BANKRUPTCY LAW

PRINCIPLES, POLICIES, AND PRACTICE
SECOND EDITION

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LEXISNEXIS

CHAPTER 1

(Add the following paragraph after the first paragraph under Part C. "Introduction to Bankruptcy" on page 57)

Since BAPCPA became effective in October 2005, the number of bankruptcy filings initially plummeted, but in the past year has steadily climbed. In hindsight, it now appears that much of the 2006 plunge in filings was attributable to the dramatic rush to file in 2005 before BAPCPA took effect. In 2006, only 617,660 bankruptcy cases were filed, fewer than a third as many as in 2005, and less than half as many as in the eight years from 1997-2004. In 2007, however, filings were up over 37% from 2006, to a total of 850,912. In 2008, the climb continued unabated, with first quarter filings up 27% from 2007. Projections point to slightly over a million new filings for 2008 – up about 65% over the 2006 low.

Consumer filings continue to account for over 96% of all bankruptcies. Of those consumer cases, in 2007 about 60% were filed under chapter 7 (500,613) and 40% under chapter 13 (321,359). In 2008, though, the percentage of chapter 13 cases has been steadily decreasing, down to about a third of consumer filings – much as was the case prior to BAPCPA.

(Add the following rows to the bottom of the chart on page 58)

2006	617,660	19,695	597,965	96.81%
2007	850,912	28,322	822,590	96.67%

CHAPTER 2
INVOKING BANKRUPTCY RELIEF

(Replace the last paragraph on page 92 with the following)

A separate section deals with the venue of "proceedings" that arise under, arise in, or are related to the overall "case." 28 U.S.C. § 1409. The default venue is the district where the case is pending. § 1409(a). However, some types of proceedings are venued in other districts to protect the legitimate interests of nondebtor parties. For example, a defendant who is sued for less than $1,100 by the bankruptcy trustee is entitled to have venue placed in her home district, rather than having to travel to the place where the bankruptcy case is located. After BAPCPA, this $1,100 amount applies only to insiders sued for business debts. For all consumer debts (insider and noninsider alike), the relevant cutoff amount is much larger – $16,425 (increased from $5,000 to $15,000 by BAPCPA, and then indexed upward as of April 1, 2007). BAPCPA also added a provision protecting noninsider defendants from out-of-home-district suits for business debts of less than $10,950. The district courts have broad authority to change the venue of either an entire case or any individual proceeding. 28 U.S.C. § 1412. The court may transfer the case or proceeding "to a district court for another district, in the interest of justice or for the convenience of the parties."

(Replace the last bullet point on page 105 with the following)

- the petitioners as a group must hold *unsecured* claims totaling at least $13,475

(Replace Question 5 on page 106 with the following)

5. In BAPCPA, Congress amended the bona fide dispute requirement to be a petitioning creditor to require that its claim not be disputed as to "liability or amount." Assume that a creditor has a claim that it asserts to be $5,000, while the debtor disputes that amount and concedes only that it owes $4,000. Does the BAPCPA amendment really mean that this creditor is totally disqualified from serving as a petitioning creditor, since there is a "bona fide dispute as to ... amount," or does it rather mean that this creditor's claim can only be counted for $4,000 of the necessary $13,475 in unsecured amount?

(Add the following on page 114 after the second bulleted paragraph and before "1. Consumer Cases")

Regarding the first bulleted new ground for dismissal, that the debtor's failure to provide information required by §521(a) mandates automatic dismissal on the 46th day, courts have puzzled over what it means for dismissal to be "automatic," particularly where such dismissal may be dependent on the determination of underlying facts. Adding to the puzzle is the provision in § 521(i)(2) that a party may request dismissal in such a case. If dismissal is automatic, then whence the need for a request for same? And what if a case proceeds for an extended period of time, assets are collected and sold, distributions made – and then it is

discovered that some of the required § 521(a) information had not been filed, and thus the case had "automatically" been dismissed on day 46 – are all the case actions for naught?

The following case, invoking the spirit of "Dr. Seuss," poetically explores these automatic dismissal riddles – in a case titled, appropriately (as humorist Dave Barry would say, "I'm not making this up") -- *In re Riddle*. Judge Cristol joins those who believe that automatic dismissal might not be so "automatic" after all.

IN RE RIDDLE

344 B.R. 702 (Bankr. S.D. Fla. 2006)

Sua sponte order determining debtors' compliance with filing requirements of Section 521(a)(l)

CRISTOL, BANKRUPTCY JUDGE:

Pursuant to 11 U.S.C. Section 521(1), if an individual debtor in a voluntary case under Chapter 7 or 13 fails to file all of the information required under 11 U.S.C. Section 521(a)(l) within 45 days after the date of the filing of the petition, the case shall be "automatically dismissed" effective on the 46th day after the date of the filing of the petition.

The court has reviewed the docket and the papers filed by debtors in this case and believes the information required by 11 U.S.C. Section 521(a)(l), and provided by the debtors, is complete. Moreover, no party in interest has filed a request for an order of dismissal pursuant to 11 U.S.C. Section 521(i)(2). Notwithstanding, the court feels compelled to comment on the unusual and confusing language in this statutory provision.

I do not like dismissal automatic,
It seems to me to be traumatic.
I do not like it in this case,
I do not like it any place.

As a judge I am most keen
to understand, *What does it mean*?
How can any person know
what the docket does not show?

What is the clue on the 46th day?
Is the case still here, or gone away?
And if a debtor did not do
what the Code had told him to
and no concerned party knew it,
Still the Code says the debtor blew it.
Well that is what it seems to say:
the debtor's case is then '*Oy vey*.'

This kind of law is symptomatic
of something very problematic.
For if the trustee does not know
then which way should the trustee go?

Should the trustee's view prismatic
continue to search the debtor's attic

and collect debtors' assets in his fist
for distribution in a case that stands dismissed?

After a dismissal automatic
would this not be a bit erratic?

The poor trustee cannot know
the docket does not dismissal show.

What's a poor trustee to do --
except perhaps to say, "Boo hoo!""

And if the case goes on as normal
and debtor gets a discharge formal,
what if a year later some fanatic
claims the case was dismissed automatic?

Was there a case, or wasn't there one?
How do you undo what's been done?

