title 28.ⁿ²³ If a motion to reopen is required in such circumstances, it should be granted as a matter of course; the bankruptcy court should rarely decline to exercise its jurisdiction to enforce rights arising under the Bankruptcy Code.

MORE INFORMATION

For further discussion of the discharge injunction and protections against discrimination see chapters 29 and 20 *supra*, respectively.

Debtors, or occasionally creditors, may also file motions to reopen to determine the dischargeability of a debt. The bankruptcy court has concurrent jurisdiction with other courtsⁿ²⁴ to decide if particular debts were discharged in a bankruptcy case, other than debts alleged to be nondischargeable under section 523(a)(2), (4), or (6), which can be found nondischargeable only by the bankruptcy court.ⁿ²⁵ While a bankruptcy court should normally grant a motion to reopen to determine the dischargeability of a debt, it may choose to abstain if proceedings in another court are well advanced before the issue is brought to the bankruptcy court.ⁿ²⁶

MORE INFORMATION

The dischargeability of debt is discussed in chapter 26 *supra*.

[5] Reopening for Other Cause

In addition to the specified causes of the need to administer assets or to accord relief to the debtor, the court may reopen a case "for other cause."ⁿ²⁷ For example, courts have granted motions to reopen a case to determine the validity of lien.ⁿ²⁸ In the court's discretion, however, upon consideration of all the circumstances, it may refuse to reopen a case.ⁿ²⁹ While the Code does not define "other cause" for purposes of reopening a case under section 350(b), the decision to reopen is discretionary with the court, which may consider numerous factors including equitable concerns, and ought to emphasize substance over technical considerations.ⁿ³⁰

FOOTNOTES:

(n1)Footnote 1. *Vasquez v. Adair* (*In re Adair*), 253 B.R. 85 (B.A.P. 9th Cir. 2000) .

(n2)Footnote 2. 767 F.2d 1556, 1559 n.4 (11th Cir. 1985) .

(n3)Footnote 3. *See, e.g., Woods v. Kenan* (*In re Woods*), 173 F.3d 770 (10th Cir.) , *cert. denied*, 528 U.S. 878, 120 S. Ct. 187, 145 L. Ed. 2d 157 (1999) .

(n4)Footnote 4. *See In re Halstead*, 228 B.R. 915 (Bankr. S.D. Ind. 1998) (language of Rule 9024 providing that one year limit does not apply to motions to reopen indicates intent that rule does not apply to motion to reopen).

(n5)Footnote 5. *See 5 Collier on Bankruptcy*, P 541.16 (Matthew Bender); *Collier Bankruptcy Manual*, P 541.17

(Matthew Bender 3rd Ed. Revised).

(n6)Footnote 6. *Samuel v. Baitcher (In the Matter of Baitcher)*, 781 F.2d 1529 (11th Cir. 1986) ; *Rosinski v. Boyd (In re Rosinski)*, 759 F.2d 539, 12 C.B.C.2d 923 (6th Cir. 1985) ; *Stark v. St. Mary's Hospital (In the Matter of Stark)*, 717 F.2d 322, 324, 9 C.B.C.2d 319 (7th Cir. 1983) .

(n7)Footnote 7. *See Rosinski v. Boyd (In re Rosinski)*, 759 F.2d 539, 12 C.B.C.2d 923 (6th Cir. 1985) .

(n8)Footnote 8. 78 F.3d 110, 35 C.B.C.2d 698 (3d Cir. 1996) .

(n9)Footnote 9. 11 U.S.C. § 523(a)(3). *See 4 Collier on Bankruptcy*, P 523.09 (Matthew Bender).

(n10)Footnote 10. 11 U.S.C. § 523(a)(3). *See 4 Collier on Bankruptcy*, P 523.09 (Matthew Bender); 78 F.3d 110, 116, 35 C.B.C.2d 698, 706 (3d Cir. 1996) . *Accord, Zirnhelt v. Madaj (In re Madaj)*, 149 F.3d 467 (6th Cir. 1998) ; *Beezley*, 994 F.2d 1433, 1439 (9th Cir. 1993) .

(n11)Footnote 11. 78 F.3d 110, 116, 35 C.B.C.2d 698, 706 (3d Cir. 1996) .

(n12)Footnote 12. 78 F.3d 110, 117, 35 C.B.C.2d 698, 707 (3d Cir. 1996) .

(n13)Footnote 13. *See In re Brown*, 60 B.R. 983 (Bankr. S.D. Ohio 1986) ; *In re Scism*, 11 C.B.C.2d 137, 41 B.R. 384 (Bankr. W.D. Okla. 1984) *La Bate & Conti, Inc. v. Davidson (In the Matter of Davidson)*, 10 C.B.C.2d 46, 36 B.R. 539 (Bankr. D.N.J. 1983)

(n14)Footnote 14. *E.g., In re Stone*, 10 F.3d 285, 30 C.B.C.2d 634 (5th Cir. 1994) ; *Rosinski v. Boyd (In re Rosinski)*, 759 F.2d 539, 12 C.B.C.2d 923 (6th Cir. 1985) .

(n15)Footnote 15. *See In re Wilding*, 475 F.3d 428 (1[st] Cir. 2007) (debtor permitted to avoid judicial lien under section 522(f) two years after discharge even if he has satisfied the lien prior to filing a motion to avoid, so long as the lien in question impaired an exemption as of the bankruptcy petition date). *In re Cummings*, 172 B.R. 268 (W.D. Ark. 1994) (finding lien avoidance sufficient cause to reopen case); *McDonald v. Home State Bank & Trust Co. (In re McDonald)*, 161 B.R. 697 (D. Kan. 1993) (allowing debtor to reopen case to utilize avoiding powers).

(n16)Footnote 16. *E.g., 11 U.S.C. § 546(a), Fed. R. Bankr. P. 4003(a) & (b).*

(n17)Footnote 17. *In re Keller*, 24 B.R. 720 (Bankr. N.D. Ohio 1982) .

(n18)Footnote 18. *In re Tarkington*, 301 B.R. 502 (E.D. Tenn. 2003) (denying debtor's motion to reopen based on undue prejudice to creditor); *ITT Financial Services v. Ricks (In re Ricks)*, 19 C.B.C.2d 1437, 89 B.R. 73 (B.A.P. 9th Cir. 1988) (affirming lower court finding of insufficient prejudice to creditor to bar reopening of case).

(n19)Footnote 19. *See Hawkins v. Landmark Finance Co.*, 727 F.2d 324, 10 C.B.C.2d 94 (4th Cir. 1984) ; *Serafini v. Union Bank & Trust Co. (In re Serafini)*, 8 C.B.C.2d 1334, 30 B.R. 606 (Bankr. W.D. Pa. 1983) , *aff'd*, 41 B.R. 880 (W.D. Pa. 1984) ; H.R. Rep. No. 595, 95th Cong., 1st Sess. 338 (1977), *reprinted in* Vol. C *Collier on Bankruptcy*, App. Pt. 4(d)(i) (Matthew Bender); S. Rep. No. 989, 95th Cong., 2d Sess. 49 (1978), *reprinted in* Vol. D *Collier on Bankruptcy*, App. Pt. 4(e)(i) (Matthew Bender).

(n20)Footnote 20. *In the Matter of Parker*, 64 B.R. 402 (Bankr. M.D. Fla. 1986) ; *Noble v. Yingling*, 37 B.R. 647 (D. Del. 1984) ; *cf. Davidson*, 10 C.B.C.2d 46, 36 B.R. 539 (Bankr. D.N.J. 1983) (amending schedule of creditors). *See also Webb v. Robert A. Boroughs, Ltd. (In re Webb)*, 48 B.R. 454 (Bankr. E.D. Va. 1985) (court will not condition postdischarge relief under § 522(f) on payment of attorney's fees and costs unless creditor can demonstrate by clear and convincing evidence that debtor was guilty of unreasonable delay which prejudiced creditor); *In re Ricks*, 62 B.R. 681 (Bankr. S.D. Cal. 1986) , *aff'd*, 19 C.B.C.2d 1437, 89 B.R. 73 (B.A.P. 9th Cir. 1988) .

(n21)Footnote 21. *See, e.g., In re Skakalski*, 67 B.R. 448 (Bankr. W.D. Pa. 1986) ; *In re Carilli*, 15 C.B.C.2d 798, 65 B.R. 280 (Bankr. E.D.N.Y. 1986) ; *In re Yazzie*, 9 C.B.C.2d 62, 24 B.R. 576 (B.A.P. 9th Cir. 1982) ; *but see In re Williams*, 17 B.R. 204 (Bankr. W.D. Ky. 1982) ; *In re Ridill*, 1 B.R. 216 (C.D. Cal. 1979) .

(n22)Footnote 21a. Unlike other matters relating to the discharge, a reopening for this purpose is currently subject to a new case filing fee under the bankruptcy courts' miscellaneous fee schedule. *See P 31.03[2] infra*.

(n23)Footnote 22. Section 1228 was added to the Code by the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554 *reprinted in*, Vol. E Collier on Bankruptcy, App. Pt. 7(a) (Matthew Bender). *See In re Lowerree*, 157 F.2d 831 (2d Cir. 1946) .

(n24)Footnote 23. *See Menk v. Lapaglia (In re Menk)*, 241 B.R. 896 (B.A.P. 9th Cir. 1999) (reopening case is not necessary for court to exercise jurisdiction not relating to administration).

(n25)Footnote 24. 28 U.S.C. § 1334(b). *See 1 Collier on Bankruptcy*, P 3.01[1][c][iii] (Matthew Bender).

(n26)Footnote 25. 11 U.S.C. § 523(c), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n27)Footnote 26. *See In re Brice*, 79 B.R. 310 (Bankr. S.D. Ohio 1987) ; *In re Dabbs*, 72 B.R. 73 (Bankr. N.D. Ala. 1987) ; *In the Matter of Coppi*, 75 B.R. 81 (Bankr. S.D. Iowa 1987) ; *In re Iannacone*, 21 B.R. 153 (D. Mass. 1982) .

(n28)Footnote 27. *See In the Matter of Mesta Machine Co.*, 67 B.R. 147 (Bankr. W.D. Pa. 1985) (union's motion to reopen to provide for accounting was "cause" within § 350(b)); *In re Frontier Enterprises*, 70 B.R. 356 (Bankr. C.D. Ill. 1987) (blatant error in distribution of proceeds of estate was compelling cause to reopen).

(n29)Footnote 28. *In re Walters*, 22 C.B.C.2d 1747, 113 B.R. 602 (Bankr. D.S.D. 1990) .

(n30)Footnote 29. *See, e.g., Hawkins v. Landmark Finance Co.*, (727 F.2d 324, 10 C.B.C.2d 94 (4th Cir. 1984) , in which the Fourth Circuit held that a bankruptcy court did not abuse its discretion by refusing to reopen a case for a lien avoidance complaint when the debtor did not seek reopening until after the creditor had incurred court costs and counsel fees in seeking lien enforcement in state court.

(n31)Footnote 30. *In the Matter of Shondel*, 950 F.2d 1301, 26 C.B.C.2d 193 (7th Cir. 1991) .



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CHAPTER 31 Reopening Bankruptcy Cases

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P 31.03 Procedure for Reopening a Case

[1] Who May Move to Reopen

Federal Rule of Bankruptcy Procedure 5010 gives the debtor or any other party in interest the right to file a motion to reopen. In addition, it has been held that the bankruptcy court may reopen a case sua sponte.ⁿ¹ However, courts have disagreed with respect to whether a former trustee has standing to move to reopen.ⁿ²

A debtor has the right to oppose an attempt to reopen the case for the purpose of further examining the debtor to discover assets,ⁿ³ and such application should be granted only if the moving papers reasonably satisfy the court that there are some unadministered assets belonging to the estate.ⁿ⁴

[2] Motion to Reopen Case

Federal Rule of Bankruptcy Procedure 5010 provides that a case is to be reopened on motion.ⁿ⁵ Verification of a motion to reopen is not explicitly required by *Rule 5010* and therefore pursuant to *Rule 9011(e)* a motion to reopen need not be verified. In many courts a motion to reopen is treated as an administrative matter and considered summarily. However, if the motion is opposed, it becomes a contested matter considered pursuant to *Federal Rule of Bankruptcy Procedure 9014*.ⁿ⁶

FORMS

For forms of motions to reopen see *Collier Consumer Bankruptcy Forms*, §§ CS22.02-. 04 (Matthew Bender).

