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Bankruptcy Law

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BANKRUPTCY LAW

The Honorable Douglas O. Tice, Jr. *
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I. INTRODUCTION

This article is a survey of bankruptcy cases from courts in the Fourth Circuit and the Supreme Court of the United States since Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") in 2005.[1] Because bankruptcy law is federal law, there are many cases outside of the Fourth Circuit that are highly persuasive and instructive to courts within the Fourth Circuit on bankruptcy and insolvency issues. Many bankruptcy cases outside of the Fourth Circuit are widely reported in the news—*Chrysler*[2] and *GM*[3] are the most notable at this time. This

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1. For a discussion of the changes made to the Bankruptcy Code by BAPCPA, see Richard C. Maxwell & B. Webb King, *Annual Survey of Virginia Law: Bankruptcy Law*, 40 U. RICH. L. REV. 53 (2005).

2. *See* John Anastasi, *Chrysler Files for Bankruptcy; Dealers Optimistic*, BUCKS COUNTY COURIER TIMES, May 1, 2009, at 1; Aleksanders Rozens, *Chrysler Files for Bankruptcy*, MERGERS & ACQUISITIONS REP., May 4, 2009, at 20; Jim Rutenberg & Bill Vlasic, *Chrysler Files for Bankruptcy; U.A.W. and Fiat to Take Control*, N.Y. TIMES, May 1, 2009, at A1.

3. *See* Kristine Owram, *GM Files for Bankruptcy Protection; Automaker Says No Cuts to Canadian Plants Beyond Ones Already Announced*, GUELPH MERCURY (Canada), June 2, 2009, at A10; David Welch, *GM Files for Bankruptcy*, BUS. WK. ONLINE, June 2, 2009.

article is restricted to a sampling of interesting Fourth Circuit and Supreme Court cases about common issues in consumer and business bankruptcies so that practitioners in this region may use these case summaries as a starting point for more focused research.

II. CONSUMER BANKRUPTCY CASES

A. *Filing Fees*

In *In re Davis*, a Chapter 7 debtor filed a motion to proceed in forma pauperis, seeking to waive the Chapter 7 filing fee under 28 U.S.C. § 1930(f).[4] The debtor engaged the local legal aid office to assist in filing the bankruptcy case and tendered $299 to legal aid to be held in escrow for the filing fee.[5] The debtor testified that the $300 cash-in-hand listed on her Schedule B included the money held in escrow by legal aid.[6]

Section 1930(f)(1) provides a two-prong test for waiving the filing fee. The first prong is to determine if the debtor's income is less than one hundred fifty percent of the poverty guidelines set forth by the U.S. Department of Health and Human Services.[7] If so, the court then examines whether the debtor has the ability to pay the filing fee in installments.[8] Before deciding *Davis*, in *In re Lineberry* the court cited a case from the Bankruptcy Court for the Western District of Missouri that examined three factors related to paying in installments.[9] These factors were: (1) whether the debtor can pay the fee from his income after reasonable expenses are considered, or from his assets; (2) whether the debtor is able to pay the fee in installments; and (3) if there is a fee arrangement between the debtor and his attorney.[10] In *Davis*, the debtor satisfied the first prong of the test.[11] But when the court reviewed the three factors laid out in *Nuttall* under the second prong, it found that the debtor's ability to place $299 in escrow indicated she did have the ability to pay the

4. *In re* Davis, 372 B.R. 282, 284 (Bankr. W.D. Va. 2007).
5. *Id.*
6. *Id.*
7. 28 U.S.C. § 1930(f)(1) (2006).
8. *Id.*
9. 344 B.R. 487, 492 (Bankr. W.D. Va. 2006) (citing *In re* Nuttall, 334 B.R. 921, 923–25 (Bankr. W.D. Mo. 2005)).
10. *In re* Nuttall, 334 B.R. at 923–25.
11. *In re* Davis, 372 B.R. at 285.

filing fee.[12] The debtor argued that the escrowed funds were exempt and necessary for her fresh start, but the court determined that

> it is not only the exempt assets of a Chapter 7 debtor that aid in the "fresh start," but also the discharge of the Debtor's unsecured debts. In order for a debtor to receive the discharge of unsecured debts, a potential Chapter 7 debtor must file a bankruptcy petition along with the Chapter 7 filing fee.[13]

