

Consumer Workshop III: The Luge: Negotiating the Turns through Commercial Chapter 13 Cases, Business Chapter 7 Cases and Hot Topics

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**The Luge: Negotiating the Turns Through Commercial
Chapter 13 Cases, Business Chapter 7 Cases and Hot Topics**

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Negotiating the Turns Through Commercial Chapter 13 Cases &
Business Chapter 7 Cases

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- I. Evaluating a Case for Commercial or Business Chapter 7 & 13 –Initial Interview Questions
- II. Documents Needed to Evaluate Commercial or Business Bankruptcy
- III. Considerations in Selecting an Appropriate Bankruptcy Chapter

I. Evaluating a Case for Commercial or Business Chapter 7 & 13 – Initial Interview Questions

Counseling and advising small business owners about a possible bankruptcy can be challenging without a clear understanding of all the options that are available. As an attorney preparing to work in this area, it is also important to be well informed as to the financial health of the business, its record keeping standards and all of the assets or potential assets the company possesses. It is not uncommon for closely held entities to be poorly managed; without a clear definition of the entity status, commingling of corporate and personal assets, and a misapplication of corporate funds for personal obligations. Untangling the business from the owners' personal financial situation is critical in giving appropriate advice and setting, both the business and its principals, on the right track going forward.

A thorough interview of the business owners is the first step in evaluating a case for possible commercial or business bankruptcy. It is important to gain a clear picture of the history of both the business and its owners before making recommendations for action. You are seeking the “story” that will explain the current situation and help you make appropriate follow up inquiries.

Here is a list of questions that may be helpful in gathering initial information about the business. Not every question is appropriate in every case. You must select that that are useful for each client's situation.

Organizational Issues:

- What is the corporate structure? (Sole proprietorship, LLC, corporation)
- How and when was the entity formed?
- Who created the entity (self, professional, former owner)?
- Are there debts owed from the purchase?
- Is the entity in good standing?
- Who are the equity holders, owners, members or shareholders of the entity?
- How is the equity interest owed or shared?
- Who can act on behalf of the entity?
- Have corporate formalities been followed?
- What are the requirements to liquidate, sell assets, file bankruptcy, wind up the company?
- Any disputes within the company about management or control?

Debts and Obligations:

- What debts does the business owe?
 - Which are secured by business assets?
 - Which are unsecured?
 - Are there outstanding deposits or other customer funds being held for unperformed work or unfulfilled orders?
- Who is the borrower?
- Was the debt personally guaranteed?
- Is the personal liability capped or limited?
- Did the client pledge personal assets such as a home or life insurance policy (in addition to the business assets) to guarantee the loan?
- What are the repayment terms, including interest rate, of each debt?
- When do loans mature/can debts be renegotiated?
- What are the events of default?
- What is the notice/cure provision?
- Are the debts cross-collateralized or cross-defaulted?
- Is there an SBA guarantee??
- Are there real estate or equipment lease obligations?
- Was the lease executed in a in a non-corporate capacity, is there personal liability?
- Who is the landlord?
- Is there a security deposit?
- What are the payment terms?
- Can the lease be assigned or can there be a sublease?

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- Is there a purchase option?
- For personal property or equipment lease, where are the leased items?
- Is the business a plaintiff or defendant in any litigation?
- If a defendant, are there counterclaims (that might constitute an asset)?
- What litigation is threatened (is there a potential of a class action -all parties need notice)?
- Is insurance paying to defend?
- Will insurance cover any judgments for damages?
- Are there past due wages (owner has potential personal liability)?
- Are there potential employee discrimination or other related claims?
- Are the utilities past due (is shut down imminent -need to find money to pay)?

Financial Situation

- Does the company have an accountant?
- Is the accountant familiar with the business?
- Has the accountant been paid?
- Has the business filed all required returns (Forms 1040,940,941, etc.)?
- Are there past due tax liabilities?
- Is there personal liability for corporate taxes?
- Are there tax liens filed or threatened?
- When were the tax liens filed?
- What taxing authorities will need to be notified in the event of shut down by the filing of final returns?
- Are there tax refunds that haven't been received yet?
- Are the returns filed consistently with the organization documents?
- How is the business taxed (a pass-through entity, such as a limited liability company or subchapter S corporation, subchapter C corporation)?
- Will there be other tax advantages or disadvantages if assets are liquidated or foreclosed?
- Is the owner paying him/herself a salary?
- If a salary is being paid, is it over market?
- Is there an individual actually "looting" the company by paying a huge salary?
- Are there loan repayments to owners/officers/directors?
- Were dividends paid while the entity was insolvent?
- Where are the business and personal checking accounts?
- Are the business and personal accounts commingled?

Insurance

- Is there cash value in life insurance policy?
- Is there a sales tax or other bond posted with the State?
- Is the business operating without essential insurance such as liability/casualty/work comp and in possible violation of state law?
- Is there employee loss/dishonesty policy?
- If the business files bankruptcy, will the officer and directors be covered by the D&O in the event a trustee sues them?

Assets

- What are the assets of the company?
 - Real Property?
 - Personal Property?
- Is there property owned by the debtor personally that is being used in the business?
- Which property is encumbered by debt or lease obligations?
- Have assets been sold?
- Were any of the assets sold subject to a lien?
- Were corporate formalities followed?
- Were the sales for fair market value?
- What was the disposition of the proceeds?

Miscellaneous Details

- How many employees are there?
- Who are the employees and what are their compensation terms?
- Are there past due wages?
- Are there family members employed?
- Who are the utility providers?
- How much does it cost on a monthly basis to pay utilities?
- Are there utility security deposits?

II. Documents Needed to Evaluate Commercial or Business Bankruptcy

Once you have gathered basic information, you need to follow up with a request for specific supporting documents. In cases where the owners are unable to answer your specific questions, it may be more helpful to start with a request for documents so that you can begin to put events into order based on the documents themselves.

