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Current Topics in Chapter 13 and Consumer Bankruptcy

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Exploring current topics in Chapter 13 cases and consumer bankruptcy.

1. Getting discharged at the end of a Chapter 13 case.

[Trustee Bassel] Denial of the Chapter 13 discharge when the debtor does not make all the direct payments required by the plan - *In re Heinzle*, 511 B. R. 69 (Bankr. W. D. Tex 2014), *In re Kessler*, 2015 WL 4726794 (Bankr. N. D. Tex. 2015), affirmed No. 6:15-cv-00040-C, slip op. at 7 (N. D. Texas Nov. 19, 2015). *Kessler* is on appeal to the Fifth Circuit. The case number is #15-11252 (docketed 12/18/15). In *Heinzle* and *Kessler*, the courts decided that pursuant to Fifth Circuit precedent, "direct" payments (those payments disbursed by the debtor directly to the creditor, rather than the trustee acting as the disbursing agent) are payments under the plan. Of course, pursuant to §1328, the debtor must make "all payments under the plan" in order to get a discharge. In both of these cases, the debtor did not get a discharge for just this reason - they failed to make "direct" payments to their home mortgage lenders.

So, when the debtor reaches the end of the plan and has not made the direct payments to the mortgage lender, is it possible to salvage the discharge by surrendering the collateral which in these cases was the debtor's home. This is the issue presented in *In re Ramos*, 540 B. R. 580 (Bank. N. D. Tex. 2015). Can the debtor modify the Chapter 13 Plan post-confirmation (particularly at the end of the case) to surrender collateral? There is a split of authority on this issue as discussed in the opinion but *Ramos* limits post-confirmation plan modifications. Per this ruling, the debtor cannot modify to surrender collateral post-confirmation. Modification could occur if the lender forecloses on the collateral under §1329(a)(3) based, not on a surrender, but instead on payment of a claim other than under the plan (proceeds from the foreclosure sale). Judge Jernigan is right about the statutory construction. Surrender is not listed as one of the four bases on which the debtor can modify a plan under §1329. And the decision in *Ramos* is not troubling based on the facts of that case. It was an end-of-plan surrender of a house, on which the debtor had not made payments for a substantial period of time, to try to save the discharge in light of the rulings in *Heinzle* and *Kessler*. But what about the situation in which the debtor needs to surrender an asset when he/she can no longer afford to service the debt because of a job loss or health issue? Development of this issue will be interesting.

[Judge Norman] From my perspective the issue is with the debtor's material default under the terms of a confirmed Chapter 13 plan. Bankruptcy Code section 1307(c) provides, in pertinent part, that "the court…may dismiss a case under [Chapter 13], for cause, including -…(6) material default by the debtor with respect to a term of a confirmed plan." 11 U.S.C. § 1307(c)(6). A confirmed plan acts as a binding contract and an order of the bankruptcy court. The debtor may not materially impugn that contract without consequences. The issue in my Court typically arises when a debtor confirms a Chapter 13 plan with direct mortgage payments and then fails to make those payments for an extended period of time without reasonable cause.

I am surprised by the somewhat lackadaisical attitude of some home lenders or servicers. I often see debtors who are more than 12 months in arrears in mortgage payments and yet the payment default has not been brought to the attention of the Chapter 13 Trustee or the Court. Debtor's

counsel is often unaware of any payment issues as both the creditor and debtor have been silent as to the issue.

2. Tax Return Issues.

[Judge Norman] Trustee's obligations as it relates to tax returns. The issue has arisen in the following ways:

A. Debtors are married, yet each file Head of Household. During 341 meeting, the debtors admit they have not been separated at any point during the tax year. This means the debtors need to file an amended return to actually reflect their true filing status which will in all likelihood cause an additional tax liability not reflected in their schedules.

B. Debtor's tax return shows a business loss. During 341 meeting, debtor states he/she never owned or operated a business and has no idea why a business loss appears on the tax return. (As a result of the business loss debtor gets a hefty refund). Once again debtor's tax liability will be understated and an amended return is necessary to determine true tax liability.

C. Trustee notes obvious error on return (debtor writes off entire value of vehicle purchase on Other Expenses line). Once again, tax liabilities will be understated.

Some Courts have taken the position that the Trustee's job as it relates to objecting to confirmation pursuant to 1325(9) is simply to check the box regarding whether or not "the debtor has filed all applicable Federal, State and local tax returns as required by section 1308."

I have not yet taken any of these issues. Procedurally my Chapter 13 Trustee does object to confirmation based on the debtor’s filing of a tax return based on incorrect filing status, which always appears to be an incorrect head of household in order to generate a more substantial tax refund. I have never had a debtor challenge this objection and therefore have never ruled. The other issues arose when I was a Chapter 13 Trustee but I have never seen them as a Judge. As a Chapter 13 Trustee, I routinely objected to confirmation based on incorrect tax returns based on good faith.

There appear to be two differing positions on this issue. The first is that the IRS is a capable and well-represented creditor with the ability to protect its own position. This, however, may be a misnomer as my experience locally is that the IRS is understaffed and that there are few debtor audits. This position holds that the Trustee should be limited to a determination that the tax return was filed and that the IRS is fully able to protect its interests. This may oversimplify the Trustee’s duties.

The second issue is that the all-encompassing “good faith” objection requires the filing of a truthful tax return and that the Chapter 13 Trustee should object. In each of these scenarios counsel should be aware that most, if not all, Chapter 13 Trustees regularly refer or report debtors with incorrect tax returns to the United States Trustee. These referrals may lead to a debtor audit as well as criminal referral and prosecution.

For example, a tax preparer will spend the next four-plus years behind bars (Jan. 6, 2016). A Monroe tax preparer was sentenced Monday to 57 months in prison for filing multiple false tax

returns. Richard Allan Scott, 38, of Monroe, was sentenced by U.S. District Judge Robert G. James for multiple counts of aiding or subscribing a false tax return. Evidence admitted at trial showed that more than 50 false tax returns for years 2011 and 2012 were prepared. Many of the tax returns contained fictitious information pertaining to W-2 withholdings, dependent care expenses and tax credits.

In a somewhat related tax issue, the Ninth Circuit B.A.P. has rejected the literal interpretation of 11 U.S.C. § 523(a) regarding the dischargeability of tax debt. So far, the Fifth, First and Tenth Circuits have all employed a literal construction of the so-called hanging paragraph added by Congress to the end of Section 523(a) in the 2005 BAPCPA amendments. *Fahey v. Massachusetts Department of Revenue (In re Fahey)*, 779 F.3d 1 (1st Cir. 2015); *In re Mallo*, 774 F.3d 1313, 1321 (10th Cir. 2014); *McCoy v. Mississippi State Tax Commission (In re McCoy)*, 666 F.3d 924 (5th Cir. 2012). Those amendments defines the term "return" to exclude any taxpayer filing that does not wholly and strictly comply with all applicable return filing requirements, even if the taxing authority itself could and would forgive that noncompliance. In effect, the Circuits have held that tax debts could not be discharged when the debtor taxpayers failed to file a tax return and were required to do so.

The Ninth Circuit B.A.P, recently has recently bucked that trend and perhaps will provide a circuit split for Supreme Court review. *U.S. v. Martin (In re Martin)*, 14-1180 (B.A.P. 9th Cir. Dec. 17, 2015). It rejects a literal interpretation of the "return" definition under § 523. The *Martin* opinion rejects the IRS' contention that the dischargeability of income tax debts associated with a late-filed tax return should hinge on whether the taxpayer filed the return before or after the IRS made any assessment. However, the opinion does not appear to be final as the case was remanded to the bankruptcy court and therefore is not final or appealable, so any potential Supreme Court review may not be soon.

[Trustee Bassel] I discussed the issue of incorrect returns not only with my own staff, but also with the another trustee in our division and with his staff. We have had situations in which the IRS had a representative at the first meeting when a problem with the tax return was discussed and the IRS has taken no action on the returns in question which were clearly incorrect. The IRS has a real man-power problem with regard to these issues. When our office discovers potential problems with the tax return, we report those to the United States Trustee.

3. Proof of claim bar dates, extensions of time, and whether Bankruptcy Rule 3002(c) applies to secured creditors?

[Judge Norman] The 90-day bar date for filing timely proofs of claim pursuant to Bankruptcy Rule 3002(c) applies to secured creditors. *In re Pajian*, 2015 WL 2182951 (7th Cir. 2015). This decision is contra to my early days of bankruptcy practice where a common interpretation was that Bankruptcy Rule 3002 did not require a secured claim holder to file a proof of claim within 90 days of the first date set for the meeting of creditors. Bankruptcy Rule 3002(a) references only an unsecured creditor or an equity security holder but not a secured creditor, and 3002(c) references the time for timely filing a proof of claim.

