RECENT STATISTICS

BANKRUPTCY SECTION NEWSLETTER
MARCH 2006

Inside this issue:

IMPORTANT DATES:

18th annual FBA Bankruptcy Seminar: August 17-19, 2006 at the TREETOP GOLF RESORT, near Gaylord, Michigan. Get the latest information on the impact of BACPA Look for materials in May 2006. We hope to see you there. For more information contact:

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February 13, 2006: Changes in means test amounts.

Something missing? Let us know about other dates!

THE BACPA BUBBLE

During the week prior to the effective date of the extensive amendments to the Bankruptcy Code ("BACPA"), 5574 bankruptcy cases were filed in the Western District of Michigan. This included 5175 chapter 7's, 392 chapter 13's, and 7 chapter 11's. Similar large filing numbers occurred throughout the nation, according to news reports.

By law, 341 hearings for those cases filed needed to be heard within approximately the 2 months following filing. That made for quite an interesting holiday season for all those participating in those hearings. With 3 hearings being held at the same time in the same location, occasional system breakdowns in the scheduling of hearings, (not to mention a decision by someone to start a major plumbing project in the basement of Kalamazoo federal building) we can all be proud that the process went as smoothly as it did. Most people endured it all with patience and, once in a while, humor.

The "BACPA Bubble" is now traveling through the system: large numbers of document production requests, motions, follow up hearings. Eventually, the adversary proceedings will start. Hopefully, we can process all of this work prior to when the new filings start again in earnest.

With the few cases filed under BACPA, we will start to understand what it may mean. How do you complete and review the means test? What documents need to be sent to the trustee prior to the 341 hearing? What should be included in a chapter 13 plan? How do all of the new pre-filing and post-filing requirements work within the system? What new forms do we need to use?

To keep up, you should continuously review the websites for the court, the US Trustee program and the chapter 13 trustees, in addition to attending seminars as they come up. See chapter 13 information in this newsletter.

CHAPTER 13 AND TAX CLAIMS

THIS INFORMATION WAS RECEIVED FROM THE GRAND RAPIDS CHAPTER 13 TRUSTEE OFFICES:

BAPCPA places a duty on the Debtor to provide copies of tax returns or transcripts to various entities within specific time limits. The Trustee's office would like to coordinate with Debtors' attorneys and the IRS to find the most efficient method to obtain and then transmit this tax information to the Chapter 13 Trustee. To that end, we have met with representatives of the IRS and discussed streamlined procedures to ensure compliance with BAPCPA.

Chapter 13 Debtors will have to comply with three new sections relating to tax returns:

1. Section 1308 requires the Chapter 13 Trustee to ascertain whether the Debtor has filed all tax returns required for the four years preceding the bankruptcy filing. The returns must be filed no later than the day before the original date for the First Meeting of Creditors.

2. Section 521(e)(2)(A) requires the Debtor to provide to the Trustee a copy of the Debtor's federal tax return (or a transcript) for the most recent tax year no later than 7 days before the original First Meeting of Creditors.

3. Section 521(f) permits the Chapter 13 Trustee to request copies of any federal income tax returns (or transcripts) with respect to each tax year of the Debtor ending while the case is pending. The returns are to be provided at the same time they are filed with the taxing authority.

To meet the "due diligence" standard, a Debtor's attorney will want to review the tax information prior to a new bankruptcy case being filed. Since Debtors often do not have all of their records, the cheapest and easiest way to comply with the requirements for the pre-petition tax years may be to have the Debtor request the tax transcripts directly from the IRS. These transcripts are available for free and can be requested by phone or by mail. The Debtor can call the IRS's toll-free customer service number, (800) 829-1040, to request a transcript and they will generally respond within 10 days. Transcripts can be ordered by mail using IRS Form 4506T. The IRS has several types of transcripts available:

1. The tax return transcript shows most line items from the tax return as it was originally filed. It does not show any changes or adjustments made after the return was filed.

2. The tax account transcript shows basic financial data, such as adjusted gross income, taxable income, and whether the Debtor paid the tax due or received a refund. It also shows later adjustments made after the return was filed.