Debtor's property is gone as if by a thief,
and debtor is stripped but gets no relief.
I do not like dismissal automatic.
On this point I am emphatic!

I do not wish to be dramatic,
but I cannot endure this static.
Something more in 521 is needed
for dismissal automatic to be heeded.

Dismissal automatic is not understood.
For all concerned this is not good.
Before this problem gets too old
it would be good if we were told:

What does automatic dismissal mean?
And by what means can it been seen?
Are we only left to guess?
Oh please Congress, fix this mess!

Until it's fixed what should I do?
How can I explain this mess to you?

If the Code required an old fashioned order,
that would create a legal border,
with complying debtors' cases defended
and 521 violators' cases ended,
from the unknown status of dismissal automatic,
to the certainly of a status charismatic.

The dismissal automatic problem would be gone,
and debtors, trustees and courts could move on.

As to this case, how should I proceed?
Review of the record is warranted, indeed.

A very careful record review,
tells this court what it should do.
Was this case dismissed automatic?
It definitely was NOT and that's emphatic.

Based upon the court's review, the court has determined that the debtors have complied with the information requirements of 11 U.S.C. Section 521(a)(l).

Accordingly, it is ordered:

1. This case is not subject to automatic dismissal under 11 U.S.C. Section 521(i)(l) or (2).

2. If any party in interest has any reason to contest the Court's finding that the debtors have filed all information required by 11 U.S.C. Section 521(a)(l), that party shall file a motion for reconsideration not later than 20 days from the date of the entry of this order, and serve such motion on the trustee, the United States Trustee, debtors and debtors' counsel, if any. The motion should specifically identify the information and document(s) required by 11 U.S.C. Section 521(a)(l) that the debtors have failed to file.

3. Nothing in this order shall excuse the debtors' duty to cooperate with the United States Trustee and the trustee assigned to this case, and shall not prevent the United States Trustee or case trustee from requesting by any authorized means, including, but not limited to motion, that the debtors supply further information.

(Replace the second paragraph of the second step (i.e., the third paragraph on the page) on page 123 with the following)

So, for example, in Illinois the single earner income median applicable to cases filed on or after March 17, 2008 is $44,673. The median income for a family of two in Illinois would be $56,545; for a family of three, $66,607; and for a family of four, $77,634. For each additional family member beyond four, add another $6,900. So, for example, an Illinois family of six would have a median of $91,434 ($77,634 for a 4-person family, plus $13,800 ($6,900 each) for persons five and six).

(Replace part d of the third step and the paragraph following on the bottom of page 123 with the following)

d. The debtor fails the means test if that total is not less than the *lesser* of:

(i) $6,575 or 25% of the debtor's nonpriority unsecured claims, whichever is *greater*, § 707(b)(2)(A)(i)(I)

or

(ii) $10,950, § 707(b)(2)(A)(i)(II).

Thus, the range of repayment capacity that may demonstrate presumptive abuse ranges from a low of $6,575 to a high of $10,950 (depending on the amount of nonpriority unsecured claims). That means that any debtor with primarily consumer debts whose family income is above the state median and who has $109.59 per month in repayment capacity according to the means test could potentially face a presumption of abuse, and a debtor with excess income of $182.50 per month definitely would face the presumption of abuse.

(Replace the income of $22,200 with $22,500 in part b of Problem 2.8 on page 124)

(Replace the state median in part d of Problem 2.8 on page 124 with $56,545)

(Replace the last paragraph before Problem 2.9 on page 126 with the following)

If the debtor is in a household of more than 4 individuals, the highest median family income of the applicable state for a family of 4 or fewer individuals is used, plus an additional $575 per month (or $6900 per year) for each individual in excess of four. § 707(b)(7)(A).

(Replace Problem 2.9 on page 126 with the following)

1. In the following cases, decide whether the means test would apply to the debtor. Assume that Debtor lives in Illinois. For cases filed on or after March 17, 2008, Illinois state medians were: for one person, $44,673; for a family of two, $56,545; a family of three, $66,607; and for a family of four, $77,634.

   a. Debtor has a family of four. Debtor's income as computed under § 707(b)(7) is $58,000 per year. Debtor's spouse does freelance work and brings in $20,000 per year.
   b. Same as in (a) but debtor's spouse now makes $19,000 per year.
   c. Same as in (a) but the debtor's grandmother moves into the debtor's household permanently.
   d. Same as in (a) but debtor and his spouse are legally divorced, and spouse makes no payments to debtor that would be included in current monthly income. Debtor has custody of children.

2. A debtor with a family of four currently resides in New Jersey and has current monthly income multiplied by 12 equal to $85,000. The debtor is considering moving to New York to reduce her commute time to work. She wants to file bankruptcy under chapter 7. Would you advise this move? For 2007, the median income for a family of four in New York was $77,664 and in New Jersey was $97,131.

(Replace the citation in the last paragraph on page 128 with the following):

(1) *Living Expenses*. For purposes of the means test, Congress decided that the debtor's allowed living expenses should be those specified in the Collection Financial Standards of the Internal Revenue Service. See http://www.usdoj.gov/ust/eo/bapcpa/20080317/meanstesting.htm.

(Replace the citation in the first full paragraph on page 129 with the following):

The U.S. Trustee's office of the Department of Justice now maintains a web site for use in applying the bankruptcy means test, and updates the allowed amounts on a periodic basis. See http://www.usdoj.gov/ust/eo/bapcpa/20080317/meanstesting.htm (Applicable to cases filed on or after 3/17/08).

(Replace the last two paragraphs on page 129 and the tables on page 130 with the following):

The *National* Standards establish allowances for: food, housekeeping supplies, apparel and services, and personal care products and services, plus a "miscellaneous" allowance. See http://www.usdoj.gov/ust/eo/bapcpa/20080317/bci_data/national_expense_standards.htm. The amount of these allowances increases with family size. Originally, they also increased with income level, but that distinction was abandoned effective January 1, 2008. There is also a separate national allowance for out-of-pocket healthcare expenses. That allowance is larger for a person who is 65 or older ($144 per month) than for those younger than 65 ($57 per month). See http://www.usdoj.gov/ust/eo/bapcpa/20080317/bci_data/national_oop_healthcare.htm.

