

The Nuts & Bolts of Chapter 7

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The Nuts & Bolts of Chapter 7

A panel discussion of the usual and not-so-usual topics arising in Chapter 7 practice.

A note to attendees: When I have presented at conferences and seminars in the past, I have prepared my materials in a narrative form, as have my colleagues on the panel. Due to the nature of our presentation today, we have decided to present our materials in an outline-type format. We believe this will spark critical thinking and discussion among the panelists and attendees, which should be more beneficial to everyone as the “best practice” of one may not necessarily trump the “best practice” of another. - Cara

The Bottom Line: Perjury and former mayors...or, Horseshoes and hand grenades... (How else can we make “accurate” interesting???)

Caralyce M. Lassner, Moderator
Caralyce M. Lassner, JD, PC; Utica, Mich.

- I. What is the current standard of a 707(b)(3) motion?
 - A. What difference does that make?
 1. Bad faith?
 2. Totality of Circumstances?
 - a. Totality of Circumstances may include evaluation of debtor’s ability to pay despite the outcome of the means test. “[Debtors’] decision to keep paying for these “unnecessary, luxury items” showed that they were not prepared to earnestly engage in the “give and take process” of bankruptcy.” *Witcher v. Early (In re Witcher)*, Case No. 11-15883 (11th Cir. Dec. 13, 2012), Court of Appeals referencing the lower court’s reasoning. See also *Calhoun v. U.S. Trustee*, No. 09-1646 (4th Cir. May 3, 2011).

- b. Failure to adjust household expenditures may support dismissal under totality of circumstances. *In re Weixel*, 13 FED App.0003P; BAP Case No. 12-8047. “[Debtors’] avoidance of belt-tightening is also exhibited through their recreational habits.... The evidence supports the trial court’s finding that the [Debtors] failed to adjust their upscale lifestyle despite their financial circumstances.” Of note, decided by Humphrey, McIvor and Preston. See also *In re Krohn*, 886 F.2d 123 (6th Circuit, 1989).

B. The United States Trustee hasn’t filed a motion, so what’s the problem? Considerations.

1. Who can file such a motion?
2. Why might they choose to?

II. Accuracy of the Petition, Schedules, Statement of Financial Affairs, and the Means Test.

A. Initially:

1. How accurate is accurate?

“All information that you are required to provide with a petition and thereafter during a case under the Bankruptcy Code is required to be complete, accurate, and truthful....Failure to provide such information may result in dismissal of the case under this title or other sanction, including criminal sanctions....” 11 USC

527(a)(2)¹

2. How should the information be gathered?

¹ See also Sean Cowley’s (Attorney, United States Trustee Program, Detroit, Mich.) materials under the Proper Disclosure panel materials for this conference.

- a. Written questionnaire?
 - b. Verbally by interview?
 - c. Combination?
 - d. Other methods.
3. An attorney's duty to investigate.
- a. Document review?
 - b. Public records search? Local agencies? Westlaw/subscription service?
 - c. Does the attorney's signature on the Petition only certify accuracy if a motion under 11 USC 707(b)(4) is filed?

"In a case in which § 707(b)(4)(D) applies, this signature also constitutes a certification that the attorney has no knowledge after an inquiry that the information in the schedules is incorrect." Official Form B1 (Petition)
 - d. Or is 11 USC 707(b)(4) simply restating FRBP 9011(b):

(b) Representations to the Court. By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,—

(1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

(2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

B. Duties after filing; Disclosures, amendments, and such:

1. Is there a duty to continuously disclose and update?

-Property of the estate: 11 USC 522(a)(2), 11 USC 541.

2. What is the standard for amending freely? “A series or pattern of errors or omissions may have a cumulative effect giving rise to an inference of an intent to deceive.” *In re Cutler*, 291 BR 718 (Bankr ED MI 2003), citing *Rouse v. Stanke (In re Stanke)*, 234 B.R. 449, 458 (Bankr. W.D. Mo. 1999), internal citation omitted.

3. If you amend one, do you have to amend all?

a. For instance, if you correct Schedule I, must you correct the means test too? What if your client does not qualify for a Chapter 7 if a correct means test is filed?

b. What if your client takes a post-petition lump-sum distribution from a retirement account? What, if anything, would be amended? What, if anything, should be amended? Does it matter if it is pre-341 vs post-341?

C. Who is responsible for the information in the pleadings? Counsel or Debtor?

Consider this:

[The Court] did not find that the Levesques had committed fraud, and it did not determine that the Levesques had “lied.” However, the bankruptcy court did find that the Levesques “didn’t tell the truth and certainly signed things under oath and under penalty of perjury that were not true.” The record, as discussed above, amply supports those findings. In addition, the bankruptcy court questioned the Levesques’ credibility based on their failure to pursue any claim

against their former bankruptcy counsel, whose advice they claim led them to their failures of disclosure and thus allegedly put them in their present predicament. *Levesque v. Shapiro (In re Levesque)*, BAP No. NV-11-1742-DKiPa (B.A.P. 9th Cir. June 25, 2012), internal citations omitted.

