Pigs Get Fat, Hogs Get Slaughtered: Pre-bankruptcy Planning and Dischargeability

Allan D. NewDelman, Moderator
Allan D. NewDelman, P.C.; Phoenix

Diane L. Drain
Law Office of Diane L. Drain, PA; Phoenix

Hon. Frank L. Kurtz
U.S. Bankruptcy Court (E.D. Wash.); Yakima

William N. Lobel
The Lobel Firm, LLP; Newport Beach, Calif.

Brian D. Shapiro
Law Office of Brian D. Shapiro; Las Vegas

21ST ANNUAL SOUTHWEST BANKRUPTCY CONFERENCE

"Stuck Between a Rock and a Hard Place. The plight of the homeowner, the homeowner's association and how the discharge effects them both", by Diane L. Drain

INTRODUCTION:

These materials and the case summaries attached hereto, depict a tension between the rights of the homeowner and the homeowner's association. Outside bankruptcy this rights and obligations are dictated by the applicable state law and contractual obligations. It is important to review the conditions, covenants and restrictions "CC&R's" of the homeowner's association in order to answer the basic question: "does the responsibility to pay the financial obligation and perform the required duties run with the land and/or is that responsibility also the personal obligation of the homeowner?" To put the question in simple legal terms: "is the contract in rem, in personam or both"? For the most part, bankruptcy does not disturb that contractual obligation. Therefore, if bankruptcy is part of the picture then the lawyer must review the CC&R's and statutory requirements in order to determine the rights and obligations of the parties involved.

The law:

Pre-BAPCPA:

523(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -

> (16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a dwelling unit that has condominium ownership or in a share of a cooperative housing corporation, but only if such fee or assessment is payable for a period during which -
>
> (A) the debtor physically occupied a dwelling unit in the condominium or cooperative project; or
>
> (B) the debtor rented the dwelling unit to a tenant and received payments from the tenant for such period, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case;

Post-BAPCPA:

523(a) A discharge under section 727, 1141, 1228 (a), 1228 (b), or 1328 (b) of this title does not discharge an individual debtor from any debt—

> (16) for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or a lot in a homeowners association, for as

long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit, such corporation, or such lot, but nothing in this paragraph shall except from discharge the debt of a debtor for a membership association fee or assessment for a period arising before entry of the order for relief in a pending or subsequent bankruptcy case;

1228 (a) Subject to subsection (d), as soon as practicable after completion by the debtor of all payments under the plan, and in the case of a debtor who is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, after such debtor certifies that all amounts payable under such order or such statute that are due on or before the date of the certification (including amounts due before the petition was filed, but only to the extent provided for by the plan) have been paid, other than payments to holders of allowed claims provided for under section 1222 (b)(5) or 1222 (b)(9) of this title, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan allowed under section 503 of this title or disallowed under section 502 of this title, except any debt—

(1) provided for under section 1222 (b)(5) or 1222 (b)(9) of this title; or

(2) of the kind specified in section 523 (a) of this title.

(b) Subject to subsection (d), at any time after the confirmation of the plan and after notice and a hearing, the court may grant a discharge to a debtor that has not completed payments under the plan only if—

(1) the debtor's failure to complete such payments is due to circumstances for which the debtor should not justly be held accountable;

(2) the value, as of the effective date of the plan, of property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7 of this title on such date; and

(3) modification of the plan under section 1229 of this title is not practicable.

1328 (a) Subject to subsection (d), as soon as practicable after completion by the debtor of all payments under the plan, and in the case of a debtor who is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, after such debtor certifies that all amounts payable under such order or such statute that are due on or before the date of the certification (including amounts due before the petition was filed, but only to the extent provided for by the plan) have been paid, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt—

(1) provided for under section 1322 (b)(5);

(2) of the kind specified in section 507 (a)(8)(C) or in paragraph (1)(B), (1)(C), (2), (3), (4), (5), (8), or (9) of section 523 (a);

(3) for restitution, or a criminal fine, included in a sentence on the debtor's conviction of a crime; or

(4) for restitution, or damages, awarded in a civil action against the debtor as a result of willful or malicious injury by the debtor that caused personal injury to an individual or the death of an individual.

(b) Subject to subsection (d), at any time after the confirmation of the plan and after notice and a hearing, the court may grant a discharge to a debtor that has not completed payments under the plan only if—

(1) the debtor's failure to complete such payments is due to circumstances for which the debtor should not justly be held accountable;

(2) the value, as of the effective date of the plan, of property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7 of this title on such date; and

(3) modification of the plan under section 1329 of this title is not practicable.

Legal, equitable or possessory ownership interest: the 2005 version did away with the exclusion for vacant units and now provides that nondischargeability applies regardless of whether or not the unit is occupied by anyone. Thus, there must be a transfer of ownership in order for the debtor or trustee to cease their obligation for post-petition assessments and/or fees.

Chapter 7, 11, 12 versus chapter 13: By strict interpretation of the Code it appears that post petition assessment and fees are discharged in a chapter 13 because 1328(a) is not one of the enumerated exceptions to discharge in 523(a)(16). To borrow a quote from In re Foster United States Bankruptcy Appellate Panel of the Ninth Circuit. July 19, 2010 435 B.R. 650 2010 "Whether the omission of § 1328(a) in § 523(a)(16) or vice versa is a statutory misstep is a question we need not answer. Suffice to say, on the facts before us, there is no statutory default rule regarding an exception to discharge for postpetition HOA dues." Foster 435 at 658.

It is important to note that there is relatively little case law applying this exclusion. A few cases have held that, for this reason, assessments which have accrued postpetition and are dealt with in the plan are discharged by completion of a Chapter 13 plan; see, e.g., In re Cook, 2010 Bankr. LEXIS 4372 (Bankr. E.D. Va. 2010) and In re Heflin, 2010 Bankr. LEXIS 1253 (Bankr. E.D. Va. 2010); In re Colon, 465 B.R. 657 (Bankr. D. Utah 2011). These cases generally seem to be based on the idea that the assessments are "contractual" in nature, therefore essentially prepetition obligations which merely mature after the petition date.

The other side of this argument is that the obligation to pay post-petition dues is based on a covenant that runs with the land, thus does not arise prepetition and would not be included in the discharge. See, e.g., Maple Forest Condominium Association v. Spencer (In re Spencer), 457 B.R. 601 (E.D. Mich. 2011) (post-petition accruals were not discharged because, under local law, they arose under a covenant running with the land; reversing the decision to the contrary by the

bankruptcy court); also In re Foster, 435 B.R. 650 (9th Cir. BAP 2010)(obligation to pay dues arises from a covenant running with the land, thus is not "contractual," instead is incidental to ownership and not discharged post-petition). In the relatively rare case in which a hardship discharge is granted pursuant to §1328(b), all of §523(a) applies, including §523(a)(16); cf. §1328(c)(2). It appears that this issue has not yet been fully fleshed out. In addition, it is unclear how the precedents that do exist would be applied to a co-op, where the "owner" is merely a tenant.

Conclusion: So long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in the real property, then any association fees or assessments that accrue before the petition is filed are dischargeable, whether 7, 11, 12 or 13. But, dues and fees accrued after the petition is filed cannot be discharged, unless the discharge is a traditional chapter 13.

So, how does the homeowner deal with this very sticky wicket? The homeowner is faced with serious issues they cannot resolve without help: underwater values, lenders refusing to foreclose and aggressive HOAs.

1) Can the homeowner quit claim to the lender or HOA? No, a quit claim must be accepted in order to be binding.
2) Transfer title to a shell entity. Creative, but not able to find any case law pro or con. How about the arguments related to piercing the corporate veil?
3) Can the homeowner ask the court for relief? In general, the courts have offered no relief.

But, see an extraordinary result In Pigg v. BAC Home Loans Servicing LLP (In re Pigg), 457 B.R. 728 (Bankr. M.D. Tenn. 2011). Facts: the Chapter 7 debtor owned a condo that was severely damaged in a catastrophic flood that devastated Nashville. The debtor had abandoned the unit, and the **bank had taken possession to prevent further damage, but refused to foreclose.** HOA fees continued to accrue leaving debtor locked into a never ending situation: she could not live in the property, but was liable for the HOA dues. The debtor then filed an adversary asking that the court compel the bank to complete the foreclosure or accept a deed in lieu. The court was sympatric, noting that the Bank is the unintended beneficiary of the perfect storm of natural disaster and this legislative inequity. While the HOA fees continue to accrue against the debtor, the Bank is de-incentivized to take any action. The economics of the situation allow the Bank to sit idle and not foreclose as long as the debtor, not the Bank, is liable for the HOA fees. Both the HOA and the Bank admitted, the Bank receives the benefit of the HOA services such as landscaping improvements, common area maintenance, signage and security. Meanwhile the debtor receives minimal if any benefit for fees she must pay. Pigg, supra, 457 B.R. at 733 n.5.

The court also noted with disgust that §523(a)(16), which it observed was "no doubt the result of special interest lobbying," did not exonerate the victims of natural disasters such as the Nashville floods and the horrendous tornado which had destroyed Joplin, Mo. and concluded that "the perfect storm of the Great Recession and these unspeakable natural disasters" left debtors such as Ms. Pigg "to suffer unbearable losses...and be denied the fresh start promised by bankruptcy." Id. at 733.

Conclusion: The court could not grant a discharge of the fees in contravention of §523(a)(16), but 105 permitted the court latitude in resolving the debtor's dire situation. The court ordered that the debtor's discharge and the order modifying the stay be set aside temporarily; that the trustee sell the property and apply the proceeds according to the proper priorities; and then reinstating the discharge. Under state law the condominium association lien had first priority which meant that a sale would wipe out the debtor's obligation for association fees. The court further found that the Bank and the HOA had effectively consented to a Section 363 sale free and clear of liens by virtue of their inaction.

INDEX

Case law deciphering the issues dealing with association dues and the debtor's discharge has been slow in coming since BAPCPA, but has been gathering speed in the last couple years. See some of the recent cases as set forth below.

AUTOMATIC STAY ISSUES:

Rainbow Bend Homeowners Ass'n v. Wilder

United States District Court, D. Nevada. May 28, 2013 Slip Copy 2013 WL 2326886

This case arises out of the foreclosure of a lien for delinquent homeowner's association fees. Pending before the Court is a Motion to Remand (ECF No. 7). For the reasons given herein, the...

...This case arises out of the foreclosure of a lien for delinquent homeowner's association fees.... ...Wilder became delinquent in her assessments owed to Plaintiff Rainbow Bend Homeowners Association, and during or after Wilder's bankruptcy, Plaintiff foreclosed upon the Property and purchased it with a credit bid at a trustee's sale when the bankruptcy judge lifted the automatic stay....

