

BANKRUPTCY LAW

PRINCIPLES, POLICIES, AND PRACTICE
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TEACHER'S MANUAL

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LEXISNEXIS

CHAPTER 1

INTRODUCTION TO DEBT COLLECTION AND BANKRUPTCY

(Note that the \$2 million amount on for § 101(51D) used on in the third paragraph on page 60 changed to \$2,190,000 with the 2007 amendment)

CHAPTER 2

INVOKING BANKRUPTCY RELIEF

(Replace the second and third paragraphs of section c on page 85 with the following)

Section 1409(b) offers some protection to distant defendants. Under that section, as revised in 2007, if the trustee (or DIP) is suing on a consumer debt of less than \$16,425, is suing a noninsider on a debt (other than a consumer debt) of less than \$10,950, or is suing anybody else for \$1,100 or less, the trustee or DIP can only sue in the district where the defendant resides. The reason for this exception is that the home court rule can severely disadvantage parties located some distance from the home court. It takes a pretty good chunk of change to make it worth your while to hire local counsel and be prepared to fly to the home court for trial, etc. So if the trustee or DIP could sue a whole bunch of people in Maine for \$500 each in home court in Hawaii, the trustee or DIP would be assured of a whole bunch of default judgments, so that it might be economical to sue them just to get the default judgments and dismiss as to anybody who actually answers the complaint. Well, the small claims exception restricts a trustee's or DIP's ability to do that on incredibly small claims.

Before BAPCPA, Creditor for sure would have been out of luck, because the old rule only protected non-consumer defendants on debts of less than \$1,000, and the debt sued on here is \$1,200. So, until 2005, Maine-based Creditor would have to go all the way to Hawaii to defend that little \$1,200 preference suit. Not very fair, was it? Accordingly, BAPCPA changed the result under 28 U.S.C. § 1409(b) in the instance of suits by the trustee against out-of-home-district non-insider defendants sued on business debts, by raising the venue protection amount from \$1,000 to \$10,000, and later to \$10,950 in 2007. Thus, if Creditor is not an insider (defined in § 101(31)) of Debtor, Inc., the suit in Hawaii is improperly venued. Creditor is entitled to have the suit brought in Maine. If Creditor is an insider, though, the suit in Hawaii is proper.

(Replace the second full paragraph on page 93 with the following)

The other thing that § 303(b) is after is that we want a sufficient number of creditors filing the petition that we've got some indication that we really need a collective proceeding. So assuming it's not a very small debtor with not very many creditors, § 303(b) requires three petitioning creditors, with aggregate unsecured debts of at least \$13,475.

Class Coverage of section b., "Abuse" and the Means Test:

Many users of the casebook have asked us about what to cover in part b on "abuse" and the means test. We devote 23 pages and seven problems to this issue in the casebook. To cover all of that in depth would *easily* take up two 75-minute classes, and not everyone has that luxury (or desire). At the very least, if you are devoting one 75-minute class to this topic, you should have the students read all the text at pp. 121-144, and you should cover problem 2.8 in class. Beyond that, you can pick and choose. Problems 2.9, 2.10, 2.11(1), 2.13, and 2.14 are all fairly simple and straightforward and should not take much time. If you want to dig down deep, you can delve into problem 2.11(2). We recommend doing so – we think it is worth the effort for the students to see in agonizing detail how the subtleties, and oddities, of the means test play out. Problem 2.12 is a good comprehensive review problem.

(Replace the second part of Problem 2.8(a) on page 106 with the following)

Second: is Debtor's income above the applicable State median income for the same family size? According to the text, a single earner residing in Illinois for cases filed on or after March 17, 2008 is looking at a median of \$44,673. Our debtor earned \$21,000 for the six months *before* bankruptcy; thus her "current monthly income" (§ 101(10A)) is \$3,500, and when multiplied times 12 months = **\$42,000**. REMEMBER: use historical income only: the fact that Debtor will soon be making an annual salary of \$100,000, well *above* the State median income, is irrelevant for these purposes. Since \$42,000 is of course less than \$44,673, Debtor (by the slimmest of margins!) falls within the safe harbor from a means test dismissal motion: "no judge, United States trustee, ..., trustee, or party in interest may file a motion under paragraph (2)" § 707(b)(7)(A). Paragraph (2) is the means test presumption paragraph. Thus, note that even if the Debtor would have excess income over the means test presumptive abuse amount, it does not matter if they are below median income – they are protected from a motion to dismiss based on the means test.

(Replace the calculations beginning on page 107 with the following)

current monthly income, § 101(10A)(A) (\$21,000 ÷ 6 months)	\$3,500
less:	
IRS living expenses, § 707(b)(2)(A)(ii)(I)	\$2,500
secured debts, § 707(b)(2)(A)(iii)	\$400
priority debts, § 707(b)(2)(A)(iv)	\$200
Total reductions, § 707(b)(2)(A)(I)	\$3,100

net monthly income	\$400
times 60, § 707(b)(2)(A)(I)	\$24,000

compare the **\$24,000** estimated "can pay" amount to lesser of:

§ 707(b)(2)(A)(i)(I): 25% of nonpriority unsecured claims (\$20,000) = \$5,000
 or \$6,575, whichever is *greater*, ... thus, => **\$6,575**

or

§ 707(b)(2)(A)(i)(II): \$10,950 \$10,950
THUS \$6,575

CONCLUDE: since \$24,000 estimated “can pay” amount exceeds the \$6,575 expected payable amount, a presumption of abuse would arise.

HOWEVER, as noted above, it doesn't matter; even though a presumption of abuse would arise under the means test formula, Debtor's annual income (based upon the *historical* six-month average) is under the state median income, which would exempt her from means testing. § 707(b)(7)(A)(i).

(Replace the second part of Problem 2.8(b) beginning on page 107 with the following)

Second: is Debtor above the State income median? As a single person in Illinois, he is looking at a median of **\$44,673**. He had income of \$22,500 for the six months before bankruptcy, so **\$45,000** for the year – too bad! JUST above the median. Ah, if he had only kept that six-months' income below \$22,336 – that extra \$114 was bad news indeed for him (more to the point, if he had gotten advice from a bankruptcy attorney, he might have been able to cut back just a hair on work hours in order to fall just *below* the median income – but would doing that constitute “abuse” under § 707(b)(3)? Who knows?).

(Replace the calculations beginning on page 108 with the following)

Third: calculate the means test to see if a presumption of abuse arises:

current monthly income, § 101(10A)(A) (\$22,500 ÷ 6 months)	\$3,750
less:	
IRS living expenses, § 707(b)(2)(A)(ii)(I)	\$2,800
secured debts, § 707(b)(2)(A)(iii)	\$500
priority debts, § 707(b)(2)(A)(iv)	\$200
Total reductions, § 707(b)(2)(A)(I)	\$3,500

net monthly income	\$250
times 60, § 707(b)(2)(A)(I)	\$15,000

compare the **\$15,000** estimated “can pay” amount to lesser of:

§ 707(b)(2)(A)(i)(I): 25% of nonpriority unsecured claims (\$20,000) = \$5,000
 or \$6,575, whichever is *greater*, ... thus, => \$6,575

or

§ 707(b)(2)(A)(i)(II): \$10,950

\$10,950
 THUS **\$6,575**

CONCLUDE: since \$15,000 estimated “can pay” amount exceeds the \$6,575 expected payable amount, a presumption of abuse would arise under § 707(b)(2).