3. The information return transcript is a combination of line item information and later adjustments to the account.

The Debtor can request a copy of his filed tax return by submitting Form 4506 to the IRS. There is a fee of $39 per requested return and it may take 60 days to be processed.

The IRS does not have the statutory authority to disclose a Debtor's tax information to a Chapter 13 Trustee unless it pertains to an IRS claim in that case. A Debtor's attorney or a Chapter 13 Trustee can have direct access to the Debtor's tax information, however, if the Debtor provides the IRS with a signed consent. Both Form 4506-T and Form 4506 can be used to mail the tax transcript or return directly to the Debtor, Debtor's attorney or to the Trustee. For a copy of IRS Form 4506-T, go to www.irs.gov and do a keyword search for "Form 4506-T" and click on the Form 4506-T link.

Once the Debtor and/or the Debtor's attorney have the tax information, it will need to be submitted to the Chapter 13 Trustee in a timely manner. Do this as early as possible in the case so that it can be reviewed it well before the First Meeting of Creditors. Since the attorney should have the tax information prior to filing, do this at filing. It is preferable to email this to the trustee at the trustee's recommended email address. Please note the email the case name, number, and that it is for a Grand Rapids, Traverse City or Marquette case. Otherwise fax the documents to the recommended fax number for that trustee.

The Trustee will also require copies of post-petition tax information pursuant to section 521(f). The Debtor's attorney should have the Debtor sign Form 8821, which permits the IRS to disclose a Debtor's tax information to whomever the Debtor designates for up to three years from the date it is signed. The Debtor could designate her attorney and /or the Chapter 13 Trustee to receive copies of future tax returns or transcripts while the Debtor is in a pending Chapter 13 case. The attorney for the Debtor may want to review the tax information before forwarding it to the Trustee. The tax information can then be sent to the Trustee's office by fax or by email. Using Form 8821 would certainly reduce the number of Motions to Dismiss filed by the Trustee for failure to provide post-petition tax returns.

For additional information regarding these tax forms and related tax issues, visit www.irs.gov/newsroom, and check your trustee's website. Our thanks to SueAnn Symons of the IRS and Agnes Kempker-Cloyd of the US Attorney's Office for their assistance. Feel free to contact the trustee office with suggestions and ideas to make this process even more efficient for all involved.

THIS INFORMATION WAS RECEIVED FROM MARY HAMLIN, KALAMAZOO CHAPTER 13 TRUSTEE:

I thought it might be helpful to provide a status report as to how BAPCPA has or will affect Chapter 13 cases assigned to myself.

- A revised model plan has not yet been developed. I have been working on a draft model plan that will incorporate the provisions of BAPCPA. It is my hope to circulate this to the debtor and creditor bars soon. Unfortunately, I am still working on the wave of case filings just prior to October 17, 2005 but am hopeful that I will have a draft available soon.

- Many attorneys have continued to use plans used prior to BAPCPA and I am reviewing these plans on a case by case basis and will object to specific provisions or omissions if necessary. Many of the debtors are below the median income and the applicable requirements are similar to pre-BAPCPA with the exception of the 910 day rule, adequate protection payments, and equal monthly installment payments. These issues can be addressed under the pre-BAPCPA model plan.

- I have prepared a summary of important issues to know under BAPCPA. I have provided this to the debtors bar and a copy is located on my website (see below).

- The Local Rules Committee is meeting to discuss recommended changes to the local rules as a result of BAPCPA.

- The most important recommendation is to read BAPCPA carefully.

If anyone has any comments or suggestions as to the contents of a model plan or changes to the local rules in light of BAPCPA please do not hesitate to contact me.

Editor's note: please review Mary's NOTICE TO THE DEBTORS BAR (her summary of important issues, referred to above), on her website : http://www.13network.com/trustees/kal/kalhome.asp . This provides a clear list of the documents and other items she will required for a successful chapter 13 case, and, while not binding upon another trustee, will likely be helpful in any chapter 13 proceedings in the Western District of Michigan.