In a similar case, *In re Phillips*, Chapter 7 debtors filed a motion to waive the payment of the case filing fee.[14] The court reviewed the motion in accordance with the requirements of 28 U.S.C. § 1930(f)(1).[15] Upon review of their bankruptcy schedules, the court took note of monthly expenses of $107 per month for cell phone service for two phones, $79 per month for satellite television service, and $130 per month for Christmas Club payroll deductions.[16] The court denied the motion altogether because it was not persuaded that the debtors were unable to pay the filing fee in installments in light of their ability to pay for the convenience of two cell phones and the Christmas Club payroll deductions. [17]

The court in *In re Lephew* again denied a motion to waive the Chapter 7 filing fee.[18] At the time they filed their petition, the debtors reported cash on hand of $5,050; on the day of the hearing on the motion to waive the fee, the debtors reported this money was no longer available to pay the fee because they used it to pay bills.[19] The court denied the motion because the debtors had sufficient funds at the time they filed the petition to pay the filing fee.[20] The court reasoned that it would be unfair to punish the debtor in the aforementioned *Davis* case, who escrowed the filing fee prior to filing the petition, and to reward the current debtors who had sufficient funds at the time they filed their petition but chose to spend those funds prior to the hearing.[21]

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12. *Id.* at 286.
13. *Id.* at 286 (internal citation omitted).
14. 375 B.R. 201, 203 (Bankr. W.D. Va. 2007).
15. *Id.* at 204–05 (quoting 28 U.S.C. § 1930(f)(1) (2006)).
16. *In re* Phillips, 375 B.R. at 207.
17. *Id.* at 207–08.
18. 380 B.R. 171, 172 (Bankr. W.D. Va. 2007).
19. *Id.* at 174.
20. *Id.* at 179.
21. *Id.* at 178.

B. *Disposable Income, Means Testing, Dismissal Under § 707, and Conversion*

1. *In re Lynch*

In *In re Lynch*, the Chapter 13 trustee objected to the Chapter 13 plan proposed by an above-median income debtor,[22] arguing that the debtor was not committing all disposable income to repay her creditors because her disposable income calculation on Official Form B22C included a vehicle ownership expense, even though the debtor had no actual ownership expenses—she did not owe any lease or finance payments.[23] The question in *Lynch* arose from the instructions on the Official Form B22C:

> Lines 27 through 29 of form B22C address allowed ownership expenses for debtor's transportation. Line 27 allows a deduction for vehicle operation or public transportation expenses. The debtor checked the box stating that she pays operating expenses for one vehicle, and entered the appropriate Local Standard amount of $260.00. Line 28 allows a deduction for ownership/lease expense for up to two owned vehicles. A check-box prompts the debtor to select whether she claims an ownership/lease expense for one, or two or more vehicles. The debtor claims only one vehicle. According to the instructions on the form, the debtor is to enter in sub-part a "the amount of the IRS Transportation Standards, Ownership Costs, First Car (available at *www.usdoj.gov/ust/* or from the clerk of the

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22. The court explained the meaning and relevance of having above-median income:

> The debtor's schedules . . . include Official Form B22C which provides a summary of the debtor's income and expenses in accordance with 11 U.S.C. § 1325(b)(3). The debtor is the only member of her household. According to this form, the debtor's total gross monthly income, derived from her average monthly income during the six months prior to filing the bankruptcy petition, is $4,541.52. Annualized, this current income amounts to $54,498.24. In Virginia, the median income for a single person household is $45,143.00. Therefore, the debtor's income is above the median and the debtor must propose a chapter 13 plan with a commitment period of 5 years according to § 1325(b)(4). Further, the debtor must determine her disposable income in accordance with § 1325(b)(3).
>
> Section 1325(b)(3) requires the debtor to calculate her disposable income in accordance with 11 U.S.C. § 707(b)(2), popularly known as the "means test," which is also used in determining eligibility for chapter 7.

In re Lynch 368 B.R. 487, 488–89 (Bankr. E.D. Va. 2007). For further discussion of the means test, see David Gray Carlson, *Means Testing: The Failed Bankruptcy Revolution of 2005*, 15 AM. BANKR. INST. L. REV. 223 (2007); Kathleen Murphy & Justin H. Dion, *"Means Test" or "Just a Mean Test": An Examination of the Requirement that Converted Chapter 7 Bankruptcy Debtors Comply with Amended Section 707(b)*, 16 AM. BANKR. INST. L. REV. 413 (2008).

23. *In re* Lynch, 368 B.R. at 488–90.

