CONSUMER BANKRUPTCY NEWS

CRITICAL ISSUES AND WINNING STRATEGIES FOR BANKRUPTCY PROFESSIONALS

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ADVISING CLIENT TO INCUR DEBT TO PAY FEE VIOLATES SECTION 526

Attorneys who instruct clients to use their credit cards to pay bankruptcy-related legal fees violate Section 526(a)(4), the 11th U.S. Circuit Court of Appeals held in *Cadwell v. Kaufman, Englett & Lynd PLLC*, 2018 WL 1550612 (11th Cir. 3/30/18).

The 11th Circuit reversed and remanded the district court's ruling.

The district court relied on *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229 (2010), in ruling that legal advice to incur debt violates Section 526(a)(4) only if it is given for an invalid purpose. The 11th Circuit found that advising a client to use a credit card to pay for bankruptcy-related legal services is "inherently abusive."

"Section 526(a)(4)'s second prohibition ... has no need for any further invalid-purpose gloss, because the advice it targets is, in effect, suspect *per se*," the 11th Circuit said.

Background

Loyd Cadwell sued the law firm of Kaufman, Englett & Lynd PLLC after allegedly signing an agreement to have the firm represent him in a Chapter 7 case.

According to Cadwell's complaint, the agreement obligated him to pay $1,700 in attorney fees. An addendum established a payment schedule that required immediate payment of a $250 retainer, a second $250 installment shortly thereafter, and then four monthly installments of $300.

Cadwell's complaint asserts that "KEL instructed [him] to pay the initial retainer and all subsequent payments by credit card."

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Cadwell said he used two different credit cards to pay the initial retainer and the next three installments.

The lawsuit was filed after Cadwell terminated his relationship with the law firm. The complaint asserts that KEL's instruction to use his credit cards to pay the firm's fee violated Section 526(a)(4).

The district court granted KEL's motion to dismiss on the basis that Cadwell had not stated a claim on which relief could be granted.

The district court ruled that "mere advice to use credit cards to pay for legal fees does not violate" Section 526(a)(4). The district court concluded that Section 526(a)(4) only "prohibits a debt relief agency from advising a debtor to incur additional debt for an invalid purpose."

Section 526(a)(4)

Section 526(a)(4) states that a "debt relief agency ... shall not ... advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer a fee or charge for services performed as part of preparing for or representing a debtor in a case under this title."

The parties agreed that Cadwell was an "assisted person" or "prospective assisted person."

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They also agreed that KEL was a "debt relief agency."

Finally, they agreed that Section 526(a)(4) prohibits advising clients to incur debt in anticipation of filing for bankruptcy in general, and prohibits advising clients to incur debt to pay for bankruptcy-related legal services.

The parties disagreed as to where the first prohibition ended and the second began.

"Unfortunately, the statute contains no punctuation that might help us determine where to place the 'hinge' that divides the two prohibitions – which, as it turns out, really matters. We are presented here with three different ways of reading Section 526(a)(4) – one (sort of) suggested by the Supreme Court in *Milavetz*, another proposed by KEL and adopted by the district court, and yet another advocated by Cadwell. Each locates the hinge in a different place in the text, resulting in three very different meanings."

Milavetz

Neither party argued that Section 526(a)(4) should be interpreted as *Milavetz* suggested it should be.

In passing, the Supreme Court observed that Section 526(a)(4) "prohibits a debt relief agency from 'advising an assisted person' either 'to incur more debt in contemplation of' filing for bankruptcy 'or to pay an attorney or bankruptcy petition preparer fee or charge for services' performed in preparation for filing."

By placing "either" before "to incur more debt" Section 526(a)(4) prohibits advice (1) "to incur more debt in contemplation of" filing for bankruptcy and (2) "to pay an attorney" for bankruptcy-related representation.

The 11th Circuit said the Supreme Court's reading of the statute was not an unusual one in a grammatical sense but was unworkable in practice.

"Under it, both prohibitions would begin (neatly) with infinitives – 'to incur' and 'to pay.' But the interpretation does have a pretty big wart – namely, that it would flatly prohibit *all* advice 'to pay an attorney' for bankruptcy-related representation. That makes little sense, it seems to us, particularly in light of other provisions of the Bankruptcy Code that clearly contemplate that attorneys will get paid for bankruptcy-related services."

The 11th Circuit concluded that it was not required to use the *Milavetz* definition because the Supreme Court's ruling dealt with Section 526(a)(4)'s first prohibition and not the second.

District court's interpretation

The district court interpreted Section 526(a)(4) as prohibiting lawyers from advising their clients to incur debt to pay for bankruptcy-related legal services only if that advice was given for an "invalid purpose." The district court said this reading was compelled by *Milavetz*.

The 11th Circuit noted that the issue in *Milavetz* was whether the first prohibition in Section 526(a)(4) unconstitutionally restricted a law firm's attorney-client communications.

The Court concluded that the first prohibition prevents an attorney "only from advising a debtor to incur more debt because the debtor is filing for bankruptcy, rather than for a valid purpose." The Court explained that the phrase "in contemplation of" is a term of art historically associated with abusive conduct. Here, that abusive conduct would be to take on debt in anticipation of discharging it in bankruptcy.

The Supreme Court unanimously concluded that Section 526(a)(4)'s first prohibition requires proof that the advice was given for an invalid purpose. The 11th Circuit found that this restriction did not apply to the section's second prohibition.

"[R]eading the phrase 'in contemplation of' to apply to both prohibitions renders the second prohibition essentially meaningless." The 11th Circuit said.

"Under that reading, the second prohibition becomes a mere subset of the first – it has no independent bite. We disfavor interpretations of statutes that render words or clauses superfluous."

Don't incur debt to pay fee

The third interpretation places the "hinge" after the phrase "to incur more debt." In this position, Section 526(a)(4) prohibits advice "to incur more debt" either (1) "in contemplation of" a bankruptcy filing or (2) "to pay an attorney" for bankruptcy-related legal services.

"Unlike the first two interpretations, this one doesn't produce goofy results, defy the usual rules of syntax, or render a phrase meaningless," the 11th Circuit said.

While the first prohibition requires an invalid purpose to separate abusive advice from proper advice, the second prohibition establishes that advising debtors to incur debt to pay for bankruptcy-related services is "inherently abusive in at least two respects. First, it puts the attorney's financial interest – getting paid in full – ahead of the debtor-client's. If a creditor discovers the timing and reason for the fee-related debt, it could challenge the debt's dischargeability, thereby compromising the debtor's fresh start. *See Milavetz*, 559 U.S. at 245. Second, it puts the lawyer's own interests ahead of the creditors' in that, while ensuring the lawyer's full payment, it leaves a diminished estate on which creditors can draw. *See id.* Section 526(a)(4)'s second prohibition, then, has no need for any further invalid-purpose gloss, because the advice it targets is, in effect, suspect *per se*."

After concluding that attorneys violate Section 526(a)(4) by advising clients to incur additional debt to pay for bankruptcy-related legal representation, the 11th Circuit ruled that Cadwell's allegation that the law firm instructed him to pay his bankruptcy-related legal bills by credit card stated a viable claim under Section 526(a)(4).

Finally, the 11th Circuit found none of the constitutional arguments raised by the law firm warranted invalidating the statute on First Amendment grounds.

NEWS

FILINGS DOWN 4 PERCENT IN FIRST QUARTER

Total bankruptcy filings fell 4 percent during the first three months of 2018 as compared to the first three months of 2017, according to the American Bankruptcy Institute reporting data provided by Epiq Systems Inc.

Bankruptcy filings totaled 187,331 in the first quarter of 2018, down 4 percent from the 195,283 filings in the first calendar quarter of 2017.

Consumer bankruptcy filings totaled 178,004 during the first quarter of 2018, which was a 4 percent decrease from the 2017 total of 185,850.

The 75,992 total filings in March 2018 represented a 7 percent decrease from the 81,632 total filings registered in March 2017. Total consumer filings in March 2018 also decreased 7 percent to 72,353 from the 77,908 filings recorded in March 2017.

U.S. SUPREME COURT

HIGH COURT URGED TO AFFIRM DISCHARGE OF ATTORNEY FEE

A federal appeals court properly allowed a Chapter 7 debtor to discharge a $104,000 debt to a law firm despite the debtor's allegedly false oral statements

about the tax refund he promised to use to pay the bill, the debtor has told the U.S. Supreme Court. (*Lamar, Archer & Cofrin v. Appling*, No. 16-1215, *respondent's brief filed*, 2018 WL 1532765 (U.S. Mar. 28, 2018).)

The 11th U.S. Circuit Court of Appeals correctly interpreted a Bankruptcy Code provision designed to prevent debtors from discharging debts obtained by fraudulent oral statements, but not if the allegedly false statement was one "respecting the debtor's ... financial condition," debtor Scott Appling says.

Here, he says, the appeals court correctly concluded that his statement about a single asset – the tax refund he was expecting – was a statement about his financial condition that brought the debt within the exception to nondischargeability.

"A debtor's statement describing a single asset or liability has a direct impact on the sum of his assets and liabilities," Appling says in a March 28 response brief, urging the high court to affirm the 11th Circuit's decision.

Earlier this year the U.S. Supreme Court agreed to review the ruling. Oral argument was scheduled for April 17 and a decision is expected before the end of the Supreme Court's term in June.

The case centers on Section 523(a)(2)(A), which bars the discharge of any debt, including for services or an extension of credit, obtained by "false pretenses, a false representation or actual fraud, other than a statement respecting the debtor's ... financial condition."

For a debt stemming from a debtor's false statements about his financial condition to be nondischargeable, the statements must meet requirements set forth in Section 523(a)(2)(B), including that the statement was in writing and made with intent to deceive the creditor and the creditor reasonably relied on it.

In its certiorari petition, the law firm Lamar, Archer & Cofrin argued that the 11th Circuit's decision conflicted with rulings from three other federal appeals courts that all said a statement about a specific asset was not a statement about a debtor's financial condition.

Unpaid legal bill

Appling retained Lamar Archer in 2004 to represent him in litigation against the former owners of a business he had recently purchased, according to the 11th Circuit's opinion.

By March 2005, Appling owed $60,000 to Lamar Archer for representing him in the suit, and the firm told him it would drop the case and file an attorney's lien if he did not pay up, the opinion said.

Appling met with Lamar Archer on March 18, 2005, the opinion said. According to the firm, Appling said at the meeting that he was expecting a tax refund of more than $100,000, which he would use to pay his attorney fees.

In fact, Appling requested and received a refund of only about $60,000, and he used the money to prop up his business, the opinion said.

Appling met Lamar Archer again in November. Appling claimed he told the firm at that meeting that he had used the money, while Lamar Archer said he claimed he had not yet received the refund and would use it to pay the fees, according to the opinion.

Lamar Archer ultimately won a $104,000 state court judgment against Appling, who then filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Middle District of Georgia. The firm then sought to have the debt barred from discharge under Section 523(a)(2)(A).

The bankruptcy court sided with the firm, finding Appling had made misrepresentations at the March and November 2005 meetings about his intent to pay the fees. *Lamar, Archer & Cofrin v. Appling (In re Appling),* 527 B.R. 545 (Bankr. M.D. Ga. 2015).

Appling appealed to the district court, which affirmed the bankruptcy court. *Appling v. Lamar, Archer & Cofrin,* 2016 WL 1183128 (M.D. Ga. Mar. 28, 2016).

The 11th Circuit reversed, prompting the law firm to seek Supreme Court review. *Appling v. Lamar, Archer & Cofrin (In re Appling)*, 848 F.3d 953 (11th Cir. 2017).

'Assets on Monday, debts on Tuesday'

Congress included the financial-condition exception to nondischargeability in its current form when it enacted the Bankruptcy Code in 1978, Lamar Archer said in its opening brief to the Supreme Court.

The exception was designed to prevent unscrupulous creditors from eliciting incomplete financial statements from consumers and then using those statements to prevent the consumers from discharging their debts, according to the brief.

It was never intended to allow a debtor who made a false statement about a specific asset to escape the Bankruptcy Code's ban on the discharge of debts obtained by fraud or false representations, the law firm said.

Appling counters that Lamar Archer's interpretation would allow creditors to evade the protection

Section 523(a)(2)(B) offers to debtors by asking about everything except "overall" financial condition, Appling says in its response brief.

"Under this logic, a creditor could also avoid (2)(B) by asking a borrower to list his assets on Monday and his debts on Tuesday," the debtor says.

The word "respecting" in the phrase "respecting a debtor's financial condition was a "broadening term" intended to prevent that type of manipulation, Appling says, disputing Lamar Archer's contention that the word "respecting" covers only a "more holistic snapshot" of one's overall financial status.

"If a friend announces that she just won $500,000 in the lottery, most everyone would understand that as a "statement respecting her financial condition," Appling says.

The 11th Circuit's ruling also recognized that Congress intended to encourage written documentation when it enacted Section 523(a)(2)(B).

"Writing enhances accuracy at the start, and it obviates the sort of guesswork that occurred below, where the bankruptcy court sought to reconstruct oral conversations that occurred a decade earlier," the debtor says. "Congress's decision to encourage writing – a policy apparent on the face of the statute – promotes fairness, accuracy, and efficiency."

Appling says the appeals court's ruling also reflects how borrowers and lenders behave in the real world.

"Creditors rely on representations borrowers make about individual assets because those statements shed light on the borrower's financial condition and thus the likelihood that the borrower will repay," he says. "In form, substance, and effect, there is often little distinction between a statement that describes the entirety of a borrower's financial condition and one that describes some important aspect of it."

(Reporting by Donna Higgins.)

FEDS, PROFESSORS BACK BROAD READING OF SECTION 523(a)(2)(B)

A debtor's oral statement about a single asset can in some circumstances constitute a "statement respecting" his financial condition for purposes of determining whether a debt can be discharged, the federal government has told the U.S. Supreme Court. (*Lamar, Archer & Cofrin v. Appling*, No. 16-1215, *amicus brief filed*, 2018 WL 1665999 (U.S. Apr. 4, 2018).)

"The phrase 'statement respecting the debtor's ... financial condition' is naturally understood to encompass a representation about a debtor's asset that is offered as evidence of ability to pay," the U.S. solicitor general said in an April 4 amicus curiae brief.

The government, along with two groups of law professors and a retired bankruptcy judge, are supporting respondent R. Scott Appling, who wants the high court to affirm a ruling from the 11th U.S. Circuit Court of Appeals.

That ruling said Appling could discharge his $104,000 debt to a law firm under an exception to the rule that debts obtained by fraud or false representations are not dischargeable in bankruptcy.

The law firm, Lamar, Archer & Cofrin, contends that the debt should be nondischargeable because Appling allegedly lied to the firm about an expected tax refund he said he would use to pay the legal bill.

The case centers on Section 523(a)(2)(A), which bars the discharge of any debt, including for services or an extension of credit, obtained by "false pretenses, a false representation or actual fraud, other than a statement respecting the debtor's ... financial condition."

The 11th Circuit said Appling's false statements about a single asset – the tax refund – could constitute a statement about his financial condition under Section 523(a)(2)(A) and thus bring the debt to Lamar Archer within the exception to nondischargeability.

"When a debtor's statement about a particular asset is offered as evidence of his ability to pay, and the statement actually induces a creditor to extend value to the debtor, no evident reason exists to treat that statement differently from a statement about the debtor's overall finances that is offered for the same purpose and has the same effect," the government said in its amicus brief.

Avoiding 'bizarre outcomes'

A group of 18 law professors, and another group consisting of three law professors and retired U.S. Bankruptcy Judge Eugene Wedoff, filed amicus briefs urging the high court to reject the petitioner's reading of Section 523(a)(2)(A).

Under Lamar Archer's interpretation, "a debt arising from an oral lie about a single asset is not dischargeable, whereas the debt arising from an oral lie about all assets and liabilities would be dischargeable," the larger group of law professors says in its brief. "Rejecting petitioner's fundamental misinterpretation of the statute not only means that Appling's debt is dischargeable, but leads to a clean, coherent meaning of the statute that avoids bizarre outcomes."

In their brief, Judge Wedoff and the three professors say Lamar Archer's interpretation is based on a flawed view of Chapter 7 debtors as "'can-pay' individuals who will opportunistically seek to game the system when given the chance."

"Petitioner's brief is premised on this unflattering view of the population of individual debtors and a notion that Congress has sought to rein in misconduct by ever stricter views of who deserves a discharge," they say.

In reality, they argue, Congress has over the past several decades sought to expand the availability of the bankruptcy discharge to individual debtors.

(Reporting by Donna Higgins.)