FROM THE CLERK'S OFFICE

Court Address. Send all mail intended for the Court's Grand Rapids office to: U.S. Bankruptcy Court, One Division Ave., N.W., Room 200, Grand Rapids, MI 49503. **Do not use the old post office box address.**

Practice tip: If the trustee files a complaint, the filing fee should be payable only from the estate and to the extent there is any estate realized (see Appendix to 28 U.S.C. § 1930). The trustee may request a deferral of the fee at the time a complaint is filed if there are no funds in the estate. However, if there is money in the estate, the adversary filing fee should be paid at the time a complaint is filed.

BANKRUPTCY SECTION
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THIS NEWSLETTER

This newsletter is published by the Federal Bar Association, Bankruptcy Section, for the Western District of Michigan. Prepared by lawyers with busy practices, every effort is made to publish on a quarterly basis, but that has not always been possible.

This newsletter is sent to members of the FBA who have indicated that they wish to be members of the bankruptcy section. Membership renewals must be made in the fall of each year, by sending the renewal dues to the Grand Rapids Bar Association, which manages the mailing list. Renewal notices are sent by GRBA every fall, and the person to contact there is Debbie Kurtz debbie@grbar.org .

If you have suggestions, articles or information for upcoming newsletters, please send these to the editor, Marcia R. Meoli, at mmeoli@ameritech.net .

For your records, here are the dates of newsletters for the recent past: October 2005, June 2005, February 2005, October 2004, May 2004, January 2004, October 2003, July 2003, April 2003 and January 2003.

Thank you, Marcia R. Meoli, Editor. mmeoli@ameritech.net .

RECENT STATISTICS

Through February 14, 2006: Chapter 7: 227 Chapter 13: 83
Chapter 11: 3 Chapter 12: 1. Total: 314.

2005 Totals: Chapter 7: 20612 Chapter 13: 2832
Chapter 11: 47 Chapter 12: 8. Total: 23499

BANKRUPTCY CASES FROM OCTOBER 1, 2005, THROUGH FEBRUARY 14, 2006

Supreme Court

Central Virginia Community College v Katz, -- S.Ct. --, 2006 WL 151985 (U.S., Jan. 23, 2006) – Chapter 11 trustee brought adversary proceedings under §§ 547(b) and 550(a) to set aside alleged preferential transfers by the debtor to state agencies, and agencies claimed the proceeding was barred by sovereign immunity. Bankruptcy Court denied agencies' motions to dismiss on that ground; district court and Sixth Circuit affirmed, based on the Circuit's prior determination that Congress has abrogated the States' sovereign immunity in bankruptcy proceedings. In a five-to-four decision, the Supreme Court held that the adversary proceedings brought by the trustee to set aside the alleged preferential transfers were not barred by the agencies' sovereign immunity. The majority articulated five reasons in support of its conclusion. First, it concluded from the history and circumstances surrounding the adoption of the Bankruptcy Clause that it was more than a grant of legislative authority to Congress – it was meant to authorize limited subordination of state sovereign immunity in the bankruptcy field. Second, the Court reasoned that uniform federal bankruptcy laws were a necessity, given that in a state-by-state bankruptcy system – as was the case during the Nation's infancy – one state could imprison a debtor who had been discharged by another state for the same debts. Thus the Court concluded that States are bound by a bankruptcy court's order discharging a debtor, just as other creditors, whether or not they choose to participate. Third, the Court focused on the nature of bankruptcy proceeding as primarily *in rem*. From this characterization, it concluded that bankruptcy courts traditionally had the power to issue ancillary orders enforcing their *in rem* adjudications, and that the Framers would have understood the Bankruptcy Clause's grant of power to enact laws on the entire "subject of Bankruptcies" to include authorizing Congress to authorize courts to avoid preferential transfers and to recover transferred property. Fourth, the Court concluded that the States had agreed in the plan of the Constitutional Convention not to assert sovereign immunity insofar as orders ancillary to a court's *in rem* jurisdiction implicated such immunity, like orders demanding the return of preferential transfers. The Court supported this conclusion by looking at the Bankruptcy Clause's history, along with the legislation enacted following the Constitution's ratification. The Court also analogized orders to turn over preferential transfers to the authority of early federal courts to issue writs of habeas to release debtors from state prisons, which authority had never been challenged on the basis that it impinged on the States' sovereign immunity. Lastly, the Court briefly offered the brief conclusion that it was within Congress' power to enact Bankruptcy laws for it to determine that States should be subject to such proceedings. Justices Thomas, Scalia, Kennedy, and the Chief Justice joined in a lengthy dissent, taking the majority to task on each point of its analysis.

