Today's Chapter 7 (in Three Installments)

Concurrent Session

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Today's Chapter 7

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A. EXEMPTIONS

1. ***Schwab v. Reilly*, __ U.S. __, 130 S.Ct. 2652 (2010)**
2. ***Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992)**
3. ***In re Gebhart*, 621 F.3d 1206 (9th Cir. 2010)**
4. ***In re Messina*, 386, Fed. Appx. 152, 2010 WL 2712141 (3rd Cir. 2010)**

(1) Supreme Court reverses Circuit Court's in-kind exemption holding

The debtor in this case had valued her kitchen equipment at $10,718 and claimed an exemption in that same dollar amount (i.e., an in-kind exemption). The trustee did not object within the 30-day period allowed by Rule 4003(b). When the trustee sought to sell the equipment, the debtor objected to his motion claiming that the asset had been removed from the estate through an exemption, the deadline to object to which had already expired. The Bankruptcy Court, District Court, and Circuit Court all ruled in favor of the debtor. The Supreme Court reversed, agreeing with the trustee (and the United States and National Association of Bankruptcy Trustees as *amici curiae)* that the Bankruptcy Code defines the property the debtor is authorized to exempt as an interest, the value of which may not exceed a certain dollar amount in a particular type of asset, not as the asset itself. Accordingly, the trustee had no duty to object to an exemption within the limits the Code allowed.

The Supreme Court determined that the Third Circuit erred in holding that the Supreme Court's earlier decision in *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992), dictated a contrary conclusion. While *Taylor*, likewise concerned a trustee's obligation to object to the debtor's entry of a "value claimed as exempt," there was no colorable basis for claiming the exemption. In *Schwab v. Reilly*, the opposite was true as the amounts listed by the debtor as the value of the claimed exemptions were facially within the limits prescribed by the Code and raised no warning flags that warranted an objection. *Taylor* did not rest on an "unstated premise" that a debtor who exempts the entire reported value of an asset is claiming the "full amount," whatever it turns out to be. Instead, *Taylor* stood for the straightforward proposition that an interested party must object to a claimed exemption if the amount the debtor lists as the "value claimed exempt" is not within statutory limits. The Supreme Court concluded that the debtor's approach "threatens to convert a fresh start into a free pass." The Supreme Court's ruling effectively overturns *In re Green*, 31 F.3d 1098 (11th Cir. 1994) where the Eleventh Circuit also interpreted *Taylor* to mean that an in-kind exemption was an indication of a claim that the asset was being fully exempted regardless of its actual value, thereby requiring an objection to the exemption claimed.

(2) Trustees entitled to sell homes based on post-petition appreciation

In the two consolidated cases, individual debtors had filed Chapter 7 petitions in 2003 and 2004 respectively and obtained their discharge later in the same year. In each case, there was disclosed equity in the homes that did not exceed the lawful exemption amounts. Debtors had, in fact, listed the dollar amount of equity in each case as exempt. In neither case did the trustee file an objection to the claimed exemption. Because of other assets in the cases, the estates remained open. The trustees believed that while the cases remained open, the homes had appreciated in value significantly. In one case, the trustee sought to employ a broker to sell the home and was

met with a motion by the debtor to compel abandonment. The bankruptcy court ruled in favor of the trustee, and the district court affirmed. Debtor then appealed to the Ninth Circuit. In the other case, due to payment defaults, the lender had filed a stay relief motion that the trustee opposed on the basis of the equity. The bankruptcy court ruled against the trustee on the basis of the failure to object to the exemption. The Ninth Circuit BAP reversed and held that the appreciation in the homestead belonged to the estate. That decision was also appealed to the Ninth Circuit. The Ninth Circuit affirmed both the district court and BAP opinions, holding that the increase in value belonged to the bankruptcy estates in each of the cases. *In re Gebhart*, 621 F.3d 1206 (9th Cir. 2010). In light of *Schwab v. Reilly*, 130 S.Ct. 2652 (2010), it was clear to the Ninth Circuit that the trustee had no obligation to object to the exemptions claimed in each case even though the value of the claimed exemptions plus the amount of the encumbrances was, in each case, equal to the market value of the residences. The failure to object did not remove the entire asset from the estate. The Ninth Circuit noted that in *Reilly*, the debtor had undervalued the asset where as in these cases they were accurately valued. Nevertheless, any additional value in the property remained property of the estate regardless of whether the property increased in value after the filing. Moreover, the Circuit Court held that what is frozen as of the date of the filing of a petition is the value of the debtor's exemption, not the fair market value of the property claimed as exempt. Finally, the Circuit Court acknowledged that, in some instances, trustees might be inclined to leave the case open longer than necessary. However, the remedy was to seek an abandonment under § 554(b) or hold the U.S. Trustee to its oversight obligations. Denying creditors assets that had not been exempted was not an available remedy. [*Comment*: Based on this holding, certainly trustees in the Ninth Circuit will be tempted to keep open cases during rising real estate markets, and debtors will be tempted to move quickly for abandonment under § 554(b).]

(3) Another Circuit applies *Schwab v. Reilly*

The Trustee did not object to the $36,900 homestead exemption claimed by the debtors, and subsequently brought an action to avoid a mortgage on the property in the amount of $396,000. While this action was pending, the court approved the trustee's proposed sale of the property for a little over $200,000. After the sale, the defendant-mortgagee consented to avoidance. The trustee then moved for an order declaring the debtors' homestead exemption to have a value of zero, as there was no equity in the property to which the exemption could attach. The debtors responded by moving for satisfaction of their $36,900 exemption claim from the sale proceeds because the trustee had failed to timely object under Bankruptcy Rule 4003. The Bankruptcy Court held for the trustee, but the District Court reversed on appeal. Further appeal was taken to the Third Circuit. *In re Messima*, 386 Fed. Appx. 152, 2010 WL 2712141 (3rd Cir.).

The Circuit Court suspended the appeal, awaiting determination of the then-pending Supreme Court case of *Schwab v. Reilly*, 130 S.Ct. 2652 (2010). Based on the subsequent Supreme Court decision, the Third Circuit noted that the 30-day objection period of Rule 4003 "applies to objections based on 'three and only three' elements of a claimed Schedule C exemption" :1) exempted property description; 2) the Bankruptcy Code exemption provisions; and 3) the amount stated as the value of claimed exemption. The court found that when an exemption objection is based on other elements, such as the debtor's market value estimation and the right of the estate to retain value beyond the amount exempted, the Rule 4003 30-day deadline does not apply.

B. BANK ACCOUNT FREEZES/TURNOVER/STAY VIOLATION

1. ***In re Mwangi*, 432 B.R. 810 (9th Cir. BAP 2010.**
2. ***In re Young*, 439 B.R. 211 (Bankr. M.D. Fla. 2010)**
3. ***In re Bucchino*, 2010 WL 3911369 (Bankr. D. N. M. 2010)**
4. ***In re Zavala*, 2011 WL 476874 (Bankr. E.D. Cal. 2011)**
3. ***Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995).**
4. ***In re Brubaker,* 426 B.R. 902 (Bankr. M.D. Fla. 2010), aff'd 443 B.R. 176 (M.D. Fla. 2011)**
5. ***In re Pyatt*, 486 F.3d 423 (8th Cir. 2007)**
6. ***In re Bailey*, 380 B.R. 486 (6th Cir. BAP 2008)**

(1) Cases split on whether stay violated by Wells Fargo's freeze of accounts

When Wells Fargo learned of the chapter 7 debtors' bankruptcy filing, it placed an administrative freeze on the debtors' checking and savings account, pursuant to its national policy. The Debtors had scheduled two accounts with balance totaling $1,300.00. Wells Fargo's freeze was against four accounts of the debtors totaling $17,075.06. Debtors amended to list all of the accounts and funds and claimed 75% exempt. No objection was ever filed by anyone to the claim of exemption. Wells Fargo took no action after receiving no instructions from the trustee to whom it had sent notice of the freeze. It also had refused to release the funds to the debtors in the meantime. Debtors brought a contempt action against Wells Fargo for willful violation of the stay, not withstanding the § 542(b) requirement that property of the estate be paid to the trustee. The bankruptcy court ruled against debtors after determining that §362(a) did not apply because the funds were exempted and not property of the estate. Debtors appealed. The BAP reversed and remanded finding Wells Fargo had exercised control over property of the estate and, therefore, violated the automatic stay, notwithstanding the § 542(b) requirement that property of the estate be paid to the trustee. *In re Mwangi*, 432 B.R. 812 (9th Cir. BAP 2010). The BAP determined that *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995) was inapplicable since there were no setoff rights to protect here. Next, it determined that the accounts were property of the bankruptcy estate and the bank could have paid the account funds to the trustee or released the account funds claimed as exempt to the debtors when demand was made, but it did neither. Moreover, the bank could have sought direction from the bankruptcy court by way of a stay relief motion or otherwise, but it did not. Instead, the bank chose to hold the funds until a demand was made for payment that it alone deemed appropriate. The case was remanded to the bankruptcy court to determine if the violation was willful, and if so, the appropriate amounts of damages to be assessed under § 362(k). *Contra, In re Young*, 2010 WL 3965698 (Bankr. M.D. Fla. 2010)(Williamson, J.)(stay not violated by bank's hold on debtor's accounts pending instructions from trustee because it was merely a refusal to perform its promise to pay to the debtor, who had absolutely no authority to direct disposition of estate property after the case was filed). *See also contra, In re Bucchino*, 2010 WL 3911369 (Bankr. D. N.M. 2010) and *In re Zavala*, 2011 WL 476874 (Bankr. E. D. Cal. 2011).

(2) Trustee entitled to turnover of petition date bank balance

Debtors scheduled their bank account balance at $513. The actual bank account balance on the petition date was $5,862.38. The difference was attributable to checks written by the

debtor pre-petition that had not cleared as of the petition date. The trustee demanded turnover of the account balance on the petition date of $5,862.38. Debtors opposed the motion arguing that because the funds were no longer in the account the trustee could not obtain turnover of the petition-date balance, citing *In re Pyatt*, 486 F.3d 423 (8th Cir. 2007). The bankruptcy court here disagreed. *In re Brubaker*, 426 B.R. 902 (Bankr. M.D. Fla. 2010), *aff'd* 2011 WL 43455 (M.D. Fla. 2011). Judge Paskay noted that there were two schools of thought. One school placed the burden on the debtor to recover the money and the other believed the trustee should be responsible and have to pursue the transferees. However, both schools had agreed that the funds were property of the estate and that neither outcome would be good for debtors. The court held that the funds remained in the account until the checks cleared and were therefore property of the bankruptcy estate subject to the control of the debtors until they had cleared. The checks that had been written were negotiable instruments that constituted an unconditional promise to pay. Although debtors may not have had technical custody of those funds as to which they had written checks to their creditors, they did have control over the funds on the date they filed their petition. Accordingly, debtors were ordered to turnover the funds to the trustee with no reduction for checks which the debtors had written pre-petition, but which had not cleared their account as of the petition date

The Eighth Circuit Court has ruled that § 542 does not allow a Trustee to recover property of the estate from a debtor, where such property is money in the debtor's bank account at the time of filing, which gets transferred post-petition through negotiation of a check written by the debtor. *In re Pyatt*, 486 F.3d 423 (8th Cir. 2007).

On the date he filed his petition, the debtor had $1,938.76 in his bank account. He had written several checks to creditors on the eve of filing, and scheduled $300.00 in the account on his Schedule B, having apparently subtracted the amount of the outstanding checks. The trustee sought turnover of the $1,938.76 petition date balance under § 542(a), which was subsequently compelled by Bankruptcy Court order. On appeal, the BAP reversed, with the majority finding the bankruptcy trustee was better positioned to recover the funds as unauthorized post-petition transfers, under § 549. The concurring opinion disagreed, finding the debtor was better able to prevent loss to the estate, but held that § 542(a) was not authorized for turnover of funds that the debtor no longer possessed or controlled.

The trustee argued the funds were property of the estate because they remained in the account at the time of bankruptcy filing. She further argued that § 542(a) provides for turnover of property or its "value"; and cited the Seventh Circuit Court case of *In re USA Diversified Products, Inc.*, 100 F.3d 53 (7th Cir. 1996), which held that a turnover defendant need not possess property of the estate for a trustee to compel its turnover. The Seventh Circuit reasoned that if present possession were required, "the possessor…could thwart the demand simply by transferring the property to someone else."

The Eighth Circuit agreed with the BAP that a § 542(a) turnover action is not available unless the property remains in the "possession, custody, or control" of the entity against whom turnover is sought. Answering the Seventh Circuit Court concern that this might lead to manipulation through planned transfers of property, the Eighth Circuit held that §549 was available for the trustee to "proceed against the payees of the checks and bring the transferred funds back into the administration of the estate." The court further suggested that trustees could

obligate banks to turn over the petition date balance under §542(b), by notifying them prior to post-petition honor of checks

Comment:: In *In re Schoonover*, 2006 WL 3093649 (Bkrtcy. Kan. 2006), a bankruptcy court in the Eighth Circuit specifically rejected the BAP holding in *In re Pyatt*, 348 B.R. 783 (8th Cir. BAP 2006), and noted that in seven prior reported decisions on this issue, four cases found the debtor responsible for returning the funds to the estate, while three required the trustee to recover the money from the payees under §549. In *Schoonover*, Judge Karlin took a practical approach, based on the realities of bankruptcy estate administration He acknowledged that trustees could file avoidance claims under § 549, but the cost of filing and prosecuting these adversary complaints would frequently, if not almost always, outweigh the benefit of any recovery. The $250.00 filing fee alone would chill many actions. Judge Karlin further considered the trustee's ability to expeditiously notify banks prior to post-petition honor of checks. Unlike the Eighth Circuit, the Bankruptcy Judge acknowledged the "real life" difficulty, if not impossibility, of accomplishing this. The *Schoonover* Court further noted the obvious fact, which was somehow overlooked by the Eighth Circuit that debtors are in control of their checkbooks and accounts, while the trustee is not. When read in the context of actual, rather than academic bankruptcy estate administration, the Eighth Circuit *Pyatt* decision does exactly what the Seventh Circuit feared in *USA Diversified Products, Inc.* It allows debtors to thwart estate administration by permitting them to transfer estate property to whom they choose, while remaining immune from any consequence for this action.

(3) Debtors required to pay amount of tax refund received post-petition, which they had previously paid to their attorney

After filing their case, the debtors received a tax refund derived from pre-petition earnings. On advice of counsel that the funds were exempt, they used part of this money to pay their counsel's attorney fee. The trustee subsequently filed a turnover motion under § 542(a), and the Bankruptcy Court ruled for the trustee, finding the funds were not exempt, and ordering the Debtors to pay the entire amount, including what they had paid their attorney. Appeal was taken to the BAP. *In re Bailey*, 380 B.R. 486 (6th Cir. BAP 2008).

Writing for the BAP, Judge Gregg first found that the erroneous advice of counsel did not create a defense to the turnover action. Further, turnover was appropriate because the refund was property of the estate which was in the debtors' possession during the pendency of the bankruptcy proceeding. The court noted that under pre-1978 Code law, as held by the Supreme Court in a 1948 case, turnover would not be permitted if the defendant did not have possession of the property when the turnover action was filed. However, under the 1978 Code amendments, the trustee's recovery rights were expanded in § 542 to include recovery of "such property, *or the value* of such property." The addition of the words "or the value of such property" were held to specifically apply to this situation, where the debtors are in control of property and are liable for its unauthorized transfer.

C. INHERITED IRAS

(1) PRE-BAPCPA

1. ***In re Sims*, 241 B.R. 467 (Bankr. N.D. Okla. 1999)**
2. ***In re Navarre*, 332 B.R. 24 (Bankr. M.D. Ala. 2004**
3. ***In re Jarboe,* 365 B.R. 717 (Bankr. S.D. Tex. 2007)**

Virtually all courts pre-BAPCPA and many post-BAPCPA have ruled that IRAs inherited by anyone other than a spouse are non tax-exempt, not qualified as retirement plans of the debtor, and may not be exempted from the bankruptcy estate. These cases include *In re Sims,* 241 B.R. 467 (Banker. N.D. Okla 1999); *In re Navarre*, 332 B.R. 24 (Bankr. M.D. Ala. 2004); and *In re Jarboe*, 365 B.R. 717 (Bankr. S.D. Tex 2007). These courts essentially found that an inherited IRA was no longer an IRA at all. There could be no further contributions to it; it could not be rolled over; beneficiaries could take withdrawals at any time without penalty; and withdrawals were required so that the full amount would be entirely disbursed within five years, regardless of the age of the inheriting owner.

(2) POST-BAPCPA

1. ***In re Nessa*, 426 B.R. 312 (8th Cir. BAP April 9, 2010)**
2. ***In re Kuchta, 434 B.R.* 837 (Bankr. S.D. Ohio April 16, 2010)**
3. ***In re Tabor*, 433 B.R. 469 (Bankr. N.D. Pa. June 18, 2010)**
4. ***In re Chilton*, 426 B.R. 612 (Bankr. E.D. Tex. March 5, 2010)**
5. ***In re Klipsch*, 435 B.R. 586 (Bankr. S.D. Ind. June 7, 2010)**
6. ***In re Ard*, 435 B.R. 719 (Bankr. M.D. Fla. August 18, 2010)**
7. ***In re Weilhammer*, 2010 WL 3431465 (Bankr. S.D. Cal. Aug. 30, 2010)**
8. ***In re Mathusa*, 2011 WL 1134680 (Bankr. M.D. Fla. 2011)**
9. ***In re Johnson*, 2011 WL _____ (Bankr. W.D. Wash. May 4, 2011)**
10. ***In re Thiem*, 443 B.R. 832 (Bankr. D. Ariz. 2011)**

For whatever reason, a multitude of cases on this issue have been decided in 2010. Some have found that inherited IRAs remain exempt under two BAPCPA provisions: § 522(d)(12) (under election of federal exemptions) or § 522(b)(3)(c) (preemption of state law exemptions). *In re Nessa*, 426 B.R. 312 (8th Cir. BAP April 9, 2010); *In re Kuchta*, 434 B.R. 837 (Bankr. S.D. Ohio April 16, 2010); *In re Tabor*, 433 B.R. 469 (Bankr. M.D. Pa. June 18, 2010, as amended on July 30, 2010). Contra decisions include *In re Chilton*, 426 B.R. 612 (Bankr. E.D. Tex. March 5, 2010) *aff'd* 2011 WL 938310 (E.D. Tex. 2011); *In re Klipsch*, 435 B.R. 586 (Bankr. S.D. Ind. June 7, 2010); and *In re Ard*, 435 B.R. 719 (Bankr. M.D. Fla. August 18, 2010).