CONCEALED ASSET

DEBTOR WHO 'MADE A MOCKERY' OF BANKRUPTCY COURT CAN'T COLLECT AWARD

An Alabama woman who recently discharged debts through Chapter 7 cannot collect a $116,700 arbitration award over workplace discrimination because she concealed both the discrimination suit and the award during her bankruptcy proceedings, a Birmingham federal judge has ruled. (*Wholesalecars.com v. Hutcherson*, 2018 WL 1509509 (N.D. Ala. 3/27/18).)

U.S. District Judge Karon Owen Bowdre of the Northern District of Alabama applied judicial estoppel to prevent Cory Hutcherson from enforcing the award against her former employer Wholesalecars.com, finding Hutcherson had "intended to make a mockery of the judicial system."

However, the trustee in her Chapter 7 proceedings can collect the award on behalf of Hutcherson's bankruptcy estate, Judge Bowdre said.

Proceedings unknown to each other

Hutcherson sued Wholesalecars.com in July 2014 in the district court, alleging that the company had illegally terminated her employment because she was pregnant, Judge Bowdre explained in her opinion.

The case proceeded to arbitration, and on Nov. 24, 2015, an arbitrator awarded Hutcherson $116,677, the opinion said.

Meanwhile, two months before receiving the award, while arbitration was ongoing, Hutcherson filed a Chapter 7 bankruptcy petition in the U.S. Bankruptcy Court for the Northern District of Alabama.

Hutcherson failed to mention her lawsuit against Wholesalecars.com in her original bankruptcy filings, and on Nov. 5, 2015, when asked by the trustee at the creditors meeting whether she was "suing anyone for any reason," Hutcherson responded under oath, "no sir," the opinion said.

Subsequently, when she filed amended bankruptcy schedules after having won the award in arbitration, Hutcherson omitted the arbitration award.

On Jan. 7, 2016, the bankruptcy court discharged Hutcherson's debts.

Soon after, Wholesalecars.com sued Hutcherson in the district court, alleging that she had obtained the arbitration award through fraud.

Hutcherson did not tell the arbitrator she was going through bankruptcy proceedings and therefore falsely represented to the arbitrator that she was entitled to pursue a claim that actually belonged to her bankruptcy estate, Wholesalecars.com argued.

Hutcherson's former employer asked the court to vacate the award under the Federal Arbitration Act, 9 U.S.C.A. § 10 as having been obtained by fraud or, failing that, estop Hutcherson from collecting the award.

'Mockery'

Judge Bowdre refused to vacate the award, finding that Hutcherson's failure to tell the arbitrator that she was going through bankruptcy was not sufficiently related to an issue in the arbitration.

"The arbitrator's decision, the merits of the case, and Wholesalecars.com's ability to present its defense would not have changed had Ms. Hutcherson revealed her lack of standing and the trustee was appropriately substituted in to the arbitration," the judge said.

However, the judge concluded that Hutcherson was judicially estopped from enforcing the award.

Hutcherson's repeated omissions of the suit and the award evinced an intent to "make a mockery of the judicial system," the judge said, citing *Slater v. U.S. Steel Corp.*, 871 F.3d 1174 (11th Cir. 2017).

Most "egregiously," Hutcherson did not answer truthfully about her participation in any lawsuits when asked directly by the bankruptcy trustee at her creditor meeting, the judge said.

"The question was not a trick question," the judge wrote, granting the former employer's motion to the extent it requested the court to bar Hutcherson from enforcing the award.

However, because Hutcherson's bankruptcy trustee never took inconsistent positions under oath, the trustee can enforce the award in the interests of the bankruptcy estate, Judge Bowdre concluded.

(Reporting by Thomas Parry.)

EXEMPTION

EXEMPT PROPERTY INCLUDED IN DISPOSABLE-INCOME CALCULATION

A Texas bankruptcy court properly denied confirmation of a couple's Chapter 13 plan that excluded workers' compensation settlement funds from their disposable-income calculation, even though the funds were classified as exempt, a federal district judge has ruled. (*Ortiz-Peredo et al. v. Viegelahn*, 2018 WL 1598676 (W.D. Texas 3/29/18).)

Exempt property must still be included in the disposable-income analysis required for confirmation of a Chapter 13 plan, U.S. District Judge Orlando L. Garcia of the Western District of Texas said, rejecting the debtors' argument that 2005 amendments to the Bankruptcy Code necessitated a different outcome.

Exemption, objection to confirmation

Jose Ortiz-Peredo and his wife, Lilia Guadalupe Lopez, filed a Chapter 13 petition in the U.S. Bankruptcy Court for the Western District of Texas in April 2017. They listed as an asset a workers' compensation claim that they ultimately settled for $22,500, with a $8,600 recovery after litigation costs, according to Judge Garcia's opinion.

The debtors, claiming the settlement funds as exempt, proposed a Chapter 13 plan that did not provide for payment of any of the funds to creditors, the opinion said. Chapter 13 trustee Mary K. Viegelahn objected to confirmation.

Citing Section 1325 the trustee said the settlement funds were disposable income that had to be included in the plan and be applied to repay unsecured creditors.

The bankruptcy court sustained the trustee's objection and granted the debtors 14 days to propose a new plan. When they failed to do so, the court dismissed their case pursuant to Section 1307(c)(5), which allows a bankruptcy court to dismiss a Chapter 13 case if plan confirmation is denied under Section 1325.

The debtors appealed, saying the bankruptcy court erred by finding the exempt settlement funds were required to be included in the disposable-income calculation.

'Best efforts' test

Section 1325, in subsections (a) and (b), establish several requirements for confirmation of a Chapter 13 plan, including the "best efforts" test set forth in Section 1325(b)(1).

Under that test, if a party objects to confirmation, a court may confirm a plan only if it provides that all of the debtor's projected disposable income will be included in the plan and used to pay unsecured creditors.

Here, the parties disagree as to whether property that has been exempted from a bankruptcy estate under Section 522 is included in the projected disposable income that must be paid to unsecured creditors under the "best efforts" test, Judge Garcia said.

Included in disposable income

In siding with the trustee, the bankruptcy court followed the majority of courts that have considered the issue and found that exempt property must be included in the disposable-income analysis, he said.

On appeal, the debtors argued that the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which amended the Bankruptcy Code, abrogated the majority view by changing the code's definition of "disposable income."

Rejecting that argument, Judge Garcia said Section 1325(b)'s plain language, both before and after BAPCPA's enactment, "makes no express or implied reference to the exempt status of income."

That interpretation does not conflict with Section 522(c), which provides that a debtor's exempt property is not liable for any debt that arose prior to the bankruptcy, the judge said.

He cited *In re Koch*, 109 F.3d 1285 (8th Cir. 1997), which noted that Section 1325(b)'s disposable-income provision "does not render property that is exempt under Section 522(c) liable for pre-petition debts, but rather defines the terms upon which Congress has made the benefits of Chapter 13 available."

The bankruptcy court thus did not err in finding the settlement funds' exempt status did not exclude them from the debtors' disposable-income calculation, Judge Garcia said.

He therefore affirmed the denial of confirmation and the order dismissing the debtors' case under Section 1307(c)(5).

(Reporting by Lisa Uhlman.)

EXEMPTION DOESN'T BAR COLLECTION BY MEDICAL PROVIDERS

Proceeds from a debtor's settlement of a workers' compensation claim are exempt against general creditors under Illinois law but not against health care providers, a federal judge has ruled, affirming a bankruptcy court's finding for several medical provider creditors. (*In re Hernandez*, 2018 WL 1469000 (N.D. Ill. 3/26/18).)

U.S. Bankruptcy Judge Jorge Alonso of the Northern District of Illinois rejected the debtor's argument that the Illinois Workers' Compensation Act made awards on workers' compensation claims 100 percent exempt, saying it misinterpreted a 2005 amendment to the law.

Exemption claim

Elena Hernandez filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of Illinois in 2016, listing as her only creditors health care providers that had provided medical services to her in connection with a workplace injury.

Hernandez claimed an exemption pursuant to Section 21 of the Illinois Workers' Compensation Act, 820 Ill. Comp. Stat. Ann. § 305/21, in a workers' compensation claim she had filed over the injury.

That statute states that "no payment, claim, award or decision under this act shall be assignable or subject to any lien, attachment or garnishment, or be held liable in any way for any lien, debt, penalty or damages."

In December 2016 Hernandez settled her workers' compensation claim with her employer.

Several of the medical provider creditors subsequently objected to her claimed exemption.

At a hearing on the objection, Hernandez argued that, under Illinois law, workers' compensation awards are 100 percent exempt from creditor claims. The creditors countered that allowing the exemption would "write [them] out of [their] statutory rights ... regarding payment for medical services rendered."

The bankruptcy court sustained the objection and denied the exemption. Hernandez then appealed to the district court.

Section 21 amendments

Illinois has opted out of the federal bankruptcy exemption scheme set forth in Section 522(b), so debtors must instead use the applicable state law exemptions.

Under Illinois law, property may be exempt with regard to certain claims but not others, Judge Alonso said.

Here, Hernandez, citing *In re McClure*, 175 B.R. 21 (Bankr. N.D. Ill. 1994), argued that her workers' compensation claim was entirely exempt from all creditors under Section 21 of the Illinois WCA.

The *McClure* court held that Section 21 exempts workers' compensation claims from any bankruptcy estate. However, in 2005 the Illinois Legislature amended the WCA, and the new language provides that workers' compensation claims are not exempt with respect to medical providers.

The amendments protected employees by expanding benefits, restricting what medical providers can charge and prohibiting collection efforts during the pendency of any dispute over a workers' compensation claim.

They also added protections for medical providers by ensuring they can resume collection efforts against an employee if a disputed workers' compensation claim is ultimately resolved in the employer's favor or settled.

No 'blanket exemption'

Rejecting Hernandez's interpretation of Section 21, Judge Alonso said he was "not persuaded that the Illinois Legislature ... intended that the very medical providers whose right to collect payment the Legislature sought to protect, and whose services are integral to the workers' compensation system, should not be able to resort to legal process to obtain payment from an injured employee who has settled her claim with her employer."

Hernandez had argued that the 2005 amendments had no bearing on Section 21, "but to accept that interpretation would be to ignore [the] principles of statutory construction" under which each part of a statute must be given a reasonable meaning, Judge Alonso said.

"The debtor interprets the statute to specifically provide that medical providers may collect payment for their services from the injured employee after her disputed claim has been resolved – except when they have to resort to legal process to do so," the judge said. "This interpretation is not reasonable."

Section 21 of the WCA "does not provide a blanket exemption from the bankruptcy estate for workers' compensation claims," and rather exempts such claims from the reach of general creditors but not of medical providers, Judge Alonso said.

He therefore affirmed the bankruptcy court's decision.

(Reporting by Lisa Uhlman.)

LIENS

CHAPTER 13 DEBTOR MAY STRIP LIEN DESPITE BANK'S FAILURE TO FILE CLAIM

A bank's fully underwater junior lien on a Chapter 13 debtor's home can be stripped off even though the bank didn't file a proof of claim in the bankruptcy, a federal appeals panel has ruled. (*Burkhart v. Grigsby et al.*, 2018 WL 1526628 (4th Cir. 3/29/18).)

Undisputed evidence that the bank's liens are entirely without value established that the bank holds an unsecured claim that can be removed entirely, the 4th U.S. Circuit Court of Appeals said.

The 4th Circuit panel reversed a district court decision that said the Bankruptcy Code's claim-allowance process must precede application of the code's lien-stripping provision.

"This conclusion confuses the claim-allowance and lien-avoidance process and turns a blind eye to economic reality," the panel said.

Underwater principal residence

Edwin and Teresa Burkhart filed for Chapter 13 relief in the U.S. Bankruptcy Court for the District of Maryland in 2012.

The couple listed a principal residence valued at $435,000 and subject to Chase Bank's first-priority lien of $610,000, two liens held by Community Bank of Tri-County totaling nearly $128,000, and a PNC Bank lien for $106,000.

Chase and PNC filed proofs of claim in the bankruptcy but Tri-County did not.

Lien status determination

In May 2013 the Burkharts filed an adversary complaint against Tri-County and PNC, seeking a declaration that the junior liens were void because Chase's first-priority secured interest exceeded the property's value.

The debtors also proposed a Chapter 13 plan indicating their intention to treat the liens as determined in the adversary proceeding.

The complaint cited Section 506(d), which provides that "to the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void."

It also referenced Section 1322(b), which allows Chapter 13 plans to "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence."

The rights of partially underwater claimholders fall within the statute's anti-modification clause, but fully underwater liens fall outside its protection, the 4th Circuit panel explained.

Prerequisite to avoidance

The banks did not answer the adversary complaint and the bankruptcy court entered default judgment, finding the liens to be fully underwater.

The court also stripped off PNC's lien, but said it could not strip Tri-County's lien, heeding Chapter 13 trustee Nancy Grigsby's opposition to the avoidance claim.

Lien avoidance under Section 506(d) can occur only if the creditor has filed a proof of claim, the bankruptcy court said.

The U.S. District Court for the District of Maryland affirmed, adding that the power to modify secured creditors' rights under Section 1322(b) is not in play until a claim has been allowed and valued under Section 506(a).

The Burkharts appealed.

Lien-stripping statute controls

The 4th Circuit panel reversed, rejecting the position that a formally filed proof of claim is a prerequisite to stripping off a valueless lien.

The panel noted that Section 1322(b)(2) focuses on a claimholder's "rights" instead of the claim itself, citing *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993).

Section 506(a)'s valuation process refers only to a "claim" and does not determine a creditor's rights under Section 1322(b) (2), the panel said.

"The ability of a Chapter 13 debtor to strip off an underwater lien stems from Section 1322(b), not Section 506(d)," the panel concluded.

(Reporting by Michael Nordskog.)

11TH CIRCUIT AFFIRMS REQUIRING DEBTORS TO SURRENDER HOME

A Florida bankruptcy court acted properly when it reopened the debtors' Chapter 7 case after five years and ordered the debtors to surrender their home, the 11th U.S. Circuit Court of Appeals ruled in an unpublished decision. (*Woide v. Federal National Mortgage Association (In re Woide)*, 2018 WL 1633550 (11th Cir. 4/5/18) (unpublished).)

The debtors initially filed for Chapter 13 relief in December 2010. They converted their case to Chapter 7 in April 2011.

Their original Schedule A said the debtors were going to surrender their home.

The debtors filed amended schedules after converting their case to Chapter 7. Their amended Schedule A was blank and they did not file a Statement of Intention.

The debtors received a Chapter 7 discharge on July 12, 2011.

Fannie Mae initiated a foreclosure action on Dec. 7, 2011. The debtors vigorously opposed the foreclosure action and proactively asserted claims to either invalidate or rescind the note and mortgage.

In March 2016, frustrated by the delays caused by the debtors' actions, Fannie Mae moved to reopen their case for the purpose of seeking an order compelling the debtors to surrender the property. The bankruptcy court granted the motion, finding that the debtors had a duty to surrender their home.

The debtors appealed pro se. The district court affirmed, as did the 11th Circuit.

The debtors asserted that the bankruptcy court erred in reopening their case. They argued that they could not be compelled to surrender their home because they did not file a Statement of Intention stating that they intended to do so.

While the debtors did not file a Statement of Intention under Section 521(a)(2) after converting to Chapter 7, the 11th Circuit said their initial Schedule A stated an intent to surrender the home that was not modified by their amended schedules.

Rule 1019(1)(A) states that when a case is converted from Chapter 13 to Chapter 7 "schedules[ ] and statements of financial affairs theretofore filed shall be deemed to be filed in the Chapter 7 case, unless the court directs otherwise." Therefore, the bankruptcy court was within its discretion to hold that the debtors had a duty to surrender the property.

"Second, our case law is clear that Section 521(a)(2) provides only three options for a debtor who has property that serves as collateral for his debts: redeem the property, reaffirm the debt, or surrender the property," the 11th Circuit said, citing *In re Failla*, 838 F.3d 1170 (11th Cir. 2016).

In *In re Taylor*, 3 F.3d 1512 (11th Cir. 1993), the 11th Circuit ruled that debtors may keep collateral only if their redeem it or reaffirm the secured debt.

"If we were to accept the Woides' argument, we would reward a debtor for failing to choose (and complete) one of these options. Both *Failla* and *Taylor* prohibit this outcome," the 11th Circuit said.

Finally, the 11th Circuit rejected the debtors' argument that Fannie Mae waited too long before acting.

In order to establish that the action to reopen the case was barred by laches, the debtors needed to establish that they were unduly prejudiced by the delay. Rather than being prejudiced, the 11th Circuit said the debtors received the benefit of rent-free living for several years.

In addition, the 11th Circuit ruled that the bankruptcy court did not abuse its discretion in denying the debtors' request for a stay pending appeal because it was unlikely that they were going to prevail.