The motion should state facts which reasonably satisfy the court of the requisite "cause" for reopening. The court may take judicial notice of the record of the original proceeding before it.ⁿ⁷ The limited nature of the proceeding, however, indicates that the order of reopening is not a final adjudication of the substantive issues raised by the party who sought to reopen the case.ⁿ⁸

The reopening of a case does not reinstate the discharged trustee. *Federal Rule of Bankruptcy Procedure 5010* provides that, in a reopened chapter 7, 12 or 13 case, "a trustee shall not be appointed by the United States trustee unless the court determines that a trustee is necessary to protect the interests of creditors and the debtor or to insure efficient

administration of the case."⁹ If a trustee is necessary, the United States trustee would appoint a new trustee under the respective provisions in the operative chapters of the Code.

The Schedule of bankruptcy fees adopted by the Judicial Conference of the United States provides that a filing fee is to be charged for a motion to reopen a case in the amount currently charged for a case under the same chapter. However, the Schedule provides that the fee is not charged for a reopening to permit a party to file a complaint to obtain a determination of dischargeability under *Rule 4007(b)*, or, (2) when a creditor is violating the terms of the discharge under *11 U.S.C. § 524*. The Schedule does not provide for automatic waiver of the fee when the debtor reopens to obtain a discharge after the case is closed without a discharge because the debtor did not complete a financial management course and the debtor later completes the course. Similarly, *Federal Rule of Bankruptcy Procedure 4007(b)* states that a case may be reopened without payment of a filing fee to obtain a determination of the dischargeability of a debt. The fee may also be waived by the court in appropriate circumstances, such as when the party seeking reopening is indigent or, if the reopening is by a trustee, the fee may be deferred pending discovery of additional assets.

FOOTNOTES:

(n1)Footnote 1. *In re Mullendore*, 741 F.2d 306 (10th Cir. 1984) (construing former Rule 515).

(n2)Footnote 2. *See In the Matter of Ayoub*, 72 B.R. 808 (Bankr. M.D. Fla. 1987) , in which a former trustee who had been discharged when the case was closed was held to have no cognizable interest in the case. *But see In re Stanke*, 11 C.B.C.2d 79, 41 B.R. 379 (Bankr. W.D. Mo. 1984) , in which the court held that under the Code and *Rule 5010* a former trustee was a party in interest who could move to reopen.

(n3)Footnote 3. *Matter of Chapman*, 55 F.2d 965 (N.D.N.Y. 1930) .

(n4)Footnote 4. *Matter of Chapman*, 55 F.2d 965 (N.D.N.Y. 1930) .

(n5)Footnote 5. *See 9 Collier on Bankruptcy*, P 5010.01 (Matthew Bender).

(n6)Footnote 6. Procedure in contested matters is discussed in ch. 32 *infra*.

(n7)Footnote 7. *Pollack v. Meyer Bros. Drug Co.*, 233 F 861 (8th Cir. 1916) .

(n8)Footnote 8. *Matter of Dixon*, 49 F. Supp. 977 (S.D. Ga. 1943) , *see Matter of Leigh*, 272 F. 678 (7th Cir. 1921) , *cert. denied*, 256 U.S. 698, 41 S. Ct. 537, 65 L. Ed. 1177 .

(n9)Footnote 9. The 1991 Advisory Committee Note to *Rule 5010* states that in most reopened cases, a trustee is not needed because there are no assets to be administered and that, in the interest of judicial economy, the rule was amended so that a trustee would not be appointed unless the United States trustee or a party in interest seeks the appointment of a trustee in the reopened case.



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CHAPTER 32 Litigation Procedures in Bankruptcy Cases

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CHAPTER 32 Litigation Procedures in Bankruptcy Cases

1-32 Collier Consumer Bankruptcy Practice Guide Scope

Scope

SCOPE NOTE

This chapter covers the procedures that are applicable to the resolution of disputes or potential disputes in a bankruptcy case. The chapter describes the rules that govern procedure in adversary proceedings and contested matters. Next, the chapter discusses the concept of notice and a hearing in bankruptcy cases. The chapter ends with a discussion of *in forma pauperis* bankruptcy proceedings.



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CHAPTER 32 Litigation Procedures in Bankruptcy Cases

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P 32.01 Introduction

The expanded jurisdiction of the bankruptcy court under the Bankruptcy Reform Act of 1978, as it was ultimately amended in 1984 with minor changes thereafter,ⁿ¹ brought into the federal bankruptcy forum the litigation of many disputes that previously were resolved in nonbankruptcy courts. In consumer bankruptcy cases, these disputes included claims of debtors against creditors and others under a variety of causes of action ranging from consumer protection statutes like unfair trade practices lawsⁿ² to the civil rights acts.ⁿ³

In addition, the expanded rights of debtors, such as rights to avoid liens and to deal with secured creditors in various ways through chapter 13, has increased greatly the number of other litigated matters in consumer bankruptcy cases.

MORE INFORMATION

See chapter 14 *supra* for discussion of dealing with secured creditors in chapter 13. See chapter 19 *supra* for discussion of objecting to claims of secured creditors. See chapter 18 *supra* for discussion of the avoiding powers of debtors.

There are several courses such litigation may follow, depending upon the type of proceeding involved. Generally, many of the most complex proceedings are litigated as adversary proceedings, essentially full-blown lawsuits initiated by complaints and subject to rules closely following the Federal Rules of Civil Procedure.ⁿ⁴ Most other litigated proceedings are classed as contested matters, which are usually initiated by motions or objections and which follow a somewhat truncated version of the adversary proceeding rules.ⁿ⁵ Yet other types of matters are handled through an even more streamlined process, providing notice of a proposed action and the opportunity to contest it.ⁿ⁶

FOOTNOTES:

(n1)Footnote 1. See 1 Collier on Bankruptcy, chs. 1-3 (Matthew Bender) for discussion of the evolution of bankruptcy jurisdiction since 1978.

(n2)Footnote 2. *E.g.*, *In re Fleet*, 95 B.R. 319 (E.D. Pa. 1989) (class action against mortgage counselors who referred clients to bankruptcy attorney committed unfair trade practices).

(n3)Footnote 3. *E.g.*, *Morris v. Philadelphia Electric Co.*, 45 B.R. 350 (E.D. Pa. 1984) .

(n4)Footnote 4. *See P 32.03 infra.*

(n5)Footnote 5. *See P 32.04 infra.*

(n6)Footnote 6. *See P 32.05 infra.*



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CHAPTER 32 Litigation Procedures in Bankruptcy Cases

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P 32.02 Connection of Proceedings to the Bankruptcy Case

The bankruptcy case itself is the legal proceeding initiated by the petition filed under chapter 7 or chapter 13. Adversary proceedings and contested matters are the mechanisms for resolving disputes that arise as the bankruptcy case is being administered by the court. To be within the jurisdiction of the bankruptcy court, a proceeding must be connected in some way to the bankruptcy case. A proceeding may arise in the bankruptcy case, under the Bankruptcy Code, or it may be related to the bankruptcy case.ⁿ¹ A proceeding within the scope of this bankruptcy jurisdiction may also be removed from another court for resolution as part of the bankruptcy case.ⁿ² However, like the jurisdiction of all federal courts, the bankruptcy court's jurisdiction is limited by the *Eleventh Amendment*.ⁿ³

Although the district court has jurisdiction over all bankruptcy cases and proceedings connected to bankruptcy cases, that jurisdiction is normally delegated to the bankruptcy court.ⁿ⁴ In most situations, this means that the bankruptcy court may enter a final order resolving a proceeding, but in certain cases that are less central to the administration of the bankruptcy case, which are designated as "non-core" proceedings, the bankruptcy court may only make recommendations to the district court unless the parties consent to a final order by the bankruptcy court.ⁿ⁵ In addition, the district court may withdraw proceedings or parts of proceedings from the bankruptcy court and resolve them in the district court,ⁿ⁶ or the court may abstain from hearing a proceeding.ⁿ⁷

Thus, all adversary proceedings and contested matters fall under the umbrella of the main bankruptcy case (or, occasionally, a number of bankruptcy cases.) The typical progression of the main bankruptcy case in chapter 7 and chapter 13 is discussed earlier,ⁿ⁸ and the most typical types of contested matters and adversary proceedings are discussed throughout this volume.

FOOTNOTES:

(n1)Footnote 1. *28 U.S.C. § 1334(b)*. See 1 *Collier on Bankruptcy*, P 3.01 (Matthew Bender).

(n2)Footnote 2. See 1 *Collier on Bankruptcy*, P 3.07 (Matthew Bender). 1 *Collier Bankruptcy Manual*, ch. 3 (Matthew Bender).

(n3)Footnote 3. See 1 *Collier Bankruptcy Manual* P 3.01[4][a] (Matthew Bender). 1 *Collier Bankruptcy Manual*, ch. 3 (Matthew Bender).

(n4)Footnote 4. See *28 U.S.C. § 157(a)*. See 1 *Collier on Bankruptcy*, P 3.02 (Matthew Bender). 1 *Collier*

Bankruptcy Manual, ch. 3 (Matthew Bender).

(n5)Footnote 5. *See* 1 *Collier on Bankruptcy*, P 3.02-. 03 (Matthew Bender). 1 Collier Bankruptcy Manual, ch. 3 (Matthew Bender).

(n6)Footnote 6. *See* 1 *Collier on Bankruptcy*, P 3.04 (Matthew Bender). 1 Collier Bankruptcy Manual, ch. 3 (Matthew Bender).

(n7)Footnote 7. *See* 1 *Collier on Bankruptcy*, P 3.05 (Matthew Bender). 1 Collier Bankruptcy Manual, ch. 3 (Matthew Bender).

(n8)Footnote 8. *See* chs. 1-2 *supra*.



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CHAPTER 32 Litigation Procedures in Bankruptcy Cases

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P 32.03 Procedure in Adversary Proceedings

As discussed below, the procedure in adversary proceedings closely follows that for civil actions in federal district court under the Federal Rules of Civil Procedure. Most of those Rules are incorporated by reference in correspondingly numbered adversary proceeding Rules which preface the civil rule number with the numbers 70. For example, *Federal Rule of Bankruptcy Procedure 7033* incorporates by reference *Federal Rule of Civil Procedure 33*.

Although it might appear that certain Federal Rules of Civil Procedure are not applicable to adversary proceedings because they are not incorporated in the Part VII adversary proceeding Rules, most of these Rules are also applicable because they are incorporated in the Part IX Rules applicable to all bankruptcy proceedings. For example, *Federal Rules of Civil Procedure 59* and *60* are incorporated by reference in *Federal Rule of Bankruptcy Procedure 9023* and *9024*.

There are, however, a few important deviations from the Federal Rules of Civil Procedure, which are discussed below.

[1] Proceedings that Must Be Brought as Adversary Proceedings

Federal Rule of Bankruptcy Procedure 7001 lists the types of proceedings that must be brought as adversary proceedings. They include proceedings to recover money or property, with a few limited exceptions.ⁿ¹ Thus, a debtor or trustee seeking the turnover of property or suing for damages must file an adversary proceeding to pursue those ends. Similarly, if an objection to a claim raises an affirmative counterclaim against the claimant, it must be brought as an adversary proceeding.

The second major category of proceedings includes efforts to determine the validity, priority, or extent of liens, other than those initiated by the debtor under the avoiding powers of section 522(f).ⁿ² This encompasses the trustee's avoiding powers, whether exercised by the trustee or by the debtor. It also encompasses proceedings raising defenses to secured claims that might reduce a lien. However, if the only issue raised in connection with a lien is valuation with respect to determining an allowed secured claim, that issue may be raised by a motion pursuant to *Federal Rule of Bankruptcy Procedure 3012*.

MORE INFORMATION

For discussion of the avoiding powers of the trustee and debtor see chapters 17 and 18, respectively. Also, see chapter 19 *supra* for discussion of determining allowed secured claims.