In re Kanohokula United States Bankruptcy Court, D. Hawai'i. April 02, 2013 Slip Copy 2013 WL 1346020

The question in this chapter 7 case is whether a condominium association violated the automatic stay or the discharge injunction by attempting to collect a special assessment from the...

...Condominium associations enjoy a special exemption from the usual rule that the bankruptcy discharge eliminates debts that arose before the date of the petition. 11 U.S.C. § 523(a)(16) provides that the chapter 7 discharge does not apply to a debt: For a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit, such corporation, or such lot, but nothing in this paragraph shall except from discharge...

...I conclude that the association's claim was not discharged, so there was no violation of the discharge injunction, and that the association willfully violated the automatic stay but inflicted only limited harm on the debtors....

In re Hall, 454 B.R. 230, February 18, 2011 United States Bankruptcy Court, N.D. Georgia **(2011)**

Background: Property management company for condominium **association** filed motion to reconsider and vacate contempt order that had been entered against it in connection with a litigation notice and an assessment lien notice that it sent to Chapter 13 debtor regarding postpetition defaults of her condominium assessments.

CONCLUSION: The Court's finding that post-petition assessments are not claims and subject to the automatic stay comports with the sound reasoning that the creditor's right to payment simply does not exist at the time of a debtor's bankruptcy filing.
Additionally, the nature of the claim for assessments is a covenant that runs with the land and binds property owners to pay obligations in the state of Georgia and under the subject Declaration. Therefore, the Court finds that Liberty did not violate the automatic stay in its attempt to collect the postpetition assessments.

The Court further notes that the purpose of the automatic stay is in no way compromised. The automatic stay protects debtors from harassment, foreclosure, and other financial pressures related to their pre-petition debts. The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy. In a chapter 13 plan, a debtor has the right and obligation to pay pre-petition arrears. However, the Debtor, as the plan in this case acknowledges, must pay post-petition payments directly to the creditor. Continuing to default on post-petition payments is not protected by the bankruptcy laws. The Debtor's fresh start entitles her to relief under her confirmed plan, but that fresh start does not and should not encourage further defaults.
Accordingly, the motion is granted.

In re Heck United States Bankruptcy Court, N.D. California. January 13, 2011 Slip Copy 2011 WL 133015

Background: Debtors filed three separate motions to reopen their chapter 7 bankruptcy case. Debtors seek to enforce the discharge injunction against Elysian Community Association RB 214 (Elysian), a homeowners association that Debtors contend is attempting to collect *postpetition* homeowners dues. 1 Debtors also seek to compel the mortgagee (Chase) to take legal title to the Properties, effective as of the bankruptcy petition date, to assume financial responsibility for the Properties, and to remove from county records and Debtors' credit reports delinquencies reported against Debtors with respect to the Properties.

Holding: First, Elysian's collection efforts do not violate the discharge injunction, because Debtors continue to hold legal title to the Properties, and because a discharge under section 727 does not discharge a debtor with a "legal, equitable, or possessory ownership interest" from any debt for homeowners association assessments due and payable postpetition. 11 U.S.C. §

523(a)(16). 2 Debtors themselves acknowledge that the HOA fees Elysian seeks to collect came due postpetition.

Second, the court does not have subject matter jurisdiction to enter injunctive or declaratory relief against Chase. Such claims for relief do not "arise under" the Bankruptcy Code or "arise in" the bankruptcy case. Although the Bankruptcy Code requires individual debtors to file a statement as to whether they intend to retain or surrender property encumbered by secured debt, the Code does not impose a duty on the affected secured creditor to act upon Debtors' statement of intention. Nor are such claims "related to" the bankruptcy case, because the outcome of a lawsuit for injunctive or declaratory relief would not have any conceivable effect on Debtor's bankruptcy estate.

The complained-of conduct occurred postpetition, and the Properties are no longer property of the bankruptcy estate. 11 U.S.C. § 554(c); 28 U.S.C §§ 157(b), 1334(b).

The court denies Debtors' motions to reopen their bankruptcy case.

In re Barr, 457 B.R. 733 (2011) United States Bankruptcy Court, N.D. Illinois,E.D.

Background: Chapter 7 debtors moved for sanctions and award of damages against condominium association, alleging willful violation of discharge order. Association asserted defense that its claim, if it arose prepetition, was excepted from discharge.

Holdings: Motion denied, the Bankruptcy Court held that:

1) special assessment levied by association postpetition was prepetition debt;
2) special assessment fell within scope of discharge exception for community association fees and assessments; and
3) association did not act with intent and knowledge required for award of sanctions for willful violation of post-discharge injunction.

COLLECTION OF INTEREST AND FEES INCURRED PRE-PETITION:

In re Moreno United States Bankruptcy Court, E.D. California, Fresno Division. August 15, 2012 479 B.R. 553 2012 WL 3542254

Background: Chapter 7 debtor moved for award of sanctions against property owners' association for common interest development in which debtor owned a home for violating discharge injunction.

Holding: 1) debtor's obligation for any dues assessed by property owners' association for the common interest development in which she owned home subsequent to commencement of her bankruptcy case, as well as for any interest or other charges associated with those postpetition assessments, was not subject to discharge;

2) association could not collect interest and attorney fees, even interest accruing, and attorney fees incurred, after commencement of bankruptcy case, to extent that interest and fees related to dues assessed against debtor prior to his bankruptcy filing;
3) regardless of whether property owners' association, in seeking to collect only interest and fees assessed/incurred postpetition, thought that it was honoring debtor's discharge, its violation of discharge injunction was willful and subjected it to award of contempt sanctions; and
4) *Rooker–Feldman* doctrine did not apply to prevent court from enforcing discharge injunction.

CHAPTER 7 & 13 LIEN STRIP:

In re Almeida United States Bankruptcy Court, M.D. FL, March 18, 2013 6:12-bk-12965 (memorandum opinion)

Chapter 7 case. This matter came before the Court on the Debtors Motion to Strip Lien of LKV Condominium Association, Inc. Motion to strip lien was granted.

In re Plummer, United States Bankruptcy Court, M.D. FL January 14, 2013 Case No. 8:12-bk-03870-MGW (memorandum opinion)

Chapter 13 case. Under 11 U.S.C. § 1322(b)(2), a chapter 13 debtor's plan may modify the rights of a holder of a secured claim other than a claim secured by a lien on the debtor's principal residence. In this case, a condominium association holds a lien for unpaid assessments that is secured by the debtor's principal residence. However, because the amount of the first mortgage exceeds the value of the property, under bankruptcy law, the condominium association's lien is unsecured. And while Florida statutes section 718.116 does give the condominium association certain rights against the bank holding the first mortgage, those rights do not include subordination of the bank's lien on the residence. Accordingly, the Court will grant the debtor's Motion to Determine Secured Status of Timber Lake Estates, Inc. (the "Motion").

In re Young, No. 11–09267–8–SWH United States Bankruptcy Court, E.D. North Carolina, November 7, 2012 Not Reported in B.R., 2012 WL 5430987

Pending before the court is the motion of the chapter 13 debtor, Rashondia L. Young, to value the debtor's residence and to determine the status of a pre-petition lien in the amount of $1,095.73 as against the debtor's property held by the Bison Court Homeowners Association, Inc., which the debtor contends should be deemed unsecured pursuant to § 506 of the Bankruptcy Code.

"In sum, discharge and stripdown are two wholly distinct things. The bottom line is that if, as in this case, a lien is wholly unsecured as of the petition date, it may be stripped off. It is, however, *only* that *pre-petition* lien that is stripped off upon discharge, not BCHA's entitlement to subsequently assert any post-petition lien rights that may accrue. *See, e.g., In re Guillebeaux,* 361 B.R. 87 (Bankr.M.D.N.C.2007) (discussing *In re Rosenfeld,* 23 F.3d 833, 836–37 (4th Cir.1994)

and the extent to which homeowners' association assessments are dischargeable). This court will, for the foregoing reasons, allow the debtor's motion to avoid the BCHA lien.

CONCLUSION: The debtor's motion to value collateral and determine status of claim is ALLOWED. The value of the debtor's residence is $110,000 and, consequently, the claim of BCHA is an unsecured claim pursuant to § 506(d), and the Claim of Lien recorded by BCHA upon the debtor's residence (case number 11M6959) is wholly unsecured. It is further ORDERED that BCHA must cancel the claim of lien upon the debtor's completion of her chapter 13 plan and her receipt of a discharge in this chapter 13 case."

CHAPTER 7 ISSUES:

In re Richins, United States Bankruptcy Court, D. Utah. March 13, 2012 469 B.R. 375 2012 WL 863809

BANKRUPTCY - Avoidance. Chapter 7 debtors could not "strip off" junior deed of trust lien.

... While discharge is also a goal in chapter 13, such discharge is conditioned upon performance and repayment under a court-ordered plan of reorganization....

...In support of the Motion, the Plaintiffs cite to a variety of chapter 13 cases that permitted the strip off of junior liens, including Tanner v. FirstPlus Financial,30 McDonald v. Master Financial, Inc.,31 and Bartee v. Tara Colony Homeowners Association....

In re Allard

United States Bankruptcy Court, N.D. California. July 10, 2012 Slip Copy 2012 WL 2830158

In this adversary proceeding, Chapter 7 debtor and plaintiff Misty Allard seeks to enjoin collection of homeowners' association dues on a condominium she owned prior to and for a time after...

...Defendant Courtyards East Homeowners Association's motion for summary judgment is now before the court....

...All parties agree that this case is governed by § 523(a)(16) of the Bankruptcy Code as last amended in 2005, which provides that there is an exception to discharge "for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit..

In re Eckerdt United States Bankruptcy Court, D. Arizona. October 15, 2012 Slip Copy 2012 WL 4906511

A trial in this action came on for hearing on October 9–10, 2012. The complaint alleged that there existed a debt owed to Plaintiff which should be declared non-dischargeable on...

...Section 523(a)(2)(A) provides that: (a) A discharge does not discharge an individual debtor from any debt-...

...To support her theory, Ms. Emerick relies upon a series of either open meetings or board-only meetings of the Mountain Vista Villas homeowners' association....

In re Springer United States Bankruptcy Appellate Panel, of the Ninth Circuit. March 09, 2012 Not Reported in B.R. 2012 WL 762830

Chapter 7 debtor, Christine E. Springer, appeals the bankruptcy court's order denying her motion to reopen her case. We AFFIRM. Debtor's motion to reopen her bankruptcy case related to the...

