Federal Bar Association – Bankruptcy Section Newsletter

Fall 2017

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News & Announcements

HOLIDAY PARTIES

The Bankruptcy Section annual holiday parties begin **November 30**. Please see attached flier for more details.

COURT CLOSURE ON NOVEMBER 24, 2017 AND DECEMBER 26, 2017

The court will be closed for business and inaccessible on Tuesday, December 26, 2017. In accordance with Federal Rule of Bankruptcy Procedure 9006(a)(3), filings due on that day will be deemed timely if filed on the next regularly scheduled business day.

EIGHTH ANNUAL DEBTORS BAR CONFERENCE

The Eighth Annual Debtors Bar of Michigan Winter Conference will be held on Monday, January 15, 2018, at Grand Valley State University, L.V. Eberhard Center in Grand Rapids. Attached please find a flier with details regarding registration.

UPCOMING AMENDMENTS TO RULE 3002

Please see attached letter from Judge Dales regarding the upcoming amendments to Fed. R. Bankr. P. 3002.

JOINT FBA-TMA EVENT SERIES IN 2018

The Bankruptcy Section will be working with the West Michigan Chapter of the Turnaround Management Association to produce an event series in 2018. The series will include discussions with local judges and professionals in private practice from a variety of disciplines regarding uncommon and unique issues involving risk and insolvency. More information to follow.

BANKRUPTCY SECTION WEBSITE

For more information and announcements, please visit the Bankruptcy Section's website – www.fbabankruptcy.com

BANKRUPTCY ESTATE(S) IN JOINT SPOUSE FILINGS YOURS, MINE OR OURS?

HAROLD NELSON
RHOADES MCKEE

Section 302 of the Bankruptcy Code governs the bankruptcy estates created in a joint spouse case. That section reads:

> **11 USC § 302. Joint cases**
>
> (a) A joint case under a chapter of this title is commenced by the filing with the bankruptcy court of a single petition under such chapter by an individual that may be a debtor under such chapter and such individual's spouse. The commencement of a joint case under a chapter of this title constitutes an order for relief under such chapter.
>
> (b) After the commencement of a joint case, the court shall determine the extent, if any, to which the debtors' estates shall be consolidated.

The result of § 302 is that there is a bankruptcy estate created for each individual spouse unless the two estates are consolidated.

> Nor is there anything in § 302 to suggest the filing of a joint case by husband and wife, as two debtors, results in the creation of only one bankruptcy estate under § 541. To the contrary, § 302(b) permits the Bankruptcy Court to determine to what extent, if any, the two bankruptcy estates should be consolidated. Until such time as the Bankruptcy Court has been asked to substantively consolidate the estates of these two Debtors and determines to substantively consolidate them, after due notice and process, the two estates of the Debtors remain separate.[1]

The legislative history of the Court explains the purpose of the requirements of § 302 as follows:

> **House and Senate Reports (Reform Act of 1978)**
>
> Subsection (b) requires the court to determine the extent, if any, to which the estates of the two debtors will be consolidated; that is, assets and liabilities combined in a single pool to pay creditors. Factors that will be relevant in the court's determination include the extent of jointly held property and the amount of jointly-owed debts. The section, of course, is not license to consolidate in order to avoid other provisions of the title to the detriment of either the debtors or their creditors. It is designed mainly for ease of administration. (The Reports are identical.)[2]

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[1] *In re Lindstrom*, 331 B.R. 267, 270 (Bkrtcy. E.D. Mich 2005).

[2] HR Rep No. 595, 95th Cong, 1st Sess 321 (1977); S Rep No. 989, 95th Cong, 2d Sess 32 (1978)).

Many Courts describe the purpose of § 302 as being designed for ease of administration and to permit the spouses to pay only one filing fee, but creating two separate bankruptcy estates.[3]

Despite the mandatory directive (the use of the word "shall") in § 302(b), as well as that the legislative history of § 302(b) "requires" the Court make a determination as to the extent to which the separate spousal estates be consolidated, Courts rarely, if ever, *sua sponte* address this issue. Instead, the issue of whether there should be consolidation of spousal estates requires a motion by the debtors, the trustee, creditors, or other parties in interest. Nor do trustees commonly request Courts enter an Order for joint administration for the estates under Fed. R. Bankr. P. 1015. Instead, the separate estates are jointly administered as a matter of course.

Although Schedules A and B required to be filed in bankruptcy cases provide for assets to the designated as joint or applicable to an individual spouse, it is not unusual to find those designation boxes blank. By the same token, Schedules D, E and F often do not designate whether particular claims are joint or applicable to an individual spouse only. The lack of such information makes life difficult for trustees in determining what assets belong to what estate, as well as which claims may be asserted against which estate.

Substantive Consolidation

Some Courts question the ability of the Bankruptcy Court to order substantive consolidation due to certain statements by the Supreme Court in *Law v Siegel*,[4] as well as prior Supreme Court cases regarding the extent of a Court's equitable powers under §105. In the case of joint spouse filings, however, §302(b) clearly contemplates the ability to substantively consolidate two spousal estates and the Court's decision to do so would be well within the confines of the Bankruptcy Code and, therefore, would allow for consolidation.

Even though the Bankruptcy Court may substantively consolidate separate spousal estates, that remedy should be invoked sparingly and the proponent of a substantive consolidation motion bears a burden of proof which is "exacting".[5]

Some Courts have observed that §302(b) does not provide any standards for determining the circumstances under which cases should be consolidated.[6] The lynchpin in making determinations of substantive consolidation is the extent that the financial affairs of the spouses are so intermingled that their respective assets and liabilities cannot be separated.[7]

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[3] *In re Estrada*, 224 B.R. 132 (Bkrtcy. S.D. CA 1998).

[4] 134 S.Ct. 1188, 188 L.Ed. 2nd 146 (2014)

[5] *Reider v Federal Deposit Insurance Corporation (In re Reider)*, 31 F3d 1102, 1109 (11th Circuit 1994); *In re Knobel*, 167 B.R. 436, FN10 (Bkrtcy. W.D. TX 1994) (Courts impose an exacting burden on the party seeking consolidation).

[6] *Chan v Austin Bank of Chicago (In re Chan)*, 113 B.R. 427 (N.D. IL 1990). (Substantive consolidation should be decided on a case by case basis).

[7] *In re Barnes*, 14 B.R. 788, 790 (Bkrtcy. N.D. TX 1981).

It is necessary to examine whether the debtors' financial affairs are so intermingled that it would be difficult to disentangle them; whether it would be unfair to creditors to treat them as separate estates; and, determine an equitable balance of prejudice to the creditors of each estate.[8]

Perhaps the best analysis of the requirements for substantive consolidation is contained in the 11th Circuit's decision in *Reider*, supra. The *Reider* Court noted that consolidation of individual spouses' estates was an issue of first impression in the 11th Circuit and, as a result, analyzed a number of major substantive consolidation actions (all of which involved substantive consolidation of cases that were not joint spouse filings). Ultimately, the *Reider* Court adopted the principles applied in *Eastgroup Properties v Southern Motel Assn., Ltd.*[9]

In applying the *Eastgroup* analysis, the *Reider* Court acknowledged that few decisions have addressed or even discussed substantive consolidation in the context of joint spousal filings. The Court then stated a two part analysis which must be conducted to determine the propriety of substantive consolidation:

1. Whether there is a substantial identity between the assets and liabilities and handling the financial affairs between the debtor spouses; and
2. Whether harm will result in permitting or denying consolidation.

