

# Consumer All Stars: Hot Topics and Hotter Opinions

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**Consumer Update:  
Hot Topics and Hotter Opinions**

- 1. Money Judgments in Dischargeability Proceedings**
- 2. Some Questions After *Clark v. Rameker***
- 3. Willful and Malicious Injury Under § 523(a)(6)**
- 4. Applicability of 11 U.S.C. § 1325(b) to Plan Modification under 11 U.S.C. § 1329**
- 5. Charitable Contributions**
- 6. Questioning *Brunner's* Validity**
- 7. Separate classification and other means of dealing with student loan debts**
- 8. § 1306 and Inheritances Received More than 180 Days after Filing**
- 9. Standing to Pursue Stay Relief under 11 U.S.C. § 362(d)(2)**
- 10. Automatic Stay Issues**

## Money Judgments in Dischargeability Proceedings

### Introduction

1. **Requests for money judgment** – a creditor seeking determination of the dischargeability of a debt will often also request that the bankruptcy court enter a money judgment against the debtor, obviating the need to obtain a judgment from a state court in a subsequent proceeding.
2. **The issue**
  - After *Stern v. Marshall*, 133 S. Ct. 2594 (2011), does a bankruptcy court have the authority to enter money judgment on a nondischargeable debt?
  - Apart from the issue of constitutional authority, does a bankruptcy court even have jurisdiction to do so?

### Does a bankruptcy court have the authority to enter money judgment after *Stern*?

1. *Stern v. Marshall* limits a bankruptcy court's authority to enter final judgment on state law claims that cannot be necessarily resolved by a ruling on the creditor's proof of claim. 133 S. Ct. 2594, 2611 (2011).
2. **Authority to enter money judgment** – several courts have held that, notwithstanding the *Stern* holding, a bankruptcy court has the authority to enter money judgment on a nondischargeable debt. *In re Dietz*, 469 B.R. 11, 22 (B.A.P. 2012); *In re Boricich*, 464 B.R. 335, 337 (Bankr. N.D. Ill. 2011); *contra In re Wood*, 503 B.R. 705, 709 (Bankr. W.D. Wisc. 2013).

### Does a bankruptcy court have jurisdiction to enter money judgment at all?

1. **Scope of bankruptcy jurisdiction**
  - **28 U.S.C. § 1334(b)** – the bankruptcy courts' jurisdiction is tied to the district courts' jurisdiction over all cases arising under title 11, or arising in or related to cases under title 11.
2. **The expansive approach to bankruptcy jurisdiction**
  - **Equity jurisdiction** – as courts of equity, bankruptcy courts have jurisdiction to decide all disputed matters and decree relief. *Matter of Hallahan*, 936 F.2d 1496, 1508 (7th Cir. 1991) (citing *Alexander v. Hillman*, 296 U.S. 222, 242 (1935)).
  - **Liquidation of debt and entry of judgment are essential elements of the dischargeability determination** – the amount of a nondischargeable debt and the extent of the debtor's liability for the debt cannot be severed from the determination of dischargeability. *In re Huang*, 509 B.R. 742 (Bankr. D. Mass. 2014); *In re Devitt*, 126 B.R. 212, 215 (Bankr. D. Md. 1991).
  - Every circuit court that has addressed the question has adopted the expansive approach:
    - *In re Morrison*, 555 F.3d 473, 478 (5th Cir. 2009)

- *In re McGavin*, 189 F.3d 1215, 1220 (10th Cir. 1999)
- *In re Kennedy*, 108 F.3d 1015, 1017-18 (9th Cir. 1997)
- *In re McLaren*, 3 F.3d 958, 966 (6th Cir. 1993)
- *Matter of Hallahan*, 936 F.2d at 1508

### 3. The narrow approach

- **No statutory basis for jurisdiction** – bankruptcy courts are courts of limited jurisdiction. Therefore, jurisdiction to enter money judgment must result from 28 U.S.C. § 1334(b). *In re Thrall*, 196 B.R. 959, 968 (Bankr. D. Colo. 1996) *cited with approval in In re Cambio*, 353 B.R. 30, 33 (B.A.P. 1st Cir. 2003)
  - **Entry of money judgment does not arise under title 11** because § 523 simply gives a bankruptcy court the power to determine the scope of a debtor’s discharge. Nothing in § 523 gives a bankruptcy court the power to enter judgment on a nondischargeable debt.
  - **Entry of money judgment is not arising in or related to a case under title 11** because a judgment against a post-discharge debtor will have no effect on distribution of the estate to creditors.
- Can bankruptcy courts exercise **supplemental jurisdiction** over a matter that is not within its “arising under” or “related to” jurisdiction?
  - Courts are split on the question of the bankruptcy courts’ supplemental jurisdiction. *Compare In re Lionel Corp.*, 29 F.3d 88, 92 (2d. Cir. 1994), and *In re Pegasus Gold Corp.*, 394 F.3d 1189, 1194-95 (9th Cir. 2005) (each upholding supplemental jurisdiction) *with In re Walker*, 51 F.3d 562, 572-73 (5th Cir. 1995), and *In re Vienneau*, 410 B.R. 329, 337 (Bankr. D. Mass 2009) (holding that bankruptcy courts do not have supplemental jurisdiction to enter money judgment on nondischargeable debt).
  - However, even assuming that a bankruptcy court could exercise supplemental jurisdiction, it may not be able to enter money judgment because final judgments are reserved for matters within its “arising under” jurisdiction. Any other result would lead to inconsistency with the statutory treatment of “related to” jurisdiction. *Townsquare Media, Inc. v. Brill*, 652 F.3d 767, 771-72 (7th Cir. 2011) (noting that supplemental jurisdiction should not give bankruptcy courts a broader grant of power than “related to” jurisdiction).

Some Questions After *Clark v. Rameker*

***Clark v. Rameker*, 134 S.Ct. 2242 (June 12, 2014)**

The Supreme Court held that an inherited IRA does not constitute a “retirement fund” within the meaning of 11 U.S.C. § 522(b)(3)(C). Since that Code section is identical to § 522(d)(12), inherited IRAs would not be exempt under the latter section either. Although the Court affirmed the Seventh Circuit’s decision, *In re Clark*, 714 F.3d 559 (2013), the unanimous opinion by Justice Sotomayor is broader than the Seventh Circuit’s. The Circuit Court had distinguished the IRA before it, one inherited from someone other than the debtor’s spouse, from spousal inheritance, leaving open the argument that an IRA inherited from a spouse would be exempt, but the Supreme Court held that an inherited IRA lacked the legal characteristics of funds set aside for retirement.

The Court recognized that if the heir is the original owner’s spouse, the heir may “roll over” the IRA into his or her own IRA, while an heir of someone other a spouse does not have the “roll over” option. Notwithstanding this distinction, the Court broadly concluded that an inherited IRA simply does not operate like an ordinary IRA, stating that the inquiry into exempt status is an objective one, not a case-by-case factual examination. Looking at three legal characteristics of an inherited IRA, the heir is not able to invest additional funds in the account; the heir is required to withdraw the funds or take minimum annual distributions, rather than hold the funds for retirement; and the heir may withdraw the funds without tax penalty, rather than wait until age 59 ½, as is the case with a regular IRA.

**Effect of *Clark* on state-law exemptions**

Since the *Clark* opinion construed the language of §§ 522(b)(3)(C) and (d)(12), one question is the effect it may have on debtors claiming under neither of those sections but instead using an applicable state-law exemption. Of course, some debtors may claim a portion of an inherited IRA under a wildcard exemption, but more particularly, most states have some form of exemption in retirement funds, but not all use the term as used in §§ 522(b)(3)(C) and (d)(12). Even if the state law uses the same term “retirement fund,” the Supreme Court was not considering the scope or use of state exemptions.

**Effect of Opt Out and § 522(b)(3)(C)**

If a debtor is governed by a state’s opt out, or if the debtor has a choice between state exemptions and § 522(d), § 522(b)(3)(C) in itself places no limit on that debtor’s use of state exemptions—the latter section appears to be an additional exemption available to such debtors. Note that § 522(b)(3)(A), which describes the opt out, provides such debtors with Federal exemptions other than those under § 522(d) and local or state exemptions, subject only to “subsections (o) and (p).” Section 522(b)(4), which describes the conditions of retirement funds only refers to “purposes of “§§ 522(b)(3)(C) and (d)(12), and not to state-law exemptions. It would theoretically be offensive to the concept of opt out for Congress to place restrictions on the terms of a particular state’s exemptions.

