Consumer Practice Extravaganza

Judges' Session: Circuits 5, 7, 8, 9, 10

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U.S. Bankruptcy Court (N.D. Ill.) | Chicago

Hon. Martin R. Barash
U.S. Bankruptcy Court (C.D. Cal.) | Woodland Hills

Hon. Donald R. Cassling
U.S. Bankruptcy Court (N.D. Ill.) | Chicago

Hon. Brian T. Fenimore
U.S. Bankruptcy Court (W.D. Mo.) | Kansas City

Hon. Mary P. Gorman
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2023

Consumer Corner

By Tom Riske and Evan Miller

Some or All Parties-in-Interest?

The Gradual Evolution of Factors Considered in Debtors' Involuntary Conversions

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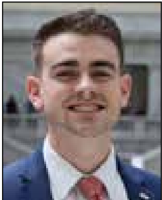
Carmody MacDonald, PC; St. Louis



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Bankruptcy is often a tale of "too many creditors chasing too few dollars,"[1] but what happens when creditors and parties-in-interest suspect that a debtor may have the ability to make meaningful distributions to creditors, and the debtor disagrees? This question highlights the tension between the creditors and debtors in motions to convert from chapter 7 to 11. The Thirteenth Amendment and Anti-Peonage Act both forbid involuntary servitude, and several debtors have continued to cite to these laws in an effort to prevent involuntary conversion from chapter 7 to chapter 11.[2] Initially, some bankruptcy courts were inclined to view conversion motions in this context. However, since *Toibb v. Radloff*, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) and other contributing factors, a shift in views has created a wider lens in which these conversion motions are considered.[3] This article elucidates § 706(b)'s history and highlights themes from the case law in an effort to guide bankruptcy litigants.

Section 706(b) Motions to Convert

On request of a party-in-interest and after notice and a hearing, the court may convert a chapter 7 case to chapter 11 at any time.[4] The only requirement to convert is that the debtor must be eligible to be a debtor in the chapter to which conversion is sought.[5] The court has discretion to grant or deny the motion based on what will inure to the benefit of all parties-in-interest.[6] However, once the court involuntarily converts the debtor's case to chapter 11, the debtor may not convert back to chapter 7.[7] Only the court or another party-in-interest may move the case back to chapter 7.[8]

Early cases inferred a congressional intent against involuntary chapter 11 cases.[9] When Congress passed the Bankruptcy Code, it stated that if courts forced chapter 13 wage-earners to work for one's creditors, the plan would be "preordained to fail" and might violate the Thirteenth Amendment's prohibition against involuntary servitude.[10] The Code also exempted post-petition wages from the bankruptcy estate.[11] Thus, it comes as no surprise that bankruptcy judges denied most creditors' early § 706(b) motions to convert from chapter 7 to 11.[12] These courts also believed that Congress intended chapter 11 for business reorganizations, not individuals, so converting an individual's chapter 7 to 11 was inappropriate.[13]

Post-Petition Wages Pre-BAPCPA

The first shift in § 706(b) jurisprudence came in 1991 when the U.S. Supreme Court explicitly held in *Toibb v. Radloff* that individuals could reorganize in chapter 11.[14] In *dicta*, the court surmised that such an outcome was permissible because the debtor need not commit any post-petition wages to the reorganization, obviating any Thirteenth Amendment concerns.[15]

The *dicta* had a mixed effect over the next decade, and the most cited line of cases suggested that § 541(a)(6) prevented the debtor's post-petition personal-service wages from entering the chapter 11 estate.[16] Relying on pre-*Toibb* decisions, other courts disagreed and held that § 541(a)(7) actually swept all of the debtor's interests in the wages into the chapter 11 estate.[17]

Bankruptcy courts in the 1990s tended to follow the former line of cases, holding that the Bankruptcy Code did not require debtors to contribute post-petition income to the chapter 11 estate.[18] However, courts' attitudes toward the § 706(b) motion appeared to be shifting, due in part to *Toibb*.

One bankruptcy court disagreed with the earlier cases dismissing § 706(b) motions on the grounds that individuals could not reorganize in chapter 11.[19]

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1 *In re Hollstrom*, 133 B.R. 535, 540 (Bankr. D. Colo. 1991).
2 *See, e.g., In re Gordon*, 465 B.R. 683, 704 (Bankr. N.D. Ga. 2012).
3 *See, e.g., In re Parvin*, 538 B.R. 96, 108 (Bankr. W.D. Wash. 2015), *aff'd*, 549 B.R. 268 (W.D. Wash. 2016) (granting motion to convert on grounds that conversion would benefit all parties-in-interest).
4 11 U.S.C. § 706(b). Congress passed this section to encourage debtors to pay their debts. H.R. Rep. 95-595 at 380 (1977).
5 11 U.S.C. § 706(d).
6 H.R. Rep. 95-595 at 380 (1977).
7 11 U.S.C. § 1112(a).
8 *See In re Clemente*, 409 B.R. 288, 295 (Bankr. D.N.J. 2009).
9 *Matter of Noonan*, 17 B.R. 793, 800 (Bankr. S.D.N.Y. 1982); *see also* 11 U.S.C. § 706(c).
10 H.R. Rep. 95-595 at 120 (1977).
11 11 U.S.C. § 541(a)(6).
12 *See, e.g., Matter of Noonan*, 17 B.R. at 797 (dismissing motion to convert on grounds that singer could not be forced to perform his music contract).
13 *In re Graham*, 21 B.R. 235, 238-39 (Bankr. N.D. Iowa 1982); *In re Brophy*, 49 B.R. 483, 484 (Bankr. D. Haw. 1985); *In re Freunscht*, 53 B.R. 110, 112 (Bankr. D. Vt. 1985).
14 *Toibb v. Radloff*, 501 U.S. 157, 160-61 (1991).
15 *Id.* at 166.
16 *In re Molina Y Vedia*, 150 B.R. 393, 399 (Bankr. S.D. Tex. 1992) (citing *In re FitzSimmons*, 725 F.2d 1208, 1211 (9th Cir. 1984) (keeping post-petition wages out of chapter 11 estate avoided Thirteenth Amendment concerns)).
17 *In re Harp*, 166 B.R. 740, 755 (Bankr. N.D. Ala. 1993) (citing *In re Herberman*, 122 B.R. 273, 278 (Bankr. W.D. Tex. 1990)).
18 *In re Lenartz*, No. 01-40268, 2001 WL 35814401, at *2 (Bankr. D. Idaho May 3, 2001).
19 *Id.*

Although the court had concerns about the way the debtors spent their money and believed that the debtors could pay more, it ultimately denied the judgment creditor's motion to convert under § 706(b) to chapter 11.[20] Because the Code did not require debtors to contribute any post-petition wages to a chapter 11 plan, chapter 11 was not a meaningful alternative to chapter 7.[21] However, the court ordered the debtors to "voluntarily" file a chapter 11 petition or have their chapter 7 case dismissed for substantial abuse under § 707(b).[22]

The only other post-*Toibb* case followed similar reasoning. An involuntary chapter 11 felt too much like an involuntary chapter 13, but the court could dismiss the chapter 7 petition and require the debtor to "voluntarily" re-file under chapter 11.[23]

In 2005, Congress passed BAPCPA, which, some argued, renewed constitutional concerns about involuntary chapter 11 cases.[24] Under BAPCPA, all post-petition income generated by the debtor's personal services enters the bankruptcy estate.[25] Courts inferred that Congress wanted individual debtors to pay all they can in chapter 11.[26] However, some scholars have criticized this shift as unconstitutional because chapter 11 seemed to resemble chapter 13, but the trustee or creditors could force the debtor into chapter 11.[27]

In re Clemente illustrated the constitutional concern. In 2009, a New York doctor found himself in between a rock (§ 1112) and a hard place (§ 1115(a)(2)).[28] Because the court previously appointed a trustee, the debtor could not convert his case to chapter 7.[29] However, he was also required to contribute all of his disposable income to the plan, which seemed like peonage.[30] Under the doctrine of Constitutional Avoidance, the court used § 105(a) to terminate the chapter 11 trustee's appointment, move the debtor from chapter 11 to chapter 7, and appoint a chapter 7 trustee.[31]

Current Trends in the Post-BAPCPA World

Clemente proved to be unique, as most cases in this era featured debtors in chapter 7 fighting trustees or creditors that were trying to convert their cases to chapter 11.[32] Courts began focusing less on constitutional concerns and more on what factors favored or militated against conversion.[33]

The treatment of debtors with higher incomes has varied on contested conversions. The court in *In re Gordon* held that converting the case from chapter 7 to 11 would "further the goals of the Bankruptcy Code" because the debtor had the ability to pay his debts.[34] In this case, conversion to chapter 11 would maximize the estate because the debtor could pay 45 to 100 percent of his debts over the course of five years.[35] Chapter 11's alleged ability to remove the debtor from an extra-bankruptcy dispute[36] and the debtor's historical compliance with the court also factored into the court's decision to convert the case to chapter 11.[37]

In contrast, the *In re Quinn* court denied the trustee's motion to dismiss for cause, or in the alternative, conversion to chapter 11 for a debtor making about twice the amount that the debtor in *Gordon* made.[38] The trustee believed that the debtors' chapter 7 petition had been filed in bad faith because the debtors took multiple vacations each year, drove luxury vehicles and purchased a home costing nearly $1 million after filing their chapter 7 petition.[39] The court stated that their good actions outweighed their mistakes, and that their allegedly "lavish lifestyle" was not a sufficient condition to dismiss the chapter 7 petition for cause.[40] Because the trustee relied on the same evidence for the dismissal-for-cause motion and the § 706(b) motion, the court held that conversion was inappropriate and cited *Gordon* for the proposition that discretion allowed the court to deny the motion to convert.[41]

Courts also have held contrasting views about a debtor's motivation to fund a chapter 11 plan. *In re Decker* featured a couple caring extensively for their daughter, who was slowly emerging from rehabilitation after battling a drug addiction.[42] The debtors had monthly net income of roughly $17,000.[43] The husband threatened to retire, arguing that the couple could live off their sizeable, exempt retirement of roughly $10,000 per month.[44] Unconvinced, the court converted the case to chapter 11.[45]

In contrast, *In re Cook* examined a debtor trying to settle business debts while supporting college-aged children and paying a domestic-support obligation.[46] Hypothesizing that the debtor would be unlikely to give up future income to a chapter 11 plan and that chapter 11 would slow repayment to the non-moving creditors, the court denied the motion to convert, despite the debtor's substantial income as a doctor.[47] Both courts mentioned the debtors' tax debts. The debtor in *Cook* had less than $10,000 in property tax debts,[48] whereas the debtors in *Decker* owed more than $200,000 in back taxes.[49]

These cases create a striking juxtaposition illustrating the breadth of a bankruptcy court's discretion to grant or deny § 706(b) motions to convert, and despite factual similarities,

continued on page 47

20 *In re Lenartz*, 263 B.R. 331, 335 (Bankr. D. Idaho 2001).
21 *Id.*
22 *Id.* at 342.
23 *In re Ryan*, 267 B.R. 635, 637-39 (Bankr. N.D. Iowa 2001).
24 *In re Clemente*, 409 B.R. 288, 293 (Bankr. D.N.J. 2009); *In re Lobera*, 454 B.R. 824, 855 n.33 (Bankr. D.N.M. 2011); *In re Snyder*, 509 B.R. 945, 955 (Bankr. D.N.M. 2014).
25 11 U.S.C. § 1115(a)(2).
26 *In re Martin*, 497 B.R. 349, 358 (Bankr. M.D. Fla. 2013) (looking to § 1115(a)(2) for justification that debtors should pay all they can in chapter 11).
27 Erwin Chemerinsky, "Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," 79 *Am. Bankr. L. J.* 571, 589 (2005).
28 *Clemente*, 409 B.R. at 295.
29 *Id.* at 292-93. *See also* 11 U.S.C. § 1112(a)(1).
30 *Clemente*, 409 B.R. at 293. *See* 11 U.S.C. § 1115(a)(2).
31 *Id.* at 294.
32 *See, e.g., In re Gordon*, 465 B.R. 683, 701 (Bankr. N.D. Ga. 2012) (creditor); *In re Decker*, 535 B.R. 828, 830 (Bankr. D. Alaska) (trustee); *see generally In re Baker*, 503 B.R. 751, 754-55 (Bankr. M.D. Fla. 2013) (one creditor); *S. River Cap. LLC v. Kane*, No. 21-CV-03493-WHO, 2022 WL 2905354, at *2 (N.D. Cal. July 22, 2022) (multiple creditors joining motion to convert).
33 *See, e.g., S. River Cap. LLC v. Kane*, No. 21-CV-03493-WHO, 2022 WL 2905354, at *5 (N.D. Cal. July 22, 2022) (considering ability to repay debts, likelihood of reconversion to chapter 7, likelihood of confirming plan, and whether parties would benefit from conversion as relevant factors).
34 *In re Gordon*, 465 B.R. at 692 (citing *In re Lobera*, 454 B.R. 824, 854 (Bankr. D.N.M. 2011)).
35 *Id.* at 693.
36 *Id.* at 694.
37 *Id.* at 704.
38 490 B.R. 607, 611 (Bankr. D.N.M. 2012). The trustee primarily filed to dismiss the case for cause, or in the alternative, convert to chapter 11. *Id.* at 609.
39 *Id.* at 613.
40 *Id.* at 620-21.
41 *Id.* at 621-22.
42 535 B.R. 828, 830 (Bankr. D. Alaska), *aff'd sub. nom.*, *Decker v. Off. of the United States Tr.*, 548 B.R. 813 (D. Alaska 2015).
43 *Id.* at 832.
44 *Id.* at 841.
45 *Id.*
46 599 B.R. 323, 332 (Bankr. W.D. Ark. 2019).
47 *Id.* at 332-33.
48 *Id.* at 330.
49 *Decker*, 535 B.R. at 831.