Under the means test, debtors can add an extra 5% to the National Standards food and clothing allowances, if such an increase is demonstrated to be "reasonable and necessary" – whatever that means! The following table provides the National Standards for a family of 4 (for cases filed on or after 3/17/08):

Four Persons National Standards

Item	**Allowance**
Food	752
Housekeeping supplies	74
Apparel & services	244
Personal care products & services	65
Miscellaneous	235
Out-of-Pocket Health Care (all family members under 65)	228
Total	1598

Potential 5% Increase in Food and Clothing Allowance	
Normal Food & Clothing (Apparel & services) Allowance	996
5% of Food & Clothing	50

See http://www.usdoj.gov/ust/eo/bapcpa/20080317/bci_data/national_expense_standards.htm

(Replace the last paragraph on page 130 and the first three paragraphs on page 131 with the following):

In choosing the appropriate region to use for a debtor, the area in which the debtor resides as of the date of the order of relief should be used. To illustrate the importance of where the debtor lives (and the potential for gaming the system via careful pre-bankruptcy planning), consider the following. For example, for cases filed on or after March 17, 2008, a debtor who lives in Cook County, Illinois has a housing allowance for a family of 4 of $1,984 ($604 for non-mortgage or rent expenses, and $1380 for mortgage or rent costs); for neighboring DuPage County, the allowance is $2,273 – $289 per month higher. So, by moving across the county line, a debtor could insulate an additional $17,340 of income over the 60-month means test calculation period. Such a substantial sum could well make the difference between failing and passing the means test.

The transportation allowance has two components: (1) ownership costs and (2) operating costs -- or public transportation costs. For operating costs, different caps are set depending on the number of cars the debtor has, up to two cars.

The ownership cost is based on a national standard of $489 per car. Note that prior to January 1, 2008, a smaller amount was allowed for the second car. The debtor can also claim operating costs for one or two cars or else claim the public transportation allowance. For example, in the Midwest region, Chicago Metropolitan Statistical Area, the operating allowances are $217 for one car, and $434 for two cars while the public transportation cost is $163 nationally. Here, the advantage to the debtor of buying additional cars is manifest. A debtor in the Chicago region with no cars would receive a total transportation allowance of a paltry $163 per month (zero for "ownership costs," and $163 for public transportation costs). However, if that same debtor had two cars, she would receive an allowance of $1,412 (ownership allowance of $489 for each car and a $434 operating allowance) – $1249 per month higher! So, over the 60-month period, that debtor could protect $74,940 more in income.

Thus, our "planning" debtor who approached bankruptcy living in Cook County with no cars, who decided to move to DuPage County and buy two cars, would have an additional $92,280 ($17,340 for the housing allowance, and $74,940 for transportation) in permissible expense deductions to offset against income for purposes of the means test calculation! Of course, such a debtor still might be vulnerable to an "abuse" finding based on bad faith/totality of circumstances under § 707(b)(3), but would be much less likely to fail the means test and be facing a presumption of abuse under § 707(b)(2).

(In the first two paragraphs on page 132, replace the $471 ownership allowance amount with $489, and the $150 difference with $168)

(In the fifth paragraph on page 133, replace the 7.2% allowance with 6.3%)

(In the sixth paragraph on page 133, replace the reference to $1,500 with $1,650)

(In the third paragraph on page 135, replace the reference to $10,000 with $10,950)

(Replace Problem 2.11(2) on page 136 with the following)

2. Debtor, who has a family of 4 (all under age 65), lives in Chicago, Cook County, Illinois, and has monthly income of $6,500. In Illinois the 4-person family median income is $77,634. Debtor owns two cars and has monthly payments of $500 on each, car insurance of $200 monthly, and other vehicle operating costs of $200 per month. According to the U.S. Trustee website: the Local Standard Transportation operating cost for two cars in the Chicago area is $434; Transportation ownership allowance is $489 for each car; Local non-mortgage housing and utilities allowance in Cook County is $604; and Local mortgage allowance for Cook County is $1380. Debtor owns a condo and has a monthly mortgage payment of $2,000, property taxes of $400 a month, homeowners' insurance of $200 per month, and utilities of $600 per month. Ignoring possible "Other Necessary Expenses," how much can Debtor deduct from income under the means test?

(Replace Step 3 on page 136 through Problem 2.12 on page 138 with the following)

Step Three: *Compare* that figure with the *lesser* of–

25% of the debtor's nonpriority unsecured claims *or* $6,575, whichever is *greater*

or

$10,950.

If the amount computed in Step Two (debtor's actual projected repayment capacity) is *greater* than the figure in Step Three (the trigger amount), then abuse is presumed. § 707(b)(2)(A)(I).

A convenient way to think about the means test is to split debtors into three tiers based on the amount of unsecured debt they have.

- Tier One is for debtors with less than <u>$26,300</u> of unsecured debt. For these debtors, abuse is presumed if their Step Two total of net monthly income over 60 months is at least **$6,575**.
- Tier Two is for debtors with unsecured debts <u>between $26,300 and $43,800</u>. Abuse is presumed if the debtor's Step Two total ("net monthly income" over 60 months) is more than **25%** of the debtor's unsecured debts; the repayment range is between $6,575 and $10,950.
- Tier Three includes debtors with <u>more than $43,800</u> of unsecured debt. For these debtors, abuse is presumed if the debtor's Step Two total of net monthly income over five years is more than **$10,950**, without regard to how much unsecured debt such debtor actually has.

Another way to conceptualize the means test is in terms of "trigger points." Since $6,575 is the minimum amount that can trigger a presumption of abuse, and because $6,575 divided by 60 months (the projected presumption period) is $109.58, if a debtor has net monthly income (current monthly income minus deductions) of *less than $109.58 a month*, the means test presumption of abuse *never* arises. On the other hand, since any repayment capacity over 60 months in excess of $10,950 always triggers the presumption, given that $10,950 divided by 60

is $182.50, the presumption of abuse *always* arises if a debtors net monthly income is *more than $182.50*. These trigger points can be summarized by the following table:

"Current Monthly Income" after defined deductions	**Presumption of Abuse**
Less than $109.59	Never Arises
$109.59-$182.50	(1) Arises if nonpriority unsecured debt ≤ $26,300; (2) If nonpriority unsecured debts > $26,300, arises if repayment capacity ≥ 25% of unsecured debts
More than $182.50	Always Arises

Note how small a margin a debtor has under the means test. A difference of $73 of income over expenses a month can be the difference between abuse *never* being presumed and abuse *always* being presumed!