### State-law restrictions on exemptions of retirement funds

Merely as illustrations of the range of state-law provisions, some courts have, prior to *Clark*, interpreted applicable state exemptions concerning inherited IRAs. For example, in *In re Kirchen*, 344 B.R. 908 (Bankr. E.D. Wis. 2006), the Chapter 7 debtor had inherited an IRA from his mother. The applicable Wisconsin exemption was for “assets held or amounts payable under any retirement, pension, disability, death benefit, stock bonus, profit sharing plan, annuity, individual retirement account, individual retirement annuity, Keogh, 401-K or similar plan or contract *providing benefits by reason of age, illness, disability, death or length of service.*” Wis. Stat. § 815.18(3)(j). Other conditions were that the plan or contract complied with provisions of the Internal Revenue Code. The court denied the exemption, finding that the inherited IRA’s character had changed and that as to the debtor, payments were not related to age or retirement status.

Some states provide 100% exemption, without mentioning the effect of inheritance. For example, Alabama Code § 19-3B-508 broadly exempts: “Any benefits provided under a plan which includes a trust that constitutes a “qualified trust” may not be assigned or alienated, voluntarily or involuntarily, and shall be exempt from the operation of any bankruptcy or insolvency laws under 11 U.S.C. § 522(b), as from time to time amended. This subsection may not be waived by a participant or beneficiary of any qualified plan.” The statute goes on to define “qualified trust” as including an individual retirement plan as defined by the Internal Revenue Code.

The Florida legislature amended its 100% exemption in qualified retirement plans, as defined by the Internal Revenue Code, to clarify that inheritance did not disturb the exemption. Fla. Stat. Ann. § 222.21(c) provides: “Any money or other assets or any interest in any fund or account that is exempt from claims of creditors of the owner, beneficiary, or participant under paragraph (a) does not cease to be exempt after the owner's death by reason of a direct transfer or eligible rollover that is excluded from gross income under the Internal Revenue Code of 1986, including, but not limited to, a direct transfer or eligible rollover to an inherited individual retirement account as defined in § 408(d)(3) of the Internal Revenue Code of 1986, as amended. *This paragraph is intended to clarify existing law, is remedial in nature, and shall have retroactive application to all inherited individual retirement accounts without regard to the date an account was created.*”

Typically, state-law exemptions in IRAs and retirement accounts refer to the Internal Revenue Code for qualifications, but some states limit the amount to the extent necessary for the support of the debtor when the debtor retires and for the support of the debtor’s spouse and dependents. *See* Cal. Code Civ. Proc. § 704.115(a)(3), (b), (e). Some case law related to the California exemption has interpreted that an IRA must be used principally for retirement purposes. *See, e.g., In re Dudley*, 249 F.3d 1170 (9th Cir. 2001).

Colorado’s exemption refers to the Internal Revenue Code, placing no limit on amount, but the statute’s term “retirement plan,” as used in the statute permitting debtors to exempt their interests in such retirement plans and in certain specifically identified ERISA-qualified or tax-qualified retirement accounts, had to be interpreted in accordance with other terms surrounding it.

The term was not a broad exemption for any and all retirement plans. *In re Ludwig*, 345 B.R. 310 (Bankr. D. Colo. 2006).

Other states limit the exemption in an IRA, as defined in 26 U.S.C. § 408(a) or 408A, to those contributions made within a specific time. For example, Montana Code Ann. § 25-13-608(1)(e) restricts the exemption to the extent qualified contributions were made before a creditor's suit was filed.

Arizona's Rev. Stat. Ann. § 33-1126(B) permits 100% exemption in qualified retirement plan, as defined by the Internal Revenue Code, but the exemption does not apply to any amounts contributed within 120 days of filing bankruptcy.

### **Encouragement of exemption planning**

The point of these illustrative references to state laws is that *Clark v. Rameker* will not end the bankruptcy courts' inquiry into exemption of inherited IRAs or other retirement funds. Since many debtors are utilizing state exemptions under laws other than the state in which they filed bankruptcy, because of § 522(b)(3)(A)'s look-back period, examination of the applicable state law exemption will be required, and one effect of *Clark* will be to force debtors to consider using state exemptions rather than § 522(b)(3)(C).

Also, debtors may be encouraged by *Clark* to consider pre-bankruptcy conversion of an inherited IRA into another exempt asset, requiring the bankruptcy court to examine whether that conversion crossed the line from permissible to fraudulent.

Those persons holding IRAs, who intend to pass those on to children or others at death, may be encouraged by *Clark* to use other methods, such as spendthrift trusts or other asset protection devices that may be excluded from the debtor's bankruptcy estate or may otherwise be exempt, again requiring the bankruptcy court to examine the validity of such devices.

### **Transfers to spouses under divorce decree or QDRO**

Arizona's Rev. Stat. Ann. § 33-1126(B)(1) states that its unlimited exemption does not impair the rights of an alternative payee under a qualified domestic relations order, as defined in the Internal Revenue Code, but the effect of *Clark* on exemption of IRAs that are passed from one spouse to another presents questions. Does *Clark*'s reasoning reach to such transfers? Does it depend on whether the recipient spouse is claiming exemption under §§ 522(b)(3)(C) or (d)(12), or under an applicable state exemption, such as Arizona's?

A few courts have looked at the issue of such exemptions. For example, *In re Farmer*, 295 B.R. 322 (Bankr. W.D. Wis. 2003), overruled the Chapter 7 trustee's objection to the debtor's exemption of retirement funds received from the former husband under a QDRO. The husband had established the ERISA-qualified plan, and under *In re Nelson*, 322 F.3d 541 (8th Cir. 2003), the beneficiary of the QDRO had the same protections ERISA afforded to the spouse, including the plan's anti-alienation provisions. The retirement account was excluded from the estate; moreover, the court held that the proceeds would be exempt under Wisconsin Stat. § 815.13(3)(j),

concluding that the statute placed no restrictions on the source of the funds or the transfer to the debtor from her spouse.

In *In re West*, 507 B.R. 252 (Bankr. N.D. Ill. 2014), the Chapter 7 debtor received \$80,000 interest in former husband's tax-qualified employee retirement plan in a marital dissolution decree, and the funds were found to be entitled to exemption under the Illinois statute, despite fact that the transfer meant that proceeds were no longer in hands of employee who had funded the plan. Under Illinois law, the retirement plan was marital property before the entry of marital dissolution, and the debtor's interest became quantified as her separate property on entry of the decree. Although that interest became property of the Chapter 7 estate, it was exempt, distinguishing *In re Clark*, 714 F.3d 559 (7th Cir. 2013). "The critical factor in *Clark* was that the IRA's retirement attributes had been lost upon inheritance by a non-spouse. In contrast, a retirement plan transferred pursuant to a QDRO is done expressly for the purpose of preserving the retirement nature of the plan." The trustee's objection to exemption was overruled.

In contrast, construing Minnesota's exemption statute, the Bankruptcy Appellate Panel in *Anderson v. Seaver (In re Anderson)*, 269 B.R. 27 (BAP 8th Cir. 2001), held that the Chapter 7 debtor's interest in an IRA transferred by the former spouse pursuant to a divorce decree was not exempt. Minn. Stat. § 550.37, subd. 24(a), placed a monetary limit (then \$54,000), and the debtor's interest was not obtained from his own employment. The statute had been interpreted by *Deretich v. City of St. Francis*, 128 F.3d 1209 (8th Cir. 1997), to allow exemption only for assets derived directly from the debtor's employment.

**Willful and Malicious Injury Under § 523(a)(6)**

Issue: Whether courts are basing determinations of nondischargeability under § 523(a)(6) on facts beyond its foundation in tort law, without giving any consideration to the significance of such an extension.