Consumer Corner: Some or All Parties-in-Interest?

from page 21

courts continue to arrive at different conclusions on § 706(b) motions. Courts consider the debtor's income,[50] the debtor's ability to save for retirement,[51] the likelihood of confirming the putative chapter 11 plan,[52] whether the creditors would be worse off after converting,[53] the burden on the debtor to manage a chapter 11 case,[54] whether the outcome in chapter 11 would be appreciably different from the outcome in chapter 7,[55] and the debtor's motivation to make payments under the plan.[56] As long as the record supports the bankruptcy judge's decision, the reviewing court also will probably not disturb it.[57]

50 *In re Baker*, 503 B.R. 751, 757 (Bankr. M.D. Fla. 2013) (granting motion to convert to chapter 11 where debtor made more than $700,000 per year).
51 *In re Snyder*, 509 B.R. 945, 955 (Bankr. D.N.M. 2014) (denying motion to convert despite substantial income because debtor had only saved $120,000 for retirement).
52 *In re Hardigan*, 517 B.R. 374, 379 (S.D. Ga. 2014).
53 *In re Karlinger-Smith*, 544 B.R. 126, 134 (Bankr. W.D. Tex. 2016) (holding that all parties would be worse off in chapter 11).
54 *In re West*, No. 16-40358-CAN7, 2017 WL 746250, at *15 (Bankr. W.D. Mo. Feb. 24, 2017).
55 *In re Peterson*, 524 B.R. 808, 815 (Bankr. S.D. Ind. 2015).
56 *In re Cook*, 599 B.R. 323, 333 (Bankr. W.D. Ark. 2019).
57 *In re Schlehuber*, 489 B.R. 570, 576 (B.A.P. 8th Cir. 2013), *aff'd*, 558 F. App'x 715 (8th Cir. 2014); *see also Decker v. Off. of the United States Tr.*, 548 B.R. 813, 817 (D. Alaska 2015); *In re Parvin*, 549 B.R. 268, 272 (W.D. Wash. 2016).

Conclusion

As the Bankruptcy Code and accompanying case law have continued to evolve, so have the attitudes toward debtors with purported abilities to pay in the context of conversion-motion practice. A debtor's historical and future ability to pay, while important, is often not determinative. In addition, many of the previous constitutional concerns are often ameliorated with creative solutions or by presenting a debtor with best of the worst alternatives to achieve a fresh start.

A new factor to be considered could include how subchapter V, while still in its infancy, may be used as a sword or shield by a debtor facing conversion. Conversion disputes continue to highlight the push and pull that courts and practitioners face between the objectives behind a debtor's "fresh start" while balancing the interests of other stakeholders. Counsel for all stakeholders would be wise to evaluate the myriad factors discussed in the post-BAPCPA cases when deciding whether to move for conversion and how to respond to a § 706(b) motion. abi

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JUNE 6, 2023

BAP Gives Post-Petition Appreciation to Chapter 7 Estate on Conversion from Chapter 13

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> In a rising real estate market, chapter 13 debtors risk losing their homes if they sell or convert to chapter 7.

Taking sides on a question where the courts are split, the Bankruptcy Appellate Panel for the Eighth Circuit puts chapter 13 debtors at risk of losing their homes if the price of real estate has risen and the debtors sell their homes or convert their cases to chapter 7.

Unless the case goes to the Eighth Circuit and the Court of Appeals reads the statute differently, chapter 13 debtors need to remain in their homes until they have completed plan payments and received their discharges, and the cases have been closed.

Pity the debtor who is forced to sell her home, perhaps to take a job in another city or because of divorce. By losing the equity above the homestead exemption, the debtor may not be able to purchase a comparable home elsewhere.

Affirming Chief Bankruptcy Judge Brian T. Fenimore of Kansas City, Mo., the BAP held on June 1 that the post-petition appreciation in the value of a home belongs to creditors if the case converts to chapter 7.

Typical Facts

The debtor filed a chapter 13 petition and confirmed a plan. She scheduled her home as worth $130,000 and claimed a $15,000 homestead exemption. The home had a $107,000 mortgage. Everyone agreed that the estate would have received nothing had the home been sold on the filing date. In other words, the debtor was *not* buying back the equity in her home through the plan. The home revested in the debtor on confirmation.

The debtor converted her case to chapter 7 about two years after filing. The parties agreed that the home had increased $75,000 in value during the chapter 13 case. While in chapter 13, the debtor had reduced the mortgage by almost $1,000. After paying the mortgage and the debtor's $15,000 homestead exemption, the trustee was laying claim to some $62,000.

To stop the chapter 7 trustee from selling the home, the debtor filed a motion to compel the trustee to abandon the home under Section 554. The debtor contended that the home still had inconsequential value for the chapter 7 estate because the equity above the mortgage and the exemption were fixed as of the chapter 13 filing date when there was no objection to the claimed exemption.

In November, Judge Fenimore denied the debtor's motion to compel abandonment. *In re Goetz*, 647 B.R. 412 (Bankr. W.D. Mo. Nov. 10, 2022). To read ABI's report, **click here**. The debtor appealed, but the BAP affirmed, in an opinion by Bankruptcy Judge Shon Hastings.

The Debtor's Theories

The debtor had several theories underpinning her claimed right to retain post-petition appreciation. She wasn't alone: The National Association of Consumer Bankruptcy Attorneys and the National Consumer Bankruptcy Rights Center submitted a brief in support of the debtor.

The debtor theorized that she retained all of the equity because the home had revested in her on confirmation and the increased equity did not exist on filing. The debtor and the *amici* urged the panel to rely on legislative history in connection with the amendment to Section 348(f)(1)(A). They also argued that turning the appreciation over to the trustee would treat the debtor as though she had converted the case in bad faith.

None of the arguments persuaded the panel.

The Split

Two statutory provisions come into play. Neither is on point.

When a chapter 13 case converts to a case under another chapter, Section 348(f)(1)(A) provides that "property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion." The section does not say who gets appreciation in property between the filing date and the date of conversion.

More expansively, Section 541(a) provides that estate property includes "(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case" and "(7) Any interest in property that the estate acquires after the commencement of the case."

Judge Hastings said that the "courts are split on the question of whether postpetition preconversion market appreciation or an increase in equity resulting from payments toward a lien inures to a debtor's benefit upon conversion to a Chapter 7 case."

"Some courts," Judge Hastings said, believe that post-petition appreciation is new property carved out of the converted estate by Section 348(f)(1)(A). Others use "a slightly different rationale" by focusing on legislative history and policy to say that taking away appreciation penalizes a debtor for making a stab at chapter 13.

Courts taking away appreciation, Judge Hastings said, do not see the new value as a separate asset acquired after filing but as a constituent part of the home on the filing date.

Plain Meaning Carries the Day

For Judge Hastings, the "plain meaning of a statute is conclusive." She declined to assume that Congress amended Section 548(f) to mean that debtors may retain "postpetition preconversion market appreciation" because there was no "language articulating this intent." She therefore held that "the bankruptcy court correctly concluded that postpetition preconversion nonexempt equity accrues for the benefit of the converted Chapter 7 estate."

Judge Hastings also dismissed the idea that revesting on confirmation took the home and its appreciation out of the estate. She said that "neither section 1327(b) nor the relevant provision of the confirmation order applies in the converted Chapter 7 case."

"Rather," Judge Hastings said, Section 348 "governs the scope of estate property upon conversion."

Reliance on the state's exemption statute was likewise of no avail. The exemption did not take the entire home out of the estate, only $15,000.

Finally, Judge Hastings was influenced by the use of present-tense verbs in Section 544(b), governing abandonment. Because the statute refers to property that "is burdensome" or "is of inconsequential value," the idea that the "homestead exemption claim limited the estate's interest in her residence to its value on the petition date is not persuasive."

Holding that "the postpetition preconversion equity increase in [the debtor's] residence is property of the bankruptcy estate," Judge Hastings upheld denial of the motion aiming to compel the trustee to abandon the home.

Questions

Assume that Section 348(f)(1)(A) does not exclude appreciation from the chapter 7 estate:

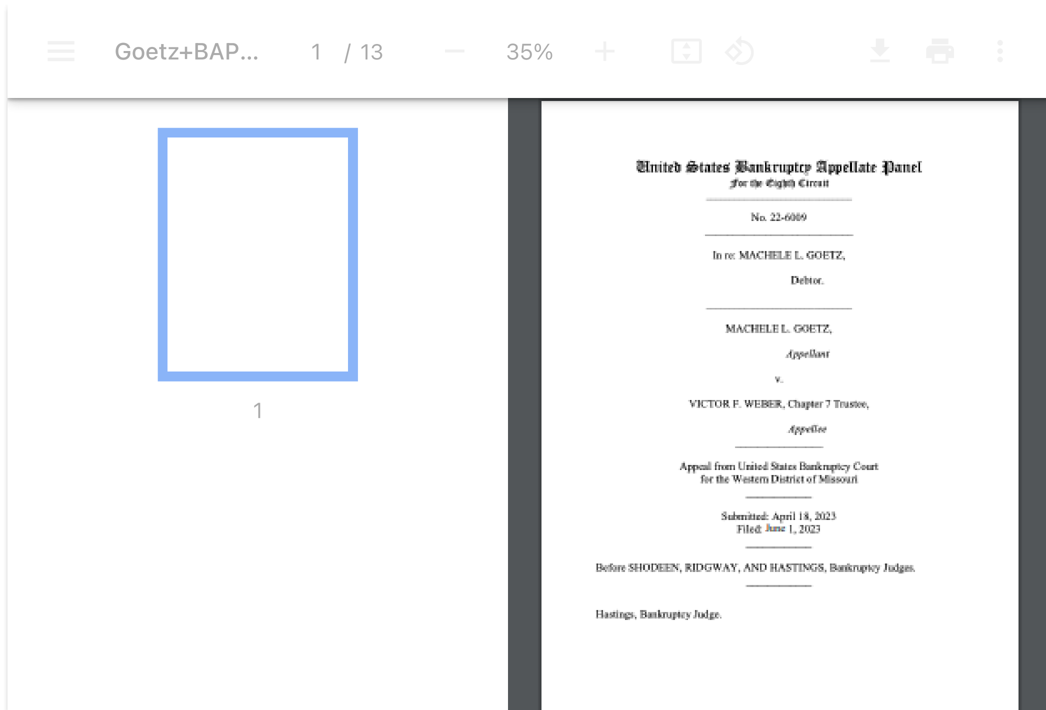
(1) Wasn't the homestead exemption final when no one objected early in the chapter 13 case? What authority allows the chapter 7 trustee or a creditor to reopen final exemptions?