> bankruptcy court)"; in sub-part b the debtor is to enter the "total of the Average Monthly Payments for any debts secured by Vehicle 1, as stated in line 47"; finally, the allowed net ownership/lease expense for the vehicle is determined by subtracting sub-part b from sub-part a. In sub-part a the debtor inserted the ownership cost of $471.00, which, according to the United States Trustee's website, is the ownership expense allowed for one car in Virginia. The debtor listed no average monthly payment on debts secured by that vehicle in line 47 and likewise entered zero in sub-part b of line 28. Therefore, the total ownership/lease expense claimed by the debtor is $471.00 – 0 = $471.00. The debtor does not claim an ownership expense for a second car, and line 29 is inapplicable.[24]

The court followed the majority of published cases and allowed the ownership expense deduction even though the car was owned outright.[25] The court listed five factors in support of its decision: (1) statutory construction canons and the legislative history supported allowance of the expense deduction; (2) Congress intended to create a bright-line rule that would minimize flexibility for judicial interpretation; (3) the use of IRS standards would place the judiciary in the role of enforcing IRS mandates; (4) the Official Form B22C itself referenced the clerk of the bankruptcy court and the office of the U.S. Trustee's website as the source for allowable standard deduction amounts, divorcing other IRS sources or manuals from the process; and finally, (5) the IRS guidance documents must be applied uniformly, if at all—a discontinuous result would be achieved if debtors who pay a positive amount of debt or lease payment on a vehicle were entitled to the entire amount of the IRS standard deduction expense.[26] The court concluded that the debtor was entitled to use the deduction for ownership expense in the absence of any actual positive payment on debt secured by the vehicle, or a lease payment.[27]

2. *In re Hylton*

In *In re Hylton*, a creditor objected to the debtors' proposed Chapter 13 plan pursuant to 11 U.S.C. § 1325(b)(1)(B) for two reasons: first, the plan did not satisfy the requirement that all the debtors' income be committed to fund the Chapter 13 plan because they

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24. *Id.* at 489.
25. *Id.* at 491.
26. *Id.* at 491–92.
27. *Id.* at 492.

claimed ownership expense deductions for two cars that would be owned free and clear of liens during some portion of their plan, and for a boat, which the creditor argued was an impermissible expense; and second, the plan proposed an applicable commitment period that is less than the sixty months required for above-median debtors.[28] The court first found that the debtors were above-median debtors, for which "the amount of disposable income is determined by using the means test provided for in Section 707(b)(2)."[29] Next, the court concluded that the ownership expenses claimed for the two vehicles were allowable even though the vehicles would be owned outright during the plan period.[30] Similarly, the court concluded that the debt for the boat falls squarely within § 707(b)(2)(A)(iii)(I) as debt contractually due to a secured creditor within the sixty months following the petition, that § 707(b)(2)(A)(iii)(II) was not relevant, and that payments on the boat were not reasonably necessary for the debtors' maintenance and support.[31] However, the court noted that confirmation of a plan under § 1325(a)(3) requires that payments on it be filed in good faith,[32] and it cited other courts' denial of confirmation of Chapter 13 plans that propose to pay for nonessential or luxury assets.[33]

Lastly, the court concluded that the plain language of § 1325(b)(4)(A) reflects a temporal requirement, thereby rejecting the debtors' argument that it instead reflects only a monetary requirement—a so-called "multiplier" approach, where "a confirmable plan need only include an amount of projected disposable income equal to that which would be received during the 'applicable commitment period.'"[34] The court noted that Congress could have used a multiplier approach in § 1325(b)(4)(A) as it had in various other Code sections added by BAPCPA, but by not doing so, Congress did not intend for the multiplier approach to be used.[35] The court denied

28. *In re* Hylton, 374 B.R. 579, 581 (Bankr. W.D. Va. 2007). The Chapter 13 trustee also objected to the plan and raised the same issue of plan duration that was raised by the creditor. *Id.* at 581 n.5.

29. *Id.* at 582 (citing 11 U.S.C. § 1325(b)(3) (2006)).

30. *Id.* at 584.

31. *Id.* at 585, 586 (quoting and citing 11 U.S.C. § 707(b)(2)(A)(iii)).

32. *In re* Hylton, 374 B.R. at 586 (citing 11 U.S.C. § 1325(a)(3)).

33. *Id.* at 586 (citing *In re* Kasun, 186 B.R. 62, 63–64 (Bankr. E.D. Va. 1995)).

34. *Id.* at 587; *see* 11 U.S.C. § 1325(b)(4)(A).