TRUSTEES

TRUSTEE CAN GET DEBTOR'S FEDERAL BUT NOT STATE TAX RETURNS

A Chapter 13 Trustee had a legitimate need to see an electronic transcript of a debtor's federal income tax returns, but had no basis to obtain her state tax returns, the 9th Circuit Bankruptcy Appellate Panel ruled in an unpublished decision that partially reversed an Arizona bankruptcy judge's decision. (*Romeo v. Maney (In re Romer),* 2018 WL 1463850 (Bankr. 9th Cir. 3/23/18) (unpublished).)

Section 521(g)(2) addresses only access to debtors' federal tax returns and makes no mention of state tax returns, the BAP said.

The panel said it could find no case law addressing either issue presented in the appeal – what evidence a trustee needs to present to show a "demonstrated need" for access to a debtor's federal tax return, and whether Section 521(g)(2) includes state tax returns.

Rose A. Romeo filed for Chapter 13 protection in May 2014 in the U.S. Bankruptcy Court for the District of Arizona and her repayment plan was later confirmed.

In September 2016, she filed an electronic transcript of her 2015 federal tax return with the court, as required by Section 521(f).

Chapter 13 Trustee Edward J. Maney filed a motion seeking access to Romeo's federal tax return as well as an order that she provide a copy of her corresponding state tax return. While the motion was pending, Romeo filed a copy of her 2016 federal return with the bankruptcy court.

The trustee's motion relied on Section 521(g)(2), which states that certain documents, including the tax returns provided under Section 521(f), "shall be available" to the trustee, subject to the requirements of Section 315(c) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23.

Section 315(c) requires the director of the Administrative Office of U.S. Courts to establish safeguards to protect information produced under Section 521 of the Bankruptcy Code.

The office issued a final guidance in March 2015 listing the requirements for gaining access to the information, including that the person seeking access show a "demonstrated need" for it.

Maney argued that he needed access to the federal and state returns to carry out his duty to monitor Romeo's financial affairs and determine whether any modifications to her Chapter 13 plan were needed.

Judge Brenda K. Martin granted the trustee's motion, and Romeo appealed to the bankruptcy panel.

The panel affirmed in part, saying the trustee showed he had a legitimate need to see Romeo's federal returns.

"Utilizing a Chapter 13 debtor's tax information as a means for plan modification is proper and consistent with the [Bankruptcy] Code," the panel said, adding that Maney's request was not "illogical, implausible, or without support in the record."

The panel reversed the bankruptcy court with respect to the state returns, however, saying that Section 521(f) mentions only federal tax returns, not state returns.

"Congress has been very clear as to when state income tax returns are required under the code," the panel said. "If Congress intended that post-petition state income tax returns or transcripts be filed with the court under Section 521(f), it could have easily stated so."

(Reporting by Donna Higgins.)

FRAUD

DISBARRED ATTORNEY SENTENCED FOR FRAUD

On April 5, 2018, J. Douglass Jennings, a disbarred California attorney, was sentenced to 34 months in federal prison for committing bankruptcy fraud (concealment of assets) and for tax evasion, according to the U.S. Attorney's Office for the Southern District of California.

According to the government, Jennings and his wife Peggy filed for bankruptcy protection in January 2010. On Sept. 11, 2017, Mr. Jennings pleaded guilty to devising a scheme to defraud his unsecured creditors by concealing assets and income valued at nearly $1.5 million, including a luxury yacht and antiques.

Peggy Jennings was sentenced to bank fraud in a related action.

TEXAS MAN PLEADS GUILTY IN FORECLOSURE RESCUE SCHEME

Mark D. Stein of Carrollton, Texas, pleaded guilty on April 4 to one count of mail fraud, according to U.S. Attorney Erin Nealy Cox of the Northern District of Texas.

A federal grand jury in Dallas returned an indictment in December 2016 charging Stein and three others with felony offenses stemming from a "foreclosure rescue scheme" they ran from approximately February 2012 through January 2013.

Bruce Kevin Hawkins of Desoto, Richard Bruce Stevens of San Antonio, and Christina Renee Caveny of Dallas, also pleaded guilty to their roles in the scheme. Hawkins and Caveny have been sentenced to 41 months and 15 months in federal prison, respectively. Stevens is scheduled to be sentenced on May 7, 2018.

According to U.S. Attorney Cox, "Stein operated Real Estate Solutions, Stevens used Texas Real Estate Services, and Hawkins formed ERealty Mortgage Group, LLC, as foreclosure rescue companies. The conspirators used third parties to contact homeowners and offer them an opportunity to get out of their present home loans and receive a new home loan with a reduced interest payment and reduced monthly payment. Hawkins and other conspirators falsely represented to homeowners that

they had 'investors' standing by who were ready to quickly purchase the homeowner's present loan from the lender holding the current mortgage. They also falsely represented that they would use investors to purchase the homeowner's loan from the original lender at a greatly reduced price through a 'short sale' process."

According to the government, the defendants conducted phony closings on new "loans" that the homeowners were supposedly receiving. At the closing the homeowners were required to make large down payments and instructed to make subsequent payments to the defendants, who told the homeowners to ignore late payment notices sent by lenders.

The government said at least 70 homeowners who were facing the imminent threat of foreclosure on their homes fell for the scam, and paid a total of at least $242,000.

CASE NOTES

Consumer Bankruptcy News reports published cases concerning consumer bankruptcy. The following were obtained between March 29 and April 12, 2018.

FIRST CIRCUIT

OLDER DEBTOR DISCHARGES STUDENT LOANS

Case name: *Erkson v. U.S. Department of Education, et al. (In re Barbara S. Erkson),* 28 CBN 351, 2018 WL 1635225 (Bankr. D. Maine 4/3/18).

Ruling: The bankruptcy court ruled that the debtor's student loans were discharged.

What it means: "Every decision regarding the dischargeability of student loans rises or falls on the unique facts of the case. Here, the plaintiff offered credible and uncontroverted testimony that she initially borrowed money to pursue a particular career and when that path was not lucrative enough to repay her then-existing loans and support her expenses, she applied to graduate school. Following graduation from her graduate program and after working for various agencies for six or so years, she sought to supplement her income by opening her own counseling practice. Nonetheless, despite working five to six days per week, the plaintiff can barely fund her own minimalist lifestyle. Her age and her professional trajectory belie any notion that she will be able to generate sufficient income in the coming years to repay her student loans while maintaining that minimal standard of living. Given this, the Court concludes that the plaintiff has met her burden under Section 523(a)(8) to obtain a discharge of her educational loans[.]"

Summary: The 64-year-old Chapter 7 debtor owed $107,000 in student loans. She incurred that debt while attending Vermont College of Norwich University, where she graduated in 2002 with a Bachelor of Arts in Interdisciplinary Studies, and Salve Regina University, where she obtained a Master of Arts in Holistic Counseling in 2011. After graduating from Vermont College, the debtor worked internships at various community agencies in order to become a Licensed Clinical Professional Counselor and Licensed Alcohol and Drug Counselor. Although these internships paid very little, the debtor was able to make some payments on her student loans and negotiated a reduced payment schedule. Faced with economic challenges posed by low-paying jobs in her chosen career, the debtor returned to school in an effort to enhance her earning ability. She obtained full-time employment immediately upon graduating from Salve Regional University. After a few years, funding cuts resulted in the elimination of the debtor's job. She was moved to an administrative position, but she left this position to return to counseling. After she filed for bankruptcy relief in March 2016 the debtor filed an adversary proceeding asking the court to discharge her student loans. The court determined that the debtor had monthly take-home pay of between $2,213 and $2,860 from her private practice and part-time counseling work for Crossroads, an agency providing addiction and behavioral health treatment where the debtor worked as a fee-for-service clinician. The debtor scheduled expenses of $2,940 including $319 to lease a Subaru Forester and $195 for a dog walker because her job at Crossroads prevented her from going home at noon to walk her dog. The court noted that while the debtor's expenses allowed for $175 for medical costs she did not have insurance and this cost covered only basic prescriptions and doctors' visits. The court also noted that the debtor's expenses exceeded even her highest estimated income. Employing the "totality of the circumstances" test, the court ruled that the debtor's student loans were discharged. The court was convinced that the debtor's dog-walker expense was reasonable and necessary. The debtor testified that her hearing impairment made it difficult for her to hear the smoke detector, the phone and the doorbell. She said she relied on her dog in many situations to help her go about her daily activities safely and with some measure of efficiency. The court also found that the car lease was reasonable because the debtor needed reliable transportation. The court concluded that the debtor's current income and expenses precluded her from paying any portion of her student loans while maintaining a minimal standard of living, and that her economic hardship was likely continue into the future. The debtor asserted that her hearing impairment made it impossible for her to generate more income. The creditors argued that the court should not

consider this assertion because the debtor failed to present corroborating evidence. "Regardless of whether courts employ the 'totality of the circumstances' test or the *Brunner* test, the inquiry under Section 523(a)(8) is factually intensive and, in that vein, the determination as to the necessity of corroborating medical evidence depends on any number of factors, such as the nature of the condition, the impact that condition has on the debtor's earning potential and the specifics of the debtor's own testimony regarding the condition," the court said, responding that it did not need "expert medical testimony or corroborating evidence to establish that, as one ages, it becomes increasingly unlikely for an existing hearing impairment to substantially resolve." The court added that its determination that the student loans were discharged did not turn on its finding that the debtor's hearing was impaired, but on the facts that her current financial condition and her future economic prospects established the propriety of discharging the debts. Finally, the court found that the debtor's return to school and failure to make meaningful payments were not indicative of bad faith. The debtor returned to school in the hope of improving her financial situation and her failure to make meaningful payments indicated that her efforts had been unsuccessful.

Opinion by Judge Peter G. Cary

CASE DISMISSED WITH PREJUDICE AFTER DEBTORS 'THUMB NOSES' AT PROCESS

Case name: *In re David M. and Susan M. Macomber,* 28 CBN 352, 2018 WL 1582626 (Bankr. D. Maine 3/27/18).

Ruling: The bankruptcy court dismissed the debtors' Chapter 13 case with prejudice.

What it means: The debtors' modified plan obligated them to pay an inheritance into their plan. They did not do so, and then asked the court to dismiss their case. The court doubted that the debtors forgot about their obligation to pay the inheritance into their plan, and inferred that they deliberately failed to comply with the confirmed plan. The court found that this failure caused material harm to creditors holding allowed claims constituting cause to dismiss the case with prejudice under Section 349(a).

Summary: The debtors filed for Chapter 13 relief in June 2012. The debtors' modified plan stated that they had a 1/6th interest in family property that was being probated. The modified plan provided that the debtors would pay their share of the net proceeds into the plan. The trustee alleged that the debtors received $50,000 from the probate estate and did not pay it into their plan. The trustee also said that the probate distribution was more than double the size of the plan's $24,300 base. The debtors agreed that their share of the sale proceeds was not turned over to the trustee for administration in accordance with the plan. The debtors asked the court to dismiss their case. The court doubted that the debtors forgot about their obligation to pay the distribution into their plan, and inferred that they deliberately failed to comply with the confirmed plan. The court found that this failure caused material harm to the creditors holding allowed claims in this case constituting cause to dismiss the case with prejudice under Section 349(a). "Accordingly, the Court rules that any debt that would have been discharged in this case if the debtors had received a Chapter 13 discharge will be non-dischargeable in any subsequent case filed by the debtors (or either of them). According to the debtors, a ruling of this nature is 'unduly harsh' and 'draconian.' But, the sale proceeds that should have been paid into the debtors' confirmed plan have been dissipated. As a result, creditors will not receive the dividend that they anticipated in this case. Dismissing the case, at the debtors' request, will not remedy this harm. Having come this far in this Chapter 13 case and having received a sizeable sum that should have been paid into the plan, the debtors should not be allowed to simply walk away with a relatively brief ban on the filing of another case under Title 11. As the trustee said, the debtors have effectively 'thumbed their noses' at the bankruptcy process. In these circumstances, something more than a dismissal with a prohibition on refiling is warranted," the court said. A 6-month prohibition on filing for bankruptcy was also imposed on both debtors.

Opinion by Judge Michael A. Fagone

DEBTOR'S HARDSHIP WAS 'UNDUE' UNDER EVEN HARSHEST STANDARD

Case name: *Smith v. United States Department of Education (In re Kirt F. Smith),* 28 CBN 353, 2018 WL 1664847 (Bankr. D. Mass. 4/4/18).

Ruling: The bankruptcy court ruled that the debtor's student loan was discharged.

What it means: In considering the debtor's request for a discharge of his student loan, the court criticized the *Brunner* and "totality of the circumstances" tests as being outdated and "hard-hearted." "[A]ny test that allows for the court to determine a student debtor's good or bad faith while living at a subsistence level, virtually strait-jacketed by circumstance, displaces the focus from where the statute would have it: the hardship. It also imposes on courts the virtually impossible task of evaluating good or bad faith in debtors whose range of options is exceedingly limited and includes no realistic hope of repaying their loans to any appreciable extent," the court said.

Summary: At the age of nine, the debtor was diagnosed with an intractable juvenile absence seizure disorder, a form of epilepsy. He was being treated for this disorder at the Brigham and Women's Hospital in Boston. "The debtor was also diagnosed with the affective disorders, including depression accompanied by a history of suicidal ideation and panic attacks. In addition, the debtor was diagnosed with attention deficit hyperactivity disorder and executive functioning difficulties with sustained, divided, and complex attention in both visual and verbal domains," the bankruptcy court said. In the summer of 2008, the debtor enrolled at ITT Technical Institute to pursue a degree in computer drafting and design. He earned an associate's degree from ITT in June 2010. The debtor filed for Chapter 7 relief in March 2016, and subsequently initiated an adversary proceeding seeking to discharge $49,980 in student loan debt incurred at ITT. The debtor never made a payment on his student loans. He participated in an income-based repayment program for one year during which time he was not required to make payments. When he filed for bankruptcy the debtor's only income was $1,369 each month in Social Security Disability payments. He also received food stamps. In considering the debtor's request for a discharge of his student loan, the court criticized the *Brunner* and "totality of the circumstances" tests as being outdated and "hard-hearted." "While the totality-of-the-circumstances test offers a court more flexibility in determining undue hardship, any test that allows for the court to determine a student debtor's good or bad faith while living at a subsistence level, virtually strait-jacketed by circumstance, displaces the focus from where the statute would have it: the hardship. It also imposes on courts the virtually impossible task of evaluating good or bad faith in debtors whose range of options is exceedingly limited and includes no realistic hope of repaying their loans to any appreciable extent," the court said. Like the *Brunner* test, the "totality of the circumstances" test requires a three-part analysis. First, courts must consider the debtor's past, present, and reasonably reliable future financial resources. The court found that the debtor's future prospects for employment were so dim as to be nonexistent based on his current medical and psychiatric circumstances along with his past failures. Second, courts must calculate the reasonable necessary living expenses for the debtor and the debtor's dependents. The court noted that the debtor and his mother had modest expenses that exceeded their income. The government argued that the debtor's mother was not his dependent. The court defined "dependent" as "a person who reasonably relies on the debtor for support and whom the debtor has reason to and does support financially." The court noted that the debtor's mother was elderly and needed his help, and that he had reasons to support her. As such, she was his dependent. Third, the court must consider any other relevant facts and circumstances surrounding the case. The court considered the fact that the debtor made no payments but also considered that he had not worked since graduating. "The debtor spends his days in a small bedroom watching television and playing video games, leaving only to visit medical professionals. He takes a number of medications each day that result in some relief but have troubling side effects. The debtor has demonstrated a prolonged period of inability to work and to pay on his loans, and he suffers from both a chronic medical condition and a psychiatric condition. And the debtor's problems would increase were his caretaker mother no longer able to help him. Even by the harshest and most demanding standards, this is a case of undue hardship."

Opinion by Judge Frank J. Bailey

DEBTOR CAN'T DISCHARGE DEBT FOR TAKING HOUSEHOLD MONEY

Case name: *Aguiar v. Santiago (In re Arlene S. Santiago),* 28 CBN 354, 2018 WL 1569788 (Bankr. D.P.R. 3/28/18).

Ruling: The bankruptcy court ruled that the plaintiff's claim was excepted from discharge by Sections 523(a)(2)(A) and (a)(4).

What it means: A court found that the debtor defrauded the plaintiff while administering their household affairs and his medical office by diverting and stealing community funds and property for herself without the plaintiff's knowledge. The court found that the debtor took advantage of a position of trust, and failed to pay debts owed by her and the plaintiff. The bankruptcy court found that collateral estoppel prevented the debtor from relitigating these issues, and that the facts established that the plaintiff's claim was excepted from discharge.