Here is a list of documents that should be requested in most business cases in order to verify or establish key facts of the case:

Organizational Documents:

- Articles of incorporation,
- By-laws,
- Membership or partnership agreement,
- Shareholder agreements,
- Stock certificates,
- Corporate minute book,
- List of equity holders,
- History of entity from Secretary of State,
- Certificate of Good Standing,

Documents related to Debts and Obligations

- Promissory notes,
- Security agreements,
- Mortgages or deeds of trust,
- Subordination agreements,
- Factoring agreements,
- Personal guaranties,
- Financial statements,
- UCC-I s,
- Credit card statements
- Information about undocumented loans

- Lawsuits
- Property Leases
- Equipment Leases, including vehicles, software, office equipment, credit card machines,
- Unpaid Payroll Obligations
- Past-due Utilities

Financial Records

- Bank Account Statements
- Business Tax Returns, at least two years
- Personal Tax Returns, at least two years
- Sales Tax reports
- Quarterly Tax Withholding history
- Property taxes
- Any correspondence or documentation of tax obligations, including warrants, levies, or notices of review
- Profit & Loss Statements, at least two years,
- Financial Statements, at least two years
- Balance Sheet
- Inventory Report
- Accounts Payable
- Accounts Receivable
- Cash Flow Projections
- Loans between the company and principal, any other insider transactions,
- 401K, defined benefit or contribution pension plans,

Insurance Policies and Documents

- D&O or Errors & Omissions Policies
- “Key Man” Life Insurance
- Premises Liability,
- Casualty Policies
- Auto Insurance
- Disability Insurance
- Unemployment Policies
- Workers Compensation Coverage

Asset Documentation

- Titles and lists of non-titled assets
- Bills of Sale
- Asset Purchase Agreements

Other Operating Information

- List of Employees and Contractors
- Utilities, list of providers and terms of service

III. Considerations in Selecting an Appropriate Bankruptcy Chapter

After obtaining the documents listed above from the small business owner, you can begin to determine whether is it more appropriate to file a Chapter 7 Bankruptcy or a Chapter 13 Bankruptcy. Our analysis will generally exclude Chapter 11 reorganization options due to the cost for same. Often with creative thinking a Chapter 7 Bankruptcy or Chapter 13 Bankruptcy can provide a positive result for your small business client at a fraction of the cost for a Chapter 11 reorganization.

What is the Intended Result

As a starting point, you must determine what the client actually wants in terms of a result. In many instances the client simply wants to eliminate unsecured debt and start over. In some instances a simple individual Chapter 7 Bankruptcy will accomplish this result because the tools of the trade are owned individually by the proprietor and the individual's other assets are exempt or secured. In such cases, a simple personal business Chapter 7 Bankruptcy will effectuate relief from the unsecured debt and allow the business person to start over.

In other instances, the situation is more complex because the debtor either has priority tax liabilities or the debtor has unencumbered assets or the debtor has secured debt which

is delinquent. In these instances a Chapter 7 Bankruptcy with “pre-bankruptcy planning” or a Chapter 13 Bankruptcy may yield a positive result.

Legal Entities

In those instances in which the business is a legal entity (corporation, Limited Liability Company, partnership, etc.) a two-level analysis needs to be conducted; first to determine the impact of a Chapter 7 Bankruptcy filing at the entity level. Secondly, an analysis needs to be conducted to determine the impact of the entity Chapter 7 Bankruptcy on the individual owner.

As an example, if the corporation owns the assets used to conduct the business, corporations are not entitled to exemptions and if the assets are not secured, the Chapter 7 Trustee will liquidate these assets to pay the unsecured debts of the corporation. Consideration of “collapsing” the legal entity may be appropriate with a complete discussion of the potential risks and benefits.

In some instances it is not necessary or desirable to “collapse” the business entity. Take for instance the situation where the debtor owns 100% of his small business corporation. Assume further the corporation has tools of the trade or assets which are owned outright by the corporation. If the corporation also owes taxes or other debts which the individual owner might be personally responsible for, a planning opportunity exists. Consider having the individual debtor buy the assets from the corporation at an appraised liquidation value. The money paid by the individual into the corporation for the purchase of these assets can then be used by the corporation to pay the priority tax debt or other liability which the individual owner might be responsible for.

“Hybrid” Chapter 7 Bankruptcy

In some situations a “hybrid” Chapter 7 Bankruptcy filing may be appropriate. As an example, even if the corporation owns the assets used to conduct the business, it may be appropriate to first file an individual Chapter 7 Bankruptcy for the business owner to eliminate all personal liability. Secondly, an entity Chapter 7 Bankruptcy might be appropriate whereby the now discharged small business owner purchases the unencumbered or secured business assets from the Chapter 7 Bankruptcy Trustee for the entity.

Observance of Corporate Proprieties

One of the difficulties with “pre-bankruptcy planning” or “hybrid” situations is the debtor’s reluctance to observe corporate proprieties. Individual small business owners and their businesses frequently fail to follow or observe the rules that are applicable. Often the small business owner fails to draw a salary and instead has the business pay personal expenses on his behalf directly to third parties. In many instances small business owners fail to pay themselves a salary with appropriate reporting to the various tax authorities. In other instances, the small business fails to file appropriate tax returns and/or pay taxes. In fact, frequently, business operations are subsidized by the non-payment of applicable taxes. These issues frequently need to be identified and addressed before either a Chapter 7 Bankruptcy or Chapter 13 Bankruptcy should be filed.