35. *In re* Hylton, 374 B.R. at 587–88 & n.10 (citing *In re* Slusher, 359 B.R. 290, 301–02 (Bankr. D. Nev. 2007); Keene Corp. v. United States, 508 U.S. 200, 208 (1993)).

confirmation of the plan because it did not propose the required sixty-month applicable commitment period. [36]

For similar results when a debtor deducts expenses for property that will be surrendered during the plan, see *In re Hoskings*[37] and *In re Degrosseilliers*.[38] In *Degrosseilliers*, the court made this important observation: "The disposable income test requires that a debtor's projected disposable income over the applicable commitment period 'be applied to make payments to *unsecured creditors* under the plan.'"[39]

> Thus, where a plan also pays secured and priority claims, it is not sufficient that the *plan payment* equals projected disposable income. Secured and priority debts (including the chapter 13 trustee's fee) are already accounted for in the disposable income calculation. Accordingly, the payments into the plan must equal at least the debtor's disposable income over the commitment period *plus* the amounts needed to pay secured and priority debts under the plan.[40]

Moreover, the court in *In re Demesones* noted that the deduction of expenses for property the debtor intends to surrender is a factor to consider when deciding whether a case is abusive under the totality of the circumstances test codified in § 707(b)(3).[41]

3. *In re Parulan*

In re Parulan involved an above-median income debtor whose monthly disposable income was $576; however, the debtor proposed a plan payment of only $451.[42] The Chapter 13 trustee objected to confirmation of the plan because the debtor deducted an expense for a vehicle that she intended to surrender.[43] The debtor did not address the Chapter 13 trustee's argument, but instead argued that special circumstances existed—the loss of overtime pay to which she was accustomed—for which there is no reasonable alternative

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36. *In re* Hylton, 374 B.R. at 588.

37. No. 07-13785-RGM, 2008 Bankr. LEXIS 1785, at *18–20 (Bankr. E.D. Va. May 29, 2008) (holding that an above-median debtor's deductions should be determined as of the petition date and without regard to whether the debtor intends to surrender the collateral).

38. No. 08-10942-SSM, 2008 Bankr. LEXIS 2017, at *8 (Bankr. E.D. Va. July 11, 2008) (following the analysis in *Hoskings*, 2008 Bankr. LEXIS 1785).

39. *Id.* at *11 (quoting 11 U.S.C. § 1325(b)(1)(B)).

40. *Id.* at *11–12.

41. 406 B.R. 711, 714 (Bankr. E.D. Va. 2008) (citing 11 U.S.C. § 707(b)(3)(B)).

42. 387 B.R. 168, 169 (Bankr. E.D. Va. 2008).

43. *Id.* at 170.

but to downwardly adjust the debtor's income pursuant to 11 U.S.C. § 707(b)(2)(B).[44]

This Code section has both procedural and substantive requirements that must be met for the court to consider such a downward adjustment based on special circumstances. Procedurally,

> the debtor is required (1) to itemize additional expenses or adjustments; (2) to provide documentation of additional expenses or adjustments; (3) to provide a detailed explanation of the special circumstances that make the additional expenses or adjustments necessary and reasonable; and (4) to give oral testimony under oath to the accuracy of the information provided.[45]

Substantively, the debtor is required "(1) to demonstrate 'special circumstances, such as a serious medical condition or a call or order to active duty in the armed forces' that justify the additional expense or income adjustment; and (2) to demonstrate that there is no reasonable alternative to making the additional expense or income adjustment."[46]

The court found that the debtor had not complied with the procedural requirements, and even if that failure was "not fatal to her claim of special circumstances, the evidence offered [fell] short of meeting the substantive standard contemplated by the statute," which was an extremely high standard to meet.[47] The court also found that the debtor failed to show that the circumstances were permanent—"[b]y its very nature, overtime tends to fluctuate."[48] Additionally, "the debtor did not provide any evidence to show that there was no reasonable alternative (such as taking on a second job) to mitigate any loss of take-home pay resulting from a reduction or elimination of overtime."[49] For that reason, the court denied confirmation of the Chapter 13 plan.[50]

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44. *Id.*; *see* 11 U.S.C. § 707(b)(2)(B) (2006).

45. *In re* Parulan, 387 B.R. at 171 (citing *In re* Pageau, 383 B.R. 221, 225 (Bankr. D.N.H. 2008)).

46. *Id.* at 172 (quoting *In re* Harman, 366 B.R. 307, 311 (Bankr. D. Del. 2007) (emphasis omitted)).

47. *Id.* at 171–72.

48. *Id.* at 173.