The latter cases distinguish the *Nessa* line of cases based on the proposition that for funds "to be retirement funds," they must contain contributions made by the debtor for retirement, which these inherited IRAs do not. In *Ard*, Judge May made the further important distinction that funds in the original IRA account do not retain the same tax exempt status after being distributed to the beneficiary. The court was assisted in this analysis by a Florida state court decision,

Robertson v. Deeb, 26 So. 3d 936 (Fla. 2d DCA 2009), where the state court held that an inherited IRA is not exempt from the claims of a garnishing creditor of a non-spouse beneficiary.

Comment: Interestingly, neither line of cases cite as authority § 408(d)(3)(C)(i) of the Tax Code, which appears to provide that an inherited IRA is *not an IRA*. This is simply omitted from the *Nessa* line of cases, while the contra cases are based on the law of the particular state which had opted out of the federal exemption scheme.

D. DISCHARGE ISSUES

1. ***In re Coady*, 588 F.3d 1312 (11th Cir. 2009)**
2. ***In re Matos*, 267 Fed. Appx. 884 (11th Cir. 2008)**
3. ***In re Jordan*, 521 F.3d 430 (4th Cir. 2008)**
4. ***In re Jones*, 490 F.2d 452 (5th Cir. 1974)**
5. ***In re Eckert*, 375 B.R. 474 (Bkrtcy. N.D. Ill. 2007)**

(1) Eleventh Circuit affirms debtor's denial of discharge for concealing equitable interest in wife's business

Debtor had formerly been a successful real estate developer with a net worth of approximately $10 million, but an economic downturn left him $27 million in debt. While so indebted, he married, moved into his wife's house, drove a car leased in her name, and for over ten years worked exclusively as an "uncompensated independent contractor" for business entities under her sole ownership. He drew no salary (which his judgment creditors could have garnished), but his wife allowed him to write checks in her name on the business accounts to pay personal expenses. She also paid for his country club and golf club memberships. Although he had neither income nor an individual bank account, he was able to personally execute a $164,000 promissory note to fund a real estate development for one of the businesses. One of his creditors sued him in 2004 to recover on a $290,000 judgment. He filed his Chapter 7 petition in Florida before the conclusion of those proceedings. The creditor then objected to his discharge under §§ 727(a)(2)(A), claiming that he had "concealed" his equitable interest in his wife's businesses. Debtor denied that he had any equitable interest in his wife's property and, alternatively, that any concealment occurred well more than the one-year look-back under that code section. The Bankruptcy Court found debtor had, with the intent to shield assets from his creditors, diverted the fruits of his labor to his wife's businesses and then used business assets to support his personal lifestyle. The debtor appealed and the District Court affirmed. The debtor then appealed to the Court of Appeals for the Eleventh Circuit which also affirmed. *In re Coady*, 588 F.3d 1312 (11th Cir. 2009).

The Circuit Court noted that the debtor was the sole person actually and actively involved in the businesses, and their success depended solely on his continued efforts. Whatever increase in equity resulting in the future from his labor would be protected from his creditors, while being available for his benefit or to fulfill his legal obligations of support for his family. Moreover, the Circuit Court noted that debtor's personal use of business accounts, along with his wife's financial support, replaced any regular compensation that might otherwise have been available to satisfy his creditors' claims. Through this arrangement, he acquired and concealed an equitable interest in his wife's businesses. The Circuit Court also held that the doctrine of continuing

concealment provided for situations such as this where a debtor had kept his assets out of a creditor's reach during the look-back period by means of a sham ownership arrangement established more than one year before the bankruptcy petition was filed. Accordingly, the discharge was denied. [*Comment*: Debtor's equitable interest in his wife's businesses would constitute property of the bankruptcy estate under § 541 that should be administered by the trustee.]

(2) Eleventh Circuit clarifies grounds for revocation of discharge

After the Debtor received his Chapter 7 discharge, a creditor sought revocation based on, among other grounds, the Debtor's failure to obey a court order directing production of documents and setting a four-week deadline for production. The Debtor produced 694 documents prior to the deadline, and another 5,300 after the deadline. On appeal the Eleventh Circuit affirmed the lower Court's denial of discharge revocation. *In re Matos*, 267 Fed.Appx. 884 (11th Cir. 2008).

The Court found late production of documents alone was insufficient to show the requisite willful or intentional refusal to obey an order, or that the order was ignored. The Circuit Court also noted that the Bankruptcy Court's analysis had fully comported with the relevant factors set out in *In re Jones*, 490 F.2d 452 (5th Cir. 1974). The factors to be considered thereunder are (1) the detriment to the proceedings and the dignity of the court versus the potential harm to the Debtor if discharge is denied; (2) whether the Debtor's acts were willful, or was there a justifiable excuse, (3) whether there was injury to creditors, and (4) whether there was some way the Debtor could make amends for the conduct.

Compare this to another revocation case where the Debtor failed to comply with a series of court orders requiring production of documents and testimony at a BR 2004 examination, and was ordered to pay a $3,000.00 sanction. The Debtor failed to pay the sanction, produce the documents, testify, or otherwise respond to material questions concerning disposition of property of the bankruptcy estate. The Trustee and some creditors filed a complaint to revoke the Debtor's discharge under §§727(d)(3) and (a)(6)(C). *In re Eckert*, 375 B.R. 474 (Bkrtcy. N.D. Ill. 2007).

(3) Discharge revoked: burden of proof

Judge Squires joined the majority court view that the plaintiffs in a revocation of discharge action had to establish that the debtor willfully and intentionally refused to obey a court order and not just failed to obey the order as a result of inadvertence, mistake, or inability to comply. This required the plaintiffs to demonstrate some degree of willfulness on the part of the debtor. However, the plaintiffs could meet their initial burden by showing that the debtor received the order in question and failed to comply with its terms, thereby shifting the burden of proof to the debtor to explain non-compliance. Here, plaintiffs showed that the debtor had a "disparaging pattern of refusing to comply with lawful orders of the court." This constituted grounds for revocation of discharge, along with separate grounds established by the failure to produce documents and respond to material questions concerning the disposition of assets.

(4) Revocation of debtor's discharge reversed

After performing a liquidation analysis, the trustee determined that there was insufficient realizable value to market and sell debtor's home. However, the case remained open and no abandonment of the home had occurred. After debtor received a discharge, she promptly refinanced her home, paying off the existing mortgages and receiving approximately $15,000 which she used for living expenses. The refinancing occurred without the knowledge or consent of the trustee or the court. The trustee only learned of the refinancing when he obtained a buyer for the property without the assistance of a realtor so that sufficient value could be realized for the estate. Thereafter, the trustee filed a complaint to revoke the debtor's discharge pursuant to § 727(a)(6) for violating an order of the court. The bankruptcy court revoked the discharge, and its order was affirmed on appeal. The case was further appealed to the Circuit Court, which reversed in part in a split decision. *In re Jordan*, 521 F.3d 430 (4th Cir. 2008). Both the majority and dissenting opinions agreed that the court was required to find that the debtor's lack of compliance with the relevant court order was willful and intentional, that the trustee could satisfy his burden by demonstrating that the debtor received the order in question and failed to comply with its terms, and that the burden would then be shifted to the debtor to explain the non-compliance. However, the majority noted that the bankruptcy court had found that the failure to comply was not willful and, therefore, reversed. The dissenting judge noted that the trustee was required to show simply that the debtor had intentionally and willfully refinanced her home and that the refinancing violated the terms of the court's order. The trustee was not required to show any maliciousness on the part of the debtor. The dissent would, therefore, have affirmed the revocation of discharge.

E. *ESPINOSA* AND DUE PROCESS

1. ***United Student Aid Funds, Inc. v. Espinosa*, ___ U.S. ___, 130 S.Ct. 1367 (2010)**
2. **In re Miell, 439 B.R. 704 (8th Cir. BAP December 9, 2010)**

Upon conversion from Chapter 11 to Chapter 7, the trustee filed a motion to sell several parcels of real estate, free and clear of all liens, encumbrances, claims, and other interests, to Heritage Bank. The Holsingers were junior lienholders against two of the parcels. The trustee gave written notice of her motion to all creditors and other parties in interest, including the Holsingers, but failed to actually serve them with the motion. The only objection filed to the sale was by the debtor, and that objection was overruled. The bankruptcy court entered an order authorizing the proposed sale, and no appeal was taken from that order. The sale was consummated. Thereafter, the Holsingers filed an adversary complaint challenging the sufficiency of the trustee's notice and sought a determination that their liens were unaffected by the sale or a declaration that their liens attached to the proceeds of the sale. The bank moved to dismiss the complaint for failure to state a claim. The bankruptcy court granted the bank's motion, and the Holsingers appealed. The BAP affirmed. *In re Miell*, 439 B.R. 704 (8th Cir. BAP December 9, 2010).

The Holsingers first argued that the bank was not a good-faith purchaser and, thus, not entitled to the protections afforded such a purchaser under § 363(m). However, the BAP noted

that no one had appealed the bankruptcy court order authorizing the sale and, therefore, § 363(m) was inapposite. That left the Holsingers with only a Rule 60(b) argument that the judgment was void. The Holsingers argued that they were denied due process because the trustee's motion did not specifically identify them as secured creditors or specifically describe their liens. The BAP disagreed. The Holsingers did not deny having actually received a copy of the notice of the proposed sale even if they were not directly served with the motion. The notice itself was captioned "NOTICE OF MOTION TO SELL REAL ESTATE FREE AND CLEAR OF ALL LIENS AND ENCUMBRANCES…." The notice went on to list the parcels to be sold, noted that he sale was free and clear of all liens and encumbrances, informed interested parties how to obtain a copy of the motion, the deadline for filing an objection, the deadline for submitting a competing bid, and when and where a hearing would be held to consider any objection or competing bid. Although the trustee clearly violated Rule 6004(c) by failing to serve the motion itself on a party with a lien on the property to be sold, the BAP held it did not rise to a violation of due process rights, citing *United Student Aid Funds, Inc. v. Espinosa*, ___ U.S. ___ , 130 S.Ct. 1367 (2010).

In that case, the Supreme Court stated: "Rule 60(b)(4) strikes a balance between the need for finality of judgments and the importance of insuring that litigants have a full and fair opportunity to litigate a dispute. Where, as here, a party is notified of a plan's contents and fails to object to confirmation of the plan before the time for appeal expires, that party has been afforded a full and fair opportunity to litigate, and the party's failure to avail itself of that opportunity will not justify Rule 60(b)(4) relief. *Id.* at 1380. The BAP concluded: "Like the creditor in *Espinosa*, the Holsingers were afforded a full and fair opportunity to litigate, and like the creditor in *Espinosa*, their failure to avail themselves of that opportunity does not justify Rule 60(b)(4) relief." 439 B.R. at 710.

F. JUDICIAL ESTOPPEL

1. ***Reed v. City of Arlington*, 620 F.3d 477 (5th Cir. 2010)**
2. ***Kane v. National Union Fire Ins. Co.*, 535 F.3d 380 (5th Cir. 2008)**
3. ***Biesek v. Soo Lion R.R.*, 440 F.3d. 410 (7th Cir. 2006)**
4. ***Parker v. Wendy's Int'l, Inc.*, 365 F.3d 1268 (11th Cir. 2004)**
5. ***Pavlov v. Ingles Markets, Inc.*, 236 Fed. Appx. 549 (11th Cir. 2007)**

(1) Trustee judicially estopped due to debtor misconduct

The debtor was a firefighter for the City of Arlington, Texas. He had brought a pre-petition action against the City asserting that he was terminated in violation of the Family and Medical Leave Act. He obtained a judgment for over one million dollars. The City appealed. During the appeal, the debtor and his wife filed a Chapter 7 petition, omitting the lawsuit and judgment from their statements and schedules. They obtained a discharge of approximately $300,000 of unsecured debt. Creditors had been led to believe that this was a "no asset" case. When the trustee and court learned of the omissions, the discharge was revoked. The trustee then attempted to pursue the action so that a distribution could be made to creditors of the estate. The district court found the elements of judicial estoppel were satisfied regarding the debtor but not

the trustee. The district court held that the trustee should be permitted to pursue the debtors' claim, reasoning that the trustee had not engaged in inconsistent conduct and that the creditors would be unduly harmed by her inability to further pursue the appeal. The Court ordered the City to pay the entire judgment to the trustee but, to the extent of any remaining funds, they would be returned to the City rather than the debtor. The City appealed. The Circuit Court reversed. *Reed v. City of Arlington*, 620 F.3d 477 (5th Cir. 2010). The Fifth Circuit determined that the district court had erred in two ways. First, by incorrectly distinguishing the debtor's conduct from that of the trustee in applying judicial estoppel. "Even though [the trustee] herself takes no inconsistent legal positions, she succeeds to the debtor's claim with all of its attributes, including the potential for judicial estoppel." Second, the district court was held to have erred in its weighing of equitable factors. The Fifth Circuit did not believe creditors would be materially advantaged if the case were to proceed further because many had not filed proofs of claim or filed them late and only one-sixth of the original creditors had timely filed and would be behind large priority administrative expenses caused by the ongoing litigation, including the claim of the trustee which was substantially increased because of the judicial estoppel litigation, and the debtor's trial attorney who had already received some payment for his services. In reversing the district court, the Fifth Circuit recognized that its prior decisions had been inconsistent on the judicial estoppel principle, with the court noting that "Their results create, to put it kindly, a mosaic." The panel seemed to invite *en banc* consideration.

Comment: Wow!!!!! The Fifth Circuit straightforwardly applied judicial estoppel to the Chapter 7 trustee, while conceding that the trustee neither misrepresented nor concealed anything in the bankruptcy case process. The court apparently assigned such misdeeds to the trustee as successor to the debtor. How does a trustee, as representative of the bankruptcy estate, become liable for post-petition misdeeds of a debtor? And what about the creditors? Apparently the fact that the trustee would be paid a little more than 5 percent of the amount to be distributed to creditors was a problem for the court, along with the fact that many creditors did not file timely claims. Should those creditors who did file timely be denied payment of their claims? And are not the untimely filed claimants likely to receive distribution as well, as this appears to be a surplus case, though the defendant rather than the debtor would receive any surplus? Is this decision really based upon a dislike and distrust of the bankruptcy system itself? The Fifth Circuit decisions are also completely inconsistent with the Fifth Circuit's earlier decision of *Kane v. National Union Fire Ins. Co.*, 535 F.3d 380 (5th Cir. 2008).

(2) Raising *Kane*

The debtors neither disclosed their pending personal injury action in the schedules filed in their Chapter 7 case, nor otherwise informed the trustee, who filed a no asset report. The debtors subsequently received their discharges. When the personal injury action defendants filed a motion in state court seeking dismissal based on judicial estoppel, for failure of the debtors to list the action as an asset in their bankruptcy case; the debtors moved to reopen the bankruptcy proceeding to allow the trustee to administer the lawsuit for the bankruptcy estate. Over the defendants' opposition, the bankruptcy court granted the motion to reopen. The case was then removed by the state court defendants to federal court, where they again moved for dismissal based on judicial estoppel. Shortly thereafter, the trustee moved to substitute himself for the debtors in the lawsuit as the real party in interest. The Federal District Court granted the dismissal motion, and summarily denied the trustee's motion as moot. Appeal was taken to the

Fifth Circuit. *In re Kane v. National Union Fire Ins. Co.*, 535 F.3d 380 (5th Cir. 2008).

The Circuit Court distinguished its earlier case of *In re Superior Crew Boats, Inc.*, 374 F.3d 330, upon which the District Court had relied. The Court noted that the prior case had involved an asset which the trustee was informed about, and which was formally abandoned under § 554. There, the debtors had the asset back and stood to profit from their prior nondisclosure. Here, the asset had not been abandoned and the Debtor could only benefit from surplus funds available after case administration. The Fifth Circuit cited and followed the Seventh Circuit case of *Biesek v. Soo Line R.R. Co.*, 440 F.3d 410, 413 (7th Cir. 2006), which stated, "Judicial estoppel is an equitable doctrine, and using it to land another blow on the victims of bankruptcy fraud is not an equitable application."

(3) 11th Circuit holds judicial estoppel does not apply to trustee

Approximately two years after filing an employment discrimination action, the debtor filed a Chapter 7 petition. The discrimination claim was not listed in the schedules, and a no asset discharge was granted. When the trustee subsequently learned of the lawsuit, he reopened the bankruptcy case and intervened as plaintiff in the discrimination action on behalf of the bankruptcy estate. Upon motion of the defendants, the District Court dismissed the trustee under the doctrine of judicial estoppel. Appeal was taken to the Circuit Court. *Parker v. Wendy's International, Inc.*, 365 F.3d 1268 (11th Cir. 2004). The Circuit Court found the discrimination action to be an asset that was never abandoned from the bankruptcy estate or by its representative, the trustee. Because the trustee made no false or inconsistent statement under oath in a prior proceeding, he was not tainted or burdened by the debtor's misconduct. Accordingly, the District Court was reversed, "Because the doctrine of judicial estoppel was improperly invoked."

