NEW VALUE

FEDERAL BAR ASSOCIATION—BANKRUPTCY SECTION NEWSLETTER

Spring 2012

BANKRUPTCY SECTION STEERING COMMITTEE

EDITOR'S NOTE

Benjamin M. White

Welcome to the Spring 2012 edition of New Value. While spreading mulch and planting flowers, you may find yourself wondering what effect a bankruptcy filing would have on your client's interest in an LLC. Well this issue's article by Yours Truly may be able to help with that – the LLC I mean, you're on your own with the mulch. Also included are Judge Dales's new procedures governing live testimony during motion day hearings, excellent Page 13 contributions on the 6th Circuit's *Seafort* opinion and Brett Rodger's 2011 tax-refund policy, as well as legal updates from the last quarter. Additionally, like the soft, subtle hum of a mosquito in your ear, the Supreme Court has again decided a bankruptcy issue (*RadLAX*), but this time its holding is much clearer, I promise. And lastly, the members of the Steering Committee hope to see all FBA members at Crystal Mountain Resort for what looks to be a fantastic FBA Bankruptcy Seminar on July 19-21. You can register and find more information on the FBA's website.

As always, members are encouraged to contact me (bwhite@kalawgr.com) with comments, suggestions or articles.

Benjamin M. White, Editor

IN THIS ISSUE

LETTER FROM THE CHAIR

Norman C. Witte

This is my last opportunity to write to FBA members as chair of the steering committee, as this year's upcoming seminar marks the end of my two years as chairperson. Following me for two years will be Andy Gerdes, and following Andy will be Laura Garlinghouse.

It has been a genuine pleasure to serve as the chair of the FBA Bankruptcy Section Steering Committee. One reason is that the Steering Committee is one of the best operating volunteer organizations I've ever seen. Decisions are made by consensus; I got in trouble once for trying to keep track of voting. Discussions are lively, but never personal. Whatever the decision, we all support it, regardless of whose idea it was.

Not only is there a high level of collegiality, we get things done. The FBA does a great job of providing its members with informative, entertaining and educational events throughout the year. I can say this with all humility because it's not me that makes all of this happen: it's the hard-working people who serve on the committee.

I've been thinking a bit about what makes this organization so special, and I have come to the conclusion that it is the same thing that made me decide, years ago when I was an associate at Loomis Ewert, that I wanted to practice bankruptcy law. It wasn't any particular fascination with the law of insolvency but rather the people who practiced in that arena that attracted me. I think a lot of times it's not the trip but the traveling companions that make life worthwhile, and over the past 25 years of practice in this district I have found the bankruptcy bench and bar to be fine people with whom to share the journey. After spending many of those years having lunch with the members of the Steering Committee, I would have to say that the representatives are a fair sampling of the membership.

So I would like to take this opportunity to thank you all for the opportunity to serve the bankruptcy section, however modest that service has been. It's been an honor and a privilege.

I'm looking forward to seeing you this July at Crystal Mountain.

Norman C. Witte, Chairman

NEWS & ANNOUNCEMENTS

- The 2012 FBA Bankruptcy Seminar will take place July 19-21 at Crystal Mountain. Details and registration are available on the FBA's website.
- The FBA Bankruptcy Section is still in need of sponsorships for this year's Annual Bankruptcy Seminar. Please contact Thomas P. Sarb, 250 Monroe Avenue, NW, Suite 800, PO Box 306, Grand Rapids, Michigan 49501. Sponsorship categories are as follows:

Platinum	$4,000.00 plus
Gold	$2,000.00 to $3,999.00
Silver	$1,000.00 to $1,999.00
Supporting	$500.00 to $999.00

- 2012 State of the Court Event to Feature "Stern v. Marshall" Attorney
  Save the date! On Friday, October 12, 2012, at 12:00 p.m., the Federal Bar Association - Bankruptcy Section will hold its annual State of the Court event at the JW Marriott in Grand Rapids. The featured speaker will be Los Angeles attorney Kent L. Richland, who represented Anna Nicole Smith's estate in Stern v. Marshall. Mr. Richland will share his unique insights on the legal implications of Stern, the infamous parties, and the oral arguments before the Supreme Court. Registration details will follow.
- We have received some inquiries about joining the Debtors Bar of West Michigan, which is an organization open to those representing primarily debtors, and is not affiliated with the FBA Bankruptcy Section. Anyone interested in joining the DBWM can contact Michael J. McPhillips at mjmcphillips@applestreetlawoffice.com for more information about the organization.