The *Reider* Court test requires a determination of substantial identity and only then must the Court analyze the harm or benefit of a failure to consolidate. For example, where administrative difficulties and disentangling a spouse's estates make it prohibitively expensive or where disentanglement is otherwise impractical, then the moving party must also demonstrate that creditors will be unfairly prejudiced by a failure to consolidate and may interpose the fraud or bad faith of the debtors as a defense. A creditor may also demonstrate that it has relied on the separate credit and assets of one of the spouses and would be harmed by consolidation of the assets.

Examples of Cases Granting or Denying Substantive Consolidation

A. ***Reider***[10]

Mr. and Ms. Reider operated a horse breeding business, Clermont Farms, Inc., using land owned by Ms. Reider. Clermont's primary stud "Mastercard" died. Mr. Reider entered into an Agreement to buy a replacement stud "Magnum P.I.". Clermont borrowed $250,000 from a Florida bank to purchase Magnum P.I., and Mr. Reider personally guaranteed that debt. Clermont's misfortunes continued due to the fact that the seller of Magnum P.I. was a bit of a fraudster, which left Clermont without the funds from the loan and without a horse, resulting in Mr. and Ms. Reider filing bankruptcy. Apparently because misery loves company, the Florida bank failed and was taken over by the FDIC.

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[8] *In re Thomas*, 261 B.R. 848 (Bkrtcy. E.D. VA 2001).
[9] 935 F2d 245 (11th Circuit 1991).
[10] Supra

The Court noted that included on the list of personal assets Mr. Reider tendered to bank officials, was the farmland owned by Ms. Reider, who had inherited the property from her mother. The property was sold by the trustee for $400,000. The property was titled solely in the name of Ms. Reider.

The FDIC contended that the debtors had intermingled funds and had failed to affirmatively set out a breakdown of separate assets and liabilities, such that the assets and liabilities were so intermingled that they could not be separated and, therefore, the estate should be substantively consolidated. The debtors responded by filing a motion to require separate distribution in each estate, along with amended schedules separating the assets and liabilities of the two estates. The Bankruptcy Court ordered the estates to be consolidated and the District Court affirmed. Upon appeal to the 11th Circuit, the *Reider* Court applied the *Eastgroup* Test, reversing the lower courts. It observed that the lower courts' rulings relied upon the actions of the debtors and the debtors' counsel during the bankruptcy proceedings in scheduling the assets and liabilities without separation and in administering the estates jointly. In particular, the Court dismissed the fact that Mr. Reider had listed the property on his personal financial statement, essentially ruling that the bank's reliance on Mr. Reider's financial statement was weak, specifically noting that the bank did not take a mortgage on the real property, nor did it examine the title to the real property which would have clearly shown that the property was owned by Ms. Reider. The Court concluded that the evidence of substantial identity with respect to the assets and liabilities of the debtors was also weak, and the contrary evidence that the real property was separate in fact and readily known to be, the equities favored, Ms. Reider.

It is interesting to note that one of the arguments the FDIC raised was that the trustee had commingled the funds of the two estates. The Court dismissed that contention, finding it clear that the trustee could properly allocate the funds of the two estates.

B. ***In the Matter of Chan***[11]

Mr. Chan's solely owned assets were valued at $8,900. Ms. Chan's solely owned assets were valued at $124,380 and they jointly owned assets valued at $97,020. The Bankruptcy Court found that Mr. Chan had always been the primary wage earner, having earned 77% of the family income for the last five years. Ms. Chan's primary asset was a note receivable in the amount of $100,000, resulting from a loan made to a Mr. Lua. The Bankruptcy Court found that to raise the funds to make the loan, Mr. and Ms. Chan jointly borrowed $100,000 on a home equity line of credit. Because both parties were liable for the $100,000 HELOC debt, the Bankruptcy Court classified the Lua Note as a joint asset. Mr. Chan had individual unsecured debt in excess of $1 Million and the debtors had joint and several liability on a $60,000 note to a bank.

In this case, the bank contested consolidation of the estates because Mr. Chan's debt far exceeded that of Ms. Chan. If Ms. Chan's assets were used to pay Mr. Chan's debts, the bank would receive only 36% of its outstanding indebtedness as opposed to 100% without consolidation. The Bankruptcy Court found that the majority of the Chans' assets were jointly held and that their affairs were so intermingled that they could not be separated. Crucial to that finding was the

[11] Supra

Court's finding that the Lua Note was a joint asset. The District Court affirmed the Bankruptcy Court's Order, but observed that the degree of intermingling and obscurity in the *Chan* case might have supported an order denying consolidation, however, the District Court determined that the Bankruptcy Court decision was not clear error.

C. *In Re Birch*[12]

In this case, the husband's estate had no non-exempt assets for distribution whereas the wife's estate had $50,000 available for distribution. The great majority of the claims filed in the case related to a business operated in the husband's name alone. The wife's individual assets stemmed from a real property interest which she held before the marriage.

Interestingly, in this case, the Bankruptcy Court determined to split the case administratively and directed that separate trustees be appointed for each of the spouse's estates. A prior trustee had filed a motion to determine the extent of consolidation. The debtors objected to any such substantive consolidation.

Apparently, Ms. Birch transferred her real property interest to her father. That resulted in a fraudulent transfer action which was settled. The settlement resulted in $50,000 going into the estate of Ms. Birch.

The business creditors moved for substantive consolidation of the estates. The argument showed that Mr. Birch operated a lumber company as a sole proprietorship and Ms. Birch helped out in that business as her home duties would permit. She did miscellaneous office work and was a signor on business bank accounts, but she took no part in the management of the business and had no particular knowledge or skills relating to the business.

The Court concluded that there was no evidence suggesting that any of the business creditors considered the business as anything other than Mr. Birch's sole proprietorship, or that they were looking to Ms. Birch or her separate property for repayment. The Court noted that all profits from the business went into the debtors' joint personal account and were used for family purposes. The creditors contended that the fact that Ms. Birch profited from the business would support a contention that the assets of the husband were intermingled with those of his wife. The Court rejected that argument and held there was no difficulty determining the separate property of Ms. Birch and that none of the business debtors had asked Ms. Birch to co-sign, or guaranty of the business debts. The Court observed that there was no question that consolidation would not be beneficial to business creditors, but would be beneficial to the creditors having claims in Ms. Birch's estate, and that a surplus may result in Ms. Birch's estate.

D. *In re Hicks*[13]

Ms. Hicks had a pending discrimination lawsuit against a former employer which was settled during the pendency of the bankruptcy case. Ms. Hicks objected to the trustee's final

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[12] 72 B.R. 103 (Bkrtcy. D. NH 1987)
[13] 300 B.R. 372 (Bkrtcy. D. Idaho 2003)

account on the grounds that any recovery from the lawsuit was her separate property. Idaho is a community property state.

The Court held, under Idaho law, the lawsuit settlement proceeds were the separate property of the wife rather than community property. The Court concluded that Ms. Hicks' separate estate would be liable for payment of allowed administrative claims made in her case and for payments of any allowed claims from her separate debts, with any remaining surplus distributed to Ms. Hicks.