Indeed, a shortcut would be to note that the monthly available income after deducting expenses is **\$250** (\$3750 minus \$3500), and any amount in excess of **\$182.50** per month will *always* lead to a finding of presumed abuse (because that would exceed the *higher* amount of \$10,950 in § 707(b)(2)(A)(i)(II) [i.e., \$10,950 divided by 60 months = \$182.50].

(Replace the first two paragraphs on page 109 with the following)

current monthly income, § 101(10A)(A) (\$22,500 ÷ 6 months)	\$3,750
less:	
IRS living expenses, § 707(b)(2)(A)(ii)(I)	\$2,800
secured debts, § 707(b)(2)(A)(iii)	\$1050
priority debts, § 707(b)(2)(A)(iv)	\$200
Total reductions, § 707(b)(2)(A)(I)	\$4,050

net monthly income	\$0

Thus, since Debtor has an estimated “can pay” amount of **\$0**, he will not be caught under the means test – the lowest expected payable amount there is \$6,575, and \$0 is of course less than \$6,575.

CONCLUDE: no presumption of abuse would arise under § 707(b)(2). Here, then, Debtor’s extravagant behavior in buying an expensive car on the eve of bankruptcy has enabled Debtor to pass the means test.

(Replace Problem 2.8(d) beginning on page 109 with the following)

d. First: are the debts primarily consumer debts? Maybe here this is worth looking at, since one Debtor is a self-employed painter. If a significant percentage of debts are related to his business, they might be off the hook., and not subject to § 707(b) dismissal for abuse at all. But let’s assume for now that the debts are primarily consumer debts and move on.

Second: over the State median income for family size? Yes. They make a combined \$5,000 a month, or \$60,000 per year, which exceeds the 2-person median of \$56,545. However, with some advance planning, maybe they could drop their combined incomes below the median. The median of \$56,545 is ~ \$4712.08 a month, and would be \$28,272.50 for the six months period that “current monthly income” is calculated under § 101(10A)(A). So let’s say wife keeps her \$2,500 a month job. If husband takes fewer painting jobs for a while in advance of bankruptcy, they might well be able to drop their income below the median. For example, with her making \$15,000 for those pre-bankruptcy six months, if painter husband makes less than \$13,272 for that six months, they would come within the safe harbor and be immunized from a means test attack under § 707(b)(2). Of course, a general “bad faith” or “totality” dismissal is still possible under § 707(b)(3) (although only on the motion of the judge or United States trustee, § 707(b)(6)).

Third: If they are not within the safe harbor for below-median income, run the means test presumption calculation:

current monthly income, § 101(10A)(A)	\$5,000
less:	
IRS living expenses, § 707(b)(2)(A)(ii)(I)	\$3,500
secured debts, § 707(b)(2)(A)(iii)	\$800
priority debts, § 707(b)(2)(A)(iv)	\$300
Total reductions, § 707(b)(2)(A)(i)	\$4,600

net monthly income	\$400
times 60, § 707(b)(2)(A)(i)	\$24,000

compare the **\$24,000** estimated “can pay” amount to lesser of:

§ 707(b)(2)(A)(i)(I): 25% of nonpriority unsecured claims (\$80,000) = \$20,000

or \$6,575, whichever is *greater*, ... thus, => **\$20,000**

or

§ 707(b)(2)(A)(i)(II): \$10,950

\$10,950

THUS \$10,950

CONCLUDE: since \$24,000 estimated “can pay” amount exceeds the \$10,950 expected payable amount, a presumption of abuse would arise under § 707(b)(2), they would face a likely dismissal motion, etc..

Here again, though, planning (or well-advised) debtors might be able to manipulate their pre-bankruptcy financial circumstances in order to pass the means test. Right now they have too much excess income of \$218 per month – they have \$400 excess, whereas if they had \$182, they would pass the means test (because 60 times \$182 = \$10,920, which is less than the \$10,950 expected payable amount ... go to \$183 a month, though, and they would be at \$10,980, which is over). Thus, if they could for the six months prior to bankruptcy combine to reduce income or increase expenses in the amount of at least \$218 a month, they would pass the means test. So – take a few less painting jobs? And just so the point is not lost – is this a wise system, that encourages financially distressed debtors to reduce income and increase expenses?

Note, as discussed in connection with part c. above, that if the Debtors did manipulate their income and expenses in this way, they might still be subjected to dismissal for abuse under the grounds in § 707(b)(3), for “bad faith” or “totality of the circumstances.”

(Replace Problem 2.9 on page 111 with the following)

a. Answers to each subpart:

- i.** Means test would apply (combined income of \$78,000 (\$58,000 + \$20,000) is greater than state median of \$77,634).
- ii.** Means test would not apply (combined income of \$77,000 is less than state median).

- iii. Means test would not apply (have household of 5 now so applicable median is (i) highest median family income for family of 4 or fewer (here, the \$77,634 for a family of 4) + (ii) the \$575 per month (\$6900 per year) for Grandma under § 707(b)(7)(A)(iii) = \$84,534, which is greater than household income of \$78,000).
- iv. Means test would not apply (debtor's income of \$58,000 is less than \$66,604, the applicable state median for a family of 3).

b. Advise against moving to New York. In New Jersey the applicable median income is \$97,131 so with income of \$85,000 debtor falls below that amount and the means test does not apply. However, in New York, the median income for a family of four is \$77,664, so the means test would apply.

(The numbering is switched in Problem 2.11 on pages 112-116. Instead of a.1. and so forth, it should be 1.a. and following. Thus, for example, "Income taxes" is problem 2.11(1)(b), not 2.11a.2.)

(For Problem 2.11, it is helpful to refer both to the U.S. Trustee means test website, see <http://www.usdoj.gov/ust/eo/bapcpa/20080317/meanstesting.htm>, and also to the IRS website that explains the Standards. See <http://www.irs.gov/individuals/article/0,,id=96543,00.html>)

(Replace Problem 2.11(1)(g) (which is listed as 2.11a.7.) on page 113-14 with the following):

For cases filed on or after January 1, 2008, cell phone costs have been added into the non-mortgage component of the Local Standards for Housing and Utilities. See <http://www.irs.gov/individuals/article/0,,id=96543,00.html>. Thus, cell phone charges now will be treated the same as property taxes (2.11(1)(a)) and homeowners' insurance (2.11(1)(c)).

For the internet service, the cost apparently would still be dealt with under Other Necessary Expenses. This means that the debtor must satisfy the necessary expense test – defined as expenses that are necessary to provide for a debtor's and debtor's dependents "health and welfare and/or the production of income." More facts are needed, but such an allowance, while conceivable, would hardly be routinely granted.