(2) Why limit the revaluation of homes to situations where the case converts or the debtor sells the home?

(3) Real estate prices have risen dramatically throughout the country in the last three years. Why not routinely revalue homes throughout chapter 13 cases?

(4) Why not revalue all other estate property continually until the chapter 13 debtor receives a discharge and the case is closed?

Opinion Link



United States Bankruptcy Appellate Panel
For the Eighth Circuit

No. 22-6009

In re: MACHELE L. GOETZ,

Debtor.

MACHELE L. GOETZ,

Appellant

v.

VICTOR F. WEBER, Chapter 7 Trustee,

Appellee

Appeal from United States Bankruptcy Court
for the Western District of Missouri

Submitted: April 18, 2023
Filed: June 1, 2023

Before SHODEEN, RIDGWAY, AND HASTINGS, Bankruptcy Judges.

Hastings, Bankruptcy Judge.

https://abi-opinions.s3.amazonaws.com/Goetz+BAP+Opinion.pdf

Case Details

Case Citation	Goetz v. Weber (In re Goetz), 22-6009 (B.A.P. 8th Cir. June 1, 2023)
Case Name	Goetz v. Weber (In re Goetz)
Case Type	Consumer
Court	8th Circuit
Bankruptcy Tags	Asset Sales Plan Confirmation Consumer Bankruptcy Mortgage

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[+] FEEDBACK

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OCTOBER 4, 2023

Student Loans Consolidated After Filing Can't Be Discharged, Even for Undue Hardship

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> Consolidating student loans after filing creates a post-petition debt that can't be discharged without filing bankruptcy again.

Student loans consolidated after filing cannot be discharged even on a showing of "undue hardship," for reasons explained by Bankruptcy Judge Shad M. Robinson of Austin, Texas.

The debtor filed a chapter 7 petition with a passel of student loans totaling more than $480,000. Within three months, the debtor received his general discharge, and the case soon closed. Of course, the student loans were not discharged.

More than three years after discharge, the debtor consolidated the student loans with the same lender. Four years after discharge, the debtor reopened his case and filed an adversary proceeding to discharge the consolidated student loans for allegedly being an "undue hardship" under Section 523(a)(8).

In his September 26 opinion, Judge Robinson noted that the consolidated loan "extinguished and paid off" the student loans that had been outstanding when the debtor filed his chapter 7 petition.

The lender filed a motion for summary judgment to dismiss the adversary proceeding, contending that the consolidated loan was a post-petition obligation that the debtor could not discharge. Judge Robinson agreed.

Addressing the merits, Judge Robinson first cited Section 727(b), which says that a discharge "discharges the debtor from all debts *that arose before the date of the order for relief* under this chapter." [Emphasis added.] He held that "the proceeds of the Consolidation Loans did not arise *before* the date of the order for relief as required by 11 U.S.C. § 727(b)," because "the Consolidation Loans were new and distinct postpetition debts." [Emphasis in original.]

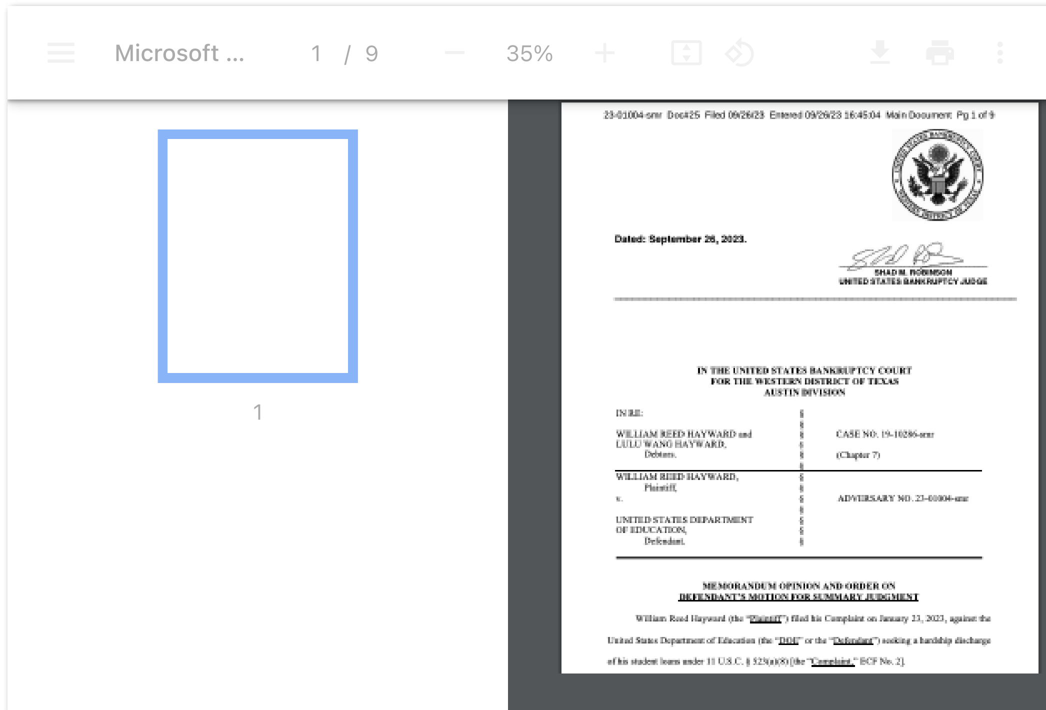
Judge Robinson buttressed his conclusion by referencing applicable regulations. One says that existing student loans are "discharged" when a consolidated loan is granted. Another regulation requires the new lender to notify the borrower that the prior loan was paid in full.

Judge Robinson granted the lender's motion for summary judgment dismissing the adversary proceeding. He held that "the Consolidation Loans are postpetition debts that are nondischargeable as a matter of law under 11 U.S.C. § 727(b)." He thus never reached the question of whether the consolidated loan represented "undue hardship."

In a footnote, Judge Robinson rejected the debtor's contention that the consolidated loan should be considered a pre-petition debt because the pre- and post-petition lender was the same institution. He said that a consolidated loan "is a new debt, even if the lender remains the same."

Opinion Link

PREVIEW



23-01004-smr Doc#25 Filed 09/26/23 Entered 09/26/23 16:45:04 Main Document Pg 1 of 9

Dated: September 26, 2023.

SHAD M. ROBINSON
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

IN RE:	§	
WILLIAM REED HAYWARD and LULU WANG HAYWARD, Debtors.	§	CASE NO: 19-10286-smr (Chapter 7)
WILLIAM REED HAYWARD, Plaintiff, v. UNITED STATES DEPARTMENT OF EDUCATION, Defendant.	§	ADVERSARY NO. 23-01004-smr

MEMORANDUM OPINION AND ORDER ON
DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

William Reed Hayward (the "Plaintiff") filed his Complaint on January 23, 2023, against the United States Department of Education (the "DOE" or the "Defendant") seeking a hardship discharge of his student loans under 11 U.S.C. § 523(a)(8) [the "Complaint," ECF No. 2].

https://abi-opinions.s3.amazonaws.com/Hayward.pdf

Case Details

Case Citation	Hayward v. U.S. Dept. of Education (In re Hayward), 23-01004 (Bankr. W.D. Tex. Sept. 26, 2023).
Case Name	Hayward v. U.S. Dept. of Education (In re Hayward)
Case Type	Consumer
Court	5th Circuit Texas Texas Western District

Bankruptcy Tags Consumer Bankruptcy Discharge/Dischargeability

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Student Gallery

By Ryan M. Deutsch

Balance 101: Recalibrating the Student Debt Relationship

Over the years, Congress has implemented various pieces of legislation amending the legal framework applied in the dischargeability analysis for student loan debt. Consequently, these amendments have imbalanced the debtor/creditor relationship by creating laws more favorable to creditors.

Debtors may have held the upper hand for quite some time in this relationship. This is the defense that members of Congress in the 1970s who originally passed the discharge exception for student loan debt would likely take. Today, the scales have tipped in the other direction. Creditors now have the advantage in adversarial student debt discharge proceedings. Whether an equilibrium can be restored is another question that this article sets out to answer.

Advocating for balanced bankruptcy laws is not a new concept; English writer Daniel Defoe warned of the necessity for balance in creditor/debtor laws back in 1697.[1] He noted that creditors and debtors will both have the upper hand at different times in their relationship. However, he also recognized how creditors can leverage creditor/debtor laws to pursue their own agendas.

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Congress designed the modern Bankruptcy Code to balance two competing policy concerns: giving honest debtors a fresh start, and "[m]aximizing total creditor return on debts by distributing a subset of the debtor's assets or income to creditors in an orderly, equitable, and efficient fashion."[2] Thus, "Congress and the judiciary are constantly striving to achieve a wise balance between" offering "a fresh start for debtors" and ensuring "fairness to creditors."[3]

With these policy goals in mind, why does history keep repeating itself? Defoe's words from more than three centuries ago still ring true, just not in the ears of Congress. With little explanation, Congress implemented legislation reducing a debtor's likelihood of having student loan debt discharged. These legislative reforms over the decades have significantly altered the statutory balance in the debtor/creditor relationship.

An Overview of Student Loan Dischargeability Legislation

Five decades ago, journalists and legislators feared abuse of the bankruptcy discharge process with regard to student loan debt.[4] The fear originated from the belief that high-earning professionals would take advantage of the system,[5] alleging that these professionals would rack up enormous debt to obtain degrees and launch lucrative careers, then file for bankruptcy to discharge student loan debt. However, no evidence of this actual abuse was ever presented to Congress.[6]

Nonetheless, Congress felt compelled to act. In 1976, it enacted the Higher Education Act, making student loan debt nondischargeable for the first time.[7] The Higher Education Act prohibited a debtor from attempting to discharge student loan debt in bankruptcy within the first five years of the repayment period.[8] Likely in order to maintain some balance in the debtor/creditor relationship, Congress carved an exception into this provision. Enter the magical and, to this day, undefined language facing debtors seeking to have student loans discharged: "*undue hardship*." Debtors determined to have faced an "undue hardship" maintained their eligibility to discharge their student loan debts within that five-year period.[9] Yet since the enactment of this standard, Congress has failed to define what an "undue hardship" is.

In 1978, Congress enacted the Bankruptcy Reform Act, which merely transferred the language from the Higher Education Act to the new 11 U.S.C. § 523(a)(8) without changing any of the substance of the law.[10] Student loan debt remained nondischargeable during the first five years of the repayment period, absent an undue hardship.

More creditor-friendly revisions followed in 1984 when Congress passed the Bankruptcy Amendments and Federal Judgeship Act.[11] This legislation eliminated the portion limiting nondischargeability to debts "of higher education."[12] This change "[b]roadened the restrictions on discharge to include private loans backed by nonprofit institutions, as well as government loans."[13]

1 Daniel Defoe, *An Essay Upon Projects* (1697) (chapter titled, "Of Bankrupts").
2 "Bankruptcy Basics: A Primer," 113th Cong. (2013).
3 *Id.* (quoting *In re Harding*, 423 B.R. 568, 575 (Bankr. S.D. Fla. 2010)).
4 Richard Pallardy, "History of Student Loans: Bankruptcy Discharge," Saving for College (March 18, 2021), *available at* savingforcollege.com/article/history-of-student-loans-bankruptcy-discharge (unless otherwise specified, all links in this article were last visited on Sept. 19, 2023).
5 *Id.*
6 *Id.*
7 Stanley Tate, "Why Can't You File Bankruptcy on Student Loans?," Tate Law (May 13, 2022), *available at* tateesq.com/learn/student-loan-bankruptcy-law-history (section titled, "When Did Student Loans Become Nondischargeable?").
8 Pub. L. No. 94-482, 90 Stat. 2081 (1976).
9 *Id.*
10 Pallardy, *supra* n.4.
11 *Id.*
12 *Id.*
13 *Id.*

Another creditor-friendly revision came with Congress's passing of the Crime Control Act of 1990. At the time, the five-year restriction period, absent an undue hardship, was still in place. The Crime Control Act extended the period before which adversary discharge proceedings could commence to seven years after repayment began.[14]

A year later, Congress decided to do away with the six-year statute of limitations on the collection of defaulted student loan debt. With this revision, Congress now permitted student loan creditors to instantly initiate collection efforts against those who defaulted on student loan debt — no matter how much time had passed. No grace period remained for students to get back on their feet when hard times struck.