E. ***In re Estrada***[14]

This case has a somewhat unusual factual pattern. Mr. Estrada had owned a cleaning business, albeit not a successful one. The Estradas' filed a joint Chapter 7 petition. The case was deemed to be a no asset case and was subsequently closed approximately four months after the petition was filed. Unfortunately, Mr. Estrada died after the case was closed and, unfortunately for Ms. Estrada, her husband's death occurred within 180 days of the filing of the Chapter 7 petition. On a lighter note, however, Mr. Estrada had $550,000 of life insurance with respect to which Ms. Estrada was the beneficiary. Not unexpectedly, the trustee filed a motion to reopen the case. Ms. Estrada brought a motion to bifurcate the joint case and convert her case to one under Chapter 13.

The trustee opposed the request on the grounds of prejudice to the business creditors, contending that the life insurance proceeds are property of the bankruptcy estate and would be sufficient to pay all of both spouses' creditors in full and still leave a surplus for Ms. Estrada. If the estates were separated, however, all of the business creditors' claims will remain unpaid while Ms. Estrada retains most of the life insurance proceeds.

Not unexpectedly, the business creditors contended that Ms. Estrada was liable for partnership debts because she was significantly involved in the day to day operation of the cleaning business. They also argued that the insurance proceeds were community property assets.

The Court first had little trouble finding the life insurance proceeds are not community property, but rather Ms. Estrada's separate property. The Court recited that the standards for substantive consolidation involved whether the affairs of the spouses are so intermingled that the assets and liabilities cannot be separated, and to weigh the economic prejudice that if the estates are separate against the economic prejudice of consolidation. Ultimately, the Court concluded that it is to determine what equity requires – often a nebulous analysis. The Court concluded that the business creditors failed to show they would suffer prejudice from maintaining the separate estates in that it would have no effect on their substantive rights. It observed that creditors who believe that Ms. Estrada's involvement in the cleaning business would render her liable for the business debts, could file a claim in Ms. Estrada's case, and she could in turn object to those claims.

The Court denied substantive consolidation and although it struggled with the unusual request, did allow Ms. Estrada to convert her case to a Chapter 13.

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[14] Supra

F. ***In re Chandler*[15]**

This a Chapter 13 case filed by Mr. and Mrs. Chandler. They filed a Plan which proposed to pay joint creditors in full, while paying only 9.6% to their individual unsecured creditors. The issue before the Court was whether the debtors' Plan met the liquidation test requirements of §1325(a)(4). The Chandlers had three joint claims totaling approximately $11,500, which their Plan proposed to pay in full with interest at 7% per annum. The debtors' individual creditors, totaling approximately $60,000, would receive an estimated dividend of 9.6%. The Court concluded that the liquidation test had been met for the reason that there had been no substantive consolidation of the two estates and, therefore, under North Carolina law, each debtor could claim their interest in entireties property as exempt and those interests would not be subject to individual claims against one spouse.[16]

Issues in Determining Value of Separate Estates

As reflected in this article, the "default" status of a joint spouse filing is that there are two separate estates. What burden does the trustee have in determining the amount of the separate estates?

For example, it is not unusual for joint spouse debtors to have joint bank accounts, which typically would be reflected as being a joint asset. Indeed, there is a presumption under Michigan law with respect to two spouse joint accounts that one-half of the funds in the joint account would be the property of one spouse and the other half property of the other spouse.[17] The problem is that presumption is rebuttable by showing a disparity in the amount each account holder supplied to the balance of the account. If there is only one working, income-generating spouse, would the trustee be required to allocate the entire balance of the joint account to that spouse's separate estate?

This issue may come up with respect to exemptions claimed. If both spouses apply their §522(d)(5) exemptions to the joint account, it would seem to be incumbent upon the trustee to object to the exemptions if he or she has reason to believe that all of the funds in the account were contributed by one of the two spouses. In such a situation, only the funding spouse would be entitled to use his or her available exemptions toward the account.

Another example is with respect to tax refunds paid pursuant to a joint return filed by spouses. In *In re Gazvoda*[18], Judge Harris dealt with a situation where one spouse in a joint spouse case was the sole wage earner and the only one whose earnings were over-withheld for taxes (the other spouse being self-employed and thus paying no withholding). The Court held only the wage earning spouse could claim an exemption in the tax refund. By analogy, any pending tax refund

[15] 148 B.R. 13 (Bkrtcy. B.D. NC 1992)
[16] *But s*ee *In re Raynard*, 327 B.R. 623 (Bkrtcy. W.D. MI 2005).
[17] *In re Demeter*, 539 B.R. 760, 765 (Bkrtcy. E.D. MI, 2015).
[18] 2011WL 2946171 (Bkrtcy. N.D. OH 2011)

would have to be allocated to the separate estates based on the withholdings of the joint filing spouses.

These issues, and others, may place yet another burden on trustees to promptly review and object to exemptions.

Conclusion

Trustees need to be cognizant of the burdens that are bestowed upon them due to the separate estates in joint spouse filings. Moreover, trustees, debtors, creditors and their attorneys need to evaluate how maintaining separate estates versus substantive consolidation would impact their interests.

How Can Debtors Afford Not to Pay Post-Petition Continuing Mortgage Payments through the Chapter 13 Trustee, Particularly in Light of Fed. R. Bankr. P. 3002.1?

Elizabeth Clark
Staff Attorney for Brett N. Rodgers, Chapter 13 Trustee

When the question of "Why don't you pay your mortgage payment through the Chapter 13 trustee?" is posed to a debtor, the resounding response by almost every debtor is that he/she simply cannot afford the trustee fee associated with the ongoing mortgage payment. While such a response seems plausible at first blush, the deeper this issue is analyzed, the more appropriate question should be "How can debtors not afford to pay their ongoing continuing mortgage payments through the Chapter 13 trustee?" Simply put, the benefits of such payments through the Chapter 13 trustee significantly outweigh any minimal cost placed upon a debtor.

One of the most obvious benefits in debtors choosing the Chapter 13 trustee as their disbursing agent for their ongoing mortgage payments that has been recited time and time again is the fact that debtors who propose to pay their continuing mortgage payment through the Chapter 13 trustee are invariably faced with less motions for relief from the automatic stay under section 362[19] from mortgagees than those debtors who propose to make their continuing mortgage payments direct. The Chapter 13 trustee will initiate a motion to dismiss the Chapter 13 proceeding under section 1307[20] if debtors fall behind on their Chapter 13 plan payments by two months, which allows debtors time to cure the payment deficiency and places debtors in a position where they can remain on track with their mortgage payments to avoid the filing of any motion for relief from the automatic stay in the first instance. In contrast, debtors who propose to make their continuing mortgage payments directly to a mortgagee place themselves at the hands of the mortgagee who may choose to file a motion for relief from the automatic stay well beyond the two-month mark of missed payments, at which point debtors' attempt at keeping their home may be lost. Allowing debtors the opportunity to recover from a two month deficit in plan payments and thus continuing mortgage payments through the Chapter 13 trustee, as opposed to placing debtors in a position to challenge and defend a more substantial deficit in continuing mortgage

[19] 11 U.S.C. § 362.
[20] 11 U.S.C. § 1307.

payments being paid direct to the mortgagee, increases the likelihood that debtors will retain their home and successfully complete all of their obligations under their confirmed Chapter 13 plan.