III. What time is it: What moment in time should I & J reflect?

- A. Pre-petition income and expenses: Considerations.
- B. Post-petition income and expenses: Considerations.

Other Not-So-Fun Quandaries:

IV. Criminal referrals.

- A. Perjury.

V. Dischargeability vs Not Being Collected.

- A. Are driver's responsibility fees dischargeable? Does "discharge" mean the same as "not being collected"? See 11 USC 101(27) in light of 523(a)(7).

VI. Reaffirming "That's not my car..." and other secured debts.

- A. Should a debtor, who is simply a co-signor on a vehicle, reaffirm the debt if they do not use the vehicle? For example: parent co-signs for child and child pays and uses car as only transportation.

Inherited IRAs and Other Asset Issues

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Inherited IRAs

Majority View – Debtor’s inherited IRA qualifies as exempt pursuant to section 522 (b)(3)(C) and 522(d)(12) of the Bankruptcy Code.

“Retirement funds” for purposes of 11 U.S.C. § 522(b)(3)(C) and (d)(12) “can include the funds that others had originally set aside for their retirement, as with inherited IRAs.

- In re Chilton, 674 F.3d 486 (5th Cir. 2012)
- In re Hamlin, 465 B.R. 863 (9th Cir. BAP 2012)
- In re Nessa, 426 B.R. 312 (8th Cir. BAP 2010)
- In re Stephenson, 2011 U.S. Dist. LEXIS 142360, 2011 WL 6152960 (E.D. Mich., Dec. 12, 2011)
- In re Seeling, 471 B.R. 320 (D. Mass. 2012)
- In re Bauer, 2013 Bankr. LEXIS 2449, 2013 WL 2661835 (Bankr. D. S.C., June 13, 2013)
- In re Kalso, 2011 Bankr. LEXIS 3098, 2011 WL 3678326 (Bankr. E.D. Mich., Aug. 19, 2011)

Analysis –

- Are the funds in an inherited IRA “retirement funds?”
 - Retirement – Withdrawal from office, active service, or business.
 - Fund – A sum of money or other resources the principal or interest of which is set apart for a specific objective or activity.
- The retirement funds do not have to be the debtor’s.
- 11 U.S.C. § 522(b)(4)(C) – The direct transfer of retirement funds does not alter the status as retirement funds.
- Are the funds in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986?
- Inherited IRAs are exempt from taxation by reason of 26 U.S.C. § 408(e).

Minority View– Inherited IRAs are **NOT** exempt pursuant to section 522(b)(3)(C) and (d)(12).

- In re Clark, 714 F.3d 559 (7th Cir. 2013) – Petition for Certiorari filed on 9/06/2013.
- Inherited IRAs represented an opportunity for current consumption, not a fund of retirement savings.
- 11 U.S.C.S. § 522(b)(3)(C)and (d)(12) provides that the exemption depends on the conjunction of tax deferral and assets' status as retirement funds; that an inherited IRA provides tax benefits is not enough.

Joint Bank Accounts

Whose money is it?

- **§ 487.718. Deposits subject to rights of creditors; laws applicable to transfers in fraud of creditors; claims against insolvent estate of deceased owner of statutory joint account.**

Sec. 8. Deposits in a statutory joint account shall be subject to the rights of creditors of the persons designated in the statutory joint account contract as owners of the funds to the extent of the ownership, except that the funds shall remain subject to laws applicable to transfers in fraud of creditors. If in his or her lifetime, a deceased person was an owner of a statutory joint account, the estate, in event of its insolvency, may recover from the surviving owner so much of the deposits as were owned by the deceased person immediately before the deceased person's death to the extent required to satisfy claims against the estate.

The presumption of equal ownership may be rebutted.

- In the absence of proof establishing their contributions toward the deposits the presumption prevails that plaintiffs were equal contributors thereto and, therefore, equal owners. See *Sussex v Snyder*, 307 Mich 30, 38; 11 NW2d 314 (1943).
- The presumption of equal ownership may be rebutted in favor of either co-owner. The nondebtor co-owner is permitted to reclaim his contributions if he can establish them. *Danielson v Lazoski*, 209 Mich. App. 623

Exemptions: Everyone's Issues.

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A. Surcharging Exemptions

1. *In Re Scrivner, 535 F3d 1258 (10th Cir)*

Court *denied* surcharge under 11 USC 105 because the Code provides specific remedies for debtor misconduct.

2. *In Re Latman, 366 F3d774 (9th Cir)*

Court *allowed* surcharge under exceptional circumstances which includes debtor misconduct.

3. *In Re Malley, 693 F3d 28 (1st Cir)*

Surcharge *allowed* under 11 USC 105.

4. *US Supreme Court (In Re Law, 435 F 697, 12th Cir)*

Court *supports* broad equitable powers of bankruptcy courts.

B. Exemptions of Inherited IRA

1. *In Re Clark (2013, 7th Cir.)*

An Inherited IRA *cannot* be claimed exempt as an IRA.