Summary: On March 31, 2008, a judgment of divorce ended the plaintiff and debtor's marriage. On Oct. 15, 2013, the Superior Court of Ponce entered judgment for the division of community property. The Superior Court found that during the marriage the parties acted as a partnership of profits and losses or community. The plaintiff was a doctor who had his own office. The debtor managed the office. She was also responsible for the management and administration of the couple's household. The Superior Court found that, during the marriage, the debtor developed a pattern of retaining for herself and diverting large sums of money belonging to the community without the plaintiff's knowledge. The Superior Court found that the debtor used $340,811 to open various accounts in her name alone. She also purchased insurance policies and art. The Superior Court found that the debtor took advantage of her position of trust within the community that existed

between her and the plaintiff. Based on its findings, the Superior Court ordered the debtor to pay the plaintiff $274,605 plus interest and attorney's fees. The amount of the judgment was equal to half of the value of the money that the debtor diverted from the community without the plaintiff's knowledge. After the debtor filed for Chapter 7 relief, the plaintiff filed an adversary proceeding asserting that his claim was excepted from discharge by Section 523(a)(2)(A) and/or (a)(4). The bankruptcy court granted the plaintiff's motion for summary judgment after finding that collateral estoppel prevent the debtor from relitigating issues decided by the Superior Court. "The state court found that Mrs. Santiago 'took advantage of her position of trust' and 'was diverting funds obtained for the partnership into private accounts of her own, without the knowledge and consent of the claimant,'" the bankruptcy court said. "The state court found that Mrs. Santiago defrauded Mr. Torres while administering their household affairs and his medical office by diverting and stealing community funds and property for herself without Mr. Torres's knowledge or consent. The state court also found that Mrs. Santiago took advantage of her position of trust within the community that existed between her and Mr. Torres. And, that Mrs. Santiago failed to pay the mutual debts of the community she had with Mr. Torres triggering the execution of properties and attachment from creditors. The state court judgment is, thus, excepted from discharge under Sections 523(a)(2)(A) and (a)(4)."

Opinion by Judge Edward A. Godoy

SECOND CIRCUIT

INVOCATION OF JUDICIAL ESTOPPEL AN ABUSE OF DISCRETION

Case name: *Clark v. AII Acquisition, LLC, et al.*, 28 CBN 355, 2018 WL 1545660 (2d Cir. 3/30/18).

Ruling: The 2d U.S. Circuit Court of Appeals vacated the district court's decision, which invoked the equitable doctrine of judicial estoppel to dismiss a personal injury claim that was not disclosed in the plaintiff's Chapter 13 case.

What it means: The district court abused its discretion in its mechanical application of the equitable doctrine of judicial estoppel without inquiring into whether the particular factual circumstances of the case tipped the balance of equities in favor of invoking the doctrine.

Summary: John and Michele Clark filed for Chapter 13 relief in 2010. The bankruptcy court confirmed a five-year plan under which the debtors' creditors would be paid in full with interest through monthly payroll deductions. Each month, for five years, $2,152 was deducted from John's paycheck from his employer, The Boeing Company. In 2015, only a few weeks before the debtors' final monthly deduction, John was diagnosed with mesothelioma. John decided to sue the corporations he believed responsible for exposing him to asbestos. Unsure of whether his bankruptcy schedules should be updated, John alerted his bankruptcy counsel and trusted counsel to do what was required. John's counsel never passed on the information to the bankruptcy court during the pendency of the bankruptcy proceeding. The Clarks timely made their final payment under the plan. The bankruptcy case remained open for another full year before being closed on Aug. 5, 2016. On July 29, 2016 – one week prior to the Clarks receiving their Chapter 13 discharge – the Clarks filed a personal injury action in New York state court against numerous corporations, including Boeing. One of the defendants had the lawsuit removed to the Southern District of New York. Boeing moved to dismiss the personal injury suit on the grounds of judicial estoppel. Boeing asserted that the debtors' failure to disclose the diagnosis during the bankruptcy barred them from pursuing personal injury claims related to that diagnosis. The district court, characterizing judicial estoppel as a "harsh rule," granted Boeing's motion to dismiss the Clarks' claims with prejudice. The 2d U.S. Circuit Court of Appeals vacated the decision and remanded. The Clarks' nondisclosure had at most a *de minimis* effect on the prior bankruptcy proceeding. There was some uncertainty in the circuit as to the proper standard by which to review a district court's decision to invoke judicial estoppel. "It is time we put this uncertainty to rest: today we hold that a district court's invocation of judicial estoppel is reviewed only for abuse of discretion," the 2d Circuit stated. As to the merits of the appeal, it was evident that the balance of equities tipped overwhelmingly in the Clarks' favor. "And yet, the district court found judicial estoppel to be required. What went wrong?" the 2d Circuit asked. The district court began by correctly noting that the party asserting judicial estoppel must show that: 1) the party against whom estoppel is asserted took an inconsistent position in a prior proceeding; and 2) such position was adopted by the first tribunal in some manner. As to the first element, the district court held that the Clarks' failure to disclose their personal injury cause of action to the bankruptcy court amounted to an implicit false representation that no such cause of action existed. As to the second element, the district court reasoned that the bankruptcy court adopted the Clarks' inconsistent position by rendering a favorable judgment, i.e. the Chapter 13 discharge. "Having satisfied itself that the Clarks met the judicial estoppel doctrine's two prerequisite elements, the district court held *ipso facto* that the couple's personal injury claims must be estopped.

And therein lies the district court's error: judicial estoppel is not a mechanical rule," the 2d Circuit stated. That a litigant took a prior inconsistent position and convinced an earlier tribunal to adopt that position may be necessary conditions for judicial estoppel to be imposed, but they are not sufficient ones. There must be a balance of equities inquiry that begins by asking whether the prior inconsistent position gave the party to be estopped an "unfair advantage" over the party seeking estoppel, the 2d Circuit stated, referencing *BPP Ill., LLC v. Royal Bank of Scotland Group LLC*, 859 F.3d 188, 64 BCD 61 (2d Cir. 2017). The 2d Circuit concluded that "to hold on the facts of this case that Mrs. Clark's claims are barred by an equitable doctrine would be to deprive the concept of equity of any meaning."

TRUSTEE CAN'T RECOVER TUITION PAYMENTS MADE FOR DEBTOR'S CHILDREN

Case name: *Pergament, Chapter 7 Trustee, v. Hofstra University (In re Harold Adamo Jr.),* 28 CBN 356, 2018 WL 1577714 (Bankr. E.D.N.Y. 3/29/18).

Ruling: The bankruptcy court granted the defendant's motion for summary judgment.

What it means: The court found that the debtor's children were the initial transferees of payments made by the debtor. The schools were merely the conduit for the payments, which the schools placed in accounts belonging to each child. The money stayed in each child's account until the child enrolled in classes, at which time the money was transferred to the school to pay for the tuition. Section 550(b) prevented the trustee from recovering the payments from the schools because they received the tuition payments in good faith.

Summary: The Chapter 7 Trustee brought adversary actions against Hofstra University and Fairfield University seeking to avoid prepetition tuition payments as fraudulent conveyances. He also filed an adversary action against Brooklyn Law School seeking to avoid a post-petition tuition payment made by the debtor as a debtor-in-possession under Chapter 11 because it was not authorized by the court. All of the tuition payments targeted by the adversary proceedings were made by the debtor for the benefit of his children. The bankruptcy court granted the defendant's motion for summary judgment in each proceeding. "The avoidance of prepetition tuition payments made by a debtor for the education of his or her child is a developing body of law, and courts across the country have reached different results," the court said. "Although the question whether a debtor receives fair consideration or reasonably equivalent value in exchange for undergraduate and graduate tuition payments for adult children is interesting, it need not be decided in the context of these motions. Rather, the result here is dictated by Section 550, which governs a transferee's liability on an avoided transfer." The defendants said the payments made by the debtor were initially placed into the children's student school accounts. When the children registered for classes they gave the schools permission to withdraw the tuition payments from their accounts. The children were entitled to a refund of the money in their student accounts if they did not register for classes because money in these accounts is considered to be the student's property. The defendants argued that this procedure meant that the debtor's children were the initial transferees of the tuition payments. The court agreed. "In these adversary proceedings, the undisputed facts establish that the defendants did not exercise dominion and control over the tuition payments at the time the debtor made the transfers. Rather, the payments were made to the students' accounts, which were created by the student with a unique username and password. After the debtor transferred the funds to those accounts, the debtor was not able to access the account absent the account holder's authorization, nor were the defendants authorized to utilize the funds. Rather, the defendants did not obtain dominion and control of those funds until the student registered for classes for that semester, at which point the funds would be applied towards the tuition amount due. In the event the student decided to withdraw from the program, the student, and not the debtor or the defendants, was entitled to any funds remaining in the account. Put simply, the student maintained dominion and control over the funds in the account upon the debtor's transfer because it was the student's decision whether to enroll in classes and have the funds applied towards tuition or to withdraw from the program and have the funds refunded directly to him or her," the court said. "Although the funds transferred by the debtor to the students' accounts were ultimately received by the defendants as tuition payments, at the time of the initial transfer by the debtor, the defendants' electronic system was merely holding the funds on behalf of the student account holders. The defendants were mere conduits, and did not have dominion and control over the funds; rather, the students did. To the extent the trustee argues the opposite, that the students' accounts were mere conduits to the defendants, he is incorrect. A conduit is an entity that holds the transferred asset for the true recipient, and has no legal right to utilize the asset while in its possession." Because the schools were not the initial transferees, Section 550(b) prevented the trustee from recovering the payments from the defendants because they received the tuition payments in good faith.

Opinion by Judge Carla E. Craig

MORTGAGE OWED BY FORMER WIFE MAKES DEBTOR INELIGIBLE FOR CHAPTER 13

Case name: *In re Patrick Fioriglio,* 28 CBN 357, 2018 WL 1629779 (Bankr. E.D.N.Y. 3/27/18).

Ruling: The bankruptcy court dismissed the debtor's Chapter 13 case because he was ineligible to be a debtor under Chapter 13. The court gave the debtor 30 days to convert his case to Chapter 7 or Chapter 11.

What it means: Although the Chapter 13 debtor was not personally liable on a mortgage secured by real property he owned with his former spouse, the mortgage was included in the calculation of the debtor's secured debt total because the creditor held a claim against property in which he had an interest.

Summary: The debtor filed for Chapter 13 relief *pro se* on Feb. 16, 2016. His Schedule A showed that he owned real property in Brooklyn and Yaphank, N.Y. Howard Balsam was the only scheduled creditor. The debtor said Balsam held an unsecured claim for $128,000 based on a "judgment of foreclosure." Included with the debtor's schedules was a copy of a Mortgage Account Statement issued by Ocwen Loan Servicing showing a mortgage on the Brooklyn Property with a principal amount of $950,642. Balsam, proceeding *pro se*, filed for stay relief on April 6, 2017, with respect to the Brooklyn Property. The motion asserted that Balsam held a second mortgage on the property, and had initiated foreclosure proceedings prior to the bankruptcy filing. On July 7, 2016, the debtor – now represented by counsel – filed amended schedules. The new schedules said the debtor's interest in the Yaphank Property was worth $0. An explanatory note said the debtor owned the property with his former wife, and he was not on the promissory note. Schedule D did not disclose a debt secured by the Yaphank Property, but it did reveal $1,093,493 in secured claims including about $1,058,500 in debt secured by the Brooklyn Property. A total of $351,000 in unsecured debt was also scheduled. The debtor filed a plan proposing to treat Balsam's claim as wholly unsecured, and an adversary proceeding to avoid Balsam's junior mortgage lien. On Dec. 2, 2016, Balsam – now represented by counsel – joined the Chapter 13 Trustee's motion to dismiss the debtor's case asserting that the debtor was not eligible for Chapter 13 relief because his secured debts exceeded the Chapter 13 maximum. Balsam said the undisclosed mortgage on the Yaphank Property secured a debt of $245,532. The debtor did not dispute that he owned an interest in the Yaphank Property, but argued that the mortgage did not count toward his secured debt total because he was not obligated on the promissory note. In opposition to the motion to dismiss, the debtor also argued that Balsam's challenge to eligibility was barred by laches because it was filed nine months after he filed for bankruptcy and his ineligibility should have been clear from the schedules. The bankruptcy court said a review of the debtor's schedules was the starting point for determining eligibility, but its review could consider material outside of the debtor's schedules. "Here, the determination should include not only a review of the schedules and proofs of claim filed, but also the mortgage on the Yaphank property presented first by Balsam, and later by Wells Fargo in support of its motion for relief from stay," the court said. "The debtor cannot avoid consideration of the Yaphank Lien solely because he omitted it from his schedules, even if that omission was made on the good faith belief that his lack of personal liability meant that it did not belong there." The court then found that the mortgage on the Yaphank Property counted toward the debtor's secured debt total. In *In re Abreu*, 2017 WL 4286141 (Bankr. E.D.N.Y. 9/25/17), the court held that a mortgagee was the holder of a "claim" within the meaning of Sections 101(5) and 1322(b)(2) to the extent that it had an *in rem* right against property owned by a debtor. "*Abreu*'s holding applies squarely to the issue here," the court said. "It is undisputed that the Yaphank Lien is enforceable against the Yaphank Property, which is owned in part by the debtor. To the extent that this is the case, *Abreu* dictates that Wells Fargo holds a claim against the debtor's estate." After finding that the debtor's secured debt total exceeded that the maximum allowed by Section 109, the court considered whether laches prevented Balsam from questioning the debtor's eligibility. The court found that it did not because the delay in raising the objection was not unreasonable and inexcusable. The court noted that the mortgage on the Yaphank Property was not mentioned until July 7, 2016, and then only as a passing reference in amended Schedule A. "While this virtually hidden reference might have been sufficient to put Balsam on notice of the Yaphank Lien, it would not, on its own, have shown that the debtor's secured debts exceeded the Section 109(e) limit. It also came five months after the Filing Date, meaning that almost half of the alleged delay was, in large part, attributable to the debtor," the court said. "Moreover, from that point forward, some additional amount of time would have been required for Balsam to track down the mortgage and determine that it put the debtor over the debt limit. He also would have had to do this while beginning to defend against the adversary proceeding that the debtor commenced, all while still *pro se*. Even though Balsam is an attorney, and is not necessarily entitled to the special considerations afforded *pro se* litigants, [citation omitted] it strains credulity to suggest that he slept on his rights when his recognition of those rights depended on following a trail of bread crumbs left by the debtor."

Opinion by Judge Nancy Hershey Lord

THIRD CIRCUIT

FAILURE TO PROVIDE TAX RETURN TO CREDITOR DID NOT REQUIRE DISMISSAL

Case name: *Artesanias Hacienda Real S.A. de C.V. v. Jeffery (In re Ivan Jeffery),* 28 CBN 358, 2018 WL 1605307 (Bankr. E.D. Pa. 3/29/18).

Ruling: The bankruptcy court denied the creditor's motion to dismiss the Chapter 7 debtor's case for failing to provide it with a copy of his income tax return.

What it means: "Since Debtor had not filed his 2015 tax return before he commenced his bankruptcy case, Section 521(e)(2)(A)(ii) did not impose any obligation on him to provide a copy of that tax return to Plaintiff." In addition, the plaintiff's first request for the tax return was not timely because it was not made until after the meeting of creditors.

Summary: The debtor filed for Chapter 7 relief on July 15, 2016. The first date set for the meeting of creditors was Aug. 22, 2016. At the first meeting of creditors, the debtor "testified that his 2015 tax returns were on extension and had not been filed[.]" After the meeting of creditors the plaintiff repeatedly demanded that the debtor provide it with a copy of his 2015 income tax returns. A continued meeting of creditors was held on Dec. 5, 2016. At that time the debtor's testimony implied that his income tax returns had been filed. However, he had not provided the plaintiff with copies. On Jan. 19, 2017, the plaintiff filed a 5-count complaint against the debtor. Count IV asked the bankruptcy court to dismiss the debtor's case because he failed to timely provide it with a copy of his 2015 income tax return and could not demonstrate that his failure to do so was beyond his control. Section 521(e)(2)(C) "provides for the mandatory dismissal of a bankruptcy case when: (i) a debtor is obligated to provide a copy of a federal income tax return to a creditor pursuant to Section 521(e)(2)(A)(ii); (ii) the debtor fails to do so; and (iii) the debtor does not demonstrate that his or her failure to provide a copy of the tax return was due to circumstances beyond his or her control," the court said. Requests to dismiss a case pursuant to Section 521(e)(2)(C) should be brought by a motion, but the court considered the plaintiff's request on the merits because the issue was squarely before it and could be decided in isolation from the rest of the complaint. A minor complication was the fact that the bankruptcy judge assigned to the case had recused himself from hearing the adversary proceeding. If the plaintiff had followed the proper procedure for seeking dismissal of the debtor's case, then the judge assigned to the case would have heard the plaintiff's motion. The judge hearing the adversary proceeding determined that she could decide the issue because familiarity with the bankruptcy case was not required to rule on the isolated and separate issues raised by Count IV. Turning to the merits, the court ruled that the plaintiff was not entitled to the relief it requested. The plaintiff complained that the debtor had not provided it with a copy of his 2015 federal income tax return but that return was filed after the debtor filed for bankruptcy. "[B]y its terms Section 521(e)(2)(A)(i) only requires the provision 'of an already-filed tax return, not the completion, filing and submission of any subsequent return,'" the court said, citing *In re Casey*, 274 Fed. Appx. 205 (3d Cir. 2008). "Since Debtor had not filed his 2015 tax return before he commenced his bankruptcy case, Section 521(e)(2)(A)(ii) did not impose any obligation on him to provide a copy of that tax return to Plaintiff." The court added that the plaintiff was not entitled to receive a copy of the debtor's income tax returns because the request was not timely made. Rule 4002(b) states that creditors must request a copy of a debtor's income tax return no later than 14 days prior to the first date set for the meeting of creditors, and the complaint stated that the demands for copies of the tax returns were made after the initial meeting. "Plaintiff, by its own factual evidence and allegations, has established that it does not have a claim for dismissal against Debtor under Section 521(e)(2)(C) for failure to provide it with a copy of his 2015 tax return," the court concluded.