49. *Id.*

50. *See id.*

4. *In re Plumb*

In *In re Plumb*, an unsecured creditor filed an objection to confirmation of the above-median income debtors' plan, arguing that the debtors were not paying all of their projected disposable income to the unsecured creditors under the terms of the plan due to increased deductions based on household size.[51] When they filed for bankruptcy, the debtors' household included seven people, besides themselves, who were children, grandchildren, and great-grandchildren.[52] One additional person lived in the house that was not a relative, but became engaged to one of the relatives in the household.[53] No one aside from the debtors contributed to monthly expenses.[54] The unsecured creditor argued that deductions should only be allowed for the debtor, the debtor's spouse, and the dependants of the debtor, pursuant to § 707(b)(2)(A)(ii).[55] But Official Form B22C instructs debtors to deduct expenses based on "family size," not the number of dependents.[56] The court resolved the question by "defer[ring] to Form B22C because of the specificity of the instructions on the form and because it recognizes the actual living situation of many families."[57] The court found that the debtors' "family size" included themselves and the seven family members, but excluded the non-family-member fiancé.[58]

5. *In re Buck*

The court in *In re Buck* noted that BAPCPA changed the mechanics of calculating disposable income for above-median debtors, but did not change the definition of "projected."[59] The modifier "projected" simply means that disposable income, calculated by the method mandated by statute, must be multiplied out over the number of months covered by the plan.[60] Because courts are no longer given

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51. 373 B.R. 429, 431–32 (Bankr. W.D.N.C. 2007).
52. *Id.* at 431.
53. *Id.* at 432.
54. *Id.*
55. *Id.* at 436; *see* 11 U.S.C. § 707(b)(2)(A)(ii) (2006).
56. *In re* Plumb, 373 B.R. at 437.
57. *Id.*
58. *Id.* at 438.
59. No. 07-31513-KRH, 2007 Bankr. LEXIS 4272, at *7–8 (Bankr. E.D. Va. Dec. 14, 2007).
60. *Id.* at *10 (citing *In re* Alexander, 344 B.R. 742, 749 (Bankr. E.D.N.C. 2006)).

discretion in determining "projected disposable income," there will be instances where debtors are left with either less than or more than they actually need to make their plan payments.

6. *In re Wolf*

In re Wolf is an interesting discussion of a debtor whose Chapter 7 case was dismissed as abusive for various reasons and who was ineligible for Chapter 13 because of his debt limits.[61] The court found that, in addition to the means test implemented by BAPCPA to determine whether the presumption of abuse arises for above-median income debtors, the Code incorporates the judicial constructs of bad faith and totality of the circumstances.[62] The court determined that pre-amendment rules would still be instructive post-BAPCPA because in the Fourth Circuit the ultimate decision on bad faith is reached through a totality of the circumstances test rather than by application of a per se rule.[63] The court held that Chapter 7 relief would be an abuse under such rules.[64] The debtor argued that his ineligibility for Chapter 13 relief—because of the debt limitations in § 109(e)—meant that § 707(b) should not apply.[65] The court did not find the debtor's argument persuasive, noting that it

> views eligibility for relief under another chapter as having either no or very minimal relevance to the proper framework for analyzing dismissal. There is no constitutional right to bankruptcy relief. The issue is whether a debtor should receive a Chapter 7 "fresh start." Where abuse is present the case should be dismissed without regard to the availability of relief under some other chapter. Relief is reserved for the "honest but unfortunate debtor," not the abusive debtor.[66]

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61. 390 B.R. 825, 830, 833–34 (Bankr. D.S.C. 2008).

62. *Id.* at 831–32.

63. *Id.* at 831.

64. *Id.* at 833.

65. *Id.* at 833–34; *see* 11 U.S.C. § 707(b) (2006).

66. *In* re Wolf, 390 B.R. at 834 (internal citations omitted). For further discussion of this dilemma and other constitutional questions under BAPCPA, see Samuel L. Bufford & Erwin Chemerinsky, *Constitutional Problems in the 2005 Bankruptcy Amendments*, 82 AM. BANKR. L.J. 1, 39 (2008) ("It remains to be seen to what extent courts will exercise their discretion to deny a motion to dismiss or convert, where the debtor (a) is subject to the means test, (b) fails the test, and (c) fails to show exceptional circumstances.").

7. *In re Grubbs*

In *In re Grubbs*, the Chapter 13 trustee objected to confirmation of the debtor's plan because the term was less than sixty months.[67] The married debtor filed this case individually and reported total monthly household income of $8,670.95, of which $4,270.95 was attributable to the debtor and $4,400 was attributable to the debtor's husband.[68] Using Official Form B22C, the debtor took a deduction of $2,900 from her monthly income "to exclude [the] portion of the income [from] the non-filing spouse that was not regularly contributed toward expenses of the [d]ebtor's household."[69] On line 15, the debtor calculated her annual income as $69,251.40, which is below-median for a household of the debtor's size in Virginia.[70] Therefore, she determined that her applicable commitment period was only thirty-six months rather than the required sixty months for above-median debtors.[71] The trustee argued that the deduction was improper and that annualized current monthly income must include both spouses' income, which would result in an above-median income for the debtor and thus a commitment period of sixty months.[72] The court disagreed with the trustee's interpretation of § 1325(b)(4)(A)(ii) that both spouses' incomes should be included in the total.[73] The court interpreted the definition of "current monthly income" in § 101(10A) to mean that a debtor must only include his or her income and not that of a non-filing spouse.[74]