(In discussing Problem 2.11(1)(h) on page 114, the \$1,500 maximum allowance should be replaced with an allowance of \$1,650. Similarly, then, the discussion about the \$3,500 balance now would refer to a balance of \$3,350)

(Replace Problem 2.11(2) on page 115 with the following)

2. Debtor's income of \$6,500 per month = \$78,000 per year, so he is over (barely!) the state median of \$77,634, and thus is vulnerable to a presumption of abuse. So, what deductions can he take from his \$6,500 monthly income?

National Standards: The allowance under the National Standards for a 4-person family is **\$1,598** per month. That includes \$228 (\$57 for each of the 4 family members) for out-of-pocket healthcare expenses.

In addition, if Debtor can show that it is "reasonable and necessary," he may claim an additional allowance of 5% of the food and clothing National Standard, which comes to **\$50**, § 707(b)(2)(A)(ii)(I). At this juncture, no one really has any idea what sort of showing courts will demand in order to grant this 5% extra allowance. The National Standards are spelled out at: http://www.usdoj.gov/ust/eo/bapcpa/bci_data/national_expense_standards.htm

Bottom line: National Standards total is either **\$1,598** or **\$1,648** (if extra 5% allowed).

Local Standards:

Housing and Utilities:

See http://www.usdoj.gov/ust/eo/bapcpa/bci_data/housing_charts/irs_housing_charts_IL.htm

Non-mortgage expenses: for a family of 4 in Cook County, Illinois is **\$604** for non-mortgage expenses. The fact that his *actual* housing and utility expenses other than his mortgage come to \$1,200 (property taxes \$400, homeowners insurance \$200, utilities \$600) does not help him out – he is capped at the Local Standard under § 707(b)(2)(A)(ii)(I).

Mortgage expenses: Standards would allow \$1,380 for mortgage expenses. However, under what we believe is the better view, given the statement in § 707(b)(2)(A)(ii)(I) that "Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts," Debtor cannot deduct the portion attributable to his \$2,000 mortgage, which is deducted separately under the secured debt provision, § 707(b)(2)(A)(iii). The entire \$1,380 mortgage allowance is eliminated by subtraction of the secured debt. Thus, we believe the mortgage deduction is **\$0**.

If we are wrong, however, then debtor can claim the entire mortgage allowance under the Local Standard for Cook County, Illinois, for a 4-person family of **\$1,380** (remember, he is capped under the Local Standards, can cannot deduct the entire \$2,000 mortgage).

Bottom line: Local Standard, Housing and Utilities, is either **\$604** (our view) or **\$1,984** (under view that no deduction is required for secured debts).

Transportation: For the Chicago MSA, allow the following expenses (see http://www.usdoj.gov/ust/eo/bapcpa/bci_data/IRS_Trans_Exp_Std_MW.htm):

Operating costs = **\$434** for a debtor with two cars. Again, the fact that Debtor's actual operating expenses are only \$400 (\$200 insurance + \$200 other) is irrelevant – Debtor gets the “amounts specified under the ... Local Standards” under § 707(b)(2)(A)(ii)(I).

Ownership costs: The Standard would allow \$489 for the first car and \$489 for the second car. But here again we run into the question about double-counting as regards secured debts, *viz.*, whether the debtor must subtract any secured debt payments from the ownership allowance. We believe the better view is that the debtor cannot double-count, but as the text notes, there is a sharp division of views on this point in the scholarly literature, especially Sommer's article. What courts will do, only time will tell. Here, if we are right that the Debtor cannot double-count, his \$500 monthly payments on each car exceed the ownership allowances under the Local Standard, eliminating that allowance entirely. Thus, the ownership portion of the Local Standard transportation allowance is, we believe, **\$0**.

If we are wrong, of course, Debtor would get the **\$978** total deduction from the two \$489 allowances, in addition to his secured debt deductions.

Bottom line: Local Standard, Transportation, is either **\$434** (our view) or **\$1,412** (under the no-secured-debt-deduction view).

Secured debt payments: allowed under § 707(b)(2)(A)(iii)

Mortgage: **\$2,000**

Cars: \$500 car 1 + \$500 car 2 = **\$1,000**

Bottom line: secured debt deduction of \$3,000

Total =

National allowance \$1590 +

Local Housing Non-mortgage \$604 +

Local Transportation Operating \$434 +

Secured debts \$3000 (mortgage \$2000 + cars \$1000)

= \$5628

If the food and clothing 5% bonus is allowed, total deductions go to **\$5678**.

If we are wrong about deducting secured debt payments from the mortgage and transportation ownership allowances, Debtor could deduct a further \$1380 for the mortgage allowance and an additional \$978 for transportation ownership allowance, putting the total deductions at **\$7986** (or \$8036 with the 5% food and clothing bonus) – easily in excess of Debtor's \$6,500 monthly income, meaning Debtor will pass the means test.

However, if we are right that you cannot double-count secured debt expenses, then Debtor has a net balance of income (\$6,500) - deductions (\$5,628) = **\$872** per month (or \$822 with the 5% food/clothing bonus).

Note, though, that this amount is *before* applying other possible deductions for:

- “Other Necessary Expenses,” or
- Priority debts (§ 707(b)(2)(A)(iv)), or
- Projected chapter 13 administration expenses (§ 707(b)(2)(A)(ii)(III)), or
- Others, including charitable contributions, or private school tuition (§ 707(b)(2)(A)(ii)(IV)), or others.

Just on income taxes alone (counted under “Other Necessary Expenses,” see Problem 2.11(a)(2)), Debtor is likely to reduce his net available income by the \$763 needed to bring his net below the \$109.58 per month amount that would always allow him to pass the means test (a Debtor making \$78,000 per year easily could owe over \$763 per month in federal income taxes).

(Replace Problem 2.12 beginning on page 116 with the following)

1. Step One: Reduce Debtor’s current monthly income (\$6,500) by all allowable monthly deductions as outlined in § 707(b)(2)(A)(ii)-(iv), calculating a net monthly income.

In the Problem, monthly deductions are allowed for:

National Standard basic living expenses (**\$1,370**) +
 National Standards for Out-of-Pocket Health care (**\$228**) +
 Local Transportation–operation (**\$217**) +
 Local Standard-Transportation-ownership (\$489 minus secured debt of \$300 = **\$189**)
 [again, the reduction for the secured debt payment is only if we are right that there is no
 double-counting – see discussion in Problem 2.11(2)] +
 Local Standards-Housing-Non-mortgage (**\$604**) +
 Local Standards-Housing-Mortgage (\$1380 allowance less \$1200 mortgage debt = **\$180**)
 –[same caveat re secured debt double-counting issue] +
 Other Necessary Expenses (**\$2,066**) +
 secured debts **\$1,500** (\$300 + \$1,200)
 = **\$6,354.**

Thus, income (**\$6,500**) - deductions (**\$6,354**) = net monthly income = **\$146** per month.

Step Two: Multiply net monthly income (\$146) by 60 = **\$8,760**

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

- [25% of the debtor's nonpriority unsecured claims (\$28,800) = \$7,200] *or*
\$6,575, whichever is *greater*, thus = \$7,200
- or* – \$10,950.

Thus, the operative Step Three amount is **\$7,200**.

So, is there a presumption of abuse? Yes. The Debtor has projected repayment capacity of \$8,760 (Step Two), which is greater than the trigger amount (Step Three) of \$7,200.