ARTICLES

Members Only:

Debtors' LLC membership interests in bankruptcy

By Benjamin M. White
Keller & Almassian, PLC

This article addresses some of the issues that arise when a member of a limited liability company ("LLC") files bankruptcy. For example, will the debtor's membership interest become property of the estate? And if so, can a bankruptcy trustee exercise the debtor's management rights or sell the debtor's interest to any willing buyer? Brains storm. What follows is an attempt to answer some of these questions.

OVERVIEW

Two primary issues arise when a member of an LLC files bankruptcy: (1) whether terms in an LLC's operating agreement or provisions of state law may keep a debtor's membership interest out of the debtor's bankruptcy estate; and (2) whether duties and restrictions in an operating agreement may be enforced against a bankruptcy trustee.

As to the first issue, a debtor's membership interest will likely become property of the estate under Section 541(a) and (c) regardless of any restrictions under state law or the LLC's operating agreement. *See In re Ellis*, 2011 WL 5147551 (Bankr. S.D. Ind. 2011). For example, it is not uncommon for operating agreements and state statutes to provide that, in the event a member files bankruptcy, the debtor-member is "disassociated" from the LLC, or that the debtor's interest terminates upon filing bankruptcy. But *notso fasto*, such provisions constitute unenforceable ipso facto clauses under Section 541(c), which states:

> [A]n interest of the debtor in property becomes property of the estate... notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law –
>
> (A) that restricts or conditions transfer of such interest by the debtor; or
>
> (B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title... and that effects or gives an option to effect a forfeiture, modification , or termination of the debtor's interest in property."

Thus, § 541(c) expressly restricts or overrides state law and contractual terms to bring a debtor's membership interest into the bankruptcy estate.

With regard to the second issue (whether restrictions under the operating agreement apply to the trustee), the answer likely hinges on whether the operating agreement constitutes an executory contract under § 365. S*ee In re Ehmann*, 319 B.R. 200 (Bankr. D. Ariz. 2005). If the operating agreement is an executory contract, § 365 will govern the trustee's rights; if not an executory contract, § 541(c) will govern. As the court explained in *In re Ehmann*, "[i]n a very general sense, [Section 365], if applicable, permits the enforcement of state and contract law restrictions on the Trustee's rights and powers, whereas [Section 541(c)], if applicable, would render such restrictions and conditions unenforceable as against the Trustee." *Id.* at 202. Thus, if the operating agreement is executory, its duties and restrictions will likely be enforceable against the trustee under § 365.

EXECUTORY CONTRACTS

Accordingly, a lot may ride on whether the operating agreement constitutes an executory contract.[1] Typically, the bankruptcy estate automatically succeeds to a debtor's assets under § 541. However, an executory contract is both a potential asset *and* a potential liability, and therefore is treated differently. *In re First Protection, Inc.*, 440 B.R. 821, 830 (B.A.P. 9th Cir. 2010). As an extension of the trustee's power to abandon burdensome property, the trustee also has the power to reject an executory contract that may be burdensome to the estate. *Id.* The flip side of the power to reject, of course, is the power to assume executory contracts. In order for the estate to be bound by an executory contract, the trustee must take an affirmative act of assumption. *Id.* A result of the trustee's option to reject or assume executory contracts is that the bankruptcy estate only becomes obligated on contracts it chooses to accept after due deliberation. *Id.*

In determining whether a particular operating agreement constituted an executory contract, one bankruptcy court explained, "[t]here are no *per se* rules regarding the classification of limited liability company operating agreements. Instead, courts individually assess each operating agreement to determine whether its particular provisions draw it into the purview of § 365. Where the operating agreement imposes no duties or only remote and hypothetical duties, it is not an executory contract." *In re Prebul*, 2011 WL 2947045, page 7 (Bankr. E.D. Tenn. 2011) (internal citations omitted). In short, where the operating agreement contains only remote or minimal duties, it may not be executory, and therefore may not bind a bankruptcy trustee. Bankruptcy counsel should therefore review operating agreements carefully to determine whether it imposes material ongoing duties on the LLC members.