Moreover, in the instance a mortgagee chooses to file a motion for relief from the automatic stay in a case where a debtor proposes to make his/her continuing mortgage payment through the Chapter 13 trustee, a debtor is able to rely upon the trustee's disbursement records, which would include such detailed information as the check numbers and amounts, check disbursement date, and the dates the checks were cashed, in his/her defense to the motion. Conversely, a debtor who proposes to pay his/her continuing mortgage directly to the mortgagee is left to his/her own records, which presumably lack the same organization and detail as the trustee's records, in defense of a motion for relief from the automatic stay.

What happens if a mortgagee chooses not to file a motion for relief from the automatic stay during the pendency of the Chapter 13 case but rather waits to raise the issue of nonpayment in the context of Fed. R. Bankr. P. 3002.1? This unsettling situation is one that a number of courts currently face, and it is starting to threaten debtors' chances of obtaining a Chapter 13 discharge under section 1328(a).[21]

The more troublesome risk currently facing debtors who propose to make their continuing mortgage payments direct to the mortgagee is the risk that if they falter on their post-petition continuing mortgage payments directly to the mortgagee, their overall Chapter 13 discharge pursuant to section 1328 could be denied. There is an emerging trend that is taking place in the context of Fed R. Bankr. P. 3002.1 which was succinctly acknowledged and stated by the bankruptcy court in *Hoyt-Kieckhaben*[22] when it stated: "[i]n the past year, however, this Court and others within this district have seen a new and disturbing trend emerge in chapter 13 cases. At the conclusion of the three- or five-year plan, the lender objects on the basis that it has not received the Direct Payments from the debtor, often over a substantial portion of the plan's term".[23] Debtors are now faced with the sobering realization that even if they have submitted all of their plan payments to the trustee, if they have failed to maintain their continuing mortgage payments directly to the mortgagee, their entire Chapter 13 discharge could be denied. Before delving into the recent trend of cases discussing this particular issue, it's imperative to first look to the precise wording of section 1328(a), which in pertinent part, reads: "Subject to subsection (d), as soon as practicable after completion by the debtor of all *payments under the plan,* . . . the court shall grant the debtor a discharge of all debts provided for by the plan . . . ."[24]

In determining whether payments required to be made directly to creditors under a confirmed plan constitute "payments under the plan" as used in the wording of section 1328(a), an overwhelming number of courts have concluded that direct payments do in fact constitute "payments under the plan" under section 1328(a).[25] Thus, if a debtor fails to maintain direct

[21] 11 U.S.C. § 1328(a).

[22] *In re Hoyt-Kieckhaben,* 546 B.R. 868 (Bankr. Colo. 2016).

[23] *Id.* at 870.

[24] 11 U.S.C. § 1328(a) (emphasis added).

[25] *See, e.g., In re Gonzales,* 532 B.R. 828 (Bankr. Colo. 2015); *Evans v. Stackhouse,* 564 B.R. 513 (E.D. Va. 2017); *In re Hoyt-Kieckhaben,* 546 B.R. 868 (Bankr. Colo. 2016); *In re Formaneck,* 534 B.R. 29 (Bankr. Colo. 2015); *In re Heinzle,* 511 B.R. 69 (Bankr. W.D. Tex. 2014).

mortgage payments to the lender, a failure of which may not be detected until the end of a Chapter 13 plan term, he/she has failed to complete "all payments under the plan" under section 1328(a), and his/her Chapter 13 discharge could be denied. While these courts were specifically dealing with the "cure and maintain" provision of section 1322(b)(5)[26] because a pre-petition mortgage arrearage existed at the time of filing, their holdings arguably are not merely limited to a "cure and maintain" mortgage under section 1322(b)(5) as is evidenced by the statements made by these courts. A direct payment is a payment "under the plan" in the "sense that they are dealt with by the Plan".[27] In applying a straightforward reading of the Code, the court in *Hoyt-Kieckhaben* construed "payments under the plan" as being payments that are "made pursuant to the provisions or terms of a plan or are dealt with by a plan".[28] Hence, even in cases where a pre-petition arrearage does not exist at the time of filing and attempted to be cured by a debtor pursuant to section 1322(b)(5), a debtor's Chapter 13 discharge could still be denied if he/she failed to directly maintain his/her ongoing mortgage payment to the mortgagee throughout the entire Chapter 13 proceeding. If the wording of section 1328(a) has not been altered in recent years, why are courts now seeing a recent trend in cases where a debtor's Chapter 13 discharge could be denied for the debtor's failure to make direct payments on their post-petition continuing mortgage obligations? That is where Fed. R. Bankr. P. 3002.1(f) comes into play.

With the enactment of Fed. R. Bankr. P. 3002.1(f), which states that "[w]ithin 30 days after the debtor completes all payments under the plan, the trustee shall file and serve on the holder of the claim, the debtor, and debtor's counsel a notice stating that the debtor has paid in full the amount required to cure any default on the claim," debtors' failures to make post-petition continuing mortgage payments directly to the lender that once went undetected are now brought to light in front of the court, the trustee, and other creditors of debtors' Chapter 13 bankruptcy estate. Once the trustee (or the debtor) files the notice under Fed. R. Bankr. P. 3002.1(f), the holder of the mortgage debt is required pursuant to Fed. R. Bankr. P. 3002.1(g), within 21 days after service of the notice in Fed. R. Bankr. P. 3002.1(f), to "file and serve on the debtor, debtor's counsel, and the trustee a statement indicating (1) whether it agrees that the debtor has paid in full the amount required to cure the default on the claim, and (2) whether the debtor is otherwise current on all payments consistent with section 1322(b)(5) of the Code."[29] Hence, because the holder of a mortgage is required to respond to the notice under Fed. R. Bankr. P. 3002.1(g) and indicate whether debtor is current on post-petition continuing mortgage payments, the court, the trustee, and other creditors are now aware of debtors' failure to complete all payments under the plan. This realization could prompt any of those entities to seek denial of a debtor's discharge under section 1328(a). Particularly in light of the enactment of Fed. R. Bankr. P. 3002.1, why would debtors place their overall Chapter 13 discharge at risk in order to pay their post-petition continuing mortgage payments directly to their mortgage? "Gambling with a Chapter 13 discharge is a risky proposition, particularly where a material default is discovered in month fifty-eight of a confirmed Chapter 13 plan"[30]

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[26] 11 U.S.C. § 1322(b)(5).
[27] *Evans v. Stackhouse,* 564 B.R. at 519 (citing *In re Hankins,* 62 B.R. 831, 835 (Bankr. W.D. Va. 1986)).
[28] *In re Hoyt-Kieckhaben,* 546 B.R. at 871.
[29] Fed. R. Bankr. P. 3002.1(g).
[30] *Formaneck,* 534 B.R. at 30.