Opinion by Judge Jean K. Fitzsimon

FOURTH CIRCUIT

FORMAL POC NOT PREREQUISITE TO LIEN STRIP OFF

Case name: *Burkhart v. Grigsby, et al.,* 28 CBN 359, 2018 WL 1526628 (4th Cir. 3/29/18).

Ruling: The 4th U.S. Circuit Court of Appeals reversed the lower courts' rulings, which denied the Chapter 13 debtors' effort to strip off wholly underwater junior liens on their home.

What it means: A bankruptcy court may strip off a valueless lien on a Chapter 13 debtor's principal residence when no proof of claim has been filed.

Summary: The Chapter 13 debtors' home was encumbered by four liens. The debtors said their home was worth $435,000. The most senior lien was held by Chase Bank. It secured a debt of $609,500. Tri-County Bank held the second and third liens. PNC Bank held the fourth lien. Chase Bank and PNC Bank filed proofs of claim. Tri-County did not file a proof of claim. The debtors filed an adversary proceeding to avoid the liens held by PNC and Tri-County. The bankruptcy court

entered a default judgment against the two banks, finding the liens completely underwater, and stripped PNC's lien. The bankruptcy court refused to strip the liens held by Tri-County because Section 506(d)(2) prohibits lien avoidance when no proof of claim has been filed. The district court affirmed, finding Section 506(d)(2) barred a lien from being voided when that lien is not an "allowed secured claim" due simply to the failure to file a proof of claim. The 4th Circuit reversed. "Our past decisions make clear that the power to effectuate a lien strip in a Chapter 13 case stems from Sections 506(a) and 1322(b)," the appellate court said. Section 506(d), on the other hand, voids liens based on the underlying claim's allowance or disallowance. Because the debtors were not challenging the validity of the debts owed to Tri-County their request to avoid Tri-County's lien was not based on Section 506(d). Instead, the debtors asked the bankruptcy court to look to Section 506(a) to value their home, and then looked to Section 1322(b)(2) to modify the bank's rights. The 4th Circuit also rejected the district court's conclusion that the filing of a formal proof of claim was a prerequisite to valuing a claim under Section 506(a). "[T]his conclusion confuses the claim allowance and lien avoidance process and turns a blind eye to economic reality. In our view, the language and purpose of Section 1322(b) compels the opposite result," the 4th Circuit said. "To summarize, the ability of a Chapter 13 debtor to strip off an underwater lien stems from Section 1322(b) not Section 506(d). The former provision permits plans to modify the rights of holders of unsecured claims. Whether a creditor has an unsecured claim turns on the value of the underlying collateral not the mere existence of a security interest. And in making this determination, courts are not limited to valuing claims that have been filed and allowed. Where, as here, a senior lienholder is only partially secured, any junior lienholder is by definition the holder of an unsecured claim for purposes of Section 1322(b), which may be stripped without the filing of a proof of claim."

'INDIVIDUAL SHARED RESPONSIBILITY PAYMENT' IS A PENALTY, NOT A TAX

Case name: *In re Angela B. Parrish,* 28 CBN 360, 2018 WL 1725385 (Bankr. E.D.N.C. 4/6/18).

Ruling: The bankruptcy court sustained the debtor's objection to a proof of claim filed by the IRS.

What it means: A debtor's "individual shared responsibility payment" imposed for failing to obtain health insurance under the Affordable Care Act is a penalty and not a tax for purposes of Section 507(a).

Summary: The Chapter 13 debtor's schedules revealed that she owed an "individual shared responsibility payment" of $664 for failing to obtain health insurance as required by the Affordable Care Act. The IRS filed a proof of claim in that amount. The POC indicated that the claim was entitled to priority as an excise tax. The debtor objected that the ISRP is not an excise tax, but is instead a penalty that is not entitled to priority under Section 507(a)(8). The IRS agreed that the ISRP was not "a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss." The IRS, however, argued that it was either an excise or income tax. The bankruptcy court sustained the debtor's objection. "The ACA established an 'individual mandate' requiring most Americans to maintain 'minimum essential' health insurance coverage. ... The failure to obtain that insurance results in the ISRP, which is called a 'penalty' within the statute," the court said. The parties agreed that the label used in the law did not determine how the ISRP was classified in bankruptcy. Instead, its bankruptcy classification depended on its function. In *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012), the U.S. Supreme Court determined that the ISRP is a penalty for purposes of the Anti-Injunction Act, and could reasonably be characterized as a tax for purposes of constitutionality. "Taking *Sebelius* as a whole, the Court found that the same exaction could be considered either a tax or a penalty, depending on the context, and that the ACA does not *require* one reading or the other. Further, the Court did not consider the question for purposes of the Bankruptcy Code, and its determination for purposes of constitutionality is not the end of the analysis for this court," the bankruptcy court said. In *United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213 (1996), the Supreme Court "adopted the general framework from *United States v. La Franca,* 282 U.S. 568, 572 (1931), that '[a] tax is an enforced contribution to provide for the support of government; a penalty, as the word is here used, is an exaction imposed by statute as punishment for an unlawful act' as 'sufficient for the decision of this case.'" In *In re Cespedes*, 393 B.R. 403 (Bankr. E.D.N.C. 2008), the court ruled that the assessment for an early withdrawal from a retirement account is a penalty. In reaching this conclusion, the court found that "unlawfulness" is not required for an exaction to be a penalty as opposed to a tax. "Because the action that results in an exaction does not have to be unlawful, the *CF&I* standard can be restated as follows: a 'tax is an enforced contribution to provide for the support of government,' while a penalty is an exaction imposed by statute as punishment for an act or omission that is discouraged," the court said, and concluded that the ISRP was a penalty. The court observed that the ISRP "has a revenue-generating component only if the goal of the ACA – health care coverage for all – fails, such that the revenue impact (while possibly significant) is incidental. Taken to-

gether with the primary purpose of the ISRP, to encourage people to buy insurance by penalizing those who do not, the court determines that the ISRP is a penalty for purposes of Section 507(a) of the Bankruptcy Code."

Opinion by Judge Stephani W. Humrickhouse

COURT REFUSES TO COMPEL ARBITRATION

Case name: *Lischwe, Trustee, v. ClearOne Advantage LLC, et al. (In re Elaine H. Erwin),* 28 CBN 361, 2018 WL 1614160 (Bankr. E.D.N.C. 3/30/18).

Ruling: The bankruptcy court denied the defendants' motion to compel arbitration.

What it means: The court denied the motion, finding that the arbitration provisions in the agreements were invalid because they prospectively limited the debtor's (and now the trustee's) rights to challenge the agreements' validity under North Carolina law and to assert the illegality of the agreements in support of a claim that the defendants engaged in unfair or deceptive trade practices.

Summary: In August 2014 the debtor entered into a Debt Resolution Agreement with ClearOne Advantage LLC. She was looking for assistance settling debts owed to Belk and Bank of America. At the same time she entered into a Dedicated Account Agreement with Global Client Solutions LLC for the purpose of maintaining an account to be used to fund the anticipated settlements. The bankruptcy court said ClearOne and GCS appeared to have a close working relationship. The debtor entered into a second set of agreements with the companies in October 2015. The debtor cancelled these agreements in November 2015 and filed for Chapter 7 relief in December 2015. The trustee initiated an adversary proceeding against the companies in August 2017. His amended complaint sought the recovery of money that the debtor paid to ClearOne and GCS during the two years preceding her bankruptcy filing pursuant to Section 548. The amended complaint also alleged that the defendants engaged in conduct "in violation of Maryland and North Carolina laws governing unfair or deceptive trade practices." ClearOne asked the bankruptcy court to compel the arbitration of both cause of action. The bankruptcy court denied the motion, finding that the arbitration provisions in the agreements were invalid because they prospectively limited the debtor's (and now the trustee's) rights to challenge the agreements' validity under North Carolina law and to assert the illegality of the agreements in support of a claim that the defendants engaged in unfair or deceptive trade practices. "[A]rbitration agreements that operate 'as a prospective waiver of a party's right to pursue statutory remedies' are not enforceable because they are in violation of public policy," the 4th Circuit stated in *Dillon v. BMO Harris Bank, N.A.*, 856 F.3d 330, 333 (4th Cir. 2017). "Without the ability to assert the illegality of the defendants' conduct in support of the UDTP Claim, the plaintiff would be severely restricted in pursuing that claim," the bankruptcy court observed. Even if the arbitration provisions were valid, the court said it would not compel arbitration because "the constitutionally core 548 Claim should not be sent to arbitration, and the UDTP Claim should not be severed from the 548 Claim in the interests of judicial efficiency and of maximizing in an expedient manner the debtor's estate for repayment of creditors (or, in the alternative, determining expeditiously that the debtor's estate will not be augmented by way of the plaintiff's claims). ... To send both the core and non-core claims or even just to send the non-core UDTP Claim to arbitration would have a significant adverse effect upon the adjudication of these claims and upon the fundamental purposes of the Bankruptcy Code and would risk compromising the debtor's rights under North Carolina law. Denying the arbitration and retaining the matters in the bankruptcy court will provide for the orderly, efficient and effective administration of the bankruptcy estate[.]"

Opinion by Judge David M. Warren

ATTORNEY BARRED FROM COURTHOUSE FOR ABUSIVE BEHAVIOR

Case name: *In re Richard O. Gates,* 28 CBN 362, 2018 WL 1684302 (Bankr. E.D. Va. 4/5/18).

Ruling: The bankruptcy court barred an attorney from practice in the bankruptcy court for six months and prohibited from entering the courthouse during his period of suspension.

What it means: The court found that the attorney had "a history of choleric, and sometimes violent, behavior directed towards court security personnel."

Summary: The bankruptcy court directed attorney Richard O. Gates to show cause why he should not be disciplined for his disruptive and abusive behavior toward court security personnel. The hearing was triggered by an incident on March 29, 2018. According to Court Security Officer Tom Melton, Gates entered the courthouse and walked through the magnetometer, which triggered an alarm indicating that Gates had something that needed to be removed or inspected. Melton required Gates to take off his belt, empty his pockets, and go though the machine again. According to Melton, Gates responded with a rather dramatic display of profanity-laced displeasure, and threw his belt onto the conveyer striking the arm of a woman waiting in the line that had formed behind him. "The March 29, 2018 Incident was not an isolated event. It was just the latest

episode in a history of choleric, and sometimes violent, behavior directed towards court security personnel," the court said. "CSO Darrin Bromseth ("Bromseth") testified that he had several contentious encounters instigated by Gates. Bromseth testified that Gates would use profanity in front of the general public while trying to clear the Security Station. Bromseth had to remind Gates that Gates was an officer of the Court and that such behavior was unbecoming of a member of the profession." The court said the security officers' undisputed testimony was disturbing. "Gates' outbursts at the Security Station were disruptive, abusive, and undignified. The Court finds that Gates acted inappropriately on multiple occasions. He publicly and profanely demeaned the CSOs. He disrupted their ability to screen other visitors entering the Courthouse. Gates' tirades were so extreme that they required the CSOs to summon the U.S. Marshals Service for assistance. On at least one occasion, Gates' flailing outburst caused harm to a member of the general public. Gates acted outside the bounds propriety expects from an officer of the Court. His utter lack of civility reflects adversely on his professional demeanor and on his fitness to practice law," the court said. As an officer of the court, Gates was expected to "demonstrate respect for the legal system and for those who serve it, including judges, other lawyers and public officials." Instead, he told the court that he believed that his status meant he should not be subjected to the courthouse's strict security measures. The court said Gates should have sought redress through appropriate legal channels if he had a grievance with how the security measures were applied. "In no event may attorneys simply turn rogue and take matters into their own hands." The court suspended Gates from practice in the bankruptcy court for six months, and barred him from entering the building during his suspension.

Opinion by Judge Kevin R. Huennekens

INJURY TO TV REPORTER WAS WILLFUL AND MALICIOUS

Case name: *Aaron v. Lilly (In re Howard J. Lilly),* 28 CBN 363, 2018 WL 1514412 (Bankr. S.D. W.Va. 3/26/18).

Ruling: The bankruptcy court ruled that the plaintiff's claim was excepted from discharge by Section 523(a)(6).

What it means: The court found that the issues of willfulness and maliciousness were actually litigated and necessarily determined by the state court.

Summary: The plaintiff was a veteran television reporter. On July 7, 2014, he received a tip about some apparently neglected horses and mules. He investigated and found a small farm with mules and horses that appeared to be thin and malnourished. The plaintiff set up his tripod and camera by the road and began filming. While the plaintiff was filming he was confronted by the debtor, who shouted for him to leave. The plaintiff refused. The debtor attempted to take the plaintiff's camera and tripod. He managed to get the tripod, which he swung at the plaintiff, who kept filming until the camera lens was broken. The plaintiff left the scene after his camera was broken. The plaintiff reported the incident to the police, and went to the emergency room for treatment. He subsequently sued the debtor asserting claims for assault, battery, and intentional infliction of emotional distress. The jury entered a verdict against the debtor for $13,066.80 including $2,066.80 for medical expenses that the debtor had already paid. After the debtor filed for Chapter 7 relief the plaintiff filed an adversary proceeding asserting that the $11,000 remaining on the judgment was not dischargeable. The bankruptcy court found that the issues of willfulness and maliciousness were actually litigated and necessarily determined by the state court judgment. Thus, the doctrine of collateral estoppel precluded the bankruptcy court from re-litigating those issues. "In order to prevail on a Section 523(a)(6) cause of action excepting a debt from discharge, the movant must demonstrate that: (1) the debtor caused an injury to an entity or property of that entity; (2) the debtor intended to cause that harm; (3) the intentional act was done maliciously; and (4) that the debt sought to be excepted from discharge arose out of such conduct. The trial court's verdict demonstrates in abundance that Mr. Aaron has satisfied each element. Specifically, the trial court found that Mr. Lilly committed assault and battery on Mr. Aaron. In addition, the court found that Mr. Lilly was liable for intentional infliction of emotional distress. More precisely, the court went beyond the intentional torts stated above and found that Mr. Lilly acted 'willfully, wantonly, and/or recklessly or with criminal indifference to civil obligations,'" the bankruptcy court said. "Manifestly, Mr. Lilly, an entity within the meaning of Section 523(a)(6), acted with the requisite malicious intent, and the debt sought to be discharged arose out of such conduct. Accordingly, the debt owed to Mr. Aaron is nondischargeable."

Opinion by Judge Frank W. Volk

FIFTH CIRCUIT

DSO ENTITLED TO POSTPETITION INTEREST THROUGH PLAN

Case name: *In re Tony and Wendy Randall,* 28 CBN 364, 2018 WL 1737620 (Bankr. N.D. Texas 4/10/18).

Ruling: The bankruptcy court ruled that the Chapter 13 debtors' plan needed to pay interest accruing on their domestic support obligations.

What it means: "Debtors must provide for the payment of six percent interest accruing on the DSO claims pursuant to Texas Family Code § 157.265. This reading of Section 101(14A), which specifically includes interest accruing under applicable nonbankruptcy law in the definition of domestic support obligations, Section 507, which entitles DSO claims to first priority treatment, and Section 1322(a)(2), which requires that all priority claims must be paid in full, adheres to bankruptcy's 'fresh start' principles and does the best job of harmonizing the provisions of the Bankruptcy Code."