SINGLE-MEMBER LLCs

In situations where the debtor is the sole member of an LLC, the estate will likely receive full control of the LLC, including its management. One Court observed, "[o]bviously, the definition of an executory contract presumes that there are other parties to the contract besides the Debtors." *In re First Protection, Inc.*, 440 B.R. 821, 831 (B.A.P. 9th Cir. 2010). The Court further explained that, in the event the debtor is the sole member of an LLC, "application of an executory contract analysis ... does not make sense." *Id.* In other words, where there are no other parties to the operating agreement besides the debtor, by definition, it cannot be executory, and therefore the trustee will not be bound by its provisions.

In *In re Albright*, 291 B.R. 538 (Bankr. D. Colo. 2003), the Court reached the same conclusion in a single-member situation – that the trustee controlled both the debtor's economic and non-economic rights— but by way of a different path. The *Albright* court held that "[b]ecause there are no other members in the LLC..., the Debtor's bankruptcy filing effectively assigned [the debtor's] entire membership interest in the LLC to the bankruptcy estate, and the Trustee obtained all [the debtor's] rights, including the right to control the management of the LLC." *Id.* at 541. Rather than simply deem the executory contract analysis inapplicable, the *Albright* court determined that the debtor's bankruptcy constituted an assignment of the debtor's entire interest to the bankruptcy estate.

[1] In the 6th Circuit, "executory contract" has been defined as "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." *riser v. Dayton Country Club Co. (In re Magness)*, 972 F.2d 689, 694 (6th Cir. 1992) (quoting Countryman, *Executory Contracts in Bankruptcy, Part I*, 57 Minn. L. Rev. 439, 460 (1973)).

MULTI-MEMBER LLCs

In multi-member situations, where there are other, non-debtor members of the LLC, the non-debtor members may try to enforce the operating agreement's duties and restrictions against the bankruptcy trustee. As stated above, to determine whether the operating agreement binds the trustee, most courts look to whether the operating agreement constitutes an executory contract. Where the operating agreement is executory, § 365 will require the trustee to promptly cure any existing default or risk forfeiting the debtor's interest.[2] "[I]f there are no material obligations that must be performed by the members..., then the contract is not executory and is not governed by Code § 365." *In re Ehmann*, 319 B.R. 200, 205 (Bankr. D. Ariz. 2005); See Also *In re Garrison-Ashburn, L.C.*, 253 B.R. 700, 708-09 (Bankr. E.D. Va. 2000) (finding that operating agreement was not executory where it contained no obligation to provide additional capital, no obligation to participate in management, and no obligation to provide personal expertise or service to the company).

Additionally, in mutli-member cases, regardless of whether or not the operating agreement is executory, support exists for enforcing restrictions on the transfer of a debtor's management rights. *See In re Albright*, 291 B.R. 538 (Bankr. D. Colo. 2003). The limited liability company was originally created to provide "tax benefits akin to a partnership and limited liability akin to the corporate form." *Elf Atochem North Am. Inc. v. Jaffari*, 727 A.2d 286, 287 (Del. 1999). In addition to being taxed like a partnership, LLCs generally have partnership-like restrictions on the transfer of ownership, particularly the transfer of management rights.[3] *Id.*; *See also, Milford Power Co. v. PDC Milford Power, LLC*, 866 A.2d 738 (Del. Ch. 2004); *In re Albright*, 291 B.R. at 540, n. 7. As one bankruptcy court has stated, "[such restrictions exist] to protect other members of an LLC from having involuntarily to share governance responsibilities with someone they did not choose, or from having to accept a creditor of another member as a co-manager." *In re Albright*, 291 B.R. 538 (Bankr. D. Colo. 2003); *But see In re Ehmann*, 319 B.R. 200 (Bankr. D. Ariz. 2005). Therefore, where the debtor is one of multiple members to an LLC, a bankruptcy trustee may be prevented from exercising or selling the debtor's management rights, in an effort to protect the non-debtor members.