(4) Judicial estoppel applies where Trustee fails to intervene

The *pro se* debtors failed to schedule a personal injury claim in their chapter 13 case. Based on judicial estoppel, the district court granted summary judgment to the defendants. The Eleventh Circuit affirmed. *Pavlov v. Ingles Markets, Inc.*, 236 Fed.Appx. 549 (11th Cir. 2007). In *Parker v. Wendy's Int'l, Inc.* at 365 F.3rd 1268 (11th Cir. 2004), the Eleventh Circuit held that a district court had abused its discretion in applying judicial estoppel because the plaintiff's cause of action was the property of her Chapter 7 bankruptcy estate, and the trustee had intervened as a party-plaintiff in the underlying lawsuit. Here, however, the circuit court distinguished *Parker* because there had been no appearance by the trustee through intervention or otherwise. (*Comment:* Once an undisclosed personal injury or other claim is discovered by the trustee, the trustee should take immediate steps to intervene to prevent a result like this one).

G. STANDING

1. ***In re Seres*, 473 B.R. 775 (Bankr. W.D.N.Y. 2010)**
2. ***In re Adams*, 424 B.R. 434 (Bankr. N.D. Ill. 2010)**
3. ***In re T.G. Morgan, Inc.*, 394 B.R. 478 (8th Cir. BAP 2008)**
4. ***In re Aja.*, 442 B.R. 857 (1st Cir. BAP 2011)**

(1) Debtor lacks standing to object to trustee's settlement

The Chapter 7 debtor had failed to schedule as an asset of the estate his pending personal injury action against those who injured him in a pre-petition motor vehicle accident. He also failed to disclose it when questioned by the trustee at the meeting of creditors. The trustee moved to approve a $75,000 settlement of the personal injury action. Debtor objected on the basis that it was woefully inadequate given the severity of his injuries. The bankruptcy court approved the settlement. *In re Seres,* 473 B.R. 775 (Bankr. W.D. N.Y. 2010). Judge Bucki ruled that debtor's failure to disclose the existence of the PI action was essentially a representation by debtor that it was of no more than *de minimis* value and was judicially estopped from challenging the adequacy of the settlement.

(2) Debtors lack standing to object to trustee's sale price

Debtors listed a 20% interest in a particular LLC which they valued at $280,000. Trustee moved to sell the estate's interest in the LLC for $20,000, and debtors objected. Trustee attempted to negotiate with the debtors over the next nine months during which time the offer increased to $36,000, but no agreement was ever reached with the debtors, so the trustee went forward with the motion. Trustee argued that debtors lacked standing to object because they had no pecuniary interest in the bankruptcy case that would directly and adversely affect them. Debtors countered that they did have a pecuniary interest because of claims filed by the IRS and the Illinois Department of Revenue for over $200,000 that debtors characterized as non-dischargeable. Thus, the more money the Trustee made on the proposed sale, the more that would be paid to satisfy the tax claims. The court overruled the objection and approved the trustee's sale. *In re Adams*, 424 B.R. 434 (Bank. N.D. Ill. 2010). Judge Goldgar first recognized that to have standing a person must have a pecuniary interest in the outcome of the bankruptcy proceedings, and, moreover, the order must directly and adversely affect that interest. Here, the debtors were hopelessly insolvent with no chance of a surplus. While the Court recognized that several other courts had endorsed the debtor's theory of standing in Chapter 7 cases, it rejected those cases. First, Judge Goldgar found that the possibility of reduction of non-dischargeable tax claims was an indirect and not a direct effect of the court's order. Second, to grant standing to every "debtor who happens to be subject to some non-dischargeable claim would interfere with the administration of chapter 7 cases." Indeed here, the debtors' objection had delayed the sale by a full year even though the debtors had not themselves offered to pay more than the trustee's proposed sale price nor had they produced a bidder willing to do so. Under no circumstances would the debtors have received a distribution from the estate in this case and, therefore, they had no standing to object to the sale

(3) Parties objecting to trustee's final report had no standing

Throughout the course of this case's 17-year history, Trustee had taken possession and distributed various assets which certain individuals claimed that they owned, and the Trustee also had pursued avoidance actions against those same individuals. These individuals had no claims against the bankruptcy estate but nevertheless objected to the Trustee's 110-page Final Report and Proposed Distribution alleging "massive fraud," breach of fiduciary duty and accusing the bankruptcy court of abrogating its jurisdiction to the Trustee. The objections were overruled and

they appealed. *In re T.G. Morgan, Inc.*, 394 B.R. 478 (8th Cir. BAP 2008). As an initial matter, the BAP agreed with the bankruptcy court that the objecting parties lacked standing to object because they had no pecuniary interest in the outcome. The BAP also agreed with the bankruptcy court's determination that the objectors' claims were barred by the doctrine of *res judicata* and collateral estoppel. The BAP noted that over a 15-year period, the objecting parties were extremely prolific in litigation to the point where several of them were admonished and enjoined from prosecuting any action against the trustee and others without an attorney or prior written authorization from a judicial officer of the District Court of Minnesota. The court agreed with the trustee's assertion that the objections had nothing to do with the Final Report but were merely frivolous and unfounded claims that had been rejected by the courts on numerous occasions in prior litigation. Accordingly, the objections were overruled and the order approving the Final Report affirmed.

(4) Debtor lacks standing to appeal *in rem* stay relief after conversion to Chapter 7

The lender loaned $400,000 to the LLC evidenced by a promissory note secured by a mortgage on real estate. Over the course of two years, the LLC filed three voluntary Chapter 11 petitions, all of which were dismissed prior to confirmation. Then the managing partner of the LLC transferred title of the property to herself for a nominal consideration and filed her own individual Chapter 11 case just minutes prior to a foreclosure sale on the property. Shortly thereafter, the lender filed a motion for *in rem* stay relief essentially for bad faith and lack of adequate protection. Before the hearing date on the motion, the case was converted to a Chapter 7, and a trustee was appointed. The trustee was given an opportunity to respond to the motion. The trustee filed an opposition to the motion alleging, among other things, that there was equity in the property and that it should be marketed commercially. At the hearing, the trustee announced that she was withdrawing her opposition because she had determined that there was no equity in the property. As it was undisputed that there was no equity and debtor could not viably reorganize, stay relief was granted. Debtor appealed. *In re Aja*, 414 B.R. 857 (1st Cir. BAP 2011). The BAP found that the lender was correct in arguing that debtor had no standing to pursue the appeal because she had no pecuniary interest in the outcome as there was no equity in the property. The only party with standing to appeal the adverse ruling on the motion for stay relief was the trustee who had withdrawn a previous objection and not pursued the appeal. Thus, the bankruptcy court was affirmed.

H. SELF-SETTLED TRUSTS

1. ***In re Schultze*, 324 B.R. 712 (Bankr. E.D. Ark. 2005)**
2. ***In re Cutter*, 398 B.R. 6 (9th Cir. BAP 2008)**
3. ***In re Phillips*, 411 B.R. 467 (Bankr. S.D. Ga. 2008)**
4. ***In re Bryan*, 415 B.R. 454 (Bankr. D. Colo. 2009)**
5. ***In re McCoy*, 274 B.R. 751 (Bkrtcy. N.D. Ill. 2002)**

(1) Self-settled spendthrift trust held property of the estate

Debtor's self-settled spendthrift trust held securities worth more than $860,000. The trust

was established to centrally manage his property and to protect it from his own financial carelessness. Debtor was the sole beneficiary although upon his death any undistributed trust corpus would be transferred to his heirs. The trustee of the trust also had broad discretion to distribute trust income or corpus to the debtor for different purposes. The bankruptcy court first determined that the self-settled nature of the trust invalidated the spendthrift provision, and second that creditors could have reached both the trust assets and income. *In re Schultze*, 324 B.R. 712 (Bankr. E.D. Ark. 2005). Judge Evans noted that the debtor had not clearly manifested an intent to create a beneficial interest in his heirs. Plus, the broad language of the trust gave the trustee thereof the ability to pay medical and other debts of the debtor. Therefore, the court held that debtor's beneficial interest extended to both the income and principal of the trust, all of which could be administered by the Chapter 7 Trustee.

(2) Self-settled spendthrift trust held property of the bankruptcy estate

Section 541(c)(2), which excepts from the bankruptcy estate property which is held in trust for the sole benefit of others, does not apply to all spendthrift trusts. Here, the Ninth Circuit BAP reversed the decision of the Bankruptcy Court, and found spendthrift provisions in a trust to invalid where the Debtor was the Trustee, a beneficiary, and had the power to invade the corpus of the trust for his own benefit. Following applicable California case law, the BAP cited *Nelson v. California Trust Co.*, 33 Cal.2d 501, 202 P.2d 1021, which stated, "It is against public policy to permit a man to tie up his property in such a way that he can enjoy it but prevent his creditors from reaching it, and where the settlor makes himself a beneficiary of a trust any restraints in the instrument on the involuntary alienation of his interest are invalid and ineffective." Thus the entire trust corpus was subject to administration by the Trustee. *In re Cutter*, 398 B.R. 6 (9th Cir. BAP 2008).

Comment: While this case applies California law, most state law would probably give the same result.

(3) Self-settled spendthrift trust held not enforceable

Debtor was the settler and sole beneficiary of a trust established in 1996. When he filed Chapter 7, the trustee attacked the spendthrift provisions as invalid and sought to have the corpus of the trust turned over to the trustee as property of the estate. The debtor argued that he was not the sole beneficiary because the trust had specifically provided for disposition of the trust corpus after his death pursuant to the terms of his will. The court found in favor of the trustee. *In re Phillips*, 411 B.R. 467 (Bankr. S.D. Ga. 2008). The court found that under Georgia law, a spendthrift provision prohibiting involuntary transfer was invalid if the beneficiary was the settlor, because otherwise the settlor would be allowed to shift assets from "one pocket to another" in an attempt to avoid creditors. Under the Restatement of Property, the court found that the reservation by the settlor for his own benefit to designate the remainder by his will alone still disqualified the trust fund from the protection sought by the debtor. Accordingly, summary judgment was granted to the trustee.

(4) Self-settled trust assets included in property of the estate

Debtor's spouse created the Bryan Family Trust at a time debtor had creditors. The trust beneficiaries were the debtor, his spouse, and their two children. The trust included a spendthrift provision. Subsequent to the creation of the trust, debtor and his spouse purchased a home with over $500,000 of equity. They later conveyed title to the property to the trust for $10.00. The home was conveyed back and forth between the trust and the debtor and his spouse at least four times. New mortgages as well as refinance mortgage transactions occurred that reduced the equity from over $500,000 to $140,000, approximately a 75% reduction. The children, for whose benefits the trust was supposedly created, never benefited at all from the existence of the trust and never received any of the funds. The Bankruptcy Court held for several reasons that the trust was void or unenforceable under Colorado law and its assets available to the trustee for the benefit of the bankruptcy estate. *In re Bryan*, 415 B.R. 454 (Bankr. D. Colo. 2009). Judge Brooks first found that the trust was an invalid spendthrift trust because the debtor was both the settler and one of the beneficiaries. Next, he determined that the trust was a "sham" as debtor and his spouse were in fact the true beneficiaries, the formalities of the trust had been disregarded (i.e., there was no distinction between the trust and the debtor's personal affairs and that the debtor and his spouse exercised complete dominion and control over the trust), and the trust document had provided the trustee of the Trust with unlimited authority to pledge any and all Trust assets as security for *any* indebtedness of the debtor. The court observed: "It is against public policy to permit a man to tie up his own property in such a way that he can still enjoy it but can prevent his creditors from reaching it." Accordingly, the trust was disregarded and the trust assets brought into the bankruptcy estate for administration by the Chapter 7 trustee.

(5) Equitable tolling of avoidance statute of limitation

An Illinois Bankruptcy Court has upheld a Chapter 7 Trustee's challenge to an alleged spendthrift trust. *In re McCoy*, 274 B.R. 751 (Bkrtcy.N.D.Ill. 2002). debtor was the sole trustee of a testamentary trust. While he was given neither trust assets nor any express power to revoke or amend the trust, he had free discretion to spend all trust assets for any purpose he desired. Debtor valued the trust assets at $595,000.00 net of liabilities. The debtor as trustee of the trust and on its behalf obtained a $200,000.00 loan primarily to fund a $165,000.00 divorce settlement. Judge Schmetterer recognized that the subject trust did restrict the beneficiary's ability to alienate, and creditors' ability to attach the trust corpus; but found that under applicable Illinois law this fact would not automatically qualify it as a spendthrift trust. The court must still determine whether the beneficiary had unregulated dominion and control over or right to distribution from the trust. Because the subject trust had a discretionary provision that allowed the debtor/trustee to make payments to himself or for his benefit so long as they were "required or desirable", it was clear that the debtor/trustee had complete dominion and control over the corpus, which invalidated the spendthrift character of the trust. The court therefore ruled in favor of the Trustee, finding that the property of the trust constituted property of the bankruptcy estate subject to turnover.

I. EXEMPTIONS IN PROPERTY HELD IN REVOCABLE TRUSTS

1. ***In re Cocke*, 371 B.R. 554 (Bankr. M.D. Fla. 2007)**
2. ***In re Edwards*, 356 B.R. 807 (Bankr. M.D. Fla. 2006)**
3. ***In re Alexander*, 346 B.R. 546 (Bankr. M.D. Fla. 2006)**
4. ***In re Kester*, 339 B.R. 749 (10th Cir. BAP 2006)**
5. ***In re Szwyd*, 370 B.R. 882 91st Cir. BAP 2007)**
6. ***In re Steffen*, 391 B.R. 874 (Bankr. M.D. Fla. 2008)**
7. ***In re Lyle*, 335 B.R. 161 Bankr. D. Ariz. 2006)**

Homestead Exemption Available Where Property Title Held in Revocable Trust

The Bankruptcy Court for the Middle District of Florida recognizes a debtor's right to claim a homestead exemption in property held in trust for the benefit of the debtor, provided: 1) the debtor has the intent to make the real property his or her homestead; 2) the debtor actually maintains the property as his or her principal residence; and 3) the debtor has a legal or equitable interest that gives the debtor the legal right to use and possess the property as a residence. The court in *In re Cocke*, 371 B.R. 554, 556-57 (Bankr. M.D. Fla. 2007), found that this last factor was satisfied by the fact that the debtors, as the grantors of the trust, retained the right to revoke the trust at any time, with 30 days notice to the trustee, and the fact that the trust granted the debtors the same rights as anyone holding fee simple title (with the exempt the ability to divide the property amongst themselves). *See also, In re Edwards*, 356 B.R. 807, 810-11 (Bankr. M.D. Fla. 2006) (due to its revocable nature, trust was owned by a "natural person" within the meaning of the Florida homestead exemption), and *In re Alexander*, 346 B.R. 546, 551 (Bankr. M.D. Fla. 2006) (individual claiming Florida's homestead exemption need not hold fee simple title; it is sufficient if the individual's legal or equitable interests give the individual the legal right to use and possess the property as a residence). Similar conclusions have been reached in other jurisdictions. *See, e.g., In re Kester*, 339 B.R. 749 (10th Cir. BAP 2006) (applying Kansas law); and *In re Szwyd,* 370 B.R. 882 (1st Cir. BAP 2007) (applying Massachusetts law).

A different result was reached, however, in a case where title to the real property at issue was held by a limited partnership, even though the limited partner, which held 100 percent of the stock of the general partner, was a trust and the debtor was sole trust beneficiary. *In re Steffen*, 391 B.R. 874, (Bankr. M.D. Fla. 2008), *affirmed, In re Steffen*, 405 B.R. 486 (M.D. Fla. 2009). *Accord*, *In re Lyle,* 355 B.R. 161 (Bankr. D. Ariz. 2006) (debtors could not claim Arizona homestead exemption in property where debtors had transferred title of the property to a limited partnership, even though they held 100 percent in the partnership).

J. RIGHTS IN AVOIDED TRANSACTIONS

(1) The issues

(a) Where a first position lien on real property is avoided by a Chapter 7 Trustee, does a junior lienholder's position improve to first position or does the Chapter 7 Trustee "stand in the shoes" of the avoided lienholder?

(b) What can the Debtor exempt?

(c) Is the Trustee limited to recovery of the avoided lien or can the Trustee recover the value of the avoided lien?

(2) Brief Answers:

When a Chapter 7 Trustee avoids a first position lien on real property, the Trustee inherits the avoided lien's priority, and the Trustee may assert any defenses the holder of the avoided lien might have against junior lienholders. Junior lienholders do not advance. The debtor has no exemption rights in the avoided lien. The trustee in some circumstances may recover the value of the avoided lien rather than the lien itself.

(3) Analysis:

a. Preservation of avoided transfers.

Pursuant to 11 U.S.C. § 551,

> Any transfer avoided under section . . . 544, 545, 547, 548 , 549 . . . of this title . . . is preserved for the benefit of the estate but only with respect to property of the estate.

Accordingly, the Trustee in avoiding an unperfected lien steps into the avoided mortgagee's shoes and obtains the rights a perfected mortga gee would have had. *See Kaler v. Letcher (In re Wegner),* 210 B.R. 799 (Bankr. D.N.D. 1997) (where the court found that a Chapter 7 trustee who avoided an unperfected first mortgage succeeded to the mortgagee's interest; and after the avoidance, the second recorded mortgage was subordinate to the trustee's interest under the unrecorded first mortgage)[1] *aff'd Kaler v. Letcher (In re Wegner)*, 162 F. 3d 1166 (8th Cir. 1998); *see also In re Kavolchyck,* 164 B.R. 1018 (S.D.Fla.1994), *In re Fowler,* 201 B.R. 771 (Bankr.E.D.Tenn.1996). By preserving the avoided lien, the bankruptcy estate acquires the rights of the holder of the avoided lien so that junior lien holders do not benefit from the avoidance to the detriment of the estate. *See Fowler,* 201 B.R. 771, 781.

(4) Administering exempt property that is brought into the estate by the Trustee's avoidance powers

A. <u>§ 522(g)</u>

Section 522 provides that:

> (g) Notwithstanding §§ 550 and 551 of this title, the debtor may exempt under subsection (b) of this section property that the trustee **<u>recovers</u>** under §§ 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property

> under § (b) of this section if such property had not been transferred, if –
>
> (1)(A) such transfer was not a voluntary transfer of such property by the debtor; and
> (B) the debtor did not conceal such property; or
> (2) the debtor could have avoided such transfer under subsection (f)(2) of this section.