A proceeding to object to a discharge or to revoke a discharge, as well as a proceeding to determine the dischargeability of a debt, regardless of whether the dischargeability proceeding is brought by a creditor or the debtor, must be brought as an adversary proceeding.ⁿ³ Any attempt to obtain an injunction or other equitable relief must be brought as an adversary proceedingⁿ⁴ including, for example, attempts to enforce the automatic stay, the discharge injunction and protections against discrimination. An exception to this general rule exists, however, for injunctions that are sought as part of a plan.ⁿ⁵

MORE INFORMATION

See chapter 29 *supra* for discussion of objections to discharge and revocation of discharge. See chapter 26 *infra* for discussion of dischargeability proceedings. The automatic stay, discharge injunction and protections against discrimination are discussed in chapters 8, 29 and 30 *supra* respectively.

Other proceedings that must be brought under the adversary proceeding rules include proceedings to revoke confirmation of a plan, and proceedings to subordinate allowed claims or interest, except when subordination is provided for in a plan. Moreover, if a proceeding seeks a declaratory judgment with respect to an issue that is listed in *Rule 7001* it must be brought as an adversary proceeding,ⁿ⁶ and if a lawsuit is removed from another court, it remains a full-blown lawsuit under the adversary proceeding Rules.ⁿ⁷

PRACTICE NOTE

If a proceeding joins requests for relief listed in section 7001 with others that are not listed, the safest course of action is to file the proceeding as an adversary proceeding. Similarly, when in doubt about which type of proceeding to file, it is usually better to file an adversary proceeding, since an opposing party can hardly complain about being given the greater procedural protections available in an adversary proceeding.

[2] Initiation of Proceeding by Complaint

An adversary proceeding, like a federal civil action in district court is initiated by a complaint.ⁿ⁸ The caption of the complaint must state the names of the court, the names of the parties and the designation of the pleading as a complaint. The file number of the bankruptcy case within which the proceeding is being brought should be listed in the caption, and once the adversary proceeding file number is assigned by the court, copies of the complaint should be conformed to include that file number as well.ⁿ⁹

FORMS

For forms of captions in adversary proceedings see *Collier Consumer Bankruptcy Forms*, § CS26.02 (Matthew Bender).

The complaint must contain a short and plain statement of the grounds upon which the court's jurisdiction depends, along with a short and plain statement of the claim showing that the plaintiff is entitled to relief and a demand for the relief the plaintiff seeks.ⁿ¹⁰ Relief in the alternative or of several types may be demanded. In the statement of jurisdiction, the complaint must state whether the proceeding is core or non-core as defined by section 157 of title 28, and if it is non-core the complaint must state whether the plaintiff agrees to a final judgment being entered by the bankruptcy court.ⁿ¹¹

Each averment of the complaint should be simple, concise, and direct. If fraud is alleged, the circumstances constituting fraud must be stated with particularity or the complaint may be subject to a motion to dismiss.ⁿ¹² Averments should be made in separate numbered paragraphs, the contents of which should be limited as far as possible to a single set of

circumstances.ⁿ¹³ Each claim founded on a separate transaction or occurrence should be stated in a separate count.

If the complaint is not filed by the debtor or the trustee, a filing fee of \$150ⁿ¹⁴ must accompany the complaint when it is filed. The bankruptcy court also requires a form known as the Adversary Proceeding Cover Sheet, with certain information about the proceeding and the parties.

[3] Service of Complaint

When a complaint is filed, a summons is issued by the clerk.ⁿ¹⁵ One of the significant deviations from the Federal Rules of Civil Procedure is in the area of service of the complaint. Under *Federal Rule of Bankruptcy Procedure 7004*, in addition to methods of service provided in *Federal Rule of Civil Procedure 4*, a complaint may be served by first class mail addressed to a defendant anywhere in the United States.ⁿ¹⁶ If the defendant is not an individual, or is incompetent or an infant, *Rule 7004(b)* directs to whom the service should be addressed. For example, service on a corporation should be addressed to the attention of an officer, a managing or general agent, or another agent authorized to receive service.

If the complaint is served on a debtor represented by an attorney, it is important to note that the complaint must be served on both the debtor and the debtor's attorney.ⁿ¹⁷ Service on the debtor's attorney can be made by any means permitted under *Federal Rule of Civil Procedure 5(b)*, which may include electronic service.^{n17a} Special rules also apply to service upon an insured depository institution, which must be served by certified mail addressed to an officer of the institution, unless the institution has appeared by its attorney, in which case the attorney should be served.ⁿ¹⁸ Certified mail service is also not necessary if the institution has waived the right to it in writing and designated an officer to receive service, or if the court has so ordered after notice by certified mail of an application to serve papers by first class mail.ⁿ¹⁹

PRACTICE NOTE

The complaint and summons must be served within 14 days of the issuance of the summons.ⁿ²⁰ This is another important difference from the Federal Rules of Civil Procedure, which provide a much longer time, dictated by the need for prompt resolution of bankruptcy proceedings. Service within this time period is crucial, because the time to respond to the complaint runs from the date the summons is issued and not the date of service.ⁿ²¹ If the complaint and summons cannot be served within the 14 day period, the Clerk can be requested to issue a new summons. However, if the complaint and summons are not served within 120 days of the filing of the complaint, the court must dismiss the action or direct service within a specified time, unless there is good cause for the failure to make service.ⁿ²²

[4] Response to Complaint and Other Pleadings

The defendant must file a response to the complaint within 30 days of issuance of the summons, except if a different time is ordered by the court or if the defendant is the United States, which has 35 days to respond.ⁿ²³ Normally, the response will be an answer, but a defendant may instead file a motion to dismiss on the grounds listed in Federal Rule of Civil Procedure 12(b), which is incorporated in *Federal Rule of Bankruptcy Procedure 7012*.ⁿ²⁴ If no response is filed, the procedures for entry of a default judgment may be followed.ⁿ²⁵

If an answer is filed, each paragraph of the complaint must be admitted or denied.ⁿ²⁶ If the defendant alleges that the proceeding is non-core, it must also state whether it consents to a final judgment being entered by the bankruptcy court.ⁿ²⁷ Under *Federal Rule of Civil Procedure 8(b)*, as incorporated in *Rule 7008*, if a defendant does not have sufficient knowledge to form a belief as to whether an averment is true, the answer should so state and this has the effect of a denial. When only part of an averment is denied, the answer should state which part is admitted and which part is denied. Denials of averments may be general denials. Other than an averment of the amount of damage, if an averment

of the complaint is not denied it is deemed admitted.ⁿ²⁸

The general rules of pleading applicable to complaints discussed above apply equally to responsive pleadings, including the rules about captions and the manner of pleading facts and claims. Affirmative defenses, counterclaims and cross-claims should be included in the answer as applicable.ⁿ²⁹ When a defense has mistakenly been designated a counterclaim or vice-versa, the court will normally treat the pleading as if it were properly designated.ⁿ³⁰

Other pleadings may include a reply to a counterclaim or an answer to a cross-claim or a third party complaint against someone not already a party to the action.ⁿ³¹ The same rules of pleading apply to these pleadings as well. Pleadings may be amended under the same rules as in the district court.ⁿ³²

[5] Pretrial Proceedings and Discovery

Assuming the matter is not resolved on a motion to dismiss or a motion for judgment on the pleadings,ⁿ³³ the court may conduct a pretrial conference pursuant to *Federal Rule of Bankruptcy Procedure 7016*. The conference may consider scheduling of the proceeding, deadlines and procedures for discovery, possible stipulations, identification of witnesses and exhibits, and trial procedures, among many other topics listed in *Federal Rule of Civil Procedure 16*.ⁿ³⁴

Discovery may be conducted pursuant to the federal discovery rules.ⁿ³⁵ The right of a district to opt out of portions of the discovery rules was eliminated by the 2000 Amendments to the Federal Rules of Civil Procedure, which were automatically incorporated in the adversary proceeding rules.ⁿ³⁶

A motion for summary judgment may be filed by one or more parties. The procedure for summary judgment is the same as in the district court.ⁿ³⁷

[6] Trial and Post Trial Procedures

The federal rules for trials and judgments in civil proceedings are generally incorporated in the adversary proceeding Rules or other parts of the Federal Rules of Bankruptcy Procedure. For example, the procedures for subpoenas under *Federal Rule of Civil Procedure 45* are incorporated in *Federal Rule of Bankruptcy Procedure 9016*. *Federal Rule of Bankruptcy Procedure 9017* provides that the Federal Rules of Evidence and *Federal Rules of Civil Procedure 43, 44, and 44.1*, pertaining to taking testimony and proof at trial, apply in bankruptcy proceedings. Jury trials are governed by *Federal Rule of Bankruptcy Procedure 9015*, which makes the federal civil rules generally applicable, but also provides the procedure for consent to the trial being conducted by a bankruptcy judge.ⁿ³⁸

The procedures for entry of judgment, for challenging judgments, and for execution on judgments are also largely identical to those in the district court.ⁿ³⁹

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 7001(1)*. See 10 Collier on Bankruptcy, P 7001.02 (Matthew Bender).

(n2)Footnote 2. See 10 Collier on Bankruptcy, P 7001.03 (Matthew Bender).

(n3)Footnote 3. See 10 Collier on Bankruptcy, P 7001.05, .07 (Matthew Bender).

(n4)Footnote 4. See 10 Collier on Bankruptcy, P 7001.08 (Matthew Bender).

(n5)Footnote 5. See 10 Collier on Bankruptcy, P 7001.08 (Matthew Bender).

(n6)Footnote 6. See 10 Collier on Bankruptcy, P 7001.10 (Matthew Bender).

- (n7)Footnote 7. *See* 10 *Collier on Bankruptcy*, P 7001.11 (Matthew Bender).
- (n8)Footnote 8. *Fed. R. Bankr. P. 7003*.
- (n9)Footnote 9. *Fed. R. Bankr. P. 7010*, incorporating *Fed. R. Civ. P. 10(a)*.
- (n10)Footnote 10. *Fed. R. Bankr. P. 7008*, incorporating *Fed. R. Civ. P. 8(a)*. *See* 10 *Collier on Bankruptcy*, P 7008.02 (Matthew Bender).
- (n11)Footnote 11. *Fed. R. Bankr. P. 7008(a)*. *See* 10 *Collier on Bankruptcy*, P 7008.02 (Matthew Bender).
- (n12)Footnote 12. *Fed. R. Bankr. P. 7009*, incorporating *Fed. R. Civ. P. 9(b)*. *See* 10 *Collier on Bankruptcy*, P 7009.03 (Matthew Bender).
- (n13)Footnote 13. *Fed. R. Bankr. P. 7010*, incorporating *Fed. R. Civ. P. 10(b)*. *See* 10 *Collier on Bankruptcy*, P 7010.04 (Matthew Bender).
- (n14)Footnote 14. *See* Judicial Conference Bankruptcy Court Miscellaneous Fee Schedule, Item 6, *reprinted in* 1 *Collier on Bankruptcy*, Ch. App. 9 (Matthew Bender)
- (n15)Footnote 15. *Fed. R. Bankr. P. 7004*, incorporating *Fed. R. Civ. P. 4(a)*. *See* 10 *Collier on Bankruptcy*, P 7004.02 (Matthew Bender).
- (n16)Footnote 16. *Fed. R. Bankr. P. 7004(b), (d)*. *See* 10 *Collier on Bankruptcy*, P 7004.03-. 04 (Matthew Bender).
- (n17)Footnote 17. *Fed. R. Bankr. P. 7004(g)*.
- (n18)Footnote 17a. *Id.*
- (n19)Footnote 18. *Fed. R. Bankr. P. 7004(h)*. *See* 10 *Collier on Bankruptcy*, P 7004.09 (Matthew Bender).
- (n20)Footnote 19. *Fed. R. Bankr. P. 7004(h)*. *See* 10 *Collier on Bankruptcy*, P 7004.09 (Matthew Bender).
- (n21)Footnote 20. *Fed. R. Bankr. P. 7004(e)*. *See* 10 *Collier on Bankruptcy*, P 7004.06 (Matthew Bender).
- (n22)Footnote 21. *Fed. R. Bankr. P. 7012(a)*.
- (n23)Footnote 22. *Fed. R. Civ. P. 4(m)*, incorporated in *Fed. R. Bankr. P. 7004*.
- (n24)Footnote 23. *Fed. R. Bankr. P. 7012(a)*. *See* 10 *Collier on Bankruptcy*, P 7012.03 (Matthew Bender).
- (n25)Footnote 24. *See* 10 *Collier on Bankruptcy*, P 7012.04 (Matthew Bender).
- (n26)Footnote 25. *Fed. R. Bankr. P. 7055*. *See* 10 *Collier on Bankruptcy*, ch. 7055 (Matthew Bender).
- (n27)Footnote 26. *Fed. R. Bankr. P. 7008*, incorporating *Fed. R. Civ. P. 8(b)*.
- (n28)Footnote 27. *Fed. R. Bankr. P. 7012(b)*.
- (n29)Footnote 28. *Fed. R. Civ. P. 8(d)* as incorporated in *Fed. R. Bankr. P. 7008*.
- (n30)Footnote 29. *Fed. R. Civ. P. 8(c)*, as incorporated in *Fed. R. Bankr. P. 7008* and 7013.
- (n31)Footnote 30. *Fed. R. Civ. P. 8(c)*, incorporated in *Fed. R. Bankr. P. 7008*.