In contrast, bankruptcy courts are unlikely to enforce transfer restrictions on a member's economic interest. Commonly, operating agreements will require unanimous consent of the other members in order for a member to transfer his or her membership interest. Such a restriction, if applied to a debtor's economic interest, would "deprive the estate of valuable assets in a way that would offend the Congressional intent behind § 541(c)." *In re LaHood*, 437 B.R. 330, 336 (Bankr. C.D. Ill. 2010). The restriction would allow the non-debtor members to block the sale of the debtor's interest to a third party by simply withholding their consent to any proposed sale, effectively cornering the market for the debtor's interest by making themselves the only viable purchasers. Such actions would prevent the estate from realizing the value of the debtor's economic interest, and if allowed, would mean an effective forfeiture of the debtor's interest to the non-debtor members at the expense of the debtor's creditors.

[2] The *Albright* Court noted, however, that such executory-contract provisions will not "create an asset shelter for clever debtors. To the extent a debtor intends to hinder, delay or defraud creditors through a multi-member LLC with 'peppercorn' co-members, bankruptcy avoidance provisions and fraudulent transfer law would provide creditors or a bankruptcy trustee with recourse." *Albright*, 291 B.R. at 541, n. 9.

[3] For example, Michigan's LLC Act provides that while an assignment of a membership interest may entitle the assignee to receive distributions, the assignment will not entitle the assignee to participate in the management of the LLC. See MCL § 450.4505.

Similarly, outside of bankruptcy, most state statutes limit an LLC member's personal creditors to an exclusive remedy called a "charging order," derived from partnership law.[4] A charging order is effectively a lien against the debtor's economic interest in the LLC, such as the debtor's future distributions. The exclusive charging order remedy serves to protect the "autonomy of the original members, and their ability to manage their own enterprise." *In re Albright*, 291 B.R. 538, 540 (Bankr. D. Colo. 2003). While it is beyond the scope of this article, one could argue that, under *Butner v. United States*, 440 U.S. 48, 55 (1979), the exclusive charging order remedy should also apply in bankruptcy, and even in cases where the debtor is the sole member. In *Butner*, the Supreme Court stated that the "uniform treatment of property interests by both state and federal courts within a state serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'" *Id.* Interestingly, looking only at the statutory language, Michigan's charging-order remedy may be interpreted to apply even against creditors of an LLC's sole member.

SUMMARY

In summary, a debtor's membership interest will become property of the bankruptcy estate despite any conflicting state or contract law provisions. Additionally, most bankruptcy courts addressing the issue hold that if the LLC's operating agreement is not an executory contract under bankruptcy law, then the restrictions generally applicable to a member's interest under state and contract law will not apply to a bankruptcy trustee.

However, in the vast majority of multi-member cases, the only realistic market for the debtor's interest will be the non-debtor members, regardless of whether the operating agreement constitutes an executory contract. In any event, the above concepts should be considered by counsel to any interested party whenever an LLC member is considering bankruptcy, or has already filed bankruptcy.

[4] Michigan's LLC Act contains a charging order provision at MCL 450.4507.

JUDGE DALES'S PROCEDURES GOVERNING LIVE TESTIMONY DURING MOTION DAY HEARINGS (FED. R. BANKR. P. 9014(e))

Honorable Scott W. Dales
United States Bankruptcy Judge, Western District of Michigan

To avoid confusion, delay, and unnecessary expense, and to comply with Fed. R. Bankr. P. 9014(e), effective on and after June 1, 2012, the following procedures will apply in matters assigned to the Honorable Scott W. Dales:

1. Except as otherwise provided herein, any hearing scheduled on the court's regular motion day shall not be conducted as an evidentiary hearing, and the court will not permit witnesses to testify except in the form of affidavit or solemn declaration as contemplated in Fed. R. Civ. P. 43(c) and 28 U.S.C. § 1746.