[Emphasis added]. Note that the term "recovers" is not defined in the bankruptcy code.

B. Rule 4003(b) – Objecting to a Claim of Exemptions

This rule provides in pertinent part:

> A party in interest may file an objection to the list of property claimed as exempt only within 30 days after the meeting of creditors held under § 341(a) is concluded or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later.

C. *Taylor v. Freeland & Kronz*, 503 U.S. 638 (1992)

In *Taylor*, a Chapter 7 debtor had claimed an exemption in potential proceeds from a pending employment discrimination suit. The *Taylor* court held that the Trustee could not contest the validity of the claimed exemption, even though the debtor had no colorable basis for claiming it, because the 30-day period for objecting under Rule 4003(b) had expired and the Trustee had not obtained an extension of time. *Id*. at 643-44. However, *Taylor* did not involve any issue of whether § 522(g)(1) applies despite the lack of a timely objection under Rule 4003(b). Most courts that have considered the issue after *Taylor* do not apply Rule 4003(b) where the Trustee's objection is based on § 522(g).

D. Majority View - Trustee Not Subject to 30-Day Objection Deadline Nor Is Formal Action Required

Most courts recognize that the 30-day objection period is in conflict with the Trustee's two years' limitations period under § 546(a)(1)(A) and, therefore, do not find the failure to object within the 30-day limitations period of Rule 4003(b) to be a bar to a later objection to an exemption claim. However, some courts have gone in the other direction. One line of defense for debtors is the phrase in § 522 (g) referring to property that Trustee "recovers." Some courts had found that the use of the word "recovers" requires that the Trustee actually institute an adversary proceeding to prevent the debtor from being able to claim an exemption. See e.g. *In re Kuhnel*, 346 B.R. 528 (10th Cir. BAP 2006), but those cases did not survive the appellate process.

In *Kuhnel*, the Trustee did not timely object to debtors' exemption claimed in a Toyota, the lien against which was unperfected by the filing date. Later, the lien on the Toyota was released in response to a demand made by Trustee's counsel. Thereafter, Trustee did object to the claimed exemption. The bankruptcy court sustained the objection and the BAP majority reversed, distinguishing between cases where the trustee recovers fraudulently conveyed property through an avoidance action as opposed to a preference recovery in response to a demand letter.

Kuhnel was reversed at 495 F.3d 1177 (10th Cir. 2007). The reversal put it in conformity with earlier decisions of the court. Almost all of the courts who have reviewed the issue, have determined that the Trustee can object outside of the 30-day period and need not bring a formal avoidance action in order to disallow an exemption under § 522(g). Otherwise, these courts find that the Trustee's two-year statute of limitations period under § 546(a)(1)(A) would be converted into a 30-day limitations period.

These cases hold that § 522(g)(1) embraces "all recoveries under the applicable code sections and did not require specific formal action." *In re Duncan*, 329 F. 3d 1195 (10th Cir. 2003); *Levine v. Weissing (In re Levine)*, 134 F.3d 1046 (11th Cir. 1998); *Glass v. Hitt (In re Glass)*, 60 F.3d 565 (9th Cir. 1995).(Trustee may "recover" fraudulently transferred property in a number of ways, including by merely using the threat of avoidance power to induce debtor or a transferee to return the property to he estate. *In re Nersinger*, 353 B.R. 792 (Bankr. .W.D. N.Y. 2006) (requiring the objections to be filed by the Trustee within the 30 day period but reversing itself on reconsideration at 2007 WL 438212 where the court determined that under § 551, the avoided mortgage liens had been preserved for the benefit of the bankruptcy estate and, even without an objection, could not be exempted); *In re Hicks*, 342 B.R. 596 (Bankr. W.D. Mo. 2006) (noting that there would be cases where a lien is patently unperfected and the creditor will yield to the Trustee without much effort, but the property still comes into the estate pursuant to the Trustee's powers nevertheless, and the debtor may not claim such a property as exempt; otherwise, the Trustee would always be required to file an adversary action resulting in unnecessary and wasteful litigation); *In re Witt*, 273 B.R. 63 (Bankr. W.D. Wis. 2000).

(5) When can the trustee recover the value of the property transferred under § 550(a) as opposed to recovering only the lien under § 551?

(a) Wells Fargo liable for value of unrecorded mortgage as a preference (*Wells Fargo Home Mortgage, Inc. v. Lindquist*, 592 F.3d 838 (8th Cir. 2010)

More than two years after Wells Fargo loaned the debtor $196,000 secured by a mortgage on his home, debtor filed a Chapter 7 petition, at which time Wells Fargo had still not recorded the mortgage. Soon after the bankruptcy filing, Wells Fargo sold a bundle of 334 mortgage loans to EMC Mortgage Corporation. Debtor received his discharge and the case was closed on March 20, 2006. EMC recorded the mortgage on or about October 11, 2006. The trustee found out and had the bankruptcy case reopened and filed a complaint against Wells Fargo to avoid the debtor's grant of the mortgage. The bankruptcy court granted summary judgment to the trustee which was affirmed on appeal to the district court and ordered Wells Fargo to pay the trustee

$190,808.71. Wells Fargo filed a further appeal. The circuit court likewise affirmed. *Wells Fargo Home Mortgage, Inc. v. Lindquist*, 592 F.3d 838 (8th Cir. 2010).

Thus, while the trustee had presented evidence that the debtor owed the lender $190,808.71 on the bankruptcy petition date, the lender had no admissible evidence of the value of the mortgage. The lender had sold its interest post-petition but presented no admissible evidence of the value of that interest on the sale. Doing so had been complicated by the fact that it was sold as part of a sale of pooled mortgages. Since the mortgage had been sold, the estate's only option was to recover the value of that interest on the date of debtor's bankruptcy filing.

(b) 9th Circuit explains when the trustee can recover the value of the property transferred under § 550(a)(*In re Taylor*, 599 F.3d 880 (9th Cir. 2010)

Debtors borrowed $18,020 to buy a new car, giving the creditor a purchase-money security interest to secure the loan. Seventeen months into the bankruptcy case, the trustee successfully avoided the transfer of the security interest as preferential. During that time, debtors had continued to make monthly payments to the lender. Given the depreciation in the vehicle and the reduced value of the lien due to the debtors' post-petition payments, the bankruptcy court determined to award the estate the value of the security interest, pursuant to § 550(a) which permits an award to the estate of the actual transferred property or its value. The bankruptcy court determined that the value of the security interest at the time of the transfer was equal to the full $18,020 loan. The lender appealed and the Ninth Circuit BAP affirmed. On further appeal, the Ninth Circuit reversed and remanded based on the bankruptcy court's evaluation of the security interest. *In re Taylor*, 599 F.3d 880 (9th Cir. 2010).

The Circuit Court held that the bankruptcy court had not abused its discretion in awarding the value of the security interest to the estate but disagreed with its valuation method. The trustee had presented no evidence that the security interest had initially been worth a loan of $18,020 nor that the car would have been worth that amount when the security interest was transferred. The car would have certainly depreciated in value over that time period. The court held that where the property's value cannot be readily or easily determined, the correct remedy was to return the property itself to the estate and not award an estimate of its value. Nevertheless, the court remanded the case to the bankruptcy court to determine whether any of the loan payments made to the lender should be reimbursed to the estate either as pre-petition preferential transfers under § 547 or post-petition transfers under § 549.

(c) No money judgment for trustee equal to value of avoided liens (*In re Trout*, 609 F.3d 1106 (10th Cir. 2010)

In companion cases, trustee successfully avoided the lenders' liens on vehicles as preferentially perfected within 30 days of debtors' receipt of possession of the vehicles and within 90 days of the petition dates. In addition to avoidance of the liens, the trustee sought to recover the value of the avoided liens as of the petition date under § 550(a)(3). The Bankruptcy Court held the liens preserved for the benefit of the estate under § 551 but determined the trustee was not entitled to further relief for the value of the avoided liens, concluding that avoided

transfers of non-possessory lien interests were not so entitled. The BAP affirmed but recognized there could be circumstances in which §§ 547 and 551 would not put the estate back to its pre-transfer position, and then some recovery under § 550 could be appropriate. The BAP further noted that even though the vehicles had declined in value, the Bankruptcy Code did not guarantee that assets recovered would be worth what they were at any relevant valuation date, only that the estate would be returned to its pre-transfer position. The trustee further appealed, and the lower court decision was affirmed. *In re Trout*, 609 F.3d 1106 (10th Cir. 2010).

The Circuit Court agreed with the BAP that there can be circumstances in which § 551 is an inadequate remedy. Examples given by the BAP were where property is unrecoverable or its value diminished by conversion or depreciation. Although the underlying asset can decline in value over the passage of time, that would happen even if the debtor had never transferred the security interest. The Bankruptcy Court has discretion to determine whether to award further relief in the form of § 550(a). In the footnote, the Circuit Court also recognizes that the time it takes to avoid the security interest can result in additional devaluation such as in the recent case of *In re Taylor*, 599 F.3d 880 (9th Cir. 2010).

K. SELECT CLAIM OBJECTION ISSUES IN CHAPTER 7

1. APPLICABLE STATUTES AND RULES

(a). TIMELY AND TARDY CLAIMS

(i) **Rule 3002(c)(5)** sets forth the typical 90-day deadline for a creditor to file a claim. §**§ 501(a) and (c)** provide that if the creditor does not timely do so, the debtor or the trustee has 30 days to file proof of such claim.

(ii) **§ 726(a)(3)** provides for payment of claims filed tardily under section 501(a) after priority and timely filed unsecured claims have been paid. See also § 502(b)(9).

(b) ALLOWANCE AND OBJECTIONS TO CLAIMS

(i) **§ 502(a)** provides that a proof of claim is deemed allowed, unless a party in interest objects. **§ 704(a)(5)** requires the trustee to "examine proofs of claims and object to the allowance of any claim that is improper."

(ii) **§ 502(b)** provides the grounds for claim objections and sets forth that the court is to determine the amount of such objected-to claim after notice and a hearing. These grounds include where "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law…" See also **§ 558** which allows the estate the benefit of any defense available to the debtor including statutes of limitations and other personal defenses

(iii) Under new **§ 502(k)(1)**, the court, on the motion of the debtor and after a hearing, may reduce a claim filed under this section based in whole on an unsecured consumer debt by not more than 20% of the claim, if the claim was filed by a creditor who unreasonably refused to negotiate a reasonable alternative repayment schedule proposed on behalf of the debtor by an approved non-profit budget and credit counseling agency after an offer was made by the debtor at least 60 days before the petition date that provided for payment of at least 60% of the amount of the debt over a period not to exceed the repayment period of the loan, or a reasonable extension thereof, on a debt that is dischargeable.

(iv) **Rule 3001** provides **(a)** that a "proof of claim shall conform substantially to the appropriate Official Form," (see also **Rule 9009**); **(c)** if based on a writing, "the original or a duplicate "shall be filed with it, and **(d)** if secured, it "shall be accompanied by evidence that the security interest has been perfected."

(v) **Rule 3001(f)** provides: "A proof of claim executed and filed in accordance with these rules shall constitute *prima facie* evidence of the validity and amount of the claim."

(vi) **Rule 3007** provides for objections to claims to be in writing with at least 30 days notice prior to the hearing thereon.

(vii) **Rule 3006** provides that after a creditor has filed a proof of claim and an objection is filed thereto, "the creditor may not withdraw the claim except on order of the court after a hearing on notice to the trustee."

(viii) **Rule 3001(e)** provides the rules relating to transferred claims.

(ix) **Official Form 10** provides the most common form for usage for a proof of claim in a Chapter 7 case.

2. MORTAGE CLAIM PROBLEMS

(a) **Wells Fargo sanctioned and required to audit every proof of claim.** In a 40-page opinion, the Bankruptcy Court sanctioned Wells Fargo (WF) and ordered it to audit every proof of claim filed in that district in cases pending on April 13, 2007, and thereafter (the "Audit"). A complete loan history on every account was also ordered. ***In re Stewart*, 391 B.R. 327 (Bankr. E.D. La. 2008) aff'd 2009 WL 2448054 (E.D. La. August 7, 2009)**. Judge Magner's holding presents an incredible, in-depth look at the methodology and decision-making employed by a national mortgage lender, which administers and/or services 7.7 million home mortgage loans. The reconciliation of the debtor's account took WF four months to research, and showed numerous violations by WF of its own loan documents. The mortgage required funds to be applied first to outstanding escrow, next to accrued interest, and then to principal; but WF paid late charges and inspection fees first. After one payment was missed, even if all subsequent

payments were made, a late fee was charged every month thereafter. Of nine broker price opinions charged to the debtor's account, three were duplicates and two were never performed. All contained hidden fees disguised as costs. The Court denied seven valuations, and disallowed 43 property inspections, while allowing only ten of the 49 late charges. The disallowed inspections and late fees were imposed while the debtor was making regular monthly payments and were not properly noticed. "The calculation of debtor's monthly escrow was almost incomprehensible and virtually incorrect in every instance." This caused WF to demand substantially erroneous and increased payments from debtor. Also: "Charges for NSF fees, tax searches, property preservation fees, and unapproved bankruptcy fees appeared on the proofs of claim filed in this and previous cases without explanation or substantiation. Further, these charges never appeared as entries on the account history." The Court assessed damages and sanctions and ordered WF to perform the Audit.

(b) GMAC Mortgage held in contempt. On similar egregious misconduct, Judge Waites found GMAC Mortgage to be in contempt and ordered $9,000 in compensatory damages, $7,641.50 in legal fees, and $1,182.65 for injury to debtor's credit and lost opportunity to refinance the home. As an additional equitable remedy, GMAC was denied late fees, attorney fees, and other charges. Punitive damages of $13,400 were also assessed. ***In re Workman* , 392 B.R. 189 (Bankr. D. S.C. 2007)**.

(c) Indymac's mortgage claim disallowed. IndyMac Bank filed a proof of claim asserting a mortgage obligation of $234,594.85 against the Chapter 13 debtors. It further asserted an arrearage claim of $30,883.70. The only document attached to the claim was a summary sheet breaking the claim down into categories of principal balance, interest, late charges, pre-petition attorney fees and costs, pre-petition escrow advances, and "other amounts for inspection fees, appraisal fees and other charges." Debtors objected challenging the lack of detail and the computation. At the hearing on the claim objection, the only document tendered was a copy of the mortgage. Judge Thomas disallowed the claim but gave IndyMac leave to file a curative amendment to its proof of claim within the following 20 days, setting forth the documentation necessary to support the claim and its components. ***In re Cramer*, 406 B.R. 267 (Bankr. M.D. Pa. 2009)**. Judge Thomas noted that the filing of a claim attaching the writings upon which the claim was based would serve as *prima facie* evidence of the validity and amount of the claim. However, without the appropriate documentation and without any further evidence tendered by either party the claim is insufficient. At a minimum, the court noted that both the mortgage and mortgage note would both need to be attached for the claimant to obtain the benefits of *prima facie* status. The court also found troubling the summary sheet of additional components of the claim because there was no indication of the basis for the computation of each item contained in the summary. Finally, the court held that if IndyMac failed to file the appropriate amended proof of claim, the court would treat the claim as disallowed for insufficient information to be enforceable under § 502(b).

(d) Mortgage loan servicer has standing to file proof of claim. The Chapter 13 debtor did not dispute that Homecomings Financial, LLC was the servicer of its mortgage loan, but debtor objected to the proof of claim filed by Homecomings on the basis that it lacked standing to file the claim. The bankruptcy court disagreed. ***In re Conde-Dedonato*, 391 B.R. 247 (Bankr. E.D. N.Y. 2008)**. Relying on ***Greer v. O'Dell*, 305 F.3d 1297, 1302 (11th Cir. 2002)**, Judge Eisenberg overrode the objection. In *Greer*, the 11th Circuit held that a loan servicer was a

party in interest in proceedings involving loans that it serviced because it had a direct stake in the litigation under such circumstances. The court also overruled an objection to additional fees requested by the claimant because the court found that such fees were reasonable under § 506(b) and that the terms of the mortgage had provided for the charging of such fees.

3. CREDIT CARD CLAIM OBJECTIONS FOR INSUFFICIENT DOCUMENTATION

(a) *In re* Kirkland, 572 F.3d 838 (10th Cir. 2009). Debtor had scheduled an unsecured credit card debt in the amount of $5,004 associated with an account number ending with 2787. NextBank filed a proof of claim for $5,328.19 for credit card debt associated with the same ending account number. The proof of claim did not include any supporting documentation. The trustee filed an objection based on the lack of supporting documentation. Soon thereafter, B-Line, LLC filed a notice indicating that the claim had been transferred to it, but still included no documentation. The Bankruptcy Court held a hearing on the trustee's objection, but still no evidence was presented. The Bankruptcy Court took judicial notice of the debtor's filed schedules but determined that B-Line had failed to meet its burden to substantiate the claim because it had failed to produce any evidence supporting it. Consequently, Judge McFeeley entered an order disallowing the claim. B-Line appealed, and in 2-1 decision, the Tenth Circuit BAP reversed. The trustee filed a timely appeal.

The Circuit Court determined that the Bankruptcy Court appropriately placed on B-Line the burden of proof for its claim and properly concluded that B-Line failed to meet its burden. Consequently, the Circuit Court reversed the BAP and reinstated the claim disallowance order of the Bankruptcy Court. The Circuit Court noted that the Bankruptcy Code does not define "proof of claim" so reference to the Federal Rules of Bankruptcy Procedure is warranted. Based on Rule 3001(a), the proof of claim must be a written statement setting forth a creditor's claim that conforms substantially to the appropriate Official Form, Form 10, which requires a claimant to "[a]ttach redacted copies of any documents that support the claim, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, judgments, mortgages and security agreements." When the proof of claim is executed and filed in accordance with Rule 3001 (including Official Form #10), the Circuit Court found that it would constitute *prima facie* evidence of the validity and amount of the claim. Here, B-Line had failed to produce any documentation to support its claim and failed to explain such insufficiency. Importantly, the Circuit Court noted that the debtor's schedules were "of no evidentiary value against the Trustee." Accordingly, the Circuit Court concluded: "Had the bankruptcy court allowed B-Line's claim despite B-Line's failure to provide either supporting evidence or an explanation for its failure to provide supporting evidence, the burden would have improperly rested with the Trustee to disprove an unsubstantiated claim."