Summary: The debtors filed for Chapter 13 relief in September 2017. Their plan provided for the payment of interest on arrearages owed on two domestic support obligations, but did not provide for full payment of general unsecured claims. The debtors filed an amended plan that did not provide for interest payments on the DSO claims after the Chapter 13 Trustee objected to confirmation of their original plan. The amended plan drew an objection from the Office of the Attorney General of Texas. The bankruptcy court confirmed the debtors' plan with the requirement that it provide for payment of postpetition interest on the DSO claims. "There is a split of authority in the Fifth Circuit regarding whether or not debtors are required to pay postpetition interest on valid DSO claims for child support through a Chapter 13 plan," the court said. In *In re Hernandez*, 2007 WL 3998301 (Bankr. E.D. Texas 11/15/07), the court found that interest on DSO claims may not be paid through the plan. The court reasoned that only DSO claims owed on the petition date were entitled to priority pursuant to Section 507(a)(1)(A). In addition, the court noted that priority is granted to allowed claims, and Section 502(b)(2) mandates that claims for unmatured interest be disallowed. The opposite conclusion was reached in *In re Resendiz*, 2013 WL 6152921 (Bankr. S.D. Texas 11/20/13) and *In re Lightfoot*, 2015 WL 3956211 (Bankr. S.D. Texas 6/22/15). Both courts relied on the plain language of Section 101(14A), which defines "domestic support obligation" as including interest accruing under applicable nonbankruptcy law. In the case at bar, the bankruptcy court found *Resendiz* and *Lightfoot* to be more persuasive. "The definition of DSO under Section 101(14A) as including interest, coupled with the amended priority scheme of Section 507(a)(1), evidences that postpetition interest must be paid on the prepetition DSO claims," the court said. "The Court notes that this does not mean that all DSOs must receive postpetition interest in a Chapter 13 plan because, at least in Texas, only certain types of DSOs accrue interest. The Texas Family Code provides for six percent interest on delinquent child support and makes that interest part of the debt. *See* § 157.265(a). Spousal maintenance DSOs, however, provided for in Chapter 8 of the Texas Family Code, do not have such a provision for interest on delinquent obligations. There is also no provision in Texas law for interest on attorneys' fees or educational expenses that may be considered part of a DSO. So, it appears that through Section 101(14A), Congress has allowed for priority treatment of interest accruing on a special subset of DSOs by making the interest accruing pursuant to applicable nonbankruptcy law part of the DSO itself. The interest and principal are intertwined and inseparable, and enforcement of the interest carries the same weight as enforcement of the principal."

Opinion by Judge Harlin D. Hale

SIXTH CIRCUIT

BAP AFFIRMS HOMESTEAD EXEMPTION DENIAL

Case name: *In re Austin C. and Dorothy I. Felix,* 28 CBN 365, 2018 WL 1659585 (Bankr. 6th Cir. 4/6/18).

Ruling: The 6th Circuit Bankruptcy Appellate Panel affirmed the bankruptcy court's denial of the debtors' homestead exemption.

What it means: The issue was whether the debtors were domiciled in Ohio. Disputes regarding domicile generally present mixed questions of law and fact. The bankruptcy court's ruling came down to applying the well-settled legal standard for determining domicile to the facts of the case. The BAP gave great weight to the bankruptcy court's findings regarding the witnesses' credibility and held that the bankruptcy court's ruling was not clearly erroneous.

Summary: The Chapter 7 debtors owned houses in Reynoldsburg, Ohio, and Upper Marlboro, Md. They listed their Ohio house as their exempt homestead, and claimed a homestead exemption of $265,800. Their Statement of Intent said they were going to keep the Ohio house and surrender the Maryland house. However, at the meeting of creditors the debtor-wife testified that the plan was to move to Maryland and that they were commuting between the two houses. The debtors' attorney told the trustee that the debtors intended to offer the Ohio house to the IRS as an offer in compromise to hopefully clear their tax debt and enable them to refinance the loan on the Maryland house. Based on this information, the trustee objected to the debtors' homestead exemption on the basis that the Ohio house was not the debtors' domicile during the 730 days immediately preceding their Chapter 7 filing. The debtors responded that would like to eventually move to Maryland but had not yet done so. The bankruptcy court sustained the trustee's objection. The 6th Circuit BAP affirmed. Disputes regarding domicile generally present mixed questions of law and fact. "The legal standard for determining domicile is well settled, and the bankruptcy court's decision rests primarily on applying that standard to the facts of this case. In other words, the bankruptcy court was compelled 'to marshal and weigh

evidence,' and 'make credibility judgments,' and therefore, the decision is reviewed for clear error," the panel said, and held that the bankruptcy court's ruling was not clearly erroneous. A domicile differs from a residence in that a domicile is where a person dwells. A domicile involves a sense of permanency. A person may have multiple residences, but only one domicile. The panel said the bankruptcy court applied the correct legal standards in concluding that the debtors' domicile was in Maryland. "As the debtors admitted and the bankruptcy court noted: 'over the last decade, Debtors have resided in and commuted between two houses, one in Ohio, and the other in Maryland.' [Citation omitted.] The debtors bought the Ohio Home in 2004, and lived there with at least five of their six children. The minor children attended Ohio public schools, and the debtors were charged owner-occupied property taxes on the Ohio property. Mrs. Felix had family in Maryland, and the debtors intended to open a business in Maryland and relocate there permanently. In furtherance of their plan to move, the debtors purchased the Maryland Home, a 4607 square foot house, for $651,815 in 2009. To obtain financing for the Maryland Home, the debtors executed a sworn affidavit as part of the mortgage process which stated that the home would be their primary residence for 12 months out of the year. Mrs. Felix physically moved to the Maryland Home, which was at least partially furnished, obtained a Maryland driver's license (although she does not drive), registered to vote in Maryland, and opened a bank account in Maryland. At least one of the debtors' adult children also moved into the Maryland Home and attended college in Maryland, while Mr. Felix and some of their children remained in Ohio. The minor children attended school in Ohio, and the family's regular physicians and churches were in Ohio during the relevant period. Both debtors frequently commuted back and forth between Maryland and Ohio. Routine daily activities occurred in both states, and even the debtors' witnesses testified regarding the existence of the Maryland Home and of the debtors' desire to move there permanently. In 2012, the debtors sold the Ohio business to their son but continued to work there. The Ohio business remained the only source of the debtors' income. Between the years 2005 and 2013, the debtors formed six entities and registered trade names in Maryland and the District of Columbia; however, none of the debtors' attempts at starting a new business in Maryland were successful. The debtors' business and personal bank records showed regular debit transactions that occurred in both states," the panel said. The bankruptcy court noted that "the hallmark of this case is the tardy disclosure of an intricate organization that defies all explanation of necessity" and that "Debtors' credibility in providing complete and candid answers suffers." In particular, the court found that the debtors' approach toward their homes changed after they learned that the IRS tax liens were recorded in the wrong Ohio county. The court found "that this change in heart is a tactic to shield a valuable asset, rather than a valid assertion of domicile." The BAP said the bankruptcy court's finding regarding credibility carried great weight. "While one could reach either domicile conclusion from the evidence, this Panel must afford due deference to the bankruptcy court's assessment of the witnesses' credibility. Therefore, the bankruptcy court's domicile determination was not clearly erroneous. This conclusion is strengthened by the bankruptcy court's express findings regarding the debtors' credibility."

EXEMPTION IN FRAUDULENTLY TRANSFERRED PROPERTY WAS NOT FRAUDULENTLY ASSERTED

Case name: *Moyer, Chapter 7 Trustee, v. Rosich (In re Carol K. Rosich),* 28 CBN 366, 2018 WL 1614214 (Bankr. W.D. Mich. 3/30/18).

Ruling: The bankruptcy court denied the trustee's motion for summary judgment.

What it means: Challenges to a debtor's exemption of an interest in a residence based on a fraudulent transfer theory must be brought within the time period prescribed in Rule 4003(b)(1), rather than Rule 4003(b)(2).

Summary: In a previous ruling the bankruptcy court announced its intention to avoid, as a constructively fraudulent transfer, the conveyance by the Chapter 7 debtor to herself and her husband, which created a tenancy by the entireties in the debtor's home that she claimed as exempt. The trustee then sought to recover the debtor's interest in the property pursuant to Section 550(a). The court denied that request because the trustee had not timely objected to the debtor's exemption claim. The trustee responded that it was not too late for him to challenge the exemption because it was "fraudulently asserted" within the meaning of Rule 4003(b)(2). "A trustee who asserts a garden-variety objection to exemptions faces a short and unforgiving thirty-day deadline, but a trustee who alleges that the debtor 'fraudulently asserted the claim of exemption' may object 'at any time prior to one year after the closing of the case,'" the court explained. With the debtor's consent, the court allowed the trustee to reassert his summary judgment motion on the basis that it was not too late for him to challenge the exemption. In his brief, the trustee provided this summary of his argument: "Knowing that she had engaged in conduct that defrauded her creditors – indeed, intending to do so – Debtor nonetheless asserted in the bankruptcy case that she could exempt the property interest that directly resulted from her own fraudulent conduct. In short, Debtor asserts that she can fraudulently create exempt property with impunity. Michigan law has never allowed this. Claiming as exempt a property interest created

through the Debtor's fraudulent conduct constitutes 'fraudulently asserting' the claim of exemption." The court noted that Rule 4003(b)(2) does not add an independent substantive basis for objecting to an exemption based on a debtor's misconduct. "So, a debtor does not forfeit an exemption by misrepresenting her entitlement thereto; she only forfeits an exemption if Section 522 or applicable nonbankruptcy law so provides. Therefore, the sole purpose of Rule 4003(b)(2) is to create a deadline, not grounds, for objecting to exemptions," the court said. Section 522(o) was added to the Bankruptcy Code in 2005 to limit state law exemptions in residential property to the extent premised on actually fraudulent transfers occurring within the decade before bankruptcy. "When Congress added Section 522(o) as an additional fraud-based ground for limiting state law exemptions in 2005 – long after *Taylor's* definitive interpretation of Rule 4003(b)(1) in 1992 – it was certainly aware that the strict 30 day deadline prescribed in Rule 4003(b)(1) would apply to this new ground for objecting to certain exemption claims. Indeed, Rule 4003(b)(2) was not added until 2008, so it is fair to conclude that Congress and the Supreme Court assumed that challenges to the exemption of an interest in a debtor's residence based on a fraudulent transfer theory (such as the trustee has advanced) must be brought within the time prescribed in Rule 4003(b)(1), rather than Rule 4003(b)(2). Despite the intuitive appeal of the trustee's argument that Mrs. Rosich filed Schedule C in bad faith as the final step in a fraudulent scheme, the rules do not give the court the authority to grant the relief the trustee seeks, based on the debtor's prepetition transfer, at this late stage in the case. *Taylor*, 503 U.S. at 645, 112 S.Ct. 1644. If timely asserted, Section 522(o) might have supplied a federal statutory basis for limiting the debtor's state law exemption based on the fraudulent transfer theory, just as Michigan case law might have, but the court hews to its earlier conclusion that a trustee must bring such challenges within the time prescribed in Rule 4003(b)(1)," the court said.

Opinion by Judge Scott W. Dales

ABUSE FOUND BASED ON TOTALITY OF CIRCUMSTANCES

Case name: *In re Micah T. and Mary Kay Shoup,* 28 CBN 367, 2018 WL 1614188 (Bankr. N.D. Ohio 3/30/18).

Ruling: The bankruptcy court granted the U.S. Trustee's motion to dismiss the debtors' case pursuant to Section 707(b), but gave the debtors 30 days to convert their case to Chapter 13.

What it means: The court found abuse based on the totality of the debtors' circumstances, which included buying two expensive cars while in financial distress and increasing their voluntary retirement contributions prior to filing.

Summary: The Chapter 7 debtors scheduled secured debt of $234,947, which included two vehicle loans – $31,237 owed on a 2014 Chevy Silverado valued at $30,000, and $35,295 owed on a 2014 GMC Acadia valued at $29,000. The debtors intended to reaffirm the mortgage on their home as well as the two vehicle loans. The debtors had combined gross income of $9,001, and net income of $6,374. The debtors listed payroll deductions for voluntary retirement contributions of $338 per month for the debtor-husband and $202 for the debtor-wife. The debtors' household included children aged two and five. Schedule J listed expenses of $6,278, giving them a monthly net income of $96. About one week after the U.S. Trustee moved to dismiss the debtors' case pursuant to Section 707(b), the debtors filed amended schedules. They added two creditors with claims secured by personal property. They reduced the debtor-wife's income and increased their expenses. As a result of the changes the debtors' monthly net income was reported as negative $260. The debtors said they reduced their income because the debtor-wife was getting less overtime, and increased their expenses because they shortchanged themselves in the initial schedule. The bankruptcy court ruled that the debtors' case should be dismissed based on the totality of their circumstances. The court noted that the debtors were eligible for Chapter 13 relief and had sufficient income to fund a plan if they eliminated their voluntary retirement contributions. "The 'presumption of abuse' level in 11 U.S.C. § 707(b)(2)(A)(i)(II) is currently at $12,850 over 5 years, or about $215 a month over 60 months. The debtors here have disposable income in excess of that amount, even ignoring [a] history of tax refunds," the court said. "While the court can find that the totality of the circumstances do not support a finding of abuse, even when there is disposable income in excess of the threshold, there is little in the way of counterbalancing facts here. Debtors have a budget that does not reflect significant belt tightening. During a period when they describe being in financial distress, they spent $85,000 on motor vehicles. As bankruptcy approached, Debtors made the decision to add an additional expense of $338 per month to their budget in the form of voluntary retirement contributions." The debtors complained that they had been able to save very little for their retirement because they liquidated the debtor-husband's retirement account in 2015. They received about $38,000 after taxes and used $18,000 to pay off student loans. The debtors were unable to explain what happened to the balance of the money. The debtors said the money was used to benefit creditors, but other than paying the student loans the debtors offered no evidence to support this argument.

Opinion by Judge John P. Gustafson

STATE COURT JUDGMENT ESTABLISHED DISCHARGE EXCEPTION

Case name: *Schulz Brau Brewing LLC, et al., v. Evans (In re Tiffany P. Evans),* 28 CBN 368, 2018 WL 1577716 (Bankr. E.D. Tenn. 3/28/18).

Ruling: The bankruptcy court ruled that the plaintiffs' claim was excepted from discharge pursuant to Section 523(a)(2)(A).

What it means: The plaintiffs sued the debtor and others in state court alleging intentional misrepresentation under Tennessee law – the elements of which fit within Section 523(a)(2)(A). The default judgment entered in the state court action included express findings of fact and conclusions of law that the defendants fraudulently, intentionally, and willfully misrepresented facts on which the plaintiffs relied to their detriment. The bankruptcy court found that this judgment satisfied all of the elements of Section 523(a)(A)(2), including intent. "Thus, the Default Judgment sufficiently establishes that, under the doctrine of collateral estoppel, the liability of Defendant established by the Default Judgment is nondischargeable under Section 523(a)(A)(2)."

Summary: In November 2015 the plaintiffs hired J. Evans Excavating & Associate Inc. to do construction work. The contract was signed by the debtor and Joshua Evans. One month later the parties executed a second construction contract. After J. Evans Excavating abandoned the project, the plaintiffs hired another contractor to finish the job and sued J Evans Excavating, Joshua Evans, and the debtor. The state court entered a default judgment in the plaintiffs' favor. The court found, among other things, that "Defendants fraudulently, knowingly and willfully misrepresented to the plaintiffs that they were properly licensed in the state of Tennessee and qualified to perform the work for which they contracted[.]" The default judgment also found that "Plaintiffs relied upon the defendants' fraudulent representations and would never have hired Defendants but for those fraudulent representations." After the debtor filed for Chapter 7 relief, the plaintiffs filed an adversary proceeding asserting that its claim was nondischargeable pursuant to Section 523(a)(2)(A) and/or (a)(6). The plaintiffs sought summary judgment arguing that the issues were previously litigated in the state court and that the judgment should be given collateral estoppel effect. The bankruptcy court agreed, finding that the default judgment addressed and was dispositive of the Section 523(a)(2)(A) elements so that summary judgment was appropriate. "As applied in Tennessee, the doctrine of collateral estoppel 'bars the same parties or their privies from re-litigating in a later proceeding legal or factual issues that were actually raised and necessarily determined in an earlier proceeding ... [so] that [such] determination is conclusive against the parties in subsequent proceedings ....' *Mullins v. State*, 294 S.W.3d 529, 534 (Tenn. 2009)," the court said. "Plaintiffs have satisfied their burden of establishing that the doctrine of collateral estoppel applies because they have established every element enumerated in the *Mullins* decision: the issue to be precluded – fraudulent misrepresentation – is identical to the issue decided in the State Court Lawsuit; fraudulent misrepresentation was actually raised, litigated, and decided on its merits; the Default Judgment, which was entered on July 22, 2016, and was not appealed, is a final order; Defendant was a party in the State Court Lawsuit; and Defendant had a full and fair opportunity to defend the State Court Lawsuit," the court said.