2. The following hearings scheduled on the court's regular motion day may be conducted as evidentiary hearings at which each party shall be prepared to proceed with witnesses in attendance and other evidence:

    a. Matters with respect to which the court has entered an order or hearing notice expressly advising parties that the hearing will be a full evidentiary hearing at which witnesses will be allowed to testify in person;

    b. Final hearings on motions for relief from stay, as contemplated in LBR 4001-1(c);

    c. Motions to continue the automatic stay under 11 U.S.C. § 362(c);

    d. Motions for authority to sell, use or lease property under 11 U.S.C. § 363 (including cash collateral), or to obtain credit under 11 U.S.C. § 364;

    e. Motions for injunctive relief under Fed. R. Civ. P. 65;

    f. Motions to convert under 11 U.S.C. § 1112(b); and

    g. Chapter 11 confirmation hearings.

3. Any party who seeks an exception to the procedure described in Paragraph 1 shall, at least 14 days in advance of the hearing: (1) consult with opposing parties regarding the need for live testimony, in order to seek consensus; and (2) file a written request, on notice to opposing parties, for an evidentiary hearing, which may result in a telephone conference with the court regarding the need for evidence and the nature of the hearing.

4. Nothing in these procedures, including the use of affidavit or solemn declaration, shall abridge a party's cross-examination rights, if asserted, or preclude the court from adjourning any motion for a full evidentiary hearing as appropriate.

5. Nothing in these procedures shall preclude interested parties from consenting to the court's hearing testimony from a witness at a hearing on the court's regular motion day, or from seeking an adjournment of an evidentiary hearing, subject to court approval.

Everybody Take A Deep Breath And RadLAX
A Summary of the Supreme Court's Opinion in the *RadLAX* Case

Benjamin M. White
Keller & Almassian, PLC

On May 29, 2012, the U.S. Supreme Court issued its opinion in *RadLAX Gateway Hotel, LLC, et al. v. Amalgamated Bank* with regard to "credit bidding." "Credit bidding" allows a secured creditor to bid for assets up to the amount the secured creditor is owed, without having to pay cash for the assets.

The decision resolved a split between the Circuits: compare *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010) (confirming a plan of reorganization that prevented credit bidding) to the *RadLAX* case, decided as *River Road Hotel Partners, LLC, et al. v. Amalgamated Bank*, 651 F.3d 642 (2011) (rejecting proposed bidding procedures that precluded the secured creditor from credit bidding).

In an 8-0 decision, the Supreme Court held that a secured creditor has a right to credit bid its secured debt under a Chapter 11 plan that calls for the sale of the secured creditor's collateral. Section 1129(b)(2)(A) of the Bankruptcy Code requires that if a secured creditor objects to a Chapter 11 plan, the creditor must receive "fair and equitable" treatment. That Section further provides that "fair and equitable" means that a secured creditor must (i) retain its lien and receive deferred cash payments, (ii) be entitled to credit bid at a sale of its collateral, or (iii) receive the "indubitable equivalent" of its claim.

In *RadLAX*, the debtor attempted to sell its assets—the secured creditor's collateral—without allowing the secured creditor to credit bid, to pay the sale proceeds to the secured creditor, and to cram down the proposed treatment over the secured creditor's objection. The debtor argued that such treatment constituted the "indubitable equivalent" of the secured creditor's claim.

The Supreme Court held that even though 1129(b)(2)(A)(iii) permits a plan to provide a secured creditor with the "indubitable equivalent" of its claim, when a plan proposes to sell a secured creditor's collateral, the plan must allow the secured creditor to credit bid under 1129(b)(2)(A)(ii), which incorporates 363(k).

"Page 13" is dedicated to Chapter 13 bankruptcy practice and issues. The columns are contributed by the offices of Barbara P. Foley and Brett N. Rodgers, the Chapter 13 Trustees for the Western District of Michigan.