What are the actual costs placed upon debtors who choose to make their post-petition continuing mortgage payments through the Chapter 13 trustee? In most cases, there isn't any cost placed upon debtors. In the majority of Chapter 13 cases, the monthly trustee fee that is associated with the post-petition ongoing mortgage payments essentially comes out of the pocket of debtors' general unsecured creditors. For example, if a trustee fee is 5% and a post-petition continuing mortgage payment is $1,000.00 per month, the trustee fee associated with that continuing mortgage payment over a sixty-month period would amount to $3,000.00. If debtors' general unsecured creditors stood to receive $20,000.00 from debtors' projected disposable income over that same sixty-year period without the continuing mortgage payment paid through the trustee, they instead would stand to receive the amount of $17,000.00 if the continuing mortgage was to be paid through the Chapter 13 trustee. While this remains the case in the majority of cases, as is the case with nearly any general rule, there are exceptions. One exception would be a Chapter 13 case in which there is a Chapter 7 liquidation base amount to general unsecured creditors required under section 1325(a)(4)[31] **and** debtors' current plan payment does not satisfy this Chapter 7 liquidation amount until the thirty-sixth or sixtieth month under the plan, whichever is applicable. In those limited and rare cases, the debtors would then have to increase their plan payment by both the continuing mortgage payment and the associated monthly trustee fee. Another limited exception would be a case where the stated payment to general unsecured creditors under the confirmed Chapter 13 plan with an applicable commitment period of thirty-six months places debtors' projected plan length at or above thirty-six months at the proposed Chapter 13 plan payment without the continuing mortgage payment and the associated trustee fee. In those cases, the trustee's 5% fee would place a minimal cost upon such debtors should they elect to make their continuing mortgage payment through the Chapter 13 trustee.

While a minimal cost exists in the minority of cases for debtors who choose to make their continuing mortgage payments through the Chapter 13 trustee, the minimal cost is nonexistent in the majority of cases. Moreover, the likelihood that debtors could falter in maintaining their continuing mortgage payments directly to the mortgagee without the supervision and monitoring of the Chapter 13 trustee puts their entire Chapter 13 discharge at risk. Thus, at the end of the day, the question that should be posited to any debtor who insists on making their post-petition continuing mortgage directly to the mortgagee is: "Are you willing to risk your Chapter 13 discharge in the event you fail to make every single mortgage payment directly to the mortgagee?" Debtors and practitioners alike should realize that proposing to make mortgage payments direct to the mortgagee is not just an arrangement between the mortgagee and debtors; such a proposal can involve the debtors' entire Chapter 13 bankruptcy estate and could ultimately jeopardize debtors' Chapter 13 discharge under section 1328(a).

[31] 11 U.S.C. § 1325(a)(4).

DEFALCATION AND CULPABLE INTENT POST-*BULLOCK*

JACOB N. WITTE [32]
WESTERN MICHIGAN UNIVERSITY THOMAS M. COOLEY LAW SCHOOL

In 2013, the United States Supreme Court granted *certiorari* to resolve a circuit split regarding whether defalcation, as used in Section 523(a)(4) of the Bankruptcy Code, requires proof of a debtor's intent.[33] The Supreme Court answered in the affirmative, clarifying the appropriate scienter (state of mind) requirement for defalcation. Despite this clarification, the issue of culpability is often not as black and white as practitioners sometimes hope. Since *Bullock*, courts have offered various interpretations of intent. Regardless of these various interpretations, at least one thing is clear – section 523(a)(4) now requires a fact intensive endeavor to prove intent.

Section 523(a)(4) of the Bankruptcy Code excepts from discharge debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."[34] The term "defalcation" is generally construed as a "failure to meet an obligation" or a "nonfraudulent default."[35] The creditor bears the burden of proof by a preponderance of the evidence.[36]

A breach of fiduciary duty generally requires the creditor to establish (1) the existence of a duty arising from a fiduciary relationship; (2) a failure to observe that duty; and (3) that such failure proximately caused injury.[37] For the purposes of 523(a)(4), a fiduciary relationship encompasses only an express or technical trust, not a constructive trust (*i.e.*, those deemed to arise at the time of wrongdoing).[38]

While the existence of a fiduciary relationship under 523(a)(4) is governed by federal law, courts look to state law to determine whether an express or technical trust has been created.[39] To establish an express or technical trust under Michigan law, a creditor must demonstrate: "(1) an intent to create a trust; (2) a trustee; (3) a trust *res*; and (4) a definite beneficiary."[40]

A. Bullock

Once a creditor establishes a breach of fiduciary duty, the creditor must next prove that the debtor acted with a sufficiently culpable state of mind. Prior to *Bullock*, courts reached different

[32] The author was an intern for the Honorable John T. Gregg at the United States Bankruptcy Court for the Western District of Michigan in the fall of 2017. This article is not intended to be a comprehensive discussion of *Bullock*.

[33] *Bullock v. BankChampaign, N.A.*, 569 U.S. 267 (2013).

[34] 11 U.S.C. § 523(a)(4). Debts of this type will be discharged unless the court, upon request from the creditor to whom the debt is owed, determines that the debt is exempt from discharge. 11 U.S.C. § 523(c)(1).

[35] *See* BLACK'S LAW DICTIONARY 479 (9th ed. 2009).

[36] *See Grogan v. Garner*, 498 U.S. 279, 291 (1991).

[37] *See, e.g., Prime Rate Premium Fin. Corp. v. Larson*, 226 F.Supp. 3d 858, 867-68 (E.D. Mich. 2016).

[38] *See In re Korn*, 567 B.R. 280, 310 (Bankr. E.D. Mich. 2017) (citation omitted).

[39] *Commonwealth Land Title Co. v. Blaszak (In re Blaszak)*, 397 F.3d 386, 390-91 (6th Cir. 2005) (citation omitted).

[40] *Patel v. Shamrock Floorcovering Servs., Inc.* (*In re Patel*), 565 F.3d 963, 968 (6th Cir. 2009) (citation omitted).

conclusions regarding whether defalcation requires culpable intent, and, if so, what degree of culpability is required.[41] This circuit split was addressed in *Bullock*, wherein the Supreme Court set forth the scienter requirement for defalcation within the meaning of Section 523(a)(4).

An understanding of the underlying facts in *Bullock* is helpful. In *Bullock*, the debtor became the trustee of a trust established by his father. The trust's only asset was the father's life insurance, and the debtor and his four siblings were the trust's sole beneficiaries. The debtor, lacking any professional experience as a trustee, borrowed from the trust on three separate occasions: to repay a debt to his father's business, to pay for certificates of deposit allowing him and his mother to buy a mill, and to purchase real property. All three transactions violated the trust agreement. The debtor had repaid all of the borrowed trust funds with interest, but was nonetheless sued by his siblings in state court, which found that the debtor breached his fiduciary duty by engaging in self-dealing and ordered him to repay the trust. The debtor was ultimately unable to satisfy the judgment and filed for bankruptcy, seeking to discharge the debt.

The bankruptcy court held that the debt was exempt from discharge under Section 523(a)(4) as a debt for defalcation, and the district court affirmed. The Eleventh Circuit also affirmed, holding that defalcation required "a known breach of fiduciary duty" as well as "objectively reckless" conduct, and that the debtor's actions met this standard. In his petition for *certiorari*, the debtor asked the Supreme Court "to decide whether the bankruptcy term 'defalcation' applies 'in the absence of a specific finding of ill intent or evidence of an ultimate loss of trust principal.'" The Supreme Court clarified the scienter requirement for defalcation, vacating the decision of the Eleventh Circuit and remanding the case for further proceedings.