Opinion by Judge Suzanne H. Bauknight

SEVENTH CIRCUIT

MODEL PLAN MODIFICATION NEEDED DEBTOR'S AGREEMENT

Case name: *In re Talecia Gilliam,* 28 CBN 369, 2018 WL 1582481 (Bankr. N.D. Ill. 3/28/18).

Ruling: The bankruptcy court ruled that the Chapter 13 debtor's counsel was not eligible to receive the district's "flat fee" but could either file an itemized fee application with compensation capped at the flat fee minus $500 or accept a fee equal to the flat fee minus $1,000.

What it means: The court found that the debtor's counsel failed to comply with the disclosure requirements by failing to disclose the firm's agreement with the debtor regarding submission of a plan that modified the district's model plan to elevate the priority of the payment of the attorney's fee. The court said such a modification required an agreement, and that agreement needed to be disclosed in order for the firm to qualify for the district's flat fee. The court gave the law firm the option of accepting a diminished flat fee instead of submitting a fee application because this individual case was representative of more than 50 cases in which the firm's request for compensation was pending.

Summary: The Chapter 13 debtor's case was representative of more than 50 Chapter 13 cases filed by debtors represented by the Semrad Law Firm in which the firm had pending applications for compensation under the Court-Approved Retention Agreement. The debtor initially proposed a plan that modified the order of payment of claims. The model plan calls for the trustee to pay claims in the following order: (1) the trustee's fee; (2) current mortgage payments; (3) other secured claims; (4) priority claims of the debtor's attorney; (5) mortgage arrears; (6) priority claims

other than those of the debtor's attorney; (7) specially classified non-priority unsecured claims; and (8) general unsecured claims. The debtor's modification moved payment of the firm's fee to the same priority position as current mortgage payments. When the trustee expressed concern regarding the priority modification, the plan was modified to remove the priority modification and to lower the initial payments on secured claims. The court said this was the typical approach taken to objections to modification of the model plan, and noted that the payments on secured claims were often lowered to the point where they were no more than minimal, adequate protection payments. "Plans such as these, so-called 'step plans' are proposed to allow counsel accelerated payments at the expense of the affected secured creditors, and only thereafter step up the set payment to secured creditors to a more fulsome amount," the court said. There was no question that modification of the model plan by the debtor's counsel was for the attorney's benefit alone, the court said. "In light of the foregoing, the court concludes that both the plan provisions themselves and any effort spent on the plan provisions by Semrad were of no benefit to the estates in question. While that does not definitively determine whether the requested fees are unreasonable, it calls into question such requests." The court then found that the law firm could not rely on the Court-Approved Retention Agreement for payment because the firm failed to adequately disclose its agreement with the debtors to modify the model plan. The firm argued that there was no agreement, but the court said that would be worse than failing to adequately disclose the agreement. The firm also argued that it could not be reasonably required to have an agreement with its clients regarding each aspect of the Bankruptcy Code, Rules, Local Rules, and General Orders. The court agreed, but said Semrad altered the baseline created by the Code and Rules when it altered the model plan. "By altering that baseline, Semrad has unquestionably changed the *status quo* regarding its payment. It is that change that must be disclosed," the court said. "Semrad has failed in its disclosure obligations to the court and has done so on a massive scale. Semrad determined that it wanted its compensation priority changed in these cases and did so without any further disclosure to the court than filing a myriad of plans containing the change. Given the volume of cases this court must handle, had the Chapter 13 Trustee not objected, it is possible that these changes may have gone unnoticed for quite some time." Because the court found that the firm was disqualified from seeking the flat fee allowed by the local rules, the firm needed to file an itemized fee application in each case. As a penalty for failing to adequately disclose its agreements with clients, the court imposed a sanction of $500 in each case. A determination of the firm's reasonable fee would be made on a case-by-case basis. The maximum fee in each case would be the flat fee minus $500. Given the amount of work that would be involved in hearing fee applications in every case, the court gave the firm the option of accepting a fee in each case equal to the flat fee minus $1,000.

Opinion by Judge Timothy A. Barnes

GOOD-FAITH FILING PART OF SCHEME TO DEFRAUD

Case name: *In the Matter of Cassondra C. House,* 28 CBN 370, 2018 WL 1505572 (Bankr. E.D. Wis. 3/26/18).

Ruling: The bankruptcy court granted a creditor's motion for in rem relief from the automatic stay pursuant to Section 362(d)(4).

What it means: "[A] finding of good faith in the granting or denial of a Section 362(c)(3)(B) motion to extend the automatic stay is not controlling as to the examination of good faith in the filing of the petition for other purposes."

Summary: The debtor and her husband purchased a rental property in August 2007. They signed a note for $64,000, which was secured by a mortgage on the property. They also executed an assignment of rents to their lender, CIT Bank. They quickly fell behind on the mortgage payments. In 2008 the loan was modified and the principal amount owed was increased to $68,302.75. In 2011 the debtor filed the first of five Chapter 13 petitions. Three of the filings were timed to stop foreclosure sales of the property. Plans were confirmed in two of the debtor's four prior cases, but all four were dismissed prior to discharge. The debtor's current case was filed on Oct. 24, 2017. Because she had another Chapter 13 case pending in the preceding year, she asked the court to continue the automatic stay. The bankruptcy court granted the debtor's motion over CIT's objection because the debtor's fourth case was dismissed due to the debtor's health issues and surgery, and because her income from her new job was more salary-based and less commission-dependent. After the court extended the stay, CIT moved for in rem relief pursuant to Section 362(d)(4). According to CIT, the debtor's history of bankruptcy filings and failure to make mortgage payments indicated that the debtor was engaged in a scheme to delay, hinder or defraud it. The debtor responded that each of her five cases was a well-intended effort to pay creditors. The dismissal of her four prior cases was the result of events outside her control. In her view there could be no "scheme" because the court had just extended the stay, finding that her current case was not filed in bad faith. CIT argued that the court's finding that the debtor's current case was filed in good faith did not preclude the court from finding that the current case was also part of a scheme to

delay or hinder it from getting paid. The court agreed with CIT, and granted in rem relief. "The very first clause of Section 362(c)(3)(C) limits its application specifically to motions for extension filed under Section 362(c)(3)(B) because it states that it only applies 'for purposes of subparagraph (B).' 11 U.S.C. § 362(c)(3)(C) ((referring to 11 U.S.C. § 362(c)(3)(B)). Moreover, Section 362 makes specific provision for relief under Section 362(d) where 'the court finds that the filing of the petition was part of a scheme to delay, hinder, or defraud creditors that involved ... multiple bankruptcy filings affecting such real property.' 11 U.S.C. § 362(d)(4)(B). **That provision in Section 362(d)(4)(B) would be wholly superfluous if Congress had intended to import Section 362(c)(3)(C)'s presumption of bad faith based on multiple filing into Section 362(d)**," the court said, providing its emphasis to a quote from *In re Juarez*, 533 B.R. 818 (Bankr. D. Colo. 2015). "The statutory presumption of bad faith found in Section 362(c)(3)(C) 'is limited in its application ... to the determination of whether the automatic stay should be extended.' Therefore, a finding of good faith in the granting or denial of a Section 362(c)(3)(B) motion to extend the automatic stay is not controlling as to the examination of good faith in the filing of the petition for other purposes." The court then found that the number of petitions filed by the debtor was persuasive but not determinative of whether they were part of a scheme. Each of the first three cases was filed very shortly after action in CIT's 2009 foreclosure case but her fourth and fifth cases were not filed "on the eve" of any foreclosure event. In addition, the debtor's payment of CIT's claim in her third case caused the creditor to dismiss its foreclosure action. This fact showed that her third case was more of an attempt to pay the claim than it was an attempt to frustrate CIT. However, the court declined to view the debtor's third case as a "relentless pursuit of a solution" because it was dismissed before discharge, she was delinquent in plan payments at the time, and refiled just three months later. "Having failed to keep up with payments in her third case, the Court questions whether the debtor had a true basis to believe she could achieve reorganization, even though she proposed, again, substantial plan payments," the court said, and questioned whether the debtor experienced a true change in circumstances between her third and fourth cases. In addition to the debtor's serial filings, the court pointed to the debtor's history of not collecting rent as indicative of a disregard for CIT's rights. The debtor said she had not collected rent on the property since 2014, that it was sometimes occupied by relatives, and that she lived there from time to time when she was separated from her husband.

Opinion by Judge Beth E. Hanan

EIGHTH CIRCUIT

NONFILING SPOUSE WAS NOT 'PERSON AGGRIEVED' BY COURT'S RULING

Case name: *Barbara Wigley v. Michael R. Wigley,* 28 CBN 371, 2018 WL 1525832 (8th Cir. 3/29/18).

Ruling: The 8th U.S. Circuit Court of Appeals dismissed an appeal from the 8th Circuit Bankruptcy Appellate Panel, agreeing with the BAP that the appellant was not a "person aggrieved" by the orders of the bankruptcy court.

What it means: Whatever risk of liability and burden of litigation that the debtor's nondebtor spouse might face in a state court fraudulent transfer action existed before the debtor's Chapter 11 case. The bankruptcy court's orders did not increase the nondebtor spouse's burdens or diminish her rights.

Summary: The Baja Sol Cantina EP LLC operated a restaurant. Its principal, Michael Wigley, personally guaranteed the company's obligations under the lease with landlord Lariat Companies. The restaurant failed. Lariat sued Baja Sol and Wigley and obtained a judgment in the amount of $2.23 million. While the lawsuit was pending but before the state court granted judgment, Wigley transferred some of his assets to his wife Barbara. After obtaining judgment, Lariat commenced a state court fraudulent transfer action against Barbara and Wigley. The state court found the defendants jointly and severally liable for $795,098 of fraudulently transferred funds. Wigley but not Barbara filed for Chapter 11 relief. Lariat's claim against Wigley was capped by Section 502(b)(6). Wigley filed a plan of reorganization that proposed to pay unsecured creditors in full. The plan also contained a settlement and release of claims against Barbara pursuant to which Barbara was to pay $350,000 to the estate in settlement of the state court fraudulent transfer action. The bankruptcy court sustained Lariat's objection and denied confirmation, concluding that the settlement was not fair to Lariat. The bankruptcy court later confirmed an amended plan of reorganization that did not settle the fraudulent transfer action. The court also granted Lariat's motion for relief from the automatic stay so that it could exercise its rights and remedies under nonbankruptcy law with respect to the fraudulent conveyance action against Barbara based on prepetition events. Barbara appealed to the BAP, challenging: 1) the bankruptcy court's order denying confirmation of the prior plan that would have settled the claim against her; 2) the bankruptcy court's order confirming the amended plan; and 3) the bankruptcy court's order granting Lariat relief from the stay. The BAP, at 557 B.R. 678, held that Barbara lacked stand-

ing and dismissed her appeal. Barbara appealed further. The 8th U.S. Circuit Court of Appeals dismissed the appeal, holding that Barbara was not a person aggrieved by the bankruptcy court's orders, and she did not have standing to appeal. Barbara argued that she had person aggrieved standing because if the court had confirmed the first plan and thereby approved the settlement, then once she paid $350,000 to the estate, she would retain her interest in the assets that Wigley had transferred to her and would avoid further litigation with her husband's creditors. Similarly, Barbara argued that the order confirming the amended plan and the order granting Lariat stay relief allowed for further prosecution against her in state court. The 8th Circuit opined that Barbara's alleged harm based on potential litigation was the sort of harm that the court of appeals declared to be too indirect for bankruptcy standing in *Opportunity Finance, LLC v. Kelley*, 822 F.3d 451 (8th Cir. 2016). In that case, the 8th Circuit concluded that the appellant lenders were not persons aggrieved even though the order they complained of arguably stripped them of an affirmative defense in certain avoidance actions. The *Opportunity Finance* court stated that in general, "a bankruptcy court order allowing litigation to proceed against an adversary defendant does not make that defendant a party aggrieved. ... Here, the bankruptcy court declined to approve a settlement agreement that would have eliminated Barbara's pecuniary risk in the fraudulent transfer action and relieved her of the burdens of ongoing litigation. The court's order granting relief from the automatic stay allows Lariat to proceed with its fraudulent transfer action against Barbara. The orders, however, merely maintain the *status quo ante* as to Barbara," the 8th Circuit stated.

ATTORNEY'S AFFIDAVIT WAS NOT 'SUBSTANTIAL EVIDENCE' OF VALUE

Case name: *United States v. Austin (In re Scott S. and Anna M. Austin),* 28 CBN 372, 2018 WL 1702742 (Bankr. 8th Cir. 4/9/18).

Ruling: The 8th Circuit Bankruptcy Appellate Panel reversed the bankruptcy court's order, which sustained the Chapter 13 debtors' objection to a proof of claim filed by the Internal Revenue Service.

What it means: In their objection to a proof of claim filed by the IRS that asserted a lien in the debtors' workers' compensation claims, the debtors asserted that their claims were worth $3,000 on the petition date. The POC asserted that the claims were worth $15,661 – the amount that the debtors received in settlement of the claims. The bankruptcy court sustained the debtors' objection, finding that an affidavit from their workers' compensation attorney constituted "substantial evidence" of the claims' value. The BAP reversed, finding that the affidavit was not "substantial evidence" because it was only the attorney's unsupported opinion of the claims' value.

Summary: The debtors filed for Chapter 13 relief in December 2014. They scheduled two pending workers' compensation claims as contingent and unliquidated exempt property of unknown value. The IRS filed a proof of claim asserting a claim that was partially secured by a tax lien. The debtors objected to the secured portion of the government's claim to the extent that it gave value to the workers' compensation claims. In the alternative, they asserted that the claims had a present value of $0 because there were no settlement offers or any basis to determine the value of the value of the claims. The bankruptcy court overruled the objections. While the court was considering the debtors' objection, the debtors negotiated a settlement of the workers' compensation claims. They received a net settlement of $15,661. The IRS filed an amended POC after learning of the settlement. The amended POC included the net settlement amount as part of the secured claim. The debtors objected to the amended POC. Attached to the debtors' objection was an affidavit from their workers' compensation attorney, who opined that the claims had a "nuisance" value of $3,000 on the petition date. The bankruptcy court found that the attorney's affidavit provided "substantial evidence" of the value of the workers' compensation claims, and was sufficient to rebut the prima facie validity of the IRS's claim. Without evidence from the IRS to support its valuation, the bankruptcy court sustained the debtors' objection. The 8th Circuit BAP reversed. The panel noted that there was no dispute as to the amount of the tax claim or the validity of the tax lien. The only issue was whether the bankruptcy court properly valued the tax lien in the workers' compensation claim at $3,000 by finding that the debtors overcame the presumption that the $15,661 value stated in the amended POC was correct. The debtors argued that the bankruptcy court correctly found that the attorney's affidavit constituted substantial evidence to support their valuation of the secured portion of the workers' compensation claims in rebuttal of the IRS's proof of claim. The BAP disagreed, noting that the affidavit did not contain the financial or factual information necessary to support the attorney's opinion of value. The panel pointed out that the attorney admitted in the affidavit that he did not know the full extent of the debtor's injuries on the petition date because the debtor had not had any independent medical exams and needed further treatment and analysis. The attorney gave the claims a "nuisance value" on the basis that he gave value to the claims by pursuing them to final settlement. However, the panel said there was nothing in the affidavit to show what the attorney did to increase the value of the claims. "The claims are for losses due to the injuries Mr. Austin

sustained at work. The evidence supporting the losses would be determined by the extent of the injury, worker's compensation schedules, etc. Mr. Smallwood's work had no impact on these factors," the panel said. "As an analogy, assume a debtor has a damaged car and he wants to file a claim with the auto insurance company but at the time he makes the claim, the full extent of the damage is not known. An agent's work to establish the extent of the damage and pursue the insurance proceeds would have no effect on the value of the damage. Rather, the agent's work made the facts known so that the claim could be resolved. ... Mr. Smallwood's work helped establish the extent of Mr. Austin's injuries and helped to recover the benefits from the worker's compensation insurance. Mr. Smallwood's work had no impact on the value of the worker's compensation claims themselves as he did not increase the extent of Mr. Austin's injuries, his efforts simply made the facts known and aided in recovery." In addition, the affidavit stated that no settlement offers had been made as of the petition date but failed to state whether any demands had been made. Finally, the BAP observed that the IRS had no opportunity to cross examine the attorney because there was no evidentiary hearing, no testimony taken, and nothing admitted into evidence.