(n32)Footnote 31. *Fed. R. Bankr. P. 7007*, incorporating *Fed. R. Civ. P. 7*. See 10 Collier on Bankruptcy, ch. 7007 (Matthew Bender).

(n33)Footnote 32. *Fed. R. Bankr. P. 7015*. See 10 Collier on Bankruptcy, ch. 7015 (Matthew Bender).

(n34)Footnote 33. A motion for judgment on the pleadings is authorized by *Fed. R. Bankr. P. 7012*, incorporating *Fed. R. Civ. P. 12(c)*. See 10 Collier on Bankruptcy, P 7012.05 (Matthew Bender).

(n35)Footnote 34. See 10 Collier on Bankruptcy, ch. 7016 (Matthew Bender).

(n36)Footnote 35. *Fed. R. Bankr. P. 7026-7037*, incorporating *Fed. R. Civ. P. 26-37*.

(n37)Footnote 36. [Reserved.]

(n38)Footnote 37. *Fed. R. Bankr. P. 7056*, incorporating *Fed. R. Civ. P. 56*. See 10 Collier on Bankruptcy, ch. 7056 (Matthew Bender).

(n39)Footnote 38. See 10 Collier on Bankruptcy, ch. 9015 (Matthew Bender).

(n40)Footnote 39. *Fed. R. Bankr. P. 7052-7070, 9021-9024*.



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CHAPTER 32 Litigation Procedures in Bankruptcy Cases

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P 32.04 Procedure in Contested Matters

Virtually all disputes that are not classified as adversary proceedings by *Rule 7001* are considered contested matters to be resolved pursuant to *Federal Rule of Bankruptcy Procedure 9014*. Usually these disputes are triggered by a motion or an objection raising the issues involved. Such motions and objections are provided for specifically in many parts of the Federal Rules of Bankruptcy Procedure, such as *Rule 4003(d)*, providing for a motion to avoid a lien under section 522(f) and *Rule 4003(b)*, providing for an objection to the debtor's claim of exemptions. These Rules often provide specific guidance on particular types of contested matters.

In general, contested matters are governed by a large subset of the adversary proceeding rules, with certain rules omitted in the interest of providing for a more expedited procedure. However, the procedure for contested matters is to a large extent governed by local rules and practices, which vary greatly.

[1] Initiation of Contested Matter

Usually, a contested matter is initiated by a motion or an objection. If the matter originates in a request for an order from the court, that request is normally in the form of a motion, unless it is one of several types of proceedings referred to as an application in the Rules, such as an application to pay the filing fee in installments.ⁿ¹ Other contested matters are initiated by an objection, usually to something filed or proposed by another party, such as an objection to a claim,ⁿ² or an objection to a proposed sale or abandonment of property by the trustee.ⁿ³

A motion must state with particularity the grounds upon which it is brought and the relief or order it seeks.ⁿ⁴ It must have the caption of the main bankruptcy case and include a designation of the type of relief sought. It normally should state the jurisdiction of the court to hear the motion and may include attached supporting documents as exhibits.

FORMS

For forms of captions see *Collier Consumer Bankruptcy Forms*, § CS26.02 (Matthew Bender).

The motion must be signed by at least one attorney of record, in that attorney's individual name, with that attorney's office address and direct telephone number.ⁿ⁵ If the motion is not signed, it will be stricken, unless it is promptly signed after the attorney whose signature is required is notified of the omission. However, only the original motion must be signed. Any copies served on other parties need not be signed, or may be photocopies of the original signed

document. In either case, the copies should indicate by whom the original was signed because the copies must conform to the original.

Many courts have local rules requiring other documents to be filed with the motion, such as a proposed order granting the relief sought by the motion or a cover sheet giving the clerk information about the motion, the parties, or similar matters. Virtually all courts require a notice of motion stating the nature of the motion and how it may be opposed, as well as any scheduled hearing date, to be sent with the motion or sent to some parties who are not served with the motion itself, and a certification of service of the motion.^{n5a} Some courts require a motion to be accompanied by a memorandum of law supporting the motion.

Generally a motion need not be verified. However, some courts by local rule require a motion to be accompanied by supporting affidavits.

For a few types of motions, such as a motion for relief from the automatic stay or a motion for abandonment of property, the motion must be accompanied by a filing fee.ⁿ⁶

If a contested matter is initiated by an objection rather than a motion, all of the above principles usually apply and, again, special requirements established by particular rules of bankruptcy procedure or by local rules must also be met.

[2] Service and Notice of Motion or Objection

Unless the motion is one which may be considered *ex parte*, it must be served on the trustee or debtor in possession and on any other entity specified in the Rules or as the court directs.ⁿ⁷ Implicitly, and perhaps obviously, the motion should also be served on the party that is the target of the relief sought.

Rule 9014 incorporates *Federal Rule of Bankruptcy Procedure 7004*, so service must be carried out in the same manner as in an adversary proceeding, although there is no summons to be served with the motion.ⁿ⁸ Bankruptcy Official Form 20A sets forth the form for notice of a motion, although the form of notice is sometimes modified by local rules. Local rules determine what papers, in addition to the motion and a notice of the motion, are served. Official Form 20B is to be used for notice of an objection to a claim. Some local rules may require a notice of a hearing to be served, or information about how to request a hearing to oppose the motion. *Rule 9006(d)* provides that, unless the court orders otherwise, a written motion and notice of a hearing on a motion may not be served later than five days before the date of the hearing. Service is complete upon mailing.ⁿ⁹

[3] Response to Motion

Federal Rule of Bankruptcy Procedure 9014 provides that no response to a motion is required unless the court directs. Many courts by local rule or practice do require a response to a motion to be filed and treat the contested matter as uncontested if none is filed, granting the motion by default without a hearing, notwithstanding the applicability to contested matters of *Federal Rule of Bankruptcy Procedure 7055* governing default judgments. Others require that a request for a hearing be filed or that a party opposing the motion initiate the process of scheduling a hearing.

If a response is to be filed, local rules may set a deadline for filing. Local rules may also require that the response be accompanied by other documents, such as a proposed order denying the motion, a certification of service, supporting affidavits, or a memorandum of law. *Federal Rule of Bankruptcy Procedure 9006(d)* requires that affidavits in opposition to a motion be filed at least one day before a hearing, but local rules may set a different deadline.

The answer to the motion or objection should be headed by the caption of the case and the title of the document, identifying the paper to which it is responding. The answer should controvert factual and legal allegations in the motion or objection and set forth other averments of the responding party relevant to the subject matter of the motion. It should

also include a demand for the relief requested, usually, a denial of the motion or objection. However, because *Federal Rule of Bankruptcy Procedure 7008* is not incorporated in *Rule 9014*, it is not clear whether the averments of the motion or objection must be admitted or denied on a paragraph by paragraph basis as in an answer to a complaint or that facts not denied are automatically deemed admitted.

Because *Rule 9014* does not incorporate by reference *Federal Rule of Bankruptcy Procedure 7012*, a motion to dismiss a motion or objection is probably not permitted, although obviously the grounds for dismissal may be included in an answer to the motion or objection. Similarly, because *Rule 9014* does not incorporate *Rule 7013*, counterclaims and cross-claims are not appropriate, although the existence of such claims may certainly be pleaded and considered.

The answer to the motion or objection must be signed by at least one attorney of record, in that attorney's individual name, with that attorney's office address and direct telephone number.ⁿ¹⁰ If the answer is not signed, it will be stricken, unless it is promptly signed after the attorney whose signature is required is notified of the omission. However, only the original document must be signed. Any copies served on other parties need not be signed, or may be photocopies of the original signed document. In either case, the copies should indicate by whom the original was signed because the copies must conform to the original.

Usually, no verification of an answer is required, but local rules may require supporting affidavits. The answer must be filed with the court and served on the moving party and, usually, other parties to the motion or parties designated by local rules.

[4] Prehearing Procedure and Discovery

Federal Rule of Bankruptcy Procedure 9014 incorporates the adversary proceeding discovery rules, giving the parties to a motion or objection the full panoply of federal discovery procedures. However, since a hearing on a motion is usually scheduled quite quickly, there is often little time in which to conduct discovery. Although *Rule 9014* provides that *Federal Civil Rule of procedure 26(a)(1), (a)(2), (a)(3), and (f)* are not applicable in contested matters, thereby eliminating the requirements for pretrial disclosure and a discovery planning conference, the short time-frame for a routine contested matter still may render the normal discovery deadlines infeasible.

As a practical matter, if a motion or objection is to be litigated, the parties will usually agree to postpone the hearing and set a period for discovery, or the court will set a discovery period and a later hearing date. However, local practices in this regard vary, especially with respect to motions for relief from the automatic stay which must be decided expeditiously. Some courts put a premium on disposing of almost every motion within a few weeks after it is filed. If this is the local practice, an order permitting expedited discovery must be sought.

Theoretically, a motion for summary judgment may be filed in a contested matter, since *Rule 7056* is made applicable by *Rule 9014*. However, this rarely occurs.

[5] Trial and Post Trial Matters

The procedures for trial and post-trial proceedings in contested matters are essentially the same as those in adversary proceedings.ⁿ¹¹ Generally, the moving party has the burden of proof, although the Bankruptcy Code or the Bankruptcy Rules may provide otherwise, as in the case of a motion for relief from the automatic stay, in which the party opposing relief has the burden of proof on many issues.ⁿ¹² A few courts decide motions based upon affidavits submitted by the parties, which may be done upon agreement of the parties,ⁿ¹³ but most courts require live testimony on disputed issues, heard under the Federal Rules of Evidence. Because local procedures vary, the court is required to provide a mechanism to enable attorneys at a reasonable time before a scheduled hearing to ascertain whether the hearing will be one at which witnesses may testify.ⁿ¹⁴

However, unlike under *Federal Rule of Bankruptcy Procedure* 7062, most orders entered in contested matters are effective immediately. Exceptions to this rule, unless the court orders otherwise, are orders granting relief from an automatic stay,ⁿ¹⁵ orders confirming chapter 11 plans,ⁿ¹⁶ orders authorizing the use, sale or lease of property other than cash collateral,ⁿ¹⁷ and orders authorizing the assignment of executory contracts.ⁿ¹⁸ These orders are normally stayed for ten days to permit time to seek a stay pending appeal.

FOOTNOTES:

(n1)Footnote 1. *Fed. R. Bankr. P. 9013*.

(n2)Footnote 2. *Fed. R. Bankr. P. 3007*.

(n3)Footnote 3. [reserved]

(n4)Footnote 4. *Fed. R. Bankr. P. 9013*. See 10 *Collier on Bankruptcy*, P 9013.03 (Matthew Bender).

(n5)Footnote 5. *Fed. R. Bankr. P. 9011(a)*.

(n6)Footnote 5a. Ordinarily, this notice is Official Form 20A, *reprinted at Collier Forms Manual* § 29.06.

(n7)Footnote 6. For the Federal Judicial Conference Bankruptcy Court Miscellaneous Fee Schedule, see 1 *Collier on Bankruptcy*, Ch. App. 9 (Matthew Bender).

(n8)Footnote 7. *Fed. R. Bankr. P. 9013*. See 10 *Collier on Bankruptcy*, P 9013.04 (Matthew Bender).