...Although debtor was not living in the property, her homeowners' association fees and other expenses associated with the property continued to accrue....

...In September 2010, debtor's homeowners' association ("HOA") sent her a letter for past due amounts on her association fees, which totaled $6,783.77....

SURRENDER OF PROPERTY IN CHAPTER 7:

In Pigg v. BAC Home Loans Servicing LLP (**In re Pigg**), 457 B.R. 728 (Bankr. M.D. Tenn. 2011)

Background: Chapter 7 debtor brought adversary proceeding against mortgagee, mortgage loan servicer, and homeowners association (HOA), seeking equitable relief to stop accrual of HOA fees for her flood-damaged condominium unit, which she had vacated, surrendered and the mortgagee took possession, and, if statute made postpetition fees nondischargeable, to compel mortgagee to either accept deed in lieu of foreclosure or to instigate foreclosure proceeding. (See additional notes supra)

Holdings: The Bankruptcy Court held that:

1) HOA's lien was entitled to priority over mortgagee's security interest under deed of trust for amounts that became due after bank took possession, and
2) equity required bankruptcy court to fashion remedy which would prevent eradication of debtor's fresh start due to nondischargeability of HOA fees.

CHAPTER 13 ISSUES:

In re Murphy United States Bankruptcy Court, D. Colorado June 07, 2013 --- B.R. ---- 2013 WL 3327039

Background: Chapter 13 debtor moved to void sheriff's sale conducted during the gap period between dismissal of her Chapter 13 case for her default in plan payments and reinstatement...

...Reinstatement of Chapter 13 case that had been dismissed based on debtor's default in making payments under confirmed plan did not resurrect the plan and once more bind homeowners' association to its terms, where relationship between debtor and homeowners' association had substantially changed during the gap period between dismissal and reinstatement of case, as result of completed sheriff's sale of debtor's home for unpaid association fees. ...

...Homeowners' association moved for stay relief in order to evict debtor....

In re Cisneros United States Bankruptcy Court, N.D. California. October 01, 2012 Slip Copy 2012 WL 4627833

Chapter 13 debtor Antonio Cisneros owns two condominiums at 333 and 337 West 9th Street in Santa Rosa, California. He fell behind in his payment to the Land Smith Business Park Homeowners'...

...The courts in both cases held that Civ.Code § 1366.1 only limited the homeowners association and did not create a cause of action against homeowners associations or businesses employed by the associations....

...The policy behind California's laws governing homeowners association rights when a property owner is in default is clear, and very much akin to the policy governing nonjudicial foreclosure: the state wants homeowners associations to be compensated for their expenses, but individual property owners ought not have unreasonable burdens on their ability to save their units.1...

In re Dabney United States Bankruptcy Court, D. Colorado. August 27, 2012 Slip Copy 2012 WL 3704719

Debtors' Motion for Summary Judgment ("Motion") presents the issue of whether a debtor who proposes and obtains confirmation of a Chapter 13 plan which bifurcates the allowed...

...The following creditors shall retain the liens securing their claims until discharge under 11 U.S.C. § 1328 or payment in full under nonbankruptcy law, and they shall be paid the amount specified which represents the lesser of: (a) the value of their interest in collateral or (b) the remaining balance payable on the debt over the period required to pay the sum in full....

...Flying Horse Homeowners Association, Inc....

In re Pecho , United States Bankruptcy Court, N.D. California, Oakland Division. October 18, 2012 Slip Copy 2012 WL 5180341

Jose A. Pecho, Sr. ("debtor") filed this chapter 13 case on August 24, 2011. This case was filed approximately two months after debtor received a discharge in his prior chapter...

...The current version of the plan (docket no. 65), calls for payments of $500 per month for the first 12 months of the plan, and $3,555 per month for the remaining 48 months; pre-confirmation adequate protection payments for a car loan; cure of a $7,000 arrearage to a homeowners' association; payment of priority claims totaling approximately $10,000; surrender of a timeshare; and direct payments of $3,900 per month to Marix and of $70 per month to the homeowners' association....

...In support of confirmation, debtor argues that (1) because the value of the residence is less than the debt owed to the first priority lien holder, Jiminez has only unsecured claims so § 1322(b)(2), § 1328(f)(1) and § 1325(a)(5)(B)(i)(I) are not applicable; (2) Jiminez's in rem rights are to be satisfied by debtor's complete performance under the plan; (3) § 1325(a)(4) and § 1325(b)(1) do not require a discharge, only that a debtor must pay the value of non-exempt assets and all disposable income; (4) upon completion of his plan, his unsecured debt will be eliminated without the need for a second discharge....

In re Spencer, 437 B.R. 563 (October 6, 2010) United States Bankruptcy Court, E.D. Michigan, Southern Division

Background: Condominium association sued for declaratory judgment that certain obligations of Chapter 13 debtor, a unit owner, were nondischargeable in bankruptcy, including debtor's obligation for postpetition assessments and damages caused by his alleged failure to properly maintain his unit. Debtor stated his intention to surrender the property (with loans to three different lenders). Both parties moved for summary judgment.

Holdings: the court determined that:

1) condominium association's claim for condominium dues that became due and payable after commencement of unit owner's Chapter 13 case, and for which unit owner was contractually liable pursuant to terms of condominium purchase agreement that he signed prepetition, was in nature of "prepetition claim";
2) dischargeability exception for condominium fees or assessments which became due and payable postpetition did not apply in Chapter 13 case in which debtor was not seeking a hardship discharge; and
3) genuine issues of material fact precluded entry of summary judgment in nondischargeability proceeding brought by condominium association based on debtor's alleged failure to properly maintain his unit.

Debtor's motion granted in part; association's motion denied.

In short, not only was the continuing accrual of condominium association dues post-petition within the "fair contemplation" of Maple Forest in an abstract sense, but a review of its proof of claim demonstrates that Maple Forest well understood when it filed its proof of claim, that the condominium association dues that became due and payable post-petition also made up a part of its pre-petition claim in this case. Therefore, the Court holds that all of the condominium association dues assessed by Maple Forest against the Debtor with respect to condominium unit 63 make up a pre-petition claim, regardless of whether such dues were assessed prior to the Debtor's Chapter 13 petition or whether they became due and payable after the Debtor's Chapter 13 petition.

In re Foster United States Bankruptcy Appellate Panel of the Ninth Circuit. July 19, 2010 435 B.R. 650 2010

Background: Applying Washington law where a Chapter 13 debtor sought to discharge postpetition homeowner's association dues, ruling that the dues arose out of a covenant running with the land, and therefore the "debtor's personal liability for the dues is an incidence of ownership of his property not affected by the filing of his bankruptcy" as long as the debtor "maintains his legal, equitable or possessory interest in the property[,] and is unaffected by his discharge"), BUT SEE *In re Hawk,* 314 B.R. 312, 315–16 (Bankr.D.N.J.2004) (looking to New Jersey law, which gives condominium associations the right to make assessments upon an owner taking title, finding that the post-petition assessments arose pre-petition when the debtor took title, and concluding that the post-petition assessments were the " 'contingent', 'unmatured' portion of that prepetition claim").

Conclusions:

1) the bankruptcy court did not abuse its discretion when it heard association's motion for summary judgment on shortened time;
2) the discharge exception for debts arising from unpaid postpetition homeowners' association dues does not apply to Chapter 13 cases;
3) under Washington law, the requirement to pay homeowners' association dues was not contractual, but was a covenant running with the land, and so debtor's personal liability for the dues was an incidence of property ownership unaffected by the filing of the bankruptcy petition; and
4) the declaration of covenants to which debtor's property was subject did not support an award of attorneys fees to association.

Finally, we would be remiss if we ignored the distinction between the treatment of property rights and contract rights under the Bankruptcy Code. While a debtor's personal obligation under a contract may be discharged in most instances, "bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation." *In re Rivera,* 256 B.R. 828, 834 (Bankr.M.D.Fla.2000) (quoting *United States v. Sec. Indus. Bank,* 459 U.S. 70, 75, 103 S.Ct. 407, 74 L.Ed.2d 235 (1982)). "A homeowners' association's right to impose postpetition assessments pursuant to a recorded Declaration of Covenants and Restrictions is within the scope of the traditional property interests protected by the Fifth Amendment." *Rivera,* 256 B.R. at 834.

Although § 101(5)(A) defines a "claim" as a "right to payment", "[t]he key to distinguishing a right to payment that is or is not subject to ... discharge is simply whether the right to payment is based on a property interest or something else." *Id.* at 833. Since Washington law does not view the Declaration as a contract (or "something else") and the affirmative covenant to pay HOA dues is one that runs with the land, it follows that the Association's right to payment of unassessed postpetition HOA dues is based on a property interest not subject to discharge under § 1328(a). The *Rivera* court explained the reason for this rule:

> A covenant running with the land, including any express provision for the debtor to be personally obligated to pay the homeowners' association, is an integral part of the property which the debtor acquired when the debtor acquired title to the property. The debtor never had title clear of the previously recorded covenant running with the land. Even though a mortgage and deed may be executed simultaneously, they are separate transactions. The debtor's acceptance of a deed and the corresponding recorded covenants, however, is one single and inseparable transaction.

Therefore, to release the debtor from a recorded covenant is to take a property interest away from the homeowners' association and give the debtor a property interest which the debtor never had in the first place. Any release from a covenant would in effect be a forced conveyance of a property interest from the homeowners' association to the debtor, something clearly beyond the scope of the Chapter 7 discharge.

In re Blenheim United States Bankruptcy Court, W.D. Washington, at Seattle. December 27, 2011 Slip Copy 2011 WL 6779709

This matter came before the Court on Debtors' Motion to Confirm Amended Plan (see Dkt. Nos. 140, 155, 156, and 170), in which Debtors seek confirmation of their ninth amended Chapter 13...

...Harbor West is to receive payment of $195 per month toward payment of pre-petition arrears on homeowners' association dues "inside" the Plan, and is to receive $550 per month (or the amount set by Harbor West) for ongoing homeowners' association dues "outside" the Plan....

...Post-filing, Debtors also discovered a dispute with Harbor West Condo Association ("Harbor West") regarding a lien against their Residence due to unpaid pre-petition homeowners' association dues and other obligations....