ELEVENTH CIRCUIT

SECTION 526(a)(4) PROHIBITS ADVISING CLIENT TO INCUR DEBT TO PAY FEE

Case name: *Cadwell v. Kaufman, Englett & Lynd, PLLC,* 28 CBN 373, 2018 WL 1550612 (11th Cir. 3/30/18).

Ruling: The 11th U.S. Circuit Court of Appeals reversed the district court's ruling that the plaintiff's complaint failed to state a claim, and remanded the matter.

What it means: The court held "(1) that a debt-relief agency (including a law firm) violates 11 U.S.C. § 526(a)(4) if it advises a client to incur additional debt to pay for bankruptcy-related legal representation, without respect to whether the advice was given for some independently 'invalid purpose'; (2) that Cadwell's allegation that KEL instructed him to pay his bankruptcy-related legal bills by credit card states a viable claim under Section 526(a)(4); and (3) that none of the constitutional arguments that KEL has presented to us warrants invalidating the statute on First Amendment grounds."

Summary: After meeting with the law firm of Kaufman, Englett & Lynd to discuss the possibility of filing a Chapter 7 petition, Loyd Cadwell entered into an agreement that obligated him to pay a fee of $1,700 for the firm to represent him. The agreement called for an initial payment of $250 followed by another $250 payment soon thereafter. The $1,200 balance was to be paid in four monthly payments of $300. According to Cadwell's complaint, "KEL instructed [him] to pay the initial retainer and all subsequent payments by credit card." Cadwell terminated KEL's services after paying $1,100. He used two different credit cards to make the payments. Cadwell sued KEL alleging that the firm violated Section 526(a)(4) by advising him to incur more debt to pay the firm's fee for bankruptcy-related legal services. The district court granted KEL's motion to dismiss, stating that "the mere advice to use credit cards to pay for legal fees does not violate" Section 526(a)(4). Instead, applying *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229 (2010), the district court found that Section 526(a)(4) only "prohibits a debt relief agency from advising a debtor to incur additional debt for an invalid purpose." The 11th Circuit reversed and remanded. There was no dispute that KEL was a "debt relief agency" and Cadwell was an "assisted person" within the meaning of the statute. The parties also agreed that Section 526(a)(4) prohibits incurring debt in anticipation of bankruptcy filings generally, and incurring debt to pay for bankruptcy-related legal services more specifically. The parties disagreed on whether the phrase "in contemplation of" – which the Supreme Court in *Milavetz* construed to require proof that the advice to incur debt was given for an invalid purpose – applies to both prohibitions or only the first. "Unfortunately, the statute contains no punctuation that might help us determine where to place the 'hinge' that divides the two prohibitions – which, as it turns out, really matters. We are presented here with three different ways of reading Section 526(a)(4) – one (sort of) suggested by the Supreme Court in *Milavetz*, another proposed by KEL and adopted by the district court, and yet another advocated by Cadwell. Each locates the hinge in a different place in the text, resulting in three very different meanings," the 11th Circuit said. The appellate court agreed with Cadwell that the hinge comes after the phrase "to incur more debt." Thus, Section 526(a)(4) prohibits advice "to incur more debt" either "in contemplation of" a bankruptcy filing or "to pay an attorney" for bankruptcy-related legal services. The 11th Circuit said this interpretation, unlike the others, did not produce "goofy results, defy the usual rules of syntax, or render a phrase meaningless." Given this interpretation of Section 526(a)(4), the 11th Circuit had no trouble concluding that Cadwell's complaint stated a claim. Finally, the 11th Circuit rejected KEL's argument that Section 526(a)(4) was an unconstitutional restriction on attorney-client communications. The appellate court noted that in *Milavetz* the Supreme Court rejected the suggestion "that Section 526(a)(4) broadly prohibits debt relief agencies from discussing covered subjects instead

of merely proscribing affirmative advice to undertake a particular action." The same was true here. "Section 526(a)(4) doesn't prevent firms like KEL from discussing with debtors potential options and their legal consequences. It merely prohibits them from giving their clients 'affirmative advice' to incur more debt in order to pay for bankruptcy-related representation."

POSTPETITION FEES MUST BE PROVIDED FOR IN MORTGAGE

Case name: *In re Talmadge R. and Elaine B. England,* 28 CBN 374, 2018 WL 1614166, and *In re Jeffrey L. Ochab*, 2018 WL 1614164 (Bankr. M.D. Ala. 3/30/18).

Ruling: The bankruptcy court denied the creditor's request for postpetition fees and charges.

What it means: "[A] mortgagee may recover reasonable fees incurred in connection with the enforcement of a mortgage only where the mortgage contractually imposes a duty on the mortgagor to pay those fees."

Summary: In two Chapter 13 cases the debtors filed motions to determine postpetition fees and charges after mortgagees filed notices pursuant to Rule 3002.1. In *In re England*, the notice stated that the debtors incurred a postpetition fee of $300 for the filing of the creditor's proof of claim and $350 for reviewing the debtors' plan. In *In re Ochab*, the creditor filed a notice stating that the debtor incurred a fee of $400 for "Attorney Fee" and $500 for filing the proof of claim. Neither notice described the fees in detail. The debtors objected that the filing of a notice pursuant to Rule 3002.1 does not constitute prima facie evidence that the charges are valid. They asserted that without evidentiary support, the creditors were not entitled to payment. They argued that their mortgages did not provide for the assessment of such charges in bankruptcy, and that the amounts charged were unreasonable. The creditors responded that Rule 3002.1(c) did not require it to provide evidentiary support for the charges, and that the fees charged for its services in filing a proof of claim and reviewing the debtors' plans were reasonable. "Upon a debtor filing a motion to determine mortgage fees, expenses, and charges pursuant to Section 1322(e), the Court must look to the underlying agreement and applicable nonbankruptcy law to determine if the amounts are permissible. The 'reasonableness standard' applied under Section 506(b) challenges does not apply to postpetition fees, expenses, and charges necessary to cure a default as Section 1322(e) explicitly excepts Section 506(b) from consideration. Instead, the underlying agreement and applicable nonbankruptcy law are determinative," the court said. "Both mortgages pertaining to the underlying cases relate to property with a *situs* in Alabama. Additionally, both mortgages contain choice of law provisions naming Alabama state law as the applicable law. It is well-established law in Alabama that the parties to a mortgage may agree to the payment of *reasonable* fees if certain circumstances arise or actions are taken. Therefore, a mortgagee may recover reasonable fees incurred in connection with the enforcement of a mortgage only where the mortgage contractually imposes a duty on the mortgagor to pay those fees." The court found that the mortgage in *In re England* provided for the payment of attorney's fees and charges only in a foreclosure proceeding initiated under the power of sale or when permitted by applicable law. "Alabama law only permits the recovery of reasonable fees relating to a mortgage when a provision in the mortgage unambiguously provides for the collection of such fees. Thus, the mortgage pertaining to the Englands' personal residence only permits the recovery of fees incurred during a foreclosure proceeding initiated pursuant to a power of sale clause; however, the fees listed in the Notice of Postpetition Mortgage Fees, Expenses, and Charges were incurred in connection with a bankruptcy, not a foreclosure, proceeding," the court said. Therefore, they were not allowed. The mortgage in *In re Ochab* allowed for the payment of attorney's fees, but the court found the amount charged was not reasonable. The court said it is a relatively simple matter for a creditor to determine whether it is provided for in the debtor's plan and to file a proof of claim. The court added that the creditor's failure to provide details regarding the charges for these services supported a finding that the charges were unreasonable. The court disallowed both of the creditors' notices, but gave the creditor in *In re Ochab* an opportunity to amend its response to the debtor's motion to determine fees.

Opinion by Judge William R. Sawyer

TERMINATED LEASE ARGUMENT DID NOT EXCUSE STAY VIOLATIONS

Case name: *Brodgen v. Holmes Motors Inc. (In re Stacey H. Brodgen),* 28 CBN 375, 2018 WL 1577921 (Bankr. M.D. Ala. 3/30/18).

Ruling: The bankruptcy court denied the defendant's motion for summary judgment.

What it means: The creditor asserted that it leased a vehicle to the debtor, and that the lease terminated prior to her bankruptcy filing. The creditor argued that its postpetition actions of repossessing the vehicle and demanding payment could not have violated the automatic stay because the lease terminated postpetition. The court said that even if the agreement was a lease that terminated prepetition, the automatic stay still protected the debtor from the creditor's efforts to collect its prepetition claim.

Summary: The Chapter 13 debtor's confirmed plan provided for payment of Holmes Motor Inc.'s claim,

which was treated as secured by her 2007 Chevrolet Tahoe. Holmes did not object to confirmation of the debtor's plan. Although Holmes was aware of the bankruptcy filing, the creditor kept calling the debtor to demand payments. Prior to plan confirmation, Holmes repossessed the vehicle while the debtor was at work. Holmes told her that she needed to pay $703 immediately in order to keep the vehicle. She was also told that she would be arrested if she attempted to move the vehicle. The debtor sued Holmes alleging that the creditor willfully violated the automatic stay. Holmes responded that the debtor was leasing the vehicle and that the lease terminated prior to the bankruptcy filing. The bankruptcy court denied the creditor's motion for summary judgment. "The creditor failed to establish, as a matter of undisputed fact, that Debtor's leasehold interest in the Chevy Tahoe terminated; rather it is established, to the contrary, that Creditor has a secured claim which is provided for under the plan," the court said. "Creditor's argument, that the lease terminated, is further rejected, because it offers no evidence that the lease was, in fact, terminated. By Creditor's own admission, Debtor was only $200 behind on her obligation to Holmes at the time her vehicle was repossessed. There is nothing in any of the evidentiary submissions that shows that Creditor had taken any action to terminate the lease. When they repossessed the vehicle, on April 12, 2017, they released it upon receiving payment of $703. Thus, the lease had not in fact been terminated on April 12, 2017 – unless Creditor takes the position that they let Debtor drive off its property, with its car, out of the goodness of its heart! That is not plausible. Rather, the fact that Debtor drove off with her car, after paying $703, on April 12, 2017, it was well established that the lease – if one wants to call it that – was still in effect. To be sure, the document under which Debtor claims rights to the car is denominated a lease. Whether it was actually a lease or a disguised security interest was an issue which was then in dispute. However, when this Court confirmed the Chapter 13 Plan, on June 23, 2017, that issue was resolved. After June 23, 2017, Creditor holds a claim, secured by an interest in the 2007 Chevy Tahoe, that was property of the estate." But even if the parties' agreement was a lease, the creditor's actions still violated the automatic stay by attempting to collect its prepetition claim.

Opinion by Judge William R. Sawyer

CHAPTER 13 USED TO CURE REVERSE MORTGAGE DEFAULT

Case name: *In re Aleida C. Nunez,* 28 CBN 376, 2018 WL 1568524 (Bankr. S.D. Fla. 3/28/18).

Ruling: The bankruptcy court overruled an objection to confirmation of the debtor's plan made by the holder of a reverse mortgage on the debtor's real property.

What it means: The lender objected that the debtor could not cure a default on a reverse mortgage because she was not the borrower, her late mother was. However, the reverse mortgage indentified the debtor and her mother as "Borrower." The court found it unnecessary to look outside the reverse mortgage document for the definition of a term that was defined within the document's four corners.

Summary: In July 2008, the debtor's mother owned a life estate in her home. The debtor held the remainder interest. The debtor's mother was over the age of 62 and eligible for a reverse mortgage. The debtor was not. On July 14, 2008, the debtor's mother borrowed $531,000 from Reverse Mortgage Solutions Inc. The transaction required the debtor's mother to sign many documents including the reverse mortgage itself. The debtor also signed the reverse mortgage. Both the debtor and her mother were collectively referred to in the reverse mortgage as the "Borrower." The debtor's signature line was marked with her name and the word "Remainderman." The debtor's mother died on June 23, 2016. The reverse mortgage had gone into default prior to her death because she had fallen behind on paying the real estate taxes and insurance. RMS amended its foreclosure complaint after the debtor's mother died to add her death as an addition ground for default. The debtor filed for Chapter 13 relief on Aug. 30, 2017. The debtor's plan proposed to cure the tax and insurance defaults. It did not provide for payment of the reverse mortgage because the reverse mortgage did not require payment of principal and interest. RMS objected to confirmation, arguing that the debtor was not a borrower under the reverse mortgage. Therefore, she could not "cure and maintain" the reverse mortgage under the plan. The bankruptcy court overruled the objection. The court said the "reverse mortgage" document used by RMS was a commonly used form. Consequently, there were numerous cases that addressed whether the reference to "Borrower" includes everyone identified in the preamble as "Borrower" or only the "Borrower" as designated in other documents executed in connection with the reverse mortgage. Those cases were not in agreement. RMS urged the court to follow the cases that limit "Borrower" to the person who signed the promissory note and other documents related to the reverse mortgage. The court did not agree with those cases, finding it unnecessary to look outside the reverse mortgage document for the definition of a term that was defined within the document's four corners. "While Florida case law certainly invites, and sometimes dictates, consideration of documents executed together as part of a contemporaneous transac-

tion to determine the intent of the parties in connection with the agreement as a whole, none of those cases looks at documents to alter defined terms for the purposes of one particular document in the absence of an ambiguity. It is unfortunate that the Reverse Mortgage (both in this instance and in the apparent official form) uses the same defined term for those who are actually the mortgagors as is used for 'borrower' in the other Loan Documents; however this does not modify the unambiguous defined term 'Borrower' in the Reverse Mortgage," the court said. "Reverse mortgages were clearly designed to assist elderly borrowers but that laudable purpose does not override rules of construction or the Bankruptcy Code. Because the debtor is the Borrower as defined in the Reverse Mortgage, she has the rights and the obligations of the 'Borrower' with respect to the Reverse Mortgage."

Opinion by Judge Laurel M. Isicoff

GOOD FAITH DOES NOT REQUIRE USING SOCIAL SECURITY PAYMENTS TO FUND PLAN

Case name: *In re Richard P. Green,* 28 CBN 377, 2018 WL 1581635 (Bankr. S.D. Ga. 3/27/18).

Ruling: The bankruptcy court ruled that the debtor's failure to use his Social Security income to fund his Chapter 13 plan did not mean that his plan was not proposed in good faith. Other issues regarding whether the debtor's plan was proposed in good faith were not resolved.

What it means: Section 1325(a)(3)'s general good faith requirement for plan confirmation "does not override Congress's very specific exclusion of SSI from current monthly income."

Summary: The debtor was retired. He lived with his daughter. He did not pay rent but did pay for the utilities. Every month he received $975 in Social Security and $2,072 in pension benefits. The debtor filed for Chapter 13 relief on July 31, 2017. He did not include his Social Security income on Schedule I because it was not included in the definition of "current monthly income." Based on his pension income, and $14 per month as the prorated portion of his expected income tax refund, the debtor had monthly income of $2,086. He reported monthly expenses of $1,877. He scheduled six creditors. Each of their claims was secured by televisions. The debtor's schedules did not state when the claims were incurred or provide the last four digits of the account numbers as requested by the schedule. Based on proofs of claim filed by five of the creditors, the trustee was able to determine that these five debts were incurred from March 31, 2017, through July 3, 2017. The debtor proposed a 36-month plan with monthly payments of $250. The plan stated that the debtor intended to avoid the creditors' liens. The plan paid nothing to holders of unsecured claims. The trustee objected to confirmation of the debtor's plan asserting that it was not proposed in good faith as required by Section 1325 based on the totality of the debtor's circumstances including that he had not committed his Social Security income to plan payments. The trustee relied on *In re Thomas*, 443 B.R. 213 (Bankr. N.D. Ga. 2010), which found that a plan fails to satisfy the good faith requirement of Section 1325(a)(3) if the plan payment is not consistent with the debtor's available resources. "The Eleventh Circuit uses a totality of the circumstances approach to determine whether a Chapter 13 debtor's plan satisfies the good faith requirement," the court said, citing *In re Kitchens*, 702 F.2d 885 (11th Cir. 1983). "As in *Thomas*, the trustee argues good faith is a separate and distinct requirement of Chapter 13 confirmation and Debtor's lack of paying any dividend to his unsecured creditors when he has the ability to do so, coupled with his incurrence of the secured debts on the eve of bankruptcy show a lack of good faith under the totality of the circumstances. As to Debtor's SSI, I disagree. Debtor's exclusion of SSI is expressly allowed by the Bankruptcy Code and its omission from the plan cannot alone constitute bad faith." The court noted that nothing precluded the debtor from using his Social Security income to fund his plan, and nothing precluded the court from considering the availability of Social Security income when ruling on a plan's feasibility. While allowing the debtor to keep his Social Security income for himself might smell bad and seem unfair to creditors, Congress said it was okay. Because there were other questions regarding good faith that the debtor did not address, the court continued the hearing to allow for the presentation of additional evidence.

Opinion by Judge Susan D. Barrett

