Marcia R. Meoli

From: Marcia R. Meoli, Editor <mmeoli@hannpersinger.com>
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To: Marcia Meoli
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Federal Bar Association

Bankruptcy Section Newsletter
November 2008

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. For your records, here are the dates of newsletters for the recent past: July 2008, April, 2008, January 2008, October 2007, August 2007, April 2007, January 2007, October 2006, July 2006, February 2006, October 2005, June 2005, February 2005, October 2004, May 2004, January 2004, October 2003, July 2003, April 2003 and January 2003.

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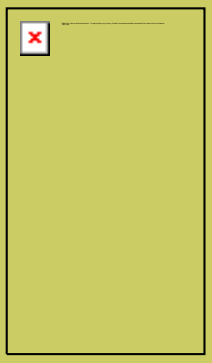
"In Kind" Exemptions, article by Steven M. Ellis

"In Kind" Exemptions After Taylor v. Freeland & Kronz Michigan Bankruptcy Judges' Split Representative of Growing Split Among Circuits

By Steven M. Ellis



Upcoming dates:

1. 21st Annual FBA Summer Seminar: July 23-25, 2009, Crystal Mountain, Michigan.

2. FBA Steering Committee will meet on November 14, 2008 and December 12, 2008 and otherwise meets typically on the 3rd Friday of each month for lunch at the University Club in downtown Grand Rapids. Check in advance with Chair A. Todd Almassian @ talmassian@kvalawyers.com .

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Taylor v. Freeland & Kronz

In 1992, the U.S. Supreme Court decided the now infamous case of Taylor v. Freeland & Kronz, 503 U.S. 638 (1992). In Taylor, the chapter 7 debtor had disclosed an employment discrimination lawsuit, scheduled its value as "unknown" and claimed the full amount as exempt. The trustee appointed to the case did not object to the claimed exemption within the 30 day period set forth in Bankruptcy Rule 4003(b), believing the lawsuit to be without value. When the discrimination suit was later settled for $110,000, the trustee filed a complaint demanding turn over of the settlement proceeds, claiming the exemption lacked good faith in light of the substantial settlement figure.

Concluding that the debtor had no statutory basis for claiming the proceeds exempt, the bankruptcy court ordered turnover of funds sufficient to pay the creditors in full. The district court affirmed, but the Court of Appeals for the Third Circuit reversed, holding that the Bankruptcy Court had erred because the debtor had claimed the money in question as exempt, and the trustee had failed to object to the claimed exemption in a timely manner.

The Supreme Court, in an opinion by Justice Clarence Thomas, upheld the lower courts' denial of the objection as untimely, reasoning that Rule 4003(b)'s allowance of 30 days to object to an exemption negatively implied that no objection was possible after that period absent an extension, even though the debtor had no colorable basis for claiming the exemption. Thomas explained:

> Deadlines may lead to unwelcome results, but they prompt parties to act and they produce finality .... If [the trustee] did not know the value of the potential proceeds of the lawsuit, he could have sought a hearing on the issue..., or he could have asked the Bankruptcy Court for an extension of time to object.... Having done neither, [the trustee] cannot now seek to deprive [the debtor] of the exemption.

Taylor v. Freeland & Kronz, 503 U.S. at 644.

Since Taylor, there has been significant litigation at the bankruptcy court level, and increasingly at the appellate level, as to Taylor's application in other circumstances. Most recently,

3. November 11, 2008: Detroit Consumer Bankruptcy Conference of the American Bankruptcy Institute. You may retrieve the program on the ABI website (see link below.)

Quick Links...

United States Bankruptcy Court, Western District of Michigan

Local filing statistics

United States Trustee Program, including means test tables and other BACPA data

United States Bankruptcy Courts

Chapter 13 Trustee Brett N. Rodgers

the question before many courts has been the legal effect under Taylor of a debtor's claim of exemption which equals or exceeds the equity available to exempt. The question, by way of example, is this: if a debtor has a vacant lot worth $10,000 in which she claims a $10,000 exemption under 11 U.S.C. Section 522(d)(5), must the trustee object to the exemption if it appears that the property is worth more than $10,000, but the exemption is otherwise valid? The answer depends on the district, and sometimes even the judge. The difference in opinion between two Michigan judges has highlighted the split in authorities and the potential headaches facing trustees in Taylor's wake- as well as some possible relief.