Taxes

In many instances the individual business owner and/or the entity have tax liabilities or other nondischargeable debts. It is often possible to “kill two birds with one stone” by paying a Chapter 7 Bankruptcy Trustee to acquire assets knowing that the Chapter 7

Bankruptcy Trustee will have to pay priority taxes for which the small business owner would otherwise be liable. In this fashion the small business owner obtains clear post-bankruptcy title to assets while at the same time paying a priority tax liability for which the small business owner would otherwise be liable.

Chapter 13 Small Business

Chapter 13 presents unique limitations and opportunities for the small business owner. First it must be remembered that Chapter 13 is not available to legal entities. It is only available to individuals pursuant to 11 U.S.C. § 109 (e) who have noncontingent, liquidated, unsecured debts of less than \$383,175.00 and noncontingent liquidated, secured debts of less than \$1,149,525.00. The term individual with regular income is defined at 11 U.S.C. § 101 (30).

Authorization to Conduct Business

Unlike Chapter 7 Bankruptcy where a trustee is not authorized to operate a business without court approval pursuant to 11 U.S.C. § 721. Conversely, a Chapter 13 debtor is authorized pursuant to 11 U.S.C. § 1304 to continue operating the debtor's business.

It is important to isolate and analyze the "assets" or value of the business. In some instances it may be the personal services of the principal operator of the business. In other instances it may be the business location or even something as simple as its phone number or client lists. Counsel needs to be sophisticated in understanding how each of these assets would be treated in a Chapter 7 liquidation or in a Chapter 13 reorganization. Chapter 13 Trustees are much more sophisticated these days at arguing that an increased payout needs to be made to the Class 4 unsecured creditors based upon the argument that there are valuable assets in the small business. Whether the business is continued to be

operated or whether it is liquidated, may directly impact this issue and the debtor, through pre-bankruptcy planning, has a significant amount of control over the timing of any bankruptcy filing.

Benefits of Chapter 13 Bankruptcy

In some instances the small business owner can effectuate a mini Chapter 11 Bankruptcy utilizing the five (5) year term available in Chapter 13 for a reorganization plan. As with a hybrid Chapter 7 Bankruptcy, frequently individual small business owners owe taxes or other priority debts and simply need an opportunity to cure the payment on same. In other instances the small business owner is delinquent on secured debt and needs the availability of the cure provisions in Chapter 13.

In some instances an individual who owns all or a part of a legal entity can benefit from an individual Chapter 13 small business filing. Notwithstanding the fact that the legal entity is not in bankruptcy (only the individual owner is), benefits can result to the legal entity by the principal's Chapter 13 filing. The individual business owner will need to account for the value of his ownership interest in the legal entity in his individual Chapter 13 Bankruptcy. Nevertheless, many businesses have little or no equity or value beyond the income stream that the principal derives from the business. This is particularly true in businesses which are based upon the personal services of the principal (such as doctors, lawyers, etc.).

The Exit Strategy

One of the primary advantages to Chapter 13 is the relative ease with which the debtor has an exit strategy if the case does not progress as anticipated. Although Chapter 13 debtors do not have an absolute right to dismissal, debtors acting in good faith are

generally assured the ability to dismiss a Chapter 13 Bankruptcy as opposed to the extreme difficulty involved in dismissing a Chapter 7 Bankruptcy where the Chapter 7 Trustee opposes same.

Healthcare Business

In advising the small business owner, counsel needs to be aware of the various unique issues that can arise such as those concerning healthcare businesses. 11 U.S.C. § 101 (27A) defines a healthcare business. . 11 U.S.C. § 333 provides that if a debtor in a case under Chapter 7, 9 or 11 is a healthcare business, that the court shall order, not later than thirty (30) days after the commencement of the case, the appointment of an ombudsman to monitor the quality of patient care and to represent the interests of the patients of the healthcare business unless the court finds that the appointment of such ombudsman is not necessary for the protection of patients under the specific facts of the case. Although ostensibly this section does not apply to Chapter 13 Bankruptcies, counsel needs to advise the client of the possibility of this issue.

Rental Properties

A common scenario during the past recession and continuing is a small business owner with multiple rental properties. In some instances the properties are all residential and in others they are residential and commercial. Many of these individuals have had a foreclosure(s) with deficiencies making a Chapter 13 Bankruptcy filing impossible. In some instances a hybrid Chapter 7 will still afford the owner relief if the properties do not have equity and the debtor seeks an abandonment of the property from the Chapter 7 Bankruptcy Estate and Trustee. Hybrid Chapter 7's frequently allow the debtor to surrender unprofitable properties while attempting to keep marginally profitable

properties through abandonment. A particular advantage of the bankruptcy option is the elimination of tax on debt forgiveness pursuant to I.R.S. Form 1099-C.

Recognize the issues associated with rental properties, including the treatment in bankruptcy of security deposits and rental income. Aggressive Chapter 7 Trustees argue that rental income should be payable to the Bankruptcy Estate until such time as a mortgage company exercises its rights under the assignment of rents provision of most mortgages. Some trustees will furthermore argue that notwithstanding established landlord-tenant law that security deposits are not actually the property of tenants held in trust by the landlord but rather they are property of the landlord subject to claims by tenants.

Thinking Outside the Box

Frequently bankruptcy, either Chapter 7 or Chapter 13, affords an economical avenue to resolve complex problems. As an example, the author had an individual small business owner who owned a limited liability company that performed printing services. The business had been purchased for \$650,000.00 with the bank loan secured by an SBA guaranty. The actual physical assets of the business were valued by a liquidating auctioneer at \$30,000.00. The company filed Chapter 11 reorganization and offered to pay the bank \$100,000.00 over the course of the Chapter 11 Plan. The bank rejected this Plan, due in part by the fact that its debt was guaranteed by the SBA. Furthermore, the SBA refused to negotiate a resolution until the business was liquidated.

The individual business owner elected to file an individual Chapter 7 Bankruptcy and valued his ownership in the printing business as \$0.00 due to the overwhelming secured debt.