(n9)Footnote 8. See P 32.03 *supra*

(n10)Footnote 9. *Fed. R. Bankr. P. 9006(e)*.

(n11)Footnote 10. *Fed. R. Bankr. P. 9011(a)*.

(n12)Footnote 11. *Fed. R. Bankr. P. 9014(d)*. See P 32.03[5] *supra*.

(n13)Footnote 12. 11 U.S.C. § 362(g). See P 10.05 *supra*.

(n14)Footnote 13. See Advisory Committee Comment to the 2002 Amendments to *Rule 9014*.

(n15)Footnote 14. *Fed. R. Bankr. P. 9014(e)*. See *Delaney-Morin v. Day* (*In re Delaney-Morin*), 304 B.R. 365 (B.A.P. 9th Cir. 2003) (reversing order granting relief from automatic stay because debtor, who was not present at the hearing and who had been informed that the hearing was to be non-evidentiary, did not have opportunity to respond to new allegations not made in the motion served upon her).

(n16)Footnote 15. *Fed. R. Bankr. P. 4001(a)(3)*.

(n17)Footnote 16. *Fed. R. Bankr. P. 3020(e)*.

(n18)Footnote 17. *Fed. R. Bankr. P. 6004(g)*.

(n19)Footnote 18. *Fed. R. Bankr. P. 6006(d)*.



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CHAPTER 32 Litigation Procedures in Bankruptcy Cases

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P 32.05 Procedure for Actions to Be Taken After Notice and a Hearing

The phrase "after notice and a hearing" appears frequently in the Bankruptcy Code and in the Federal Rules of Bankruptcy Procedure. It is defined at *section 102(1) of the Bankruptcy Code* as authorizing an act to be taken without an actual hearing if appropriate notice has been given to the appropriate entities and either no one has requested a hearing or the court has authorized the act because there is insufficient time for a hearing.ⁿ¹

Many acts authorized to be taken after notice and a hearing are brought about by motions heard under the procedures outlined above for contested matters and after a court order authorizing them. For example, under *section 362(d) of the Bankruptcy Code* relief from the automatic stay may be granted after notice and a hearing, and *Rule 4001(a) of the Federal Rules of Bankruptcy Procedure* provides that such relief is sought by filing a motion.

Other types of acts may be taken without a court order, provided that appropriate notice is given and the entities who are given notice have the opportunity for a hearing. For example, under *Federal Rule of Bankruptcy Procedure 6004* a trustee may sell property without the necessity of a court order authorizing the sale, if the trustee gives the required notice of the sale and no objection to the sale is filed.ⁿ²

If an objection to a noticed action is filed, the matter then becomes a contested matter to be decided by the court, and a court order resolving the objection is necessary.

FOOTNOTES:

(n1)Footnote 1. *See 2 Collier on Bankruptcy, P 102.02* (Matthew Bender); *1 Collier Bankruptcy Manual, P 102.02* (Matthew Bender).

(n2)Footnote 2. *See 10 Collier on Bankruptcy, P 6004.01* (Matthew Bender).



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CHAPTER 32 Litigation Procedures in Bankruptcy Cases

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P 32.06 *In Forma Pauperis* Proceedings in Bankruptcy Cases.

Section 1930(f), added in 2005,ⁿ¹ codified the rights of debtors and creditors with respect to *in forma pauperis* bankruptcy proceedings.ⁿ² Many courts had accepted the principle that bankruptcy proceedings, other than the filing of the actual bankruptcy petition, could be instituted *in forma pauperis*. For Chapter 7 debtors whose income is less than 150 percent of the official poverty line for the applicable family size and who are unable to pay in installments, the district court or bankruptcy courtⁿ³ may waive the filing fee.ⁿ⁴ Waiver of the fee is sought by filing Official Form 3B with the petition.^{n4a} Further, for such debtors the court may waive the fee required for certain notices or orders allowing appeal and other miscellaneous fees required by the Judicial Conference Fee Schedule.ⁿ⁵

In addition to relief for indigent Chapter 7 debtors, section 1930(f)(3) permits the district court or bankruptcy court to waive, in accordance with Judicial Conference policy, fees for other debtors or creditors. Presumably, this permissive waiver could extend to Chapter 7 debtors whose income is above the threshold 1930(f)(1), as well as Chapter 13 debtors. Such waivers also may apply to indigent creditors.ⁿ⁶ The costs of an appeal may likewise be waived if the appeal is not frivolous.ⁿ⁷

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n2)Footnote 2. The enactment of 1930(f) partially overrules *United States v. Kras*, 409 U.S. 434, 93 S. Ct. 631, 34 L. Ed. 2d 626 (1973), in which the Supreme Court held that due process does not require a right to waiver of the basic bankruptcy filing fee for indigents. See, e.g., *In re Lindsey*, 178 B.R. 895 (Bankr. N.D. Ga. 1995); *In re Brooks*, 175 B.R. 409 (Bankr. S.D. Ala. 1994); *In re Melendez*, 153 B.R. 386 (Bankr. D. Conn. 1993); *In re McGinnis*, 155 B.R. 294 (Bankr. D.N.H. 1993).

(n3)Footnote 3. The bankruptcy court is specifically authorized to waive fees under the provisions of § 1930(f), thus resolving conflicting case law regarding the authority of the bankruptcy court to waive fees.

(n4)Footnote 4. Section 1930(f)(1) defines "filing fee" as certain fees "payable to the clerk upon commencement of a case under chapter 7."

(n5)Footnote 4a. Official Form 3a is *reprinted at* Collier Consumer Forms Manual § CS10.02.

(n6)Footnote 5. 28 U.S.C. 1930(f)(2). The Judicial Conference Bankruptcy Court Miscellaneous Fee Schedule is reproduced at 1 Collier on Bankruptcy, Ch. App. 9 (Matthew Bender).

(n7)Footnote 6. See *Tripati v. Eastern Dist. of Tex.*, 180 B.R. 160 (E.D. Tex. 1995) (constitution requires that an indigent creditor "be afforded an opportunity to be heard before his claims are disposed of").

(n8)Footnote 7. 28 U.S.C. 1915(a). See *In re Perry*, 223 B.R. 167 (B.A.P. 8[th] Cir. 1998)(in forma pauperis status denied for bad faith appeal).



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CHAPTER 33 Appeals in Bankruptcy Cases

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CHAPTER 33 Appeals in Bankruptcy Cases

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Scope

SCOPE NOTE

This chapter covers appeals in bankruptcy cases. The chapter examines the various routes that appeals may take. Next, the chapter outlines the procedure to be followed in appeals from the bankruptcy court. The chapter then reviews the procedures required for direct appeals to the circuit court of appeals. Finally, the chapter describes the procedure for litigating an appeal from a district court or a bankruptcy appellate panel.



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CHAPTER 33 Appeals in Bankruptcy Cases

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P 33.01 Introduction

The appellate system in bankruptcy cases is one that is unique in the federal courts. The bankruptcy court is a unit of the district court, with limited jurisdiction, so cases are handled in distinct manners in different parts of the country; the district courts and circuit courts of appeal control the types of appeals that are available. Parties must consent to final judgments by bankruptcy judges, who are not Article III judges, so these parties often have a choice of appellate routes for their cases.

Initial appeals from decisions of the bankruptcy courtsⁿ¹ may be heard by a three-judge bankruptcy appellate panel, the district court, or, in limited circumstances, the circuit court of appeals. A bankruptcy appellate panel may hear an appeal only if it has been authorized to do so in the judicial district in which the matter is pending, and if the parties consent. Consent is inferred from the silence of the parties. New section 158(d)(2), enacted in 2005,ⁿ² permits the court of appeals to hear an appeal directly from the bankruptcy court if the decision involves a question of law for which there is no controlling decision, involves a matter of public importance, involves a question of law requiring resolution of conflicting decisions or materially advances the progress of the case. The circuit court of appeals also hears appeals from either a district court or from a bankruptcy appellate panel.

Appeals from the bankruptcy court are governed by Part VIII of the Federal Rules of Bankruptcy Procedure, which are similar to the Federal Rules of Appellate Procedure but follow a more expedited schedule. Appeals from the district court, in cases withdrawn to the district court as well as in cases in which the district court rather than the bankruptcy court enters the final judgment, are heard by the circuit court of appeals.

FOOTNOTES:

(n1)Footnote 1. The review by a district court of a non-core matter, in which a bankruptcy judge makes recommended findings, is not considered an appeal. It is governed by *Fed. R. Bankr. P. 9033*. See 10 Collier on Bankruptcy, ch. 9033 (Matthew Bender). As discussed below, the judgment of the district court in such a matter is reviewed by a court of appeals under the Federal Rules of Appellate Procedure.

(n2)Footnote 2. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.



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CHAPTER 33 Appeals in Bankruptcy Cases

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P 33.02 Appellate Structure for Appeals from the Bankruptcy Court

[1] Establishment of Bankruptcy Appellate Panels

The district courtⁿ¹ is the usual forum for appeals from decisions of a bankruptcy court. However, an alternative route for appeals is available in some judicial districts. An appeal that would otherwise go to the district court may be heard by an appellate panel of three bankruptcy judgesⁿ² if all of the following conditions are met:

- the judicial council of the circuit has established a bankruptcy appellate panel service;ⁿ³
- the district judges for the district, by majority vote, authorize referral of appeals from that district to the appellate panel service;ⁿ⁴ and
- all parties consent.ⁿ⁵

Most courts have held that decisions of a bankruptcy appellate panel, like decisions of one district judge in a multi-judge district, are not binding on bankruptcy courts in the same circuit.ⁿ⁶

With respect to the first and second requirements, some circuit courts of appeals have established appellate panels, and within those circuits some, but not all, of the judicial districts have authorized appeals to such panels. Currently, Bankruptcy Appellate Panel Services have been established in the First, Sixth, Eighth, Ninth and Tenth Circuits. The panels established hear cases from some or all of the districts in the circuit. The First Circuit panel hears appeals from all districts in the circuit. The Sixth Circuit appellate panel hears appeals arising only in the Northern and Southern Districts of Ohio and the Western District of Tennessee. The Eighth Circuit panel hears appeals arising anywhere in the circuit except the districts of North Dakota and South Dakota. The Ninth Circuit panel hears appeals from every district in the circuit. The Tenth Circuit's panel hears appeals arising throughout the circuit except for those arising in the District of Colorado.

[2] Method of Determining Whether Parties Consent to Bankruptcy Appellate Panel

The Bankruptcy Reform Act of 1994 contained several amendments designed to encourage, but not require, the use of bankruptcy appellate panels, now referred to as a judicial circuit's "bankruptcy appellate panel service."ⁿ⁷

Under section 158(c) of title 28, if a bankruptcy appellate panel may hear an appeal, the parties must consent to the panel hearing it. If the appellant elects to go to district court instead, this election must be made in a separate written statement filed at the time of filing the appeal.ⁿ⁸ The appellee may elect to go to district court up to 30 days after service of the notice of appeal.ⁿ⁹ If neither party affirmatively elects to go to district court, the parties are deemed to have consented to a bankruptcy appellate panel hearing the appeal.

FORMS

Official Form 17, Notice of Appeal, is reprinted in *Collier Consumer Bankruptcy Forms, Form CS3.02-1* (Matthew Bender).