Future legislation would continue the trend of tipping the scales in creditors' favor. Eventually, amendments to the Higher Education Act eliminated the seven-year period after which student loan debt could potentially be eliminated through bankruptcy proceedings.[15] What remained at this point? Only the confusing "undue hardship" portion. Now, debtors could only discharge their debts by showing that they or their dependents had been impacted by an undue hardship.

If you are keeping score, that is four concurrent creditor-friendly revisions without implementing *any* debtor-friendly reform. So, it is unsurprising that creditors leveraged this momentum into the largest creditor-friendly reform of them all: The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), which excepted from discharge all qualified education loans, including most private loans.[16] This meant that "[p]rivate student loans no longer needed to be associated with a nonprofit institution to be excepted from bankruptcy discharge."[17]

As briefly mentioned, Congress never presented empirical evidence "[t]o demonstrate either real threats to the fiscal solvency of student loan programs or abuse of the bankruptcy system by student loan debtors."[18] This lack of evidence includes the BAPCPA revisions where for-profit student loan lenders received special treatment that had been reserved, up to that point in time, for governmental and nonprofit student loan lenders.[19] No lawmakers objected, even those House Members who "[e]xpressed dissenting views to accompany the House Judiciary Committee's report on" BAPCPA.[20] Instead, these amendments were created based on the excessive lobbying influence of student debt creditors.[21] Thus, Congress significantly decreased the likelihood that debtors could obtain a discharge of student loans without legitimate justification.[22]

One potential reason for the significant change in 2005 was to reduce the amount of federal money at risk. By making private student loan debt nondischargeable, banks and other private creditors would become more willing to dish out loan money to students who needed it, reducing students' reliance on the federal government's aid programs.[23] As such, "Congress' rationale, if there is such a thing, for giving student loan creditors favorable treatment in bankruptcy was to protect the viability of the Federal student loan program, and more generally, public monies."[24]

Resetting the Balance

Defoe warned of the need for balanced bankruptcy laws centuries ago.[25] In doing so, he characterized four groups of parties likely to interact with the debtor/creditor laws at the time. First, there is the classic honest-but-unfortunate debtor who "[f]ails by visible necessity, losses, sickness, decay of trade, or the like."[26] This is the debtor for which Congress created the modern-day Bankruptcy Code. The second classification regards the "Knavish, Designing, or Idle, Extravagant Debtor, who fails because either he has run out his Estate in Excesses, or on purpose to cheat and abuse his creditors,"[27] which is the extravagant debtor.

The third category, and on the creditor side, is the "moderate creditor," who "[s]eeks but his own, but will omit no lawful Means to gain it, and yet will hear reasonable and just Arguments and proposals."[28] This is a normal creditor in a modern bankruptcy who simply abides by the Bankruptcy Code without causing excess drama. Finally, Defoe wrote about the hostile creditor who "[v]alues not whether the Debtor be Honest Man or Knave, Able, or Unable; but will have his Debt, whether it be to be had or no; without Mercy, without Compassion, full of Ill Language, Passion, and Revenge."[29]

A balanced Code would promote interactions between the honest-but-unfortunate debtor and the moderate creditor. These two parties are the most likely to interact with one another in a collaborative way to promote the Code's underlying public policies. They will play no tricks or games, but merely take care of business in an equitable fashion. However, the current discharge exception for student loan debt does not work for the honest-but-unfortunate debtor, because it is utterly unbalanced. The exception, as currently enforced, instead provides the creditor groups with a remarkable amount of leverage, and this enormous amount of leverage even appears to prohibit space for the moderate creditor, instead only leaving room for hostile creditors.

Even more confusing, Congress implemented these legislative changes without any evidence of abuse in the first place.[30] In 1977, the House Judiciary Committee reviewed and analyzed the current amount of abuse of student loan dischargeability and concluded that the nondischargeability provision should be repealed,[31] as there was no actual abuse at the time. Less than 1 percent of all federally insured and guaranteed educational loans were discharged in bankrupt-

14 *Id.*
15 *Id.*
16 *Id.*
17 *Id.*
18 An Undue Hardship? Discharging Educational Debt in Bankruptcy, Before the Subcomm. on Com. and Admin. L., Comm. of the Judiciary, 111 Cong. 111-58 (2009).
19 *Id.*
20 *Id.*
21 *Id.*
22 *Id.*
23 *Id.*
24 *Id.*
25 Defoe, *supra* n.1.
26 *Id.*
27 *Id.*
28 *Id.*
29 *Id.*
30 Pallardy, *supra* n.4.
31 "The Student Loan 'Debt Bomb': America's Next Mortgage-Style Economic Crisis?," Nat'l Ass'n of Consumer Bankr. Trustees (Feb. 7, 2012), *available at* perma.cc/8MJ4-PH6J.

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Student Gallery: Balance 101: Recalibrating the Student Debt Relationship

from page 39

cy.[32] Decades later, in 2005, private lenders lobbied Congress to make private loans as difficult to discharge in bankruptcy as federal loans.[33] These lobbying efforts on behalf of student loan creditors are the types of actions, without merit, that justify the label "hostile creditor." These are the types of actions that impurify the Bankruptcy Code's balance.

Currently, the *Brunner* test is the most frequently used test to define "undue hardship" among the circuits.[34] The *Brunner* test relies on the following three-pronged standard to evaluate whether a debtor has incurred an undue hardship:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans;
> (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and
> (3) that the debtor has made good faith efforts to repay the loans.[35]

Some commentators have conceptualized these prongs as "temporal dimensions": past, present and future. The first prong represents the debtor's present ability to maintain a minimal standard of living if obligated to repay the student loan debts. The second prong represents the debtor's future by analyzing whether the "additional circumstances" will inhibit the debtor from repaying the loan indefinitely. The third prong represents the debtor's past by looking at the debtor's previous conduct in repaying the debt.

However, the Eighth Circuit has taken a "less restrictive" approach to defining "undue hardship" by analyzing it through a totality-of-the-circumstances approach,[36] believing that requiring "[b]ankruptcy courts to adhere to the strict parameters of a particular test would diminish the inherent discretion contained in § 523(a)(8)(B)."[37] To promote fairness and equity, the Eighth Circuit reasoned that each undue-hardship case should be examined on the unique facts and circumstances that surround the particular bankruptcy.[38] Thus, the Eighth Circuit laid out three factors for bankruptcy courts to consider:

> (1) the debtor's past, present, and reasonably reliable future financial resources;
> (2) a calculation of the debtor's and [the] dependent's reasonable necessary living expenses; and
> (3) any other relevant facts and circumstances surrounding each particular bankruptcy case.[39]

The Eighth Circuit added that "[i]f the debtor's reasonable future financial resources will sufficiently cover payment of the student loan debt — while still allowing for a minimal standard of living — then the debt should not be discharged."[40] In sum, "[t]his determination requires a special consideration of the debtor's 'present employment' and 'financial situation' — including assets, expenses, and earnings — along with the prospect of future changes — positive or adverse — in the debtor's financial position." For example, the third factor is a "catch all" that tasks the judge with looking at "any other relevant facts and circumstances surrounding each particular bankruptcy case."[41] However, this discretion could be problematic because it gives judges too much weight in deciding whether to except the debt from discharge. In theory, this discretion turns the discharge exception into a game of luck. The debtor must pray to the bankruptcy gods that the judge to whom they are randomly assigned is debtor-friendly and willing to use discretion in their favor. Creditors, while also hoping to get lucky, at least have the weight of case law on their side.

However, recall that the *Brunner* test is framed as a test looking at the debtor's past, present and future conduct. The Eighth Circuit's test swallows *Brunner* in one gulp with its first factor, which looks at "the debtor's past, present, and reasonably reliable future financial resources."[42] While tailored specifically to financial resources, that is likely all that bankruptcy courts will care about as courts of equity. Furthermore, the Eighth Circuit's second factor instructs judges to calculate the debtor's (and the debtor's dependents') reasonably necessary living expenses.[43] The verbiage at the end of this factor, "reasonably necessary living expenses," appears to be quite like *Brunner*'s "minimum standard of living" prong.

While the Eighth Circuit has championed a test that appears to recalibrate at least some of the balance between student loan debtors/creditors, this test appears to simply mimic *Brunner* with a catch-all provision. Unless that catch-all provision makes it notably easier for the honest-but-unfortunate debtor to discharge student loan debt, the Eighth Circuit's test does not help restore balance in the debtor/creditor relationship.

Conclusion

This article has explored the Bankruptcy Code's student loan debt discharge exception from a balance perspective. Student loan dischargeability reform over the years has consistently favored creditors. In fact, Congress has never implemented any debtor-friendly legislation regarding student loan debt dischargeability.

But as Defoe highlighted, "Laws, tho' in themselves good, are more or less so, as they are more or less reasonable, squar'd and adapted to the Circumstances and Time of the Evil they were made against."[44] In the late 1970s, Congress decided that the circumstances of the time called for eradicat-

32 *Id.*
33 *Id.*
34 *Brunner v. New York State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987).
35 *Id.* at 396.
36 *Long v. Educ. Credit Mgmt. Corp. (In re Long)*, 322 F.3d 549, 554 (8th Cir. 2003).
37 *Id.*
38 *Id.*
39 *Id.*
40 *Id.* at 554-55.
41 *Id.* at 554.
42 *Id.*
43 *Id.*
44 Defoe, *supra* n.1.

ing debtors' opportunity to discharge student loan debt out of fear of abuse. Perhaps times have changed and student loan debt discharges should be more easily obtainable for the honest-but-unfortunate debtor. This is not to say discharges should be a walk in the park. However, reform is necessary to shift the current balance of the debtor/creditor relationship back to the middle of the spectrum.

In addition, Defoe wrote that "Time and Experience ha[ve] furnished the Debtors with Ways and Means to evade the Force of this Statute, and to secure their Estates against the reach of it; which renders it often insignificant."[45] Today, the issue is not with the debtors but with student loan creditors, who have figured out ways to evade creating adverse precedent. While this is often praised as being merely good lawyering, perhaps it is time to shake things up again and implement more balanced standards. In the future, creditors or debtors may find workarounds for the suggested revised statute. Defoe would surely argue that this is the likely outcome, because we are dealing with sophisticated parties. If, or when, this scenario becomes reality, Congress must implement new reform to restore that balance.

Centuries later, history keeps repeating itself. How to craft a discharge exception tailored to the needs of the honest-but-unfortunate debtor and moderate creditor is difficult, but not impossible. After more than 40 years of one-sided, creditor-friendly legislation, it is time for Congress to enroll in Balance 101 to learn how to recalibrate the balance of power between the parties and redefine the debtor/creditor relationship. abi

45 *Id.*

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APRIL 11, 2023

Judge Klein Charts the Path for Discharging Student Loans and Not Being Reversed

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> Bankruptcy Judge Christopher Klein provides authority for student loan debtors who win in bankruptcy court but face an appeal aimed at the trial court's fact-findings.

Bankruptcy Judge Christopher M. Klein decried the "widespread belief that student loans are virtually impossible to discharge in bankruptcy."

In his April 5 opinion, Judge Klein said,

> Only the most compelling cases seem to be able to qualify for discharge as "undue hardship" on a standard of proof that is preponderance of evidence.

It is now time, Judge Klein said,

> to demythologize unwarranted and fallacious dogmas and propaganda that have encrusted, ossified, neutralized, and transmogrified § 523(a)(8) analysis into a misconception that student loan debt is virtually impossible to discharge, even though the "undue hardship" standard of proof is preponderance of evidence and the standard of appellate review is "clear error."

As the "solution" for trial and appellate courts to reach the proper resolution in student loan cases, Judge Klein cited *U.S. Bank Nat'l Ass'n v. Village at Lakeridge*, 138 S. Ct. 960 (2018). Courts, he said, should follow "the Supreme Court's explication of the proper roles of trial and appellate courts facing 'mixed questions' of law and fact and proper standard of review." To read ABI's report on *Lakeridge*, **click here**.