Several recent cases have applied § 523(a)(6) without giving any attention to this issue:

*Shankle v. Shankle (In re Shankle)*, 554 Fed.Appx. 264, 2014 U.S. App. LEXIS 2356, 2014 WL 486208 (5th Cir. Feb. 7, 2014).

Facts: In a 1999 divorce, the ex-husband was ordered to pay half of the amounts in three accounts (totaling approximately \$92,000), held in his separate name, to his ex-wife. He did not do so, despite repeatedly being held in contempt by the state court, and filed a Chapter 7 petition in 2005.

Procedure: The ex-wife objected to discharge of the marital obligation, and the bankruptcy court held that Debtor's conduct constituted willful and malicious injury under § 523(a)(6). The district court affirmed and Debtor appealed to the Fifth Circuit.

Holding: A debtor's repeated refusal to transfer marital assets, despite multiple contempt orders, constitutes an objective substantial certainty of harm to the former spouse and, accordingly, constitutes a willful and malicious injury nondischargeable under § 523(a)(6)

An injury is willful and malicious, and thus nondischargeable under § 523(a)(6), "when there is either a subjective motive to cause harm or an objective substantial certainty of harm." *Miller v. J.D. Abrams Inc. (In re Miller)*, 156 F.3d 598, 606 (5th Cir. 1998).

Several bankruptcy courts have so held, when a debtor has failed to tender marital assets in contravention of a divorce decree. [Cases the court cited, however, included one in which the debtor had conveyed assets *before* a court order could be entered.]

Debtor's repeated refusal to comply with the divorce decree's requirement that he transfer marital assets to his ex-wife was a willful and malicious injury for purposes of § 523(a)(6). There was an objective substantial certainty of harm to the former spouse by the debtor's failures.

*Goaz v. Rolex Watch U.S.A., Inc. (In re Goaz)*, 2014 U.S. App. LEXIS 5186, 2014 WL 1047020 (5th Cir. March 19, 2014):

Facts: Rolex brought suit against Debtor in federal court, alleging that he had engaged in counterfeiting, trademark infringement, and false designation of

origin. Debtor filed bankruptcy before the court could rule on Rolex's motion for summary judgment, and he listed Rolex as an unsecured creditor. Rolex sought to except its obligation from discharge under § 523(a)(6).

Procedure: The bankruptcy court concluded that, because Debtor intentionally sold and offered for sale watches, with full knowledge they bore counterfeit **Rolex** trademarks, there was an objective certainty that these activities would harm **Rolex** and its registered marks; thus, the debt was nondischargeable under § 523(a)(6). The district court affirmed and Debtor appealed to the Fifth Circuit.

Holding: A debtor's knowledge that he is selling more than 100 counterfeit watches constitutes an objective substantial certainty of harm, sufficient to bar discharge under § 523(a)(6).

Reasoning:

Debtor's arguments concerning the need for local counsel and sufficiency of the evidence were unavailing.

Similarly, Debtor's argument that the district court erred by applying the "condensed approach" to § 523(a)(6), failing to analyze "willful" and "malicious" as separate requirements, is foreclosed by governing precedent. Under *Williams v. International Brotherhood of Electrical Workers Local 520 (In re Williams)*, 337 F.3d 504 (5th Cir. 2003), the test "is condensed into a single inquiry of whether there exists either an objective substantial certainty of harm or a subjective motive to cause harm on the part of the debtor." *Id.* at 509.

*Brown v. Ausley (In re Ausley)*, 507 B.R. 234 (Bankr. W.D. Tenn. March 18, 2014):

Facts: Brown, Debtors' tenant, prevailed in a state court proceeding for forcible entry and detainer, brought by Debtors. The result was erroneously entered in the court's computers, however, as a judgment for Debtors. On the basis of that erroneous entry, Debtors obtained a writ of possession and, in Brown's absence, evicted her from the premises. She promptly went to the court clerk's office and the error was discovered. With the assistance of court officials, Brown was able to reacquire possession. Ten days later, Debtors again sued for forcible entry and detainer, and also sought \$2,200 in damages. They obtained judgment and Brown appealed; she also counter-sued for unlawful ouster in violation of state statutes. After Debtors failed to appear four times, the court awarded Brown a judgment for \$104,000: \$26,350 in damages for loss of her personal property; \$51,300 in punitive damages for Debtors' willful and malicious actions; and \$26,350 in attorney's fees. The court also dismissed Debtors' detainer action, with prejudice, for failure to prosecute. Debtors filed bankruptcy two years later and Brown sought to bar discharge under § 523(a)(6).

Holding: Debtor-landlords commit a willful and malicious injury to their tenant, nondischargeable under § 523(a)(6), by proceeding with an eviction they know to be contrary to the ruling of a state court.

Reasoning:

Collateral estopped does not apply, because the issues before the state court and the bankruptcy court are not identical.

The test for willful and malicious injury, in the Sixth Circuit, is subjective: “[U]nless ‘the actor desires to cause consequences of his act, or believes that the consequences are substantially certain to result from it,’ he has not committed a ‘willful and malicious injury’ as defined under § 523(a)(6).” *Markowitz v. Campbell (In re Markowitz)*, 190 F.3d 455, 463 (6th Cir. 1999) (quoting Restatement (Second) of Torts § 8A, at 15 (1964)).

Injury is willful when the debtor wants to cause the consequences of his or her act, and acts with actual intent to cause injury. *Cash Am. Fin. Servs., Inc. v. Fox (In re Fox)*, 370 B.R. 104, 119 (BAP 6th Cir. 2007). Injury is malicious if caused in conscious disregard of one’s duties or without just cause or excuse. *Vulcan Coals, Inc. v. Howard*, 946 F. 2d 1226, 1228 (6th Cir. 1991).

Malicious injury is established “when a creditor shows that a debtor acted in conscious disregard of the rights of others, without just cause or excuse.” *River View Land Co., Inc. v. Bucak (In re Bucak)*, 278 B.R. 488, 493 (Bankr. W.D. Tenn. 2002).

Debtors deliberately caused harm, and acted maliciously, by seeking an order of possession on the basis of a computer entry they knew to be in error.

This court is precluded from relitigating the damages issue, so the entire amount of Brown’s judgment—\$104,000—is nondischargeable.

In *Kawaauhau v. Geiger*, 523 U.S. 57 (1998), the Supreme Court made clear that § 523(a)(6) is rooted in tort law:

The Court stated that the statute’s “formulation triggers in the lawyer’s mind the category ‘intentional torts,’ as distinguished from negligent or reckless torts.” *Id.* at 61. The Court looked to the definition of intentional torts in § 8A of the *Restatement (Second) of Torts*, which generally requires “that the actor intend ‘the consequences of an act,’ not simply ‘the act itself.’ ” *Id.* at 61-62 (quoting *Restatement (Second) of Torts* § 8A, cmt. a, p. 15 (1964) (emphasis added by the Court)).

To hold otherwise, according to the Court, would open subsection (a)(6) to every traffic accident and “knowing” breach of contract, creating an exception so broad that it would violate the well-known maxim that discharge exceptions should be narrowly construed. *Id.* at 62.

A few courts have articulated tests that may very well reach conduct representing little more than mere contractual breach.

*Petralia v. Jercich (In re Jercich)*, 238 F.3d 1202 (9th Cir.), *cert. denied*, 533 U.S. 930 (2001):

Facts: Rather than paying commissions earned by a former employee, Debtor-employer used the money for his own personal investments, including a horse ranch. The employee sued in state court and obtained a judgment that included \$20,000 for punitive damages. The state court found that the employer’s conduct constituted “oppression” under a state statute defining the term as “despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person’s rights.” The employee-creditor then sought to except the debt from discharge in Debtor-employer’s ensuing bankruptcy proceeding.

Holding: Because state tort law permits recovery for bad faith breach of a contract when the defendant’s actions violate fundamental public policy, and there is a state public policy favoring the full and prompt payment of wages, a debtor’s failure to pay wages earned by an employee may be nondischargeable under § 523(a)(6).