B. Culpable State of Mind

Bullock held that defalcation requires not only a breach of fiduciary duty, but also a certain level of culpable intent – particularly the presence of bad faith, moral turpitude, immoral conduct or an intentional wrong on behalf of the fiduciary debtor. The Court explained that an "intentional wrong" includes both conduct known by the debtor to be improper and conduct that is criminally reckless in nature. The Court reasoned that this scienter requirement for defalcation is consistent with the statutory text, while avoiding any redundancy with its statutory neighbors -- embezzlement, fraud and larceny, all of which require some degree of wrongful intent. Defalcation, however, is distinguishable because it can "encompass a breach of fiduciary obligation that involves neither conversion, nor taking and carrying away another's property, nor falsity." The Court further recognized that this requirement conformed with the policy goal of confining exceptions to discharge to those plainly expressed (such as debtors at fault).

Courts have interpreted *Bullock's* scienter standard to generally create three categories of culpability: (1) immoral or bad faith conduct; (2) intentional conduct known by the debtor to be improper; and (3) conduct that is sufficiently reckless to be treated as intentional.[42]

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[41] *Compare In re Sherman*, 658 F.3d 1009, 1019 (9th Cir. 2011) (innocent acts may constitute defalcation) *with In re Baylis*, 313 F.3d 9, 20 (1st Cir. 2002) (defalcation requires something close to "extreme recklessness").

[42] *See*, *e.g.*, *In re Rachel*, 527 B.R. 529, 541 (Bankr. N.D. Ga. 2015).

1. *Immoral or Bad Faith Conduct*

Bullock did not specifically define what is included in "bad faith, moral turpitude, or other immoral conduct," but courts have concluded that it encompasses acts of self-dealing or conduct that statutorily requires a finding of bad faith.[43]

2. *Intentional Wrong*

Where a breach of fiduciary duty does not involve "bad faith, moral turpitude, or other immoral conduct," it must be shown that the fiduciary committed an intentional wrong or acted recklessly. An "intentional wrong" encompasses conduct known by the debtor to be improper – it is not enough that the debtor intended to commit the wrongful act. Rather, the debtor must have intended to act wrongfully.

A good-faith belief in the propriety of the conduct at issue is extremely relevant in determining whether the debtor acted with sufficiently culpable intent. For example, a debtor who wrongfully withheld payment to a creditor for what the debtor believed to be subpar work was held to be outside the level of intentional or criminal conduct required by *Bullock* for defalcation.[44] The *Woodford* court observed that an incorrect but sincerely-held belief on behalf of the debtor was sufficient to establish that the debtor did not act in an intentionally wrongful manner. According to the *Woodford* court, even if the conduct at issue is objectively wrong, it will not be deemed intentional unless the debtor has actual knowledge of its wrongful nature.

3. *Recklessness*

Recklessness, as set forth in *Bullock*, requires a level of culpability that "falls between 'mere' negligence and a specific intent to injure," and necessitates analysis of the debtor's appreciation and awareness of the facts and circumstances surrounding the conduct at issue.[45] While civil recklessness is evaluated objectively, at least one court has held that criminal recklessness requires an examination of the debtor's subjective state of mind.[46] To prove recklessness, a creditor must show that a debtor consciously disregarded or was willfully blind to a substantial and unjustifiable risk that his or her conduct would violate a fiduciary duty.[47]

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[43] *See, e.g., In re Licursi,* 573 B.R. 786, 807 (Bankr. C.D. Cal. 2017) (bad faith found where assets were sold without paying or notifying creditors); *In re Lazzari*, 2016 WL 5956651 (B.A.P. 9th Cir. 2016) (bad faith when debtor took, concealed and disposed of property for his own benefit); *In re Tomasi*, 2013 WL 4399229 (B.A.P. 9th Cir. 2013) (bad faith standard satisfied where debtor violated probate code which inherently required a bad faith finding); *In re Pearl*, 502 B.R. 429, 440 (Bankr. E.D. Pa. 2013) (self-dealing offered as an example of bad faith conduct).

[44] *See In re Woodford*, 560 B.R. 710, 720 (Bankr. E.D. Mich. 2016).

[45] *See In re Pearl*, 502 B.R. 429, 440 (Bankr. E.D. Pa. 2013).

[46] *See*, *e.g.*, *In re Rachel*, 527 B.R. at 542.

[47] *See Bullock*, 569 U.S. at 274; *see also In re Rachel*, 527 B.R. at 542 (defining substantiality and unjustifiability of risk); *In re Chidester*, 524 B.R. 656 (Bankr. W.D. Va. 2015) (describing standard for "conscious disregard"); *In re Cupit*, 514 B.R. 42, 50 (Bankr. D. Colo. 2014) (describing standard for "willful blindness").

C. Applying Bullock

While the Sixth Circuit has not yet addressed *Bullock's* heightened standard for culpable intent, a number of lower courts have addressed this issue. For example, in *In re Vestal*[48], the debtor's construction company entered into a contract to repair a creditor's residence after it was damaged by a storm.[49] The debtor received the creditor's security deposit and ordered the goods necessary to begin repairs, but the creditor cancelled the contract before the goods could be installed and requested return of the security deposit. After consulting with his attorney, the debtor withheld the security deposit as stipulated damages under the contract for wrongful termination. The creditor objected to discharge of this debt because the debtor had allegedly violated the Michigan Building Contract Fund Act.[50]

The court found that a statutory trust had been created under the MBCFA, and that the debtor had failed to properly account for funds held in trust. However, the court held that the debtor's wrongful retention of a homeowners' security deposit did not rise to the requisite level of intentional misconduct to support a finding of defalcation. Because the debtor did not know his conduct was improper and had acted in reliance on the advice of his counsel, he could not be deemed to have disregarded a substantial and unjustifiable risk that his conduct would violate a fiduciary duty. The court concluded that mere proof of a breach of fiduciary duty, especially in instances involving nonprofessional trustees, was insufficient to justify a discharge under Section 523(a)(4).

Wrongful intent was also found lacking where an inexperienced debtor failed to account for trust funds and allowed his wife to divert trust funds for her own use.[51] In *Maxwell*, the debtor, who was appointed trustee of his aunt and uncle's farmland after their death, did "very little to fulfill his duties as trustee," ultimately relying on his wife to assist him with the financial aspects of a trust. The debtor was removed as trustee, and a judgment was issued against him for breach of fiduciary duty.

In determining the dischargeability of this debt, the court recognized that although the debtor's actions strongly suggested a breach of duty, the debtor's conduct was not intentional or reckless. The debtor's lack of education, experience, expertise and professional guidance supported the court's finding that he did not have actual knowledge of his duties. Moreover, the debtor's reliance upon his wife, an experienced bank officer, to handle the financial aspects of the trust did not constitute recklessness, as the court found that the debtor was not actually aware of his wife's actions, he did not authorize them, nor did he know that such reliance was a breach of duty.

The court also declined to find an agency relationship between the spouses on the basis of the marital union alone. Moreover, even if such a relationship did exist, the wife's mental state could not be imputed vicariously to the debtor. Absent a showing of actual knowledge, wrongful

[48] 521 B.R. 604 (Bankr. W.D. Mich. 2014).
[49] *See id.* at 610-11.
[50] M.C.L. § 570.151, *et seq*.
[51] *See In re Maxwell*, 509 B.R. 286, 288-91 (Bankr. E.D. Cal. 2014).

intent, or gross recklessness, the *Maxwell* court concluded that the "rigorous" burden of intent for defalcation under *Bullock* had not been satisfied.