I am frequently asked to (1) allow a proof of claim filed after the bar date in a Chapter 13, typically a mortgage claim with a mortgage arrears cure, or (2) grant an extension of time to file a proof of claim, by both secured and unsecured creditors. These seem like simple requests, but the rule and interpretations of the rule are often less than clear.

Typically the requests follow certain fact patterns:

(a) The mortgage company is late in filing its proof of claim and seeks by motion to file a claim late;

(b) The mortgage company cannot file a timely proof of claim and seeks to extend the time for the filing of a claim.

(c) The debtor wants to allow a late filed unsecured claim typically due to lack of notice to the creditor, either due to an incorrect address or failure to schedule the debt.

The 90-day and 180-day bar dates for filing proofs of claim have been strictly construed by the courts and the *Pajian* decision supports that proposition. The general rule is that there is no exceptions to, or extensions of, bar dates except as provided by the Code and Rules. Under Bankruptcy Rule 9006, the 90-day and 180-day periods in Bankruptcy Rule 3002(c) cannot be extended except under the conditions stated in Rule 3002(c), and cannot be reduced under any circumstances. Many courts have held that a bankruptcy court has no power to extend the deadlines for timely filing claims for any equitable reason, including lack of notice or excusable neglect.

Bankruptcy Rule 3002 says that a claim is "deemed allowed" under § 502(a) if a proof of claim is filed and no party in interest objects. Therefore, timeliness is not a condition precedent to the filing of a claim under § 501 or § 502. In the absence of objection, even an untimely proof of claim is allowed by § 502(a) and entitled to payment through the plan in the same manner as other claims of its class. However, if you practice in a jurisdiction where the Chapter 13 Trustee objects to all untimely filed claims, this exceptions does little for you.

Nationally, Chapter 13 Trustees seem to take one of two very different positions. The first position is that the Trustee has a fiduciary obligation to object to any untimely filed proof of claim. The second position is that the Trustee will not routinely object to claims not filed timely because only the debtor has sufficient information or incentive to know whether to object.

As my Chapter 13 Trustee routinely objects to late-filed claims, and as I routinely disallow those untimely claims, am I being inconsistent by approving motions to allow a late-filed claim? If the creditor did not receive notice and an opportunity to file a claim, are they being denied due process?

A plain reading of the Code and Rules reveals no exception to the bar dates for claims not scheduled by the debtor. Some recognize that disallowance unscheduled claim based on its late filing is a harsh rule, but the Bankruptcy Code protects the rights of creditors without notice in other ways. For example, creditors can seek relief from the stay, relief from the confirmation

order, and they can seek an exception to discharge. Is there a due process exception to the disallowance of late-filed claims when the creditor is not properly scheduled and given notice?

One of the most significant changes included in the proposed rule changes for a national Chapter 13 plan is the proposed shortening of the proof of claim deadline for claims secured by the debtor's principal residence. The proposed deadline to file such claims will be 60 days after the petition date, as opposed to the 120 days under the current rules. A proof of claim would need to be filed within 60 days of the petition date, with an additional 60 days allowed for filing the required loan documentation. I see problems with mortgage claims being timely filed, should the rule change be adopted.

[Trustee Bassel] Our office, currently, does not disburse without a filed claim, either pre-or post-confirmation. When a mortgage lender does not timely file a proof of claim and there is a mortgage arrearage that needs to be paid through disbursements by the trustee, it really creates a problem. We send a letter to the debtor and their counsel once the bar date has passed if no claim has been filed by a secured lender, including the mortgage lender, if we are the disbursing agent, in the hopes that the debtor will file a claim pursuant to Rule 3004. If the debtor does not timely file the claim, but files a claim late, we require a showing of excusable neglect. The proposed rule change is going to exacerbate the problem.

4. Interplay of the Bankruptcy Code and the federal Fair Debt Collection Practices Act (FDCPA).

[Judge Norman] There is a trend nationally, but not in the Western District of Louisiana, to use the Fair Debt Collection Practice Act (FDCPA) to address creditor collection practices both during and after a bankruptcy filing. This arises in a number of factual contexts, including, but not limited to, collecting on discharged debt, reporting to consumer reporting agencies, and filing proofs of claim in Chapter 13 cases based on debts that have been prescribed or are uncollectable under a statute of limitations.

On January 4, 2016, the Second Circuit handed down a debtor friendly opinion accentuating an existing circuit split and laying the foundation for the Supreme Court to determine if the Bankruptcy Code precludes claims under the FDCPA. *Garfield v. Ocwen Loan Servicing LLC,* 2016 U.S. App. LEXIS 3 (2d Cir. 2016).

The fact pattern in *Garfield* case is not uncommon. The debtor completed a five year Chapter 13 plan, including a cure and maintain on her home. Thereafter, she received a discharge but later defaulted on her post-discharge mortgage payments. Ocwen dunned her for the pre-discharge arrears and post-discharge payments. The plaintiff then sued under the FDCPA contending the lender was attempting to collect personal obligations on the mortgage that had been discharged. The District Court dismissed the complaint holding that the Bankruptcy Code provided the debtors exclusive remedy for attempting to discharge debt and the proper procedure would have been a motion for contempt of the discharge injunction. The Second Circuit then reversed because it felt constrained by its previous holding in *Simmons v. Roundup Funding,* 622 F.3d 93 (2d Cir. 2010), which barred FDCPA claims during a bankruptcy case. However, the bankruptcy case in *Garfield* was complete, and while FDCPA claims could not be made during a bankruptcy

case, they were allowable after completion. The collection actions took place after discharge when the debtor was no longer protected by the Bankruptcy Code.

According to the Second Circuit, there is a conflict among the circuits with the Ninth and Second precluding FDCPA claims during bankruptcy and the Seventh and Third allowing them.

A rehearing *en banc* in the *Garfield* case is a possibility. When debt collectors violate the automatic stay or the discharge injunction, some debtors prefer using the FDCPA because it carries more favorable remedies, including the automatic recovery of the plaintiff's attorneys' fees if the claim is allowed.

FDCPA class action against debt buyer for illegally filing proofs of claim without a Maryland debt collection license is precluded by confirmation of Chapter 13 plans. *Covert v. LVNV Funding, LLC*, 2015 WL 877133 at *4 (4th Cir. 2015) ("[Debtors] should have raised these statutory claims during the plan confirmation hearings, and their failure to do so means that these claims are barred by res judicata.").

In Jacksonville, Florida, federal district court judge is predicting the Eleventh Circuit will decide that the Bankruptcy Code precludes a bankrupt debtor from maintaining a lawsuit for violation of the federal Fair Debt Collection Practices Act based on the filing of a time-barred claim. *Mears v. LVNV Funding LLC*, 14-cv-1207 (M.D. Fla. 2015). This is despite the holding in *Crawford v. LVNV Funding LLC*. District Judge Harvey E. Schlesinger faced the question that the Eleventh Circuit avoided in *Crawford*. He recited how the Second and Ninth Circuits hold that the Code precludes suits under the FDCPA, while the Third and Seventh permit them. Judge Schlesinger recognized that one federal law does not preclude another. Instead, he said there is a presumption "against the implied repeal of one federal statute by another." For a later statute to replace another, he said, there must be "irreconcilable conflict." On that question, lower courts in the Eleventh Circuit are divided, Judge Schlesinger said. Some hold that the Code precludes an FDCPA claim, while others say that it does not. Judge Schlesinger came down on the side of preclusion, saying that the Code permits filing a claim while the FDCPA does not. His opinion did not address an argument the Eleventh Circuit used in *Crawford* to find an FDCPA violation. The circuit court said it wanted to end a practice that was forcing trustees and debtors to waste estate funds by knocking out stale claims. Absent objections, other creditors' recoveries will be diluted by distributions on claims no longer enforceable in state courts.

Courts that find preclusion ordinarily posit that claims are not extinguished by statutes of limitation. Rather, enforcement is barred. Because the claim itself survives, the claim holder has the right to file a proof of claim in bankruptcy, those courts will say. Those courts often say that to avoid violating the FDCPA, the claim holder must include sufficient information in the proof of claim to alert the reader that the claim is time-barred.

Glenn v. Calvary Investments LLC (In re Glenn), 14-ap-560 (N.D. Ill. 2016). The prototypical case presented by an adversary proceeding in bankruptcy court alleging an FDCPA violation simply based on the filing of a claim asserting a stale debt. The Court acknowledged that "an industry has sprung up around the acquisition of and realization upon time-barred claims." Nonetheless, it held that unadorned suits based on stale claims must be dismissed, although he

left the door slightly open for complaints based on more egregious facts. The Court, construing the FDCPA, found nothing false, misleading, deceptive, unfair or unconscionable in filing a claim on a stale debt that complies with Bankruptcy Rule 3001(c)(3). Although commencing a lawsuit on a stale claim would violate the FDCPA, filing a claim would not, given the Bankruptcy Code's lack of a bar against asserting a claim based on a stale debt.