SURRENDER OF PROPERTY IN CHAPTER 13:

In re Heflin, Not report in B.R., No. 09–18642–SSM. United States Bankruptcy Court, E.D. Virginia, Alexandria Division April 1, 2010 WL 1417776

Background: George C. Heflin, Jr. ("the debtor") filed a voluntary petition in this court on October 20, 2009, for adjustment of his debts under chapter 13 of the Bankruptcy Code. Among the assets listed on his schedules were two parcels of real estate, one located in Alexandria, Virginia, and the other in Haymarket, Virginia, with both parcels being encumbered substantially in excess of their fair market value. "Potters Glen HOA" is shown as the holder of a unsecured claim in the amount of $4,307 for "HOA dues."

Court's analysis: However, § 523(a)(16) does not apply in chapter 13 except in the rare instances when a debtor who is unable to complete payments under a plan is granted a so-called "hardship discharge" under § 1328(b), Bankruptcy Code. By contrast, a chapter 13 discharge that is granted upon completion of plan payments is significantly broader than the discharge granted an individual debtor under chapter 7, 11 or 12 and does *not* exclude post-petition home owner association dues. *See* § 1328(a)(2),

Although the trustee recommends confirmation, Potters Glen Community Association ("Potters Glen") has objected to confirmation of the modified plan filed by the debtor because it does not provide for payment of on-going property owner assessments on property that the debtor is surrendering. A hearing was held on March 10, 2010, at which the court heard the contentions of the parties and took the matter under advisement. For the reasons stated, the objection will be overruled and the plan will be confirmed.

In re Kelly United States Bankruptcy Court, N.D. California. April 28, 2010 Not Reported in B.R. 2010 WL 1740739

Background; On June 9, 2009, the Court confirmed Debtor's Chapter 13 Plan, which provided that Debtor would surrender the Property and pay general unsecured creditors on a pro tanto basis. On June 24, 2009, Chase obtained an order granting its motion for relief from stay as holder of the first Deed of Trust on the Property. Despite obtaining relief from stay, Chase has not yet foreclosed on the Property.

Conclusions:

1) The motion for relief from stay is granted to allow Movant to record a lien against the Property and foreclose on that lien.
2) Movant's request for relief from stay to collect amounts owed from Debtor personally is denied.

In re Rosa United States Bankruptcy Court, D. Hawai'i. July 08, 2013 --- B.R. ---- 2013 WL 3380166

Background: Debtor's chapter 13 plan provides that title to real property will vest in mortgagee. Mortgagee does not object to plan, but chapter 13 trustee does. Property is subject to HOA assessments. The trustee correctly points out that surrender does not transfer ownership of the surrendered property. Debtor points out the plan proposes that title be vested in the first mortgagee, and that the Bankruptcy Code specifically authorizes such a provision: [T]he plan may . . . provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity . . .

Conclusion: Plan providing for vesting of mortgage property in mortgagee could be confirmed on "acceptance" theory.

CONVERTING FROM 11 to 7:

In re Hijjawi, 471 B.R. 917 (2012) May 14, 2012 United States Bankruptcy Court, N.D. Illinois, Eastern Division.

Background: Chapter 7 debtor sought to extend automatic stay, which the Bankruptcy Court had previously found "cause" to lift on request of condominium association, on theory that debtor's debt for condominium assessments would be discharged.

The court held that the phrase "after the order for relief," as used in Bankruptcy Code provision excepting from discharge any condominium assessment that becomes due and payable after the order for relief, served to denote date that original Chapter 11 petition was filed in case converted from Chapter 11 to Chapter 7, and because debtor's obligation for condominium assessments that were made postpetition and preconversion could not be discharged, such assessments provided sufficient basis for the court to lift automatic stay.

CHAPTER 11 ISSUES:

In re Burgueno United States Bankruptcy Court, D. Arizona. May 26, 2011 451 B.R. 1 2011

Background: Individual Chapter 11 debtor moved for orders determining that homeowner/condominium associations that sought postpetition assessments for condominium unit owned by debtor were bound by confirmed plan and thus limited to their allowed prepetition claims.

Neither confirmation of individual debtor's Chapter 11 plan nor granting of relief from automatic stay to creditor holding security interest in debtor's condominium unit terminated debtor's nondischargeable personal liability for postpetition assessments by homeowner/condominium associations for condominium unit, to which debtor retained legal title as a result of creditor's failure to foreclose despite stay relief. 11 U.S.C.A. §§ 362, 523(a)(16), 1141(d)(2).

Holdings: The Bankruptcy Court, Randolph J. Haines, J.,held that:

1) neither plan confirmation nor stay relief terminated debtor's nondischargeable personal liability for associations' postpetition assessments, and
2) debt deemed nondischargeable under discharge exception for postpetition membership association dues included attorney fees incurred by associations

In re Colon United States Bankruptcy Court, D. Utah. October 05, 2011 465 B.R. 657 2011

Background: Debtors purchased a townhome, then vacated the property. A year later debtors filed a chapter 13 case. Schedules included the HOA as a creditor. Debtors' amended plan that stated the Debtors surrendered the Property to the secured creditor, "Countrywide/BAC Home Loans Servicing." On October 14, 2010, the Court signed a Confirmation Order confirming the Debtors' Plan. BAC obtained relief, but one year later had not completed a foreclosure.

Homeowners association moved for relief from automatic stay or, alternatively, for determination that stay did not apply to association's postpetition assessments against Chapter 13 debtors.

Holdings: Motion denied, held that:

1) postpetition assessments were provided for by debtors' plan;
2) Debt deemed nondischargeable under discharge exception for postpetition membership association dues, which stemmed from Chapter 11 debtor's retention of legal title to condominium unit, despite his postpetition surrender of possession to secured creditor; and
3) neither association nor debtors could recover attorney fees

In re Vista Ridge Development, LLC United States Bankruptcy Appellate Panel, of the Tenth Circuit. December 20, 2010 463 B.R. 143, Unpublished Disposition 2010 WL 5154221

BANKRUPTCY - Claims. Homeowners' association's affidavit was sufficient to demonstrate that the assessments conferred an actual benefit to the estate.

...Although the Lenz court granted administrative expense status to the homeowners' association assessments in that case, it also offset them, in their entirety, with the damages incurred by the debtor and caused by the association....

...In the present case, the Bankruptcy Court concluded that the homeowners' association assessments provided an "actual benefit" to the Debtor's estate....

Bankruptcy Trustees And The Short Sale Racket

by Cathy Moran

Can a bankruptcy trustee force the sale of the debtor's underwater home?

Incredibly, that seems to be happening in some districts.

Here's how the scheme works.

The bankruptcy trustee cuts a deal with the secured lender for a small piece of the action to come to the bankruptcy estate from a short sale.

In return, the bankruptcy trustee manoevres the sale through the bankruptcy court.

The lender is spared the time and expense of a foreclosure sale.

And the debtor, who may have been hoping for a loan modification, or who may even have been current to the lender at filing, finds themselves homeless.

What?

One court says no

Last week, a bankruptcy judge in California's Central District reined in the trustee who sought to sell the debtor's underwater home.

In a written opinion marked for publication, Judge Scott Clarkson characterized the sum agreed to be paid to the bankruptcy estate upon sale as a "tip" to the trustee for sparing the lender from California's consumer protection laws touching bankruptcy.

As if we need to allow banks one more way to skirt the law.

The *Wilson* decision nominally turns on the debtor's claim of exemption under California Code of Civil Procedure 703.140. When the debtor got wind of the trustee's deal with the bank, she amended her exemptions to claim a grubstake, or wildcard, exemption in the property that would have taken the "profit" out of the deal for the trustee.

The trustee unsuccessfully argued that the "tip" to the bankruptcy trustee from the bank didn't exist as of the filing of the bankruptcy case.

The court turned back that argument and said, rightly, that the exemption was claimed in the underlying property, not in the gratuity to the estate.

Benefit to creditors unaddressed

Judges only rule on the issue before them. In this case, the issue was framed in terms of a contest over the amended exemption asserted in the properties without equity.

The judge was not presented with the question about the benefit to the creditors from the trustee's attempted sale.

In *Wilson*, two underwater properties were tagged for short sale. The carve-out for the bankruptcy estate in one instance was $15,000 and in the other, $21,250.

In the absence of Ms. Wilson's claim of exemption, the carve out would be available to the bankruptcy trustee to pay the administrative expenses of the estate and the trustee's commission, with the balance going to creditors.

We don't know what other expenses the trustee might have that would shrink the pot available to creditors.

In bed together

But to my mind, this whole bankruptcy carve out from short sales stinks.

It seems to disproportionately benefit the trustee and to generate very little real benefit to creditors.

And of course, it benefits the realtors involved. I found it kind of creepy that the trustee's real estate broker of choice worked for **Bankruptcy Short Sale Solutions**.

Another entire business enterprise focused on tormenting consumers for profit!

Historically, bankruptcy courts have rejected attempts by trustees to serve as liquidating agents for secured creditors. The UST handbook for Chapter 7 trustees tells trustees to only liquidate assets where there is a real benefit to creditors.

I'm also bothered by the bankruptcy trustee lining up to further the interests of lenders.

The court, in a footnote, said it wouldn't analyze the "bad faith use of the federal bankruptcy system by such actions, except to question whether the Bankruptcy Code was enacted to provide cover for lending entities desirous of avoiding state-imposed consumer protection laws."

Maybe Judge Clarkson didn't *analyze* the bad faith, but he certainly got the name right.

Image courtesy of FEMA.

Bankruptcy and Short Sales

What agents need to know

April 2013

Bank of America Home Loans

Bankruptcy and Short Sales

What happens to the short sale if the seller files for bankruptcy?

- Bank of America can review a short sale offer while the loan is in an active bankruptcy. However, to complete a short sale and issue the approval letter, the bankruptcy documents must be filed and approved by the court. Any final agreement will require bankruptcy court approval.

- Homeowners should consult with their bankruptcy counsel about how short sale programs could affect their mortgage and their bankruptcy case.

- When a loan is in bankruptcy, there is an automatic stay, also known as a "hold," of any collection activity placed on all debts that are included in the bankruptcy filing. Before the short sale specialist can discuss loss mitigation options, including a short sale, with the homeowner, Bank of America must have written authorization from the homeowner's bankruptcy attorney on the law firm's letterhead. This is in addition to the Bank of America Third-Party Authorization Form, which gives the bank permission to speak to the homeowner's bankruptcy attorney and listing agent.

Bankruptcy and Short Sales

If homeowners are currently in a bankruptcy proceeding, or they have previously obtained a discharge of their mortgage debt under applicable bankruptcy law, all communication and notices from Bank of America are for information purposes only. They are not an attempt to collect the debt, a demand for payment, or an attempt to impose personal liability for that debt.

Homeowners are not obligated to discuss their home loans with Bank of America or enter into a short sale agreement or other loan-assistance program. Customers should consult with their bankruptcy attorney or other advisor about their legal rights and options.