That a presumption of abuse arises also can be seen by looking at the monthly amounts. Here, Debtor has monthly net income available of **\$146**. That amount will not *always* trigger the presumption of abuse, because it is less than \$182.50. Here, though, it is larger than the trigger, as computed by “tier.” This Debtor falls into Tier Two, with unsecured nonpriority debts between \$26,300 and \$43,800 (\$28,800). Thus, for this Debtor, the trigger amount is 25% of \$28,800, which is \$7200, which on a per month basis is \$120 (dividing \$7,200 by 60 months). Clearly $\$146 > \120 , so debtor raises a presumption of abuse, and will not be allowed to file under chapter 7 unless she can rebut the presumption.

Note, though, how close the margins are. This Debtor, if she could persuade the court to allow the extra 5% food and clothing amount of \$50 per month, would then have a monthly repayment capacity of $\$146 - \$50 = \$96$, which (being less than \$109.58) will *never* trigger the presumption of abuse.

Okay, what about planning – anything debtor can do to escape the presumption? Recall that her net monthly income is \$146. However, for Debtor to not raise the presumption of abuse, her net monthly income needs to be less than \$120 (\$7,200 divided by 12). *Somehow Debtor must find a way to deduct at least another \$26.01 from her net monthly income.* What tactics might a debtor employ to deduce her income by \$26.01 or more per month? First, she could start donating to an eligible religious or charitable organization. In fact, she could donate up 15% of her gross income of \$6,500, which equals \$975 a year, or about \$81.25 a month. Second, the debtor could refinance her home or car loan and increase her monthly payments by \$26.01 or more. Alternatively, Debtor could just not make a few secured debt payments prior to bankruptcy. The amount of those arrearages will comprise part of the deductible secured debt. See § 707(b)(2)(A)(iii)(II). Third, the debtor might consider making small increases in the amounts she spends in various “Other Necessary Expense” categories, as actual expenses are used. Examples would be slightly increasing child care costs, increasing the premiums one pays for health insurance or life insurance, running more heat or air conditioning to raise electricity bills in hopes of getting an extra allowance for home energy costs, etc. [The health insurance example is not outside the realm of possibility. A quick glance at one insurance provider's plans for a family of four had plans with premiums differing by over \$330. Moving up only \$26.01 from the cheapest plan hardly seems unreasonable]. So – if our Debtor *increases expenses* in anticipation of bankruptcy – surely the sort of responsible financial management Congress hoped to spur [yes, that was intended to be sarcastic] – Debtor may escape the presumption of abuse.

2. This question is the same as (1), except the housing allowance has changed: non-mortgage expenses go down by \$7 (from \$604 to \$597), but the mortgage allowance goes up by \$296 (from \$1380 to \$1676). With a mortgage debt of \$1200, which is less than the Local Standard Housing allowance, debtor will be able to deduct all of that additional \$296. Net, then, debtor has an additional \$289 (\$296-\$7) in allowable deductions. Therefore, the debtor is just subtracting an additional \$289 from the net monthly income found in (a). The net monthly income in (a) was \$146, so \$146 minus \$289 is of course a negative number. Clearly, this debtor does not raise the presumption of abuse. Good move!

(Replace Problem 2.13 on page 118 with the following)

a. Debtor should be able to rebut the presumption of abuse. The information the court has is that the debtor will be receiving income of \$2,275 (35% of \$6,500) a month with expenses of \$6,354 a month, not an abuse. The court should allow this income adjustment as the debtor no longer can make \$6,500 at her old job. The only question here might be if the court would force the debtor to present her job prospects and if the court would factor that information in.

b. If debtor accepts the \$6,600 job *before* the petition is filed, clearly no judge will allow this Debtor to rebut the presumption of abuse, as the debtor's monthly income has increased! However, if Debtor accepts the job *after* the petition is filed, what result? Debtor would calculate and document the rebuttal of the presumption of abuse with the \$2,275 income figure and then hope to pass the means test. Query whether, if the debtor has been offered the \$6,600 a month job at the time her petition is filed, and the judge is aware of that information, would the judge refuse to find that Debtor had rebutted the presumption, even if Debtor had not yet accepted the \$6,600 job? Would it matter why the Debtor has not accepted? And how would the court learn of the offer?

In terms of incentives, clearly Debtor should wait until after filing to take the more lucrative job, an odd result, as Debtor is taking unemployed benefits when she could be gainfully employed, but chooses not to in order to file bankruptcy in chapter 7. As for the other situations, if a judge will take into account a debtor's job prospects, Debtor has the incentive to do nothing in her job search before filing, as then she would have no prospects.

(Replace the first paragraph of Problem 2.14 beginning on page 119 with the following)

Assuming the judge allows the expenses of \$75 for food, the new calculation is \$6,500 minus $(\$6,354 + \$75 = \$6,429) = \71 . Being less than \$109.58, this amount does not raise the presumption of abuse (indeed, here the trigger point is \$120).

(Add to the first full paragraph on page 120 the following)

For a case that also finds (in dicta) that § 707(b)(3) is available on ability to pay grounds, even when no presumption of abuse arises, see *In re Walker*, 2006 WL 1314125 at *8 (Bankr.

N.D. Ga. 2006). For a case that demands a showing of more “abuse” under § 707(b)(3) than just ability to pay, see *In re Nockerts*, 357 B.R. 497 (Bankr. E.D. Wisc. 2006).

(Replace Problem 2.15 on page 126 with the following)

a. Yes, as long as her Chapter 7 case was not the result of a conversion *from* Chapter 11, 12, or 13. See § 706(a).

b. So what is Sue Debtor up to here? No good. She misstated the value of her home, presumably in the hopes that the trustee would abandon the home back to her (a concept we’ll discuss in Chapter 6), at which point she would capture all of its equity, free and clear of the claims of her creditors being discharged in the chapter 7 case. Once her plan is foiled by the trustee discovering its true value and preparing to sell the home (to realize the equity value for the benefit of Debtor’s unsecured creditors), Debtor wants to convert to chapter 13, which will displace the chapter 7 trustee, and Debtor will become a debtor-in-possession with the right to “remain in possession of all property of the estate.” § 1306(b). Debtor can then propose a repayment plan that permits her to retain her home. Should she be permitted to do that? Not any more.