(b) *In re O'Brien*, 440 B.R. 654 (Bankr. E.D. Pa. 2010). Judge Frank provides an excellent review of the documentation requirements for a credit card proof of claim to attain prima facie evidentiary status including (a) the amount of the claim, and (b) that a purported assignee is the proper holder/owner of the claim and how the burden of proof and persuasion shifts from the objecting party to the claimant where deficiencies exist. In this case, no additional proof was offered at the hearing so the outcome turned on which party had the burden

of proof. Insufficient documentation was attached to the claim to establish that the claimant was in fact the lawful assignee of the claim, so that alone resulted in the claim being disallowed.

(c) *In re Plourde*, 397 B.R. 207 (Bankr. D. N.H. 2008). Trustee objected to two claims. The AmEx claim was unscheduled by the debtor and had attached only a single-page copy of an account statement, but did not indicate whether the claim included interest or other charges and no itemization of such interest or charges was attached. The eCast claim was filed for $6,813.06 compared to the debtor's scheduled amount of $6,309.75. Likewise, it included a single-page computer generated summary of the account, which provided minimal account information and did not indicate whether the claim included interest or other charges and no itemization of such was attached. The Chapter 7 trustee sought to have both claims disallowed. The bankruptcy court disallowed the AmEx claim and reduced the eCast claim to the amount scheduled by the debtor Judge Deasy noted (a) that § 502 provides the substantive grounds for objections to claims, (b) Rule 3001 was a procedural rule prescribed by the United States Supreme Court under a delegation of authority from Congress, 28 U.S.C. § 2075, (c) the rules could not supersede substantive rights nor could the official forms promulgated by the Judicial Conference of the United States under a delegation from the Supreme Court, (d) the significance of Rule 3001(f) is that a proof of claim "executed and filed in accordance with these rules *shall constitute prima facie evidence of the validity and amount of the claim,*" and (d) the burden shifts to the objecting party where compliance with the rule has been met.

The court determined that where debtor's schedules did not list a claim at all, the creditor has the burden of establishing its claim with more than a bare bones summary of its records, and where the claim is for more than the scheduled amount, it must present evidence explaining the difference. At a minimum, the court held that in order to establish the *prima facie* case validity of a credit card claim, a proof of claim should include "(i) a sufficient number of monthly account statements to show how the total amount asserted has been calculated, and (ii) a copy of the agreement authorizing charges and fees included in the claim." Additionally, if an assignee files the claim, evidence of the assignment or other evidence establishing ownership of the claim must be provided. Thus, a proof of claim supported by a summary, or a copy of a computer printout, which simply contains a balance due, account number, debtor's name and the like is not sufficient to establish the *prima facie* validity of the claim and to receive the benefits of Rule 3001(f). Although, absent a proper objection, such claim would still be allowed under § 502. The court holds that when the objecting party is the trustee, the schedules are not admissible as an admission against the trustee, but are admissible under the residual exception in FRE 807.

Finally, Judge Deasy looks at the Bankruptcy Code's subordination/distribution scheme under § 726 where fines and penalties are subordinated to payment of general unsecured claims to the extent they do not represent compensation for actual pecuniary loss. The one-page account summaries here do not contain sufficient information for the court to determine whether such charges amounted to a penalty. "[T]he unilateral rights, which credit card issuers reserve to themselves under the terms of agreements drafted by them, provide the opportunity for them to impose charges, fees and interest thereon which, although enforceable under nonbankruptcy law, could be penalties subject to subordination under §§ 726(a)(4) … So long as credit card issuers wish to maintain sole discretion to vary the terms of their agreement with the consumer at any time, and from time to time, they must accept the legal consequences of that business model …

[and] may need to provide details of the charges and interest imposed by them in response to a proper objection to a proof of claim in a bankruptcy proceeding."

(d). *In re* Plourde, 418 B.R. 495 (1st Cir. BAP October 19, 2009). On appeal, the First Circuit BAP reversed the disallowance of the AmEx claim, affirmed allowance of the eCast claim but treated both claims as entitled only to subordinated priority under § 726(a)(4). Because these claims did not comply with Rule 3001(a) and (c) and Official Form 10, they were not entitled to *prima facie* evidence of the validity and amount of the claim under Rule 3001(f). This shifted the burden to the claimants. The court noted that allowance of a claim merely establishes it as a charge against the estate, whereas its distributional priority is separately addressed in § 726(a). Neither claim noted on the form that it included "interest or other charges." This representation was deemed untrue for a credit card claim and the BAP noted that that "the trustee properly took exception to it." The claimants argued that all interest and other assessments were "canceled" on the petition date and became part of the "principal." Quoting Abraham Lincoln, the BAP stated: "Calling a tail a leg does not make it a leg."

The trustee was held entitled to know what charges were assessed and the contractual basis for each charge. Information necessary for the trustee to ascertain the bases for the claims or the effect of the terms of the credit agreements in force at the time the accounts were debited was not provided. The BAP found that rather than provide the necessary documentation, the claimants "stonewalled" and refused to provide or introduce evidence to establish the nature of the charges, thereby failing to sustain their burden of demonstrating that their claims should be entitled to share with other general unsecured claims. Therefore, the BAP determined that the claims had to be allowed entirely under the subordination provision of § 726(a)(4).

(e). *In re Sandifer*, 318 B.R. 609 (Bankr. M.D. Fla. 2004). eCast filed proofs of claim as assignee of GE Private Label/Sam's Club, Chase Manhattan Bank, U.S.A., N.A., and NB&A America Bank, N.A. None of the claims nor the attachments provided adequate documentation according to the bankruptcy court. Judge Briskman found that eCast had left blank the box on Official Form 10 regarding whether the claims included interest or other charges above the principal amount nor was the summary attached reflective of those items. Additionally, eCast had altered paragraph 8 of the Official Form. The court found that the proofs of claim initially filed did not enable determination of the accuracy of the claim based on such failure to provide documentation of charges, payments, fees, and interest. Accordingly, to the extent that proper documentation was not provided, the claims were to be disallowed.

In a second similar case, a chapter 13 debtor had objected on the basis of insufficient documentation. In that case, however, the court found that the claims were merely deprived of their *prima facie* validity under Bankruptcy Rule 3001(f). The debtor was required to come forward with some additional evidence that the claims were invalid. ***In re Mazzoni*, 318 B.R. 576 (Bankr. D. Kan. 2004).** Judge Berger noted that the analysis would be different if it was a chapter 7 or 11 trustee objecting for lack of sufficient documentation because the trustee would have no personal or firsthand knowledge of the debtor's debts. "As a result, a Chapter 7 or 11 trustee's objection to a proof of claim on the ground that no documents were attached supporting the claim likely mandates a different analysis and conclusion." *Accord.* **In re**

Jorczak, 314 B.R. 474 (Bankr. D. Conn. 2004) (Debtors' scheduling of the debt would estop debtors but not be binding on a Chapter 7 trustee).

(f). *In re Cluff*, 313 B.R. 323 (Bankr. D. Utah 2004). Chapter 13 debtors objected to claims they had scheduled, based on insufficient documentation in the proofs of claim filed by the creditors. Judge Boulden first determined what must be filed in order for the claim to be *prima facie* valid under Rule 3001(f). For credit card debts the proof of claim should 1) include amount of debts; 2) indicate the name and account number of the debtor; 3) be in the form of a business record or other reliable format; and 4) include a breakdown of any charges such as interest, late fees, and attorney fees. The Court further found, however, that failure to include these elements in the proof of claim was not a basis for claim disallowance. Rather, it shifted the initial burden of proving claim existence and amount to the creditor; so the debtor was still required to rebut the evidence in the proof of claim, even if it was not *prima facie* valid. Finally, as to properly filed proofs of claim, the debtor's formal objection as to sufficiency of documentation could not overcome *prima facie* validity, especially where the debtors had originally scheduled the debt as uncontested, liquidated, and non-contingent. But *see, contra,* ***In re Henry*, 311 B.R. 813 (Bankr. N.D. Wash. 2004)**, where the Bankruptcy Court sustained objections by a Chapter 13 debtor to claims lacking sufficient documentation. This Court found Rule 3001(c) to require submission of a copy of a credit card agreement or promissory note as proof of a claim's existence. Claims of creditors who either failed to respond to the debtor's objection, or amended their claims without adequate documentation were denied.

4. SELECT CLAIM OBJECTION ISSUES

(a). Informal proof of claim denied.

(i) *In re* Nowak, 586 F.3d 450 (6th Cir. 2009). After debtor received a discharge, trustee filed an adversary proceeding under § 544(a) to avoid a creditor's mortgage lien on the debtor's residence due to improper attestation. Trustee moved to sell the residence on the basis of a "bona fide dispute" under § 363(f). The creditor objected to that motion and filed its own motion for stay relief and abandonment. The court overruled the objection and authorized the sale. The creditor withdrew its motion. The Bankruptcy Court also ruled in favor of the trustee in the adversary proceeding and avoided the mortgage rendering the creditor as unsecured. The creditor appealed, but the BAP affirmed the bankruptcy court. No further appeal was filed. When the trustee filed a final report recommending distribution to unsecured creditors, the subject creditor was not included in the proposed distribution because it had not filed a proof of claim. The creditor then objected to the trustee's final report and moved for allowance of an informal proof of claim. The Bankruptcy Court disallowed the claim, on the basis that (a) the various pleadings filed by the creditor did not contain a demand on debtor's estate or express an intent to hold debtor liable for the debt and (b) the equities weighed in favor of disallowing the claim. The creditor appealed and the Sixth Circuit BAP majority concluded that the pleadings filed by the creditor did qualify as an informal proof of claim but nevertheless agreed with the bankruptcy court's discretion in disallowing the claim based on balancing of equities. The creditor then appealed to the Circuit Court, which affirmed the lower courts. ***In re Nowak*, 586 F.3d 450 (6th Cir. 2009)**. The Circuit Court set forth four elements required for an informal proof of claim: (1) It must be in writing, (2) containing a demand by the creditor on the debtor's estate, (3) expressing an intent to hold the debtor liable for the debt, and (4) must be filed with

the Bankruptcy Court. If these conditions are met, a fifth factor may be examined as to whether it would be equitable to allow the informal claim. This last factor is an equitable determination within the sound discretion of the Bankruptcy Court that requires a balancing of the interests of those involved.

Normally a secured creditor is not required to file a proof of claim to maintain its interest in the collateral to which its security interest attaches, but two exceptions are where the secured creditor is undersecured or where the trustee has avoided the lien, in which case the creditor has 30 days from the judgment that voids its security interest to file an unsecured claim. The Circuit Court reviewed the Bankruptcy Court's consideration of three factors for disallowance of the claim. First, was the length of the creditor's delay in pursuing an unsecured claim, which the lower court found to be unreasonable. After the trustee had initiated the adversary proceeding, the creditor had ample notice of a likelihood that it would lose its status as a secured creditor necessitating the filing of a claim. Moreover, even if the creditor had prevailed, the sale of debtor's residence would have created an unsecured deficiency for which a claim would be required for a further distribution. The creditor had even recognized this deficiency in objecting to the trustee's proposed sale but still did not file a claim. Therefore, the creditor had failed to protect its own interests. Second, the creditor was unable to explain its delay other than as an "oversight." The Circuit Court explained that this was a "self-inflicted wound" that bode against recognizing an informal proof of claim for a sophisticated party who was represented by counsel throughout the proceedings. Third, if the claim were allowed, it would reduce significantly the distribution available to other creditors from 100% to 29%. Although the creditor made sound counter arguments, the Circuit Court held that it had failed to demonstrate that the Bankruptcy Court's decision was an abuse of discretion. As reasonable persons could differ in their balancing analysis, the court could not be held to have abused its discretion in making an equitable determination and refusing to allow the creditor's informal proof of claim.

(ii) *In re Elleco, Inc.*, 295 B.R. 797 (Bankr. D. S.C. 2002). The creditor/surety failed to file a formal proof of claim before the bar date. It subsequently moved to file an amended claim based on a prior informal claim, arguing that its notice of appearance, participation in the 341 meeting, Rule 2004 examination, and negotiating settlement of bond claims on the debtor's behalf, taken together, were sufficient to establish an informal proof of claim. Judge Waites noted that the Fourth Circuit had adopted a liberal view which allowed an amendment of an informal claim "if there is anything in the bankruptcy case's record that establishes a claim, …when substantial justice will be done by allowing the amendment." *Fyne v. Atlas Supply Co.*, 245 F.2d 107 (4th Cir. 1957). Here, the Court found that none of the writings in the Court file could be viewed as an assertion of a claim and were insufficient to alert other parties to the claim and desire to be paid from the estate.

(iii) Informal proof of claim granted. After a subsidiary of a corporate debtor converted from Chapter 11 to Chapter 7, a creditor filed a proof of claim one month after the bar date. The creditor had previously filed a timely proof of claim in the parent corporation's case, and sought to have it allowed as an informal claim in the subsidiary's case. ***In re Rowe Furniture, Inc.*, 384 B.R. 732 (Bkrtcy. E.D. Va. 2008)**. Judge Mitchell acknowledged the tendency of courts to favor the finding of an informal proof of claim; but could not agree that the filing of a claim in the parent's case would suffice. The Court thus held that the filing of a claim

in a related case would not constitute an informal claim in a later case. However, the claimant had also objected to a sale of property in the present case, and had asserted that it was the assignee of a claim. Even though the motion did not contain all of the elements of a proper proof of claim, the Court noted the "Fourth Circuit's liberal view with respect to informal proofs of claim", and found that "the objection to the sale of the debtor's assets was sufficient to constitute notice of a claim against the estate".

(b) Late claims.

(i.) Objection filed to the Trustee's final report by a creditor who missed the claims bar deadline by approximately **three years, allegedly as a result of not receiving notice.** The Court denied the objection, ***In re Schemper*, 303 B.R. 385 (Bankr. N.D. Iowa 2003)** noting that § 726(a)(2)(C) allows tardily filed claims to be treated equally with timely filed claims where the creditor "did not have notice or actual knowledge of the case in time for timely filing a proof of claim." Here the bar notice was properly served at an address reasonably calculated to reach the creditor who had been at all times aware of the bankruptcy case. Relying on *Hagner v. United States*, 285 U.S. 427, 430 (1932) and Rule 9006(e), the Court found a strong presumption at law that mail handled by the U.S. Postal Service that was properly addressed and stamped was in fact received by the addressee. Further relying on *In re Bucknum*, 951 F.2d 204, 206-7 (9th Cir. 1991) and *In re Coastal Alaska Lines, Inc.*, 920 F.2d 1428 (9th Cir. 1990), the Court found that if a party were permitted to defeat the presumption of receipt of notice resulting from the certificate of mailing by a simple affidavit to the contrary, the "scheme of deadlines and bar dates under the Bankruptcy Code would become unraveled."

(ii) Claim **filed one day late.** 81 days later, the claimant moved for judicial relief to have the claim held timely under the "excusable neglect" standard of *Pioneer Investments Services Co. v. Brunswick Associates Ltd. Partnership*, 507 U.S. 380 (1993). ***In re Kmart Corp.*, 381 F.3d 709 (7th Cir. 2004)**. The Circuit Court held the Bankruptcy Court did not abuse its discretion when it failed to allow the claim.

(iii)Trustee files late claims for creditors. The debtor objected to eight proofs of claim filed by the Chapter 7 Trustee on behalf of creditors who failed to file their claims prior to the deadline set by the Court. Relying on *In re Nettles*, 251 B.R. 899 (Bankr. M.D. Fla. 2000), the debtor argued that the Trustee's motive in filing claims may be a basis for disallowance; and noted that Trustee compensation would increase, and surplus to the debtor would decrease if the claims were allowed. The Trustee relied on §501(c), which provides for Trustee filing of proofs of claim when a creditor fails to timely do so, and further argued that Rule 3004 specifically authorizes a Trustee to file such claims within 30 days after the bar date, as was done in this case. ***In re Schmidt*, 333 B.R. 868 (Bankr. N.D. Fla. 2005)**. In ruling for the Trustee, Judge Killian stated: "The statute is clear and unambiguous and, as such, any inquiry into its meaning and intent must begin and end with its language…. The Court's sole duty is to enforce it according to its terms."

(iv) Untimely claims filed by Trustee not entitled to distribution. Trustee settled Debtor's Fen-Phen litigation but no creditor claims were filed prior to the bar date. Over 6

months later, the Trustee filed proofs of claim for 11 creditors, and the Debtor moved for payment of all the money held, as surplus funds, arguing that the claims filed by the Trustee were untimely and not entitled to any distribution. The Trustee countered that even if the claims were untimely, under §726(a)(3) they were to be fully satisfied before funds were returned to the Debtor. ***In re Rothman*, 373 B.R. 785 (Bankr.S.D.Ga. 2006)**. Judge Davis concluded that the claims filed by the Trustee were not timely filed nor entitled to any distribution as late-filed .because § 726(a)(3) referred only to claims "tardily filed under §501(a)," whereas, the trustee's authority to file claims for creditors was derived from § 501(c).

(c) Standing to Object.

The Chapter 7 Trustee had filed and was prosecuting certain claim objections. Other creditors sought to intervene and assert their own, similar objections to those claims. The Trustee challenged their standing to do so, and the bankruptcy court agreed with the Trustee. ***In re Trusted Net Media Holdings, LLC*, 334 B.R. 470 (Bankr. N.D. Ga. 2005).** Judge Mullins analyzed the issue and determined that only where the trustee had declined to file claim objections would a creditor have standing to object. Otherwise, it would clearly hinder the orderly and efficient administration of the estate.