The Court dismissed without prejudice to filing an amended complaint if the plaintiff can base the suit on something more than the filing of a stale claim.

[Trustee Bassel] We have seen, literally, none of these. When we have a claim with a limitations issue and there is an unsecured creditors pool, generally there is a claim objection based on limitations, but I have not seen anyone bring an FDCPA action. I cannot recall a case in which we have even had a response to such a claim objection, much less a contested issue or adversary proceeding. It is probably coming, though.

5. Supreme Court to Decide Whether "Actual Fraud" Requires Misrepresentation.

[Judge Norman] The Supreme Court granted certiorari to resolve the circuit split concerning whether non-dischargeability for "actual fraud" under 11 U.S.C. § 523(a)(2)(A) requires a misrepresentation as held by the Fifth Circuit in *Husky International Electronics, Inc. v. Ritz (In re Ritz)*, 787 F.3d 312 (5th Cir. 2015), or more broadly applies to a fraudulent transfer scheme as held by the First Circuit in *Sauer Inc. v. Lawson (In re Lawson)*, 791 F.3d 214 (1st Cir. 2015), and the Seventh Circuit in *McClellan v. Cantrell, 217 F.3d 890* (7th Cir. 2000).

In *Ritz*, the debtor, a principal of Chrysalis Manufacturing bought components from Husky International Electronics but failed to make payment. The debtor then caused Chrysalis to make substantial transfers from its bank accounts to various entities he controlled (therefore making Chrysalis arguably unable to pay Husky). Husky sued under § 523(a)(2)(A) but the bankruptcy court and circuit court held that the "actual fraud" exception to discharge did not apply because it was not shown that Ritz made an false representation to Husky.

The 7th Circuit has held that "actual fraud" under § 523(a)(2)(A) is not limited to misrepresentations or misleading omissions and under 7th Circuit jurisprudence the Court could have held for the plaintiff on a claim under § 523(a)(2)(A). The 7th Circuit has held that a fraudulent transfer can constitute "actual fraud" under § 523(a)(2)(A). *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000).

[Trustee Bassel] We have not seen this type of argument, probably because we are in the Fifth Circuit. Since a fraudulent transfer can occur without actual fraud, is the 7th Circuit correct on this issue?

6. Supreme Court asked to set student loan discharge standard in *Tetzlaff* case.

[Note: The Supreme Court denied the petition for certiorari in *Tetzlaff v. Educ. Credit Mgmt. Corp.* on January 11, 2016.]

[Judge Norman] As the Supreme Court has denied cert, the questions presented in the appeal will go unanswered for now. Questions presented: (1) Is the three-element *Brunner* test

(*Brunner v. N.Y. State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2nd Cir. 1987)) the proper standard for determining "undue hardship" for the discharge of student loan debt? (2) If the *Brunner* test is the proper standard, should it be modified to eliminate the requirement that a debtor in the past have "made a good faith effort to repay the loans," and clarified to establish that a debtor need only prove by a preponderance of the evidence that his inability to pay is "likely to persist for a significant portion of the repayment period," and not that there is a "certainty of hopelessness"?

[Judge Norman] *Tetzlaff v. Educational Credit Management Corporation*, 2016 U.S. LEXIS 61 (2016), cert. denied Jan. 11, 2016. The First Circuit may consider application of *Brunner* test. *Murphy v. U.S. Department of Education*, No. 14-1691. A federal appeals court in Boston is considering the case of a 54-year-old former corporate executive, unemployed since 2002, who is trying to discharge nearly 250k in student loan debt he incurred to finance his three kids' college education. The debtor has not worked for 13 years and is losing his home to foreclosure. His only income is $13k per year from his wife. Remember, *Brunner* is almost 30 years old and was decided long before the landscape of student loan discharge changed. In *Brunner*, student loans were automatically discharged in bankruptcy as long as they had been due and unpaid for five years. But, the law was changed in 1988 to make federal student loans non-dischargeable in bankruptcy except if the debtor can show "undue hardship."

Brunner established a three-part test for proving "undue hardship":

(1) The debtor cannot maintain a minimal standard of living if forced to repay the loans.
(2) The circumstances of the hardship will persist through most or all of the repayment period.
(3) The debtor has made a "good faith effort" to repay the loans.

Additionally, there is a new student loan repayment program. The REPAYE program (Revised Pay As You Earn), which launched December 16, 2015, gives every American with a federal student loan the option of capping monthly payments at 10% of disposable income. The most flexible and generous of the government's income-based programs, the new plan will:

> (1) **Lower payments**. REPAYE adjusts borrowers' payments to 10% of their disposable income, which is calculated as the difference between their Adjusted Gross Income and 150% of the poverty line. For a single person in 2016, that would mean total payments would not exceed 10% of whatever they earn above $17,655.00. So, a single person earning $25,000.00 a year would likely have their monthly federal student loan bills capped at less than $100.00 per month, no matter how much he or she owed. The Department of Education's online Repayment Estimator calculated projected payments based on student loans and income. See:
> https://studentloans.gov/myDirectLoan/mobile/repayment/repaymentEstimator.action
>
> (2) **Enable forgiveness**. Borrowers who sign up for REPAYE and work in a government or nonprofit job for 10 years (and make 120 on-time payments) can have the rest of their loan forgiven. REPAYE will also forgive the remaining balance on loans for other workers who only have debt for undergraduate study, after 20 years of payments. Those

who are using the program to repay graduate debt will have their debts forgiven after they have made 25 years' worth of payments.

The new lower cap of 10%, was widened to include all outstanding federal student loans, and includes a forgiveness feature. Any loan balance remaining after 20 years of payments will be forgiven for undergraduate loans. For money borrowed for graduate school, the forgiveness comes after 25 years.

[Trustee Bassel] Judge Norman makes the excellent point that *Brunner*, decided in 1987, pre-dates the raft of student loans we see today and the lack of regard for the recipient's ability to ever re-pay the loan(s) at the time the loans are made, based on the likely future earning capacity of the borrower in light of the degree he/she is seeking. Lending is a two way street. The borrower should consider the problems in repaying the loan, but so should the lender. *Brunner* has been a troubling and a difficult-to-prove standard for a long time. Student loan debt has surpassed credit card debt in this country, which is astounding. Everyone would benefit from guidance on this issue because it effects so many people. It's a shame we will not get that guidance from the Supreme Court, at least for now.

7. The Good, the Bad and the Incomplete. Issues with the new forms and rules.

[Judge Norman] I am just now starting to review the new forms Chapter 13 cases come up for confirmation. The biggest issues I see the in new forms are with missing information. New/additional/different information on the modernized forms that may simply be in a new location on the forms and then just left blank. I get the impression that attorneys' intake forms have not kept up with the form changes. Additionally, I now personally feel disjointed from the bankruptcy forms. Prior to the new forms, I had practiced with the old forms and was aware of the location of all of the required disclosures. I now have to hunt and peck and am not as familiar with the forms yet as I would like to be.

[Trustee Bassel] Like many others, we braced ourselves for problems with people completing the new forms correctly. So far, we have had very minor issues - no more than we have had all along with the correct completion of required documents. However, the new forms are much more clunky. Information is hard to find and comparisons are harder to make.

8. Judicial Estoppel

[Trustee Bassel] The Fifth Circuit wrote twice on judicial estoppel and the debtor's failure to disclose in 2015 – *Allen v. C&H Distributors*, 2015 WL 9461591 (5th Cir. 2015) and *Long v. GSD&M Idea City, L.L.C.*, 798 F. 3d. 265 (5th Cir. 2015). Judge Norman sets out the three elements of judicial estoppel in his discussion of the *Allen* case, below. The trigger for whether judicial estoppel should apply is not whether the debtor knew there was a duty to disclose the existence of a claim to the bankruptcy court but is, instead, the debtor's knowledge of the facts giving rise to the claim. For example, if the debtor knows he/she has a claim based on the fact that he/she was injured at work, they have a duty to disclose that claim whether or not they know they have that duty. "I didn't know I was supposed to tell you about this" is not going to save the situation. It is really important for counsel to make sure the debtor knows to report these things

to them. I tell the debtors this in the first meetings I conduct, but you wonder how much of that is retained, particularly three/four years later. Interestingly, in both of these cases, the Fifth Circuit refers to the debtor's duty to disclose without reference to any plan language or the provisions of a local rule. There is simply a duty of full disclosure.