Upon discharge the business owner elected to have the printing business liquidated through the auctioneer by an online auction. The physical assets were never removed from the business location and arraignments were made with a successive business owner to assume the lease for the business premises. The assets were liquidated online for approximately \$30,000.00 and the business owner made arrangements to acquire these assets from the successful bidder and to operate a new printing business which now only had \$30,000.00 of secured debt.

The individual business owner had eliminated his liability for the bank/SBA deficiency in his individual Chapter 7 Bankruptcy. The results achieved were obtained at a fraction of the cost of Chapter 11 reorganization without the necessity of protracted five (5) year plan. Further, the fact that the assets were liquidated on site via an online auction resulted in little, if any, disruption to business operations.

The Co-Debtor Auto Stay

Counsel should remember that Chapter 13 Bankruptcy contains an additional provision pursuant to 11 U.S.C. § 1301 for a co-debtor stay. 11 U.S.C. § 1301 (a) provides for a stay against co-debtors for consumer debts. Although no stay automatically applies to co-debtors on business debt, the co-debtor stay for consumer debts may be beneficial for the small business owner attempting to reorganize in Chapter 13.

Non-Dischargeable Debts

Counsel should be ever mindful, whether filing Chapter 7 or Chapter 13, as to the non-dischargeability issues faced by the client. The scope of a Chapter 13 discharge is obviously broader than the scope of a Chapter 7 discharge. As an example, willful and

malicious injury debts are not excepted from Chapter 13 discharge as they are in Chapter 7. Similarly, violations of federal security laws can be dischargeable in Chapter 13 even though they are not in Chapter 7.

Pre-bankruptcy planning may afford the debtor an opportunity to resolve an otherwise non-dischargeable debt prior to filing either Chapter 7 or Chapter 13.

THE LUGE: NEGOTIATING THE TURNS THROUGH
COMMERCIAL CHAPTER 13 CASES, BUSINESS
CHAPTER 7 CASES AND HOT TOPICS



A FEW RECENT CASES OF NOTE
CHIEF JUDGE WILLIAM T. THURMAN
U.S. BANKRUPTCY COURT DISTRICT OF UTAH

CHAPTER 13 CASES:

- BENEFITS OF FILING COMMERCIAL CHAPTER 13:
 - *In re Friedman*, 466 B.R. 471 (B.A.P. 9th Cir. 2012) (Jury, Kirscher, Clarkson, J.): In holding that the absolute priority rule does not apply in individual chapter 11 cases, the Ninth Circuit Bankruptcy Appellate Panel discussed similarities and differences between individual chapter 11 filings and chapter 13 filings. For example, in a chapter 13 case, the unsecured creditors may only object to confirmation of the proposed plan and are not entitled to vote on the proposed plan. *But see Dill Oil Company, LLC v. Stephens (In re Stephens)*, 704 F.3d 1279 (10th Cir. 2013) (holding that BAPCPA did not abolish the absolute priority rule in individual Chapter 11 cases).

- PLAN CONFIRMATION:
 - *In re Bond*, No. 11-bk-33849, 2012 WL 3867427 (Bankr. D. Ariz. Sept. 5, 2012) (Hollowell, J.): Debtors, self-employed and engaged in business, filed a chapter 13 petition listing their partnership interests in two limited liability companies. Debtors valued these assets using a liquidation value, not a going concern value. A creditor objected to the Debtors' proposed plan claiming that its treatment was not fair or reasonable since the Debtors intended to maintain their partnership interests and continue operations. The bankruptcy court held that when a debtor intends to maintain possession and continue operation of a company, the debtor must calculate the value of the company based on the going concern value. The Debtors were required to amend their calculation of disposable income to include the annual profits and monthly wages from the companies after payment of all necessary business expenses.
 - *In re Harkins*, 491 B.R. 518 (Bankr. S.D. Ohio 2013) (Hoffman, J.): The Chapter 13 Trustee objected to confirmation of proposed plans in three separate bankruptcy filings. In each case, the self-employed Debtor deducted his or her ordinary and necessary business expenses to arrive at a net business income figure, which figure was used to calculate current monthly income ("CMI"). The bankruptcy court found that this method of deducting business expenses to then calculate CMI is consistent with Official Form 22C, but such calculation can impact the applicable commitment period. For example, here, if allowed to deduct business expenses to determine CMI, each Debtor would be in a thirty-six month commitment period rather than a sixty month commitment period. An alternative method of calculation provides that business expenses be deducted from the debtor's disposable income. Courts are split on which method to use. The bankruptcy court reasoned that § 1325(b) makes it clear that business expenses should not be deducted when calculating CMI. The court held that the debtors must include their gross business receipts when calculating CMI.
 - *In re Weilnau*, No. 11-30467, 2012 WL 893264 (Bankr. N.D. Ohio Mar. 14, 2012) (Whipple, J.): Chapter 13 Debtors listed an ownership interest in a limited liability company ("LLC") and included income received from the LLC on their Schedule I. The Operating Agreement of the LLC did not restrict the transfer of an interest in the LLC, but did not allow a transferee to manage the company without consent of a majority of the members. The Trustee objected to confirmation of the plan claiming that a Chapter 7 trustee could sell the membership interest and yield a higher return to unsecured creditors than what was proposed in the Debtors' proposed plan. The Debtors argued that their plan complied with the best interest of creditors test because the value of the membership interest was significantly less than what was listed on Schedule B if the interest did not include the ability to manage the company. The Debtors presented no evidence of a lower value, and the bankruptcy court denied confirmation of the plan.