In re Seafort:

An analysis of the 6th Circuit's Decision in In re Seafort, 669 F.3d 662 (6th Cir. 2011)

By Barbara P. Foley
Chapter 13 Trustee, Kalamazoo, Michigan

In In re Seafort, 669 F.3d 662 (6th Cir. 2011), the Sixth Circuit Court of Appeals addressed whether funds which become available after repayment of retirement loans constitute disposable income which must be committed to the plan, or alternatively, whether the funds are protected under Section 541(b) as funds committed to the retirement account of the debtors? The Seafort court held that the available funds constitute disposable income.

Both debtors in Seafort were repaying qualified retirement loans that would be paid off prior to completion of their Chapter 13 plan. The plan, however, did not provide for any "step-up" in payments upon repayment of the loans. The chapter 13 Trustee objected to confirmation of the plan on the grounds that the plan failed to provide for payment of all disposable income, i.e. the "step-up" amounts.

The Court's analysis begins with a review of 11 USC 1322(f), which provides that "[a] plan may not materially alter the terms of a loan described in section 362(b)(19) and *any amounts required to repay such loan shall not constitute 'disposable income' under section 1325.*" (emphasis added). Therefore, retirement loan repayment is clearly allowed.

Next, the Court's analysis moved to the interplay between Sections 541 and 1306. While Section 541 describes the bankruptcy estate in general , Section 1306 expands that description for chapter 13 cases. However, two provisions appear to conflict: 541(b)(7) and 1306(a)(2).

Section 541(a) is the inclusive provision that generally defines property of the estate. As interpreted by the Seafort court, section 541(b) removes certain assets from the estate. In particular, 541(b)(7) removes from the estate "any amount (A) withheld by an employer from the wages of employees for payment as contributions to …. " retirement accounts, and further excludes amounts "… (B) received by an employer from employees for payment as contribution (i) to…" a retirement account. In Seafort, the debtors argued that section 541(b)(7) removes from the chapter 13 estate payments to a retirement account.

Such an interpretation, though, is seemingly at odds with section 1306, which provides that a chapter 13 bankruptcy estate includes all earnings for services performed by the debtor after commencement of the case, i.e., future income, but without reduction by retirement contributions. *See* Section 1306(a)(2).

Seafort resolves this apparent conflict. According to Seafort, at the commencement of the case, 541(a) defines the bankruptcy estate while 541(b) removes from this estate certain assets. That is, 11 USC 541(b)'s removal from the estate is contingent on 11 USC 541(a)'s inclusion. Specifically regarding 541(b)(7), to the extent the employer holds debtor's retirement account at the commencement, the Seafort court indicated these funds are neither an asset of the estate nor disposable income.

11 USC 541 defines assets of the estate at commencement of the case; 11 USC 1306 defines assets of the estate after commencement. Future income is included in 1306, not 541(a). Since 11 USC 541 (b) cannot exclude from the estate what is not given in 11 USC 541(a), 541(b) cannot be used to exclude the future on-going retirement contributions from the estate. Interestingly, there is no corresponding limitation in 11 USC 1306 for on-going debtor contributions to debtor's retirement accounts. Also significant to the Court was the absence of an exclusion from disposable income for on-going debtor contributions to the debtor's retirement account in 11 USC 1322. Thus, the Seafort court found the

funds available after the retirement account loans were paid in full were disposable income payable to the chapter 13 estate.

The practice here in the Western District of Michigan is to increase the chapter 13 plan payments if the 401k loan is paid in full during the course of the chapter 13. That issue, regardless of the theory used, appears to be well settled. The question then becomes what is the nature of the funds committed to the retirement account of the debtor not for loan repayment? Based on Seafort, it can be argued the retirement account payments are disposable income.

Brett N. Rodgers, Chapter 13 Trustee

2011 Tax Return Program

Bill Anderson,
Controller/Operations Manager

I want to take this time to explain how the Trustee's office is handling the annual review of tax returns for 2011. Every year it has been our intent to quickly and efficiently process over 1,000 tax returns. I met with the Trustee and some of our staff after reviewing the results of last year's tax program. As a result, we have made some significant changes to help expedite the program and not have it drag out until Christmas!