Olson v. Anderson (In re Anderson)

U.S. Bankruptcy Judge Jeffrey R. Hughes (W.D. Mich.) has joined a number of other jurists interpreting the Supreme Court's opinion in Taylor v. Freeland & Kronz to conclude that a debtor who claims an exemption under 11 U.S.C. Section 522(d) which consumes any available equity presumptively intends to claim an in-kind exemption in the entire property, shifting the burden to clarify any ambiguity to the trustee and depriving the estate of the asset if the trustee fails to object within 30 days under Fed.R.Bankr.P. 4003(b). In contrast, U.S. Bankruptcy Judge James D. Gregg (W.D. Mich.) has concluded that Taylor's reach is much shorter, and that section 522(d)'s language makes a mere exemption in excess of scheduled value insufficient to show such an intent or shift any burden of clarification. Taken together, the two opinions illustrate the argument a trustee can expect to face from a party seeking to prevent liquidation of an interest the trustee thought was non-exempt, and a possible means of overcoming it.

Hughes set the stage for the split when he adopted the more debtor-friendly of the two positions in Olson v. Anderson (In re Anderson), 357 B.R. 452, and then affirmed it in Olson v. Anderson (In re Anderson), 357.B.R. 473. There, the debtors owned an undivided half interest in hunting land in northern Michigan as tenants by the entirety. They scheduled their interest at $15,000 and claimed an exemption in the same amount under 11 U.S.C. Section 522(d)(5). At that time, the section allowed each debtor to exempt up to $10,225 in value, so the exemption was less than the amount allowed. Trustee Colleen M. Olson, following precedent established by then-sitting Judge Jo Ann C. Stevenson (who later retired - Judge Hughes taking her place on the case) made no objection. However, when the trustee later learned that the land was worth $60,000, she sought to recover the value of the debtors' interest in excess of their claimed exemption of $15,000.

The trustee brought an adversary proceeding under 11 U.S.C. Section 363(h) against the debtors' family members who co-

Chapter 13 Trustee Mary K. Viegelahn Hamlin

Federal post judgment rate of interest

State Bar of Michigan

American Bankruptcy Institute

National Association of Bankruptcy Trustees

National Conference of Bankruptcy Judges

National Association of Consumer Bankruptcy Attorneys

National Association of Chapter 13 Trustees

Federal Bar Association of Western Michigan

Pro bono procedures and client retainer agreement

New dollar amounts in bankrutpcy

Information on reporting bankrutpcy fraud

owned the land to permit the trustee to sell the property. The co-owners acknowledged the $60,000 valuation and agreed to purchase the estate's interest for $13,560, but when the trustee moved to approve the settlement, the debtors objected. The debtors later withdrew the objection, having filed it under the mistaken belief that the settlement would divest them of their interest in the property.

At a hearing on the trustee's motion, Hughes questioned sua sponte whether the trustee actually held an interest to convey given the trustee's failure to object to the exemption. The debtors immediately reinstated their objection and argued that the estate held no interest in the property. Not surprisingly, given his sua sponte raising of the question, Hughes agreed and denied the trustee's motion, ruling that the land was exempt in its entirety. Noting that the debtors had clearly described the land, and had scheduled value and exemption in an amount within 11 U.S.C. Section 522(d)(5)'s limits, he wrote that the debtors' amended schedules showed an intent to keep the entirety of their interest in the land, and that it therefore ceased being property of the estate under 11 U.S.C. Section 522(l)-which provides that debtor's claimed exemptions become exempt unless a party in interest objects-when no one timely objected. [1] Hughes reasoned that his interpretation of 11 U.S.C. Section 522(l) was correct based on Taylor.

The trustee appealed to the Sixth Circuit Bankruptcy Appellate Panel, but the court affirmed Hughes' conclusion-albeit not his full reasoning-in Olson v. Anderson (In re Anderson), 377 B.R. 865 (2007).[2] Bankruptcy Appellate Panel Judge Joseph M. Scott Jr., joined by Judges Jennie D. Latta and Marcia P. Parsons, wrote that even though Hughes should have evaluated the settlement to determine whether it was fair and equitable, rather than examining the trustee's adherence to her fiduciary duties in negotiating it, Hughes had correctly determined that the trustee had no interest to convey, rendering denial appropriate and any error harmless.

Writing that Taylor stood for the proposition that "when a debtor makes an unambiguous manifestation of intent to seek an unlimited exemption in property... absent a timely objection, that property is exempt in its entirety, even if its actual value exceeds statutory limits, and it is no longer property of the estate," the B.A.P. rejected any suggestion that a debtor must list an asset's value as "unknown" and make a notation such as "100%" evidencing a specific intent to exempt an asset in full in order to actually do so. As the bankruptcy court correctly noted," Scott wrote, "there is nothing on the form Schedule C that alerts a debtor that the required way to assert an in- kind exemption is to list the value unknown and the exemption as 100%. To the contrary, the form which is entitled 'Property Claimed As Exempt' simply asks a debtor to list the property

claimed exempt and to place values on the exemption and the property. Anderson, 377 B.R. at 876.