- *Anderson v. Cranmer*, 697 F.3d 1314 (10th Cir. 2012): The debtor did not include Social Security Income (“SSI”) in his projected disposable income calculation, thus the bankruptcy court denied confirmation of the Debtor’s Chapter 13 plan. The Debtor appealed, and the district court reversed. The Tenth Circuit affirmed the district court, holding that the Debtor is not required to include SSI in the projected disposable income calculation of 11 U.S.C. § 1325(b), and that not including it does not constitute a lack of good faith.
- DEBT LIMITS - § 109(e)
 - *In re Thompson*, No. 11-20138-13, 2011 WL 5520963 (Bankr. D. Kan. Nov. 14, 2011) (Somers, J.): The Chapter 13 Trustee claimed that the Debtors’ unsecured debts exceeded the statutory limits of § 109(e). The Trustee argued that to the extent the secured claims listed on Schedule D were undersecured, those amounts must be included in the total amount of unsecured debt. Like the amount in controversy question in federal diversity jurisdiction cases, the bankruptcy court agreed with the Sixth, Seventh, and Ninth Circuits that § 109(e) questions should be addressed based on the schedules of the debtors unless made in bad faith. Finding no bad faith, the court reasoned that § 109(e) addresses “debts,” not “allowed claims,” and held that the undersecured amount of the business debt listed on Schedule D was enough to make the Debtors ineligible to be Chapter 13 debtors. The court allowed the Debtors twenty-eight days to convert or the case would be dismissed.
 - *In re Thompson*, No. 11-40805-H3-13, 2012 WL 5959994 (Bankr. S.D. Tex. Nov. 28, 2012) (Paul, J.): The Chapter 13 Trustee moved to dismiss the Debtors’ case claiming the Debtors did not qualify as Chapter 13 debtors under § 109(e). In response, the Debtors amended their Schedules E and F. The amendments lowered the Debtors’ noncontingent, liquidated, unsecured debts by almost \$300,000. One amendment changed a business debt from \$164,247.20 to “unknown.” The debt was incurred by one of the Debtors for the purchase of vending machines. The Debtor testified that he listed the debt in a previous bankruptcy, and that the creditor repossessed the machines over a year before the current filing. The Debtor made several attempts to contact the creditor to quantify the amounts owed, but to no avail. The bankruptcy court found the Debtor credible, allowed the amendments, and the Debtors qualified as Chapter 13 debtors.

- *In re Denaeyer*, No. BK11-43089-TLS, 2012 WL 1605555 (Bankr. N.D. Neb. May 8, 2012) (Saladino, J.): In the Debtor's previous bankruptcy filing, a creditor filed two proofs of claim, claiming the debts owed were secured. The Debtor objected to the claims. The Debtor argued that the claims were unsecured because the creditor made the loans to a separate entity, and the Debtor had only guaranteed the loans. The Debtor's objection was sustained, and the claims were reclassified as unsecured. In the bankruptcy filing at issue, the same creditor filed two proofs of claim for the same unsecured amounts. At first, the Debtor did not list the debts owed, but, when the Chapter 13 Trustee moved to dismiss under § 109(e), she amended her Schedule F to list the claims as "unliquidated" and "disputed." The bankruptcy court found that the amounts owed to the creditor were "readily calculable" and "fixed, liquidated amount[s]." The court included the amounts the § 109(e) eligibility calculation and found that the Debtor did not qualify as a Chapter 13 debtor. The motion to dismiss was granted.
- *In re Reed*, No. 12-5542, 2013 WL 2147967 (Bankr. S.D. Ind. May 14, 2013) (Moberly, J.): Debtor personally guaranteed a loan of \$400,000 made to his solely-owned corporation. When the Debtor filed bankruptcy, the corporation was in default on the loan, and the creditor filed a proof of claim in the Debtor's chapter 13 bankruptcy for \$410,936.83. Whether the Debtor qualified as a Chapter 13 debtor depended on if the debt owed to the creditor was contingent. The Debtor argued that the debt was contingent because he did not have notice of the corporation's default until after filing his petition. However, the bankruptcy court found that when the Debtor personally guaranteed the debt he also waived his right to notice. The debt was defaulted on before the filing, thus the debt was noncontingent. The Debtor was given thirty days to convert to another chapter or the case would be dismissed.
- ATTORNEY'S FEES:
 - *In re Romero*, No. 09-14343, 2010 WL 964209 (Bankr. D.N.M. Mar. 12, 2010) (Jacobvitz, J.): Counsel to a Chapter 13 Debtor engaged in business charged a higher hourly rate than the customary rates charged by chapter 13 practitioners in the district. Counsel contended that because most of his chapter 13 clients were engaged in business, the issues presented in each case were more complicated, thus justifying a higher hourly rate. The bankruptcy court noted that some deference should be given to the Debtor's decision to retain counsel; however, the court emphasized that debtors do not have economic incentive to limit legal fees in a chapter 13 case since the fees "simply reduce[] the distribution to unsecured non-priority creditors." Here, the bankruptcy court held that although complex legal issues could justify an increased hourly rate those circumstances were not present in the current case. Counsel's fees were reduced.

- *In re Cole*, No.10-925, 2013 WL 5429422 (Bankr. N.D.W. Va. Sept. 30, 2013) (Flatley, J.): The Debtor’s Attorney filed a Disclosure of Compensation of Attorney (the “Disclosure”) showing a flat fee of \$4,500, which was on the higher end of customary chapter 13 fees in the district. The Debtor’s Attorney requested supplemental compensation of \$18,104.75 for services rendered, in particular for services performed addressing the Chapter 13 Trustee’s objection to confirmation. Local rules in the district do not establish a “no-look” fee or require a fee application, but rather the court relies on the Disclosure. The bankruptcy court found that the Debtor’s Attorney was entitled to some additional compensation in part because the Debtor was engaged in business. However, the court noted that the Debtor’s Attorney knew the case would be complicated, thus he should have accepted a larger flat fee or have entered into a different fee arrangement. The court reduced the supplemental compensation.