To complete a short sale for a loan in bankruptcy, Bank of America must receive one of the following releases issued by the bankruptcy court:

- Granted Motion to Sell*
- Granted Motion for Relief from Automatic Stay with noted short sale negotiation*
- Dismissal
- Discharge with Abandonment, Closing Order, Final Decree, Trustee No Asset Review

*A *granted* Motion differs from a *requested* Motion.

Bankruptcy and Short Sales

Note: If homeowners receive a discharge under a Chapter 7 bankruptcy proceeding, discharge releases the homeowners from personal liability for certain specified types of debts. The homeowners are no longer legally required to pay any debts that are discharged.

The discharge is a permanent order prohibiting creditors from taking any form of collection action on discharged debts, including legal action and communications such as telephone calls, letters, and personal contacts.

Although homeowners are not personally liable for discharged debts, a valid lien (a charge upon specific property to secure payment of a debt) that has not been made unenforceable in the bankruptcy case will remain on the property after the bankruptcy case. Therefore, a secured creditor may enforce the lien to recover the property secured by the lien.

Frequently Asked Questions

1. Are additional documents required for a short sale when the homeowner is in active bankruptcy?

   Yes. Two additional documents are needed for a short sale that is in active bankruptcy:

   - An attorney authorization letter from the bankruptcy attorney. This should be on the law firm's letterhead, and give Bank of America permission to speak with the homeowner. It is separate and in addition to the Bank of America Third-Party Authorization Form, which gives permission from the borrower for us to speak to the bankruptcy attorney and the listing agent. If the homeowner and the attorney prefer, the short sale can be negotiated through the attorney rather than the homeowner. If the homeowner does not have a bankruptcy attorney, we will not need the attorney authorization letter.
   - A release issued by the bankruptcy court (see page 3).

2. When will I receive the approval letter?

   An approval letter cannot be issued until the release from the bankruptcy court has been received (see page 3). Once the release is received, the file can be submitted for approval to the appropriate investor(s) and/or mortgage insurance company. The file will then follow the normal approval process to ensure it meets investor requirements.

Frequently Asked Questions

3. Why can't you approve a short sale file while waiting for the bankruptcy to be released?

   An approval must follow the direction provided in the release by the bankruptcy court. That is why a short sale will not be approved until a court order permitting the sale is received.

4. Can a homeowner qualify for a Home Affordable Foreclosure Alternative (HAFA) incentive while in bankruptcy?

   Yes. However, any funds going to the homeowner through state incentives or other incentive programs must be properly disclosed and handled in accordance with bankruptcy legislation and local rules.

Service Release

During the short sale process, loan servicing may be transferred to a different loan servicer.

- Servicing refers to collecting principal, interest and escrow payments, if any, as well as sending monthly or annual statements, tracking account balances and handling other aspects of the loan.
- Bank of America may assign, sell or transfer the servicing of a loan at any point while the loan is outstanding.
- Your client will be given advance notice before a transfer occurs.
- Depending on the status of the short sale when the servicing of a loan is transferred, the new servicer may not be required to accept the terms and conditions of a short sale.

During the short sale process, loan servicing may be transferred to a different loan servicer. Servicing refers to collecting principal, interest, and escrow payments, if any, as well as sending monthly or annual statements, tracking account balances, and handling other aspects of the loan. We may assign, sell, or transfer the servicing of a loan at any point while the loan is outstanding. Your client will be given advance notice before a transfer occurs. Depending on the status of the short sale when the servicing of a loan is transferred, the new servicer may not be required to accept the terms and conditions of a short sale. This material is solely intended as education and training documentation for real estate professionals and is not intended for consumer use or distribution. Programs, rates, terms and conditions are subject to change without notice. Bank of America, N.A., Member FDIC. Equal Housing Lender. C36379-2 PRES-04-13-1559 04-2013

Bank of America Home Loans

WHEN THERE IS A CHOICE: Advantages and Disadvantages of Utilizing Chapter 11 for an Individual Debtor vs. The Old Standby Chapter 13

By

Allan D. NewDelman

I. ORIGIN.

Toibb vs Radloff, 501 U.S. 157, 111 S.Ct. 2197, 115 L.Ed. 2d 145 (1991). The Supreme Court establishes the right of an individual debtor not engaged in business to file for relief under Chapter 11.

II. BAPCPA: (Six (6) significant amendments to Chapter 11 relevant to an individual debtor).

A. 11 U.S.C. §1115. Property of the estate shall include all property that the debtor acquires after the commencement of the case and all earnings from post-petition services performed by the debtor. (Does this include the debtor's exempt portion of wages ?).

B. 11 U.S.C. §1123(a)(8). A plan may provide for the payments of creditors through post-petition earnings from personal services performed by the debtor.

C. 11 U.S.C. §1129(a)(15). Notwithstanding the objection to a plan by a creditor with an allowed unsecured claim the plan may be confirmed so long as the debtor pays either property valued as of the effective date of the plan an amount equal to the creditor's allowed claim or the debtor distributes an amount equal to or greater than the projected disposable income of the debtor, as defined in §1325(b)(2), during a five (5) year period beginning on the date the first payment is due under the plan or during the period for which the plan provides for payment, whichever is longer.

D, 11 U.S.C. §1129(b)(2)(B)(ii). Elimination of the Absolute Priority Rule still in doubt. Absolute Priority Rule does not apply, see In re Friedman, 466 B.R. 471 (9th Cir. BAP 2012). But, see In re Maharha, 681 F.3d 558 (4th Cir. 2012); In re Stephens, 704 F.3d 1274 (10th Cir. 2013); In re Lively, 2013 W.L. 2347045 (5th Cir. 2013).

E. 11 U.S.C. §1141(d)(5). A discharge is granted after the completion of all payments under the plan. In addition, a discharge may be granted to a debtor who has not completed payments under the confirmed plan as long as modification under 11 U.S.C. §1127 is not practicable and the value of payments that have been provided for under the plan to allowed unsecured claims is equal to or exceeds the amount that such claims would have been paid if the debtor had been liquidated under a Chapter 7 case.

F. 11 U.S.C. §1127(e). The Chapter 11 plan may be modified at any time after confirmation notwithstanding that the plan has been substantially consummated.

III. THE CHOICE IS YOURS

A. Advantages of Chapter 11

1. For the over-medium income chapter 13 debtor, who pursuant to form B22C has disposable income, if a creditor or the trustee objects, that disposable income must be distributed for the benefit of unsecured creditors. Disposable income under Chapter 11 needs only to be part of the property to be distributed under the plan. 11 U.S.C. §1129(a)(15). Accordingly, disposable income under Chapter 11 may be devoted to priority creditors, secured creditors and administrative claimants.

2. The Chapter 11 disposable income test found in 11 U.S.C. §1129(a)(15) does not incorporate the IRS expense limits applicable to the over-medium debtor under Chapter 13. Section 1129(a)(15) refers only to §1325(b)(2) which calculates disposable income with reference to the debtor's actual expenses.

3. The anti-cramdown provisions of 11 U.S.C. §1325(a) which prohibits bifurcation of certain purchase money secured claims if the secured creditor is undersecured, does not apply in Chapter 11.

4. The valuation standards contained in 11 U.S.C. §506(a)(2) requiring retail valuation, do not apply in Chapter 11.

5. Length of Plan: Chapter 13 for the over-median income debtor is five (5) years unless there is a full payment. Chapter 11 plans may exceed five (5) years, if necessary.

6. Commencement of Payment: Payments under a Chapter 13 plan must commence thirty (30) days after the case is filed and generally be paid monthly. Chapter 11 Plan payments usually will not start until after confirmation of the plan. The payment schedule under the Chapter 11 Plan could be quarterly or semi-annually which allows for more flexibility.

7. A Chapter 11 individual debtor has relatively more freedom to manage personal expenditures limited by the concept of fiduciary duties to the creditors.

8. A Chapter 11 individual debtor has more control to operate a business in the ordinary course.

9. If the debtor is engaged in business, the small business provisions of Chapter 11 will likely apply. Although this will impose additional reporting requirements on an individual debtor, the exclusivity period for the debtor is extended. Further, the debtor may obtain conditional approval of the Disclosure Statement to expedite the process and reduce administrative expenses.

10. In a Chapter 11 case, the debtor may request a bar date, by which date, creditors are to file claims (or at least disputed, unliquidated or contingent creditors must file a claim). In a Chapter 13 case, the Trustee may file claims on behalf of those creditors who failed to file a claim or elect not to participate in the bankruptcy process.

11. In a Chapter 11 case, the debtor may propose an administrative convenience class pursuant to 11 U.S.C. §1122(b).

B. Disadvantages of Chapter 11

1. There is no automatic co-debtor stay in Chapter 11.

2. Chapter 11 has no statutory authorization for separate classifications of debts for which the debtor is co-liable.

3. Chapter 11 Plans require the debtor to obtain at least one (1) impaired class voting in favor of the Chapter 11 Plan of Reorganization whereas there is no voting under a Chapter 13.

4. A Chapter 13 debtor may discharge certain marital property settlements to the extent that the settlement is covered by 11 U.S.C §523(a)(15) and may discharge some forms of willful and malicious injury that does not involve personal injury or death.

5. Taxes: In a Chapter 13, interest is not paid on priority claims related to income taxes against the debtor. In a Chapter 11, interest will continue to run on income taxes against the debtor (although not against the estate).

6. Disclosure Statement: An individual Chapter 11 debtor has to generate a Disclosure Statement whereas no such requirement exists in a Chapter 13 case.

7. The monthly reporting requirements (business operating reports) is somewhat more complex in a Chapter 11 case. In addition, the debtor is required to open and maintain a debtor-in-possession (DIP) account. Other accounts may be also required, such as payroll accounts and tax accounts.

8. Rule 2015.3 RBP: - Report of Financial Information on Entities in which the individual Chapter 11 debtor holds a controlling or substantial interest.

9. In a Chapter 13, the debtor has a right to dismiss (in most situations). No such rights exist in Chapter 11 and the Court may consider what would be in the best interests of the creditors, after notice and hearing. Compare 11 U.S.C. §1307(b) to §1112(b). The individual debtor could be forced into "indentured servitude" should the Court not dismiss the Chapter 11 case. This could involve a constitutional issue under the 13th Amendment if there is a creditor's Plan or payments are forced upon the debtor without his consent.