Reasoning that the debtors had complied with these instructions, Scott said it was "clear" the debtors sought to exempt their full interest and, quoting the U.S. Bankruptcy Court for the Middle District of Georgia, wrote "if a trustee is uncertain about an exemption claimed by a debtor, the trustee may seek a hearing on the issue or request an extension of time to object." Of course, Scott continued, "[f]ailure to timely object will leave the trustee without recourse if the court later determines that the debtor intended to exempt the property in full, even if such a ruling results in an exemption greater that the statutory limits."

In re Cormier

In another courtroom, Judge James D. Gregg faced a similar situation in the chapter 7 case of Michael and Linda Cormier. In that case, the debtors initially failed to list their 4.167% ownership interest in stock of a closely held corporation on their schedules, alluding to it only on their schedule of current income and listing it as "Mineral Rights" from which they received $1,277 per month. They subsequently filed amended schedules listing the stock as jointly owned with a value of $1, and a claim of exemption under 11 U.S.C. Section 522(d)(5), first in the same amount, and then later in the amount of $14,150, the maximum amount of exemption remaining available to them under the statute.

Trustee James W. Boyd did not object to the exemption, but moved to sell the stock. The trustee informed the court that the corporation had offered to purchase the stock for $26,826, and the debtors for $27,000, and asked for authority to sell it to the highest bidder at an auction, with the debtors allowed a credit in the amount of their claimed exemption. Gregg allowed the auction to proceed, and the debtors submitted the winning bid of $47,000. However, when the trustee moved for approval of the result, the debtors objected.

Upon review, Gregg concluded that the debtors lacked standing and approved the sale, but before he could sign the trustee's proposed order, the B.A.P. issued its Anderson decision. After rehearing argument on the trustee's motion, Gregg again approved it and set forth his rationale for doing so in In re Cormier, 382 B.R. 377 (2008).

Holding initially that the bidding procedures had sufficiently satisfied the corporation's bylaws, and that the debtors lost the ability to assert any cause of action or objection to the sale in their capacity as shareholders when they filed their case, Gregg similarly concluded that any value in the stock above the

debtors' exemption was property of the estate and that they lacked standing to challenge its sale at any price above the exempt amount. Gregg resolved the question of the estate's interest by examining both Taylor and the language of 11 U.S.C. Section 522 (d).

Judge Gregg took issue with the B.A.P.'s reading of Taylor-saying that the opinion meant only that "when a debtor claims property as fully exempt, and no objection is timely filed, the property is exempt"-and concluded that a mere exemption in excess of scheduled value is insufficient to show an intent by debtors to claim it entirely exempt or to shift the burden of clarifying any ambiguity to the trustee.

Noting that the Supreme Court in Taylor had not touched on what, specifically, is "claimed exempt," or on how a debtor could claim an in-kind exemption in property in full, Gregg focused on 11 U.S.C. Section 522(d)(5)'s language allowing debtors to claim an exemption "not to exceed in value" a specific, aggregate amount. Writing that the language was "direct and unambiguous," and noting that eight of 11 U.S.C. Section 522(d)'s 12 subsections contained similar caps, he reasoned that only the subsections without such language could appropriately qualify as in-kind exemptions, and criticized the B.A.P. for failing to give proper weight to statutory language. "The language of 11 U.S.C. Section 522(d)," he wrote, "contrasted with the 'in-kind' exemption subsections, encourages a reader to conclude that a difference must exist-the maximum stated amount must mean something...[and] the statute says nothing about a debtor's scheduled value begetting an unassailable in-kind exemption."

Gregg also rejected the B.A.P.'s attempt to use the schedule C form and its requirement that debtors assign a value to create an "in-kind formula," noting that valuation information is not required by 11 U.S.C. Section 522, and wrote further that the policy underlying the Bankruptcy Code of providing a debtor with a "fresh start" necessitated that a debtor seeking relief bear the burden of resolving any ambiguities in his schedules. "Who created the ambiguity," Gregg asked, "the debtor or the trustee? What common sense is there, as bankruptcy policy, to require a trustee to affirmatively clear up any (or all) ambiguities that debtors may state in their Schedules?" Writing that "an ambiguous assertion of an exemption is insufficient to claim property of the estate as exempt and...such property does not become 'exempt by operation of law under 11 U.S.C. Section 522(l),'" Gregg concluded that the non-exempt portion of the stock was part of the bankruptcy estate.