Applying *Lakeridge*, Judge Klein said:

> Student loan "undue hardship" questions depend intensely on the facts of each case. As such, they are mixed questions of law and fact in which factual questions predominate over legal analysis that must . . . be reviewed on appeal under the deferential "clear error" standard . . . . [T]he "clear error" standard . . . does not permit appellate courts to substitute judgment for that of the trial court. *Lakeridge*, 138 S. Ct. at 966-67.

Judge Klein, who sits in Sacramento, Calif., "is known for being a master of statutory analysis, and this opinion doesn't disappoint," said Prof. Nancy B. Rapoport. She said that he "points out that the question of undue hardship is a mixed question of law and fact, subject to review only for clear error."

In commentary provided to the National Association of Chapter Thirteen Trustees, Prof. Rapoport described the case before Judge Klein as involving "the prototypical honest but (extremely) unfortunate debtor who tried her best to improve her position in life, but a rubbish heap of a university and a former abusive husband made it impossible for her to dig out of the hole of student debt." Prof. Rapoport is a UNLV Distinguished Professor and the

Garman Turner Gordon Professor of Law at the Univ. of Nevada at Las Vegas William S. Boyd School of Law.

The *Brunner* and *Pena* Tests

The opinion by Judge Klein is the definitive explication of the so-called *Brunner* test, taken from *Brunner v. New York State Higher Educ. Serv. (In re Brunner)*, 831 F.2d 395 (2d Cir. 1987), as adopted by the Ninth Circuit in *United Student Aid Funds, Inc. v. Pena*, 155 F.3d 1108 (9th Cir. 1998).

Applying the same standard, the courts in *Brunner* and *Pena* reached opposite conclusions. *Pena* discharged the debt, but *Brunner* didn't. "The facts make all the difference," Judge Klein said.

With regard to the first *Brunner* test — inability to maintain a minimal standard of living — the debtor's income in *Pena* was $41 short of covering expenses. When income and expenses fluctuate, the Ninth Circuit allowed the bankruptcy court to average the figures without being bound to accept the circumstances at the time of trial.

On the second *Brunner* test — "additional circumstances" indicating that the inability to maintain a minimal standard of living will persist — the Ninth Circuit in *Pena* did not require expert corroboration of the debtor's medical problems. The appeals court found no clear error in the bankruptcy court's finding that the debtor satisfied the second *Brunner* test.

On the third *Brunner* test — a "good faith" effort to repay the loan — the appeals court in *Pena* saw no clear error in finding good faith, because the debtor had made several payments.

Critique of Ninth Circuit Precedent

Judge Klein examined Ninth Circuit student loan cases in light of *Lakeridge*. Many appeals, he said, involved mixed questions of fact and law on the issue of "undue hardship." Some courts, he said, paid "lip-service to 'clear error' but then [used] the 'mixed question' label as license to nit-pick the trial court all the way to reversal in a manner that is the antithesis of 'clear error' review."

Judge Klein parsed *Lakeridge* to discern how appellate courts should treat mixed questions of fact and law regarding "undue hardship." In the unanimous *Lakeridge* opinion, he said that the Supreme Court gave a "master class" in assessing the standard of review when there are mixed questions of law and fact. *Lakeridge* teaches us how to choose between *de novo* and clear error.

Judge Klein quoted *Lakeridge* for saying that "the standard of review for a mixed question all depends . . . on whether answering it entails primarily legal or factual work." *Lakeridge*, *supra*, 138 S. Ct. at 967.

Applying *Lakeridge* to student loan cases, Judge Klein said that the mixed question about undue hardship "immerses the court in case-specific factual issues. The controlling law — the *Brunner* test — is well known and needs little explication."

Because the undue hardship question is "primarily factual," Judge Klein said "it follows" that an appellate court should apply the "deferential 'clear error'" standard of review.

Judge Klein identified two pre-*Lakeridge* decisions from the Ninth Circuit as being inconsistent with the "clear error" rule announced by the Supreme Court. *See Rifino v. U.S. (In re Rifino)*, 245 F.3d 1083 (9th Cir. 2001); and *Educ. Credit Mgmt. Corp. v. Mason (In re Mason)*, 464 F.3d 878 (9th Cir. 2006). He said they were both "garden-variety decisions in which a bankruptcy court found 'undue hardship,'" but the appellate courts had reversed.

On the other hand, Judge Klein lauded *Hedlund v. Educ. Res. Inst. Inc.*, 718 F.3d 848, 854 (9th Cir. 2013), where he described the Ninth Circuit as having held that it was "error for an appellate court to substitute its judgment for that of the trial court on the question of *Brunner* 'good faith.'" He cited the Seventh Circuit for reaching the same conclusion from the same reasoning.

Applying the Law to the Facts

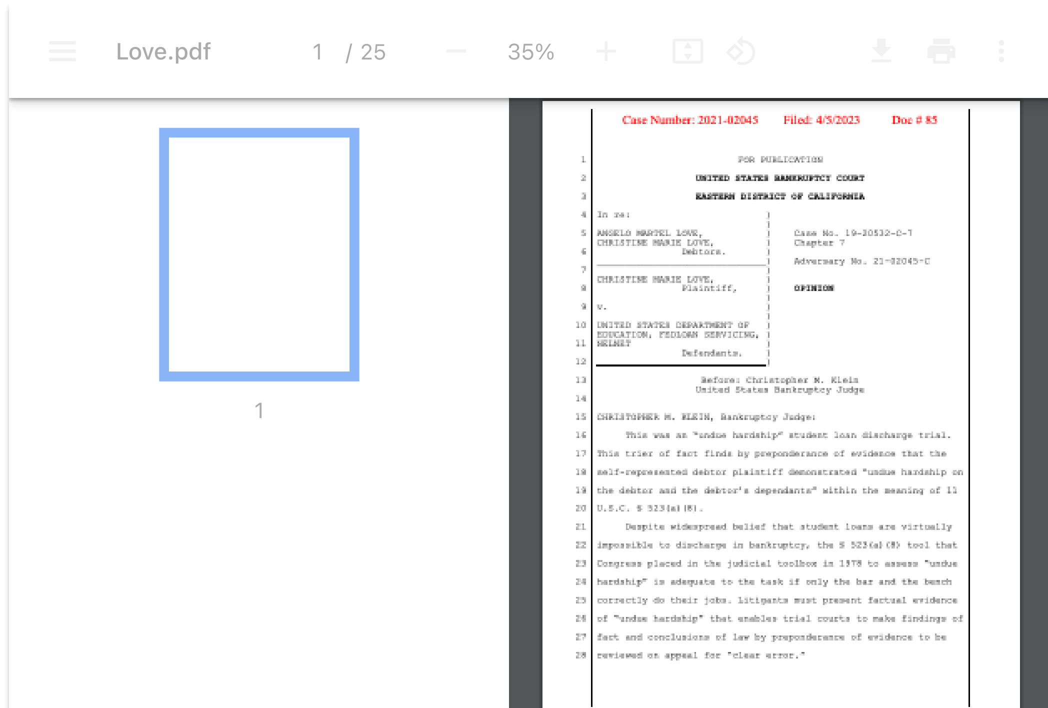
After explicating the law on undue hardship, Judge Klein applied the law to the facts of the case before him. Prof. Rapoport aptly summarized the debtor's

economic circumstances above. The debtor had attended a now-defunct for-profit university to obtain a certificate that qualified her for nothing. She had an abusive husband who was convicted and jailed for beating her up. The expenses for herself and her two minor children exceeded her after-tax income. The judge saw no likelihood of an increase in the debtor's income.

There being no requirement to exhaust administrative remedies, Judge Klein dismissed the government's contention that the debtor should apply for relief under the Biden administration's attempts to provide relief for student loan debtors without amending the statute. He said there was only the "mere possibility" of administrative relief.

By a "preponderance of the evidence," Judge Klein found that the debtor satisfied all three *Brunner* tests, entitling her to discharge all of her student loans under the Section 523(a)(8) undue hardship standard.

Opinion Link



Case Number: 2021-02045 Filed: 4/5/2023 Doc # 85

FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

In re:

ANGELO MARTEL LOVE,
CHRISTINE MARIE LOVE,
Debtors.

Case No. 19-20532-C-7
Chapter 7

Adversary No. 21-02045-C

CHRISTINE MARIE LOVE,
Plaintiff,

v.

UNITED STATES DEPARTMENT OF EDUCATION, FEDLOAN SERVICING, NELNET
Defendants.

OPINION

Before: Christopher M. Klein
United States Bankruptcy Judge

CHRISTOPHER M. KLEIN, Bankruptcy Judge:

This was an "undue hardship" student loan discharge trial. This trier of fact finds by preponderance of evidence that the self-represented debtor plaintiff demonstrated "undue hardship on the debtor and the debtor's dependants" within the meaning of 11 U.S.C. § 523(a)(8).

Despite widespread belief that student loans are virtually impossible to discharge in bankruptcy, the § 523(a)(8) tool that Congress placed in the judicial toolbox in 1978 to assess "undue hardship" is adequate to the task if only the bar and the bench correctly do their jobs. Litigants must present factual evidence of "undue hardship" that enables trial courts to make findings of fact and conclusions of law by preponderance of evidence to be reviewed on appeal for "clear error."

https://abi-opinions.s3.amazonaws.com/Love.pdf

Case Details

Case Citation	Love v. U.S. (In re Love), 21-02045 (Bankr. E.D. Cal. April 5, 2023)
Case Name	Love v. U.S. (In re Love)
Case Type	Consumer
Court	9th Circuit California California Eastern District
Bankruptcy Tags	Practice and Procedure Consumer Bankruptcy Govt. Claims/Sovereign Immunity

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[+] FEEDBACK

Consumer Corner

By Amelia Martin Adams

Think First and File Later: Pitfalls in Claims Litigation

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Almost everything filed in bankruptcy cases bears a signature or affirmation. Documents signed in ink or digitally with an /s/ certify the signatory's approval of their content. Documents filed electronically using an attorney's login credentials demonstrate that the attorney approved them for filing. These include proofs of claim and claim objections, which the filing attorney represents to the court as being grounded in law and fact.

Consequently, while the demands on counsel's time are great, completing a due-diligence review before filing or objecting to a claim is as important as satisfying deadlines. In other words, as case law demonstrates, counsel must "think first and file later" to avoid potential pitfalls in claims litigation.

Rule 9011 Applies to Filing and Advocating for Proofs of Claim

Rule 9011(a) of the Federal Rules of Bankruptcy Procedure requires nearly every paper filed by a represented party to be signed by the party's attorney of record.[1] "By presenting [a paper] to the court (whether by signing, filing, submitting, or later advocating) ... an attorney ... is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances." The filing is not presented for an improper purpose, is warranted by law or a nonfrivolous argument for extension, modification or reversal of existing law or establishment of new law, contains only factual contentions that have or are likely to have evidentiary support, and contains only denials of factual contentions that are warranted by evidence or reasonably based on a lack of information or belief.[2] Courts may sanction attorneys, law firms or parties that violate Rule 9011.[3]

Rule 9011(b) is the bankruptcy counterpart of Rule 11 of the Federal Rules of Civil Procedure, which "*requires* lawyers to think first and file later, on pain of personal liability."[4] Likewise, "[t]he duty imposed by Rule 9011 requires an attorney to 'stop, think and investigate more carefully before ... filing papers' with the court or making assertions in those papers."[5] That adage must guide counsel when filing proofs of claim and claim objections.

Although "[t]here is no litmus test that can be applied to a given filing to determine whether Rule 9011 has been violated" and a case-by-case-inquiry is thus required, sometimes "the violation is so obvious that the filing speaks for itself."[6] In *In re Obasi*, the court found an obviously sanctionable situation when a law firm's regular practice was for an associate attorney to review and file proofs of claim using a supervising attorney's electronic signature and login credentials — without the supervising attorney reviewing them.[7] Rather than reviewing them himself, the supervising attorney authorized the associate, in advance, to review proofs of claim using a checklist, then file them under the supervisor's signature.