- *In re Puffer*, 674 F.3d 78 (1st Cir. 2012): Debtor had \$15,000 in unsecured debt, and his anticipated disposable income was approximately \$100 a month. In consultation with Counsel, Debtor was advised that he could file either a chapter 7 bankruptcy, which could discharge his debts within a few months, or a chapter 13 bankruptcy, which would keep him in bankruptcy a minimum of thirty-six months. Counsel told the Debtor that he would not provide services in a chapter 7 case unless the fees were paid up front. The Debtor, not having funds on hand to pay an attorney and unwilling to proceed unrepresented, opted for a chapter 13 bankruptcy filing. The proposed chapter 13 plan provided for monthly payments of \$100, a return to unsecured creditors of \$300 (about 2% of the \$15,000 owed), and Counsel would receive more than \$2,900 for legal services. The bankruptcy court held that the plan was proposed in bad faith, and the district court affirmed. The First Circuit reversed holding that there is no per se bad faith rule for fee-only chapter 13 plans, and that good faith should be assessed on a case-by-case basis.

- AUTOMATIC STAY
 - *In re Biorge*, No. 10-23318, 2011 WL 1134109, at *1 (Bankr. D. Utah Mar. 28, 2011) (Marker, J.): Post-confirmation, Debtors sought sanctions against a creditor who continued to prosecute a state court action against the Debtors’ wholly-owned limited liability company (“LLC”), despite notice of the Debtors’ chapter 13 filing. The Debtors argued that the LLC was a *dba* of the Debtors and was part of their Chapter 13 bankruptcy case because they included the assets and debts of the company on their schedules. The bankruptcy court found that the LLC was a separate entity, and that the Debtors had “assumed the benefits of the L.L.C. structure and ‘[could not] now ignore the existence of the L.L.C. in order to escape its disadvantages’” (quoting *Kreiser v. Goldberg*, 478 F.3d 209, 213 (4th Cir. 2007)). The court further explained that some courts may use § 105(a) to grant a temporary injunction against nondebtors; however, such relief is not to be extended after confirmation. Thus, the Debtors were not entitled to a temporary injunction against the creditors of the LLC.

- *In re McCormick*, 381 B.R. 594 (Bankr. S.D.N.Y. 2008) (Morris, J.): Self-employed Debtor, and sole member of a limited liability company (“LLC”), filed for chapter 13 relief. Debtor motioned the bankruptcy court to extend the automatic stay to the LLC, claiming that he would not be able to effectively reorganize with the collection actions proceeding against the LLC. Debtor did not detail any irreparable harm that could occur, and he requested the bankruptcy court to use § 105(a) to extend the automatic stay. The bankruptcy court noted that an LLC could not be a debtor under chapter 13, nor was it a “codebtor” under § 1301(a), thus the “codebtor stay” did not apply. The court denied the motion, explaining that by creating an LLC the Debtor excluded himself from the self-employed debtors classified under § 1304.

 - *In re Nemec*, No. 12-00986, 2012 WL 2803735 (Bankr. N.D. Iowa July 10, 2012) (Kilburg, J.): Chapter 13 Debtor was the sole shareholder of a limited company (“LC”). The LC entered into a mortgage agreement with a creditor, which the Debtor personally guaranteed. The creditor moved to foreclose on the property, arguing that the stay did not apply to the foreclosure proceeding because the property did not belong to the bankruptcy estate. The Debtor claimed an equitable interest in the property and argued that he could sell the property and pay off the creditor’s loan through his chapter 13 plan. The court held that the automatic stay in the Debtor’s case did not apply to the property owned by the solely-owned LC. The court refused to use § 105(a) to extend the stay where the debt was not a consumer debt and the LC was not an individual.
- OTHER CONSIDERATIONS
 - *In re Bullard*, 494 B.R. 92 (B.A.P. 1st Cir. 2013) (Haines, Tester, Godoy, J.): Debtor proposed a “hybrid plan,” in which the Debtor would bifurcate a secured claim of a mortgage lienholder. The property securing the mortgage consisted of the Debtor’s principal residence and another unit. The proposed bifurcation provided that the secured portion of the claim would be reduced to the value of the collateral and paid directly to the creditor beyond the terms of the plan. The Debtor would pay the unsecured portion a dividend over sixty months. The bankruptcy court held that the hybrid plan was not confirmable, and the First Circuit Bankruptcy Appellate Panel affirmed. The BAP held that “§ 1328(a)(1) establishes that as long as a plan employs § 1322(b)(5), it can *only* be confirmed over the creditor’s objection via § 1325(a)(5)(B)(i)(I)(aa). And, since that section states the debt, *as determined by nonbankruptcy law*, must be paid, a debtor may not use it *and* bifurcate the applicable claim via § 506(a). To do so would render § 1325(a)(5)(B)(i)(I) ineffective.”

- *Alvarez v. HSBC Bank USA (In re Alvarez)*, 733 F.3d 136 (4th Cir. 2013): Debtor and his non-filing spouse owned real property as tenants by entireties. The property was valued at \$442,400, and it was encumbered by two mortgage liens. Chase Home Finance held the first mortgage lien of \$447,572.84, and HSBC Mortgage Service held the second-priority mortgage lien of \$75,455.08. The claim held by HSBC was valueless, and the Debtor and his non-filing spouse jointly filed a complaint to strip off the lien. The bankruptcy court held that it did not have the authority in a chapter 13 proceeding to strip off a valueless lien on property held in a tenancy by the entirety. The Forth Circuit affirmed and explained that the Debtor and his non-filing spouse “were not entitled to obtain the removal of the lien against their entireties property without submitting both parties to the burden of a bankruptcy filing.”