This problem raises the issue decided by the Supreme Court in *Marrama v. Citizens Bank*, 127 S.Ct. 1105 (2007). In that case, the Court qualified what is described in the legislative history to § 706(a) as a debtor’s “one-time absolute right of conversion of a liquidation case to a reorganization case.” S. Rep. No. 95-989, at 94 (1978); H.R. Rep. No. 95-595, at 30 (1977). The only explicit restriction on this right of conversion is that stated in § 706(d), that “the debtor may be a debtor” under the chapter to which she’s seeking to convert, which seems to be the case in this problem. The Court, however, expressly endorsed the approach of the lower courts in implying a “good faith” eligibility requirement—“prepetition bad-faith conduct may cause a forfeiture of any right to proceed with a Chapter 13 case” (127 S.Ct. at 1107)—and held that this implicit eligibility requirement also restricted a chapter 7 debtor’s ability to convert to chapter 13. The court found indirect textual support for its bad-faith exception to a debtor’s 7-13 conversion right in § 1307(c), which authorizes dismissal of a chapter 13 case or reconversion to chapter 7 “for cause,” which is a standard flexible enough to encompass that which the bankruptcy courts consider “bad faith.” According to the *Marrama* Court, then, “[i]n practical effect, a ruling that an individual’s Chapter 13 case should be dismissed or converted to Chapter 7 because of prepetition bad-faith conduct, including fraudulent acts committed in an earlier Chapter 7 proceeding, is tantamount to a ruling that the individual does not qualify as a debtor under Chapter 13,” (127 S.Ct. at 1111). *Marrama*, thus, establishes *both* a bad-faith exception to a debtor’s ability to convert a chapter 7 case to chapter 13 *and* an implicit good-faith filing requirement as an eligibility requisite in chapter 13 (and, presumably, for all other chapters too, as they all contain provision for dismissal “for cause”). Dishonesty in a debtor’s bankruptcy filing is uniformly regarded as bad faith. Thus, Sue Debtor’s misstatement regarding the value of her home would be grounds for denying her motion to convert to Chapter 13.

Given the unquestioned authority of the bankruptcy court to reconvert Debtor’s case to chapter 7 “for cause” under § 1307(c) based on her bad-faith conduct, one might wonder why all

the to-do over preemptively denying Debtor the ability to convert initially—why not simply move to reconvert to chapter 7 after the debtor converts to chapter 13? Because of the consequences of conversion in displacing the chapter 7 trustee and installing Debtor as chapter 13 debtor-in-possession, though, reconversion is not a perfect substitute for denying the initial conversion. There is concern that a debtor bent on defrauding her creditors may well seize on her chapter 13 DIP status to dissipate estate assets in ways that cannot be easily undone. Moreover, the party most likely to detect Debtor's misconduct and who is in the best position to bring it to the attention of the court is the chapter 7 trustee. Indeed, policing debtor misconduct is one of a chapter 7 trustee's principal functions. There is a trustee in chapter 13 cases, technically charged with similar functions. The reality, though, is that chapter 13 trustees function in almost purely an administrative capacity, as payment agents—receiving debtors' periodic plan payments and distributing them to creditors—and they may not be as effective in policing debtor misconduct. Indeed, there is some dispute as to whether a chapter 13 trustee even has standing to seek conversion of a chapter 13 case to chapter 7. *See In re Kutner*, 3 B.R. 422 (Bankr. N.D. Tex. 1980). Once a debtor has already converted a chapter 7 case to chapter 13, the former chapter 7 trustee clearly no longer has standing to seek reconversion of the case to chapter 7. Denying a chapter 7 trustee any ability to initially oppose a 7-13 conversion based on the debtor's bad faith, therefore, raises the possibility that there will be no one who makes a § 1307(c) reconversion motion after the 7-13 conversion. This reality likely informed the Court's decision in *Marrama* to recognize a bad-faith exception to a debtor's ability to convert from chapter 7 to chapter 13.

- c. The debtor's case cannot be converted to Chapter 13 involuntarily. *See* § 706(c).
- d. Yes, in line with the idea that a debtor cannot be compelled to be in Chapter 13. *See* § 1307(a).
- e. Debtor can't remain in Chapter 13 indefinitely just because she wants to. So if she isn't really trying to repay creditors (or succeeding) under a workable repayment plan, her case could be converted on the trustee's motion. *See* § 1307(c)(1), (3)-(8).
- f. Yes. *See* § 1112(a).
- g. This is a permissible involuntary conversion, from Chapter 11 to Chapter 7, as an alternative to dismissal of the case completely. If it becomes clear during the Chapter 11 case that the debtor's business is never going to be profitable and will have to be shut down, but at the same time it looks like there's going to be some money left for over for unsecured creditors, then conversion to Chapter 7 may be preferable to dismissal, to avoid the state-law collection race that would occur on dismissal of the Chapter 11 case. The court could convert in that instance using the same standard as dismissal—§ 1112(b)'s "cause" and "best interest of creditors and the estate" standard applies to both dismissals and conversion to Chapter 7.

CHAPTER 3 PROPERTY OF THE STATE

(Replace the first and second full paragraphs on page 155 with the following)

As explained in the note material in Question 5, new Code § 541(b)(5) excludes from a debtor's bankruptcy estate any amounts that the debtor contributed to an IRC-qualified educational IRA, as long as (1) the account is for the benefit of the debtor's child or grandchild, and (2) the funds were placed in the account at least one year before the petition date. With respect to funds contributed between one and two years before the petition date, the exclusion is limited to \$5,475 per beneficiary, but the exclusion is apparently unlimited with respect to amounts contributed over two years before the petition date. New Code § 541(b)(6) contains a similar exclusion (with identical limitations) for an IRC-qualified state tuition program.

The note material in Question 4 explains the important new exemptions regarding all tax-exempt retirement funds. The 2005 amendments also made clear that IRA assets are exempt, up to \$1,095,000 (or \$2,190,000 in a joint case), thus reaffirming and extending the holding in *Rousey v Jacoway*, which the Supreme Court decided on the eve of the enactment of BAPCPA.

CHAPTER 4 AUTOMATIC STAY

No changes.

CHAPTER 5 UNSECURED CLAIMS

No changes.

CHAPTER 6

SECURED CLAIMS

(Insert the following on page 258 following Problem 6.4)

In re Wright (2008 Supplement at p. 17)

Wright is the first Court of Appeals decision on the effect of the so-called “hanging paragraph” enacted in § 306(b) of BAPCPA, PL 109-8 (2005), in the situation where a chapter 13 debtor proposes to surrender collateral to a “910” car lender under § 1325(a)(5)(C). The Sixth Circuit since has weighed in with *In re Long*, 519 F.3d 288 (6th Cir. 2008), in which the majority agreed in result with the Seventh Circuit but on different reasoning. Several other circuit courts have followed both the result and the reasoning of *Wright*, holding for the lender and resting the decision on state law default principles. See *In re Kenney*, 2008 WL 2514194 (4th Cir. June 25, 2008); *In re Ballard*, 526 F.3d 634 (10th Cir. 2008); *Capital One Auto Fin. v. Osborn*, 515 F.3d 817 (8th Cir. 2008).

Section 306(b) provides:

“b) RESTORING THE FOUNDATION FOR SECURED CREDIT.--Section 1325(a) of title 11, United States Code, is amended by adding at the end the following:

"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 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."

The facts in *Wright* are simple and common. The debtors, Craig Wright and LaChone P. Giles-Wright, purchased a car (a 2006 Dodge Magnum – a really ugly car, no? see model below)



on August 10, 2005 on credit and granted a PMSI to the lender (the wonderfully named “Drive Financial Services”). On October 18, 2006, Debtors filed a chapter 13 bankruptcy. Since August 10, 2005 is within 910 days of October 18, 2006 (434 to be exact, if I counted correctly) before they filed chapter 13 bankruptcy, the new rule of BAPCPA § 306(b) applied. The collateral was a motor vehicle, purchased for the debtors’ personal use, and a PMSI was granted, so 306(a) was fully operative.