(d) Attorney fees allowed in claim.

Creditor's proof of claim included post-petition attorney fees and costs. The creditor was stipulated as over-secured and nobody contested the reasonableness of those fees and costs. However, the Trustee objected on the basis that Georgia state law only authorized collection of attorney's fees if a "10-day" letter was issued and the time lapsed without payment of the debt prior to seeking collection of such fees and costs. No such letter was issued in this case. ***In re Amron Technologies, Inc.*, 376 B.R. 49 (Bankr. M.D. Ga. 2007).** Judge Walker disagreed with the Trustee finding persuasive similar cases from two other circuits: *First West Bank & Trust v. Drewes (In re Schriock)*, 104 F.3d 200 (8th Cir. 1997), and *Unsecured Creditors' Committee v. Walter E. Heller Company Southeast, Inc. (In re K.H. Stephenson Supply Co.)*, 768 F.2d 580 (4th Cir. 1985). Like those cases, Judge Walker noted that § 506(b) required only that the fees be provided for by contract and that they be reasonable. It did not require them to be enforceable under state law.

(e) Supporting documents not required for IRS claim.

The objection to the IRS's proof of claim, alleged that it lacked documentation required under Bankruptcy Rule 3001(c). Upon denial of the objection by the Bankruptcy Court, the debtor appealed. ***In re Carlisle*, 320 B.R. 796 (M.D.Pa. 2004)**. The District Court noted that Rule 3001(c) requires "the original or a duplicate" when a claim is based on a writing. Finding the IRS claim to instead be based on a statute, the Court held that documentation was not required, and the proof of claim was valid.

(f) Administrative expense claim denied.

Pre-petition the IRS obtained a continuing contempt order against the debtor for failure to produce documents as part of a tax investigation. After the debtor filed bankruptcy, the IRS argued that the continuing contempt should be given administrative expense status. The

bankruptcy court denied the motion, and the district court affirmed, ***In re Chris-Marine, U.S.A., Inc.*, 321 B.R. 63 (M.D. Fla. 2004),** noting that while the 11th Cir. had created a new category of administrative expenses under § 503(b) for punitive civil penalties assessed post-petition for post-petition violations of state mining regulations, *In re N.P. Mining Co., Inc.*, 963 F.2d 1449 (11th Cir. 1992), the sanctions order here occurred pre-petition and, thus, would not fall within this narrow category.

(g) Claims unenforceable against the debtor.

A Chapter 7 debtor objected to a creditor's claim on the ground that the applicable state law statute of limitations had lapsed pre-petition, making the claim unenforceable. § 502(b)(1). An evidentiary hearing was held, and the Bankruptcy Court found that the debtor had carried his burden as to this affirmative defense. Judge Somma noted that the claims were contractual in nature, and that under applicable Massachusetts law a contracts action must be commenced within six years after it accrues. Here the last charges comprising the claim were incurred over seven years prior to the bankruptcy filing, rendering it unenforceable at that time. The claim was, therefore, disallowed. ***In re Makein*, 334 B.R. 527 (Bankr.D.Mass. 2005)**. (See § 558 as well). [*Editor's Note*: Holders of credit card accounts frequently file proofs of claim with mere summaries that do not indicate the age of the charges. Many Courts have denied Trustee objections to such claims for lack of sufficient documentation, based on the Debtor's scheduling of the claim. This case highlights one reason why such documentation is important. While Debtors may recognize that they incurred a debt, they might not understand that it could no longer be legally collected. Trustees should be entitled to independently determine the validity and enforceability of such claims]

(h) Trustee allowed applies strong-arm power as defense to claim.

After the two-year, avoidance action limitation period had expired under §546(a), the Trustee objected to secured proofs of claim filed by certain creditors. The objections alleged that the security interests were not perfected pre-petition, and were therefore not effective against the Trustee under §544(a)(1). The creditors countered that the Trustee's failure to avoid the security interests precluded a subsequent claim objection based on §544. ***In re American Pie, Inc.*, 361 B.R. 318 (Bankr.D.Mass. 2007)**. Judge Feeney first found that the creditors had the ultimate burden to prove that their claims were secured. Based on the Trustee's proof that UCC continuation statements had not been filed, the burden shifted to the creditors to show how the security interest remained perfected, after expiration of the initial UCC filings. Thus, §546(a) was found inapplicable, enabling the use of §544(a)(1) to assert lack of perfection.

(i) Debtors' claims filed against their own estate disallowed.

After payment of administrative expenses, the remaining estate assets consisted of $12,941.22 in cash proceeds. Five general unsecured claims had been filed totaling $85,893.94. The trustee did not propose to pay any of the funds to those creditors. Instead, the trustee recognized two priority claims filed by the debtors in the amount of $19,573 and proposed to pay the funds to the debtors instead. The debtors had checked the priority box on the claim form and indicated "tax or penalties owed to governmental units" under § 507(a)(8). These claims were apparently predicated on the debtors paying the IRS, from their

own personal assets. The bankruptcy court *sua sponte* disallowed the claims and would not approve the trustee's final report. ***In re Sarnovsky*, 436 B.R. 461 (Bankr. N.D. Ohio 2010)**. Judge Speer first noted that for purposes of bankruptcy law, an individual could not be a "governmental unit." Therefore, their claims could not be entitled to priority distribution. Moreover, a creditor is defined under § 101(10) as an "entity" that has a claim against the debtor …" and under § 101(5)(A), a "claim" is defined as a "right to payment." The court held that the law does not recognize an entity's right to enforce a payment from itself, making the two proofs of claim filed by the debtors a legal nullity. In reality, the debtors and the trustee wanted the court to overlook the disqualifying nature of the claims because had debtors not paid their outstanding tax liabilities, the tax claimants would have received the entire $12,942.22 in cash proceeds available for distribution. However, the court found there was neither an equitable nor legally cognizable basis for proceeding in this manner. Accordingly, the claims were disallowed and the trustee's final report disapproved.

(j) PACA Trust claims disallowed.

Debtor Ebro Foods, Inc. and its supplier G & G Peppers, LLC were both licensed as PACA dealers by the U.S. Department of Agriculture under the Perishable Agricultural Commodities Act, 7 U.S.C. § 499(a) et seq. Ebro sent three purchase orders to G & G specifying the amount of peppers desired, price per pound, required delivery date, and delivery protocol, and the payment terms – "Net 30 days." G & G sent all three shipments of peppers to Ebro and thereafter faxed invoices requesting payment. The invoices stated that the payment terms were "PACA terms" and a pre-printed statement declared that G & G had a statutory trust claim under section 5(c) of PACA. When Ebro did not pay for the peppers, G & G filed a lawsuit in U.S. District Court that was stayed by Ebro's bankruptcy filing. The bankruptcy court determined that G & G failed to comply with the requirements of PACA and held its claim to be a general unsecured claim. ***In re Ebro Foods, Inc.*, 424 B.R. 420 (Bankr. N.D. Ill. 2010)**. Judge Wedoff first noted that PACA established strict eligibility requirements. If eligible, any produce or proceeds therefrom received by a licensed buyer would be held in a non-segregated floating trust for the benefit of the unpaid supplier who had met the applicable statutory requirements. The maximum time for payment under PACA is 30 days after receipt and acceptance unless otherwise agreed. The supplier must also comply with extensive notice requirements set forth in 7 U.S.C. §§ 499(a)(c)(3) & (4) and 7 C.F.R. § 46.46(f)(2006). G & G simply wrote "PACA terms" on its invoices rather than disclose the extended payment terms to which the parties had agreed thus barring it from establishing a trust claim under PACA. ***Accord, In re Northern Michigan Fruit Co., Inc.*, 433 B.R. 671 (W.D. Mich. 2010)**. (*Editor's Note*: These cases highlight the need for careful inspection of any claim filed as a PACA trust fund claim.)

(k) Consent order resolving claim objection held time-barred under Rule 9024.

The Georgia Department of Revenue ("GDR") had filed a proof of claim establishing a priority tax claim and an unsecured claim against a corporate chapter 11 debtor. As commonly occurs, a portion of the amounts claimed were estimated due to the debtor's failure to file sales and use tax returns. The debtor objected to the proof of claim after filing several delinquent tax returns, challenging the amounts claimed based upon those

recently filed returns. Ultimately, the parties reached a resolution that resulted in the entry of a consent order allowing the GDR a priority tax claim in the amount of $174,348.84 and an unsecured claim of $29,683.15. Thereafter, the debtor's case was voluntarily dismissed. Following the dismissal, the GDR issued assessments against the debtor and its corporate officers. The corporate officers asserted that the delinquent tax returns prepared for the debtor had contained errors and challenged the assessment amount. The GDR contended that the parties were bound by the court's consent order. The debtor and the corporate officers then moved to reopen the bankruptcy case to determine the proper tax liability under Rule 9024, which makes applicable Rule 60 of the FRCP, based on a material mistake of fact. The GDR opposed the motion as untimely under the one-year limitations period set forth in Rule 60(c) for "the reconsideration of an order allowing or disallowing a claim against the estate entered without a contest." The bankruptcy court held that the exception applied because the parties did not litigate their dispute in the sense of having the court resolve it. The court entered an order vacating the consent order. The GDR appealed, and the district court affirmed, agreeing that there was no "contest" where the court had an opportunity to weigh the arguments or issue a ruling. The GDR then appealed to the 11th Circuit Court of Appeals, which reversed. ***In re Mozon Enterprises, Inc.*, 610 F.3d 1329, (11th Cir. 2010)**.

The Circuit Court noted that the phrase "entered without a contest" was not defined by the rule. It determined that a "contest" would arise from the filing of an objection to a proof of claim in bankruptcy, which would give rise to a contested matter under the bankruptcy rules. The filing of the objection to a proof of claim itself created a contested matter. The court determined that "the filing of an objection to a proof of claim in bankruptcy creates a contested matter" regardless of whether it is ultimately resolved by settlement or on the merits by the bankruptcy court. Here, since the debtor had objected to the GDR's proof of claim, a consent order by which the objection was resolved was not "entered without a contest." Consequently, the debtor's motion to vacate the consent order, which was filed more than one year after the consent order was entered, was untimely under Rule 9024 and should have been dismissed.

5. LANDLORD ADMINISTRATIVE EXPENSE CLAIMS

(a) Obligation to pay post-petition, pre-rejection rent is not an administrative expense.

After conversion from Chapter 11, a commercial lease became automatically terminated 60 days thereafter, but the Chapter 7 Trustee then entered into a lease agreement to continue using the space. The Trustee argued that both the pre-rejection lease payments and the lease payments due under the new lease agreement were administrative expenses under §503(b)(1). The lessor sought immediate payment of the amount due for the first 60 days, under §365(d)(3), and the Trustee objected. ***In re C.Q., LLC*, 343 B.R. 915 (Bkrtcy. W.D. Wis. 2005)**.

Judge Martin noted that § 503 requires a finding that the requested expenses be necessary to the administration of the estate, while § 365(d)(3) includes no such requirement. Further, § 365(d)(3) does not require notice or a hearing, and is not a part of the priority scheme set forth in § 507. From this, the Court found that the Trustee must perform the obligation to pay pre-rejection rent according to the procedure for making operational payments under § 363(c)(1),

which does not involve court action. The Court further found that payment of § 365(d) rent should not be treated as an administrative expense; and, if the estate were administratively insolvent, these rent payments would not be subject to disgorgement. Accordingly, the Trustee was ordered to make immediate payment of the pre-rejection lease.

(b) Landlord's administrative expense claims allowed only as general unsecured claims. Pre-petition, debtors bought assets at a § 363 sale that included assumption of two non-residential leases that were seriously in arrears. To facilitate the assumption of the leases, the landlords entered into lease modification and consent agreements reducing on one lease the unpaid rent from $68,030 to $15,666 and on the other lease from $82,080 to $47,375. These reduced amounts were to become due only upon expiration or earlier termination of the leases. When debtors filed for Chapter 11 relief, they rejected the two leases, thus triggering their obligations to make the agreed payments. The landlords filed proofs of claim seeking payment of $15,666 and $47,375 as administrative expenses. The debtors and unsecured creditor committee objected. The bankruptcy court sustained the objections and reclassified the claims as general unsecured claims. ***In re BH S&B Holdings LLC*, 426 B.R. 478 (Bankr. S.D. N.Y. 2010)**. Judge Glenn found that the claim obligations arose upon rejection and were thus general unsecured claims under § 365(g)(1) rather than under § 365(d)(3) as claimants had argued. The court found that the debtors' obligations were triggered upon expiration and early termination of the leases, which occurred at rejection.

(c) Landlord awarded administrative claim for "stub rent." Rent was due on the debtor's leases on the first of each month. Debtor was current on its rent obligations until June 1, 2008, when it did not pay the rent due. The debtor filed its chapter 11 petition on June 9, 2008, and paid rent due for July on July 1, 2008. However, debtor did not pay the "stub rent" for its post-petition occupancy of the premises from June 9, 2008, through June 30, 2008. During that time, the premises were used to conduct lucrative store-closing sales, for which the debtor received from the store-closing agent an amount equal to per diem rent associated with use of the premises to conduct the sales, including the stub-rent period. The landlords filed administrative claims under § 503(b)(1) for stub rent. The debtor objected arguing that the stub-rent was due pre-petition and therefore constituted a general unsecured claim under § 365, which it maintained was the exclusive source of obligations and remedies under unexpired leases. The bankruptcy court granted the landlords the requested administrative claims, the district court affirmed, and appeal was taken to the circuit court which likewise affirmed. ***In re Goody's Family Clothing, Inc., et al.*, 610 F.3d 812 (3rd Cir. 2010)**. The Circuit Court held that § 365(d)(3) does not preempt § 503(b)(1). The circuit court found that the debtor's occupancy of the premises unquestionably was an actual and necessary benefit to the estate and preserved value for the estate. The recovery by the landlords was outside the scope of § 365(d)(3) but nevertheless recoverable.

6. OVERSECURED CREDITOR CLAIMS

(a) Oversecured creditor can collect prepayment penalty from solvent debtor. A Chapter 11 Debtor objected to the claim of an over-secured creditor, on the basis that the prepayment penalty (3% or $200,000) was unreasonable. ***In re Gencarelli*, 501 F.3d 1 (1st Cir. 2007).** The Debtor argued that § 506(b) mandates that fees or expenses allowed to an over-secured creditor must be "reasonable". The Court rejected this argument, finding

that allowance under § 506(b) was not the applicable Code provision. Rather, the claim is allowable under § 502(b)(1), unless it is "unenforceable under 'applicable law'". Because the prepayment penalty was enforceable under non-bankruptcy law, the element of reasonableness was not relevant. The Court concluded that "Section 502, not Section 506(b), affords the ultimate test for allowability, and any claim satisfying that test is, at the very worst, collectible as an unsecured claim". The "unreasonable" penalty was, therefore, allowed as part of the claim.

(b) Oversecured creditor entitled to default interest rate. The Chapter 11 debtor and the creditor entered into an agreement for a loan and a revolving line of credit. The pre-default interest rate was 2% per annum less than the post-default rate. The loan agreement also obligated the debtor to pay attorneys' fees and costs incurred by the creditor in connection with any dispute relating to the loan agreement. All advances under the loan agreement were secured by a first-position blanket lien on all of debtor's assets. There were pre-petition defaults, and the loan began to bear interest at the default rate. Debtor then filed Chapter 11 and began an orderly liquidation process with various sales under § 363. The creditor also provided post-petition financing, which included use of cash collateral. The stipulation entered into between debtor and the creditor contained all the usual provisions and agreed that the creditor was entitled to be paid interest at the default rate. The committee of unsecured creditors objected to that stipulation and insisted that it was only entitled to interest at the non-default rate. The bankruptcy court ruled in favor of the committee and the creditor appealed. ***General Electric Capital Corp. v. Future Media Productions, Inc.*, 2008 WL 3091471 (9th Cir. 2008)**. On appeal, the Ninth Circuit reversed. The court noted that the sales were pursuant to motions under § 363 and involved no plan cure provisions, thereby distinguishing its earlier decision of *In re Entz v. White Lumber & Supply, Inc.*, 850 F.2d 1338 (9th Cir. 1988), which held that an oversecured creditor was not entitled to interest at the default rate when its claim was paid in full pursuant to the terms of a Chapter 11 plan. On remand, the circuit court directed the bankruptcy court to (a) evaluate whether the default rate was appropriate using the standards set forth by the Fifth and Seventh Circuit Courts of presuming allowability of the contracted-for default rate if enforceable under applicable non-bankruptcy law and (b) reconsider whether the creditor was entitled to attorney's fees, costs, and expenses incurred in the litigation to determine the applicability of the default rate.

(c) Oversecured creditor entitled to contractual default interest. A Chapter 11 debtor challenged that portion of a lender's claim that included interest at the default rate, contending that it constituted an unenforceable penalty under Florida law that was not allowable under § 506(b) or, alternatively, should be disallowed based on a balancing of the equities of the case under federal law. The bankruptcy court found it had no discretion to disallow the inclusion of interest at the default rate. ***In re Sundale, Ltd.*, 410 B.R. 101 (Bankr. S.D. Fla. 2009)**. Following *U.S. v.The Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), and a number of Eleventh Circuit opinions thereafter, Judge Isicoff found that the "reasonable" modifier in § 506(b) related only to "fees, costs or charges" and does not limit interest. The court noted that several cases under Florida law found that certain fees and charges were improperly disguised as penalties, but no Florida case did so with respect to a lender's entitlement to default interest. The court further found that it may not use its equitable powers to alter the lender's state law contract rights even under Florida law or

federal law. [*Editor's Note:* This issue arises in connection with a lender's stated payoff in a stay relief motion, at closing or in its proof of claim amount.]