- *Shelton v. CitiMortgage (In re Shelton)*, 477 B.R. 749 (B.A.P. 8th Cir. 2012) (Kressel, Federman, Venters, J.): CitiMortgage filed its proof of claim almost eight months after the deadline for filing proofs of claim. The Debtors did not contest the validity of CitiMortgage’s lien or seek avoidance, but objected to the claim urging that it be disallowed as untimely filed. The bankruptcy court sustained the objection and disallowed the claim. Subsequently, the Debtors filed an adversary proceeding seeking the avoidance of the lien, but the bankruptcy court dismissed the action. The Debtors appealed arguing that CitiMortgage’s lien was void under the plain language of § 506(d). The Eighth Circuit Bankruptcy Appellate Panel held that a creditor’s lien cannot be avoided under §506(d) based solely on the untimely filing of a proof of claim; a lien passes through bankruptcy unless avoided on its merits.

CHAPTER 7 CASES:

- JURISDICTION
 - *Executive Benefits Insurance Agency v. Arkison (In re Bellingham)*, 702 F.3d 553 (9th Cir. 2012), *cert. granted*, 81 U.S.L.W. 3582 (U.S. June 24, 2013) (No. 12-1200). Bellingham Insurance Agency, Inc. (“Bellingham”) filed chapter 7 bankruptcy, and the Chapter 7 Trustee filed an adversary proceeding to recover fraudulent conveyances from Executive Benefits Insurance Agency (“EBIA”), a noncreditor of the bankruptcy estate. The bankruptcy court entered a final judgment against EBIA, and EBIA appealed. The district court affirmed the bankruptcy court. EBIA appealed to the Ninth Circuit, and, for the first time, argued that the bankruptcy court lacked subject-matter jurisdiction. The Ninth Circuit found that the United States Constitution forbids a bankruptcy judge from entering a final judgment in a fraudulent conveyance action against noncreditors of the bankruptcy estate *unless* the parties have consented. If the parties consent, as EBIA did by its conduct, the bankruptcy court can constitutionally enter a final judgment. Further, the court held that the bankruptcy court may hear and enter proposed findings of fact and conclusions of law subject to *de novo* review by a federal district court in core proceedings. The Supreme Court granted certiorari, and argument was set for January 14, 2014.
 - *Wellness Int’l Network, Ltd. v. Sharif (In re Sharif)*, 727 F.3d 751 (7th Cir. 2013): The Debtor filed chapter 7 bankruptcy shortly after a state court judgment was entered against him for over \$650,000 for failing to participate in discovery. Wellness International Network (“WIN”), the only creditor to file a proof of claim, filed an adversary proceeding against the Debtor seeking denial of his discharge under § 727 and a declaratory judgment that a trust was the alter-ego of the Debtor. The Debtor did not comply with discovery, and, after a warning to the Debtor, the bankruptcy court entered a default judgment in favor of the creditor. On appeal, the Debtor argued that the bankruptcy court lacked constitutional authority to enter a final judgment on the alter-ego claim, and WIN countered that the Debtor waived his argument and consented to final adjudication through his conduct. The Seventh Circuit affirmed the entry of the default judgment denying the Debtor’s discharge, but vacated the bankruptcy court’s entry of default judgment on the alter-ego claim. The Seventh Circuit held that an objection to a bankruptcy court’s constitutional authority on a state court claim cannot be waived under *Stern v. Marshall*.

- *In re Chameleon Entertainment Systems, Inc.*, 2012 WL 5995448 (10th Cir. BAP Dec. 3, 2012) (Cornish, Rasure, Somers, J.): The decision affirms the bankruptcy court's denial of the corporate debtor's motion to set aside a settlement agreement that resulted in an involuntary petition against it, rejecting the argument that the bankruptcy court had no authority or jurisdiction to enter an order prior to deciding whether the petition satisfied the requirements of § 303(b). The decision concludes that the requirements of § 303(b) are not jurisdictional under a plain language reading of the statute, and thus the bankruptcy court had jurisdiction to approve the settlement agreement and to enter other orders.

- PRE-BANKRUPTCY PLANNING
 - *In re Stanton*, 457 B.R. 80 (Bankr. D. Nev. 2011) (Markell, J.): Debtor filed chapter 7 bankruptcy and claimed a homestead exemption of \$244,000 (particular to Nevada law, the homestead exemption is not to exceed \$550,000). Debtor's sister obtained a state court judgment for over \$1,000,000 against her sister before the petition date. When her sister was attempting to collect on the judgment and before the petition date, Debtor increased her homestead value by \$89,000 when she paid off her deed of trust. The Debtor did so by selling nonexempt assets to her son, who in turn paid off the deed of trust. Debtor's sister objected to the homestead exemption. The bankruptcy court found that the homestead value had increased within ten years of her filing, and that the Debtor had the intent to hinder and delay her sister's collection efforts. Under § 522(o), the court reduced the Debtor's homestead exemption by the payoff amount of \$89,000.

- PROPERTY OF THE ESTATE
 - *Rajala v. Gardner*, 709 F.3d 1031, 1032 (10th Cir. 2013): The Chapter 7 Trustee brought an action against a limited liability company for fraudulent transfers allegedly made by insiders of the Debtor. The Trustee argued that the fraudulently transferred property, not just the fraudulent transfer claims, was property of the bankruptcy estate. Looking to the plain language of § 541 and noting the impact the Trustee's interpretation of § 541 would have on a bona fide purchaser, the Tenth Circuit held that "fraudulently transferred property is not property of the bankruptcy estate *until recovered*."