By the time of the bankruptcy filing, the debt on the car (\$18,845.88) was greater than the car’s value (exact amount not disclosed in briefs or opinion). In their chapter 13 plan, the debtors proposed simply to surrender the car to the creditor, as contemplated by § 1325(a)(5)(C). Their Chapter 13 plan provided: “No claim, secured or unsecured, is to be paid to Drive Financial, as the 2006 Dodge Magnum will be surrendered in full satisfaction of the claim.”

In short, the debtors did not make any provision in the plan for the unsecured deficiency claim that would result when the creditor sold the returned vehicle at foreclosure under Article 9 of the UCC. The creditor objected to confirmation on that ground. Bankruptcy Judge Ben Goldgar agreed with the creditor and denied confirmation. The Seventh Circuit (in an omitted portion of the opinion) then granted direct appeal under the new provisions in BAPCPA authorizing same. On appeal, the Seventh Circuit **affirmed**, holding that the creditor’s unsecured deficiency claim (that arises after the debtor returns the car and the lender sells the collateral at foreclosure) must be provided for by the debtors in their chapter 13 plan.

Thus, in **answer to question 1** after the case in the Supplement, what the debtors must do after the Seventh Circuit’s holding in order to confirm their chapter 13 plan is to provide for the car lender’s unsecured deficiency claim in their chapter 13 plan. So, for example, if after foreclosure the lender had a \$3,000 deficiency remaining, that \$3,000 unsecured claim would have to be included in the unsecured claims paid in the chapter 13 plan.

That accordingly means, to **answer question 2**, that all the other unsecured creditors of the debtors will be paid a smaller percentage on their claims pursuant to the chapter 13 plan. Consider a hypothetical example. Let’s say (before the Seventh Circuit holding) that the debtors were proposing to pay a total of \$6,000 over the life of the plan to other unsecured claims totaling \$12,000. Thus, on those facts, all other unsecured creditors would be paid 50 cents on the dollar (6000/12,000). After the Seventh Circuit decision, Drive’s \$3,000 (in our hypo) unsecured deficiency claim must be paid as well. Thus, instead of paying off a pool of \$12,000 in unsecured claims, the debtors will pay \$15,000 in unsecured claims. Since the debtors already must be paying the maximum they can to all unsecured claims (under § 1325(b)), we must assume that \$6,000 is all they can pay. The effect, then, is simply that the \$6,000 in payments now must be made to \$15,000 in claims (including \$3,000 to the 910 lender, Drive). So, everyone gets paid 40% on their unsecured claims (6,000/15,000), rather than 50%. So, the net is that Drive will get paid 40% on their \$3,000 deficiency claim (thus, a total of \$1,200) that otherwise would have been paid to other unsecured creditors. In short, of the \$6,000 to be paid to unsecured creditors under the debtors’ chapter 13 plan, Drive now takes \$1,200 of that, leaving only \$4,800 to be paid to other unsecured creditors. In sum, the net effect of the court’s holding is to compel a direct transfer of chapter 13 payments from one set of creditors (other unsecured) to the 910 lender. Viewed in this light, the whole discussion of the legislative history and the congressional purpose to “restore the foundation of secured credit” rings hollow, since the financial pain is being suffered not by the debtors but by competing creditors. Many commentators have observed (see, e.g., Whitford, *A History of the Automobile Lender Provisions*

of BAPCPA, 2007 U. Ill. L. Rev.143) that the real wealth transfer effected by the automobile lender provisions of BAPCPA is from unsecured creditors to auto lenders, not from the debtor to auto lenders.

Questions 3 and 4 seek to explore the court's rationale, and whether it is defensible. It probably does not take a super sleuth to divine from the way the questions are asked that at least one of us thinks the court's analysis is deeply flawed and very difficult to defend; in short, that the lower court majority view (*viz.*, that the elimination of § 506 for § 1325(a)(5) means that surrender is in full satisfaction) is correct. Unfortunately (we think), the Seventh Circuit has triggered a spate (five and counting) of court of appeals decisions holding for the 910 lender.

Here is the heart of the court's reasoning (at Supp. Page 19):

... 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. ... 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.

As **Question 3** asks, if Chief Judge Easterbrook is correct in his analysis, then isn't § 506(a) surplusage? If, as he claims, § 506(a) is not in fact the *only* source of authority for a deficiency judgment cognizable in bankruptcy when there is a collateral shortfall, since one could just as well look to state law entitlements, then what role does § 506(a) serve? It is entirely unnecessary and superfluous, isn't it? You get the same result (bifurcation of an undersecured claim into a secured portion up to the collateral value and an unsecured balance for the remainder) with or without § 506(a).

Some observers and courts have been tempted to say that the result in cases like *Wright* makes sense because § 506(a) is not an allowance section, and that allowance is instead governed by §§ 501 and 502. Under this view, the elimination of § 506(a) from the mix in § 1325(a)(5) cases because of the hanging paragraph does nothing to undermine the allowability of the 910 lender's unsecured deficiency claim under §§ 501 and 502. It is true that §§ 501 and 502 govern allowance, and that in §§ 501 and 502 we look to underlying non-bankruptcy law (here state law) to determine allowance, but having said that, we still have not addressed the issue raised by the hanging paragraph in § 1325(a)(5)(C) surrender cases.

That is, speaking of allowance under §§ 501 and 502 is irrelevant. The issue at hand in surrender cases is: what is the allocation *between the secured and unsecured portions of the 910 lender's otherwise allowable claim*? Judge Easterbrook would say that, absent a specific federal bankruptcy statute on point, we can look (under *Butner*) to non-bankruptcy law to make that allocation determination. But, as one learned commentator has observed, "*Butner* is certainly appropriate to determine that a creditor has a debt under state law; [it] does not compel *allowance* of the unsecured portion of that claim...." Keith M. Lundin, Chapter 13 Bankruptcy, 3d Ed. 451.5-12, 13 (2000 & Supp.2007-1). Accordingly, the majority of courts insist that allocation is a federal bankruptcy question dictated by § 506(a), and when § 506 does not apply (as required by the hanging paragraph in § 1325(a)(5) cases, including surrender), no basis exists for making a division of a claim into secured and unsecured portions; thus, the only solution is to assume that the car is worth the amount of the debt.

One also might argue with Easterbrook about whether there really is a vacuum of federal law that would leave the field open to state law. Note, Congress did not say nothing here; quite to the contrary, Congress made it clear in the hanging paragraph that § 506 bifurcations were off-limits in § 1325(a)(5) cases. That is, the import of the hanging paragraph is not to say “no federal law applies here”; the import is to say, “no bifurcation of undersecured claims is allowed here.” As suggested by **Question 4**, we know they really meant it in cases involving retention under § 1325(a)(5)(B), so why not also in § 1325(a)(5)(C)? There certainly is no statutory basis for making a distinction between cases under subsections (B) and (C) in terms of the hanging paragraph’s effect on § 1325(a)(5) cases. The effect of *Wright* is to create just such a distinction, which creates a serious problem with faithfulness to the mandate that statutory construction be an “holistic endeavor.” Under the Seventh Circuit view, the upshot is that the 910 lender in a retention case under § 1325(a)(5)(B) is permitted to insist on a fiction that the collateral is worth the full amount of the debt, even though it plainly isn’t; whereas in a surrender case under § 1325(a)(5)(C) the debtor is not entitled to invoke the same fiction.