8. *In re Minahan*

In *In re Minahan*, the debtors made pre-confirmation monthly payments of $1,650 to the trustee.[75] The debtors' prepetition car payments were $1,042, and after the trustee's commission of $112.20, $495.80 was left available for other purposes.[76] While this

67. No. 07-32822-KRH, 2007 Bankr. LEXIS 4282, at *3 (Bankr. E.D. Va. Dec. 14, 2007).
68. *Id.* at *2.
69. *Id.*
70. *Id.*
71. *Id.*
72. *Id.* at *3.
73. *Id.* at *5–6 (quoting 11 U.S.C. § 1325(b)(4)(A)(ii) (2006)).
74. *In re* Grubbs, 2007 Bankr. LEXIS 4282 at *6; *see* 11 U.S.C. § 101(10A).
75. 394 B.R. 116, 121 (Bankr. W.D. Va. 2008).
76. *Id.* at 127.

could be applied to other debts, including attorney's fees, § 1326(a)(1)(C) provides that, unless the court orders otherwise, the excess should be paid to the secured auto creditors as adequate protection.[77] The court concluded that adequate protection payments must "come off the top" and are payable to secured creditors before payment of anything else in the case, because to do otherwise would improperly subvert the priority scheme devised by Congress.[78]

9. *In re Wyatt*

In this Chapter 13 case, the court reviewed whether disability payments from the Veterans Administration ("VA") must be included as income in the calculation of projected disposable income for above-median debtors.[79] The court denied confirmation.[80] The definition of "current monthly income" in § 101(10A) unambiguously requires the addition of income "from all sources."[81] VA disability compensation is not one of the named exceptions, and the debtor could not offer any cases that held otherwise.[82] Indeed, at least two other courts have held that this income is not excepted.[83]

10. *Marrama v. Citizens Bank of Massachusetts*

In *Marrama v. Citizens Bank of Massachusetts*, a case governed by the pre-BAPCPA Code, Chapter 7 debtor Marrama misrepresented the value of his out-of-state real property, as well as whether he had transferred it in the preceding year.[84] The Chapter 7 trustee stated his intent to recover the property as an asset of the bankruptcy estate.[85] As a result, Marrama moved to convert to Chapter 13, but both the trustee and respondent bank objected and argued that the conversion request was in bad faith and would be an abuse of the bankruptcy system.[86]

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77. *Id.*; *see* 11 U.S.C. § 1326(a)(1)(C).

78. *In re* Minahan, 394 B.R. at 127–28.

79. No. 08-14792–SSM, 2008 WL 4572506, at *1 (Bankr. E.D. Va. Oct. 10, 2008).

80. *Id.*

81. *Id.* (quoting 11 U.S.C. § 101(10A) (emphasis removed)).

82. *Id.* at *2.

83. *See In re* Waters, 384 B.R. 432, 438 (Bankr. N.D. W. Va. 2008); *In re* Hedge, 394 B.R. 463, 466 (Bankr. S.D. Ind. 2008).

84. 549 U.S. 365, 368 (2007).

85. *Id.*

86. *Id.* at 368–69.

The Supreme Court of the United States affirmed the bankruptcy court's judgment that denied the motion to convert, reasoning that the debtor forfeited his right to a Chapter 13 conversion by his prepetition bad faith conduct.[87] Such conduct established "cause" for dismissal of a Chapter 13 case or reconversion to Chapter 7, while also rendering him ineligible to be a Chapter 13 debtor.[88] Because the Bankruptcy Code conditions conversion on a debtor's ability to qualify as a "debtor" under Chapter 13, Marrama could not convert from Chapter 7 to Chapter 13, regardless of his contention that the Code gives an unqualified right of conversion.[89] Bankruptcy judges have broad authority to take any action necessary "to prevent an abuse of process," and such authority is "adequate to authorize an immediate denial of a motion to convert," rather than allowing the conversion to go forward and only postpone the inevitable dismissal or reconversion of the Chapter 13 case for "cause," which postponement could provide a debtor with time "to take action prejudicial to creditors."[90]