10. Costs and Fees: The current Chapter 11 filing fee is $1,213.00 plus quarterly fees based on total disbursements on a sliding scale until the case is closed. The current Chapter 13 filing fee is $281.00. However, the debtor is obligated to pay fees to the Chapter 13 Trustee based on a percentage of plan disbursements. Thus, the debtor is paying a fee in order to pay mortgage arrearages, priority claims, secured claims upon personal property and other obligations to be paid under the plan. In a Chapter 11, the individual debtor will serve as the debtor-in-possession and no fees will be incurred. Submitted: There is a point at which Chapter 11 administrative expenses will be less than the cost of proceeding under Chapter 13. Individual Chapter 11 cases can be closed prior to the debtor receiving a discharge. (See attachment 1).

11. 1111(b) Election. The election could prevent the so-call "cram down" of the undersecured lien. Would not apply to the totally "unsecured" junior lien as §1111(b)(1)(B)(i) makes the 1111(b) election not applicable to the holder of a claim on property of inconsequential value.

C. Other Minor Issues

1. Chapter 13 debtor must complete a course in financial education to obtain a discharge. No such requirements exist under Chapter 11.

2. The Chapter 11 case will require additional involvement by debtor's counsel. This would include a private interview with a representative of the United States Trustee's Office and periodic status hearings with the Court. Further, hearings are generally required for approval of the Disclosure Statement and for the Plan of Reorganization. A Chapter 13 case may proceed from commencement to final discharge and closure without a single appearance by either the debtor or counsel before the Court.

IV. SUGGESTED READING.

Robert J. Keach, "Dead Man Filing Redux: Is the New Individual Chapter 11 Unconstitutional ?", 13 AM. Bankr. Inst. L.Rev. 483 (2005)

G. Ray Warner, "Garnishment Restrictions and the Involuntary Chapter 11: Rethinking Kokoszka in a Means Test World", 13 AM Bankr. Inst. L.Rev. 773 (2005).

Jack F. Williams and Jacob L. Todres. "Tax Consequences of Post-Petition Income as Property of the Estate in an Individual Debtor Chapter 11 Case and Tax Disclosure in Chapter 11", 13 AM Bankr. Inst. L.Rev. 701 (2005).

Robert J. Landry, III, Individual Chapter 11 Reorganizations: Big Problems with the New "Big" Chapter 13, Univ of Arkansas (Little Rock) L.Rev. Vol. 29, Feb (2007).

Bruce A. Markell, "The Subrosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA", Univ. of Ill, Vol. 2007 (No. 1).

N:\Carole Data\DATA\Carole Forms\ABI 2013 Seminar materials

The Honorable Randolph J. Haines: "Chapter 11 May Resolve Some Chapter 13 Issues", Norton Bankruptcy Law Adviser, August 2007, Issue No. 8.

David S. Jennis and Kathleen L. DiSanto: "How Disposable Is Your Individual Chapter 11 Debtor's Income", American Bankruptcy Institute Journal, Vol. XXX, No. 8 (October 2011).

ATTACHMENT "1"

AMERICAN BANKRUPTCY INSTITUTE
JOURNAL
The Essential Resource for Today's Busy Insolvency Professional

Individual Chapter 11s: Case Closing Reconsidered

Written by:
Walter W. Theus, Jr.
Executive Office for U.S. Trustees
Washington, D.C.
walter.w.theus@usdoj.gov

About the Author

Walter Theus, Jr. is a trial attorney with the Executive Office for U.S. Trustees in Washington, D.C.

Individuals have been filing chapter 11 petitions since the early days of the Bankruptcy Code. The U.S. Supreme Court finally resolved any question over the eligibility of individuals for chapter 11 relief in *Toibb v. Radloff*,[1] holding that even individuals who were not engaged in business could seek to confirm a plan under chapter 11. While several issues continually bubbled to the surface in reported decisions, one is left with the sense that most individual chapter 11 cases were resolved by consent according to local practice.

Amendments contained in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[2] (BAPCPA) changed the treatment of individual chapter 11 cases. These changes seem to have been designed to carry the "means testing" concept from chapters 7 and 13 into chapter 11 and to respond to a perception that the "super-rich" were obtaining unfair relief under chapter 11.[3] In many ways, BAPCPA appears to have been intended to make individual chapter 11 cases work like "big" chapter 13 cases. The changes have given rise to numerous thorny issues. This article will deal with only one of those issues: May an individual chapter 11 case be closed before the court has entered an order discharging the debtor?

Chapter 11 Case Closure Before BAPCPA

Chapter 11 case closure was never much of an issue before 1996. Under §350(a) of the Bankruptcy Code and Rule 3022, courts were to close a chapter 11 case when the estate had been "fully administered."[4] Courts liked to close cases to clean up their dockets, but generally a chapter 11 debtor suffered no adverse consequences by keeping the case open for a while. This changed in 1996. Congress amended the statute that requires chapter 11 debtors to pay quarterly fees to the U.S. Trustee Program (USTP). While prior law terminated the quarterly fee obligation upon plan confirmation, the revised law continued the obligation "until the case is converted or dismissed, whichever occurs first."[5] The obligation also terminates upon the closing of the case. Therefore, many reorganized chapter 11 debtors sought to close their cases very quickly to minimize their quarterly fee exposure. A number of reported decisions from the ensuing years reflect efforts by reorganized debtors to close their cases "early," before the requirements of §350(a) and Rule 3022 were met.[6] Case closing issues arose less frequently in the years immediately preceding the enactment of BAPCPA.

BAPCPA Changes the Rules

BAPCPA amendments returned case closing issues to the forefront in individual chapter 11 cases. Before BAPCPA, all chapter 11 debtors, including individuals, were generally discharged by the confirmation of a plan.[7] After BAPCPA, individual chapter 11 debtors generally do not receive a discharge until they have completed all payments under the plan.[8] This change conformed individual chapter 11 cases to chapter 13 cases, where debtors usually receive their discharge only after completion of all plan payments.[9] The new delay in the granting of individual chapter 11 discharges quickly caused many to question whether these cases, like chapter 13 cases, could be closed only after the debtor had completed plan payments and received a discharge.[10] Many individual debtors blanched at the prospect of paying quarterly fees for periods of at least five years from confirmation.[11] Debtors began to seek to close their cases soon after confirmation, explaining that they would reopen their cases to obtain discharges after they had completed their plan payments.

The courts that have considered whether an individual chapter 11 debtor must receive a discharge before the case can be closed have reached a variety of results. While some courts are closing these cases, reported decisions are sparse. In *In re Bali*,[12] the court rejected the debtor's argument that he was entitled to a discharge because he had completed all payments under his plan by executing a secured promissory

On Our Watch

1 501 U.S. 157 (1991).
2 Pub. L. No. 109-8, 119 Stat. 23 (2005).
3 See Bruce A. Markell, "The Sub Rosa Subchapter: Individual Debtors in Chapter 11 after BAPCPA," 2007 U. Ill. L. Rev. 67, 73-75 (2006).
4 11 U.S.C. §350(a); Fed. R. Bankr. P. 3022.
5 28 U.S.C. §1930(a)(6), as amended by Pub. L. No. 104-99, 110 Stat. 26, 37-38 (1996).
6 *See, e.g., In re Aquatic Development Group Inc.*, 352 F.3d 671 (2d Cir. 2003) (case could not be closed nunc pro tunc to date of substantial consummation); *In re Commonwealth Avenue Corp.*, 213 B.R. 784 (Bankr. D. Mass. 1997) (case could not be closed while appeals were pending); and *In re Jr. Food Mart of Arkansas Inc.*, 201 B.R. 522 (Bankr. E.D. Ark. 1996) (court permitted "retroactive" closing of case even though adversary proceedings remained pending).
7 11 U.S.C. §1141(d)(1).
8 11 U.S.C. §1141(d)(5).
9 11 U.S.C. §1328(a). Chapter 13 debtors can seek a "hardship discharge" under §1328(b). Individual chapter 11 debtors are afforded a similar right under §1141(d)(5)(B).
10 *See, e.g.*, Robert J. Landry III, "Individual Chapter 11 Cases After BAPCPA: Can You Still Close the Case Early," Am. Bankr. Inst. J., July/August 2006, at 10.
11 See 11 U.S.C. §1129(a)(15), which on its face seems to require that if an unsecured creditor objects to confirmation, the plan provides that the debtor devote all of the debtor's projected disposable income to plan payments for at least five years (unless the plan provides for full payment over time).
12 No. 06-1002, 2006 WL 2223863 (Bankr. N.D. N.Y.a. May 23, 2006).

note in favor of his unsecured creditors. The court further concluded that the case should remain open because the debtor was not entitled to a discharge. Noting that the plan called for payments over a short period of time, the court left open the question of whether some accommodation might be made for a debtor whose plan called for payments over a longer period.[13]

In *In re Sheridan*,[14] the debtor sought an "early" discharge under 11 U.S.C. §1141(d)(5)(A), which provides that the court may approve, "for cause," a discharge before all payments have been made. Because the court approved an early discharge, the court did not need to reach the issue of whether a case could be closed before discharge. Nevertheless, the court, in a lengthy footnote, prescribed procedures for early-closing cases of where discharge will not be granted until the completion of periodic payments to creditors.[15]

In two recently reported decisions, the courts considered this issue very carefully—and disagreed. The court in *In re Johnson*[16] focused on 11 U.S.C. §350(a)[17] and Bankruptcy Rule 3022[18] in holding that an estate can be considered fully administered even if a discharge has not yet been granted. Two factors influenced the court's analysis. First, because the debtor's plan was a "pot plan," payment of the quarterly fee over the life of the plan would have a material impact on the return to unsecured creditors.[19] Second, a debtor might be saddled with quarterly fees for many years because of the possibly open-ended nature of individual chapter 11 cases.[20] By contrast, the court in *In re Belcher*[21] rejected the *Johnson* analysis and concluded that a case cannot be closed until a discharge has been granted upon the completion of plan payments. The *Belcher* court pointed out that, pre-BAPCPA, a confirmed plan could be modified only before substantial consummation.[22] Under BAPCPA, new 11 U.S.C. §1127(c) permits many parties in interest to seek modifications to a substantially consummated confirmed plan in an individual chapter 11 case at any time before the completion of plan payments.[23] The *Belcher* court reasoned that the possibility that a party might seek such a modification prevented it from finding that the estate had been fully administered and, therefore, prevented it from allowing a predischarge closing of the case.[24]