Published Sixth Circuit Cases

In re Adkins, 425 F.3d 296 (6th Cir., Oct. 4, 2005) – Chapter 13 debtor defaulted on car payments and holder of claim secured by the debtor's car moved to repossess the vehicle. As part of the motion, the secured creditor requested that any deficiency balance be paid to it as a secured claim as set forth in the original confirmed plan. The Trustee argued that any debt remaining after the repossession and sale of the car at auction should be reclassified as an unsecured debt. The secured creditor argued that *Chrysler Financial Corp. v. Nolan*, 232 F.3d 528 (6th Cir. 2000) precluded such reclassification, and the bankruptcy court and district court agreed. In *Nolan*, the Sixth Circuit held that a debtor cannot modify a plan under 11 U.S.C. § 1329 by surrendering collateral to a creditor, having the creditor sell the collateral and apply the proceeds toward the claim, and having the remaining deficiency classified as an unsecured claim. The trustee argued that *Nolan* was distinguishable and that allowing the secured creditor to repossess the vehicle and retain its secured status in the plan would be unfair to other secured creditors as a "double recovery." The trustee further argued that it made no sense under

§ 506(a) to allow a secured claim where the claim is no longer secured by a lien on property in which the bankruptcy estate has an interest. The Sixth Circuit, Judge Batchelder and District Judge Caldwell (sitting by designation), noted that *Nolan* was based not only on § 1329, but also on §§ 1325 and 1327, the former of which fixes the amount of a secured claim which must be paid once allowed, and the latter of which binds both debtor and creditor to a plan once confirmed. Noting that the trustee's argument could allow to a double reduction of a debtor's debt, the Court concluded that *Nolan's* prohibition against post-confirmation reclassifications applied equally to cases in which the debtor's actions served as the basis for a secured creditor having the automatic stay lifted in order to repossess the collateral. Judge Moore dissented on the basis that *Nolan* was not controlling.

In re Copper, 426 F.3d 810 (6th Cir., Oct. 18, 2005) – Chapter 7 debtor moved to convert his Chapter 7 case to one under Chapter 13. The bankruptcy court denied his motion, and the Bankruptcy Appellate Panel affirmed. On appeal, the debtor's position was that he had an absolute right under § 706(a) to convert and that the BAP erred when it denied the request on the basis of bad faith. The Sixth Circuit, in an opinion authored by Judge Norris, noted the split of authority on the question as to whether the right to convert is absolute or whether there is an exception for motions filed in bad faith. The Court proceeded to adopt the position that there is no absolute right to convert under 11 U.S.C. § 706(a). In support of its conclusion, the Court reasoned that if a Chapter 13 petition can be dismissed for lack of good faith, it is logical to conclude that conversion from Chapter 7 to Chapter 13 could be denied absent good faith, per *In re Alt*, 305 F.3d 413 (6th Cir. 2002). Given the bankruptcy court's finding that the debtor's motion to convert was motivated only by a desire to avoid a determination that the debtor's obligations to his ex-wife were nondischargeable (as evidenced by the timing of the motion and misrepresentations in schedules, *inter alia*), the Court concluded that such bad faith and abuse of process justified the denial of a motion to convert under § 706(a). The Court further dismissed the argument that the statute provides an absolute right to convert, noting that such conclusion was supported by neither the language of the statute (use of "may" instead of "shall be able to convert") nor the legislative history. As a final matter, the Court noted that common sense dictates that a bankruptcy court should have the ability to police the integrity of its proceedings.