[Judge Norman] I like to say that judicial estoppel is alive and well in the Fifth Circuit. There appears to be little or no argument on the issue of whether a debtor has an ongoing duty to disclose in bankruptcy. In a very recent case the Eighth Circuit slammed the door on the argument by NACBA that a chapter 13 debtor can avoid the doctrine of judicial estoppel by contending there is no obligation to disclose a cause of action arising after filing. Jones v. Bob Evans Farms Inc., 15-2068 (8th Cir. Jan. 26, 2016). If there is a rule for debtor's counsel, it should be disclose everything and then disclose some more. Attorneys should always highlight to their clients the absolute importance of disclosure in a bankruptcy case and especially stress that the obligation to disclose is a continuing one. However, I understand how hard it is to disclose as a debtor's lawyer if your client remains silent, as they often do.

Allen v. C & H Distributors, L.L.C., 2015 WL 9461591 (5th Cir. 2015). This case is a great example of a debtor's continuing duty to disclose. I might also add that it is a case that arose out my judicial district and division and that I have been asked to reopen the case and convert it to a Chapter 7. In *Allen*, the court held that individual debtors asserting a personal injury suit were judicially estopped from bringing their action because they never disclosed the existence of the lawsuit to the bankruptcy court. The debtors filed a Chapter 13 bankruptcy case in July 2009 and their plan was confirmed in September of the same year. The debtors then amended their plan multiple times, with the last amendment occurring in January 2013. In April 2014, the bankruptcy court closed the chapter 13 case without granting the debtors a discharge because of their failure to file certain required documentation.

In October 2010, after confirmation of the debtors' original chapter 13 plan, but before filing any of their plan amendments, the debtors commenced a personal injury suit against various entities in federal district court. The suit alleged that one year earlier, in October 2009, one of the debtors was injured at work when the stool she was sitting on broke apart. In September 2014, the defendants moved for summary judgment, arguing that they only first learned of the debtors' Chapter 13 case in late August 2014 and contending that the suit was barred by judicial estoppel because the debtors failed to disclose the suit to the bankruptcy court. The district court granted the defendants' motion for summary judgment, finding that judicial estoppel barred the debtors from pursuing their personal injury claim, and dismissed the claims with prejudice. However, the dismissal was without prejudice to the rights of a Chapter 7 trustee to pursue the claims if the debtors' bankruptcy case was reopened and converted to a Chapter 7 case. The debtors appealed the judgment.

In reviewing the lower court's decision, the Fifth Circuit first considered the purpose of the doctrine of judicial estoppel which is "to protect the integrity of the judicial process" by 'prevent[ing] parties from playing fast and loose with the courts to suit the exigencies of self-interest." *In re Coastal Plains, Inc.*, 179 F.3d at 205 (*quoting Brandon v. Interfirst Corp.*, 858 F.2d 266, 268 (5th Cir. 1988)). The court then identified the three elements of judicial estoppel:

(1) the party against whom it is sought has asserted a legal position that is plainly inconsistent with a prior position; (2) a court accepted the prior position; and (3) the party did not act inadvertently.

Pursuant to sections 521(a)(1) and 1306(a)(1) of the Bankruptcy Code, a Chapter 13 debtor has a continuing obligation to disclose claims that arise, or assets that are acquired, after the commencement of a bankruptcy case, regardless of whether the debtor' plan was confirmed. That is because the Chapter 13 debtor's property of the estate includes all assets acquired by the debtor post-petition until the case is closed, dismissed, or converted. Therefore, once the personal injury claim arose, the *Allen* debtors had a duty to disclose its existence to the bankruptcy court and their creditors.

In addressing the first element, the court acknowledged that the debtors never disclosed the existence of their personal injury suit to the bankruptcy court. Because the debtors failed to do so, they impliedly represented that they had no such claim. By now asserting the claim, the debtors were taking a legal position inconsistent with the prior one, satisfying the first element of judicial estoppel.

Next, as to judicial acceptance, the bankruptcy court confirmed the debtors' plan and plan modifications on the assumption that the debtors' schedules were accurate and that the debtors had truthfully disclosed all of their assets. The accurate and continuous disclosure of assets by a Chapter 13 debtor – even after confirmation – is essential to the Chapter 13 process. By concealing the existence of the claim, the debtors withheld property that should have been available for creditor distribution. The Fifth Circuit concluded that the bankruptcy court accepted the debtors' prior position by omitting any reference to the personal injury claim in the modified plan. That is, had the court known about the claim, potential recoveries flowing therefrom would have been included in the assets available to creditors. Finally, as to inadvertence, the court explained that where a debtor has no motive to conceal assets, the debtor's failure to disclose the assets could be found to be inadvertent. Here, however, the court found that concealing the claim would have allowed the debtors to "reap a windfall had they been able to recover on the undisclosed claim without having disclosed it to the creditors" because, absent disclosure, the debtors could have retained any proceeds of the suit instead of distributing them to creditors. The debtors' motivation for concealment, the court stated, was self-evident because of this potential financial benefit they stood to gain from the non-disclosure. According to the court, the debtors could not show that their failure to disclose the suit was inadvertent.

Because the three elements of judicial estoppel were satisfied, the court ruled that the district court did not abuse its discretion by dismissing the debtors' claims and by allowing the bankruptcy trustee to pursue the personal injury claim in place of the debtors. The Fifth Circuit, however, clarified that the district court could reopen the debtors' case and substitute a chapter 7 trustee for the debtors so long as the trustee decided to pursue the claim within a reasonable period of time.

9. Debtor Gets Refund at Conversion (good faith), Trustee gets the money at conversion (bad faith).

[Trustee Henley] At conversion (in good faith) to Chapter 7 after confirmation, undistributed funds held by Chapter 13 trustee must be refunded to debtor. *Harris v. Viegelahan*, 135 S. Ct. 1829 (2015). However, bad faith conversion triggers 11 U.S.C. § 348(f)(2). Property of the estate consists of the property of the estate as of the date of conversion; therefore, the Chapter 7 Trustee gets the refund of the debtor's Chapter 13 plan payments.

[Judge Norman] I don't see this outcome often. But, the first time I ruled on this issue, I could tell by the response that the issue had not been given much thought by the litigants.

[Trustee Bassel] We have not had a bad faith situation yet, so we have been sending all after acquired property (§1306 property) to the debtor following conversion. However, we have had a case in which we held proceeds from the sale of pre-petition property and that those proceeds were turned over to the Chapter 7 Trustee. The Chapter 13 Trustee must analyze the origin of the funds he/she holds so that they can be properly disbursed at conversion.

10. Stay Violations and damages.

[Judge Norman] The 9th Circuit quickly rectifies its own mistake by allowing creditors to recover attorney fees in suits to recover damages for automatic stay violations. *America's Servicing Co. v. Schwartz-Tallard (In re Schwartz-Tallard)*, 12-60052 (9th Cir. 2015). The court rejected its horrible previous opinion in *Sternberg*. In *Sternberg*, the court had managed to interpret the attorney's fees out of the equation. Debtors could recover their attorney's fees from misbehaving creditors, said the 9th Circuit panel, only to the point that the violation of the stay ceased. No attorney's fees were available to collect damages caused by the stay violation. In *Schwartz-Tallard*, the court affirmed the judgment of the Bankruptcy Appellate Panel and held that 11 U.S.C. § 362(k) authorizes an award of attorney's fees reasonably incurred in a debtor's prosecution of a suit for damages to provide redress for a violation of the automatic stay. Now we have the unusual situation in which there is total uniformity on this issue among all the circuits.

As a judge, I have an interest in damage awards for stay violations. What sort of damages do you get for stay violation cases? Here is a summary of some recent cases:

In re Heeley, 2014 WL 7012652 (Bankr. E.D.N.C. 2014). Post-petition referral of prepetition NSF check to Worthless Check Collection Program after receipt of actual notice of bankruptcy was willful violation of automatic stay. The debtor recovered actual damages of $5,601.30, attorney fees of $3,500 and punitive damages of $5,000. BJ's wholesale club collected a pre-petition debt by excluding the debtors from shopping at its store and by the threat of criminal prosecution. A creditor is motivated in making a worthless check referral in whole, or in part, by the hope of getting reimbursed. The referral of the debt to worthless check collection program constitutes a willful violation of the stay, and the acceptance of the collected funds ratified that improper action.

Walker v. Sillman (In re Sillman), 2015 WL 1291427 (E.D. Cal. 2015). Interesting case. On April 3, an order dismissing the debtor's Chapter 13 case was entered, but unfortunately it was a mistake. Less than two weeks later, the order was vacated. However, in the interim, the creditor conducted a non-judicial foreclosure sale of debtor's property. Thereafter, the attorneys agreed to undue the foreclosure sale, but that was never done. The debtor makes plan payments for a time and then the Chapter 13 case is dismissed and the creditor evicts the debtor based on the earlier foreclosure.