Noting "the personal nature of an attorney's obligations under ... Rule 9011," the court explained that compliance is "'a *nondelegable* responsibility to the court'" and "a party whose signature appears on a document must personally review [it] prior to filing."[8] The court ruled that the supervising attorney and his firm violated Rule 9011, but it declined to impose sanctions because the movant failed to satisfy the pre-filing notice requirements of Rule 9011's "safe-harbor provision."[9]

As part of reviewing proofs of claim, counsel must ensure that all asserted claims are grounded in fact and law. In *Cash-N-Advance v. Danserau*, the Fifth Circuit explained that "[Rule] 9011(b) required that [the creditor's] attorney ... sign each of the proofs of claim submitted to the court and certify, among other things, that 'to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,' the claims were warranted by law and the factual contentions had evidentiary support."[10] Unfortunately, the creditor's proofs of claim in several cases classified its unsecured claims as priority claims "without any factual or legal basis."[11] The bankruptcy court determined that Rule 9011 sanctions were warranted,[12] and the Fifth Circuit agreed.

1 Fed. R. Bankr. P. 9011(a).
2 Fed. R. Bankr. P. 9011(b).
3 Fed. R. Bankr. P. 9011(c).
4 *Stewart v. RCA Corp.*, 790 F.2d 624, 633 (7th Cir. 1986) (emphasis in original; citation omitted).
5 *Young v. Young (In re Young)*, 789 F.3d 872, 880 (8th Cir. 2015) (quoting *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 398 (1990) (internal quotation marks omitted)).
6 *In re KTMA Acquisition Corp.*, 153 B.R. 238, 249 (Bankr. D. Minn. 1993).
7 *In re Obasi*, No. 10-10494 (SHL), 2011 Bankr. LEXIS 5011 (Bankr. S.D.N.Y. Dec. 19, 2011).
8 *Id.* at *12 (quoting Fed. R. Civ. P. 11 Advisory Committee's Note (emphasis added)).
9 *See* Fed. R. Bankr. P. 9011(c)(1)(A).
10 *Cash-N-Advance v. Dansereau (In re Dansereau)*, No. 02-50930, 2003 U.S. App. LEXIS 29206, at *2 (5th Cir. March 17, 2003) (quoting Fed. R. Bankr. P. 9011(a) and (b)).
11 *Id.*
12 *In re Dansereau*, 274 B.R. 686 (Bankr. W.D. Tex. 2002).

Counsel's duty to review proofs of claim is ongoing,[13] and attorneys may be sanctioned under Rule 9011(b) for "later advocating" a frivolous proof of claim that a client — not the attorney — filed. In *In re Lewis*, the court sanctioned creditor's counsel because he "failed to reasonably inquire" into the nature of the claimed debt before advocating for it by email, in response to debtors' motion for sanctions, and at a hearing.[14] The court determined that counsel's failure to reasonably investigate and perform adequate legal research concerning the claim and the parties' respective obligations prior to advocating for it "is tantamount to a finding of frivolousness" that warranted monetary sanctions under Rule 9011(b).[15]

Bankruptcy Rule 9011 Applies to Filing and Advocating for Claim Objections

Like counsel who file unsupportable proofs of claim, counsel who file baseless claim objections risk being sanctioned. Facing frivolous claim objections in multiple cases, the *In re Velez* court explained that it had entered show-cause orders "with a singular aim — to address ... a pervasive problem within th[at] district stemming from wholesale unjustified claim objections, and to stop that practice."[16] Debtors' counsel had "filed and prosecuted five claim objections ... without reasonable investigation into the facts or law," all seeking to entirely disallow claims even though the debtors had admitted to owing the money.[17] To the court, "[t]he gig [was] up ... on debtors taking advantage of the cost of responding to claims objections and obtaining orders striking claims [that] the debtor has acknowledged owing in whole or substantial part."[18] Thus, the court suspended counsel from practicing there for 31 days under Rule 9011(b).

In *In re Davis*, "an affluent debtor ... sought to manipulate bankruptcy procedures to accomplish what the [Bankruptcy] Code prohibits — the elimination of all of her credit card debts despite her obvious ability to repay those debts over time."[19] After obtaining confirmation of a chapter 13 plan proposing to fully pay her unsecured debts, the debtor objected to every general unsecured creditor's claim. She withdrew objections to claims of creditors who responded, then requested entry of default orders sustaining objections to claims of creditors who did not respond.

In the court's view, the "debtor and her counsel were motivated by the off-chance that the claimants would not respond to the objections and, consequently, that th[e] Court would sustain the objections without substantive review."[20] The court noted that "[t]his approach of 'throwing it against the wall and seeing what sticks' is precisely the sort of conduct ... [that Rule 9011] seeks to counter.'"[21] It vacated the confirmation order on bad-faith grounds and, after a subsequent hearing, sanctioned debtor's counsel because he "engaged in an improper scheme to allow [the debtor] to obtain a quick discharge of her unsecured debt in violation of ... Rule 9011(b)."[22] The district court affirmed.[23]

Another court considered "when pursuit of a legal argument [advocating for a claims objection] crosses the line that separates zealous advocacy for one's client from sanctionable conduct."[24] In *In re Pearson*, a creditor sought sanctions against debtor's counsel for his role in objecting to a creditor's proofs of claim. Although debtor's counsel argued that he did not intend to violate Rule 9011, the court determined that he nevertheless did, stating that "there is no empty-head, pure-heart defense in the Rule 9011 context."[25] Because debtor's counsel "omi[tted] ... relevant facts and continued pressing ... arguments that had previously been rejected [in prior opinions by other courts] without accounting for the effect of those rejections," the court sanctioned him under Rule 9011.[26]

Counsel's Ethical Obligations Apply in Claims Litigation

In addition to the risk of sanctions, counsel in claims litigation risk being referred to state disciplinary authorities for ethics violations arising out of unsupportable proofs of claim and frivolous claim objections. Code of Conduct for U.S. Judges Canon 3(B)(6) states that "[a] judge should take appropriate action upon receipt of reliable information indicating ... that a lawyer violated applicable rules of professional conduct." The Canon's Official Commentary explains that "[a]ppropriate action may include direct communication with the ... lawyer, other direct action if available, [or] reporting the conduct to appropriate authorities."

The American Bar Association's Model Rules of Professional Conduct and similar state rules dictate the level of competence, diligence and candor required of counsel in the claims process. Model Rule 1.1 requires counsel to provide competent representation by using the "thoroughness and preparation reasonably necessary." Model Rule 3.1 directs counsel not to "bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous." Model Rule 3.3(a)(1) similarly provides that "[a] lawyer shall not knowingly ... make a false statement of fact or law to a tribunal or fail to correct a [prior] false statement," and Model Rule 4.1 states that "[i]n the course of representing a client, a lawyer shall not knowingly ... make a false statement of material fact or law to a third person."

Counsel may zealously represent clients within the bounds of the law and their ethical responsibilities without sanction. Where advocacy crosses the line, however, the "tired excuse for abuse of opposing parties and the advancement of baseless claims [that counsel was simply fulfilling duties to the client] has been thoroughly discredited."[27] The

13 *Hannon v. Countrywide Home Loans Inc. (In re Hannon)*, 421 B.R. 728, 733 (Bankr. M.D. Pa. 2009) ("Certainly, the Rules of Conduct imply a continuing duty to correct false statements.") (citing Pa. RPC 3.3 and collecting cases).
14 *In re Lewis*, 637 B.R. 861, 878 (Bankr. W.D. Ark. 2022).
15 *Id.* (quoting *In re Schivo*, 462 B.R. 765, 777 (Bankr. D. Nev. 2011)).
16 *In re Velez*, 465 B.R. 912, 921 (Bankr. S.D. Fla. 2012).
17 *Id.*
18 *Id.* (quoting *In re Moreno*, 341 B.R. 813, 819-20 (Bankr. S.D. Fla. 2006)).
19 *In re Davis*, No. 09-42865, 2011 Bankr. LEXIS 1323, at *1 (Bankr. E.D. Tex. March 31, 2011).
20 *Id.* at *36-37.
21 *Id.* at *37 (quoting *Bernal v. All Am. Inv. Realty Inc.*, 479 F. Supp. 2d 1291, 1329 (S.D. Fla. 2007) (internal citation omitted)).
22 *Armstrong v. Davis*, 487 B.R. 764, 769 (E.D. Tex. 2012).
23 *Id.* at 775.
24 *In re Pearson*, No. 19-27718, 2023 Bankr. LEXIS 349, at *1 (Bankr. D. Utah Feb. 8, 2023).
25 *Id.* at *16 (citation omitted).
26 *Id.* at *47.
27 *Armstrong v. Davis*, 487 B.R. at 773.

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Armstrong v. Davis court explained that counsel's duty of zealous advocacy must operate within other ethical rules and "be undertaken with the other responsibilities to opponents and the court."[28] Those rules include "not ... assert[ing] or controvert[ing] an issue ... unless the lawyer reasonably believes that there is a basis for doing so that is not frivolous," and "not tak[ing] a position that unreasonably increases the costs or other burdens of the case."[29]

In *Pipkins-Thomas v. U.S.*, the bankruptcy court noted the relationship between Rule 9011(b) and ethical rules when sanctioning an attorney who "prepared, signed, and filed a false petition, an improper chapter 13 plan summary and chapter 13 plan, an objection to claim and related memoranda without factual or legal basis, and a proof of claim and ... advocated all of those for improper purpose and knowing that they were factually incorrect."[30] The sanctions included three parts: (1) "because [counsel] in open court twice refused to recognize a duty of candor, the court imposed an ethics instruction"; (2) the court forwarded its opinion to the U.S. Attorney "because making a false representation in a bankruptcy proceeding is a federal crime" under 18 U.S.C. § 157(3); and (3) the court forwarded its opinion to the Texas State Bar.[31] Affirming, the Fifth Circuit recognized that while the sanctions were strong, "strong sanctions are necessary to deter this type of behavior."[32]

False Claims and Claim Objections Are Subject to Criminal Liability

Under federal law, "[a] person who ... knowingly and fraudulently presents any false claim for proof against the estate of a debtor, or uses any such claim in any case under [the Bankruptcy Code], in a personal capacity or as or through an ... attorney ... shall be fined ... imprisoned not more than [five] years, or both."[33] Similarly, "[a] person who, having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so," either files a document in a bankruptcy proceeding or "makes a false or fraudulent representation, claim, or promise concerning or in relation to a [bankruptcy] proceeding ... or in relation to a proceeding falsely asserted to be pending under [the Bankruptcy Code] ... shall be fined ... imprisoned not more than [five] years, or both."[34] Although there is no private right of action under those statutes,[35] counsel who violate them risk that a court will refer them to a U.S. Attorney in addition to risking sanctions under Rule 9011.[36]

Think First and File Later in Claims Litigation

The claims-litigation process is at the heart of every bankruptcy. For the system to work, debtors and creditors must be able to rely on the veracity of all parties' statements to each other and the court. The legal and ethical guardrails discussed herein give structure to that process, and, by "thinking first and filing later," counsel can guide their clients to stay between the rails. abi

28 *Id.*
29 *Id.* (quoting Tex. R. Prof. Cond. 3.01, 3.02).
30 *Pipkins-Thomas v. U.S. (In re Thomas)*, 223 F. App'x 310, 314 (5th Cir. 2007).
31 *Id.* at 314-15.
32 *Id.* at 315.
33 18 U.S.C. § 152(4).
34 18 U.S.C. § 157(2), (3).
35 *See, e.g., Aziz v. U.S. Bank NA (In re Aziz)*, No. AZ-16-1133-BTaF, 2017 Bankr. LEXIS 2199, at *8 n.7 (B.A.P. 9th Cir. Aug. 3, 2017) (18 U.S.C. §§ 152 and 157 are "criminal statutes ... for which there is no private right of action").
36 *See, e.g., Hannon*, 421 B.R. at 734 (upon record indicating "a pattern of conduct tantamount to bad faith" when creditor failed to amend claims in multiple cases after receiving refunds, court was "compelled" to forward its opinion to U.S. Attorney and U.S. Trustee to determine whether 18 U.S.C. § 152(4) had been violated).

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Consumer Corner

By Hon. Elizabeth L. Gunn and Shelby Kostolni

Post-Petition Appreciation: Whose Line (Item) Is It, Anyway?