[3] Orders that May Be Appealed from the Bankruptcy Court

[a] Final Orders

An appeal from the bankruptcy court may be taken with respect to any final order. There is often a dispute regarding whether a particular order is a final order. There is no statutory provision explaining what is or is not a final order, judgment, or decree, but a wealth of case law does exist. A final order is "one which ends the litigation ... and leaves nothing for the court to do but execute the judgment."ⁿ¹⁰

Generally, the courts of appeal agree that orders granting or denying injunctions, including orders granting or denying relief from the automatic stay, and orders conferring rights in specific property are appealable.ⁿ¹¹ Similarly, a district court order reversing a final order of the bankruptcy court is appealable, unless further factual development is necessary.ⁿ¹² The circuit courts have also considered as final orders an order to produce allegedly privileged materials,ⁿ¹³ a district court's reversal of an order denying a right to intervene in a proceedingⁿ¹⁴ or an order dismissing a dischargeability proceeding,ⁿ¹⁵ an order confirming a debtor's plan,ⁿ¹⁶ an order for relief in an involuntary case,ⁿ¹⁷ an order dismissing an involuntary bankruptcy petition,ⁿ¹⁸ an order granting priority status,ⁿ¹⁹ an order avoiding a transfer,ⁿ²⁰ an order granting or dismissing a complaint seeking a determination as to ownership of property,ⁿ²¹ an order disallowing an exemption,ⁿ²² an order fixing the amount of a creditor's claims,ⁿ²³ and an order of a district court erroneously concluding that it has no jurisdiction to review a final order of a bankruptcy court.ⁿ²⁴

Other orders which have been held final include an order confirming a judicial sale of property of the estate,ⁿ²⁵ an order regarding obligations upon rejection of a lease,ⁿ²⁶ an order holding that a debtor could not designate how payments to the IRS should be credited,ⁿ²⁷ an order determining that a lease had not been properly terminated,ⁿ²⁸ and a decision to abstain from hearing personal injury claims against the debtor.ⁿ²⁹

There is an apparent split in authority over whether the refusal to confirm a plan, when the case is not dismissed, is appealable.ⁿ³⁰ An order denying a trustee's motion to convert a case from chapter 13 to chapter 7 has been held nonappealable,ⁿ³¹ as has a district court decision reversing a summary judgment order in favor of a creditor defendant in a preference action,ⁿ³² an order denying summary judgment,ⁿ³³ an order holding a landlord to be adequately protected,ⁿ³⁴ orders remanding cases for further consideration, unless the remand is for the bankruptcy court to perform purely ministerial tasks,ⁿ³⁵ an order refusing to withdraw the reference,ⁿ³⁶ an order setting a trial date,ⁿ³⁷ an order denying approval of a settlement agreement,ⁿ³⁸ an order dismissing one count of a counterclaim,ⁿ³⁹ an order denying a motion to dismiss,ⁿ⁴⁰ and an order denying a stay of state court proceedings to a bankruptcy debtor's codefendant.ⁿ⁴¹

Other orders which have been held nonfinal include interlocutory sanctions orders,ⁿ⁴² an order granting a jury trial in the bankruptcy court,ⁿ⁴³ an order denying motions to compel trustee performance,ⁿ⁴⁴ an order dismissing a claim for punitive damages,ⁿ⁴⁵ an order permitting a prejudgment attachment and the equivalent of a *lis pendens*,ⁿ⁴⁶ an order rejecting an assertion of sovereign immunity,ⁿ⁴⁷ an order granting a stay pending appeal,ⁿ⁴⁸ and an order extending time for filing complaints objecting to a chapter 7 discharge.ⁿ⁴⁹

[b] Interlocutory Orders

An appeal may also be taken, from an interlocutory order with leave of the court.ⁿ⁵⁰ However, it takes exceptional circumstances to justify an interlocutory appeal,ⁿ⁵¹ especially given the right to move for withdrawal of a proceeding to the district court prior to the bankruptcy court's decision.ⁿ⁵² It is clear that unlike the district court, the bankruptcy court does not have the power to certify an interlocutory order for immediate appeal.ⁿ⁵³ And once an appeal is taken to district court, the district court may not function as a trial level bankruptcy court and presumably may not withdraw the reference.ⁿ⁵⁴

FOOTNOTES:

(n1)Footnote 1. 28 U.S.C. § 158(a). The district court may not refer a bankruptcy appeal to a magistrate. *Virginia Beach Federal Sav. & Loan Ass'n v. Wood*, 901 F.2d 849 (10th Cir. 1990) (magistrates not permitted to enter final decisions in bankruptcy appeals); *Minerex Erdoel, Inc. v. Sina, Inc.*, 838 F.2d 781, 18 C.B.C.2d 510 (5th Cir. 1988) ; *Matter of Elcona Homes Corp.*, 810 F.2d 136, 16 C.B.C.2d 327 (7th Cir. 1987) . *But see Hall v. Vance*, 887 F.2d 1041 (10th Cir. 1989) (bankruptcy appeal may be referred to magistrate for advisory hearing as long as district court reserves to itself the power to make a final decision).

(n2)Footnote 2. A single judge of the appellate panel may not determine the appeal alone. *In re Caiati*, 842 F.2d 1135 (9th Cir. 1988) .

(n3)Footnote 3. 28 U.S.C. § 158(b)(1).

(n4)Footnote 4. 28 U.S.C. § 158(b)(2).

(n5)Footnote 5. 28 U.S.C. § 158(b)(1).

(n6)Footnote 6. *In re Carrozzella & Richardson*, 255 B.R. 267 (Bankr. D. Conn. 2000) .

(n7)Footnote 7. 28 U.S.C. § 158(b)(1).

(n8)Footnote 8. 28 U.S.C. § 158(c)(1)(A); *Fed. R. Bankr. P. 8001(e)*. *See In re Sullivan Jewelry, Inc.*, 218 B.R. 439 (B.A.P. 8th Cir. 1998) (statement in notice of appeal that appeal was to district court did not satisfy requirement of separate written statement); *In re Ioane*, 227 B.R. 181 (B.A.P. 9th Cir. 1998) (statement of election filed after notice of appeal not timely even though notice of appeal was premature and was not deemed filed until date of judgment, which was after statement of election); *In re County of Orange*, 183 B.R. 593 (Bankr. 9th Cir. 1995) .

(n9)Footnote 9. 28 U.S.C. § 158(c)(1)(B).

(n10)Footnote 10. *Catlin v. United States*, 324 U.S. 229, 65 S. Ct. 631, 89 L. Ed. 911 (1945) . *See 1 Collier on Bankruptcy*, P 5.07 (Matthew Bender).

(n11)Footnote 11. *See, e.g., FRG, Inc. v. Manley*, 919 F.2d 850, 24 C.B.C.2d 40 (3d Cir. 1990) (order equivalent to denial of motion for relief from stay).

(n12)Footnote 12. *E.g., In re Gardner*, 810 F.2d 87, 16 C.B.C.2d 349 (6th Cir. 1987) .

(n13)Footnote 13. *Matter of International Horizons, Inc.*, 689 F.2d 996, 7 C.B.C.2d 584 (11th Cir. 1982) .

(n14)Footnote 14. *In re Benny*, 791 F.2d 712, 14 C.B.C.2d 1244 (9th Cir. 1986) ; *Matter of Marin Motor Oil, Inc.*, 689 F.2d 445, 7 C.B.C.2d 470 (3d Cir. 1982) .

(n15)Footnote 15. *In re Dominguez*, 51 F.3d 1502, 33 C.B.C.2d 568 (9th Cir. 1995) .

- (n16)Footnote 16. *See In re Maiorino*, 691 F.2d 89, 7 C.B.C.2d 524 (2d Cir. 1982) .
- (n17)Footnote 17. *In re Mason*, 709 F.2d 1313, 9 C.B.C.2d 115 (9th Cir. 1983) .
- (n18)Footnote 18. *In re Sweet Transfer & Storage, Inc.*, 896 F.2d 1189 (9th Cir. 1990) .
- (n19)Footnote 19. *In re Olson*, 730 F.2d 1109 (8th Cir. 1984) ; *In re Saco Local Dev. Corp.*, 711 F.2d 441, 8 C.B.C.2d 1093 (1st Cir. 1983) .
- (n20)Footnote 20. *Matter of Allen*, 816 F.2d 325 (7th Cir. 1987) ; *In re Sandy Ridge Oil Co.*, 807 F.2d 1332, 15 C.B.C.2d 1234 (7th Cir. 1987) .
- (n21)Footnote 21. *Commerce Bank v. Mountain View Village, Inc.*, 5 F.3d 34, 29 C.B.C.2d 1241 (3d Cir. 1993) (order determining that rents were not property of the estate).
- (n22)Footnote 22. *E.g., In re Slimick*, 928 F.2d 304 (9th Cir. 1990) .
- (n23)Footnote 23. *In re Moody*, 849 F.2d 902 (5th Cir. 1988) .
- (n24)Footnote 24. *In re Bestmann*, 720 F.2d 484, 10 C.B.C.2d 521 (8th Cir. 1983) .
- (n25)Footnote 25. *Matter of Met-L-Wood Corp.*, 861 F.2d 1012 (7th Cir. 1988) .
- (n26)Footnote 26. *In re Vause*, 886 F.2d 794, 21 C.B.C.2d 1346 (6th Cir. 1989) (court may hear appeal by landlord regarding future damages due for rejection of lease even though debtor's prepetition obligation on lease was not yet fixed); *Saravia v. 1736 18th St., N.W. Ltd. Partnership*, 844 F.2d 823, 18 C.B.C.2d 832 (D.C. Cir. 1988) (order relieved debtor of obligation to comply with local housing code).
- (n27)Footnote 27. *In re Technical Knockout Graphics, Inc.*, 833 F.2d 797, 17 C.B.C.2d 1246 (9th Cir. 1987) .
- (n28)Footnote 28. *In re Market Square Inn, Inc.*, 978 F.2d 116, 27 C.B.C.2d 1446 (3d Cir. 1992) .
- (n29)Footnote 29. *In re Pan American Corp.*, 950 F.2d 839, 26 C.B.C.2d 20 (2d Cir. 1991) .
- (n30)Footnote 30. *Compare Lewis v. United States, Farmers Home Admin.*, 992 F.2d 767 (8th Cir. 1993) (order denying confirmation of chapter 13 plan and setting forth elements of acceptable plan was not final) with *In re Foster*, 670 F.2d 478, 6 C.B.C.2d 285 (5th Cir. 1982) (appeal of refusal to confirm plan heard by court of appeals).
- (n31)Footnote 31. *In re Kutner*, 656 F.2d 1107, 1112, 5 C.B.C.2d 58, 63 (5th Cir. 1981) , *cert. denied*, 455 U.S. 945, 102 S. Ct. 1443, 71 L. Ed. 2d 658, 2 C.B.C.2d 34 (1982) .
- (n32)Footnote 32. *In re Emerald Oil Co.*, 694 F.2d 88 (5th Cir. 1982) .
- (n33)Footnote 33. *City of New York v. Exxon Corp.*, 932 F.2d 1020, 24 C.B.C.2d 1737 (2d Cir. 1991) (order granting partial summary judgment not appealable).
- (n34)Footnote 34. *In re Alchar Hardware*, 730 F.2d 1386 (11th Cir. 1984) .
- (n35)Footnote 35. *E.g., In re Stanton*, 766 F.2d 1283 (9th Cir. 1985) ; *Matter of Fox*, 762 F.2d 54, 12 C.B.C.2d 1136 (7th Cir. 1985) .
- (n36)Footnote 36. *Allegheny Int'l v. Allegheny Ludlum Steel Corp.*, 920 F.2d 1127, 24 C.B.C.2d 546 (3d Cir. 1990) ; *Matter of Lieb*, 915 F.2d 180 (5th Cir. 1990) .

(n37)Footnote 37. *Gold v. Johns-Manville*, 723 F.2d 1068 (3d Cir. 1983) .

(n38)Footnote 38. *In re Tidewater Group, Inc.*, 734 F.2d 794 (11th Cir. 1984) .

(n39)Footnote 39. *Matter of King City Transit Mix, Inc.*, 738 F.2d 1065 (9th Cir. 1984) . See also *In re White Beaty View, Inc.*, 841 F.2d 524 (3d Cir. 1988) (summary judgment against one defendant not a final order where claims against other defendant, counterclaims and crossclaim remain to be decided).

(n40)Footnote 40. *In re Allen*, 896 F.2d 416 (9th Cir. 1990) (denial of motion to dismiss involuntary case); *Matter of Phillips*, 844 F.2d 230, 18 C.B.C.2d 1105 (5th Cir. 1988) .

(n41)Footnote 41. *Evilsizor v. Eagle-Picher Industries, Inc.*, 725 F.2d 97 (10th Cir. 1984) .

(n42)Footnote 42. *Matter of Watson*, 884 F.2d 879 (5th Cir. 1989) (sanctions order is interlocutory pending final judgment).

(n43)Footnote 43. *In re Bowers-Siemon Chemicals Co.*, 123 B.R. 821 (N.D. Ill. 1991) .