Noting that the debtors' exemption would be satisfied by the sale price-depriving them of any "pecuniary interest" which might confer standing-he denied their objection and approved

the sale. However, in the course of his opinion he also he observed that the B.A.P.'s Anderson decision was not binding upon him, and this observation illustrates a quandary chapter 7 trustees now face when confronted with exemptions that equal or exceed assets' scheduled values.

Gregg wrote of the "'real need' for the parties in interest and the courts to rely on debtors unambiguously stating what property they claim as exempt," and complained that the Anderson approach of requiring trustees to "object first and ask questions later" every time a claimed exemption exceeds value would "adversely affect case administration and result in unnecessary objections, with attendant wasteful expense and undue delay for both debtors and the appointed trustees."

But that may be an individual trustee's best approach to safeguard the estate's interest.

Although Gregg's reasoning may ultimately prove to be a source of relief to trustees, it is likely first to be the focus of protracted appellate litigation, and trustees who fail to timely object to exemptions equaling or exceeding scheduled value-at least until the question is resolved at their circuit level-will continue to run the risk of landing in front of judges who agree with Hughes, and complete loss of an asset that had value to the estate.

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1. Judge Hughes also opined that the trustee had not fulfilled her fiduciary duty of obedience to the bankruptcy estate because she had engaged in an ultra vires act by attempting to convey an interest that she was without right to convey, and said that the proposed settlement could not be approved because it was tantamount to fraud on the co-owners with whom the trustee had settled.

2. It is noted that the author of this article is part of the law firm that represented the trustee on the appeal to the Sixth Circuit B.A.P., losing 3-0, unopposed. We were really glad we did that.

About the Author: Steven M. Ellis has practiced bankruptcy law with the firm of Rayman & Stone in Kalamazoo, Michigan since 2005. Also admitted in Illinois, he previously served as a legal clerk in the Division of Legal Counsel in the Executive Office of the Governor of the State of Michigan. He graduated magna cum laude from Michigan State University College of Law in 2004, where he was a Charles H. King fellow.

From the clerk of the court / procedural changes

1. Effective October 1, 2008, certain filing fees in bankruptcy increased. The court website has a list of current filing fees. Reviewing the notice of fee increase, it appears that the increases involved fees for deconsolidating cases.

2. Means test amounts also changed, effective October 1, 2008. These are available from the United States Trustee website. Most computer software programs offer updates for such changes. Be certain that your software is updated accordingly.

Recent events / changes

If you have information regarding any professional award, achievement or other event regarding a member of our bar or other person involved in our practice, or regarding you, please let us know. Please supply sufficient information for us to report it, or to find the information to do so. You may email it to the editor, address below. Thank you.

Summaries of recent cases

Thank you to Dan Bylenga for his wonderful work in drafting these summaries.

Bankruptcy Cases: July 1 - September 24, 2008

6th Circuit

In re Hamilton, 540 F.3d 367 (6th Cir.2008) - Whether 11 USC 524(a) makes a state-court judgment void ab initio when entered against a debtor whose dischargeable debts had been discharged, or whether the Rooker-Feldman doctrine compels federal courts to honor state-court judgments. Chapter 7 debtor listed his ex-wife as a creditor and obtained discharge. The ex-wife then obtained a state- court judgment after the state court rejected debtor's argument that the bankruptcy discharge barred the lawsuit. Debtor filed adversary complaint to enjoin ex- wife from enforcing the judgment, and the bankruptcy court dismissed under the Rooker-Feldman doctrine. On appeal, the district court reversed. The Court of Appeals held that Section 524(a) renders a state-court judgment that modifies a discharge order void ab initio, regardless of the Rooker-Feldman doctrine. Vacated and remanded to determine if the debt had in fact been discharged. If so, the state-court judgment would be a modification of the discharge order and void ab initio. If not,

then the judgment would not be a modification, and the Rooker-Feldman doctrine would bar federal court jurisdiction.