Reasoning:

The court noted that, in an appropriate case, conduct constituting breach of contract might also fall within subsection (a)(6): “[A]lthough § 523(a)(6) *generally* applies to torts rather than to contracts and an intentional breach of contract *generally* will not give rise to a nondischargeable debt, where an intentional breach of contract is accompanied by tortious conduct which results in willful and malicious injury, the resulting debt is excepted from discharge under § 523(a)(6).” *Id.* at 1205 (footnotes omitted).

The willfulness prong of § 523(a)(6), requiring a subjective desire to harm the creditor or a belief by the debtor that injury is substantially certain to occur as a result of his or her actions, was satisfied by the state court’s findings that Debtor knew he owed the wages, had the ability to pay them, and knew that injury to the employee was substantially certain to occur if the wages were not paid.

The maliciousness prong was satisfied because Debtor had no just cause or excuse for failure to pay the employee and because the state court had found “oppression.”

The Ninth Circuit came very close to finding a mere breach of contract sufficient to trigger nondischargeability under § 523(a)(6), saved only by the fact that the debtor’s conduct was tortious under state law.

*Texas ex rel. Board of Regents of University of Texas System v. Walker*, 142 F.3d 813 (5th Cir. 1998):

Facts: The University filed suit against a professor who had retained professional fees, earned while a faculty member, in violation of his contract requiring that all such fees be remitted. When the professor filed bankruptcy, the University sought to prevent discharge of the obligation under § 523(a)(6).

Procedure: The district court found that Debtor’s retention of fees was “innocent and technical” and thus not within subsection (a)(6); it granted Debtor judgment as a matter of law. The University appealed to the Fifth Circuit.

Holding: If a debtor knowingly retains professional fees in violation of his or her contract with a university employer, nondischargeability under § 523(a)(6) “could result.”

Reasoning:

Claims for neither breach of contract nor the tort of conversion necessarily involve a willful and malicious injury. The determinative facts are whether Debtor knowingly retained his professional fees in violation of the contract—that is, “whether [Debtor] was aware of his obligations to the University under the [contract] and nonetheless knowingly kept his professional fees with the intent of depriving the University of money owed to it.” *Id.* at 824.

“Knowing” retention of the fees would constitute “an act which he knew would necessarily cause the University’s injury.” *Id.* Such a factual finding “could result” in the application of § 523(a)(6).

The court reversed and remanded for determination of the question.

Clearly, under the Fifth Circuit’s reasoning, nothing more is required than Debtor’s awareness that the contract required him to remit his fees. If he understood the contract’s terms, then by failing to remit the fees, he intended to deprive the creditor of its money and he knew that his conduct would cause injury.

## WINTER LEADERSHIP CONFERENCE 2014

Does that not always follow whenever a debtor fails to pay an obligation that is due and owing? See *Williams v. International Brotherhood of Electrical Workers Local 520 (In re Williams)*, 337 F.3d 504, 510 (5th Cir. 2003) (“Walker suggests that a knowing breach of a clear contractual obligation that is certain to cause injury may prevent discharge under § 523(a)(6), regardless of the existence of separate tortious conduct.”).

## Applicability of 11 U.S.C. § 1325(b) to Plan Modification under 11 U.S.C. § 1329

### Introduction

#### 1. Typical modification scenario

- The debtor proposes a plan for confirmation.
- The debtor moves to modify the plan, seeking to shorten the payment period to less than the applicable commitment period without making full payment of all allowed unsecured claims.

#### 2. The issue

- If a debtor's proposed modifications to the plan meet the requirements of 11 U.S.C. § 1329, then the court will confirm the plan.
- However, in situations where a debtor moves to shorten the length of the plan, courts disagree on whether the "applicable commitment period" requirements of 11 U.S.C. § 1325(b) apply at the modification stage.
  - *Compare e.g., In re Davis*, 439 B.R. 863 (Bankr. N.D. Ill. 2010)(permitting modification of the debtor's plan to shorter than the applicable commitment period absent full payment of all allowed unsecured claims), with *In re Heideker*, 455 B.R. 263 (Bankr. M.D. Fla. 2011)(requiring full payment of all allowed unsecured claims to modify the plan's length to shorter than the applicable commitment period).

#### 3. What are the provisions of 11 U.S.C. § 1325(b)?

- **Generally** – A trustee or holder of an allowed, unsecured claim that will not receive full payment under the plan may object to confirmation of the plan on the grounds that the debtor failed to commit the entirety of his or her projected disposable income for the applicable commitment period. 11 U.S.C. § 1325(b).
- **Disposable Income** –
  - **Definition** – "current monthly income . . . less amounts reasonably necessary to be expended—for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the petition is filed; and for charitable contributions . . . to a qualified religious or charitable organization in an amount not to exceed 15 percent of gross income of the debtor for the year in which contributions are made." 11 U.S.C. §1325(b)(2)
    - **Current Monthly Income** – the average monthly income from all sources for the six months prior to the commencement of the case or the date of determination. 11 U.S.C. § 101(10A).
      - Current monthly income does not include benefits received under the Social Security Act, payments to victim of war crimes or crimes against humanity, or payments to victims of international terrorism. 11 U.S.C. § 101(10A)(B).
- **Applicable Commitment Period** –
  - **Below-median income debtor** – 3 years. 11 U.S.C. § 1325(b)(4)(A)(i).

- **Above-median income debtor** – not less than 5 years. 11 U.S.C. § 1325(b)(4)(A)(ii)
- **Exception** – the payment period may be shorter than the required 3 or 5 years if the plan provides for full payment of all allowed unsecured claims over a shorter period. 11 U.S.C. § 1325(b)(4)(B).

**How have courts approached the application of 11 U.S.C. § 1325(b) to post-confirmation modification?**

**1. The requirements of 11 U.S.C. § 1325(b) do not apply to plan modification**

- Courts ruling that the requirements of 11 U.S.C. § 1325(b) do not apply during post-confirmation modification cite three primary lines of reasoning:
  - **Language of 11 U.S.C. § 1325(b)** – “If the trustee or holder of an allowed unsecured claim objects to the confirmation of the plan . . .”
    - The statutory language itself dictates that the provision only comes into effect when a party with standing raises an objection to the *confirmation* of a plan. *See In re Davis*, 439 B.R. 863, 866 (Bankr. N.D. Ill. 2010).
    - Confirmation and modification remain two separate processes, modification only becoming possible after an initial confirmation. *In re Lorenzo*, 2013 Bankr. LEXIS 1944 (Bankr. S.D. Fla. 2013).
  - **Language of 11 U.S.C. § 1329** – the provision outlining the requirement for modification explicitly makes applicable the requirements of numerous other subsections of the Bankruptcy Code. The maxim *expressio unius est exclusio alterius* points to an implicit exclusion of all other provisions, including § 1325(b). *See, e.g., In re Davis*, 439 B.R. 863, 867 (Bankr. N.D. Ill. 2010).
  - **Inapplicability of 11 U.S.C. § 1325(b) does not create absurd results** – the incorporation of § 1325(a)(3)’s “good faith” standard into the modification requirements prevents the creation of absurd results when not applying § 1325(b) at modification. *See, e.g., In re Davis*, 439 B.R. 863, 868 (Bankr. N.D. Ill. 2010).
- Therefore, some courts allow debtors to shorten their plans to less than the “applicable commitment period” required for confirmation.
  - *In re Tibbs*, 478 B.R. 458 (Bankr. S.D. Fla. 2012) (holding that the debtors could modify their confirmed plan to allow for payment of the remaining amount owed under the plan before the termination of the applicable commitment period without paying all allowed unsecured claims in full).
  - *In re Barnes*, 506 B.R. 777 (Bankr. E.D. Wis. 2014) (holding that the debtor need not comply with the “projected disposable income” requirement of § 1325(b) at modification, but the debtor must show why he cannot make the reduced payments through the original plan length as part of a showing of “good faith” under § 1325(a)(3)).

**2. The requirements of 11 U.S.C. § 1325(b) apply to plan modification**

- Courts ruling that the requirements of 11 U.S.C. § 1325(b) apply at modification rely primarily on the following lines of reasoning:
  - **Language of 11 U.S.C. § 1325(a)** – § 1325(b) is incorporated into § 1329 by way of § 1325(a), which states that a bankruptcy court shall confirm a plan that

complies with the requirements of § 1325(a) “except as provided in [§ 1325](b).”  
*See, e.g., In re Heideker*, 455 B.R. 263, 269 (Bankr. M.D. Fla. 2011).