An overriding factor may often be whether the debtor receives and acts upon the advice of counsel. The Bankruptcy Court for the District of Colorado recently concluded that a debtor who served as personal representative of his father's estate did not commit an act of defalcation when he wrongfully distributed estate assets.[52] In *Karch*, upon being named personal representative of his father's estate, the debtor distributed estate funds to his siblings, as well as his two nieces that had been raised by his father but were not beneficiaries of the estate.[53] The court found that the debtor acted as a reasonable person would under the same circumstances by following the advice of retained legal counsel, and that his conduct did not rise "to the minimum level of mental culpability required to sustain a nondischargeability claim under § 523(a)(4)."[54]

Similarly, intent was lacking where a nonprofessional debtor arguably breached his duties by failing to consider alternatives to a foreclosure sale.[55] In *Cloninger*, the debtor, serving as personal representative to his deceased mother's estate, sold his mother's home in an attempt to avoid foreclosure. The debtor was subsequently sued by his brother, a beneficiary of the estate, who alleged that the mother's life insurance policy could have been applied to the mortgage to prevent the sale of the home and that the debtor committed defalcation by waiting until after the sale of the house to file a claim for the death benefit.

The *Cloninger* court disagreed, concluding that the debtor lacked the subjective intent required by Section 523(a)(4). Citing to *Vestal*, the court was persuaded by the debtor's reliance on the advice of counsel, holding that no conscious disregard of or willful blindness to a substantial and unjustifiable risk results where a unsophisticated debtor consults with counsel and follows counsel's advice – regardless of how sound that advice is. The court concluded that a layperson "cannot be expected to understand the legal and equitable theories that give rise to the alternatives that he should have pursued."

In contrast, a nonprofessional debtor-conservator was deemed to have committed defalcation, even though the breach was not committed knowingly or purposefully.[56] The debtor, acting as guardian for his stepfather, failed to account for funds. It was not enough, the court reasoned, to prove that the debtor *should have* been aware of the risk, as such a finding would only prove negligence. Rather, the debtor must have consciously disregarded a substantial and unjustifiable risk, with subjective knowledge of both the existence of his fiduciary duties and the risk created by his conduct resulting in breach of such duties. In assessing the substantiality of the

[52] *See In re Karch*, 501 B.R. 403, 408 (Bankr. D. Colo. 2013).

[53] *See In re Karch*, 499 B.R. 903, 904-905 (10th Cir. 2013). Initially, the bankruptcy court applied then-controlling precedent to hold that a wrongful distribution of trust funds constituted defalcation. *In re Karch*, 2012 WL 5947866 (Bankr. D. Colo. 2012). This decision was reversed on appeal to the Tenth Circuit, which remanded the case for proceedings consistent with *Bullock's* standard for defalcation.

[54] *In re Karch*, 501 B.R. at 409.

[55] *See In re Cloninger*, 548 B.R. 839, 859 (Bankr. N.D. Ga. 2016). Florida law recognizes a personal representative as having the same fiduciary duty of a trustee of an express trust.

[56] *See In re Chidester*, 524 B.R. at 656.

risk in question, the court examined the objective probability of harm resulting from the debtor's conduct, as well as the potential magnitude of such harm.

To determine whether such a risk was unjustified, the *Chidester* court compared the debtor's actual conduct (refusing to make a final accounting of his stepfather's estate) to the magnitude of the harm risked. While the only harm that could have resulted was intangible – the violation of a fiduciary duty – it was nonetheless deemed substantial, and the debtor was found to have understood its importance, despite his lack of sophistication. The court noted that "[s]uch a failure to act, when the necessary information could be relatively easily procured with minimal effort, [could not] justify a violation of fiduciary duty."

In concluding the debtor was subjectively aware of his duty, the court emphasized that the debtor was represented by legal counsel at the appointment hearing, and that the debtor made statements acknowledging his duties and the importance thereof.[57] While the debtor argued that he had been absolved from his duties, the court found that his knowledge and understanding of his responsibilities at the time were sufficient to establish a conscious disregard of a substantial risk, thus meeting *Bullock's* standard for defalcation.

Finally, a debtor with a background in finance and investments was held to have acted with sufficient recklessness under *Bullock* when he expended trust assets in high-risk option trading.[58] In *Whittaker*, the debtor was appointed trustee of a family trust, of which the debtor and his three siblings were beneficiaries. The debtor had been instructed to invest trust assets conservatively, but began engaging in increasingly risky investments without notifying his siblings of the change in strategy.

Throughout his administration of the trust, the debtor misappropriated trust funds to pay for a timeshare, diverted trust funds to his personal investment account, and lost substantially all of the trust's funds (nearly a million dollars) engaging in high-risk option trading – intentionally withholding all of this information from his siblings. When the debtor's siblings discovered the massive losses, they filed a complaint alleging (in part) that the debtor's reckless investments amounted to defalcation. The debtor contended that: (1) the terms of the trust granted him wide latitude in investment strategies; (2) he acted in good faith, intending only to benefit trust beneficiaries; and (3) while he may have acted recklessly, his recklessness was not sufficiently extreme to constitute deflection.

To determine whether the debtor acted in accordance with his state-law-imposed duty to invest prudently, the *Whittaker* court examined whether his actions "constituted a reasonable business judgment regarding the anticipated effect on the investment portfolio as a whole under the facts and circumstances prevailing at the time of the decision." The court concluded that the debtor's risky investment strategy grossly deviated from the standard of care he should have

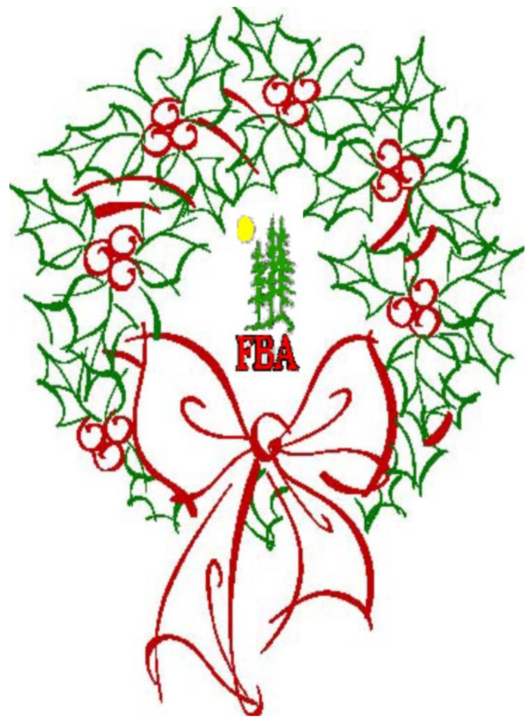
[57] In contrast to other cases where culpability is mitigated by actions taken in accordance with the advice of legal counsel, the debtor in *Chidester* was not advised to breach his duties – the presence of counsel at the appointment hearing served only to suggest that the debtor "appreciated his duties as conservator and knew how to comply therewith."