Consider some examples. Assume a debtor has current monthly income of $5,125 and allowed deductions equal to $5,000 a month, and thus her net monthly income is $125. If the debtor has unsecured debts of $30,000 or less, abuse is presumed. How does this calculation work? Take the debtor's net monthly income of $125 (from Step One) and multiply by 60, giving $7,500 (Step Two). Under Step Three, 25% of the debtor's nonpriority unsecured debts $30,000 = $7,500. Thus, if the debtor has $30,000 of unsecured debt, the two amounts for the means test comparison are equal, meaning the debtor is an abuser (the Step Two amount must be "less than" the Step Three amount). One dollar more of unsecured debt, however, and the debtor no longer is abusive, as, for example, 25% of $30,004 is $7,501 (Step Three), which is more than $7,500 (Step Two).

In another example, assume the debtor has $800,000 in unsecured debt (wow!), income of $4,000 a month and expenses of $3,800 a month. This debtor is a presumed abuser no matter how much debt she has, as her "net monthly income" is $200, an amount that always triggers the presumption of abuse ($200 times 60 equals $12,000, more than $10,950). Therefore, this debtor presumptively will be denied relief under chapter 7, even though over five years she could only afford to pay her creditors a little more than 1% of the debts she owes!

As a final example, assume a debtor has $10,000 in unsecured debt, income of $4,500 a month and expenses of $4,400 per month. This debtor has "net monthly income" of $100 a month. No matter what amount of unsecured debt she has, she would never be presumed an abuser, even though she can afford to pay 60% of her unsecured debt (60 times $100 is $6,000, 60% of $10,000).

Problem 2.12

1. A debtor with a family of four, all under age 65, living in Cook County, Illinois, has income of $6,500 a month. The debtor has unsecured debts of $ 28,800. The debtor owes secured debt payments of $300 per month for her one car and $1,200 per month for her mortgage. The debtor would like to file chapter 7. Assume the debtor is allowed the following monthly expenses: $1,370 under the National Standards for food, clothing, housekeeping

supplies, and personal care; $228 ($57 per family member) for out-of-pocket healthcare expenses; $604 for non-mortgage housing/utilities under the Local Standards for Cook County; $1380 for mortgage housing costs under Local Standards for Cook County (but subject to the $1,200 mortgage); $217 for one-car operating costs under the Local Standards for the Chicago metropolitan area; $489 for ownership costs for that car; and $2,066 for "Other Necessary Expenses." Assume the debtor has no other allowed deductions and that the debtor's income is above the state median for a family of four in Illinois ($77,634).

Calculate the means test and decide if the debtor raises the presumption of abuse. If she does, can you think of any steps she could take in order to escape raising the presumption?

2. Assume the same conditions as in problem 2.12(1), but now the debtor decides she no longer likes living in Cook County and moves her family to DuPage County. This move means the debtor now can deduct $597 in non-mortgage Local Housing costs and $1676 in mortgage Local Housing costs, as housing in DuPage County is more expensive. Assume everything else, including the Debtor's mortgage payments, remains the same. What result?

(Replace Problems 2.13 and 2.14 on pages 139-140 with the following):

Problem 2.13

Recall the debtor from problem 2.12(1), whose current monthly income equaled $6,500. Assume that the debtor's allowed expenses equal $6,354, and unsecured debts are $28,800. Assume now that two weeks before the debtor filed bankruptcy, the debtor was laid off from her job. Recall that since "current monthly income" looks only at historical income, and ignores future income projections, the fact that the debtor was laid off does not affect the calculation of the presumption of abuse (except for how the lack of pay for the two weeks before bankruptcy affects the income calculation).

1. At the time the petition is filed, the debtor does not have a new job. She is receiving unemployment benefits at 35% of her previous wage rate for up to 26 weeks. Would this debtor successfully rebut the presumption of abuse?
2. Assume that the same debtor is preparing to file chapter 7 bankruptcy tomorrow. Happily (or not?), she has just been offered a new job for $6,600 a month, but currently is still on unemployment. Should she accept the job? Wait?

Problem 2.14

Recall the debtor from problem 2.12(a), whose current monthly income equaled $6,500. Assume again that debtor's allowed expenses equaled $6,354, and unsecured debts are $28,800. Decide whether the debtor would successfully rebut the presumption of abuse:

Debtor is diabetic. Her condition requires her to spend an additional $75 for food a month. Alternatively, what if Debtor had to spend $75 extra on food, not to combat diabetes, but because Debtor was extremely obese and had to follow a special diet? What if Debtor's extra food expense were due to Debtor's adherence to a religious sect that imposes extremely strict dietary rules?

(Replace Problem 2.15 on page 155 with the following)

Problem 2.15

a. Sue Debtor filed chapter 7. She has debts of $25,000, and receives a monthly social security check of $750. She decides she wants to try to repay some of her debts. Does Debtor have an absolute right to convert to chapter 13?

b. Same facts as in (a), except that in filing her chapter 7 petition and schedules, Debtor deliberately misstates the value of her home as having no equity value, over and above the mortgage lien debts encumbering the home. In fact, though, the home has substantial equity value. When Debtor's chapter 7 trustee discovers the truth and prepares to sell Debtor's home, Debtor files a motion to convert her case to chapter 13. Does Debtor have an absolute right to convert to chapter 13?

c. Same facts as in (a), except that Debtor is content to remain in chapter 7, but her trustee moves to convert her case to chapter 13. What result?

d. Same facts as in (a), except that Debtor first filed for relief under chapter 13. Now she has given up hope. Does Debtor have an absolute right to convert to chapter 7?

e. Same facts as in (d), except that Debtor is content to remain in chapter 13, but the trustee moves to convert her case to chapter 7. What result?

f. Debtor, Inc. filed chapter 11, hoping to reorganize, and was continued as debtor in possession. Some months later, Debtor realized that the reorganization effort was hopeless. Does Debtor have an absolute right to convert to chapter 7?

g. Same facts as in (f), except that Debtor wants to keep trying to reorganize, but the unsecured creditors' committee moves to convert the case to chapter 7. What result?