- **Giving meaning to the whole statute** – reading § 1325(a) to incorporate § 1325(b) at the modification stage gives meaning to every word of the statute. *See, e.g., In re Williams*, 2014 Bankr. Lexis 330 (Bankr. D.N.J. 2014).
- **Number of requirements** – to pose fewer requirements for confirmation at the modification stage than at the initial confirmation indicates that the exclusion of § 1325(b) at the modification stage comes only from a strained reading of the statute. *See In re Keller*, 329 B.R. 697, 700 (Bankr. E.D. Cal. 2005).
- Therefore, courts following the reasoning above do not permit above-median income debtors to shorten the length of their plans below the applicable commitment period.
  - *In re Heideker*, 455 B.R. 263 (Bankr. M.D. Fla. 2011) (holding that debtors cannot amend their plans to be shorter than the applicable commitment period unless all allowed unsecured claims get paid in full).
  - *In re King*, 439 B.R. 129 (Bankr. S.D. Ill. 2010) (holding the requirements of the applicable commitment period do not vanish at modification and a plan can only be shortened if all unsecured claims receive full payment).
  - *In re Williams*, 2014 Bankr. Lexis 330 (Bankr. D.N.J. 2014) (denying debtors’ motion to modify their confirmed Chapter 13 plan to shorter than the applicable commitment period without paying all unsecured claims in full).

Charitable Contributions

Issue: When a debtor makes charitable contributions in an amount in excess of 15% of his or her gross annual income, can the trustee avoid the entire transfer under § 548(a)(1)(B), or does § 548(a)(2) protect the portion below 15%, leaving only the portion above 15% avoidable?

*Wadsworth v. Word of Life Christian Center (In re McGough)*, 737 F.3d 1268 (10th Cir. 2013):

Facts: In the two years preceding their bankruptcy filing, Debtors made over two dozen contributions to the Word of Life Christian Center. No individual contribution exceeded 15% of their annual gross income, but the aggregate did. The trustee sought to avoid the contributions in their entirety.

Procedure: The bankruptcy court agreed with the trustee that the contributions were to be aggregated, but permitted avoidance only of the amount in excess of 15%. The transferee did not appeal the issue of aggregation. The BAP affirmed as to the portion avoidable and the transferee appealed to the Tenth Circuit.

Holding: When a debtor’s charitable contributions exceed 15% of his or her gross annual income, the plain language of the statute permits avoidance of the entire transfer, not merely the portion in excess of 15%.

Reasoning:

Section 548(a)(2) was added to the Code in 1998 by the Religious Liberty and Charitable Donation Protection Act. It provides a “safe harbor,” protecting charitable contributions to qualified religious or charitable organizations from avoidance under § 548(a)(1)(B) as long as “the amount of that contribution does not exceed 15 percent of the gross annual income of the debtor for the year in which the transfer of the contribution is made” or, if in excess of 15%, the transfer was consistent with the debtor’s past practices.

Parties’ arguments:

The trustee argued that § 548(a)(2) unambiguously provides a safe harbor only if the “transfer” does not exceed 15%; thus, the converse must be true—when the “transfer” does exceed 15%, the “transfer” is avoidable in its entirety.

The transferee’s argument—characterized by the court as “conveniently confusing”—was, first, that the statute does not explicitly state that the entire transfer is avoidable under these facts, and, second, that the 15% limit does not merely act as an “avoidable” threshold but also establishes the amount of the

transfer protected from avoidance if that threshold is exceeded, because the phrase “in any case which” has a meaning similar to the phrase “to the extent.” Finally, the transferee argued that the statute is ambiguous because susceptible to both interpretations, thereby permitting the use of legislative history. Because House Report No. 105–556 states that § 548(a)(2) protects transfers “up to” 15% of the debtors gross annual income, it reflects congressional intent to protect the amount of the contribution below 15%, even when the total contribution exceeds that threshold.

The statute plainly permits avoidance of the entire transfer under these facts.

The phrase “in any case which” is a legalism widely understood to mean “if” or “when.” Thus, the transferee’s argument that it indicates “not only ‘if’ or ‘when’ the exception applies, but also the amount protected from avoidance, is vanishingly improbable.”

“Substituting ‘if’ for the phrase ‘in any case in which’ resolves any claimed ambiguity. Under § 548(a)(2), a transfer is not avoidable if its amount does not exceed 15% of GAI. Thus, the contrapositive must also be true—if the amount of a transfer exceeds 15% of GAI, the transfer is avoidable. Because there is no language limiting the amount of the transfer to be avoided, the only reasonable reading of the statute is that the amount of the transfer to be avoided is the entire amount.”

This interpretation is consistent with the only other decision interpreting this provision, *Murray v. Louisiana State University Foundation (In re Zohdi)*, 234 B.R. 371 (Bankr. M.D. La. 1999). *Zohdi* is not appropriately distinguishable on the grounds that it involved a single donation and that it interpreted § 548 (a)(2) as not requiring aggregation. That court’s analysis did not turn on the number of contributions involved, and the latter was dicta.

The transferee’s attempted reliance on *Universal Church v. Geltzer*, 463 F.3d 218 (2d Cir. 2006), *cert. denied*, 549 U.S. 1113 (2007), to establish ambiguity is misplaced because that case dealt with a different issue. *Geltzer* held that a debtor’s annual contributions must be aggregated and that § 548(a)(2) does not prevent avoidance of transfers in excess of 15%. The court found that the transferee had waived its claim that the portion below 15% could not be avoided. The court also found the statute ambiguous and thus turned to legislative history, which it found to indicate Congress’s intent that contributions be considered in the aggregate. The court, however, vacated the lower court’s finding that the debtor was

insolvent during the relevant period, and remanded to permit consideration of the debtor's pattern of giving.

The transferee's reading would ignore the first "of" in the phrase "the amount of that contribution does not exceed 15 percent," but statutory interpretation requires giving effect to each word.

This reading does not give rise to absurdity. Although it would allow avoidance of a transfer even 1¢ over the limit, thus burdening donees, it would be more burdensome if donees had to calculate the portion over 15%. The absurdity argument also overlooks the protection given to donations consistent with a prior pattern. There is nothing absurd about a decision to treat donations over 15%, if inconsistent with prior donations, as fraudulent.

Issues not decided by *McGough*:

Whether Social Security benefits received by a debtor during the relevant two-year period should be included in gross annual income for purposes of §§ 548(a)(1)(B) and (a)(2).

Whether a debtor's contributions should be aggregated for purposes of applying § 548(a)(2).

Other Code sections dealing with charitable contributions:

§ 544(b)(2): "Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3)) that is not covered under section 548(a)(1)(B), by reason of section 548(a)(2). Any claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case."

§ 707(b)(1): "In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4))."

§ 1325(b)(2)(A): excludes from the definition of disposable income "charitable contributions . . . in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made."

Questioning *Brunner's* Validity

**The *Brunner* test of undue hardship**

Under *Brunner v. N.Y. State Higher Educ. Services Corp. (In re Brunner)*, 831 F.2d 395 (2d Cir. 1987), to prove undue hardship for purposes of discharge under § 523(a)(8), the debtor must carry the burden of proof that (1) the debtor cannot maintain a minimal standard of living for himself or herself and dependents, based on current income and expenses, if required to continue repayment of the student loan; (2) circumstances indicate that this condition is likely to persist for a significant portion of the repayment period; and (3) the debtor has made good faith efforts to repay the loan.

This test continues to be expressed as the majority rule, adopted by the Third, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth and Eleventh Circuits. The First Circuit has declined to adopt it, and the Eighth Circuit uses a totality of circumstances test, in *Long v. Educational Credit Management Corp. (In re Long)*, 322 F.3d 549 (8th Cir. 2003). Some courts in the First Circuit have adopted the totality of circumstances test. See *Bronsdon v. Educational Credit Management Corp. (In re Bronsdon)*, 435 B.R. 791 (BAP 1st Cir. 2010), *Murphy v. Educational Credit Management Corp.*, \_\_\_ B.R. \_\_\_, 2014 WL 2126083 (D. Mass. May 21, 2014) (noting that differences in two tests were “modest”).