Phar-More, Inc. v. McKesson Corp., 534 F.3d 502 (6th Cir.2008) - Whether vendor's administrative-expense priority on its reclamation claim is extinguished when the goods subject to the claim are sold and the proceeds are used to satisfy a secured creditor's superior claim. Chapter 11 debtor moved to reclassify vendor's administrative expense claim against goods included in the estate as extinguished after goods were sold and proceeds went to satisfy superpriority claims of postpetition DIP financers. The bankruptcy court denied the motion and held that the reclamation claims still had administrative-expense priority over general claims; the district court affirmed. The Sixth Circuit affirmed, holding that the vendor had a valid Ohio right of reclamation that other secured creditors could not defeat, and that the bankruptcy court properly granted the vendor an administrative expense claim. The Court further held that the vendor's claim was not extinguished simply because the goods were sold to satisfy superpriority claims, abrogating In re Pittsburgh-Canfield Corp., 309 B.R. 277 (6th Cir. BAP 2004), and In re Steinberg's, Inc., 226 B.R. 8 (Bankr.S.D.Ohio 1998), and characterizing the holdings as "not practical" and the reasoning as "not compelling".

6th Circuit B.A.P.

In re Scarlett Hotels, LLC, 392 B.R. 698 (6th Cir. BAP 2008) - Whether bankruptcy court improperly placed burden upon Chapter 11 debtor to prove that fees that oversecured creditor requested under 11 U.S.C. 506 (b) were unreasonable and whether court abused its discretion in its minimal reduction of fees. Debtor appealed order awarding fees and expenses to oversecured creditor. The Panel held that the court did not misplace the burden of proof, noting that the court required the applicant to show the reasonableness of fees and made a decision based on the evidence. Furthermore, the Panel did not believe that the court made a mistake in its reductions of the fees where it responded to the debtor's concerns, despite the fact that the court could have addressed some issues with greater exactitude.

In re Brice Road Developments, LLC, 392 B.R. 274 (6th Cir. BAP 2008) - whether chapter 11 plan was feasible under 1129(a)(11), fair and equitable under Section 1129(b)(2), and provided secured creditor its rights under Section 1111(b)(2). Creditor ("GE") held a note and mortgage on real property, filed a proof of claim, and elected to have the claim treated as fully secured under Section 1111(b)(2). The Court, over the GE's objection, then approved the plan, which provided GE a secured claim that would be paid at 6% instead of at the 7.75% in the note. GE appealed. The Panel first held that the

cramdown interest rate was within the range of rates in an efficient market and that GE did not carry its burden to show that a higher rate was necessary. The Panel next held that the Court's valuation of the property was not clearly erroneous, despite GE's claim that the Court did not give sufficient weight to an arms-length offer. Third, the Panel held that plan satisfied the feasibility requirement in Section 1129 based on ample evidence regarding the debtor's financial condition. Finally, the Panel held that the plan did not accord GE its rights under Section 1111(b)(2). The plan failed to specify that total payments to GE over the life of the plan would amount to the GE's total claim and did not evidence the debtor's obligation to pay GE its Section 1111(b) premium. Affirmed in part; vacated and remanded in part.

In re Storey, 392 B.R. 266 (6th Cir. BAP 2008) - Whether bankruptcy court erred in granting Chapter 13 trustee's motion to modify confirmed plan to correct pre-confirmation mistake in calculating the plan's length. Chapter 13 trustee filed motion to modify the confirmed plan based on his pre-confirmation mistake in calculating the plan's length, resulting in a increase in the dividend to unsecured creditors from 7% to 50%. The Court granted the motion, and the debtors appealed. The Panel held that Section 1327 precludes modification of a confirmed plan, noting that a confirmation order is res judicata. While Section 1329 permits modification of a plan in certain circumstances, it is limited to matters that arise post-confirmation and does not permit modification to address issues that were or could have been decided when the plan was originally confirmed. The bankruptcy court abused its discretion in granting the motion because the decision was based on an erroneous view of the law. There was no objection to the plan, and the required plan length could have been decided at the time of confirmation. Reversed.

In re Murray, Inc., 392 B.R. 288 (6th Cir. BAP 2008) - Whether the bankruptcy court erred in finding that supplier proved ordinary course of business defense under 11 U.S.C. 547(c)(2). Liquidating Chapter 11 trustee brought preferential transfer action against foreign supplier. The bankruptcy court dismissed the complaint, ruling that the supplier was protected by the ordinary course of business defense; the trustee appealed. On appeal, the Panel ruled that the supplier failed to carry its burden where it failed to show that the payments were made according to ordinary business terms. While the debtor made the payments in the ordinary course of business, the supplier failed to show any reliable data regarding the industry standards for the timing of payments on international transactions and could not prove that the transactions comported with industry standards. Reversed.

email: mmeoli@hannpersinger.com

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Federal Bar Association - Bankruptcy Section | Marcia R. Meoli, Editor | HANN PERSINGER, PC | 503 Century Lane | Holland | MI | 49423