11. *Musselman v. eCast Settlement Corp.*

In *Musselman v. eCast Settlement Corp.*, an unsecured creditor with a claim comprising forty-eight percent of the above-median debtors' total unsecured debt objected to confirmation of the proposed fifty-five month Chapter 13 plan, arguing that it failed to pay all of the debtors' projected disposable income to unsecured creditors and did not propose the correct commitment period.[91]

The district court held that "projected disposable income" is merely the debtor's "disposable income" calculated under Official Form B22C and projected forward over the applicable commitment period.[92] Moreover, where debtors have zero or negative projected disposable income, there is no applicable commitment period because "there is nothing 'to be received in the applicable commitment

87. *Id.* at 373–74, 376.
88. *Id.* at 372–74.
89. *Id.*
90. *Id.* at 375.
91. 394 B.R. 801, 804–05 (E.D.N.C. 2008).
92. *Id.* at 813.

period'" and "nothing to 'appl[y] to make payments to unsecured creditors under the plan.'"[93] The creditor's objections were rejected.[94]

C. *Reaffirmation*[95]

1. *In re Husain*

In *In re Husain*, the court noted that the debtors' counsel had not certified that the reaffirmation agreement submitted by the debtors did not impose an undue hardship in accordance with 11 U.S.C. § 524(c)(3).[96] The court found that even if counsel had endorsed the reaffirmation agreement, further scrutiny would have been required by the court pursuant to § 524(m).[97] Because the debtors' schedules indicated there was insufficient income to pay for regular monthly expenses plus the car payments, § 524(m)'s rebuttable presumption of undue hardship applied.[98]

In order to rebut this presumption, the debtor must: (1) explain where the extra money will come from to make the payments; (2) "demonstrat[e] that the value of the asset exceeds . . . the debt to be assumed"; or (3) "prov[e] to the satisfaction of the [c]ourt that the [d]ebtors' need for the vehicles outweighs the [c]ourt's consideration of the sources" of the extra money or the undersecured nature of the asset.[99]

The court found that the debtors submitted insufficient evidence of additional sources of funds:

> The evidence advanced by the Debtors to rebut the presumption on the first point included the statement of Debtor Akhter Husain that "I expect to close the gap between my income and expenses with an expected raise and through working more hours." . . . As this projected additional income would still leave the Debtors with a deficit

93. *Id.* at 814 (quoting 11 U.S.C. § 1325(b)(1)(B) (2006)).

94. *Id.* at 820.

95. For a complete discussion of reaffirmation under 11 U.S.C. § 524 after BAPCPA, see Lisa A. Napoli, *Reaffirmation After the Bankruptcy Abuse Prevention and Consumer Act of 2005: Many Questions, Some Answers*, 81 AM. BANKR. L.J. 259 (2007).

96. 364 B.R. 211, 214–15, 216 (Bankr. E.D. Va. 2007) (citing 11 U.S.C. § 524(c)(3)).

97. *Id.* at 216 (citing 11 U.S.C. § 524(m)).

98. *Id.*

99. *Id.* at 217.

> of expenses over income of approximately $3,000.00 per month, the Court finds that it is insufficient to overcome the § 524(m) presumption of undue hardship.[100]

The debtors concentrated their efforts primarily on the third point, namely expressing to the court their concerns that the ipso facto clause in their loan documents would be triggered despite being current on payments and maintaining proper insurance.[101] The court reasoned that while a loss of the vehicle would prove to be a great hardship, that hardship alone is an insufficient reason for the court to approve what was clearly an unduly burdensome agreement.[102]

The court did not end the analysis there, however. It further explained that ipso facto clauses in installment loan contracts are generally unenforceable as a matter of law.[103] BAPCPA carved out an exception to this general rule in § 521(d), and the exception requires debtors to comply with § 362(h)(1) and (2).[104] The court reasoned that the timely filing of the mutually satisfactory reaffirmation agreements is sufficient to satisfy the standards of § 521(d).[105] The court's decision not to approve the reaffirmation agreement was entirely out of the hands of the debtors; the court's refusal to approve such agreements is not equivalent to a failure on the part of the debtors to comply with § 521(d) and thereby trigger the enforcement of ipso facto clauses. The court did not approve the reaffirmation agreements, but found that the debtors had fully, timely, and in good faith performed their duties under §§ 521(a) and 362(h).[106]

2. *In re Milby*

In *In re Milby*, the debtor asked the court to rule that he met the statutory obligations of 11 U.S.C. §§ 521(a) and 362(h) for reaffirmation of the debts associated with his two automobile loans or, in

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100. *Id.*

101. *Id.*

102. *Id.* at 217–18.