**Partial discharge**

Some courts have softened the effect of the *Brunner* test by various means, including use of partial discharge. See, e.g., *Educational Credit Management Corp. v. Jorgensen (In re Jorgensen)*, 479 B.R. 79 (BAP 9th Cir. 2012) (The bankruptcy court did not err in partially discharging student loans, properly applying the *Brunner* test to that portion that was discharged. The first prong of *Brunner* “allows the bankruptcy court to determine the amount of student loan debt that prevents the debtor from maintaining a minimum standard of living and discharge only that amount.”).

Under the totality-of-circumstances test adopted by the Eighth Circuit, although partial discharge was not available remedy, the bankruptcy court must determine undue hardship on a loan-by-loan basis. *Conway v. Nat’l Collegiate Trust (In re Conway)*, 495 B.R. 416 (BAP 8th Cir. 2013), *aff’d* 2014 WL 2565825 (8th Cir. June 9, 2014).

**Section 523(a)(8)’s changes subsequent to *Brunner***

In 1987, the statute included a 5-year period of nondischargeability from the date the loan first became due, a completely different environment from today’s statute. That period was expanded to 7 years in 1990, and the time restriction was eliminated in 1998, leaving undue hardship as the only means for discharge. The statute was amended in 2005 to include three categories of nondischargeable debts. See *Institute of Imaginal Studies v. Christoff (In re Christoff)*, \_\_\_ B.R. \_\_\_, 2014 WL 2695533 (Bankr. N.D. Cal. June 13, 2014); *Brown v. Rust*, \_\_\_ B.R. \_\_\_, 2014 WL 1796154 (Bankr. E.D. Ky. May 6, 2014). See also *Roth v. Educational Credit Management Corp.*, 490 B.R. 908, 921-23 (BAP 9th Cir. 2013), concurring opinion, describing statutory and other changes subsequent to *Brunner*.

### Applying *Brunner* in present-day context, including repayment alternatives

In *Bene v. Educational Credit Management Corp. (In re Bene)*, 474 B.R. 56 (Bankr. W.D. N.Y. 2012), the court considered the *Brunner* test in the context of whether the debtor was required to participate in the William D. Ford program for student loan repayment. The court observed that the concepts of “poverty” and “repayment period” had changed substantially since *Brunner*, and the test did not require that the 64-year old debtor indenture herself to another 25 years of debt repayment, under the Ford Program’s adjusted payments.

See also *Roth v. Educational Credit Management Corp.*, 490 B.R. 908 (BAP 9th Cir. 2013). Although debtor did not make any voluntary payment on student loans and did not enter into income contingent repayment plan (ICRP), sufficient good faith effort was found. In light of the debtor’s age, poor health and limited income prospect, her refusal to enter into ICRP was justified, when no payments would be required under that plan and the tax consequences of debt forgiveness were potentially disastrous. Requiring her to enter into ICRP was “futile.”

In *Roth*, concurring Judge Pappas stated that the *Brunner* test for undue hardship was “too narrow, no longer reflects reality, and should be revised by the Ninth Circuit when it has the opportunity to do so. Put simply, in this era, bankruptcy courts should be free to consider the totality of a debtor’s circumstances in deciding whether a discharge of student loan debt for undue hardship is warranted.”

### Clear error review

Applying a clear error standard to the bankruptcy court’s finding of good faith under the *Brunner* test, good faith was examined by a debtor’s efforts to obtain employment, maximize income and minimize expenses. Although some expenses were not reasonably necessary to maintain a minimal standard of living, the bankruptcy court did not err in finding good faith efforts. The district court applied *de novo* review, reversing and faulting the debtor for not fully maximizing income, minimizing expenses or exploring income contingency repayment options, but the circuit court reversed, restoring the bankruptcy court’s good faith finding and partial discharge. *Hedlund v. Educational Resources Institute, Inc.*, 718 F.3d 848 (9th Cir. 2013). See also *Krieger v. Educational Credit Management Corp.*, 713 F.3d 882 (7th Cir. 2013) (Bankruptcy judge’s finding of good faith effort was not clearly erroneous and “destitute” debtor’s discharge of student loan was restored, reversing district court’s decision that she could have “searched harder” for work and should have entered into 25-year repayment program.).

Compare *Roth v. Educational Credit Management Corp.*, 490 B.R. 908 (BAP 9th Cir. 2013), application of *de novo* standard to ultimate undue hardship determination, since it is mixed question of fact and law, with factual findings reviewed for clear error.

### Separate classification and other means of dealing with student loan debts

#### Objecting to claims

*Hahn v. Educational Credit Management Corp. (In re Hahn)*, 476 B.R. 344 (BAP 1st Cir. 2012), *aff’d* 711 F.3d 235 (1st Cir. 2013) (It was abuse of bankruptcy process for creditor to file proof of claim, ignore objection process and pursue collection without verifying that claim survived discharge.).

**Separate classification in Chapter 13—Interpretations of § 1322(b)(1)**

See *Carrion v. Rivera (In re Rivera)*, 490 B.R. 130 (BAP 1st Cir. 2013), citing *In re Renteria*, 470 B.R. 838 (BAP 9th Cir. 2012), for statutory construction of § 1322(b)(1). *Rivera* concluded that § 1322(b)(1) did not address allocation of projected disposable income.

**Relationship of §§ 1322(b)(1) and 1322(b)(5), and effect of § 1322(b)(10)**

In *In re Kubezko*, 2012 WL 2685115 (Bankr. D. Colo. July 6, 2012), slip copy, the below-median debtors’ plan proposed to separately classify student loan debt, treating it as long-term debt, to be paid with interest, resulting in that debt receiving 47% dividend, while other unsecured creditors would receive 1% distribution. Section 1322(b)(1) placed a fairness limitation on § 1322(b)(5)’s treatment of long-term unsecured debt, and the court found the plan to unfairly discriminate against other unsecured creditors. Also, § 1322(b)(10), added by BAPCPA, prevented payment of interest on unsecured nondischargeable debt, such as student loan, unless disposable income is sufficient to pay allowed claims in full. The court noted that this provision essentially mooted the fairness inquiry in this case. See also *Gorman v. Birts (In re Birts)*, 2012 WL 3150384 (E.D. Va. Aug. 1, 2012) (Plan paying student loan as long-term debt, with interest, unfairly discriminated against other unsecured creditors receiving 7% distribution.).

See *In re Edmonds*, 444 B.R. 898 (Bankr. E.D. Wis. 2010), for discussion of split of judicial authority on treating student loan debt as long-term debt.

In *In re Stull*, 489 B.R. 217 (Bankr. D. Kan. 2013), although the above-median debtor could separately classify student loan debt and pay it more than other unsecured debt, when the nondischargeable obligation would be paid from income in excess of projected disposable income, § 1322(b)(10) prevented payment of interest on an unsecured nondischargeable debt unless other unsecured creditors were being paid 100%.

Discussing the split of authority, in *In re Brown*, 500 B.R. 255 (Bankr. S.D. Ga. 2013), the court concluded that solely because a student loan debt was nondischargeable did not make it a “special circumstance” for purposes of the means test deduction. Moreover, § 1322(b)(5)’s cure and maintain provision does not permit the debtor to pay a long-term student loan debt directly if it would unfairly discriminate against other unsecured creditors (again citing a split of authority but noting that practice in district had been to allow long-term student loan debt to be paid directly by debtors). However, applying the traditional factors of unfair discrimination, the court determined that §§ 1322(b)(1), (b)(5) and (b)(10) were not irreconcilable, concluding that § 1322(b)(5) “deals specifically with curing and maintaining long term debts. Section 1322(b)(5) was not amended or restricted in 2005 when Congress adopted § 1322(b)(10). While § 1322(b)(5) allows interest on secured and unsecured long debt, § 1322(b)(10) restricts interest payments on non-dischargeable unsecured debts that are not eligible for cure and maintenance under § 1322(b)(5), such as debts that are non-dischargeable due to a debtor’s fraud. . . . Arguably, . . . holding that § 1322(b)(10) prevents debtors from using (b)(5) to cure and maintain student loan payments effectively strikes out the language ‘unsecured claim. . . on which the last payment is due after the date on which the final payment under the plan is due’ from § 1322(b)(5).” The court

found that this debtor's plan that would pay postpetition interest on the student loan did not unfairly discriminate, even though other unsecured creditors would receive 1% compared to 16% if all unsecured creditors were treated without the separate classification.