Most recently, in *Shotkoski v. Fokkena (In re Shotkoski)*,[25] the bankruptcy appellate panel (BAP) for the Eighth Circuit affirmed the bankruptcy court's order denying the individual debtors' motion for entry of a final decree. The BAP ruled that "bankruptcy courts are charged with reviewing each request for entry of a final decree on a case-by-case basis in determining whether the estate has been fully administered."[26] In finding that the bankruptcy court had not abused its discretion in that particular case, the BAP clarified that "we are *not* holding that every individual Chapter 11 case must remain open until such time as all long-term plan payments have been completed and a discharge is entered."[27]

Case for Pre-Discharge Closure

Where does this leave us? The USTP will not object to an individual chapter 11 debtor's request to close the case before discharge, subject to reopening for the entry of a discharge upon the completion of plan payments, if the estate has been fully administered and any trustee has been discharged.[28] The USTP's analysis begins with the language of §350(a) of the Code: "After an estate is fully administered and the court has discharged the trustee, the court shall close the case."[29] Since very few chapter 11 cases have trustees,[30] the issue boils down to whether the estate has been fully administered. Rule 3022 states that "[a]fter an estate is fully administered in a chapter 11 reorganization case, the court, on its own motion or on motion of party in interest, shall enter a final decree closing the case."[31] The Advisory Committee Notes to the Rule are instructive:

> Entry of a final decree closing a chapter 11 case should not be delayed solely because the payments required by the plan have not been completed. Factors that the court should consider in determining whether the estate has been fully administered include (1) whether the order confirming the plan has become final, (2) whether deposits required by the plan have been distributed, (3) whether the property proposed by the plan to be transferred has been transferred, (4) whether the debtor or the successor of the debtor under the plan has assumed the business or the management of the property dealt with by the plan, (5) whether payments under the plan have commenced and (6) whether all motions, contested matters, and adversary proceedings have been finally resolved.
>
> The court should not keep the case open only because of the possibility that the court's jurisdiction may be invoked in the future. A final decree closing the case after the estate is fully administered does not deprive the court of jurisdiction to enforce or interpret its own orders and does not prevent the court from reopening the case for cause pursuant to §350(b) of the Code.[32]

Committee notes do not control over the language of a rule, and rules cannot vary the meaning of a statute. These committee notes, however, date from 1991. A lot of water has passed under the bankruptcy bridge since then, and neither Congress nor the Rules Committee has seen fit to modify §350(a), Rule 3022 or the notes.[33]

An exhaustive search of reported authorities reveals no cases holding that a bankruptcy case must remain open because a debtor might receive a discharge in the future. The drafters of the committee notes advised against keeping a chapter 11 case open because the court's jurisdiction could possibly be invoked in the future. Further, a payment default will now prevent the debtor from receiving a discharge.

Opponents of an earlier closing sometimes cite the possibility that

13 *Id.* at *4.
14 [illegible] B.R. 232 (Bankr. E.D.N.C. 2008).
15 *Id.* at 250 n.2. *See also* Hon. A. Thomas Small, "Memorandum: Discharge Procedure in Chapter 11 Cases Involving Debtors Who are Individuals" (Dec. 12, 2007), [illegible].
16 402 B.R. 851 (Bankr. N.D. Ind. 2009).
17 11 U.S.C. §350(a).
18 Fed. R. Bankr. P. 3022.
19 402 B.R. at 857.
20 402 B.R. at 855.
21 410 B.R. 260 (Bankr. W.D. Va. 2009).
22 11 U.S.C. §1127(b).
23 11 U.S.C. §1127(b).
24 410 B.R. at 278.
25 No. 09-6063, 2009 WL 4042665 (B.A.P. 8th Cir. Nov. 24, 2009).
26 *Id.* at *3.
27 *Id.* at *4.
28 The USTP will not be a proponent of closing cases because the decision to close [illegible] subject to objection from creditors and adjudication by the court.
29 11 U.S.C. §350(a).
30 Some might argue that because Congress intended that individual chapter 11 cases "were like" chapter 13 cases, and because chapter 13 cases remain open until discharge, individual chapter 11 cases should remain open until discharge. This line of argument fails, however, as all chapter 13 cases have trustees, and most therefore remain open until the trustee is discharged. 11 U.S.C. §1302.
31 Fed. R. Bankr. P. 3022.
32 Fed. R. Bankr. P. 3022, Advisory Committee Note (1991).
33 2009 WL 4042665, at *3 (panel questioned "the current applicability of the Advisory Committee Note considering that it was drafted in 1991, at which time a discharge would be entered in an individual Chapter 11 case upon plan confirmation").

the debtor or another party in interest might seek to modify the plan post-confirmation deter courts from closing cases when the estates have otherwise been fully administered. The focus of this argument is attenuated somewhat by the fact that chapter 11 cases are not kept open solely to await the expiration of the 180-day period, during which a party in interest may seek revocation of confirmation.[34] Chapter 7 cases are also routinely closed well before the expiration of the one-year period during which a revocation of discharge may be sought for fraud.[35] While debtors and others in individual chapter 11 cases have an extended right to seek modification of a confirmed plan, the prospect of attempted modifications is not so certain that courts should retain active jurisdiction over these cases. Cases may be reopened under §350(b) if and when circumstances warrant.[36]

What are the consequences to the debtor and to creditors of closing an individual chapter 11 case before discharge? The closing of the case terminates the automatic stay.[37] There is no discharge injunction because no discharge has been entered.[38] Is the debtor at the creditors' mercy? No, because both are bound by the terms of the confirmed plan.[39] As long as the debtor complies with the confirmed plan, creditors may not undertake collection activities. The debtor could defend a creditor action on a prepetition claim by proving the plan confirmation and demonstrating that the debtor was current on plan obligations.

What if the debtor defaults under the plan? Must a creditor seek to reopen the bankruptcy case? No. Upon a post-closing default, a creditor should be able to bring an action in any court of competent jurisdiction. The action should allege the terms of the plan, the confirmation of the plan and the circumstances demonstrating the debtor's default. As damages for the default, the creditor should be able to recover the balance due on its undischarged claim, not just the balance due to the creditor under the plan. To limit the creditor's collection efforts to the remainder due under the plan would give the confirmation of the plan the same effect as a discharge under §1141(d)(1), contrary to the express language of §1141(d)(5).

While the U.S. Trustee will not normally object to an individual chapter 11 debtor's request to close the case before discharge once the estate has been fully administered, there are a number of other considerations:

- Disclosure statements and plans should clearly set out the debtor's intention to seek to close the case before the discharge and should specify the time when the debtor anticipates the case might be reopened for the grant of a discharge.
- Plans should subject debtors to clear, enforceable payment obligations. Creditors should not have to guess whether a debtor has defaulted under a confirmed plan.
- Cases should not be closed until the estate has been fully administered. Courts should be guided by the factors outlined in the notes to Rule 3022, including the vesting of property of the estate in the reorganized debtor or another entity under §1141(b),[40] the commencement of plan payments, the payment of all quarterly fees and the resolution of all pending issues before the court.
- Courts should not mechanically allow closure of a case upon substantial consummation. Substantial consummation, as defined in §1101(2),[41] is not the same thing as the full administration of the estate under §350(a). For instance, a plan might be substantially consummated even though multiple appeals related to the case are pending and the court has not yet ruled on claims challenges. The case should not be closed until these pending matters are resolved.
- Courts should adopt and follow clear policies on whether reopening fees will be charged to creditors or others seeking to reopen a case to modify a confirmed plan, and to debtors seeking to reopen a case to obtain a discharge.
- Rule 4006 requires the clerk to give notice to all parties in interest if an individual's case is closed without the entry of an order of discharge. Courts should assure that the notice given in individual chapter 11 cases accurately reflects the status of the case and does not mislead creditors into believing they may pursue immediate collection of the full amount of their allowed claims.
- Courts should adopt procedures requiring individual debtors seeking to reopen their cases to obtain a discharge to file a motion under §350(b) with the court and serve all parties in interest. The motion should be accompanied by a detailed accounting demonstrating that the debtor has made all payments called for under the confirmed plan. Parties should have sufficient time to object to the motion, and the court should treat any objection to the motion or accounting as a contested matter under Rule 9014,[42] with the debtor bearing the burden of establishing entitlement to a discharge.

Conclusion: Certainty Has Value

The USTP's decision not to object to an individual chapter 11 debtor's request to temporarily close the case after the estate has been fully administered comports with both the Bankruptcy Code and bankruptcy policy. Rights of debtors and other parties in interest are protected, and funds that debtors would otherwise use to pay quarterly fees become available to increase payments to creditors. ■

Reprinted with permission from the ABI Journal, Vol. XXIX, No. 1, February 2010.

34 11 U.S.C. §1144.
35 11 U.S.C. §727(e)(1).
36 11 U.S.C. §350(b).
37 11 U.S.C. §362(c)(2).
38 11 U.S.C. §524(a).
39 11 U.S.C. §1141(a).
40 11 U.S.C. §1141(b).
41 11 U.S.C. §1101(2).
42 Fed. R. Bankr. P. 9014.

Lawyer's Dilemma: The Right to Limit Representation vs. The Duty to Provide Competent Representation

By: Judge Frank L. Kurtz and Harold Marenus

Rev. Sykes: "Miss Jean Louise. Miss Jean Louise, stand up. Your father's passing."

To Kill a Mockingbird

Prologue

The subject of this presentation is the ethical problems faced by bankruptcy attorneys providing unbundled legal services as demonstrated by Judge Markell's recent decision In Re Seare, ___B.R.___, 2013 WL 2321664 (Bkrtcy. D. Nev. Judge Markell). ABA model Rule 1.2(c) states a lawyer may limit the scope of representation if the limitation is **reasonable under the circumstances** and a client gives **informed consent**. The provisos in this rule are significant and they may be a source of trouble for lawyers, particularly when they are read in conjunction with other ethical rules, particularly the rule requiring a lawyer to be competent in the representation of a client. Seare is a cautionary tale containing a moral stated by Judge Markell: "the practice of law is a professional service, not a prepackaged, one-size-fits-all product."

Facts- In re Seare

Wayne Seare sued his employer, St. Rose Dominican Health Foundation, alleging employment discrimination. To improve his litigation prospects, he embellished emails, which he submitted as evidence to the court. When his conduct was discovered, the court dismissed his lawsuit and ordered him to pay the defendants' legal fees as a sanction for committing a fraud upon the court. The court entered judgment against Mr. Seare in the amount of $67, 430.50. After the St. Rose served a writ of garnishment on Mr. Seare's new employer, he consulted a bankruptcy attorney. At the initial consultation, Mr. Seare and his wife gave the attorney the orders for wage garnishment and wage sanction, eliciting from the attorney the response that hospital bills were dischargeable. The meeting was short and even perfunctory. Later the attorney would deny that the Seares informed him about the facts upon which the St. Rose judgment was based.