(n44)Footnote 44. *Algeran Inc. v. Advance Ross Corp.*, 759 F.2d 1421, 13 C.B.C.2d 50 (9th Cir. 1985) .

(n45)Footnote 45. *In re Russell*, 957 F.2d 534 (8th Cir. 1992) .

(n46)Footnote 46. *In re Unanue-Casal*, 998 F.2d 28 (1st Cir. 1993) .

(n47)Footnote 47. *Pullman Construction Industries, Inc. v. United States*, 23 F.3d 1166 (7th Cir. 1994) .

(n48)Footnote 48. *In re TWA*, 18 F.3d 208 (3d Cir. 1994) .

(n49)Footnote 49. *Aucoin*, 35 F.3d 167 (5th Cir. 1994) ; *In re Gaines*, 932 F.2d 729 (8th Cir. 1991) .

(n50)Footnote 50. 28 U.S.C. § 158(a)(3). See 1 *Collier on Bankruptcy*, P 5.07[4] (Matthew Bender). No certification by the bankruptcy court is required. *In re Bertoli*, 812 F.2d 136, 16 C.B.C.2d 492 (3d Cir. 1987) .

(n51)Footnote 51. *Matter of Wood & Locker, Inc.*, 868 F.2d 139 (5th Cir. 1989) ; *In re National Shoes*, 20 B.R. 672 (Bankr. 1st Cir. 1982) ; *In re Hooker Investments, Inc.*, 122 B.R. 659 (S.D.N.Y. 1991) (interlocutory appeal permitted from order setting bar date for proofs of claim). See also *In re Chateaugay Corp.*, 876 F.2d 8 (2d Cir. 1989) (court of appeals has jurisdiction to review a district court decision that a particular order is interlocutory; presumably a reversal would mandate remand to district court for full consideration of the appeal); *In re Johns-Manville Corp.*, 42 B.R. 651 (S.D.N.Y. 1984) .

(n52)Footnote 52. 28 U.S.C. § 157(d).

(n53)Footnote 53. *Commerce Bank v. Mountain View Village, Inc.*, 5 F.3d 34, 29 C.B.C.2d 1241 (3d Cir. 1993) .

(n54)Footnote 54. *Matter of Powelson*, 878 F.2d 976 (7th Cir. 1989) (writ of mandamus issued directing district court to determine appeal of confirmation order rather than withdraw reference and substitute alternative nonappealable "interim" plan). See *Dallas v. S.A.G., Inc.*, 836 F.2d 1307 (11th Cir. 1988) (district court may not open default judgment on appeal when the issue had not been raised before the bankruptcy court). *In re Davis*, 169 B.R. 285 (E.D.N.Y. 1994) (district court deciding appeal could not consider new evidence not presented in bankruptcy court).



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CHAPTER 33 Appeals in Bankruptcy Cases

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P 33.03 Procedure for Appeals from the Bankruptcy Court

[1] Deadline for Appeal

Section 158(c)(2) of title 28 specifically states that appeals must be taken in the 14-day time period provided by *Federal Rule of Bankruptcy Procedure 8002*.ⁿ¹ This 14-day deadline is jurisdictionalⁿ² and cannot be waived. However, *Federal Rule of Bankruptcy Procedure 8002(c)* provides that the deadline may be extended by the bankruptcy court for up to 21 days upon a motion filed before the deadline expires.ⁿ³ In addition, the Rule provides that the court may also extend the deadline if a request is made within 21 days after the deadline has expired upon a showing of excusable neglect.ⁿ⁴

If a party files a motion under *Federal Rule of Bankruptcy Procedure 9023* or *9024* within 14 days after entry of the judgment, the appeal period is 14 days from the disposition of that motion.ⁿ⁵ Subsequent motions for reconsideration, though served within 14 days of the order denying the initial motion for reconsideration but more than 14 days after the original judgment, do not toll the appeal time on the original judgment.ⁿ⁶

A cross-appeal by any other party must be filed within 14 days of when a notice of appeal is filed.ⁿ⁷ The same rules pertaining to extensions to file apply to cross-appeals.

PRACTICE NOTE

Since the 10-day periods include intervening holidays and weekends, a decision on whether to appeal, or to cross-appeal, must be made relatively quickly.ⁿ⁸

[2] Notice of Appeal

An appeal or a cross-appeal of a final order is taken by filing a notice of appeal in the bankruptcy court.ⁿ⁹ The notice of appeal must conform substantially to Official Form 17. It should have the caption of the bankruptcy case or adversary proceeding from which the appeal arose, should contain the names of all parties to the judgment, order or decree appealed from, and the names, addresses and telephone numbers of their respective attorneys.ⁿ¹⁰ If a bankruptcy appellate panel is authorized to hear the case and the appellant desires it to be heard by the district court, the appellant must state that desire in a separate written statement of election filed with the notice of appeal.ⁿ¹¹

FORMS

For the form of a notice of appeal see *Collier Consumer Bankruptcy Forms, Form CS3.02-1* (Matthew Bender).

The appellant or cross-appellant must file sufficient copies of the notice of appeal for it to be served on all other parties and transmitted to the United States trustee under *Rule 8004*. The notice of appeal must also be accompanied by a filing fee of \$5. In addition, each party filing an appeal must pay a \$250 docketing fee.ⁿ¹²

If a party other than the appellant elects to have the appeal heard by the district court, that party must, within 30 days of service of the notice of appeal, file a written statement of that election.ⁿ¹³

[3] Motion to Appeal Interlocutory Order

In the case of an interlocutory order, the notice of appeal must be filed as set forth above, but it must be accompanied by a motion for leave to appeal under *Federal Rule of Bankruptcy Procedure 8003* and proof of service under *Rule 8008*.ⁿ¹⁴ The motion must state the facts necessary to understand the questions presented by the appeal, the issues to be presented on appeal and the relief sought, and the reasons why an appeal should be permitted.ⁿ¹⁵ A copy of the judgment, order, or decree complained of, along with any opinion or memorandum related to it, must be attached to the motion.

Within 14 days after service of the motion, any adverse party may file an answer to the motion with the clerk.ⁿ¹⁶ The motion is then transmitted to the district court or the bankruptcy appellate panel, as applicable, along with any answer to the motion. The motion is then considered and decided without oral argument, unless such argument is ordered by the district court or appellate panel.ⁿ¹⁷

If an appellant files a notice of appeal in a matter that is interlocutory, but does not file a motion for leave to appeal, the appellate court may choose either to grant leave to appeal or to direct that a motion for leave to appeal be filed.ⁿ¹⁸ The appellate court may also consider the notice of appeal to be a motion for leave to appeal and deny leave to appeal.ⁿ¹⁹ If permission for a direct appeal has been granted by the circuit court of appeals under section 158(d)(2) of title 28, that permission is deemed to be leave to appeal.^{n19a}

[4] Designation of Record and Statement of Issues

Within 14 days after filing the notice of appeal, the appellant must file with the clerk of the bankruptcy court and serve on the appellee a designation of items to be included in the record on appeal and a statement of issues to be presented.ⁿ²⁰ If these materials are not timely filed, then the appeal may be dismissed.ⁿ²¹ It is necessary to designate portions of the record because in many cases the appeal is about only some discrete portion of the bankruptcy case, and the remainder of the case may proceed while the appeal is pending.

Within 14 days after the appellant's statement is served, the appellee may file and serve a designation of additional items to be included in the record and a counterstatement of issues.ⁿ²² The party designating any item to be included in the record must provide the clerk with a copy of that item; otherwise the clerk prepares a copy at that party's expense.ⁿ²³

Once the record has been designated, the clerk of the bankruptcy court assembles the documents designated and forwards the file to the clerk of the appellate court, which then docket the appeal and sends notice to the parties that the appeal has been docketed.

[5] Briefing of the Appeal

[a] Deadlines for Briefs

Federal Rule of Bankruptcy Procedure 8009(a) sets the deadlines for briefs.ⁿ²⁴ The appellant's brief must be filed within 14 days after the appeal is docketed in the district court or bankruptcy appellate panel.^{n24a} The appellee's brief, which should also include any argument pertinent to any cross-appeal, is due 14 days after service of the appellant's brief. The appellant may file a reply brief within 14 days after the appellee's brief. If there is a cross appeal, the appellee may file a reply brief with respect to the cross appeal within 14 days after the appellant's reply brief is served. These time limits may be varied by local rule or a court order in a particular case.

[b] Contents of Briefs

The contents of briefs are governed by *Federal Rule of Bankruptcy Procedure 8010*.ⁿ²⁵ The appellant's brief must contain, in the following order, the following:

- a table of contents;
- a table of cases;
- statutes and other authorities;
- a statement of the basis of appellate jurisdiction;
- a statement of the issues presented and the applicable standard of review;
- a statement of the case including the proceedings below and the facts relevant to the appeal;
- the appellant's argument; and
- a short conclusion stating the relief sought.ⁿ²⁶

The appellee's brief must contain all of the same material, unless the appellee agrees with the appellant's statement of jurisdiction, statement of the issues or statement of the case, in which case the agreed material need not be included in the appellee's brief.ⁿ²⁷

Unless the appellate court orders otherwise, the main brief of each party may not exceed 50 pages, not including the table of contents, table of cases, and attachments.ⁿ²⁸ Reply briefs are limited to 25 pages.ⁿ²⁹

[c] Addendum to Brief

Each brief must contain or be accompanied by an addendum which reproduces any relevant statutes, rules, regulations or similar material.ⁿ³⁰

[6] Stay Pending Appeal

PRACTICE NOTE

Since an appeal does not operate as a stay of the bankruptcy court order appealed from, debtor's counsel should carefully consider the need for a motion for a stay at the time of any appeal. Making a motion for a stay is especially important if there is any potential that the debtor's property may be sold; there is a strong mootness doctrine in bankruptcy appeals.ⁿ³¹

The procedure for a stay pending appeal is governed by *Federal Rule of Bankruptcy Procedure 8005*.ⁿ³² The motion

for a stay must be made, in the first instance, in the bankruptcy court. If the bankruptcy court denies the motion, or if any party is dissatisfied with any other resolution of the motion, a motion may then be made to the appellate court hearing the appeal by the dissatisfied party. In cases that may be appealed to an appellate panel, if the appellant has not designated the district court as the appellate court, such a motion would presumably go to the appellate panel unless the appellee at the time of the motion states its desire to have the case heard by the district court.

[7] Other Procedural Issues

On most other procedural points, bankruptcy appeals are not significantly different from appeals from any other nonbankruptcy federal order or judgment. The same basic jurisprudential principles apply. For example, new issues generally may not be raised for the first time on appeal from a bankruptcy determination.ⁿ³³ The appellate court has discretion to take judicial notice of bankruptcy records in the underlying case.ⁿ³⁴ Appeals may be dismissed when the party appealing lacks standing to appeal.ⁿ³⁵ Claims may be considered abandoned on appeal when they are not briefed.ⁿ³⁶

As in other appeals, findings of fact by the bankruptcy court are reviewable under a "clearly erroneous" standard.ⁿ³⁷ Issues of law are reviewed *de novo*.

FOOTNOTES:

(n1)Footnote 1. 28 U.S.C. § 158(c)(2). See *In re Arrowhead Estates Development Co.*, 42 F.3d 1306 (9th Cir. 1994) (notice of appeal filed after the bankruptcy court's oral announcement of decision but before its entry is effective).

(n2)Footnote 2. *Suhar v. Burns (In re Burns)*, 322 F.3d 421 (6th Cir. 2003) (failure to file timely notice of appeal of order cannot be remedied by amending notice of appeal of another order); *Anderson*, 13 F.3d 326, 30 C.B.C.2d 649 (9th Cir. 1994) (untimely appeal dismissed for lack of jurisdiction). See 10 *Collier on Bankruptcy*, P 8002.03 (Matthew Bender).

(n3)Footnote 3. *Fed. R. Bankr. P. 8002(c)*; *Moore v. Hogan*, 851 F.2d 1125 (8th Cir. 1988) (request for extension after time for appeal had run is untimely). See 10 *Collier on Bankruptcy*, P 8002.09 (Matthew Bender). However, if the appeal is filed by a prisoner it is deemed filed when it is deposited with prison authorities, addressed to the clerk of court with postage paid. *In re Flanagan*, 999 F.2d 753, 29 C.B.C.2d 629 (3d Cir. 1993) .