A letter was sent out in early January to all debtors who were required to turn in their annual Federal, State, and local tax returns (if applicable) to the Trustee's office at the same time they were filed with the taxing authorities. The letter explained that failure to provide this information and/or submit tax refunds to the Trustee's office would result in a motion to dismiss the debtor's case. It is important for any debtor who has not yet turned in their tax returns and tax refunds to the Trustee's office to do so right away since the deadline to file the State and Federal tax returns has already passed.

The Trustee's office will soon be filing motions to dismiss cases for any debtor who has yet to turn in their tax returns. If the debtor will be filing an extension using Form 4868 to submit their tax returns by October 15, 2012 a copy of that form must be sent to the Trustee's office right away. Doing this will eliminate the need for our office to file a motion to dismiss the debtor's case for failure to turn in their tax returns.

The letter also mentioned that all tax refunds required to be paid in by the Plan must be submitted to the Trustee's office. If the debtor does not turn in their tax refunds as required by their Plan, a motion will be filed to dismiss the case for failing to submit all disposable income.

Perhaps the most noticeable difference in the Trustee's 2011 tax return program is the handling of disposable income issues. In the past, it was our practice to calculate the disposable income for a debtor based on the income noted on the tax return compared to Schedule I. We reviewed the Plan, any amendments, Schedule J expenses, median income, plan payment, base amount to be paid to unsecured creditors, stipulations and motions increasing plan payments and/or base amounts due to disposable income from past tax years, and any other unusual situations brought to the Trustee's attention. We also subtracted any taxes owed by the debtor to the Federal, State, or local governments from the gross disposable income amount when arriving at a potential disposable income amount.

After calculating the disposable income, a letter was sent to the debtor and their attorney with a stipulation outlining the changes. In over 60% of the cases, the stipulations were either not returned to the Trustee's office in a timely basis or the stipulation was not answered at all. In many cases the negotiation period ran far too long. Ultimately, we would file a motion to modify the debtor's plan which would take several more weeks or months to be heard by the Court. The entire process of processing disposable income issues dragged on for months. The Trustee felt this was unfair to all parties in interest so the Trustee decided to streamline the process this year as follows.

For the 2011 tax return year, the Trustee's office is still going through our due diligence of reviewing the debtor's plan, amendments, Schedule J expenses, etc. as noted above. The difference this year is that the Trustee's office is filing a motion to dismiss the case for failure to pay in disposable income based on the example noted below.

Debtor has a family of four and earned $87,000 per the 2011 tax return compared to Schedule I amount of $75,000 which equals $12,000 more gross disposable income. After our review of the case we determine that the $12,000 figure <u>is</u> disposable income. We use an overall tax rate of 30% and multiply $12,000 by 70% to yield a <u>net yearly</u> disposable income amount of $8,400. This $8,400 figure divided by 12 months equals a monthly plan payment increase of $700 per month. We file a motion to dismiss the debtor's case based upon the debtor's failure to turn over the additional $700 per month of net disposable income earned in 2011.

If we receive a response to this motion to dismiss that indicates a disagreement with disposable income amount, the Trustee will consider any new or unique circumstances of the debtor including, but not limited to, major car repairs, significant health expenses, or large home repairs (to name a few) not included in Schedule J but verified later by the debtor. The Trustee will be open to negotiating a lower monthly plan payment if mitigating circumstances are verified.

In closing, the Trustee and staff want to thank all of you for giving your best effort in keeping your clients focused on completing their Chapter 13 plan. It remains a pleasure to work with you and your staff.

CASE SUMMARIES AND LEGAL UPDATES

Thanks to Greg J. Ekdahl of Keller & Almassian, PLC for his assistance in preparing the Case Summaries.

Case Summaries

In re MQVP, Inc., 2012 WL 1233019 (6th Cir. 2012) (Unpublished).