(d) Attorney fees reduced on claim of oversecured creditor who should have done more "grazing". Trustees also see oversecured creditors with large equity cushions acting more aggressively than necessary and attempting to pass on the resulting attorney fees as part of the payoff. In this Chapter 11 case, the DIP was a motor vehicle dealer. Its primary lender was floor-planning its motor vehicle inventory. Two days after the petition was filed, the Debtor offered the lender adequate protection in the form of payment in full, with interest, within 90 days from the petition date. Based thereon, and on other restrictions placed by the court, the court ordered the lender to turn over to the Debtor the inventory collateral but allowed the lender to have stay relief if the 90-day period passed without payment in full. Nevertheless, the lender proceeded in what the court described as a "scorched earth litigation strategy … driven more by distrust of and animus toward the Debtor rather than reasoned judgment. Considerations of efficiency and economy and the use of legal resources were abandoned. At one time or another, the Bank had no less than four law firms and six consultants engaged to do battle with the Debtor." The Bank's fees were four times that sought by the Debtor and amounted to $4,500 per day during the 90-day period before Debtor satisfied its obligation in full. The court disallowed much of the Bank's legal fees as part of its oversecured claim. ***In re Woods Auto Gallery, Inc.*, 379 B.R. 875 (Bankr.W.D. Mo. 2007)**. Judge Dow found that adversary proceedings initiated by the Bank as well as other legal activity were unnecessary or overworked. The court ended up denying attorneys' fees and expenses in the amount of $197,892.02. The court concluded: "The Bank's counsel galloped along at a remarkably swift pace … where … doing a bit of grazing while waiting to be fed may [have been] the most reasonable plan of action." In a situation where there is only one oversecured creditor, appropriate security is in place to monitor the collateral, and there is a date certain when payment will be received or the stay lifted, as was the case here, the lender could not justify the level of expense charged to the estate.

7. CLAIMS ASSERTED UNDER SECTION 503(b)(9)

(a) Preference defendant not entitled to receive full payment on its allowed § 503(b)(9) claim and to use the value of the same pre-petition shipments under § 547(c)(4). Debtor was a manufacturer of carpeting and textiles. SPI supplied materials that debtor used in its manufacturing process. Within the 20-day period proceeding the petition date, debtor received two shipments totaling $302,512.06. The court had entered an order allowing SPI an administrative claim in that amount under § 503(b)(9). Thereafter, debtor filed a preference action against SPI. SPI sought to use the shipments that it had made during that same 20-day period as a credit against the amount sought under the new value defense of § 547(c)(4). Here, the court would not allow SPI both new value credit and payment of the § 503(b)(9) claim. ***In re TI Acquisition LLC*, 429 B.R. 377 (Bankr. N.D. Ga. 2010)**. Judge Diehl disagreed with another case that had considered some of the same issues, ***In re Commissary Operations, Inc.*, 421 B.R. 873 (Bankr. M.D. Tenn. 2010)**. She concluded that a creditor that delivered goods to the debtor pre-petition is not entitled to the new value defense when that creditor has been paid in full under § 503(b)(9). Here, full payment was guaranteed to the administrative claimant. The court noted that this was the same treatment provided to

reclamation claimants, in that the § 503(b)(9) claim was like a reclamation claim in that it was entitled to a higher status than other claims. A fully funded § 503(b)(9) claim also enjoyed the same level of security as a reclamation claim. Finally, for each of these claims, the creditor was paid in full for the value it delivered to the estate, which means that the estate was not enlarged by the transaction. Therefore, the court found it appropriate to treat the fully funded § 503(b)(9) similar to a reclamation claim. From a policy standpoint, the court found support for its decision. "Denying a creditor the new value defense when the creditor's § 503(b)(9) claim is paid in full and is for the same goods for which the creditor seeks new value is the best way to foster the policies behind the new value defense. The new value defense may encourage the creditor to continue extending credit to a financially troubled entity and the creditor is rewarded with the full payment of its claims. Secondly, providing a creditor with full payment of its § 503(b)(9) administrative claim and allowing the estate to recover preference payments in full is the best way to promote the equal treatment of creditors because it gives § 503(b)(9) credit full value for its claim, but only does so one time." If the creditor was allowed both the new value credit and payment of the § 503(b)(9) claim, it would result in double payment to that creditor and would reduce the funds otherwise available for distribution to other creditors.

(b) Administrative claim status for suppliers under BAPCPA includes secured creditors. A Chapter 11 Debtor which operated a chain of grocery stores objected to the administrative claim filed by one of its largest suppliers, which also held a security interest in the Debtor's inventory. The Bankruptcy Court allowed the claim, and appeal was made to the BAP. ***In re Brown & Cole Stores*, 375 B.R. 873 (9th Cir. BAP 2007)**. The Debtor contended that the new § 503(b)(9), which gives suppliers an administrative claim for unpaid goods delivered within 20 days prior to the petition filing, does not extend to secured creditors. Finding otherwise and affirming the Bankruptcy Court, the BAP followed a plain meaning interpretation of the statute. The Appellate Court found that § 503(b)(9) applies to any claim that fits within the amended subsection, including secured claims. The Court acknowledged that giving an administrative expense priority to a secured creditor could be inequitable as to other priority claimants. However, there was "no ambiguity in § 503(b)(9)", and the Court "must enforce it according to its terms and should not inquire beyond its plain language."

(c)§ 503(b)(9) administrative expenses do not include services provided in conjunction with goods purchased and unpaid. The Debtor operated a chain of retail clothing stores. Claimant provided fulfillment services which included inspecting, ticketing and repackaging apparel purchased by the Debtor from other vendors. Claimant asserted an administrative claim based on unpaid invoices for such services provided during the 20 days immediately preceding the petition filing. The Debtor objected, contending the claim was misclassified as administrative under BAPCPA § 503(b)(9), which expanded administrative expense claims to include the value of goods received by the Debtor during the 20-day period, if they were sold to the Debtor in the ordinary course of its business. ***In re Goody's Family Clothing, Inc.*, 401 B.R. 131 (Bkrtcy. D. Del. 2009)**. Judge Sontchi noted that the word "goods" is not defined in the Bankruptcy Code. The Court then assigned to goods the meaning stated in § 2-105(1) of the U.C.C.; which is something "moveable". Further, the Court noted that the term "goods" appears throughout the Bankruptcy Code, disjunctively connected to the term "services". This was found to indicate that the terms have separate meanings. Finally, the Court looked to the language of the statute, which provides that

"goods", rather than value, must be received by the Debtor to trigger application of § 503(b)(9). Therefore, claimant's argument that its contribution of value to the goods based on its services in connection with the goods, was unavailing.

(d) UCC definition of "goods." Section 503(b)(9) provides for the allowance of an administrative claim for "the value of any goods received by the debtor within 20 days before the date of commencement of a case under [Title 11] in which the goods have been sold to the debtor in the ordinary course of such debtor's business." Circuit City was a specialty retailer of consumer electronics operating 712 retail stores and nine outlets throughout the United States and Puerto Rico. The court set a bar date for the filing of administrative expense claims under §§ 105 and 503(b)(9). The debtor maintained that certain of the claims filed did not involve the sale of "goods" within the meaning of § 503(b)(9) and should be reclassified as general unsecured, non-priority claims. ***In re Circuit City Stores, Inc.*, 416 B.R. 531 (Bankr. E.D. Va. 2009)**. Judge Huennekens first concluded that the Bankruptcy Code did not define "goods" and it was not practical to use any state law definition given the multiple transactions in 48 states and Puerto Rico. The court observed that Congress would have intended a consistent, uniform approach to the definition of "goods" rather than a disparate application. Accordingly, the court adopted the UCC definition of "goods" which is the definition generally applied by bankruptcy courts to reclamation claims under § 546(c), which directly references § 503(b)(9). Next, the court looked to "hybrid" transactions involving contracts for the delivery of both goods and services and determined that it would follow the majority of courts that have adopted a "predominant purpose test" to distinguish between claims involving transactions and services, which would be treated as general unsecured claims, and claims involving the selling of goods, which would be entitled to an administrative priority. Because the claimant has the burden of proof on all elements of an administrative expense claim, the court granted the debtor's motion for partial summary judgment.

(e) Electricity held to be a "good" under § 503(b)(9). The chapter 11 debtor objected to a priority administrative claim in the amount of $281,667.88 filed by the creditor, an electricity reseller, for electricity supplied to the debtor within the 20-day period preceding the petition date, pursuant to § 503(b)(9). The debtor argued that the creditor provided a service, not "goods" in reliance on ***In re Pilgrims Pride Corp.*, 421 B.R. 231 (Bankr. N.D. Tex. 2009)**, in which the court concluded that electricity was not a good under § 503(b)(9). Here, the court disagreed and held to the contrary. *In re Erving Industries, Inc.*, 432 B.R. 354 (Bankr. D. Mass. 2010). Judge Boroff agreed with the majority view that "goods" under § 503(b)(9) should be interpreted in accord with the definition of that term found in § 2-105(1) of the UCC: "All things . . . which are moveable at the time of identification to the contract of for sale." Given that the term "goods" is not defined under the Bankruptcy Code, the court found it particularly appropriate to apply the UCC definition. The court determined that electricity is a "good" because it is literally moveable, clearly identifiable, and both moveable and identifiable at the time it is identified to the contract (i.e., when it passes through the electric meter). Moreover, the court determined that the creditor's claim arose not from the provision of services to the debtor, but solely from the sale of electricity. This creditor did not independently generate electricity, but resold electricity that it bought from others. It was not a "utility" as that term is ordinarily defined. The court engages in an interesting analysis of what electricity is and distinguishes it from telecommunication signals which are really "mechanisms by which other non-goods –

intellectual property, ideas, sounds, music, images, and words – are sent from one location to another." Whereas electricity, in contrast, is not merely a medium of delivery, but is "the thing" the customer seeks to purchase.

8. CLAIMS UNENFORCEABLE AGAINST THE DEBTOR DUE TO STATE LAW STATUTE OF LIMITATIONS

(a) *In re Hess*, 404 B.R. 747 (Bankr.S.D.N.Y. 2009).

Creditors filed claims that arose more than six years before the filing of the individual debtor's Chapter 13 bankruptcy petition. The debtor filed motions to disallow the claims asserting that New York Civil Practice Law and Rules § 213, which imposes a six-year statute of limitations on actions for breach of contract, bars the creditors from recovering money on their claims. The court granted the motions and held that:

1. Claims barred by a state's statutes of limitation should be disallowed.
2. Certain conduct by the debtor can revive the claim, for instance, partial repayment of a loan.
3. Statute of limitations is an affirmative defense that must be raised by the debtor.

(b) *In re Simpson*, 2008 WL 4216317, at *2 (Bankr.N.D.Ala. Aug. 29, 2008).

This case describes the procedure for dealing with creditor's claims barred by the state law statute of limitations. If the claim or debt is not scheduled by the debtor or scheduled as disputed, unliquidated or contingent, the claimant has the burden of filing a proof of claim pursuant to Bankruptcy Rule 3001(a). Once properly filed this serves as *prima facie* evidence of the claims validity and amount. If the debtor contests the claim, the burden is on the debtor to object to the claimants claim. Once the objection is made, the court can disallow the claim pursuant to § 502(b). If the debtor does not object, and the claim is barred by the statute of limitations, the claim will be paid pursuant to the Bankruptcy Code.

(c) *In re Chaussee*, 399 B.R. 225, 240 n. 16 (9th Cir. BAP 2008).

"Because the statute of limitations is an affirmative defense, a debtor is indeed burdened by the requirement that an objection be filed to a proof of clam that is, on its face, clearly time-barred.

(d) *In re McGregor*, 398 B.R. 561, 563 (Bankr.N.D.Miss. 2008).

The court disallowed a claim because it was barred by Mississippi's applicable state of limitations.

(e) In re Andrews, 394 B.R. 384, 388 (Bankr.E.D.N.C. 2008).

"In many states … statutes of limitations are affirmative defenses that must be affirmatively pled. Consequently a proof of claim based on a stale claim will be deemed allowed under § 501(a) unless the affirmative defense is raised in a filed objection."

(f) In re J & S Conveyors, Inc., 409 B.R. 635 (Bankr.W.D.N.Y. 2009).

The corporate debtor filed a petition initiating a Chapter 11 case. It was then converted to a Chapter 7 case approximately one year later. During the year that it was a Chapter 11 case, certain creditors filed proofs of claims, which at the time were not time-barred. The Chapter 7 case was closed, then reopened. The Bankruptcy Court Clerk mailed a Notice of Need to File Proofs of Claim Due to Discovery of Assets which required creditors to file proofs of claim in the reopened Chapter 7 case by a certain date. 11 creditors filed claims in the reopened Chapter 7 case. The creditors that had filed their proofs of claims in the Chapter 11 case did not file new proofs of claims in the reopened Chapter 7 and therefore were not included in the Trustee's final report. One of the creditors filed an objection to the Final Report claiming that since the proofs of claims had not been objected to they are deemed allowed. The Trustee claimed that although the claims may have been valid at the time they were filed in the Chapter 11 case, they were no longer valid because the state law statute of limitation had expired after the Chapter 7 case was closed and none of the claimants had taken the necessary steps to prevent their claims from becoming time-barred.

Issue 1: Are claims that were filed and allowed in a Chapter 11 case that has been converted to a Chapter 7 case valid and enforceable when the Chapter 7 case has been closed and reopened?

1. Chapter 11 claims that had not been specifically disallowed by the court in the reopened Chapter 7 case, are valid and allowed because the claims were valid and enforceable against the debtor at the time they were filed in the Chapter 11 case. These creditors established the right required right to payment under § 101(5)(a) and § 502(b)(1) for purposes of the administration of the estate and any prepetition assets that might be administered at any time, including in a case converted to Chapter 7 and even a converted case that was closed and reopened.

Issue 2: Are reopened Chapter 7 claims allowable under § 502(b)(1), even though the claims may no longer be enforceable against the debtor under applicable state law? In this case, the Court allowed the untimely proofs of claims because the creditors allegedly relied on a notice from the Clerk's office stating not to file a claim until they received a notice to do so, but the court held that a clerk's notice does not constitute a statute, equitable doctrine or court order which would toll an applicable state law statute of limitations. The court further held:

1. For any proof of claim seeking a right to payment based upon state law to be allowed in a bankruptcy case, pursuant to § 502(b)(1), the claimant's right to payment must be enforceable against the debtor under applicable state law when the claim is filed.
2. Even though a claim may otherwise be unenforceable under applicable state law, the requirements of § 502(b)(1) are met if the claimant was stayed or the applicable state law statute of limitations was tolled by a relevant statute, a recognizable equitable doctrine or a Court order, once the debtor's Chapter 7 case was closed.

L. CONVERSIONS

1. CONVERTING FROM CHAPTER 7 TO CHAPTER 13

(a) Marrama v. Citizens Bank of Massachusetts, 127 S.Ct. 1105 (2007)

(1) The Facts

Mr. Marrama filed for Chapter 7 relief. Prior to filing, he transferred properties and created a trust. When he filed his petition, he made false statements in relation to his pre-petition financial affairs. When discovered, the trustee sought to sell the assets. Mr. Marrama then sought conversion to Chapter 13 to prevent the sale of the assets. The bankruptcy court denied Mr. Marrama's request to convert to Chapter 7, based on bad faith. He appealed and the First Circuit BAP and the Court of Appeals affirmed. The Supreme Court granted cert.

(2) The Arguments

Mr. Marrama argued that § 706 provided him an absolute right to convert to Chapter 13. He further argued that the decision to convert was solely in his discretion. There is no good faith requirement in § 706(a). Citizens Bank maintained that the language in § 706 on its face expressed only a condition right. If the court allowed the conversion, with knowledge of Mr. Marrama's bad faith, it would allow Mr. Marrama to undermine the enforcement and compliance provisions of the Bankruptcy Code.

(3) The Supreme Court's Ruling.

The Court affirmed the First Circuit's ruling by holding that § 706(a) did not convey an absolute unqualified right to convert upon the debtor. Conversion is available to honest and unfortunate debtors. The court has equitable power to deny conversion when a debtor acts in bad faith pursuant to § 105(a).

(4) What does this mean?

On a broader scope *Marrama* opens the door to argue that courts should use its § 105(a) equitable powers, which have been used sparingly in the past, to argue for a position contrary to the plain meaning of the statute and legislative history. Section 105 states, "The court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

(5) Statutory interpretation

Marrama opens the door for courts to exercise greater discretion and have more flexibility in interpreting the Code which can trump seemingly clear statutory language. The "Plain Meaning Rule" is not the only guide to interpreting statutes.

(6) Burden of proof

Courts are still divided on who has the burden of proof. Some believe it is the trustee, others have held that it is the debtor to show good faith and eligibility in order to be allowed to convert to Chapter 13. *See, e.g., In re Grant*, 385 B.R. 627 (Bankr. E.D. La. 2008). Eligibility is fairly self-explanatory; however, courts have wide discretion on the factors to consider on good faith. Most courts look at:

(a) the timing of the motion to convert;
(b) the debtor's motive in filing the motion;
(c) the debtor's candor or forthrightness;
(d) whether the debtor can propose a confirmable Chapter 13 plan;
(e) the impact on the debtor of denying conversion weighed against the prejudice to creditors caused by allowing conversion;
(f) the efficient administration of the bankruptcy estate; and
(g) whether conversion would further an abuse of the bankruptcy process.

(b) Why would a Chapter 7 Debtor convert to Chapter 13?

(1) To avoid a dismissal under 707(b):

If an above median debtor fails to rebut the presumption of abuse, in lieu of dismissal, he may convert to Chapter 13.

(2) What is the procedure for converting from Chapter 7 to Chapter 13?

Section 706 allows the Debtor to convert at anytime. The Debtor must file a Rule 9013 motion to convert and give interested parties 21 days to object per FBRP 1017(f)(2). The Debtor must prepare completely updated statements and schedules.