Prior to the enactment of BAPCPA, the creditor in a case such as *Wright* clearly was entitled to assert an unsecured deficiency claim. While the debtors’ surrender of the vehicle clearly resulted in full satisfaction of the creditor’s allowed *secured* claim, it did not affect the creditor’s *unsecured* claim. This right and entitlement to assert an unsecured claim was based on § 506(a), a section entitled “Determination of Secured Status,” and which provides for the bifurcation of an allowed claim into an allowed secured claim up to the value of the collateral and an allowed unsecured claim for the deficiency balance. Allowance, of course, is governed by §§ 501 and 502. Thus, once the debtor returned the vehicle, and the secured creditor sold the vehicle at foreclosure, while the creditor’s **secured** claim was fully satisfied, the **unsecured** portion of the claim persisted, and per § 506(a) the amount of the unsecured deficiency could be determined and then asserted in the chapter 13 case. Of course, at the same time, under § 1325(a)(5)(B), the debtor ALSO had the option of stripping down the creditor’s secured claim to the collateral value and cramming the creditor down for that amount.

In enacting § 306(b) (quoted above) in BAPCPA, Congress sought to, in its words, “restor[e] the foundation for secured credit,” thinking of the very different case wherein a chapter 13 debtor proposes to *retain* a car under § 1325(a)(5)(B). But by eliminating § 506(a) in cases under § 1325(a)(5), where do we find the hook to bifurcate? While the Seventh Circuit says “state law,” the majority of courts say, “nowhere.” Doesn’t that have to be right? Now, the Sixth Circuit, recognizing the indefensibility of the Seventh Circuit’s view, but just not believing that Congress could have meant for a secured creditor to get stuck with the underwater car and nothing else, decided that the best approach was to create a uniform *federal* rule recognizing a deficiency claim, with substantial reliance on the legislative history. See *In re Long*, 519 F.3d 288 (6th Cir. 2008). That might be, if possible, an even more indefensible approach than *Wright*, because it not only totally disregards the statute, it also disregards the default mandate of *Butner*.

The Seventh Circuit also threw out the following argument as further support (make-weight?) for their position (at page 19 Supp.):

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.

This line of argument adds nothing, as far as we can see, to the *Butner*-default argument that rests at the core of the court's reasoning. To make a pitch that everything should be the same for a secured creditor before or after bankruptcy might have some appeal for an old-line "law and econ" true believer on a normative basis, but the court's departure from the reality of what the intervention of bankruptcy means for a secured creditor, and the willful disregard of the entire "holistic" statutory scheme as regards secured creditors in chapter 13, is truly impressive. We might rue it or love it, but the simple fact is that a secured creditor's economic relationship vis-à-vis a debtor is dramatically different once bankruptcy is filed.

On a final note – the effect of the hanging paragraph on chapter 13 collateral surrender cases on 910 car loans is a wonderful example of the abject drafting disaster that was BAPCPA. That is one reason we insert it here. No doubt, Congress in BAPCPA created a world of headaches for judges, and a plethora of juicy topics for law professors.

CHAPTER 7

RELIEF FROM STAY AND ADEQUATE PROTECTION

No changes.

CHAPTER 8

EXECUTORY CONTRACTS

No changes.

CHAPTER 9

AVOIDING POWERS

(Replace the second full paragraph on page 422 with the following)

An interesting question raised by the 2005 amendment that added the \$5,000 (later changed to \$5,475 in 2007) safe harbor for non-consumer debtors in § 547(c)(9) is whether that provision will be applied in conjunction with other preference defenses – here, the subsequent advance for new value defense. Read literally, the answer seems to be “no,” since § 547(c)(9) refers to “such transfer” as being less than \$5,475 as the trigger for the safe harbor, and in context, “such transfer” plainly means the total \$8,500 payment, not the net liability after the application of the new value defense. Any doubt on that score should be erased by noting that the identical language “such transfer” is used in the new value exception itself, in § 547(c)(4), and therein clearly refers to the original total amount transferred (here, the \$8,500), before any crediting for new value given by the creditor. One wonders, though, whether courts will give this literal reading to the Code, when the effect would be to treat differently two creditors who otherwise have an identical preference “liability” of < \$5,475, one of whose “liability” is entirely forgiven under § 547(c)(9) because that is the entire amount of the transfer, and the other of whom is held liable since the “liability” of < \$5,475 arose only after netting out new value given.

(Replace the second full paragraph of on page 423 with the following)

Another interesting point about the new less-than-\$5,475 safe harbor is that it does not appear that it is to be applied to reduce a liability of >\$5,475; that is, it provides an absolute defense for transfers of less than \$5,475, not a credit of up to \$5,474. Thus, a transfer of \$5,474 would be immune from preference avoidance, whereas a transferee who received one more dollar would be liable for the entire \$5,475 transferred. Thus, here, the liability is for the full \$8,500, not \$3,026 (\$8,500-\$5,474).

(Replace the first full paragraph of Problem 9.12(c) on page 423 with the following)

This sort of problem is affected by the enactment of BAPCPA. Before 2005, the analysis was straightforward: the initial transfer of \$8,500 was a preference (again of course assuming no other defense such as ordinary course); then the Creditor gets a credit of \$4,000 for goods shipped, reducing the net preference to \$4,500; and finally a new preference of \$3,000 was made, increasing the total net preference to \$7,500. Or, if the \$3,000 payment was not avoidable (probably because of the ordinary course defense), then under § 547(c)(4)(B) that \$3,000 would have to be applied to reduce the new value credit from \$4,000 to \$1,000, because new value is credited only to the extent that “on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of the creditor.” Thus, the outcome again would be a net preference of \$7,500; an initial preference of \$8,500, reduced by a net new value credit of \$3,000. After BAPCPA, in cases where the final transfer was less than \$5,475 (as here, where the April 20 payment was \$3,000), the analysis would follow the second tack, *viz.*, netting down the credit for the new value to the extent of “an otherwise unavoidable transfer,” because the \$5,475 safe harbor of § 547(c)(9) would immunize the \$3,000 itself from avoidance. However, § 547(c)(4)(B) is not affected or changed by BAPCPA, and the immunization of the

\$3,000 payment, which renders it “an otherwise unavoidable transfer,” means that the \$3,000 paid on account of the \$4,000 new value must be applied to correspondingly reduce the new value credit, here to \$1,000. Thus, post-BAPCPA, the answer will be \$7,500, computed as an initial preference of \$8,500 and a new value credit of \$1,000 (\$4,000 minus \$3,000).

CHAPTER 10

DISCHARGE

(Replace the second bullet of the second full paragraph on page 472 with the following)

- Aggregating more than
 - > \$550 For "luxury goods or services" or
 - > \$825 for credit card cash advances;

(Replace the first and second full paragraphs on page 473 with the following)

Sears, as one might expect, was not pleased when the Johannsens filed bankruptcy and attempted to discharge the thousand-dollar-plus Barbie debt. In Sears's view, this was the paradigmatic case envisioned by § 523(a)(2)(A) and (C)—a consumer debt of over \$550 to one creditor for a luxury good that was incurred within 40 days of bankruptcy (under the statute at the time – now is 90 days). Sears accordingly filed an adversary proceeding asking that Johannsen's Barbie debt be declared nondischargeable.