This case arose out of a Chapter 7 bankruptcy proceeding, converted from a Chapter 11, involving debtor MQVP, Inc. Before conversion, MQVP had been litigating two separate lawsuits alleging trademark infringement. The Chapter 7 trustee sought approval of a settlement resolving both suits. Two creditors objected to the proposed settlement on the grounds that the trustee had not met his burden of showing the settlement was reasonable. The issue on appeal was whether the bankruptcy court had abused its discretion in approving the settlement. The bankruptcy court approved the settlement, and the district court affirmed. The 6th Circuit stated that "[w]hen determining whether to approve a proposed settlement, the bankruptcy court may not rubber stamp the agreement or merely rely upon the trustee's word that the settlement is reasonable. Rather, 'the bankruptcy court is charged with an affirmative obligation to apprise itself of the underlying facts and to make an independent judgment as to whether the compromise is fair and equitable. The Court further stated that bankruptcy courts should consider the four *Bard* factors in analyzing settlements: (a) the probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises. (citing *In re Bard*, 49 F. App'x 528, 530 (6th Cir. 2002)). The Court ultimately affirmed, holding that the bankruptcy court had not abused its discretion.

Mains v. Foley, W.D. Mich, Case nos. 1:11-CV-456 and 1:11-CV-740.

Retired Debtors filed chapter 7 in 2009. The Court found the 7 filing reflected abuse under 11 USC 707(b)(3). The Debtors converted to chapter 13. The Debtors Scheduled income resulted in a net monthly surplus of $1,339.30 available after expenses. $2,905.00 of this amount was attributable to social security benefits. The total available surplus would have paid Debtors' creditors in full in 30 months. Instead, Debtors proposed paying creditors $324 per month over a 36 month period, resulting in a 5% dividend. Debtors argued that the Social Security benefits should be excluded from the good faith analysis under 1325(a)(3). The Bankruptcy Court disagreed, finding that Social Security benefits are excluded from the objective 1325(b) analysis, but are relevant to the subjective 1325(a)(3) good faith analysis. Bankruptcy Court dismissed the case and placed a 3 year bar on re-filing, absent a satisfactory good faith showing. Debtors appealed the dismissal and the 3 year bar.

The District Court upheld the dismissal, finding that courts may consider Social Security benefits in evaluating subjective good faith under 1325(a), even though it may not do so in applying the objective disposable income test of section 1325(b) because "it is entirely possible for a debtor to satisfy the objective test . . . while at the same time leaving ample factual basis upon which to find a subjective lack of good faith. The District Court did, however, vacate the lower court's three year ban on re-filing, finding that, though the question was close, "our common law process depends on robust engagement of the issues, and an extreme sanction of closing the courthouse doors for three years ought to be reserved for only the most extreme sorts of misconduct that distort the litigation process through lying, cheating or other abuses, rather than for advancing legal theories that have support in law but are simply rejected on the merits."

In re Hight, 670 F.3d 699 (6th Cir. 2012).

The Debtor filed a voluntary Chapter 13 petition on January 28, 2009. On April 8, 2009, the Debtor filed her State income tax return, which indicated she owed the State $4,900.00 for the 2008 tax year. The State did not file a proof of claim for the 2008 tax debt. On July 17, 2009, the Debtor filed a proof of claim on behalf of the State to ensure the tax debt would be paid through the Chapter 13 plan. The State objected on the grounds that the 2008 tax debt constituted a post-petition claim under section 1305, which gives only the creditor the option of filing the claim. The Bankruptcy Court and the District Court had overruled the State's objection. The 6th Circuit Court affirmed, holding that while section 1305 permitted a creditor to file a proof of claim, it did not exclude other means of allowing post-petition claims, and so the debtor was permitted to file the proof of claim for the State under section 502(i).

Legal Updates

- The American College of Bankruptcy (ACB), in cooperation with the Biddle Law Library at the University of Pennsylvania, has made available the National Bankruptcy Archives, which collects historical material regarding the development of bankruptcy.

- The US House of Representatives passed HR 4967 by unanimous consent to allow temporary bankruptcy court judgeships to be refilled if there is a vacancy in the next five years. The Senate passed similar legislation in April (HR 1021). Congress has not created new bankruptcy judgeships since 2005.

- Total bankruptcy filings in the United States decreased 12 percent in the first calendar quarter (Jan. 1—March 31) of 2012 from the same period in 2011.