(3) Eligibility to File Chapter 13

A. Chapter 7 debtor cannot convert to Chapter 13 if he is not an eligible Chapter 13 debtor. *In re Martin*, 141 F.3d 1169 (8th Cir. 1997). The Chapter 7 debtor must have a regular source of income and must not have more debtor than the § 109 debt limits.

(c) Converting from Chapter 13 to Chapter 7

(1) What is the effect of conversion?

It does not change the date of filing of the original petition. Post-petition debts that arise before the conversion are treated as though they are pre-petition debts. Liens that are satisfied in the Chapter 13 are not revived in the Chapter 7. *In re Cooke*, 169 B.R. 662 (Bankr. W.D. Mo. 1994).

(2) What is property of the estate?

§ 348(f)(1)(A): states 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 under the control of the debtor on the date of conversion. § 348(f)(2) provides that if a debtor has acted in bad faith, property of the estate will be determined as of the date of conversion. Property acquired after the filing of the Chapter 13 is not property of the estate in the Chapter 7 estate.

(3) What if the value of the property of the estate has changed?

§ 348(f)(1)(B) provides that valuations of property at the time of filing of the Chapter 13 does not apply to the converted Chapter 7 case. You must disclose the value of the property of the estate as of the date of conversion.

(4) What is the procedure for converting from Chapter 13 to 7?

§ 1307 allows a Chapter 13 debtor to convert to Chapter 7 at anytime. Debtor must file a Notice of Conversion as per FRBP 117(f)(3) and must pay a $25.00 filing fee. Debtor must update statements and schedules with current income, expenses, assets and values. Debtor must be able to demonstrate that he is an eligible Chapter 7 debtor.

(5) Other issues:

Once Chapter 13 is converted to Chapter 7, the debtor can no longer voluntarily dismiss the case. *In re Beatty*, 162 B.R. 853 (B.A.P. 9th Cir. 1994). The debtor can amend his exemptions when he converts. *In re Williamson*, 804 F.2d 1355 (5th Cir. 1986). The Chapter 13 debtor has an absolute right to convert so long as the case was not previously converted. Converting to Chapter 7 does not extend the statute of limitations on any avoiding powers for the newly appointed Chapter 7 trustee. *Singer v. Kimberly Clark Corp.*, 478 F.3d 546 (3rd Cir. 2007). *But see 11 U.S.C. § 502(d).*

2. COMPENSATION FOR FORMER CHAPTER 7 TRUSTEES IN A CONVERTED CASE

(a) Overview:

11 U.S.C. § 330 gives authority to the bankruptcy court to award a trustee reasonable and necessary compensation for services rendered and expenses incurred. § 326(a) acts to place an overall limit on the total fees that can be paid to a trustee in cases under Chapters 7 and 11, and § 326(b) places a similar limit on fees that can be paid in Chapter 12 and 13 cases. When more than one person has served as trustee in a case, § 326(c) acts to place a limit on the total fees that can be paid to the trustees by aggregating the trustees' compensation and subjecting the aggregate to the limits under §§ 326(a) and (b).

Often times, a debtor will file a petition under one chapter of the Bankruptcy Code, but then convert his case to one in another chapter. The question faced by the bankruptcy courts is whether a former Trustee in a converted case is entitled to compensation when he has made no distribution to the creditors. Several legal theories have been adopted by the courts to answer this question.

(b) Other Theories

(1) The Multiple or Composite Trustee Theory

a. Courts that adopt this theory believe that through § 326, Congress intended to place a cap on the fees that a trustee should be awarded, but that there is clear policy under the Bankruptcy Code to see that case trustees are adequately and fairly compensated. These courts also believe that it is unacceptable to penalize hard-working interim trustees whose services have contributed to the administration of the bankruptcy estate but who have not distributed funds. To balance these issues, these courts read the reference to "trustee" in § 326(a) to be a generic reference to the composite "trustee" and to the aggregate distributions made in the case by the composite "trustee" to all parties in interest other than the debtor. The result of this is that as long as there are some distributions made by some person serving as trustee at some stage of the bankruptcy case, all of the persons serving as trustee may be allowed reasonable fees for their services to be allocated among them. Their aggregate fees, however, may not exceed the amount set by the cap under § 326(a) as applied to the aggregate disbursements.

b. Cases:

i. *In re Rodriguez*, 240 B.R. 912 (Bankr. D. Colo. 1999).

(2) The Separate and Distinct Case Theory

c. Courts that adopt this theory believe that § 326 is intended to limit compensation to trustees in situations where two or more individuals served as trustees in the same bankruptcy case, not where there is a conversion. These courts view a converted case as two separate and distinct bankruptcy cases. Therefore, trustee compensation can be limited by § 326 separately, but not in the aggregate. As support for this, these courts recognize that the duties that are outlined in the Bankruptcy Code for Trustees under each chapter are different. As additional support for this "separate and distinct" position, these courts look to the language of § 1112 regarding conversion. The statute provides, "[t]he debtor may convert *a case* under this chapter to *a case* under chapter 7 of this title."

d. Cases:

i. *In re Yale Mining Corp.*, 59 B.R. 302 (Bankr. W.D. Va. 1986).

(3) The Constructive Disbursement Theory

e. Under this theory, courts impute the distributions made by the Chapter 13 Trustee to the former Chapter 7 Trustee to calculate the latter's maximum fee. They do not combine the fees of the trustees when applying the statutory cap in § 326 because it would serve as a disincentive to the former Chapter 7 Trustee to increase the value of the estate for the benefit of the creditors.

f. Cases:

i. *In re Hages*, 252 B.R. 789 (Bankr. N.D. Cal. 2000).

(4) Plain Meaning of § 326(a) Theory

g. Some courts take a strict view of the language of § 326(a) and hold that the trustee in a Chapter 7 case that converts to a Chapter 13 can receive no fees if that trustee did not disburse or turnover monies. These courts interpret the statute to be limited to the person who served as trustee while the bankruptcy case was pending under Chapter 7 or 11.

h. Cases:

i. *In re Silvus*, 329 B.R. 193 (Bankr. E.D. Va. 2005).
ii. *In re Evans*, 344 B.R. 440 (Bankr. W.D. Va. 2004).
iii. *In re Murphy*, 272 B.R. 483 (Bankr. D. Colo. 2002).

(5) Compensation Based upon § 105

i. These courts believe that a literal reading of the Bankruptcy Code does not forbid compensation to a former Chapter 7 Trustee who made no distributions to creditors prior to the conversion of the case, but rather, that the Bankruptcy Code was silent in this situation. These courts justify compensating former Chapter 7 Trustees based on § 105(a) and the equitable concerns in not paying a former Chapter 7 Trustee who completed his job diligently and effectively.

j. Cases:
   i. *In re Ferris*, No. 99-13328, 2000 WL 877038 (Bankr. N.D. Cal. June 11, 2000).
   ii. *In re Owens*, No. 99-11881, 2000 WL 1672331 (Bankr. N.D. Cal. Nov. 2, 2000).

(6) Quantum Meruit

k. Courts that adopt this theory believe that § 326 fails to address compensating former Chapter 7 Trustees and that the legal theory of quantum meruit provides a basis for compensation if the trustee provided substantial services that benefited the bankruptcy estate. One policy reason for this is that this may discourage debtors' intentional concealment of assets and encourage trustee's diligent discovery of assets. These courts do not impose the maximum limitations set forth in § 326 when determining compensation under § 330 to the former Chapter 7 Trustee. These determinations are made on a case-by-case basis.

l. Cases:
   i. *In re Jankowski*, 382 B.R. 533 (Bankr. M.D. Fla. 2007).
   ii. *In re Barkell*, 2006 WL 4846380 (Bankr. D. Utah. 2006).
   iii. *In re Conkle*, No. 04-66229, 2005 WL 6490598 (Bankr. N.D. Ga. 2005).
   iv. *Schilling v. Kinslow*, 287 B.R. 394 (W.D. Ky. 2002).
   v. *In re Washington*, 232 B.R. 814 (Bankr. S.D. Fla. 1999).

N. CASE SUMMARIES

(1) In re Jankowski, 382 B.R. 533 (Bankr. M.D. Fla. 2007).

The Trustee in a converted Chapter 13 case filed applications for fees and costs based on quantum meruit. The Court approved the applications. In reaching this conclusion, the Court considered the duties of the Trustee under § 704, the misleading and incomplete information provided by the Debtor at the inception of the case, and the Trustee's obligation to administer the estate for the benefit of the Debtor's creditors. Based on all of the circumstances, the Court found that the Trustee was entitled to "reasonable compensation for actual, necessary services" within the meaning of § 330 of the Bankruptcy Code.

(2) In re Washington, 232 B.R. 814 (Bankr. S.D. Fla. 1999).

This case was originally filed as a Chapter 7 and then was converted to a Chapter 13 before the Chapter 7 Trustee could distribute assets. The court concluded that the fee limitation set forth in § 326 should not preclude the Trustee from receiving compensation on a quantum

meruit basis. Courts have reasoned that in cases which are not fully administered, through no fault of the Trustee, compensation should still be awarded the Trustee who performs substantial services, but does not disburse any money. This prevents unfair treatment of Chapter 7 trustees where the conversion to Chapter 13 was for the purpose of avoiding the consequences of a trustee's action in locating, identifying and administering assets of the estate.

***(3) In re Barkell*, 2006 WL 4846380 (Bankr. D. Utah 2006).**

The Debtors in this case filed a petition under Chapter 7 but undervalued their home on their schedule A making the case look like a no-asset case. The Chapter 7 Trustee discovered the error and enlisted the help of a realtor to properly value the house and sell it. The Debtors converted their case to a Chapter 13 before the house was sold. The conversion terminated the Chapter 7 Trustee and turned over the case to a Chapter 13 Trustee. The Chapter 7 Trustee filed an application for compensation under the legal theory of quantum meruit for pre and post-conversion services. The Court held that the Chapter 7 Trustee is entitled to pre and post-conversion compensation based on the legal theory of quantum meruit. The court further held that:

1. § 326 is not applicable where a Trustee is required to perform services and the case has been converted before assets can be distributed.
2. Pre-conversion fees should be awarded based on the reasonable and necessary standard in § 330.
3. An award of post-conversion fees are reasonable when a Chapter 7 Trustee's services are so inextricably intertwined with the services performed prior to the conversion. This type of extraordinary relief should be allowed rarely and application of this standard must be applied on a case-by-case basis. The preparation and defense of the trustee's own fee application and any work performed to facilitate the turnover of information to the Chapter 13 Trustee and inextricably intertwined with the administration of the case.
4. Section 348(e) terminates the appointment of the chapter 7 trustee and any chapter 7 trustee work performed after a case is converted is done for the estate only as a volunteer.

***(4) In re Silvus*, 329 B.R. 193 (Bankr. E.D. Va. 2005).**

This is a consolidation of four different cases involving the same Chapter 7 Trustee. In all of the cases, the Trustee determined that the Debtors undervalued their residences and the Debtors converted their case to a Chapter 13 case after the Trustee filed applications to employ a real estate agent and a Motion to Grant Access to Estate Property. After the conversion, the Trustee filed an application for administrative expenses based on the legal theory, quantum meruit. The court held that the plain meaning of § 326 barred an award of fees to a Chapter 7 Trustee when the case was converted to a case under Chapter 13 prior to any distribution by the Chapter 7 Trustee.

***(5) In re Conkle*, No. 04-66229, 2005 WL 6490598 (Bankr. N.D. Ga. 2005).**

Former Chapter 7 Trustee is entitled to compensation based on a quantum meruit basis where the trustee performs substantial services that result in discovery of assets for the benefit of

creditor. The court's analysis in determining compensation was based on § 330's reasonable and necessary standard.

***(6) In re Evans*, 344 B.R. 440 (Bankr. W.D. Va. 2004).**

The Chapter 7 Trustee in this converted case was unable to distribute any assets prior to the debtors converting their case to a Chapter 13 case. The Court concluded, "that however laudable or desirable it might be on fairness and good bankruptcy policy grounds to award compensation to Mr. Shortridge [the Trustee] for the hard work he did in this case before its conversion, to do so would be inconsistent with the provisions of 11 U.S.C. §326(a)."

***(7) In re Yale Mining Corp.*, 59 B.R. 302 (Bankr. W.D. Va. 1986).**

The issue before the court was whether the fees awarded to the preceding Chapter 11 Trustee must be considered and taken into account in fixing the fees of the Chapter 7 Trustee under § 326 when the case has been converted to from a Chapter 11 to a case under Chapter 7. The court concluded that the cases should be treated as separate and distinct and should not be aggregated. Therefore, each case has a maximum limit as set forth in §326(a).

CONVERSIONS

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July, 2011

Converting from Chapter 7 to Chapter 13

Converting from Chapter 7 to Chapter 13

- Does the Chapter 7 Debtor have an absolute right to convert to Chapter 13?
- Why would a Chapter 7 Debtor convert to Chapter 13?
- What is the procedure for converting from Chapter 7 to Chapter 13?

Does the Chapter 7 Debtor have an Absolute Right to Convert to Chapter 13?

Marrama v. Citizens Bank of Massachusetts 127 S.Ct. 1105 (2007)

The Facts

- Mr. Marrama filed for Chapter 7 relief.
- Prior to filing, he transferred properties and created a trust.
- When he filed his petition, he made false statements in relation to his pre-petition financial affairs.
- When discovered, the trustee sought to sell the assets.
- Mr. Marrama then sought conversion to Chapter 13 to prevent the sell of the assets.
- The Bankruptcy Court denied Mr. Marrama's request to convert to Chapter 7, based on bad faith.
- He appealed and the First Circuit BAP and the Court of Appeals affirmed. The Supreme Court granted cert.

The Arguments

- Mr. Marrama argued that §706 provided him an absolute right to convert to Chapter 13.
- He further argued that the decision to convert was solely in his discretion.
- There is no good faith requirement in §706(a).

- Citizens Bank maintained that the language in §706 on its face expressed only a conditional right.
- If the Court allowed the conversion, with knowledge of Mr. Marrama's bad faith, it would allow Mr. Marrama to undermine the enforcement and compliance provisions of the Bankruptcy Code.

The Supreme Court's Ruling

- The Court affirmed the First Circuit's ruling by holding that §706(a) did not convey an absolute unqualified right to convert upon the Debtor.
- Conversion is available to honest and unfortunate Debtors.
- Court has equitable power to deny conversion when a Debtor acts in bad faith pursuant to §105(a).

What does this Mean?

On a Broader Scope…

- ***Marrama*** opens the door to argue that Courts should use its §105(a) equitable powers, which have been used sparingly in the past, to argue for a position contrary to the plain meaning of the statute and legislative history.
- **Section 105** states, "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

Statutory Interpretation…

- *Marrama* opens the door for Courts to exercise greater discretion and have more flexibility in interpreting the Code which can trump seemingly clear statutory language.
- The "Plain Meaning Rule" is not the only guide to interpreting statutes.

Why would a Chapter 7 Debtor Convert to Chapter 13?

To Avoid a Dismissal under 707(b)

If an above median Debtor fails to rebut the presumption of abuse, in lieu of dismissal, he may convert to Chapter 13.

What is the Procedure for Converting from Chapter 7 to Chapter 13?

To Convert from 7 to 13…

- §706 allows the Debtor to convert at anytime.
- The Debtor must file a Rule 9013 Motion to Convert and give interested parties twenty-one (21) days to object as per FRBP 1017(f)(2).
- Prepare completely updated statements and schedules.

Eligibility to File Chapter 13

- A Chapter 7 Debtor can not convert to Chapter 13 if he is not an eligible Chapter 13 Debtor. *In re. Martin*, 141 F.3d. 1169 (8th Circ. 1997)
- Must have regular source of income.
- Must not have more debt than the §109 debt limits.

Converting from Chapter 13 to Chapter 7

Converting from Chapter 13 to Chapter 7

- What is the effect of conversion?
- Why would a Chapter 13 Debtor convert to Chapter 7?
- What is the procedure for converting from Chapter 13 to Chapter 7?

What is the Effect of Conversion?

§348 – Effect of Conversion

- It does not change the date of filing of the original petition.
- Post-petition debts that arose before the conversion are treated as though they are pre-petition debts.
- Liens that are satisfied in the Chapter 13 are not revived in the Chapter 7. *In re.Cooke*,169 B.R. 662 (Bankr. W.D. MO. 1994)

What is Property of the Estate?

§348(f)(1)(A):

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.

§348(f)(2) provides that if a Debtor has acted in bad faith, property of the estate will be determined as of the date of conversion.

Property acquired after the filing of the Chapter 13 is not property of the estate in the Chapter 7 estate.

What if the Value of the Property of the Estate has Changed?

- 348(f)(1)(B) provides that valuations of property at the time of filing of the Chapter 13 does not apply to the converted Chapter 7 case.
- You must disclose the value of the property of the estate as of the date of conversion.

Why Would a Chapter 13 Debtor Convert to Chapter 7?

What is the Procedure for Converting from Chapter 13 to Chapter 7?

From Chapter 13 to 7

- §1307 allows a Chapter 13 debtor to convert to Chapter 7 at anytime.
- Debtor must file a Notice of Conversion as per FRBP 1017(f)(3).
- Debtor must pay a $25.00 filing fee.
- Debtor must update statements and schedules with current income, expenses, assets and values.
- Debtor must be able to demonstrate that he is an eligible Chapter 7 Debtor.

Other Issues:

- Once Chapter 13 is converted to Chapter 7, the Debtor can no longer voluntarily dismiss the case. *In re. Beatty*, 162 B.R. 853 (B.A.P. 9th Circ. 1994)
- The Debtor can amend his exemptions when he converts. *In re. Williamson*, 804 F.2d. 1355 (5ht Circ. 1986)
- The Chapter 13 Debtor has an absolute right to convert so long as the case was not previously converted.
- Converting to Chapter 7 does not extend the Statute of Limitations on any avoiding powers for the newly appointed Chapter 7 Trustee. *Singer v. Kimberly Clark Corp.*, 478 F.3d 546 (3rd Circ. 2007)