CHAPTER 3
PROPERTY OF THE STATE

(Replace Questions 4 and 5 on page 185 with the following)

4. Congress also added *exemptions* pertaining to retirement assets in the 2005 Act. For individual debtors, exemptions remove property from the estate. In new § 522(b)(3)(C) and § 522(d)(12), *all* tax-exempt retirement funds under IRS sections 401, 403, 408, 408A, 414, 457, or 501(a) are exempt in bankruptcy. Note that the new exemptions apply to Individual Retirement Accounts (IRA) under IRC § 408 or 408A. In doing so, Congress settled the long-standing dispute over the treatment of such assets. The only limitation on IRA exemptions is generous indeed: *$1,095,000* for a debtor, and double that ($2,190,000) for a couple filing jointly. § 522(n). Through the 2005 amendments, Congress reaffirmed and extended the holding of the Supreme Court in a case decided less than two weeks before the enactment of the 2005 law. In *Rousey v. Jacoway*, 544 U.S. 320 (2005), the Court held that assets in an IRA may be exempted under § 522(d)(10)(E). Note that the exemption in that section is limited to the extent reasonably necessary to support a debtor or a dependent of the debtor, whereas the BAPCPA exemption has no such restriction, but instead is limited only by the $1,095,000 cap (or $2,190,000 in a joint case).

5. In 2005, Congress added exclusions from the estate for funds placed in an educational IRA under IRC § 530(b)(1) for a child or grandchild more than a year before the bankruptcy filing. For funds placed in the account from 365 to 720 days before bankruptcy, the exclusion is limited to $5,475 per beneficiary. § 541(b)(5). A similar exclusion was added for funds placed in a tuition credit account under IRC § 529(b)(1)(A). Again, the exclusion only applies to accounts established for a child or grandchild more than a year before bankruptcy, with a $5,475 cap for funds deposited between 365 and 720 days before. § 541(b)(6).

CHAPTER 4
AUTOMATIC STAY

No changes.

CHAPTER 5
UNSECURED CLAIMS

(Replace the fourth, sixth and seventh priorities on page 258 with the following)

Fourth: employee wage claims up to $10,950 each, for the 180 days before the date of the bankruptcy filing or the date the debtor ceased its business, whichever is earlier, § 507(a)(4);

Sixth: grain producer and fishermen claims, up to $5,400 each § 507(a)(6);

Seventh: consumer 'layaway' deposits, up to $2,425 each, § 507(a)(7);

(Replace the first full paragraph on page 284 with the following)

Employees are not entitled to an unlimited priority for prepetition wages and benefits. The fourth and fifth priorities are qualified in the amount, time, and form of employee compensation. The first limitation is that each employee is only entitled to priority for a maximum amount of $10,950. This amount is indexed and will be raised every three years. The next increase will occur in 2010.

(Replace the second and third full paragraphs on page 287 with the following)

Grain producers and fishermen. In 1984 Congress added what is now the sixth priority for the claims of (1) grain producers against a debtor who owns a grain storage facility, and (2) United States fishermen against a debtor who operates a fish produce storage or processing facility. § 507(a)(6). This priority was enacted in response to an armed rebellion by several hundred farmers in Missouri and Arkansas who did not take kindly to the bankruptcy filing by the operators of 13 grain storage facilities. Taking the law into their own hands, these farmers ignored the automatic stay and the orders of the bankruptcy court and forcibly recovered "their" grain that they had delivered to the debtors before the bankruptcy filing. Sixth priority claims are limited to $5,400 per individual creditor.

Consumer layaway deposits. The seventh priority affords some protection to consumer creditors who have made a "layaway" deposit or down payment. § 507(a)(7). In the wake of the large retail bankruptcy of W.T. Grant Co. during the 1970s reform effort, Congress recognized that ignorant consumers with little bargaining power who made deposits with retailers or service providers usually were "left holding the bag" in the event of bankruptcy, often without even realizing that they were a creditor. The solution was to provide a priority, which has now been increased to $2,425.

CHAPTER 6
SECURED CLAIMS

(*Add the following on page 315 after Problem 6.4)*

The anti-strip down rule for a PMSI in motor vehicles acquired for personal use within 910 days before bankruptcy ("910 claims"), found in the unnumbered "hanging paragraph" that accompanies § 1325(a), is an example of the drafting problems that plagued BAPCPA. While it seems evident what Congress intended to do (*viz.,* prohibit strip down of car loans), the way they did it – by stating that § 506 does not apply at all to such claims – leaves a glaring statutory gap and itself raises considerable interpretive difficulties. Section 506 provides for the bifurcation of an undersecured claim into secured and unsecured components. With § 506 out of the picture, what happens to such undersecured claims? Plainly (we think) a debtor cannot keep the car and "cram down" the secured creditor's claim by paying only the "stripped down" collateral value, the option that otherwise (but for the hanging paragraph) would be available under § 1325(a)(5)(B).

Ah, but what if the debtor eschews retention, and simply surrenders the undersecured car to the creditor, the option authorized by § 1325(a)(5)(C)? Specifically – does the creditor still enjoy an unsecured claim for the deficiency that it can assert in the bankruptcy case? If so – with § 506 gone – how? And if not, does that mean that Congress effectively, albeit probably inadvertently, has converted recourse car loans into nonrecourse, thereby hurting the very car lenders it sought to help? A majority of bankruptcy courts have held that the plain meaning of the hanging paragraph is inescapable – by making § 506 inapplicable to "910" claims under § 1325(a)(5), it precludes the creditor from asserting an unsecured claim for the deficiency remaining after foreclosure of a "910" vehicle surrendered under § 1325(a)(5)(C). See, e.g., In *re Pinti*, 363 B.R. 369 (Bankr. S.D.N.Y. 2007).

One court explained this result as follows:

> The effect of the hanging paragraph is that a debtor no longer has this bifurcation tool at his or her disposal. If a creditor files a secured claim relating to 910 property and that claim is allowed under § 502, the debtor must treat the claim as fully secured. In a sense, a fiction arises that the 910 collateral is worth the exact amount of the proof of claim. So when a debtor proposes to retain the collateral, the debtor must propose to pay the entire claim as filed. Likewise, where the debtor proposes to surrender the collateral, the fiction created by the hanging paragraph serves to render the secured claim completely satisfied.