(n4)Footnote 4. See 10 *Collier on Bankruptcy*, P 8002.10 (Matthew Bender).

(n5)Footnote 5. *Fed. R. Bankr. P. 8002(b)*; *Bigelow*, 41 F.3d 493 (9th Cir. 1994) . See 10 *Collier on Bankruptcy*, P 8002.07 (Matthew Bender).

(n6)Footnote 6. See *Colomba*, 257 B.R. 368 (B.A.P. 1st Cir. 2001) .

(n7)Footnote 7. *Fed. R. Bankr. P. 8002(a)*.

(n8)Footnote 8. See *Fed. R. Bankr. P. 9006(a)*.

(N9)Footnote 9. *Fed. R. Bankr. P. 8001(a)*. See 10 *Collier on Bankruptcy*, P 8001.02- .03 (Matthew Bender).

(n10)Footnote 10. *Fed. R. Bankr. P. 8001(a)*.

(n11)Footnote 11. *Fed. R. Bankr. P. 8001(e)*. 28 U.S.C. § 158(c)(1).

(n12)Footnote 12. The fee is set in the same amount as the filing fee for an appeal to the Court of Appeals as required by Item 1 of the Court of Appeals Miscellaneous Fee Schedule. See Judicial Conference Bankruptcy Court Miscellaneous Fee Schedule, Item 14, *reprinted in 1 Collier on Bankruptcy*, Ch. App. 9 (Matthew Bender).

(n13)Footnote 13. *Fed. R. Bankr. P. 8001(e)*. 28 U.S.C. § 158(c)(1).

(n14)Footnote 14. *Fed. R. Bankr. P. 8001(b)*. See 10 Collier on Bankruptcy, P 8001.10 (Matthew Bender).

(n15)Footnote 15. *Fed. R. Bankr. P. 8003(a)*. See 10 Collier on Bankruptcy, P 8003.02 (Matthew Bender).

(n16)Footnote 16. *Fed. R. Bankr. P. 8003(a)*. See 10 Collier on Bankruptcy, P 8003.04 (Matthew Bender).

(n17)Footnote 17. *Fed. R. Bankr. P. 8003(b)*. See 10 Collier on Bankruptcy, P 8003.05 (Matthew Bender).

(n18)Footnote 18. *Fed. R. Bankr. P. 8003(c)*. See 10 Collier on Bankruptcy, P 8003.06 (Matthew Bender).

(n19)Footnote 19. *Fed. R. Bankr. P. 8003(c)*. See 10 Collier on Bankruptcy, P 8003.06 (Matthew Bender).

(n20)Footnote 19a. *Fed. R. Bankr. P. 8003(d)*.

(n21)Footnote 20. *Fed. R. Bankr. P. 8006*. See 10 Collier on Bankruptcy, ch. 8006 (Matthew Bender).

(n22)Footnote 21. *Matter of Bulic*, 997 F.2d 299 (7th Cir. 1993) (appeal was properly dismissed when debtors failed to file statement of issues or designation of record within 10 days as required by Rules and bankruptcy was a bad faith delaying tactic); *In re Fitzsimmons*, 920 F.2d 1468, 24 C.B.C.2d 562 (9th Cir. 1990) (appeal dismissed due to appellant's bad faith conduct in failing to perfect appeal by delaying in designation and preparation of record). *But see In re CPDC, Inc.*, 221 F.3d 693 (5th Cir. 2000) (untimely filing of statement of issues and incomplete designation of record did not warrant dismissal of appeal when there was no evidence of prejudice to any party); *In re SPR Corp.*, 45 F.3d 70, 32 C.B.C.2d 1446 (4th Cir. 1995) (court should consider issues of bad faith or negligence, explanation for delay, prejudice to other parties, impact of sanction, and other alternative sanctions before dismissing appeal for untimely filing of statement of issues).

(n23)Footnote 22. *Fed. R. Bankr. P. 8006*. See 10 Collier on Bankruptcy, P 8006.03 (Matthew Bender).

(n24)Footnote 23. *Fed. R. Bankr. P. 8006*. See 10 Collier on Bankruptcy, P 8006.03 (Matthew Bender).

(n25)Footnote 24. See 10 Collier on Bankruptcy, P 8009.01 (Matthew Bender).

(n26)Footnote 24a. *But see In re Enron Corp.*, 475 F.3d 131 (2d Cir. 2007) (period does not begin to run until notice of docketing is sent to parties).

(n27)Footnote 25. See 10 Collier on Bankruptcy, P 8010.02- .03 (Matthew Bender).

(n28)Footnote 26. *Fed. R. Bankr. P. 8010(a)(1)*.

(n29)Footnote 27. *Fed. R. Bankr. P. 8010(a)(2)*.

(n30)Footnote 28. *Fed. R. Bankr. P. 8010(c)*.

(n31)Footnote 29. *Fed. R. Bankr. P. 8010(c)*.

(n32)Footnote 30. *Fed. R. Bankr. P. 8010(b)*. See 10 Collier on Bankruptcy, P 8010.04 (Matthew Bender).

(n33)Footnote 31. See 11 U.S.C. § 363(m); *Matter of Sullivan Cent. Plaza, I, Ltd.*, 914 F.2d 731 (5th Cir. 1990) (where creditor was granted relief from stay and foreclosed on property in question, appeal was moot even if no grounds had existed for original relief from stay); *In re Mann*, 907 F.2d 923, 23 C.B.C.2d 608 (9th Cir. 1990) (debtor's failure to obtain stay of foreclosure sale pending appeal rendered moot appeal of bankruptcy court's ruling on foreclosure action). *But see In re Seidler*, 44 F.3d 945 (11th Cir. 1995) (confirmation of chapter 13 plan did not render moot mortgage

holder's appeal of order removing mortgage lien from property); *In re Valley Ranches Inc.*, 823 F.2d 1373, 17 C.B.C.2d 449 (9th Cir. 1987) (appeal not moot though property had been sold).

(n34)Footnote 32. See 10 Collier on Bankruptcy, ch. 8005 (Matthew Bender).

(n35)Footnote 33. *In re E.R. Fegert, Inc.*, 887 F.2d 955 (9th Cir. 1989) .

(n36)Footnote 34. *In re E.R. Fegert, Inc.*, 887 F.2d 955 (9th Cir. 1989) .

(n37)Footnote 35. *Holmes v. Silver Wings Aviation, Inc.*, 881 F.2d 939 (10th Cir. 1989) (debtors may not appeal attorney's fee award which will not affect the total amount paid out under their plan). See also *U.S. Trustee for the Western District of Virginia v. Clark*, 108 B.R. 566 (W.D. Va. 1989) (United States Trustee lacks standing to appeal refusal to dismiss chapter 7 petition under section 707).

(n38)Footnote 36. *In re Brown Family Farms, Inc.*, 872 F.2d 139, 20 C.B.C.2d 1399 (6th Cir. 1989) .

(n39)Footnote 37. *Fed. R. Bankr. P. 8013*. See 10 Collier on Bankruptcy, P 8013.01 (Matthew Bender).



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CHAPTER 33 Appeals in Bankruptcy Cases

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P 33.04 Direct Appeal to Circuit Court of Appeals

[1] Certification

Direct appeal to the circuit court of appeals is permitted where the judgment or order 1) involves a question of law as to which there is no controlling decision, 2) involves matter of public importance, 3) involves a question of law requiring resolution of conflicting decisions, or 4) materially advances the progress of the case.ⁿ¹ The bankruptcy court, district court, bankruptcy appellate panel, or all the appellants and appellees acting jointly, must certify that one or more of the above circumstances exist before a direct appeal can proceed. The court, on its own motion or at the request of a party in interest, may make a determination that circumstances warrant such certification.^{n1a} However, the court must make a certification if it receives a request by a majority of appellants and a majority of appellees. Any request for certification must be within 60 days of the entry of judgment, order or decree.

After certification, the court of appeals determines whether a direct appeal will be permitted. The court of appeals will not hear a direct appeal unless that court approves bypassing the intermediate appeal court; certification by itself is not sufficient. Courts of appeals have shown varying degrees of receptivity to direct appeals. While some requests for direct appeal have been granted, one court of appeals denying a direct appeal opined that it would most likely be granted when there is uncertainty in the bankruptcy court or when the bankruptcy court's decision was either manifestly correct or incorrect, and would be less likely to be granted when issues would benefit from percolation through the normal appeal process.^{n1b}

[2] Procedure

Federal Rule of Bankruptcy Procedure 8001(f) governs the procedure for seeking a direct appeal to the court of appeals.ⁿ² The process is initiated by filing a notice of appeal with the bankruptcy court within the time period provided by *Federal Rule of Bankruptcy Procedure 8002*. The second step is to obtain certification of the judgment or *Rule 8001(f)(2)* governs where this certification should be filed and which court is the appropriate court to make the certification. Thirdly, a petition requesting permission to appeal based on certification must be filed with the circuit clerk not later than 30 days after the certification is entered on the docket of the bankruptcy court, district court, or bankruptcy appellate panel.ⁿ³ Such petition must comply with of *Rule 5 of the Federal Rules of Appellate Procedure*.ⁿ⁴ The court of appeals may then grant the petition and authorize the direct appeal of the decision. The Federal Rules of Appellate Procedure apply to appeals under § 158(d)(2), to the extent relevant, as if the appeal were taken from a final decision of the district court or bankruptcy appellate panel.

FOOTNOTES:

(n1)Footnote 1. *28 U.S.C. 158(d)(2)*.

(n2)Footnote 1a. *See Fed. R. Bankr. P. 8001(f)*.

(n3)Footnote 1b. *Weber v. United States Tr.*, 484 F.3d 154 (2d Cir. 2007) .

(n4)Footnote 2. If a certification in support of a direct appeal is filed before the notice of appeal, it does not become effective until the notice of appeal is filed. *Fed. R. Bankr. P. 8001(f)(1)*.

(n5)Footnote 3. *Fed. R. Bankr. P. 8001(f)(5)*.

(n6)Footnote 4. *Id.*



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CHAPTER 33 Appeals in Bankruptcy Cases

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P 33.05 Appeals from the District Court or the Bankruptcy Appellate Panel

There is a further right to appeal from an appellate decision of the district court or a bankruptcy appellate panel reviewing a decision of a bankruptcy court.ⁿ¹ A party may also appeal a decision of the district court which has withdrawn a proceeding from the bankruptcy court and acted as a trial court, or which has entered a final judgment based upon recommended findings of a bankruptcy court under *Federal Rule of Bankruptcy Procedure* 9033.ⁿ² All such appeals are heard by the circuit court of appeals.

In these appeals, procedure is governed in all respects by the Federal Rules of Appellate Procedure,ⁿ³ which are amply described elsewhere.ⁿ⁴ In an appeal from a district court acting as an appellate court or from a bankruptcy appellate panel, the findings of fact of the trial court continue to be judged under a clearly erroneous standard. As a result, any rulings regarding facts made by the intermediate appellate court do not lower the deference given to the bankruptcy court's findings of fact.ⁿ⁵

FOOTNOTES:

(n1)Footnote 1. *28 U.S.C. § 158(d)*. Exceptions are a district court's review of a bankruptcy court order either granting or denying a motion to dismiss or suspend proceedings, *11 U.S.C. § 305(a), (c)*, and certain decisions to abstain, *28 U.S.C. § 1334(d)* or remand, *28 U.S.C. § 1441(e)(5), 1452(b)*, which may not be reviewed by a court of appeals. *See In re Axona Int'l Credit & Commerce, Ltd.*, *924 F.2d 31 (2d Cir. 1991)*. *See 1 Collier on Bankruptcy*, P 5.09 (Matthew Bender).

(n2)Footnote 2. *See 1 Collier on Bankruptcy*, P 5.10 (Matthew Bender).

(n3)Footnote 3. *Fed. R. App. P. 6*.

(n4)Footnote 4. *See Moore's Federal Practice*, vol. 19-21 (Matthew Bender).

(n5)Footnote 5. *In re Pearson Bros. Co.*, *787 F.2d 1157 (7th Cir. 1986)* (discussing the strict standard for reversal of factual determinations of the bankruptcy court embodied by the "clearly erroneous" test).