- ORDINARY COURSE OF BUSINESS DEFENSE:
 - *Rushton v. SMC Electrical Products, Inc. (In re C.W. Mining Co)*, 500 B.R. 635 (10th Cir. BAP 2013) (Cornish, Karlin, Romero, J.): The decision discusses the ordinary course of business defense under § 547(c)(2)(A) to a payment made by the debtor within 90 days of the filing of an involuntary bankruptcy, concluding that the bankruptcy court had adequate factual support for its conclusions that the debt to creditor had been incurred in the ordinary course of both creditor's and debtor's business, and that the payment trustee sought to avoid was also made in the ordinary course of both parties' business. The debt was incurred in an effort to increase the production of coal in debtor's primarily coal mining business, the transaction was a typical arms-length creation of a debt on the open market, and creditor's unchallenged evidence established that payment was within the ordinary course of business. (On appeal to Tenth Circuit.)
 - *Rushton v. Bank of Utah (In re C.W. Mining Co.)*, 477 B.R. 176 (10th Cir. BAP 2012) (Nugent, Karlin, Hall, J.): This decision resolved the trustee's avoidance action in favor of the creditor bank on the grounds that 1) permitting the trustee to avoid the transfer would be pointless, since avoidance would only revive bank's security interest; 2) avoidance and recovery from bank would benefit only the trustee, and not the estate, as is required by § 550(a), governing recovery on avoided transfers; and 3) stripping off the bank's lien would not be an appropriate remedy for a creditor's technical stay violation that did not result in any harm to the estate.
- DISMISSAL OR CONVERSION
 - *Piazza v. Nueterra Healthcare Physical Therapy, LLC (In re Piazza)*, 719 F.3d 1253 (11th Cir. 2013): Debtor filed for chapter 7 bankruptcy seeking to discharge business related debts, of which more than half of the unsecured debt was owed to one creditor. The creditor alleged that the filing was made in bad faith to avoid its collection efforts. The Eleventh Circuit found that a debtor's prepetition bad faith constitutes "cause" for dismissal under § 707(a), and the correct legal standard for determining bad faith under § 707(a) is the totality-of-the-circumstances inquiry, which looks for "atypical" conduct.
- EXEMPTIONS
 - *Scrivener v. Lashburn (In re Scrivener)*, 535 F.3d 1258 (10th Cir. 2008): The bankruptcy court entered an order surcharging retirement funds that debtors claimed as exempt to compensate the estate for nonexempt distributions that debtors refused to turnover. The Tenth Circuit Bankruptcy Appellate Panel affirmed, but the Tenth Circuit Court of Appeals reversed. The Tenth Circuit held that "the surcharge of exempt property is inconsistent with the Code's provisions governing exemptions and debtor misconduct [and] it is beyond the scope of a bankruptcy court's equitable authority under § 105(a)."

- *Law v. Siegel (In re Law)*, 401 B.R. 447 (Bank. C.D. Cal. 2009), *aff'd*, 435 F. App'x 697 (9th Cir. 2011), *cert. granted*, 81 U.S.L.W. 3685 (U.S. June 17, 2013) (No. 12-5196): The bankruptcy court entered an order surcharging the debtor's homestead exemption when the debtor attempted to defraud his creditors and the court by asserting a fictitious lien on his property. The Ninth Circuit Bankruptcy Appellate and the Ninth Circuit affirmed finding that a surcharge cannot be used to punish a debtor but may be used to prevent fraud that is caused by the debtor's misconduct. The United States Supreme Court granted certiorari.
- *In re Orton*, 687 F.3d 612 (3d Cir. 2012): Debtor listed a one-eighth interest in thirty-four acres of land subject to an oil and gas lease on Schedule A and a one-fourth interest in royalty interest in the oil and gas lease on Schedule B. No objections were made to the exemptions, and, in filing a motion to close the case, the Chapter 7 Trustee motioned to except the Debtor's royalty interest in the oil and gas lease from abandonment, thus preserving the estate's interest. The Debtor argued that by claiming the exemptions and no objection being raised, he secured the benefit of the assets for himself clear of any claims from creditors. Reviewing *Schwab v. Reilly*, 560 U.S. 770 (2010), and § 522, the Third Circuit held that § 522(d)(5)'s wildcard exemption preserves the Debtor's interest in the asset, not the asset itself. The court held that the Debtor did not give notice on his schedules of his intent to exempt his full interest in the oil and gas lease, hence why the Trustee did not object. The court concluded that the Debtor had no claim to future royalties.
- *Reeves v. Callaway*, 2013 WL 6085340 (4th Cir. 2013): Chapter 7 Debtors' primary residence was encumbered by a first mortgage and tax lien. The Debtors had no equity in the home. The Debtors argued that because they had no actual interest in their residence and the bankruptcy court granted their motion to reserve a \$60,000 exemption, the home was "removed" from the bankruptcy estate and the court did not have jurisdiction to authorize the Trustee to sell it. The Fourth Circuit, relying on *Schwab v. Reilly*, found that because the residence was not subject to an unlimited or in-kind exemption, the title to the Debtors' residence was held by the bankruptcy estate pursuant to § 541.

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- *In re Garcia*, 709 F.3d 861 (9th Cir. 2013): Prior to filing Chapter 7 bankruptcy, Debtor borrowed \$22,160 from creditor and used her Mercedes vehicle as collateral. The creditor perfected its nonpossessory, nonpurchase-money lien on the vehicle. After filing, Debtor claimed her vehicle as exempt under California's wildcard exemption and moved to avoid the lien as a tool of her trade. The bankruptcy court ruled that the vehicle could not be exempt under the wildcard exemption since vehicles are expressly dealt with in other provisions, and that the Debtor could not avoid a lien under § 522(f)(1)(B) as a tool of the Debtor's trade on a luxury item. The district court reversed, and the Ninth Circuit affirmed. The Ninth Circuit held that the Debtor could exempt her vehicle under the wildcard exemption and a lien on a luxury item could be avoided as a tool of the debtor's trade under § 522(f)(1)(B).