In re Durham, 361 B.R. 206, 209 (Bankr. D. Utah 2006)).

However, in the following case of *In re Wright*, 492 F.3d 829 (7th Cir. 2007), the Seventh Circuit adopted the then-minority view (ably presented in *In re Rodriguez*, 375 B.R. 535 (9th Cir. BAP 2007)). Writing for the panel, Judge Easterbrook held that *under state law*, which persists notwithstanding the intervention of bankruptcy, an undersecured car lender still has an unsecured claim after surrender and foreclosure that it can assert in the Chapter 13 case. Under

the Seventh Circuit's approach, then, the hanging paragraph creates a "head I win, tails you lose" scenario for the 910 lender – if the debtor wishes to retain an undersecured car under § 1325(a)(5)(B), she must pay the full amount of the debt, even though part of that debt really is unsecured. But if the debtor proposes to surrender the vehicle to the lender under § 1325(a)(5)(C), the lender may still assert the unsecured portion of the debt remaining after foreclosure. Since *Wright* was decided, several other circuit courts have followed suit, holding for the lender. See *In re Kenney*, 2008 WL 2514194 (4th Cir. June 25, 2008); *In re Ballard*, 526 F.3d 634 (10th Cir. 2008); *In re Long*, 519 F.3d 288 (6th Cir. 2008); *Capital One Auto Fin. v. Osborn*, 515 F.3d 817 (8th Cir. 2008).

IN RE WRIGHT

492 F.3D 829 (7th Cir. 2007)

EASTERBROOK, CHIEF JUDGE

Bankruptcy judges across the nation have divided over the effect of the unnumbered hanging paragraph that the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 added to § 1325(a) of the Bankruptcy Code, 11 U.S.C. § 1325(a). Section 1325, part of Chapter 13, specifies the circumstances under which a consumer's plan of repayment can be confirmed. The hanging paragraph says that, for the purpose of a Chapter 13 plan, § 506 of the Code, 11 U.S.C. § 506, does not apply to certain secured loans.

Section 506(a) divides loans into secured and unsecured portions; the unsecured portion is the amount by which the debt exceeds the current value of the collateral. In a Chapter 13 bankruptcy, consumers may retain the collateral (despite contractual provisions entitling creditors to repossess) by making monthly payments that the judge deems equal to the market value of the asset, with a rate of interest that the judge will set (rather than the contractual rate). See *Associates Commercial Corp. v. Rash,*520 U.S. 953 (1997); Till v. SCS Credit Corp., 541 U.S. 465 (2004). This procedure is known as a "cramdown" – the court crams down the creditor's throat the substitution of money for the collateral, a situation that creditors usually oppose because the court may underestimate the collateral's market value and the appropriate interest rate, and the debtor may fail to make all promised payments, so that the payment stream falls short of the collateral's full value. (The effect is asymmetric: if a judge overestimates the collateral's value or the interest rate, the debtor will surrender the asset and the creditor will realize no more than the market price. When the judge errs in the debtor's favor, however, the debtor keeps the asset and pays at the reduced rate. Creditors systematically lose from this asymmetry – and in the long run solvent borrowers must pay extra to make up for creditors' anticipated loss in bankruptcy.)

The question we must decide is what happens when, as a result of the hanging paragraph, § 506 vanishes from the picture. The majority view among bankruptcy judges is that, with § 506(a) gone, creditors cannot divide their loans into secured and unsecured components. Because § 1325(a)(5)(C) allows a debtor to surrender the collateral to the lender, it follows (on this view) that surrender fully satisfies the borrower's obligations. If this is so, then many secured loans have been rendered non-recourse, no matter what the contract provides. See, e.g., *In re Payne,* 347 B.R. 278 (Bankr. S.D. Ohio 2006); *In re Ezell,* 338 B.R. 330 (Bankr. E.D. Tenn.2006); *In re Kenney,* 2007 WL 1412921, at *5-6, 2007 Bankr.LEXIS 1646 at *16-17

(Bankr. E.D. Va. May 10, 2007) (collecting cases). The minority view is that Article 9 of the Uniform Commercial Code plus the law of contracts entitle the creditor to an unsecured deficiency judgment after surrender of the collateral, unless the contract itself provides that the loan is without recourse against the borrower. See, e.g., *In re Particka,* 355 B.R. 616 (Bankr. E.D. Mich.2006); *In re Zehrung,* 351 B.R. 675 (W.D. Wis.2006). That unsecured balance must be treated the same as other unsecured debts under the Chapter 13 plan.

Craig Wright and LaChone P. Giles-Wright, debtors in this proceeding, owe more on their purchase-money automobile loan than the car is worth. Because the purchase occurred within 910 days of the bankruptcy's commencement, the hanging paragraph in § 1325(a)(5) applies. This paragraph reads:

> For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day [sic] preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

Debtors proposed a plan that would surrender the car to the creditor and pay nothing on account of the difference between the loan's balance and the collateral's market value. After taking the minority position on the effect of bypassing § 506, the bankruptcy judge declined to approve the Chapter 13 plan, because debtors did not propose to pay any portion of the shortfall.

....

Like the bankruptcy court, we think that, by knocking out § 506, the hanging paragraph leaves the parties to their contractual entitlements. True enough, § 506(a) divides claims into secured and unsecured components. (Section 506 does other things as well, see *Dewsnup v. Timm,* 502 U.S. 410 (1992), but these have no bearing on the question at hand.) Yet it is a mistake to assume, as the majority of bankruptcy courts have done, that § 506 is the *only* source of authority for a deficiency judgment when the collateral is insufficient. The Supreme Court held in *Butner v. United States,* 440 U.S. 48 (1979), that state law determines rights and obligations when the Code does not supply a federal rule. See also, e.g., *Travelers Casualty & Surety Co. v. Pacific Gas & Electric Co.,* ---U.S. ----, 127 S.Ct. 1199 (2007); *Raleigh v. Illinois Dep't of Revenue,* 530 U.S. 15 (2000).