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Fluctuations in the value of real estate and personal property items occur often, resulting in the prediction of future value feeling like seeking the answer from a Magic 8 Ball. The fluid nature of real estate values is not solely an issue for real estate agents, homebuyers or homeowners; it also frequently arises in bankruptcy cases, especially consumer cases. Courts continue to struggle with and deepen a split of authority as to who has the right to the post-petition appreciation of a consumer debtor's real property: the debtor or the debtor's estate (and, thus, creditors). In considering the question, bankruptcy courts struggle with the intersection of two sections under chapter 13: 1306 (additions to § 541 property of the estate in chapter 13) and 1327 (effect of confirmation). Even considering the same sections, the answers continue to differ.

As eloquently stated in a recent case on the issue, "harmonizing the inharmonious is a tall order."[1] Most courts considering the issue have found that §§ 1306 and 1327 do not seamlessly fit together. Over time, four general approaches to reconcile §§ 1306 and 1327, and when and where property vests, have developed: (1) estate termination; (2) estate transformation/conditional vesting; (3) estate preservation; and (4) estate replenishment.[2] In addition, depending on the terms of any local form chapter 13 plan, some of these options may not be applicable in all jurisdictions. Before examining recent decisions from the Ninth Circuit and the U.S. Bankruptcy Court for the Eastern District of Michigan, it is helpful to understand each category.

Court Approaches to Vesting

Estate Termination

As generally accepted, the estate-termination approach results in all property vesting in the debtor at plan confirmation and the estate ceasing to exist.[3] This view is based on a reading of § 1327(b) that results in all property vesting in the debtor at confirmation.[4] The estate-termination approach attempts to harmonize § 1306(b)'s giving debtors possession of the property of the estate and § 1327(b)'s vesting of title and ownership by finding § 1327(b) to be the more specific, and thus controlling, section as to the ownership of appreciation of property in the estate.[5] However, in jurisdictions where the required local form plan provides for vesting only at discharge, this approach is inapplicable.

Estate Preservation/Conditional Vesting

In these substantially similar approaches, all property is deemed estate property until entry of discharge.[6] The theory of estate preservation is based on an interpretation of § 1327(b) finding that confirmation does not disturb the existence of the estate, only the debtor's responsibilities toward the property of the estate.[7]

Similarly, conditional vesting gives the debtor the right to use the property of the estate, but it is not a final right until the plan is complete and the debtor obtains a discharge.[8] These approaches rely on the premise that § 1327(b) does not remove property from the estate, but only places control of the property in the debtor pending the completion of the chapter 13 case.[9]

Estate Transformation

The estate-transformation approach is seen as a compromise between the extreme estate-termination and estate-preservation/conditional-vesting approaches.[10] It holds that at plan confirmation there is an estate transformation where all property of the estate becomes property of the debtor, except for post-petition income and property considered essential to the performance of the plan.[11] (However, this raises a new issue on how you define whether property is "essential" to performance of the plan, but that question is outside the scope of this article.)

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1 *In re Elassal*, 2023 WL 5537061, *4 (Bankr. E.D. Mich. 2023) (citing *City of Chicago v. Fulton*, 141 S. Ct. 585, 591 (2021)).

2 These approaches are very succinctly defined in *In re Baker*, 620 B.R. 655, 663-64 (Bankr. D. Colo. 2020).

3 *Baker*, 620 B.R. at 663.

4 *Calif. Franchise Tax Bd. v. Jones (In re Jones)*, 420 B.R. 506, 514 (B.A.P. 9th Cir. 2009) (citing *In re Petruccelli*, 113 B.R. 5, 15 (Bankr. S.D. Cal. 1990)).

5 *Petruccelli*, 113 B.R. at 15. *See also Oliver v. Toth (In re Toth)*, 193 B.R. 992, 996 (Bankr. N.D. Ga. 1996) (finding *Petruccelli* analysis most persuasive; policy reasons (being able to obtain credit and use property after confirmation) support concluding that vesting at confirmation ends the estate); *In re Dagen*, 386 B.R. 777, 782 (Bankr. D. Colo. 2008) (stating that "only the estate termination approach gives effect to the literal terms of § 1327(b)").

6 *Baker*, 620 B.R. at 664.

7 *Id.* at 663-64.

8 *Id.* at 664.

9 *In re Brensing*, 337 B.R. 376, 383 (Bankr. D. Kan. 2006) (citing *Sec. Bank of Marshalltown, Iowa v. Neiman*, 1 F.3d 687, 690 (8th Cir. 1993)).

10 *Telfair v. First Union Mortg. Corp.*, 216 F.3d 1333, 1340 (11th Cir. 2000) (citing *In re Heath*, 115 F.3d 521, 524 (7th Cir. 1997); *In re McKnight*, 136 B.R. 891, 894 (Bankr. S.D. Ga. 1992)).

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Estate Replenishment

Finally, the estate-replenishment approach results in all property of the estate becoming property of the debtor on confirmation, but the estate continues to exist and "refills" with property defined in § 1306 acquired by the debtor after confirmation.[12] The vesting in the estate of post-petition property is without regard to whether the property is necessary to the plan's performance.[13]

Recent Cases, Opposite Results

Two recent cases each faced the question of whether appreciated value of the debtor's real property was property of the estate or property of the debtor. In *In re Castleman*, the Ninth Circuit considered an appeal where the question was whether pre-conversion real estate appreciation belongs to the estate or the debtors who converted from a chapter 13 reorganization to a chapter 7 liquidation.[14] When the Castlemans originally filed for chapter 13, they listed their residence in their schedules with a value of $500,000 and a secured lien of $375,077, and claimed a homestead exemption in the $124,923 balance based on Washington's state exemptions.[15]

The Castlemans successfully made chapter 13 plan payments for 20 months, but after a job loss, the pandemic-deferred payments and a serious health diagnosis for John Castleman, they decided that they could no longer make their payments and converted to chapter 7.[16] The problem was that during the 20 months it took the Castlemans to make this determination, their home value had appreciated to approximately $700,000, leaving $200,000 of equity unprotected by their original homestead exemption.[17]

After conversion, the chapter 7 trustee moved to sell the home to recover the appreciated/unprotected value for the estate. The Castlemans objected to the sale on the basis that the post-petition appreciation value (*i.e.*, the "new" equity) was property of the debtor — not property of the estate.[18] In the Ninth Circuit, there is long-standing authority that even if a debtor amends the homestead exemption post-petition,[19] post-petition appreciation inures to the bankruptcy estate, not the debtor.[20] In other words, the Castlemans could not simply have increased their claimed homestead exemption (to the extent available) to exempt the new equity.

In its analysis, the court noted the potential benefits to debtors and creditors of a chapter 13 case: The ability for debtors to retain property while creditors receive a higher return than in chapter 7. The court noted that post-confirmation property of the estate is defined not by § 1306 (titled "Property of the Estate"), but rather by § 348(f) (titled, "Effect of Conversion," which explains converting from chapter 13 to another chapter). Under § 348(f), property of the estate after a good-faith conversion includes property that was part of the estate as of the petition date that remains in the possession or control of the debtor upon conversion.

Only in cases of bad-faith conversion does all property, whether acquired pre- or post-petition, become property of the chapter 7 estate. Because the appreciation was not "property" acquired post-petition, merely a change in valuation for pre-petition property, the court concluded that the appreciation was not a separate asset, and because it was part of pre-petition property, the appreciation belonged to the chapter 7 estate.[21]

Following closely on the heels of *Castleman*, in *In re Elassal* the U.S. Bankruptcy Court for the Eastern District of Michigan found that post-petition, nonexempted appreciation of real property belongs to the debtor in a chapter 13 case.[22] Wendy Elassal filed a chapter 13 petition in March 2021 in which she valued her home at $250,000, which was encumbered by $228,000 of liens.[23] She claimed a homestead exemption in the remaining $22,000 of value. Her ownership of the property was subject to three conditions arising from her pre-petition divorce: (1) her former spouse would make 24 monthly mortgage payments in lieu of child and spousal support; (2) she would sell or refinance the property on or before Dec. 31, 2022 (21 months after the petition date), to pay the former spouse's equity position; and (3) she would be responsible for any mortgage payments after Jan. 1, 2023.[24]

The debtor's chapter 13 plan, which provided for the sale of the home and included the exempt value in the liquidation analysis, was confirmed at the end of July 2021.[25] In February 2023, Elassal moved to sell the property for $435,000 and use all proceeds (the $22,000 exempted, plus approximately $171,000 of post-confirmation appreciation) to purchase a new residence without modifying her plan.[26] The chapter 13 trustee objected, arguing that Elassal should only be entitled to keep proceeds after payment in full of all her creditors.

The court described the situation as one that no party to the case could have predicted at confirmation — not the debtor, nor the trustee or the unsecured creditors. At confirmation, the debtor agreed to make a payment to creditors based on the liquidation analysis of whether her home appreciated or depreciated over the life of the plan. In considering whether the proceeds were property of the chapter 13 estate, the court compared the protections of chapter 7 vs. chapter 13. The court noted that while chapter 7 estates generally encapsulate appreciation, the standard is different in chapter 13.[27]

Next, the court recognized that many courts (including *Castleman*) have found that appreciation is property of the estate when a case is converted from chapter 13 to chap-

11 *Baker*, 620 B.R. at 664.
12 *Id.* at 663.
13 *Id.*
14 *In re Castleman*, 75 F.4th 1052, 1054 (9th Cir. 2023).
15 *Id.*
16 *Id.*
17 *Id.*
18 *Id.*
19 *See generally Wilson v. Rigby*, 909 F.3d 306 (9th Cir. 2018).
20 *Schwaber v. Reed (In re Reed)*, 940 F.2d 1317, 1323 (9th Cir. 1991).
21 *Castleman*, 75 F.4th at 1055-56.
22 *Elassal*, 2023 WL 5537061 at *1.
23 *Id.*
24 *Id.* at *2.
25 *Id.* at *10.
26 *Id.* at *2.

ter 7.[28] However, the court noted that chapter 13 cases "still present ... the best avenue for debtors to retain property in bankruptcy, and the unqualified right to dismiss their chapter 13 proceedings protects them from any adverse consequences of conversion to chapter 7."[29] The court further held that in chapter 13, "disposable income does not include prepetition property or its proceeds."[30] Ultimately, the *Elassal* court determined that the proceeds were not newly acquired property, thus they did not fall under the definition of property of the estate under § 1306, and Elassal could retain all sale proceeds while continuing to pay the dividend to creditors over the term of her originally confirmed plan.[31]

27 *Id.* at *6.
28 *Id.* (citing *In re Adams*, 641 B.R 147 (Bankr. W.D. Mich. 2022); *Coslow v. Reisz*, 811 Fed. App'x 980 (6th Cir. 2020)).
29 *Id.* at *6 (quoting *In re Adams*, 641 B.R. at 156).
30 *Id.* at *10 (citing *In re Burgie*, 239 B.R. 406, 410 (B.A.P. 9th Cir. 1999)).
31 *Id.* at *11.

Is Conversion the Key Factor?

On their face, the results in *Elassal* and *Castleman* appear to be in direct contradiction. However, at their core, these cases highlight the different results that may arise depending on the procedural history and current chapter of a debtor's case. The question of estate property is much clearer in unconverted cases. However, these definitions are complicated in converted cases, which does not mean that a party who is subject to a chapter 13 plan that they cannot afford to complete is without options.

As noted by the *Elassal* court, such debtors can seek to dismiss (or take actions that result in the dismissal of) the chapter 13 case and refile a chapter 7 petition. In that situation, it eliminates the question of whether the appreciation is or is not property of the estate. *Elassal* and *Castleman* highlight the fact that debtors need to consider the value of the property at all points during their case, particularly when considering whether to convert or dismiss. abi

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Faculty

Hon. Janet S. Baer is a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago, appointed on March 5, 2012. She also acts on a regular basis as the presiding judge in the Northern District of Illinois for naturalization ceremonies. Previously, Judge Baer was a restructuring lawyer for more than 25 years and was involved in some of the most significant chapter 11 bankruptcy cases in the country. The majority of her practice focused on the representation of large, publicly held debtors in both restructuring and chapter 11 matters, and she also represented companies in commercial litigation matters, including lender liability, fraud, breach of contract and breach of fiduciary duty. Prior to forming her own firm in 2009, Judge Baer was a partner at Kirkland & Ellis LLP, Winston & Strawn and Schwartz, Cooper, Greenberger & Krauss. She is a member of the ABI Board of Directors, the CARE National and Chicago Advisory Boards, and the Chicago IWIRC Network Board, as well as several committees. She also is chair of the NCBJ 2023 Education Committee and a frequent speaker for ABI, TMA, the Chicago Bar Association, IWIRC and NCBJ. Judge Baer received her B.A. from the University of Wisconsin - Madison and her J.D. from DePaul College of Law.