In *In re Knowles*, 501 B.R. 409 (Bankr. D. Kan. 2013), the debtors had negative projected disposable income, proposing a plan to maintain monthly payments on student loan debt, outside the plan, and pay -0- dividend to other unsecured creditors, effectively a separate classification of the student loan debt. The court found the test for unfair discrimination in *In re Bentley*, 266 B.R. 229 (BAP 1st Cir. 2001), to more accurately reflect the statutory scheme than the more commonly cited test found in *In re Leser*, 939 F.3d 669 (8th Cir. 1991). The payment of the ongoing, contractual student loan monthly amount would be from discretionary income that debtors were not required by the Code to commit to their plan—the other unsecured creditors would be receiving no distribution anyway. Thus, student loan payments were not unfair discrimination. However, there was unfair discrimination in the plan's proposal to fully pay an unsecured claim of the state for overpayment of unemployment compensation.

**Good faith as § 1322(b)(1) factor.**

See *Carrion v. Rivera (In re Rivera)*, 490 B.R. 130 (BAP 1st Cir. 2013). Also, in *Copeland v. Fink (In re Copeland)*, 742 F.3d 811 (8th Cir. 2014), the plan treated non-priority, nondischargeable tax debt at 100%, with nothing to other unsecured creditors, and the proposal was not in good faith. “In short, they propose to ‘protect’ those creditors least in need of protection, at the expense of the most vulnerable.”

**§ 1306 and Inheritances Received More than 180 Days after Filing**

Section 1306(a)(1) broadens the definition of property of the estate to include all property acquired after commencement of the case.

The question is whether this includes an inheritance received beyond the 180-day limit found in § 541(a)(5)(A).

*Carroll v. Logan*, 735 F.3d 147 (4th Cir. 2013):

Facts: Three years after filing Chapter 13, Debtors notified the bankruptcy court that Debtor-husband expected an inheritance of \$100,000 from the estate of his recently-deceased mother. Because Debtors acquired the interest before their bankruptcy case had been closed, dismissed or converted, the trustee moved to modify the plan to require payment of the amount of the inheritance necessary to repay all unsecured debts. Originally, general unsecured creditors had expected to receive only 3.8% of their claims.

Procedure: The bankruptcy court held that the inheritance constituted property of the estate, and noticed direct appeal to the Fourth Circuit.

Holding: An inheritance received by Chapter 13 debtors more than 180 days after their bankruptcy filing is property of the estate under § 1306, and is not excluded by § 541(a)(5).

Reasoning:

Section 541 is not specific to any particular type of bankruptcy proceeding, and subsection (a)(5)(A) excludes inheritances received more than 180 days after filing. Section 1306 expands the definition of property of the estate for purposes of Chapter 13 cases. It includes all property of the type described in § 541 that is received post-petition and before the case is closed, dismissed or converted.

Thus, § 1306 captures the type or kind of property—such as bequests, devises and inheritances—but not the 180-day temporal restriction.

This is an appropriate exchange for the benefits of Chapter 13, which include retention of encumbered assets and curing of defaults.

The majority of courts agree with this conclusion. See, e.g., *In re Tinney*, 2012 Bankr. LEXIS 3092, 2012 WL 2742457 (Bankr. N.D. Ala. July 9, 2012). A few, however, are to the contrary. See, e.g., *In re Key*, 465 B.R. 709 (Bankr. S.D. Ga. 2012); *Le v. Walsh (In re Walsh)*, 2011 Bankr. LEXIS 2602, 2011 WL 2621018 (Bankr. S.D. Ga. June 15, 2011).

Debtors' statutory construction arguments are unavailing.

## WINTER LEADERSHIP CONFERENCE 2014

The court's reading does not ignore the 180-day language in § 541(a)(5)(A). In fact, a contrary reading would strip all meaning from § 1306(a), which expands the temporal restriction for purposes of Chapter 13.

Debtors have it backwards in arguing that the specific language of § 541(a)(5) governs the general language of § 1306. Rather, the latter is the more specific provision.

*Accord, Dale v. Maney (In re Dale)*, 505 B.R. 8 (BAP 9th Cir. 2014) (relying heavily on *Carroll v. Logan*).

Standing to Pursue Stay Relief under 11 U.S.C. § 362(d)(2)

Introduction

1. Typical stay relief scenario

- The subject property is a Chapter 7 debtor’s primary residence.
- The movant is a purported mortgagee seeking relief from stay under 11 U.S.C. § 362(d)(2) in order to proceed with foreclosure.
- The movant alleges that the mortgage is substantially underwater.
- There is no possibility of an “effective reorganization” under 11 U.S.C. § 362(d)(2)(B) because this is a Chapter 7 case.

2. The issue

- If the debtor does not allege equity in the property or the movant subsequently proves a lack of equity, then the movant is entitled to relief from stay.
- However, in situations where there is a question as to the validity of an assignment of a mortgage or a potential defect in the formation of a mortgage itself, some debtors have attacked the movant’s standing to bring a stay relief motion.
  - See, e.g. *In re Idicula*, 484 B.R. 284 (Bankr. S.D.N.Y. 2013); *In re Hayes*, 393 B.R. 259 (Bankr. D. Mass. 2008).

3. What is standing?

- **Generally** – “a party’s right to make a legal claim or seek judicial enforcement of a duty or right.” BLACK’S LAW DICTIONARY (9th ed. 2009).
- **Doctrines of standing**
  - **Constitutional standing** – the minimum level of standing required for adjudication before a federal court
    - **Arises from “case and controversy” language of Article III of the Constitution** – limits the jurisdiction of the federal courts to “cases” and “controversies.”
    - **Elements of constitutional standing** – there are three elements to constitutional standing. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1995):
      - **Injury in fact** – the plaintiff must have suffered an invasion of a legally protected interest that is concreted and particularized. *Allen v. Wright*, 468 U.S. 737, 756 (1984). The injury must be actual or imminent. *Whitmore v. Arkansas*, 495 U.S. 149, 155 (1990).
      - **Causal connection** – there must be a “fairly traceable” causal connection between the conduct complained of and the injury in question. *Simon v. Eastern Kentucky Welfare Rights Organization*, 426 U.S. 26, 41-42 (1976).
      - **Redressability** – a favorable decision must be likely to redress the injury. *Id.* at 38.
  - **Prudential standing** – even if the plaintiff establishes the constitutional minimum of standing, courts have traditionally adhered to a set of “prudential principles that bear on the question of standing.” *Bennett v. Spear*, 520 U.S. 154, 162 (1997).

These operate as “self-imposed limits on the exercise of federal jurisdiction.” *Allen v. Wright*, 468 U.S. 737, 751 (1984).

- **“Zone of interests”** – the interest sought to be protected by the plaintiff must be “within the zone of interests to be protected or regulated by the statute or constitutional guarantee.” *Association of Data Processing Service Organizations, Inc. v. Camp*, 397 U.S. 150, 153 (1970).
- **“Generalized grievance”** – the plaintiff may not use a federal court as “a forum in which to air his general grievances.” *United States v. Richardson*, 418 U.S. 166, 174 (1974). The plaintiff may not seek to adjudicate “abstract questions of wide public significance.” *Warth v. Sedlin*, 422 U.S. 492, 499-500 (1975).
- **Adjudication of third party rights** – the plaintiff “cannot rest his claim to relief on the legal rights or interests of third parties.” *Warth v. Sedlin*, 422 U.S. at 499 (1975).
- **Statutory standing** – apart from constitutional and prudential standing, there is also the question of whether Congress has afforded the plaintiff a statutory right to sue. *Graden v. Conexant Systems Inc.*, 496 F.3d 291, 295 (3rd Cir. 2007).