Western District of Michigan Bankruptcy Court Cases

In re U.S. Flow Corp., 332 B.R. 792 (Bankr.W.D.Mich., Oct. 29, 2005) (Judge Gregg) – United States Trustee moved for disgorgement of carve-out previously negotiated by professionals in administratively insolvent Chapter 7 case. The Court considered two questions: (1) whether court-appointed professional in the chapter 11 case must disgorge carve-out funds approved by the court pursuant to a DIP financing order, and (2) whether the carve-out is defeasible in order to benefit other administrative claimants resulting from conversion of case from chapter 11 to chapter 7. Under a previously issued interim order, various banks holding a first lien position on U.S. Flow's collateral consented to the debtor continuing to use cash collateral under specified terms and conditions. These secured creditors were given replacement liens in the debtor's property, which liens were deemed valid, perfected, and indefeasible in bankruptcy. It was expressly recognized, however, that the liens would be inferior to a carve-out. After acknowledging *Specker Motor Sales Co. v. Eisen*, 393 F.3d 659, 664 (6th Cir. 2004), the court ruled that it did not apply. Next, the court concluded that the proceeds transferred from the secured creditors for the benefit of court-appointed professionals could not be recovered for the benefit of the estate. This was due in part to the fact that the secured creditors had consented to the carve-out, and that the court's order had not been appealed. As a final matter, the court ruled that *Specker* did not require disgorgement of the carve-out. The property had been earmarked and conveyed solely for the compensation of court-appointed professionals, which was unlike the situation where a debtor's attorney was compelled to return the retainer in the attorney's trust account to the estate so that it could be equally divided. Given that parties in interest never

objected to the carve-out, and never appealed once the order was entered, the carve-out was no subject to disgorgement.

In re Raynard, 333 B.R. 389 (Bankr.W.D.Mich., Nov. 04, 2005) (Judge Hughes) – Debtors proposed plan where creditors to whom they were jointly indebted would receive 100% while creditors to whom only one of them was indebted would receive much less. The Court denied confirmation, deeming the plan unfairly discriminatory, and allowed debtors a chance to amend. Amended proposed plan satisfied § 1322(b)(1) nondiscrimination plan by treating all unsecured creditors, both joint and individual, equally for the first 3 years, at which point they would pay only joint creditors until paid in full or the plan has run 5 years. Court concluded, however, that amended plan did not meet the best interests requirement of § 1325(a)(4). In order to satisfy the best interest requirement, each unsecured creditor with an allowed claim would have to receive under the proposed Chapter 13 plan at least as much as it would have received had the debtor chosen a Chapter 7 liquidating instead. The debtors argued that individual creditors would have received little, if anything, had they chose Chapter 7 because all of their equity in the entireties property would have been administered for the exclusive benefit of joint creditors, thereby easily satisfying the best interest test under § 1325(a)(4). After acknowledging that the best interest requirement of § 1325 would have been satisfied had Mr. Raynard filed the Chapter 13 proceeding alone, the Court concluded that the plan did not satisfy the best interests of the creditors test and could not be confirmed. Although converting the case to a Chapter 7 proceeding would have been in the best interests of creditors and the estate, conversion was not an option because the debtors were farmers.

In re Lucre, Inc., 333 B.R. 151 (Bankr.W.D.Mich., Nov. 09, 2005) (Judge Hughes) – Chapter 11 debtor, a telecommunications provider, received pre-petition notice that utilities intended to discontinue services. Debtor moved for authority to provide adequate assurance of future performance to utility providers pursuant to 11 U.S.C. § 366 (subsection (a) automatically enjoins a utility from discontinuing services in certain instances; subsection (b) limits the automatic component of this injunction to 20 days, at which point the utility may discontinue service unless the trustee provides adequate assurance of payment). The Court noted that the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) amended § 366 by adding subsection (c), which limits what a trustee or debtor in possession can offer as "adequate assurance of payment" and permits the automatic injunction to exceed 30 days only if the utility rejects the offered "adequate assurance of payment". In response to debtor's request that the court continue the subsection (a) injunction, the Court ruled that it had no discretion in the matter unless the requirements of subsection (c) had been met. The Court next concluded that "utility service" in the amendment refers only to traditional services that the debtor in possession itself consumes, as opposed to other services and rights provided by the utility. As a final matter, the debtor requested that its offer of adequate assurance be deemed sufficient for purposes of the 10 day "gap" between the 20 days of automatic protection under subsection (b) and the 30 days under subsection (c). The Court ruled that the non-accepting utilities were bound by subsection (b) for only the 21st through 30th days following the debtor's petition.