Hon. Martin R. Barash is a U.S. Bankruptcy Judge for the Central District of California in Woodland Hills and Santa Barbara, sworn in on March 26, 2015. He brings more than 20 years of legal experience to the bench. Prior to his appointment, Judge Barash had been a partner at Klee, Tuchin, Bogdanoff & Stern LLP in Los Angeles since 2001, where he represented debtors and other parties in chapter 11 cases and bankruptcy litigation. He first joined the firm as an associate in 1999. Earlier in his career, Judge Barash worked as an associate of Stutman, Treister & Glatt P.C. in Los Angeles. He also has served as an adjunct professor of law at California State University, Northridge. Following law school, Judge Barash clerked for Hon. Procter R. Hug, Jr. of the U.S. Court of Appeals for the Ninth Circuit from 1992-93. He is a former ABI Board member, for which he served on its Education Committee and currently serves on its Committee for Diversity, Equity, and Inclusion, and he is a former member of the Board of Governors of the Financial Lawyers Conference. In addition, he is a judicial director of the Los Angeles Bankruptcy Forum and a frequent panelist and lecturer on bankruptcy law. He also is a co-author of the national edition of the *Rutter Group Practice Guide: Bankruptcy*. Judge Barash received his A.B. *magna cum laude* in 1989 from Princeton University and his J.D. in 1992 from the UCLA School of Law, where he served as member, editor, business manager and symposium editor of the *UCLA Law Review*.

Hon. Donald R. Cassling is a U.S. Bankruptcy Judge for the Northern District of Illinois in Chicago, sworn in on Jan. 18, 2012. Prior to his appointment, he was a partner at Jenner & Block and at Quarles & Brady in Chicago, where he had a national practice in commercial and patent-infringe-ment law, as well as bankruptcy litigation, and represented chapter 11 debtors in possession, creditors' committees, individual creditors and chapter 11 trustees. Upon graduation from law school, he clerked for Chief Judge John R. Brown of the U.S. Court of Appeals for the Fifth Circuit before returning to Chicago to practice law. Judge Cassling has written and lectured extensively on the UCC, banking law and commercial litigation and has testified as an expert witness on the Illinois UCC. From 2003-11, Judge Cassling wrote "Banking Briefs," a banking litigation column for *The Banking Law Journal*, and served as a member of its board of editors. He has also participated as a faculty member for the National Institute of Trial Advocacy and was selected as an *Illinois Super Lawyer* from 2009-

12. Judge Cassling is a member of ABI, the American Bar Association and the National Conference of Bankruptcy Judges. He received his A.B. from Duke University and his J.D. from the University of Chicago Law School, where he was an editor of the *University of Chicago Law Review.*

Hon. Brian T. Fenimore is a U.S. Bankruptcy Judge for the Western District of Missouri in Kansas City, appointed on Aug. 31, 2017. Previously, he was a partner in the Kansas City, Mo., office of Lathrop & Gage LLP for more than 25 years and co-chaired its Banking & Creditors' Rights practice area, representing debtors, creditors and many other parties in interest. He also represented borrowers and lenders in problem loan matters, including loan enforcement, guarantor liability, workouts, reorganizations and bankruptcies throughout the U.S. Judge Fenimore is admitted to practice in Kansas and Missouri, and before the U.S. Bankruptcy Courts for the Eastern and Western Districts of Missouri and the District of Kansas, as well as the U.S. District Courts for the District of Kansas and the Eastern and Western Districts of Missouri. He is AV-rated by Martindale-Hubbell and has been listed in *The Best Lawyers in America* every year since 2003, among other listings. He is also a frequent speaker and ABI member. Judge Fenimore received his B.S. *magna cum laude* in 1988 in agricultural economics from the University of Missouri-Columbia and his J.D. in 1990 from the University of Michigan Law School, after which he clerked for Hon. Arthur B. Federman.

Hon. Mary P. Gorman is a U.S. Bankruptcy Judge for the Central District of Illinois in Springfield, appointed in September 2005 by the Seventh Circuit Court of Appeals. She served as Chief Judge from January 2013 until August 2019. Prior to her appointment to the bench, she was in private practice, concentrating in bankruptcy and commercial transactions and litigation, and she was admitted to practice in the Illinois Supreme Court, the Northern and Central Districts of Illinois, the Seventh Circuit Court of Appeals, the U.S. Tax Court and the U.S. Supreme Court. Judge Gorman is a past president of the Winnebago County Bar Association and has been active on the Illinois State Bar Association's Task Force on the Unauthorized Practice of Law and the Commercial, Banking, and Bankruptcy Section Council. From 1999-2003, she was an adjunct professor of bankruptcy law at the Northern Illinois University College of Law. Judge Gorman is a member of the National Conference of Bankruptcy Judges, ABI, and the Illinois State, Winnebago County and Sangamon County Bar Associations. She has served on the Administrative Office of the U.S. Courts' Bankruptcy Judges Advisory Group and on the Administrative Office's Budget and Finance Advisory Council. Judge Gorman recently completed seven years of service as one of the five bankruptcy judge representatives on the Judicial Conference Committee on the Administration of the Bankruptcy System. During her service on the Bankruptcy Committee, she served as a liaison to the Judicial Conference Advisory Committee on Bankruptcy Rules and the Judicial Conference Budget Committee's Economic Subcommittee. She also was a member of the task force created by the Bankruptcy Committee to review current policies, rules and regulations regarding unclaimed funds, and she currently serves as a member of the Administrative Office's Judiciary Data Working Group. Judge Gorman received her undergraduate degree with honors from Rosary College (now Dominican University) and also attended the University of Fribourg, Switzerland. She received her J.D. with high honors from the University of Illinois College of Law, where she served as a member of its law review and the Order of the Coif.

Hon. Meredith A. Jury is a retired U.S. Bankruptcy Judge for the Central District of California in Riverside, appointed from 1997-2018 by the Ninth Circuit Court of Appeals. She also served on the Ninth Circuit Bankruptcy Appellate Panel (BAP) from 2007-17. Since her retirement, she has

been writing *pro bono* appellate briefs for consumer debtors or amicus for NACBA. Prior to her appointment to the bench, Judge Jury had spent her entire attorney career as a civil, municipal and bankruptcy litigator for the law firm of Best, Best & Krieger in Riverside, joining as the first woman associate in 1976 and becoming its first woman partner in 1982. She has participated in innumerable panels about various aspects of bankruptcy law at local and Ninth Circuit programs. As a member of the BAP, Judge Jury was lead author of *In re Vallejo*, 408 B.R. 280 (B.A.P. 9th Cir. 2009), primarily concerning the eligibility of a city to file chapter 9. She received her B.A. *cum laude* from the University of Colorado, where she was elected Phi Beta Kappa, and her J.D. from UCLA. She also received Masters degrees in economics and English/education from the University of Wisconsin.

Hon. Peter C. McKittrick is a U.S. Bankruptcy Judge for the District of Oregon in Portland, appointed in 2015. Before his appointment, he was a partner in the law firm of McKittrick Leonard, LLP. Judge McKittrick served as a panel chapter 7 trustee from 2005-15 and was appointed as a chapter 11 trustee and receiver in many cases. Prior to starting McKittrick Leonard, he practiced law with Farleigh Wada Witt PC for 27 years. His law practice emphasized the representation of trustees and other fiduciaries, chapter 11 debtors and committees, and small business workouts. Judge McKittrick received his B.S. from Lewis and Clark College in 1981 and his J.D. *cum laude* from Willamette University College of Law in 1985.

Hon. Charles D. Novack is Chief Bankruptcy Judge for the Northern District of California in Oakland, initially appointed on May 13, 2010. He regularly lectures on a variety of bankruptcy topics, is a Rutter Group guest lecturer on bankruptcy family law issues, and is a panel member on the Bay Area Bankruptcy Forum's popular Consumer Update annual program. Judge Novack maintained his own bankruptcy practice in Oakland, Calif., during the five years preceding his appointment, representing chapter 7 trustees, and debtors, creditors and other interested parties in chapter 7, 11 and 13 cases. From 1994 until 2005, he was an associate and then a partner at the Oakland bankruptcy boutique firm of Kornfield, Paul & Nyberg. Judge Novack served as an associate professor at California State University, East Bay for several years and at Hastings College of the law during the 2017-18 school year. He received his bachelor's degree with honors in 1980 from Rutgers College and his J.D. *cum laude* in 1983 from the University of California at Hastings College of the Law.

Hon. Cathleen D. Parker is Chief U.S. Bankruptcy Judge for the District of Wyoming in Cheyenne, appointed on June 2, 2015. Prior to her appointment, she was an attorney with the Wyoming Attorney General's Office for 16 years, where she primarily represented the Wyoming Departments of Revenue and Audit in front of administrative tribunals, the Wyoming State Courts and the Wyoming Supreme Court. At the time of her appointment, she was the supervisor of the Revenue Section of the Civil Division and was the head of the Attorney General's Bankruptcy Unit. Prior to joining the Office of the Attorney General, Judge Parker worked as an attorney in private practice in Colorado, handling both civil and criminal matters. She also sits on the Tenth Circuit Bankruptcy Appellate Panel. Judge Parker received her J.D. with honors from the University of Wyoming College of Law in 1998.

Hon. Deborah J. Saltzman is a U.S. Bankruptcy Judge for the Central District of California in Los Angeles and San Fernando Valley, appointed on March 18, 2010; she also hears cases in the Northern Division in Santa Barbara. As a member of the Ninth Circuit Bankruptcy Education Committee, she welcomes the opportunity to participate in bankruptcy education programs. She also currently serves

on the Ninth Circuit Wellness Committee. Prior to her appointment to the bench, Judge Saltzman practiced bankruptcy law in Los Angeles, representing debtors, secured and unsecured creditors, asset-purchasers, creditors' committees and landlords in chapter 11 and out-of-court restructurings, as well as related financing transactions and litigation. She received her B.A. in 1991 from Amherst College Phi Beta Kappa and her J.D. in 1996 from the University of Virginia School of Law.

Hon. Madeleine C. Wanslee is a U.S. Bankruptcy Judge for the District of Arizona in Phoenix, sworn in on March 17, 2014. Previously, she was an associate and then partner at Gust Rosenfeld, PLC, where she was active in the firm's management committee and co-chaired the firm's Bankruptcy Practice Group. Her practice focused on bankruptcy and creditors' rights, and she represented small businesses, financial institutions, corporations and state agencies. While in private practice, Judge Wanslee was a certified bankruptcy specialist. She also argued a number of appeals, including *United Student Aid Funds Inc. v. Espinosa* before the U.S. Supreme Court. Judge Wanslee serves on the Ninth Circuit Conference Executive Committee (currently as program chair) and on various committees of the National Conference of Bankruptcy Judges. She is a frequent presenter and helps to train new judges through the Federal Judicial Center. Judge Wanslee is a former chair of the Ninth Circuit Bankruptcy Judges Education Committee, the Ninth Circuit Lawyer Representatives Coordinating Committee and the Arizona State Bar's Bankruptcy Section. She helped to charter and is past president of the Arizona Bankruptcy American Inn of Court. Judge Wanslee began her legal career as a law clerk for Hon. Robert Clive Jones of the Ninth Circuit Bankruptcy Appellate Panel. She received her B.F.A. and B.A. from the University of Arizona and her J.D. from Gonzaga University School of Law, where she served as a writer and executive editor of the *Gonzaga Law Review*. Following law school, she clerked for Chief Bankruptcy Judge Robert C. Jones of the District of Nevada.