[58] *See In re Whittaker*, 564 B.R. 115 (Bankr. E.D. Mass. 2017).

observed, and that he committed such deviations with full appreciation of risks involved. Significant consideration was given to the debtor's known inadequacy as an options trader. Before being appointed trustee, the debtor had lost approximately $700,000 of personal funds trading on options. Despite the debtor's assertion that he had acted in good faith, the court concluded that the debtor "fully appreciated that he was subjecting the Trusts' assets to a degree of risk that he could not justify," so that his breaches constituted defalcation within the meaning of Section 523(a)(4).

D. Conclusion

Bullock makes it clear that defalcation requires a close and careful examination of the debtor's intent. Ultimately, creditors must be prepared to embark on a highly factual endeavor to maximize their chances for recovery under section 523(a)(4) after *Bullock*.



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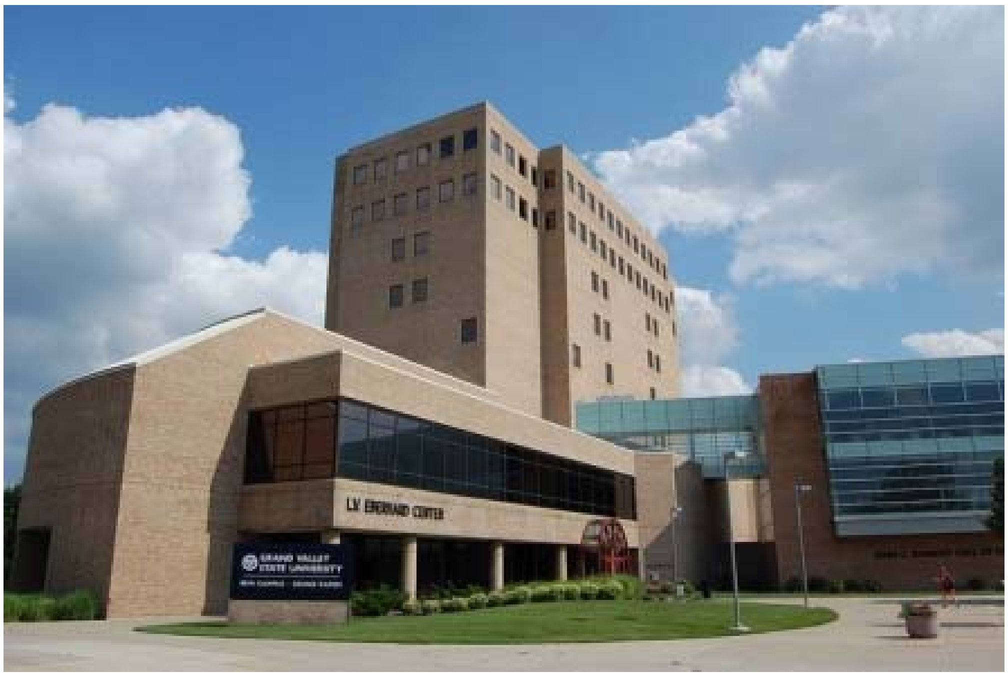

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7:30 - 8:45	**REGISTRATION / CONTINENTAL BREAKFAST**
8:45 - 9:00	**OPENING REMARKS -** Kim Young, DBWM President
9:00 -10:30	**RECENT DEVELOPMENTS IN CHAPTER 13** - Hon. Keith M. Lundin, Former Bankruptcy Judge, MDTN; Henry Hildebrand III, Ch.13 Trustee, MDTN
10:30 -10:45	**BREAK**
10:45 -11:30	**"SAVING THE SINKING SHIP" ALTERNATIVES IS DEALING WITH A FAILING CHAPTER 13 PLAN -** Barbara Foley, Ch.13 Trustee, WD MI; Rebecca Johnson-Ellis, Esq.; Ryan Beach, Esq.
11:30 -12:00	**BREAK LUNCH**
12:00 -1:00	**THE FUTURE OF UIA CLAIMS AFTER ZYNDA V ZIMMER** - Prof. Steven Gray University of Michigan Law School Michigan Unemployment Insurance Project
1:00 -1:10	**BREAK**
1:10 - 2:00	**REPRESENTING DEBTORS FACING UIA NON-DISCHARGABILITY CLAIMS** - Hon. Mark Randon, Bankruptcy Judge, EDMI; Amy Ruark Esq., Jacqueline M. Appelman Esq.
2: 00 - 2:45	**CHAPTER 7 ISSUES:** Laura J. Genovich, Ch.7 Trustee, WDMI; Thomas Richardson, Ch.7 Trustee, WDMI; Jeff Moyer, Ch.7 Trustee, WDMI; John Porter, Ch.7 trustee, WDMI
2:45 - 2:55	**BREAK**
2:55 - 3:45	**CASE LAW UPDATE -** Steve Rayman, Esq. **Moderator;** Hon. James Boyd, Bankruptcy Judge, WDMI; Hon. John T. Gregg, Bankruptcy Judge, WDMI
3:45 - 4:30	**VIEWS FROM THE BENCH: TOP 10 TIPS FOR DEBTORS COUNSEL** - Hon. James Boyd, Bankruptcy Judge, WDMI; Hon. Scott Dales, Bankruptcy Judge, WDMI
4:30 - 4:40	**CLOSING REMARKS** -Kim Young, DBWM President
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United States Bankruptcy Court
for the Western District of Michigan

Re: Amendments to Fed. R. Bankr. P. 3002 and Increased Importance of Filing Matrix with the Chapter 13 Petition

Ladies and Gentlemen:

As you are undoubtedly aware, on December 1, 2017, several changes to the Federal Rules of Bankruptcy Procedure will take effect, including an amendment to Fed. R. Bankr. P. 3002 shortening the deadline for filing proofs of claims, and requiring *secured* creditors to file proofs of claim. Under the former rule, non-government creditors had 90 days from the first date set for the meeting of creditors in which to file their claims; under the new rule, they will have only 70 days, measured from the date of the order for relief which, in a chapter 13 case, is the petition date.

Because the new claims bar date for non-government creditors (including secured creditors) will pass much earlier in the case, it is even more important that debtors file complete and accurate mailing matrices with their petitions: every day that goes by without a matrix on file is one day less for creditors (now including secured creditors) to file their proofs of claim. Inadequate notice of proceedings will not only jeopardize the creditors' opportunity to share in any dividend under the plan, but in extreme cases may also affect the dischargeability of debts under 11 U.S.C. § 523(a)(3).

These concerns similarly arise from the practice in so-called "emergency filings" of filing an obviously incomplete matrix, generally listing a single real estate creditor, with the intent of amending the matrix when time permits. Under the new rule, unfortunately, time will generally not permit.

Given the new, more direct relationship between the filing of the matrix and the bar date for claims, the court will strictly enforce Fed. R. Bankr. P. 1007(a)(1) and LBR 1007-2(c), both of which require debtors to file a matrix with the petition. Debtors who are unable to file a matrix should immediately file a motion under Fed. R. Bankr. P. 1007(a)(5) showing "cause" to enlarge the time. The failure to do so will likely elicit from the court an order to show cause why the case should not be dismissed. Moreover, the court may condition any extension of the time to file the matrix with a corresponding extension of the claims bar date.

I am sending this letter to alert you to these important rule changes, and the court's anticipated response.

Very truly yours,

Scott W. Dales