In re Koshar, 334 B.R. 889 (Bankr.W.D.Mich., Dec. 02, 2005) (Judge Hughes) – Chapter 7 trustee brought adversary proceeding to set aside mortgage lien as preferential transfer. The lender conceded that the mortgage met all of the § 547(b) requirements of a preferential transfer, but argued in its motion for summary disposition that § 547(c)(3) precluded avoidance. The Court ruled that § 547(c)(3) was not available to the lender because the provision's 20-day "relation back" period is measured from when the debtor acquired the property, not from when the mortgage was granted. The Court then went on to consider the affirmative defense of § 547(c)(1): the trustee may not avoid under this section a transfer to the extent that such transfer was (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to

the debtor; and (B) in fact a substantially contemporaneous exchange. The question then became whether the lender perfected its mortgage lien in the debtor's home within 10 days of its creation. After reviewing Michigan's perfection process and the effect of its race-notice recording statutes, the Court concluded that the date on which the register of deeds accepted the mortgage for recording remained a question of fact to be resolved. The lender's loan officer was uncertain as to whether he had resubmitted the mortgage with enough time to meet the deadline, and neither party offered any other facts on the issue. Therefore, the motion for summary disposition was denied.

In re Stojny, -- B.R. --, 2006 WL 120012 (Bankr.W.D.Mich., Jan. 05, 2005) (Judge Gregg) – judgment creditor county filed adversary complaint against Chapter 7 debtor-contractor, seeking determination that judgment debt arising from county's overpayment for debtor's services was nondischargeable under three theories – fraud, breach of fiduciary obligation, and willful and malicious injury to the property of another. With respect to the fraud argument under § 523(a)(2)(A), the Court ruled that the county failed to prove all required elements, noting the lack of evidence regarding the debtor's "intent to deceive" and "justifiable reliance" by the creditor. The Court then moved to the next argument – breach of fiduciary obligation under § 523(a)(4), which requires establishing a fiduciary relationship, breach of that relationship, and a resulting loss. The County argued that the Michigan Builders' Trust Fund Act imposed an express trust on the debtor's receipt of the contract funds. The Court acknowledged the force of the argument, but ruled that the county's argument was without merit because the Michigan Builders' Trust Fund Act does not apply to contracts for public projects. The County's last argument – that discharge was precluded by § 523(a)(6) for the willful and malicious injury by the debtor to the property of another – was equally unavailing. The Court first noted that there was no evidence that there had been any injury to the *property* of the County; next the Court ruled that there was no evidence whatsoever that the debtor's conduct was willful or malicious as defined. Therefore, the Court discharged the debtor's debt to the County resulting from the County's overpayment for contract services.

Eastern District of Michigan Bankruptcy Court Case

In re Vinson, -- B.R. --, 2006 WL 212023 (Bankr.E.D.Mich., Jan. 27, 2005) (Judge Tucker) –Chapter 7 debtors each claimed a homestead exemption in the same real property, which they co-own, and treated the Property the same way in their bankruptcy schedules. Each Debtor elected Michigan exemptions on Schedule C, and each claimed a $30,000 exemption in the Property under MCL § 600.5451(1)(n). The Trustee objected to each claimed exemption, arguing that $30,000 was the maximum aggregate amount that the debtors could exempt. The Court denied the Debtor's exemption claims entirely, ruling that the Michigan statute is unconstitutional under the Supremacy Clause of the United States Constitution. The Court's reasoning was that MCL 600.5451(1)(n) allows a debtor in bankruptcy to exempt from "property of the estate" not only the debtor's interest in a homestead, but also the interests of "the codebtor, if any, and the debtor's dependants" in that homestead. Given that § 541(a)(1) of the Bankruptcy code defines "property of the estate as "all legal or equitable interests **of the debtor** in property as of the commencement of the case", and given that plain language of the Michigan statute explicitly allows a debtor in bankruptcy to exempt property interest of persons other than the debtor, thereby permitting an exemption in bankruptcy that the Bankruptcy Code does not permit, the Court ruled that this section of Michigan law conflicts with the Bankruptcy Code. Because the statute is unconstitutional, the debtors could not use it to exempt any portion of the value of their property.