### **How have courts approached standing in stay relief motions?**

1. **Statutory standing** – the movant’s standing to bring stay relief motions depends on whether the movant has a right to pursue relief under 11 U.S.C. § 362(d)—that is, whether the movant is a “party in interest.” *See In re Smith*, 522 Fed. Appx. 760, 764 (11th Cir. 2013).

#### **2. The narrow approach**

- Some courts have ruled that a movant is a party in interest only if it has a right to foreclose on the property under applicable state law. *E.g. In re Woodberry*, 383 B.R. 373, 379 (Bankr. D.S.C. 2008).
- Therefore, these courts try to determine whether the movant would have standing under state law. The determinative issue is often whether the movant is the holder of a properly executed or assigned mortgage.
  - *In re Hayes*, 393 B.R. 259 (Bankr. D. Mass 2008) (holding that movant lacked standing because it failed to prove that it was assigned the mortgage by the original mortgagee).
  - *In re Lippold*, 457 B.R. 293 (Bankr. S.D.N.Y. 2011) (holding that purported assignee of mortgage lacked standing because assignor had no authority to assign the mortgage).
  - *In re Idicula*, 484 B.R. 284 (Bankr. S.D.N.Y. 2013) (holding that alleged assignee of mortgage lacked standing because it could not prove that assignment actually occurred).
  - *In re Veal*, 450 B.R. 897 (B.A.P. 9th Cir. 2011) (holding that alleged assignee of mortgage lacked standing because it could not show that it was the person entitled to enforce the mortgage under California law).

#### **3. The broad approach**

- Other courts take a simpler approach to the issue of standing. The relevant question is whether the automatic stay affects the movant in some way. *In re Sweports, Ltd.*, 476 B.R. 540, 542 (Bankr. N.D. Ill. 2012); 3 Collier on Bankruptcy, *supra*, ¶ 362.07[2] at 362–105 (“the better approach is to recognize any party affected by the stay”).
- Therefore, under the broad approach, the movant’s allegation that it is the holder of a defaulted mortgage in estate property is sufficient to establish standing to pursue stay relief. *In re Smith*, 522 Fed. Appx. at 765; *In re Yelverton*, 493 B.R. 290, 291 (Bankr. D. D.C. 2013) (when there is no equity in estate property, movant need only allege an interest in the property to have standing to seek stay relief).
- **The two levels of standing** – standing to move for stay relief in bankruptcy is different from standing to pursue a foreclosure in state court.
- **Division of labor between bankruptcy and state courts** – under the broad approach, the bankruptcy court need only determine whether the movant alleges an interest in estate property that is affected by the stay and whether relief is warranted under 11 U.S.C. § 362(d)(2). In the event that relief from stay is granted, the debtor may assert any defense against the movant’s claim, including the movant’s standing to foreclose, in the state court. *In re Yelverton*, 493 B.R. 290, 291 (Bankr. D. D.C. 2013).
  - **States with non-judicial foreclosure processes** – courts that engage in analysis of a movant’s standing under state law may be motivated by the fact that there is no state court in the jurisdiction to protect against wrongful foreclosure. In fact, a majority of opinions appears to originate from jurisdictions that employ non-judicial foreclosure processes, such as California and Massachusetts.

Automatic Stay Issues—Recent Opinions

**Attorney fees for stay violation continued in litigation.** In a further examination of how long the stay violator is liable for the debtor's attorney fees as damages, the Ninth Circuit withdrew its earlier opinion *In re Schwartz-Tallard*, 751 F.3d 966 (9th Cir. 2014), issuing a new opinion, at \_\_\_ F.3d \_\_\_, 2014 WL 4251571 (9th Cir. Aug. 29, 2014), in which the panel distinguished *Sternberg v. Johnson*, 595 F.3d 937 (9th Cir. 2010). In *Schwartz-Tallard*, the debtor was seeking attorney fees incurred in defense of the creditor's appeal from determination of willful stay violation, and the panel construed the debtor's attorney fees as falling within § 362(k)(1)'s damages for "remedying the stay violation. In a separate appeal, *Snowden v. Check Into Cash of Washington, Inc. (In re Snowden)*, \_\_\_ F.3d \_\_\_, 2014 WL 4476477 (9th Cir. Sept. 12, 2014), a payday lender made a conditional offer to partially reimburse the debtor's damages for its stay violation. The Chapter 7 debtor in *Snowden* rejected the small monetary offer and continued with litigation over the violation and damages. The panel first upheld an award of \$12,000 emotional distress damages and \$12,000 punitive damages flowing from the creditor's cashing of prepetition check, resulting in overdraft charges. The debtor demanded \$25,000 and the creditor offered \$1,445. The creditor never admitted its stay violation, and its offer to settle contained conditions. In declining the creditor's conditional offer, the debtor's continued litigation was not "using the stay as a sword but as a shield," a distinction from *Sternberg* made in *In re Schwartz-Tallard*. "Permitting the violator to short-circuit the remedies available under § 362(k)(1) by making a conditional offer to return the property wrongfully seized in violation of the automatic stay would undermine the remedial scheme of § 362(k)." Remand was required in *Snowden* to determine the amount of attorney fees related to remedying the stay violation; under *Sternberg's* adoption of the American Rule, attorney fees were not recoverable for the time related to proving the debtor's damages, but fees were recoverable as they related to remedying the stay violation.

**Bank's administrative freeze did not violate stay.** When the bank learned of Chapter 7 filing, it placed administrative hold on checking and savings accounts and requested trustee's instructions as to distribution of accounts, in which debtors claimed exemption under Nevada statute. The Ninth Circuit held that the debtors could not state a claim for willful stay violation under § 362(a)(3). Before the debtors' exemptions were allowed, the funds were property of the bankruptcy estate and the debtors had no rights of possession or control. After revesting of the funds in the debtors on allowance of the claimed exemptions, the funds were no longer subject to § 362(a)(3), which only addresses property of the estate. The Nevada exemptions were not allowed until the 30-day objection period ran, at which point the exemptions were deemed allowed. *Mwangi v. Wells Fargo Bank, N.A. (In re Mwangi)*, \_\_\_ F.3d \_\_\_, 2014 WL 4194057 (9th Cir. Aug. 26, 2014).

**Automatic stay does not prevent government's satisfying restitution judgment from Chapter 13 estate property.** In a matter of first impression, the Sixth Circuit held that the United States government could proceed with enforcement of its restitution judgment. Although § 362(b)(1)'s exception from the stay applies only to the debtor, 18 U.S.C. § 3613(a) permits enforcement against property of the person fined, "notwithstanding any other Federal law." The latter Code section permits enforcement of restitution judgment against property of the Chapter 13 bankruptcy estate. *United States v. Robinson (In re Robinson)*, \_\_\_ F.3d \_\_\_, 2014 WL 4116476 (6th Cir. Aug. 22, 2014).

**Emotional distress damages possible but not proven.** Although emotional distress damages are potentially available for intentional stay violations, when the notice of foreclosure sale was removed on the day of the publication and the debtor did not offer evidence other than generalized affidavits, the debtors failed to prove those damages. The Eleventh Circuit had not previously decided whether such damages were allowable, but it reviewed the decisions of four other circuits that had addressed the issue, concluding that emotional distress damages fell within the broad term of actual damages in § 362(k). "At a minimum, to recover 'actual' damages for emotional distress under § 362(k), a plaintiff must (1) suffer significant emotional distress, (2) clearly establish the significant emotional distress, and (3) demonstrate a causal connection between that significant emotional distress and the violation of the automatic stay." *Lodge v. Kondaur Capital Corp.*, 750 F.3d 1263 (11th Cir. 2014). See also *In re Voll*, \_\_\_ B.R. \_\_\_, 2014 WL 2567414 (Bankr. N.D. N.Y. June 6, 2014) (Chapter 13 debtors failed to prove significant emotional distress damages for state taxing authority's willful stay violation, but debtors were entitled to attorney fees. To recover for emotional distress, debtors must establish causal connection between distress and stay violation, and the distress must be "distinct. . . from the anxiety and pressures inherent in the bankruptcy process." Quoting *In re Dawson*, 390 F.3d 1139, 1149 (9th Cir. 2004).).