The contract between the Wrights and their lender is explicit: If the debt is not paid, the collateral may be seized and sold. Creditor "must account to Buyer for any surplus. Buyer shall be liable for any deficiency." In other words, the contract creates an ordinary secured loan with recourse against the borrower. Just in case there were doubt, the contract provides that the parties enjoy all of their rights under the Uniform Commercial Code. Section 9-615(d)(2) of the UCC, enacted in Illinois as 810 ILCS 5/9-615(d)(2), provides that the obligor must satisfy any deficiency if the collateral's value is insufficient to cover the amount due.

If the Wrights had surrendered their car the day before filing for bankruptcy, the creditor would have been entitled to treat any shortfall in the collateral's value as an unsecured debt. It is hard to see why the result should be different if the debtors surrender the collateral the day after filing for bankruptcy when, given the hanging paragraph, no operative section of the Bankruptcy

Code contains any contrary rule. Section 306(b) of the 2005 Act, Pub.L. 109-8, 119 Stat. 23, 80 (Apr. 20, 2005), which enacted the hanging paragraph, is captioned "Restoring the Foundation for Secured Credit". This implies replacing a contract-defeating provision such as § 506 (which allows judges rather than the market to value the collateral and set an interest rate, and may prevent creditors from repossessing) with the agreement freely negotiated between debtor and creditor. Debtors do not offer any argument that "the Foundation for Secured Credit" could be "restored" by making all purchase-money secured loans non-recourse; they do not argue that non-recourse lending is common in consumer transactions, and it is hard to imagine that Congress took such an indirect means of making non-recourse lending *compulsory.*

Appearing as *amicus curiae,* the National Association of Consumer Bankruptcy Attorneys makes the bold argument that loans covered by the hanging paragraph cannot be treated as secured in any respect. Only § 506 provides for an "allowed secured claim," *amicus* insists, so the entire debt must be unsecured. This also would imply that a lender is not entitled to any post-petition interest. *Amicus* recognizes that § 502 rather than § 506 determines whether a claim should be "allowed" but insists that only § 506 permits an "allowed" claim to be a "secured" one.

This line of argument makes the same basic mistake as the debtors' position: it supposes that contracts and state law are irrelevant unless specifically implemented by the Bankruptcy Code. *Butner* holds that the presumption runs the other way: rights under state law count in bankruptcy unless the Code says otherwise. Creditors don't need § 506 to create, allow, or recognize security interests, which rest on contracts (and the UCC) rather than federal law. Section 502 tells bankruptcy courts to allow claims that stem from contractual debts; nothing in § 502 disfavors or curtails secured claims. Limitations, if any, depend on § 506, which the hanging paragraph makes inapplicable to purchase-money interests in personal motor vehicles granted during the 910 days preceding bankruptcy (and in other assets during the year before bankruptcy).

Both the debtors and the *amicus curiae* observe that many decisions, of which *United States v. Ron Pair Enterprises, Inc.,* 489 U.S. 235, 238-39 (1989), is a good example, state that § 506 governs the treatment of secured claims in bankruptcy. No one doubts this, but the question at hand is what happens when § 506 does not apply. The fallback under *Butner* is the parties' contract (to the extent the deal is enforceable under state law), rather than non-recourse secured debt (the Wrights' position) or no security interest (the *amicus curiae*'s position). And there is no debate about how the parties' contract works: the secured lender is entitled to an (unsecured) deficiency judgment for the difference between the value of the collateral and the balance on the loan.

By surrendering the car, debtors gave their creditor the full market value of the collateral. Any shortfall must be treated as an unsecured debt. It need not be paid in full, any more than the Wrights' other unsecured debts, but it can't be written off *in toto* while other unsecured creditors are paid some fraction of their entitlements.

AFFIRMED

QUESTIONS

1. If *Wright* is right (sorry, couldn't resist) – what now? What must the debtors do in order to confirm their Chapter 13 plan?

2. Other than the debtors, whose ox is gored by the Seventh Circuit's holding?

3. Under Judge Easterbrook's analysis, is § 506(a) surplusage?

4. Is the court's repeated invocation of *Butner* (see Casebook page 165) and the concomitant deference to underlying state law entitlements persuasive? No one doubts or disputes that the car lender enjoys certain rights under state law, including the right to assert a deficiency for any balance remaining after foreclosure. But that isn't the issue in the Wrights' case. Rather, the issue at hand is whether the creditor is permitted to assert its unsecured deficiency claim *in the chapter 13 bankruptcy case*, so as to preclude confirmation of a chapter 13 plan that fails to provide for such unsecured claim. That is a core bankruptcy question, and in *Butner* the Supreme Court acknowledged that state law rules must give way when they conflict with a federal bankruptcy interest.

Judge Easterbrook obviously is a fan and purported devotee of the Supreme Court's decision in *Butner*. In another important Supreme Court decision, *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988) (see Casebook page 344), Justice Scalia writing for the Court emphasized that "[s]tatutory construction … is a holistic endeavor." His point was that the meaning of a provision in the Bankruptcy Code "is often clarified by the remainder of the statutory scheme." Viewed in that light, how well does Judge Easterbrook's analysis in *Wright* fare? Consider this: the hanging paragraph enables a "910" car lender to *prevent* bifurcation of an undersecured claim into secured and unsecured claims and thereby escape cram down if the chapter 13 debtor wishes to *keep* a car under § 1325(a)(5)(B), and yet, if *Wright* is good law, that same "910" lender can *enjoy* bifurcation and assert an unsecured claim if the debtor simply *surrenders* the car to the lender under § 1325(a)(5)(C).

CHAPTER 7
RELIEF FROM STAY AND ADEQUATE PROTECTION

No changes.

CHAPTER 8
EXECUTORY CONTRACTS

No changes.

CHAPTER 9
AVOIDING POWERS

(Replace the last bullet on page 529 with the following)

- transfers of less than $5,475 by non-consumer debtors, § 547(c)(9).