Was the foreclosure sale valid, even though it took place when the case was dismissed and there was no automatic stay? The court said no, the dismissal was not valid so the foreclosure was not valid.

So the court awards: Damages of $45,500—$24,000 for dispossession and loss of use of property, $14,000 for emotional distress, and $7,500 punitive damages—awarded when creditor foreclosed and obtained possession of property with knowledge that order dismissing Chapter 13 case was void.

Brantley v. CitiFinancial, Inc. (In re Brantley), 2015 WL 230186, at *3 (Bankr. E.D.N.C. 2015). Settlement of stay violation rejected *sua sponte*. An award of $49,000 "for the alleged stay violations and alleged inconveniences, such as nausea and anxiety, is outside the range of reasonableness in this case." This is really an exemption case, where the debtor filed what is an exemption claim for "personal injury" and the court holds that the stay violations are not wholly personal injury.

In re Drake, 2015 WL 393408 (Bankr. M.D.N.C. 2015). Debtor fully pays for a car in a Chapter 13 case and creditor continues to send billing notices to the debtor seeking further payment as well as reporting to the credit bureaus. Court awards $150 for lost work and $5,025 attorney fees awarded for willful violation of the stay when creditor sent notices of delinquencies to debtor and to credit reporting agency.

In re Paschal, 2014 WL 5771558 (Bankr. W.D. Ky. 2014). Debtor files case on August 8. On August 21, creditor debits the bank account of the debtor for $400, which overdrafts the debtor's account. Debtor's attorney contacts creditor regarding the unauthorized debit transaction. Creditor indicated that he was aware that the debtor had filed a Chapter 13 bankruptcy and that the automatic stay was in place, but that he would not return the funds. Attorney fees of $1,189.50 and punitive damages of $1,200 were awarded by the court for the unsecured creditor's intentional violation of the automatic stay.

In re Adams, 516 B.R. 361, (Bankr. S.D. Miss. 2014). This is another used car lot case. On March 3, the debtor filed a Chapter 13. On April 25, the repo men appeared at the debtor's home and repossessed the debtor's Ford Expedition. The debtor's lawyer attempts to get car back to no avail. The court holds that post-petition repossession and retention of vehicle entitled debtors to actual damages of $819.80 for loss of property, $380.87 for vehicle rental fees, and $17,634.00 in attorney fees. Punitive damages of $6,600 are also awarded. "If, after ten (10) years of experience in collection and bankruptcy matters, [creditor] believes that his course of action in these proceedings is the proper way to act when a customer commences a bankruptcy

case, then punitive measures are necessary to deter him from acting similarly in the future. Not only did [creditor] violate the automatic stay when he repossessed the Ford Expedition, but he also refused to return the vehicle for twenty-five (25) days despite the pleas of the Debtors and their attorney." *Id*. at 375.

Parker v. Credit Cent. S. Inc. (In re Parker), 515 B.R. 337 (Bankr. M.D. Ala. 2014). The debtor gets sued, but there is no service. The debtor files a Chapter 13 and the creditor files a proof of claim. Then, the debtor gets served at work and sues. This stay violation warranted actual damages of $30,318.00 for attorney fees, including fees for prosecution of adversary proceeding for stay violation.

In re Jeffrey, 2014 WL 4290092 (Bankr. E.D.N.C. 2014). Sanctions awarded for creditor's disregard of order directing turnover of vehicle repossessed pre-petition included forgiving balance of $771 owed on vehicle, cancellation of lien and return of certificate of title to debtor, $5,000 in damages and expenses incurred by debtor, and $2,500 in attorney fees. In the *Jeffrey* case, there was testimony that a representative of the creditor called the debtor's lawyer's office and stated the debtor was a "loser" and that the creditor would only return the vehicle after it received the sum of $2,000.00. The creditor also threatened to take the debtor to court.

[Trustee Bassel] It is a wonderful thing when the circuits agree and this is a good decision by the Ninth Circuit. But the issue of attorney's fees, as always, has to be approached with care. Fees should be tested for reasonableness. Bankruptcy is a shield, not a sword.

9. Mortgage can be "stripped off" through use of so-called "chapter 20."

[Judge Norman] *HSBC Bank USA v. Blendheim (In re Blendheim),* 803 F.3d 477 (9th Cir. 2015) The Ninth Circuit joins two other circuits and three bankruptcy appellate panels in holding that a mortgage can be "stripped off" through use of so-called "chapter 20." A chapter 20 strip off typically arises when someone first goes through chapter 7 and gets a discharge while owning a home where debt on the first mortgage is more than the value of the house. Although a debtor's personal liability on a valueless second mortgage is eliminated by discharge, the second lien remains on the home as a result of the U.S. Supreme Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992). This leaves the homeowner vulnerable to foreclosure of the second mortgage after chapter 7. When the same homeowner files a subsequent chapter 13 case, some bankruptcy courts and district courts do not permit strip off, or elimination of the second mortgage, usually reasoning that strip off is unavailable because the debtors are not entitled to a discharge in chapter 13.

In a recent opinion, Ninth Circuit Judge Jay S. Bybee sided with the Fourth and Eleventh Circuits by holding that a lien can be stripped off in chapter 20. In *Boukatch v. MidFirst Bank (In re Boukatch)*, 533 B.R. 292 (9th Cir. B.A.P. 2015), the Ninth Circuit Bankruptcy Appellate Panel allowed strip off in a chapter 20. In that case, the consumer debtors first filed under chapter 7. The chapter 7 discharge removed the first mortgage on their home as a personal liability. However, because liens ride through chapter 7, the mortgage remained on their home. They then filed a chapter 13 case one day after receiving their chapter 7 discharge. The chapter

13 petition was designed to prevent or delay foreclosure. The court held that debtors can avoid liens in subsequent chapter 13 cases even though they are not eligible for discharge.

[Trustee Bassel] The Ninth Circuit discusses the fact that the Chapter 7 discharge does not affect *in rem* rights. The discharge only releases *in personam* liability. So, since the Chapter 7 discharge does not effect the *in rem* rights of the creditor, the debtor must turn to some other remedy to void the lien. The Code provides that at dismissal or conversion, any lien avoided in a Chapter 13 proceeding is reinstated. See 11 U.S.C. §§348 and 349. However, nothing in the Code requires that the debtor receive a discharge in order for the lien avoidance to survive the **closing** of the case when the debtor completes the plan, discharge or no. And what good would the discharge be in any event since the Chapter 7 discharge has already released the debtor's *in personam* liability?

The facts of *Blendheim* are straightforward. The debtors successfully objected to the claim of the mortgage lender. This was not a case in which the lender's claim was disallowed because the claim was not timely filed. In fact, it was timely filed. Instead, the debtors objected to the claim for cause. They asserted that the lender failed to attach a copy of the signed promissory note to the proof of claim. They also alleged that a copy of the note they had previously received appeared to contain a forged signature. So, they were going to the heart of the validity of the claim. The lender did not respond to the claim and an order disallowing the claim was entered. The lender then did nothing to rectify the disallowance of the claim. The debtors filed an adversary proceeding and sought to void the lien pursuant to 11 U.S.C. §506(d) which provides, in pertinent part, "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." The claim was disallowed, so it was no longer "an allowed secured claim" and therefore could be avoided pursuant 506(d). The bankruptcy court entered an order voiding the lien.

Blendheim is not at odds with those cases in which courts have refused to void a lien solely on the basis that the proof of claim was not filed timely when there was no other allegation that the claim should be disallowed. In those cases, which are cited in the *Blendheim* opinion, the courts have determined that a late filed claim is tantamount to filing no claim at all, avoiding the affect of §506(d) which provides that the debtor cannot void the lien if the secured claim is disallowed "...due only to the failure of any entity to file a proof of such claim...". These courts conclude that a late filed claim is the same as a claim that is not filed. That stretches the statutory construction a bit, but it does make sense that an otherwise valid lien should not be disallowed when the secured claimant simply did not timely file a claim when it would be in a far better position by not filing a claim at all.

Secured creditors cannot ignore or fail to respond to anything in a bankruptcy proceeding that might impair the creditor's rights.

10. Ethics

[Judge Norman] Three cases of interest.