After their meeting with the attorney, the Seares were placed in another room where they were asked to read and sign a nineteen page retainer agreement. The agreement distinguished between basic services (preparing the bankruptcy petition, attending first meeting of creditors, and "reasonable contact with the attorney in person or by phone) and services for which

additional fees would be charged (…including fraud or nondischargeability). The fee agreement contained an explanation that certain debts including fraud are not discharged. The attorney did not sign the agreement but the Seares did. Apparently the attorney did not discuss the fee agreement and its limited representation scope with the Seares, leaving that task to his legal assistant, who limited her role to the execution of the document.

The Seares filed a chapter 7 bankruptcy petition, along with the required schedules, all prepared by the attorney. The filings appropriately disclosed the St. Rose judgment and garnishment. At the first meeting of creditors, where they were represented by the attorney, the Seares learned that Mr. Seare's former employer intended to file an adversary lawsuit challenging the discharge of the judgment debt. Ultimately the Seares received a discharge of all debts except the St. Rose judgment.

The attorney declined to represent the Seares in the adversary lawsuit and they appeared and defended as pro se defendants. After becoming familiar with the case at a scheduling conference, the bankruptcy judge ordered the attorney to show cause why he should not be sanctioned. At the evidentiary hearing, the attorney stated that he had no independent recollection of meeting with the Seares but he questioned whether they ever advised him about the nature of the St. Rose judgment. Although Judge Markell accepted the attorney's testimony on this point, he nevertheless faulted him for his failure to perform a "reasonable investigation." The court observed that if there had been a discussion about the nature of the judgment, there would have been consultation about fraudulent debt and the likelihood of an adversary lawsuit challenging dischargeability, a consultation which the court found did not occur.

Holding

The attorney was sanctioned for allowing the Seares to retain his services under an agreement that did not include representation in the adversary proceeding because a reasonable investigation would have revealed the Seares faced a nondischargeability lawsuit and they reasonably expected the attorney to represent them in that action. In Judge Markell's words: "a consumer bankruptcy attorney fulfills the duty of competence by providing the bundle of services reasonably necessary to achieve the client's reasonably anticipated result."

Rule 1.1 Duty of Competence[1]

Rule 1.1 provides: "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation." Rule 1.1 is mandatory. An attorney must represent his or her client in a competent manner. As Seare put it, whether an attorney has competently represented the client depends on the client's objectives in hiring the lawyer and whether the attorney has employed such "legal knowledge, skill, thoroughness and preparation reasonably necessary" to attempt to accomplish the client's objectives. 2013 WL 2321664, * 16 (citing Rule 1.1). The client is entitled to unilaterally decide the objectives of the representation. See Rule 1.2(a). But the attorney is charged with the duty of assisting the client to determine the means by which the client's objectives should be accomplished. See id. The attorney also is charged with the duty of assisting the client to modify his or her objectives depending on the circumstances of the case and the attorney's expert advice. See Seare, 2013 WL 2321664, ** 16, 18. In revising the objectives, the client's interests are paramount, and the attorney's interests are subordinate. See id. at ** 11, 58.

In light of these duties, the attorney cannot competently represent his or her client unless he or she makes sufficient inquiry to ascertain the specific nature of the client's goals. Id. at ** 16, 18. This was the most fundamental failure of the attorney in Seare. The attorney made insufficient inquiry into what the Seares specifically sought to accomplish by hiring him to file a bankruptcy on their behalf. Id. at ** 18-19. If he had made the requisite inquiry he necessarily would have learned that the Seares primarily sought to discharge the debt they owed to St. Rose, a debt arguably arising from Seare's fraud, and which was likely to result in the filing of a nondischargeability adversary proceeding once the bankruptcy was filed. Id. at ** 18-20. Thus, the attorney violated Rule 1.1 by failing to make a reasonable inquiry to ascertain the Sears' objectives and by failing to assess whether those objectives could be reconciled with the limitation of his representation of the Seares. Id.

[1] Here we are focusing on the Nevada Rules of Conduct rather than the ABI Model Rules. Regardless, the Rules at issue herein, Rules 1.1 and 1.2(c), are identical in both the Nevada Rules and in the ABA Model Rules. In fact, most of the Nevada Rules are identical to the ABA Model Rules. See Dignity Health v. Seare (In re Seare), 2013 WL 2321664, *12 (Bankr. D. Nev. 2013). And even though Nevada has not adopted the official comments accompanying the ABA Model Rules, the ABA official comments may be considered for purposes of interpreting the Nevada Rules to the extent they are consistent with the Nevada Rules. Id. (citing Nevada Rule 1.0A).

Rule 1.2(c) Right to Limit Representation

Rule 1.2(c) provides: "A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent." In contrast to Rule 1.1, Rule 1.2(c) is permissive. It permits under certain conditions limitations on the scope of an attorney's representation of his or her client. On their face, the two explicit conditions appear straightforward: the limitation must be reasonable, and the client must give his or her informed consent. Any complexity in applying these two conditions arises from the fact that they are fact-intensive and case-specific: whether a limitation is reasonable and whether a client has given his or her informed consent depends on the specific circumstances of the particular case. See id. at *22 ("the determination of reasonableness is fact-specific and depends on the client's particular situation and objectives"); see also id. at *27 ("The nature of the required disclosure is fact-specific and depends on the client's particular situation.").

Regardless of circumstances, an attorney cannot reasonably limit the scope of his or her representation of the client unless that representation as limited is capable of accomplishing the client's objectives. In other words, the limitation is per se unreasonable unless the attorney affirmatively ascertains that the limited representation will not undermine the client's goals. See Seare, 2013 WL 2321664, *22; see also id. at *25 ("The unbundling of adversary proceedings was unreasonable in light of the Debtors' circumstances and objectives. . . . DeLuca knew of the Debtors' goal of eliminating the St. Rose garnishment. Had he investigated the nature of the Judgment, he would have known that an adversary proceeding was a near certainty and representing the Seares in the adversary was reasonably necessary to achieve their objectives.").

In Seare, because the attorney never understood the circumstances surrounding the Seares' primary objective – to discharge the St. Rose debt – and because that objective was undermined by the attorney's limitation on representation excluding adversary proceedings, he violated Rule 1.2(c). Id. at ** 22, 25. As explained above, if the attorney had made sufficient inquiry into the Seares' circumstances, he would have learned about the true nature of the St. Rose debt and the likelihood that St. Rose was going to file a nondischargeability adversary proceeding. Under these circumstances, his attempt to limit his representation to exclude adversary proceedings was per se unreasonable. The limited representation he provided to the Seares was highly unlikely to accomplish their primary objective. Instead of tailoring the representation to fit his clients' goals, he tailored the representation to meet his own personal goals: to maximize his revenue while at the same time limiting his representational duties and liabilities. See id. at *58.

Harmonizing the two Rules

To the extent tension exists between Rules 1.1 and 1.2(c), it did not arise in Seare. Because the Seare limitation undermined the Debtors' primary objective in hiring a lawyer, Seare determined that the limitation violated both Rules. Id. at **20, 25. Indeed, Seare went so far as to opine that, for purposes of ascertaining the propriety of a limitation on representation, "[r]easonableness is coextensive with competence." Id. at *22 (citing In re Egwim, 291 B.R. 559, 571 (Bankr. N.D. Ga. 2003)). Nonetheless, we must consider whether it is possible to conceive of situations where a limitation satisfies Rule 1.2(c) but still runs afoul of Rule 1.1. Put another way, can a limitation be both reasonable and undertaken with the client's informed consent but still reflect a lack of competent representation? I would answer this question in the negative.

Because Rules 1.1 and 1.2(c) address distinct concerns (competency and reasonableness), the potential for conflict between the two Rules exists, depending on how the Rules are interpreted. But there is sufficient "play" in the concepts of competency and reasonableness – the concepts underlying the two Rules – to enable the Rules to be harmoniously applied in the context of limitations on representation. Seare harmonized the two Rules in this context by tying both competency and reasonableness to the client's objectives. Compare id. at *17 ("the duty of competence informs the agreement to unbundle by mandating the inclusion of those services reasonably necessary to achieve the client's reasonable objectives.") with id. at *22 ("a limitation on services violates the duty of competence if the unbundled service is reasonably necessary to achieve the client's reasonably anticipated result. The ABA's phrasing of [Rule 1.2(c)'s] reasonableness test is slightly different . . . but the ultimate analysis is the same."). Furthermore, the focus on client goals may be the only practicable means of harmonizing the Rules for purposes of assessing the propriety of limited representation arrangements. It certainly seems so because, in this context, the shared focus is the only apparent commonality between the two Rules.

Informed Consent and the Per Se Unreasonable Limitation

As for informed consent, there is no doubt that the Sears did not comprehend the legal significance of the attorney's boilerplate disclosures and disclaimers, nor is there any doubt that the attorney failed to advise them regarding the significance of the disclosures and disclaimers. Id. at ** 33-35. This failure to advise constituted a lack of informed consent under Rule 1.2(c). Id. at 35. But even if the attorney had better advised the Seares, no amount of advice would have rendered the proposed limitation on representation reasonable. As explained above, this limited representation arrangement was per se unreasonable because it undermined the Seares' primary objective in hiring the attorney.

In short, because the attorney's limitation on representation was per se unreasonable, informed consent was rendered irrelevant. No amount of informed consent can or should change a per se unreasonable limitation into a reasonable one. As stated in Seare: " 'Making an

effective disclosure of the risks of such an arrangement, and obtaining informed consent, may be impossible in some cases. As noted, some lawyer services are so fundamental and essential to effective representation, no amount of disclosure and consent will suffice.' " Id. at * 13 (quoting Hon. Jim D. Pappas, Simple Solution = Big Problem, 46 ADVOCATE (IDAHO) 31, 33 (2003)).

Conclusion

To the extent there is tension between Rules 1.1 and 1.2(c), that tension does not appear irreconcilable. In the context of assessing the propriety of a limitation on representation, these two ethics rules can be harmonized and jointly applied in a coherent manner. The key to harmonizing these two rules is to focus on whether the limitation interferes with or undermines the client's objectives in hiring the attorney. If it does, the lawyer has not competently represented the client, in violation of Rule 1.1. Nor has the attorney imposed a reasonable limitation on representation. The limitation thus also contravenes Rule 1.2(c). No amount of informed consent can render proper a limitation on representation that interferes with or undermines the client's objectives. In other words, the client's objectives are the key to both competent representation and to reasonable limitations on representation, and informed consent is irrelevant when the limitation cannot be reconciled with the client's objectives.