CHAPTER 10
DISCHARGE

(Replace the last paragraph on page 572 with the following)

BAPCPA added a provision which delays the entry of the discharge order if the court finds that there is reasonable cause to believe that the debtor is subject to a proceeding that might give rise to a limitation of the homestead exemption. § 727(a)(12). This might be called the "Enron rule." The new rule imposed a $125,000 homestead exemption cap (that was indexed upward to $136,875 in 2007) if the debtor is convicted of a felony which demonstrates that the filing of the bankruptcy case was an abuse, or the debtor owes a debt arising from a securities law violation, racketeering, fiduciary fraud, or crimes or intentional or reckless torts that caused death or personal injury in the past 5 years. § 522(q).

(Replace Number 12 on page 598 with the following)

12. *Pending homestead exemption limitation proceeding.* BAPCPA added a $125,000 cap to the homestead exemption in certain limited circumstances, which might be called the "Enron rule." New § 522(q) limits the homestead exemption to $125,000 (which was indexed upward to $136,875 in 2007) if the debtor is convicted of a felony which demonstrates that the filing of the bankruptcy case was an abuse, or the debtor owes a debt arising from a securities law violation, racketeering, fiduciary fraud, or crimes or intentional or reckless torts that caused death or personal injury in the past 5 years. The discharge implications of this exemption cap are that the court is to delay the entry of discharge if it finds reasonable cause to believe that a proceeding under § 522(q)(1) is pending. The court is to make this determination within 10 days before the entry of the discharge order. This discharge delay is imposed in all chapters: chapter 7 (§727(a)(12)), chapter 11 (§ 1141(d)(5)(C)), chapter 12 (§ 1228(f)), and chapter 13 (§ 1328(h)). Note that the new rule does not effect a permanent denial of discharge, but only postpones the discharge until the § 522(q) proceeding is completed.

(Replace the second paragraph under "2. Fraud" on page 611 with the following)

For the purposes of proving fraud under (A), a rebuttable presumption of fraud is now triggered under § 523(a)(2)(C) if the debtor incurred a consumer debt of $550 or more for "luxury goods or services" within 90 days of bankruptcy, or obtained cash advances aggregating more than $825 in the 70 days prior to bankruptcy.

(Note that the $500 amount under 11 U.S.C. § 523(a)(2)(C) used in Sears, Roebuck & Co. v. Johannsen on pages 625 and 626 changed to $550 under the 2007 amendments)

CHAPTER 11
EXEMPTIONS

(Replace the first full paragraph on page 662 with the following)

In cases involving the application of state exemptions, the exemption issue historically has been regarded as an issue of *state* law. In the 2005 amendments, though, Congress enacted several provisions that as a matter of *federal* law limit the amount of allowable state law exemptions in bankruptcy. First, § 522(o), applicable to any conversion of nonexempt property into an exempt homestead within 10 years before the petition date, denies any applicable state homestead exemption to the extent attributable to a conversion done "with the intent to hinder, delay, or defraud a creditor." Second, § 522(p) caps a homestead exemption under state law at $136,875 if acquired within 1215 days before bankruptcy. Unfortunately, a drafting quirk (mistake?) in § 522(p) leaves it unclear whether the cap applies only in states where a debtor may elect between state and federal exemptions (such as Texas), and not also in states where debtors are limited to state law (such as Florida). The *Kane* case, which follows *Tveten* and *Hanson*, addresses this problem. Finally, the "move to a generous state on the eve of bankruptcy" strategy was curtailed by imposing a 730-day residency requirement in § 522(b)(3)(A).

(Note that the $125,000 amount under 11 U.S.C. § 522(p) used in In re Kane on pages 677, 681 and 684 (including the appendix and note 23) changed to $136,875 under the 2007 indexing)

(Replace Question 2 on page 685 with the following)

2. Does § 522(p) impose a $136,875 cap in all cases? If not, in what situations would a debtor be able to claim more than $136,875 in a homestead exemption?

(Note that the $125,000 amount under 11 U.S.C. § 522(p) referred to in Questions 5 and 7 on page 686 changed to $136,875 under the 2007 amendments)

(Replace the last paragraph on page 689 with the following)

A serious problem that has arisen in connection with § 522(f)(1)(B) is that the categories of property listed are overbroad. That is, even collateral that does have real value to a creditor and that is monetarily significant to the granting of a loan, and thus is not the type of "leverage" collateral that Congress was targeting, still could fall within the scope of the section and thus expose the creditor to avoidance. Much of the debate about characterization in *Parrotte* actually was motivated by this overbreadth concern. In 1994, Congress attempted to remedy this problem by capping the creditor's exposure to $5,000 for implements, professional books, tools of the trade, or farm animals or crops (and subject to other limiting conditions). § 522(f)(3). This amount was indexed upward to $5,475 in 2007. In 2005, again responding to the same

overbreadth concern, Congress set forth in great detail a limiting definition of "household goods" for which the (f)(1)(B) lien avoidance power is available. § 522(f)(4).

(Note that the $1,850 updated amount under 11 U.S.C. § 522(d)(6) used in Parrotte v. Sensenich on page 693 changed to $2,025 under the 2007 amendments)

CHAPTER 12
REORGANIZATION

No changes.

CHAPTER 13
TRANSNATIONAL BANKRUPTCY CASES

(Add the following after number 7 on page 812)

8. The sale of Yukos's Yuganskneftegas unit occurred on December 19, 2004, for $9.37 billion. The buyer was a little know firm that was itself promptly purchased by Rosneft, an oil company owned by the state. The temporary order issued by the U.S. bankruptcy court may have had some effect on the sale, because it had specifically barred another state owned company, Gazprom, from taking control of the subsidiary. Gazprom's foreign lenders were sufficiently wary of the order that they backed out and the natural gas producer was unable to bid.

Rosneft's acquisition of Yuganskneftegas also gave it a $10 billion claim on Yukos for proceeds from Yuganskneftegas oil production. The largest creditors of Yukos then became the Russian government and Rosneft, who were thus powers on the creditor committee when several Western banks brought a Russian bankruptcy case. A Russian court declared Yukos bankrupt on August 1, 2006 and a receiver was appointed. The creditors voted to liquidate what was left of Yukos, a result that many expected because what was left of Yukos was simply not valuable enough to begin to repay its debts. Most of the remaining divisions and assets of Yukos were bought by Rosneft. It appears that creditors other than the Russian state received little or nothing in the liquidation. The Yukos liquidation was essentially completed by the middle of 2007.