In re Leander Young, Case No 15-44343-705 (Bankr. E. D. Mo. 2015). The debtor's attorney was suspended from practice in the bankruptcy court for 90 days. The attorney represented himself as an independent lawyer; however, the Court found that his real business was being an attorney for a bankruptcy services scheme that targeted low-income minority persons from metropolitan St. Louis. The bankruptcy service company was owned by a bankruptcy petition preparer who was enjoined from engaging in the unauthorized practice of law in 2002. The Court found that the bankruptcy services company is currently an artificial entity that contracts with attorneys, even though all legal services, including sending a non-lawyer to the 341 meeting, are provided by non-attorney staff members. The role of the attorney at the bankruptcy services company is to provide cover for the business's real operation, which is the unauthorized practice of law. Once an attorney is suspended or disbarred, the attorney is replaced and the cycle begins again.

United States v. Collier, 2015 U.S. Dist. LEXIS 153936 (W.D. La. 2015). A volume bankruptcy attorney pleaded guilty to one count of bankruptcy fraud and was disbarred in the Western District of Louisiana. It was alleged that the attorney committed various violations of the Bankruptcy Code including violations of 11 U.S.C. §§ 527 and 528, as well as violations of the 11 U.S.C. § 362 automatic stay by debiting debtors' bank accounts for attorney fees post-conversion. Still further, it was alleged the attorney failed to take action on behalf of his clients and actually suspended work on client's cases due to non-payment of legal fees. Finally, it was alleged that he knowingly collected fees he was not entitled to collect from clients and repeatedly failed to disclose the fees to the bankruptcy court.

Smith v. Robbins (In re IFS Financial Corp.), 803 F.3d 195 (5th Cir. 2015). A third violation of fiduciary duties is enough in the Fifth Circuit to remove a trustee for cause under Section 324(b). A trustee for a bankrupt company recovered a $1.5 million judgment. The trustee hired his wife to represent him in an appeal to the Fifth Circuit. He charged the bankruptcy estate approximately $3,500 for a five-day trip to New Orleans for oral argument. The trustee and his wife made the trip together, along with their two children. U.S. Bankruptcy Judge Marvin Isgur removed Smith as trustee, concluding that the lawyer "intentionally charged the estate…for substantial expenses incurred for his personal benefit." He found "clear and convincing" evidence of breach of fiduciary duty based partly on two previous instances where the court had questioned his conduct. The trustee/lawyer failed to win a stay pending appeal. Consequently, the application of the statute automatically resulted in his removal as trustee in all other cases in which he was serving. The district court upheld his removal last year because "staying in an expensive hotel might be poor judgment, but staying in an expensive one in a vacation town when you are not needed is categorically worse."

The lawyer appealed again and lost in a Sept. 25 opinion written by Fifth Circuit Judge Patrick E. Higginbotham. His opinion can be read to infer that a trustee can be more easily removed if prior criticism gave notice "that he need[s] to scrupulously observe his fiduciary duties." Construing the elements of "cause" required for removal, Judge Higginbotham held that the lawyer's conduct would meet both the "gross negligence" and "actual injury or fraud" standards. In the process, he pointed out a conflict between the Second Circuit on one side and the Third

and Ninth Circuits on the other. Where the Second Circuit requires "fraud or actual injury," the other two circuits take a "middle ground approach" where "threat of material adversity" is enough in the context of a conflict of interest. Judge Higginbotham also rejected the lawyer's argument that Section 324(a) is unconstitutional on its face or as applied.

[Trustee Bassel] One of the things I find most despicable as a Chapter 13 Trustee is an attorney or anyone else who takes advantage of financially distressed people. Our office has made referrals to the United States Trustee and our Tarrant County District Attorney when we run across these issues. The problem with the cases is that it is often hard to find the perpetrator.

On the ethics, issue, we have an interesting case developing in the Northern District of Texas. The issues causing concern for the court are: (1) when the debtor is not on a wage directive, counsel's authorized use of the debtor's debit card to make the plan payment and (2) debtor's counsel referring a debtor to a car lender in conjunction with a conversion of the case to a Chapter 7 such that the lender pays part of the debtor's counsel's fees for handling the conversion. Regarding the first issue, the debtor's counsel used the debtor's debit card to transfer funds to counsel's firm's bank account. Counsel then purchased a cashier's check to send to the trustee to make the plan payment. Regarding the second issue, the payment of the fees to debtor's counsel for the conversion were rolled into the car note and secured by the vehicle the debtor purchased. There was a problem with Rule 2016 disclosures and compliance with §329. At least in some cases, these fees were not disclosed. There is also a question whether there was compliance with §504 governing sharing of compensation. And the court also expressed concern about a conflict of interest between counsel and client.

The briefing is due February 1st (after the submission of this paper), so there is no decision on these issues as of the time this paper was submitted, but we may know more by the time of the presentation.

11. Cooperation with Trustee waives the attorney client privilege.

[Judge Norman] *In re Coyle*, 2015 WL 5675737 (Bankr. C.D. Ill. 2015). Trustees, the UST and creditors' attorneys must respect the privilege and the ethical obligations of their colleagues. The local practice of trustees and the UST insisting on the production of confidential information and debtors' attorneys assuming that production is required must be seriously reviewed and considered by all involved.

Debtor's counsel voluntarily provided the trustee with a copy of the debtor's worksheet and billing records. The trustee passed the documents on to a plaintiff who sued the debtor to deny her a discharge under § 727(a)(2). The debtor asserted that the worksheets were not admissible because of the attorney-client privilege. Court ruled that privilege has been waived.

Debtors must file honest, accurate schedules and other documents in their bankruptcy cases. But there is no requirement that the first draft of such documents or that preliminary worksheets created to facilitate preparation of such documents be pristine. Negative inferences generally should not be drawn simply because preliminary documents never filed with the court are incomplete or contain inaccuracies.

Another disputed issue this year, one in which the U.S. Court of Appeals for the Fifth Circuit appears to hold a minority view, concerns the propriety of a "third-party release" through a chapter 11 plan. As a basic principle, the Bankruptcy Code provides a chapter 11 debtor the opportunity to obtain a "fresh start" by confirming a plan of reorganization. With few exceptions, a reorganized debtor exits bankruptcy owing only those obligations preserved in the confirmed plan. However, the Code does not contemplate the discharge of liabilities belonging to non-debtors. Third-party releases operate to extinguish the liability of a non-debtor arising from certain claims, causes of action, and other rights to payment held by third parties in interest.

[Trustee Bassel] Waiver is tricky and you never want to be the attorney who caused your client to lose a right. Trustees are perfectly capable of serving discovery when information cannot be provided based on an informal request if there is an issue of privilege or some other basis to object to the request. It is great when we can get information informally because it saves everyone time and money, but sometimes that is just not possible.

On the issue of claim release, it has not come up specifically in our cases, but the leading case in the Fifth Circuit on this issue is *Republic Supply v. Shoaf*, 815 F. 2d 1046 (5th Cir. 1987) which involved the release of a third party guarantor. The Fifth Circuit allowed the release because the plan was clear, unambiguous and contained an express release. The release in *Shoaf*, by the way, was supported by substantial consideration - the payment of $850,000.00 to the debtor that was not otherwise property of the estate. The Fifth Circuit recently considered the issue of a third party release in *Hernandez v. Larry Miller Roofing, Inc.*, No. 15-10287, 2016 WL 67217(5th Cir. January 5, 2016) and the lesson is clear. If you are attempting to release a third party in the plan, state specifically what you are trying to accomplish. Everyone should be on notice regarding what you are trying to do. That lesson would appear to be just as applicable in a Chapter 12 or 13 proceeding as in a Chapter 11 and applicable to all kinds of plan issues, not just third party releases.

12. Denial of Confirmation is not a final order.

[Judge Norman] The Supreme Court unanimously held debtors must suffer dismissal or confirmation of a plan they do not want as a condition for appeal of the denial of confirmation. *Bullard v. Blue Hills Bank*, 2015 WL 1959040 (May 4, 2015).

Quoting the Supremes: "We think that in the ordinary case treating only confirmation or dismissal as final will not unfairly burden a debtor." I personally like this quote: "This prospect is made tolerable in part by our confidence that bankruptcy courts, like trial courts in ordinary litigation, rule correctly most of the time."

Is this much ado about nothing? I think so. Appeals on these types of cases are rare. Is this decision more important in commercial bankruptcies? Again, I think so.

It would appear that if you want to appeal, you either need to confirm a plan you do not want and appeal its confirmation or allow the case to dismiss and then appeal. Both alternatives for the average consumer debtor are likely unpalatable.

[Trustee Bassel] Judge Norman is correct. This is a rare issue in Chapter 13. There is also the possibility of an interlocutory appeal, also not a perfect answer to the issue.