2. *In Re Chilton (2012, 5th Cir.)*

Inherited IRA *can* be claimed exempt since 11 USC 522 does not specify the funds have to be the debtor's.

C. Miscellaneous Issues

1. Bad Faith

- a. *In Re Rice (ED MI 2012); Daniels v Agin, 482 BR 1 (2012)*

Reckless disregard for the truth.

- b. *In Re Wilson, 446 BR 555 (Fla 2011)*

Unnecessary delays prejudicial to creditors.

2. Amended Exemptions

a. Restrictive rule: 30 days to object to *only* changes made by the amendment (7th, 8th, 9th Circuit).

b. Nonrestrictive rule: 30 days to object to *any* claimed exemption – “common sense approach” (every time a piece of the case is changed the Trustee reassesses the whole). (5th Circuit)

3. Carve Out/Short Sales

a. No equity to exempt in the lender’s collateral. (*In re Moyer*, 39 B.R. 211 (GA. 1984).

b. Debtors can only claim an exemption if there is equity in the Property. (*In Re: Baldrige* (ED MI 2012)

c. Short sale incentives belong to the estate. (*In re Bunn-Rodemann*, 491 BR 132 (CA 2013)

Selected Issues Regarding Amendments to Schedules and Objections to Exemptions

Hon. Daniel S. Opperman
U.S. Bankruptcy Court (E.D. Mich.); Bay City

In some cases, the debtor needs to amend Schedules A, B, and C to disclose and exempt assets that were not disclosed and exempted in the original Schedules. A debtor is under an obligation to amend Schedules where necessary and amendments to Schedules are freely allowed. *Lucius v. McLemore*, 741 F.2d 125 (6th Cir. 1984). A debtor who amends Schedules, including Schedule C, still must be concerned about the following language in *Lucius*:

“Courts may still refuse to allow an amendment where the debtor has acted in bad faith or where the property has been concealed.”

Id. at 127.

Since the *Lucius* decision, lower Courts have had to address whether the debtor’s action is in bad faith or whether the debtor has tried to conceal property. In many cases, the facts of each case require the Court to not only evaluate the actions of the debtor, but to balance the rights of others. *Lucius* has been extended by some Courts to allow for the consideration of prejudice to the bankruptcy estate. *In re Daniels*, 270 B.R. 417 (Bankr. E.D. Mich. 2001). In *Daniels*, the Bankruptcy Court did not allow the debtor to amend exemptions because to do so would prejudice recovery by the trustee.

A further extension of *Lucius* is found in *Shapiro v. First Franklin Fin. Corp. (In re Rechis)*, 339 B.R. 643 (Bankr. E.D. Mich. 2006), where the Court sustained the objections to the debtor’s amended exemptions because the proofs showed a lack of diligence by the debtor and prejudice to the trustee.

Virtually every case addressing amendments to Schedules has to examine the actions of the debtor either to determine whether bad faith existed or whether the debtor intended to conceal property. With every amendment to exemptions, the debtor is buying a lottery ticket for an evidentiary hearing on the debtor’s actions. The debtor’s attorney’s task is to take every step necessary to make sure that lottery ticket does not turn into an evidentiary hearing.

For some reason, the most recent examples of contested objections to amended exemptions revolve around lawsuits. Fortunately, since 2012, the Sixth Circuit Court of Appeals has clarified the concept of judicial estoppel. In turn, there is a greater potential for recovery by Chapter 7 trustees. *Auday v. Wet Seal Retail Inc.*, 698 F.3d 902 (6th Cir. 2002); *Stephenson v. Malloy*, 700 F.3d 265 (6th Cir. 2012). Since the law is now better established in this area, any thought that a debtor may have that the failure to list an asset may somehow result in the recovery of the money by the debtor later does not exist. Accordingly, debtors should have a greater incentive to cooperate with the bankruptcy trustee.

The timing of amendments to Schedule C is critical. A debtor's attorney should remind the debtor of the need to completely disclose all assets, even as late as the day of the first meeting of creditors. A debtor and debtor's attorney may avoid an evidentiary hearing even if disclosure is made at the initial part of a first meeting of creditors if followed up with a written amendment as soon as possible.

Regardless of when the debtor tells debtor's attorney about the asset, the debtor's attorney should immediately note the date, time, and method of disclosure and amend Schedules A, B, and C as soon as possible thereafter. By doing so, the debtor blunts the trustee's argument that the debtor acted in bad faith or attempted to conceal the asset. Second, the Schedules should be amended to be as descriptive as possible. Phrases such as "worker's comp claim", "personal injury claim", or "class action lawsuit" with no further details should be avoided.

Finally, the debtor's attorney should take every step possible to share whatever information the attorney has with the trustee, including the providing of documents, telephone numbers, and addresses of attorneys and other parties in interest. This not only buttresses the debtor's case that the debtor did not act in bad faith or attempt to conceal the property, but also gives the trustee a greater sense that the trustee has all of the information necessary to administer the asset.