At trial, counsel for each party spent considerable energy debating whether the presumption of nondischargeability under § 523(a)(2)(C) was triggered. The attorney for Sears argued that over \$1,000 worth of Barbie equipment was not reasonably acquired for the support or maintenance of the debtor or the debtor's dependents. Brittany, Sears argued, could get by with the 25 dolls she already had; and even if a Barbie really was necessary, one of the \$9.99 variety probably would have sufficed. The Johannsens' lawyer countered that the items were ordered outside of the 40-day period, that less than \$550 of the goods by their nature could be called "luxury" goods, and that as Christmas presents none of the items were intended as luxury goods.

CHAPTER 11

EXEMPTIONS

(Replace the first full paragraph on page 501 with the following)

The subsequent enactment of § 522(p) in 2005 seems to reinforce both the federalism and the separation of powers points. In that provision, Congress has now imposed an independent *federal* limit of \$125,000 (later changed to \$136,875 in 2007) on the *state* homestead exemption that is available in bankruptcy, if the debtor acquired the homestead during the 40-month period (1215 days) before the bankruptcy filing. The negative inference then, is if Congress has *not* imposed such an independent, federal cap on other state exemptions, then there is no such cap and it's inappropriate for the federal courts to try to create one under the guise of an independent federal law of fraudulent nonexempt-to-exempt asset conversions. At the same time, though, Congress provided some fuel for the view that maybe there should be some independent federal oversight of the amount of state exemptions (in the context of nonexempt-to-exempt asset conversions). In the introductory clause to § 522(p), it says the cap is \$136,875, “[e]xcept as provided in ... sections 544 and 548.” Thus, if the bankruptcy court concludes that the acquisition of the homestead property was a fraudulent conveyance, under either state fraudulent conveyance law (using § 544) *or* federal bankruptcy law (using § 548), then the state homestead exemption may be limited even more. Likewise, § 522(o) creates a new, independent *federal* ground for denying a *state* exemption for a homestead acquired at any time during the 10-year period before the bankruptcy filing, if the debtor's interest in the homestead was acquired “with the intent to hinder, delay, or defraud a creditor.”

(Replace the first and second full paragraphs on page 506 with the following)

b. Section 522(p) can't be used to limit Debtor's Florida homestead exemption to \$136,875 because Debtor acquired the Florida homestead more than 40 months (1215 days) before filing bankruptcy. Nonetheless, it looks like the trustee can limit Debtor's homestead exemption to \$136,875 using § 522(q)(1)(B)(ii), because Debtor owes Coal Co. a \$30 million “debt arising from ... fraud, deceit, or manipulation in a fiduciary capacity.” Debtor could get more than a \$136,875 exemption in his Florida home only to the extent “reasonably necessary for the support of the debtor and any dependent of the debtor” under § 522(q)(2).

c. Now, the trustee could also use § 522(p) to limit Debtor's Florida homestead exemption to \$136,875 because Debtor acquired the Florida home within 40 months before filing bankruptcy. In addition, Debtor could not increase the cap by the amount of his Tennessee exemption that was essentially rolled-over into his Florida home. There is a provision for increasing the cap by such an exemption roll-over amount in § 522(p)(2), but it doesn't apply to an *interstate* roll-over (demonstrating that § 522(p) is primarily directed at the interstate flight problem, although it's also a more generic reaction against unlimited homestead exemptions akin to the *Tveten* majority's visceral reaction against unlimited state exemptions of any stripe). The only proviso to the conclusion that the § 522(p) cap applies to this problem is the awkward language of that provision, explored in the next case.

(Replace the last paragraph on page 506 and the first full paragraph on page 507 with the following)

The homestead exemption cap of new § 522(p), however, took effect immediately upon enactment on April 17, 2005, and the debtors had acquired their Nevada home within the 40-month period before filing Chapter 7. Moreover, they couldn't take advantage of the roll-over provision of § 522(p)(2)(B) because the debtors' home before acquisition of the Nevada home was located in California. So it looks like the debtors' Nevada homestead exemption, capped at \$350,000 under Nevada law, should be further capped at \$136,875 in the debtors' bankruptcy case by § 522(p), and that's why the trustee objected to their claim that they should be able to exempt the entire amount of their \$160,000 equity in the home. "Hold on," though, the debtors say, "we're not subject to the cap of § 522(p)," and as authority for their position, they point to this opinion by Judge Haines in the *McNabb* case. And the reasoning of *McNabb*, as applied to the Kanes, goes like this:

Look, Nevada (like most states) is an opt-out state that has specified, by statute, that Nevada residents can only claim Nevada exemptions in bankruptcy; they cannot elect the federal bankruptcy exemptions of § 522(d). Well, the \$136,875 cap of § 522(p), on its face, is applicable only in those cases where a debtor's state-law exemptions apply "as a result of electing under subsection (b)(3)(A) to exempt property under State or local law." Well, in opt-out states like Nevada, debtors don't elect state-law exemptions; those are the only exemptions available in opt-out states. Only in the handful of non-opt-out states do debtors elect between state or federal bankruptcy exemptions, and thus, it's only in non-opt-out states that the \$136,875 homestead exemption cap of § 522(p) applies.

(Replace the first paragraph of Problem 11.3 on page 509 with the following)

We first need to determine whether the harp is exempt and, if so, whether there are any limits on the amount of the exemption. Section 522(d)(3) expressly exempts "musical instruments" held for personal use, but limits the exemption to "\$525 in value in any particular item." Debtor also might argue that the harp is a "tool of the trade," since she is trying to becoming a professional harpist, and thus exempt up to \$2,025 under § 522(d)(6). Assuming that the harp is Debtor's only exempt asset, though, Debtor could use the so-called "wild card" exemption in § 522(d)(5) to exempt any value in excess of \$525 (or \$2,025). The "wild card" gives Debtor an exemption of \$1,075 plus up to \$10,125 of any unused homestead exemption. Assuming that Debtor has no homestead, the "wild card" gives Debtor an additional \$11,200 of exempt value in her harp, which will presumably cover the entire value of the harp.

(Replace the last paragraph on page 511 with the following)

Perhaps "tools of the trade" in § 522(f)(1)(B)(ii) could be given a different and more restrictive meaning than it has in § 522(d)(6) or in state statutes exempting "tools of the trade," but that seems unnatural and the courts have treated "tools of the trade" as having a consistent meaning for both purposes. Consequently, Congress enacted § 522(f)(3) in 1994, which limits the avoidance power with respect to security interests in implements, professional books, or tools of the trade, or in farm animals or crops to no more than \$5,475. The most the debtor can avoid is \$5,475 of such a security interest using § 522(f).

CHAPTER 12 REORGANIZATION

No changes.

CHAPTER 13 TRANSNATIONAL BANKRUPTCY CASES

No changes.