13. Conduit mortgage payment issues for those districts having just made or are about to make the switch.

[Judge Norman] I support conduit mortgage payments and mandatory wage orders for a multitude of reasons and think all of the reasons against conduit mortgage payments fall flat. First, conduit mortgages force debtors and their attorneys make a reasonable determination of the debtor's ability fund a Chapter 13 plan with a mortgage arrears cure. Second, conduit mortgages alleviate the legal issues involved in a debtor not making a mortgage payment in a confirmed Chapter 13 plan. Lastly, they simplify the process and accounting at the end of a Chapter 13 when a mortgage is deemed current. I have heard and, at times in my legal career, made all of the arguments for not allowing direct mortgage payments. However, except where the debtor is current on the mortgage as of the petition date, I reject these arguments and support conduit mortgage payments.

[Trustee Bassel] The only objection I've dwelled on for long regarding conduit programs is that the trustee's percentage fee increases the cost to the debtor. That bothered me when I was analyzing that issue for our judges (our district is going conduit soon). But what I found out negated my concerns. Trustees report a significant decrease in the percentage fee when they "go conduit" and that benefits every debtor on every claim for which the trustee is the disbursing agent, whether the debtor is conduit or not. The average increased cost in the average case caused by paying the mortgage payment came to about $15.00 per month which was offset by the decreased fee on other debt paid through disbursements made the Trustee. Additionally, there is a savings to the debtor because there are almost no motions for relief from stay on home mortgages in a conduit program. And the debtor has the benefit of the trustee's record keeping on disbursements made to the mortgage lender. Finally, because the trustee makes the disbursements, we can truly say at the end of the case that the pre-petition arrearage and post-petition payments have been made and that the debtor is 100% current to the mortgage lender, providing the debtor with a meaningful clean slate. I've actually convinced myself that conduit payments are a good idea and that *all* payments should be disbursed to all creditors by the trustee, not just the mortgage. You would really know at the end of the case that the debtor is entitled to a discharge.

14. Counting debt unsupported by value or personal liability. (Chapter 12 case, applicable to Chapter 13).

[Judge Norman] To calculate "aggregate debt" for purposes of determining eligibility in a Chapter 12 case, "debt" includes the unsecured portion of an undersecured claim notwithstanding discharge of the debtor's personal liability in a prior Chapter 7 case. *In re Davis*, 778 F.3d 809 (9th Cir. 2015).

But, there is a case from the same circuit which held contrary. *Free v. Malaier (In re Free)*, 14-1395 (B.A.P 9th Cir. 2015). The holding in that case was that *in personam* debts discharged in a prior chapter 7 are not to be counted toward the unsecured debt limit in a subsequent chapter 13.

[Trustee Bassel] In *Free*, the Ninth Circuit argues that its opinions in both *Free* and *Davis* are consistent. The difference boils down to whether the debtor is in a Chapter 13 proceeding or a Chapter 12 proceeding. In a Chapter 12 case, the debt limitation is determined by the total aggregate debt pursuant to §§109(f) and 101(18), unlike a Chapter 13 case in which it is bifurcated between secured and unsecured debt. In *Davis*, the debtor argued that her personal liability on a debt secured by a piece of real property was discharged in her Chapter 7 proceeding and that the amount which should be included in her aggregate debt total was only the secured portion which she proposed to pay through the Chapter 12 Plan. The Ninth Circuit concluded that the full amount owed continue to be a claim against the real property per *Dewsnup v. Timm* and was part of the aggregate debt. On the other hand, *Free wa*s a Chapter 13 proceeding and the debt limitation is split into a cap for secured debt and a cap for unsecured debt. 11 U.S.C. §109(e). The Chapter 13 Trustee moved to dismiss the case in *Free*, asserting that the unsecured debt, including the wholly unsecured junior lienholder claims, the *in personam* liability for which was discharged in the debtor previous Chapter 7 proceeding, should be included in the calculation of the debt limitation. The debtors argued that these claims should not be included in the calculation because their *in personam* liability on the claims were unenforceable because of the Chapter 7 discharge. The Ninth Circuit agreed with the debtors deciding that there is no unsecured debt unless the creditor has right to payment on an unsecured basis. But there was no such right to payment held by the junior lienholders in *Free* because personal liability was previously discharged.

15. Domestic partners cannot file a joint bankruptcy case.

[Judge Norman] *Perry v. Schwarzenegger*, 704 F. Supp. 2d 921 (N.D. Cal. 2010). The Bankruptcy Code itself contains no definition of "spouse." When the Defense of Marriage Act, which defined the term "spouse" for purposes of federal law as a person of the opposite sex who is a husband and wife, was declared unconstitutional in 2013, there was no longer any federal statute defining the term "spouse." A domestic partnership under California law is not a marriage; therefore, a domestic partner is not a spouse. As same sex couples now have a right to marry nationwide, a domestic partnership is not the same as a marriage.

[Trustee Bassel] Yes, the defendant in the case is Arnold Scharzenegger in his capacity as the governor of California. The Code does not define "spouse", but §302 provides that a joint case may be filed by a debtor and the debtor's spouse. Marriage creates the legal relationship required by §302.

16. Split between the Sixth and Fifth Circuits on the effect of an order lifting the automatic stay by permitting a lawsuit to proceed.

[Judge Norman] Are lawsuits that are filed in violation of the automatic stay void or voidable? In the Sixth Circuit, absent limited equitable circumstances, lawsuits are void and they should be dismissed. Probably not the same result in the Fifth Circuit. *Cox v. Specialty Vehicle Solutions LLC*, 15-80 (E.D. Ky. 2015). District Court Judge Amul R. Thapar pointed out the significance of a split between the Sixth and Fifth Circuits on the effect of an order lifting the automatic stay by permitting a lawsuit to proceed. A creditor filed a lawsuit not knowing that the defendant was

in bankruptcy. After receiving notice of the stay, the creditor filed a motion to modify the stay. When the bankruptcy judge lifted the stay, the creditor filed a second suit in Judge Thapar's court. The first suit was removed to Judge Thapar's court, alongside the second complaint. Judge Thapar dismissed both. In the Sixth Circuit, where Kentucky is located, a suit in violation of the stay must be dismissed, Judge Thapar said, absent "limited equitable circumstances."

[Trustee Bassel] The creditor did the right thing here by moving to lift the stay when it found out a bankruptcy was filed. Dismissing the cases seems more like a procedural kerfuffle adding confusion and costs to the matter. The cases were removed to the bankruptcy court where they could have been dealt with. The Fifth Circuit's "voidable" standard protects the rights of the debtor and the other parties.

17. Recent Miscellaneous Cases of Interest

Fifth Circuit Upholds Dismissal Under 707(a) for Debtor's Bad Faith Conduct

In an opinion that has generated considerable discussion on the Texas Bankruptcy Section listserv, the Fifth Circuit Court of Appeals upheld the Bankruptcy and District Court's dismissal of a debtor's case for bad faith pursuant to 11 U.S.C. 707(a) after the deadlines for objecting to discharge or dischargeability had already passed (without objection). *Krueger v. Torres*, (*In re Krueger)*, 14-11355, (5th Cir. 2016). The debtor contended that the grounds on which this case was dismissed must be asserted in an adversary proceeding objecting to discharge under 11 U.S.C. § 727(a). The Fifth Circuit stated the debtor's "argument fails for the simple reason that this proceeding was adjudicated as a motion to dismiss the bankruptcy case. The remedy imposed by the court was a dismissal with a temporary filing bar, not the denial of discharge or dischargeability."

Adoption Payments Exempt from Disposable Income

The Ninth Circuit's Bankruptcy Appellate Panel has ruled that adoption payments are not "disposable income" that must be devoted to payment of creditors' claims in a chapter 13 plan. The debtor adopted a child from foster care, and received $1,400 a month in adoption assistance payments under the federal Adoption Assistance and Child Welfare Act of 1980. Half of the funding came from the federal government, 37.5% from the state, and 12.5% from the county. The payments were made by the county social services agency, not by the federal government. The majority interpreted "benefits received under the Social Security Act" as meaning "benefits received subject to the authority of, and in accordance with, 42 U.S.C. §§ 301-1397mm." Although adoption benefits are paid by the county government, they are nonetheless "subject to the federal program requirements and standards of 42 U.S.C. §§ 670-679(c) and federal oversight." Because adoption benefits are "received under the Social Security Act," the majority reversed the bankruptcy court and held that they are excluded from the calculation of current monthly income. The opinion, in part, appears contra to those Courts that have held that unemployment compensation is not excluded from disposable income. *Adinolfi v. Meyer (In re Adinolfi)*, 15-1091 (B.A.P. 9th Cir. 2016).

Surrender

Failla v. Citibank, N.A., 542 B.R. 606, (S.D. Fla. Nov. 23, 2015). Surrender precluded debtors from defending against state-court foreclosure. Affirming, the district court held that once the Chapter 7 debtors filed their statement of intention to surrender real property, they had abandoned any interest in the property as against the trustee, or against any secured creditor. Although the debtors are not required to physically deliver the property to the creditor, they are precluded from taking action to interfere with the creditor's ability to obtain possession. The debtors could not defend the creditor's state-court foreclosure, and the creditor's motion to compel the debtors to surrender was properly granted.

Conversion

Borgus, Driftwood Manor Owners Association v. Borgus (In re Borgus), 14-201 (Bankr. E.D.N.C.). An owner of a condominium unit filed under chapter 13 owing a $5,000 secured claim to the homeowners' association. After filing, she ran up another $7,000 in obligations to the association. The day before the association was slated to foreclose her unit, she converted the case to chapter 7. She contended that the association's post-filing claim was discharged, citing Section 348(a), which says that conversion of a case from one chapter to another constitutes an order for relief. Court disagreed holding that Sections 727(a) and 523(a)(16) are also relevant, and that obligations to the association arising after the initial filing were not discharged by virtue of conversion to Chapter 7.

Discharge

Hanson v. Brown (In re Brown), 541 B.R. 906 (Bankr. M.D. Fla. 2015). Judgment for improper use of child's college savings account ruled nondischargeble under § 523(a)(15). The state court had entered judgment against the child's mother for improperly spending the child's college savings account, to which both the mother and father had contributed. The parents were not married, and the adversary complaint was filed by the father on behalf of the minor child. The court held that the judgment was excepted from discharge under § 523(a)(15) as a determination made by a court or record. The judgment was also excepted from discharge under § 523(a)(6) as a willful and malicious injury.

Discharge Injunction

Best v. Nationstar Mortgage LLC (In re Best), 540 B.R. 1 (BAP 1st Cir. 2015). Post-discharge letters from mortgage lender did not violate discharge and were protected by § 524(j). A residential mortgage lender sent letters to the discharged Chapter 7 debtor, which indicated that the letters were for informational purposes only and were not an attempt to collect any discharged debt, and those letters did not demand payment. The former debtor did not prove a violation of the discharge injunction. Even if the letters had constituted an act to collect a debt, under the facts, the creditor fell within the safe harbor of § 524(j). The creditor's motion for judgment on the pleadings was properly granted. Compare that holding to the one in *In re Biery*, 2015 WL 8608804 (Bankr. E.D. Ky. 2015), in which informational statements from mortgage servicers did not violate discharge injunctions, but other letters containing demands for payment could, and the court concluded that class certification was appropriate for the claims of debtors who received post-discharge regular billing statements.

Dismissal

In re Palmer, 542 B.R. 289, 2015 WL 9231503 (Bankr. D. Colo. 2015). Case dismissed under § 707(b)(2) presumption of abuse, with student loans found to be consumer debts. The Chapter 7 debtors responded to the U.S. Trustee's § 707(b) motion with the contention that student loans for a doctorate degree in business administration were incurred by the husband with the intention to become a business owner and that the debt was, therefore, non-consumer. Although the Tenth Circuit Bankruptcy Appellate Panel had held that "student loans are not consumer debts per se," in In re Stewart, 215 B.R. 456, 465 (BAP 10th Cir. 1997), the court concluded "that, in order to show a student loan was incurred with a profit motive, the debtor must demonstrate a tangible benefit to an existing business, or show some requirement for advancement or greater compensation in a current job or organization. The goal must be more than a hope or an aspiration that the education funded, in whole or in part, by student loans will necessarily lead to a better life through more income or profit." This debtor failed to make such a showing that his student loans were "incurred purely or primarily for a profit motive." The case would be dismissed unless it was converted to Chapter 13.

Unjustified refusal to pay debts may be "cause" for dismissal under § 707(a). After the bankruptcy court denied dismissal of a Chapter 7 case, finding that bad faith was not a cause for dismissal under § 707(a), the Seventh Circuit decided In re Schwartz, 799 F.3d 760 (7th Cir. 2015). In Schwartz, the Circuit held that the "for cause" language in § 707(a) included bad faith determinations, such as the debtor avoiding payment of a debt without adequate reason, but the Schwartz Court did not adopt a formalistic bad faith analysis. Therefore, bankruptcy courts have discretion to dismiss under § 707(a) for "unjustified refusal to pay one's debts, regardless of whether the debtors' conduct amounts to 'bad faith,' and the case was remanded for consideration in light of *BMO Harris Bank N.A. v. Isaacson*, 2015 WL 6701788 (N.D. Ill. Nov. 2, 2015). *See also In re Wilcox*, 539 B.R. 137 (Bankr. S.D. Tex. 2015) (Chapter 7 case was dismissed for cause, based on debtor's lavish lifestyle and excessive prepetition spending). That court rejected "the narrow interpretation of 'cause' articulated and applied by the Ninth Circuit" in *In re Padilla*, 222 F.3d 1184 (9th Cir. 2000).

Court may dismiss cases for abuse under § 707(b) when they are converted from Chapter 13 to 7. Reviewing the split of authority on whether § 707(b) applies to cases converted from Chapter 13, the court held that the statute authorized dismissal for abuse of provisions of Chapter 7, even though the case was originally filed under Chapter 13 and converted to Chapter 7. *In re Burgher*, 539 B.R. 868 (Bankr. D. Colo. 2015); *In re Croft*, 539 B.R. 122 (Bankr. W.D. Tex. 2015) (if filing abusive, dismissal is authorized even though case was filed under Chapter 13 and converted.).

Confirmation

In re Wark, 542 B.R. 522, (Bankr. D. Kan. 2015). United States Trustee's objections to confirmation overruled. In a thorough examination of ten cases in which the United States Trustee objected to confirmation, the primary issue was whether debtors exercised good faith in choosing to file Chapter 13 rather than Chapter 7, when the plans would primarily pay filing fees

and debtors' attorney fees. The United States Trustee urged the court to adopt a "high threshold" for such debtors, and that they should not be able to choose Chapter 13 "unless they can show 'special circumstances' justifying the filing of a Chapter 13 petition and plan, and being unable to raise the cash to hire competent counsel is not such a special circumstance in the U.S. Trustee's estimation." The court rejected this approach, finding under a totality of circumstances that the cases were filed in good faith and most debtors established feasibility (confirmation denied in three cases for lack of feasibility). The Code provides debtors a choice between Chapter 13 and 7, with no requirement in the Code for a "special circumstances" or other "heavy burden" test.

Modification of Plan

In re Williams, 542 B.R. 514 (Bankr. D. Kan. Dec. 2, 2015). Modification to vest surrendered property in mortgage creditor was denied. The plan had been confirmed with the debtor retaining a residence and a subsequent motion to modify to allow surrender of the property to the creditor was granted without objection. The debtor then abandoned the property and the creditor was maintaining it. The debtor then moved to further amend the confirmed plan to provide that the surrender vested the property in the creditor and that approval of the modification would constitute a deed of conveyance. A timely objection was filed to this motion by the creditor. The opinion reviewed the decisions from other courts, some of which had allowed such vesting when there was no objection, and some allowing vesting over the objection of the creditor, with some courts denying vesting as impermissible. The court noted that "surrender" and "vesting" are not synonymous terms, with neither defined in the Bankruptcy Code, and then concluded that "although § 1322(b)(9) allows vesting the title to property in a secured creditor, § 1325(b)(5) does not permit confirmation of a plan vesting title to collateral to a secured creditor over that creditor's objection. The plain meaning of the statutes compels this result. Section 1325(a)(5)(C) permits confirmation without the secured creditor's consent when the plan provides for surrender of the collateral to the creditor. Surrender and vesting are not equivalent. . . .Section 1322(b)(9) includes vesting as a discretionary term of a plan, but it does not assure confirmation of a plan providing for vesting." To permit vesting over the creditor's objection would transform "the creditor's right into an obligation, thereby rewriting both the Bankruptcy Code and the underlying loan documents, while at the same time belying the secured creditor's state law rights."

Claims

Jackson v. U.S. (In re Jackson), 541 B.R. 887 (B.A.P. 9th Cir. 2015). IRS's amended proof of claim related back to timely claim. IRS filed a timely proof of claim in the Chapter 13 case, estimating tax liability for 2009, and after the debtor's 2009 tax return was filed, IRS amended its claim. Reviewing Code § 1308 and Rule 3002(c)(1), the Bankruptcy Appellate Panel held that an amendment to a timely proof of claim relates back to the timely claim when the original claim provided "fair notice of the conduct, transaction, or occurrence that forms the basis of the claim

asserted in the amendment." The bankruptcy court correctly overruled an objection, with the amended claim relating back to a timely claim.