103. *Id.* at 218 (citing Home Owners Funding Corp. v. Belanger (*In re* Belanger), 962 F.2d 345, 348 (4th Cir. 1992); Riggs Nat'l Bank v. Perry, 729 F.2d 982, 985 (4th Cir. 1984)).

104. *Id.*; *see* 11 U.S.C. § 521(d) (2006).

105. *In re* Husain, 364 B.R. at 218; *see* 11 U.S.C. § 362(h)(1)–(2).

106. *In re* Husain, 364 B.R. at 219.

the alternative, to approve the reaffirmation agreements.[107] At the hearing on the motion, debtor's counsel represented that she was unable to execute Part C of the reaffirmation agreement as it was clear there was a presumption of undue hardship based on the debtor's schedules.[108] There was no evidence presented to rebut the presumption of undue hardship.[109]

The court was concerned that the debtor was asking for a declaratory judgment with which he might be able to prevent the lender from exercising its contractual ipso facto rights post-discharge despite the post-discharge injunction.[110] The debtor provided no evidence to support his fear of this action, and there was no evidence proffered to suggest the lender might attempt this action.[111] The court determined that in order for it to have subject-matter jurisdiction for a declaratory ruling, there must be a substantial controversy between the parties.[112] The court found that there was no evidence proffered suggesting such a controversy existed, and it denied the motion.[113]

The court went on to explain that even if it had subject-matter jurisdiction, the debtor did not prove good faith as an element of the reaffirmation process.[114] The court cited *In re Husain* and noted that Milby's situation presented different facts:

> In this case, it appears that the Debtor's intention in entering into a reaffirmation agreement with the Bank was solely to comply with the requirements of sections 362(h) and 521(a), in order to obtain a ruling that section 521(d) is not operative and that the Bank is stayed by the postdischarge injunction. In *Husain*, footnote fourteen states:
>
> > In some circumstances, a reaffirmation agreement entered into by the debtor in good faith may satisfy the requirements of §§ 362(h), 521(a)(6) and 521(d) where the court disapproves the reaffirmation agreement under § 524(c)(6), especially where, as here, the debtor intends to perform under the reaffirmation

107. 389 B.R. 466, 466–67 (Bankr. W.D. Va. 2008).
108. *Id.* at 467.
109. *Id.*
110. *Id.* at 467–68.
111. *Id.* at 468.
112. *Id.* (quoting Bank of N.Y. v Adelphia Commc'ns Corp. (*In re* Adelphia Commc'ns), 307 B.R. 432, 437 (Bankr. S.D.N.Y. 2004)).
113. *Id.*
114. *Id.* at 468–69.

agreement and where disapproval by the court is beyond the debtor's control.[115]

D. *Motor Vehicle Issues*

1. Tenants by the Entirety Ownership

The debtors in *In re Rodriguez*, a Chapter 7 case, attempted to exempt their motor vehicles by claiming a tenancy by the entirety exemption.[116] Section 522 of the Code allows debtors to utilize tenancy by the entirety exemptions to the extent such property is "'exempt from process under applicable nonbankruptcy law.'"[117] Under Virginia law, property that is held by the entirety is not subject to enforcement of debts of an individual spouse.[118] The question was whether motor vehicles could be held by the entirety.[119] Citing Virginia Code section 55-20.2(A), the debtors argued that vehicles are personal property and that Virginia law allows for personal property to be held as tenants by the entirety.[120] The trustee objected and argued that Virginia Code section 46.2-622 trumps section 55-20.2(A)—"[t]he question is whether § 55-20.2(A) which allows personal property in general to be held as tenants by the entirety is limited by § 46.2-622 which prohibits motor vehicles from being held as tenants by the entirety."[121] The court found that while both statutes were relevant, section 46.2-622 was more specific on the issue, and therefore the court disallowed the claimed exemption.[122]

2. Surrender in Full Satisfaction

a. *Tidewater Finance Co. v. Kenney*

Tidewater Finance Co. v. Kenney was a direct appeal to the United States Court of Appeals for the Fourth Circuit from the

115. *Id.* (quoting *In re* Husain, 364 B.R. 211, 219 n.14).
116. 406 B.R. 707, 708 (Bankr. E.D. Va. 2008).
117. *Id.* (quoting 11 U.S.C. § 522(b)(3)(B) (2006)).
118. *Id.*
119. *Id.* at 708–09.
120. *Id.* at 709 (citing VA. CODE ANN. § 55-20.2(A) (Repl. Vol. 2007 & Supp. 2008)).
121. *Id.* at 710 (citing VA. CODE ANN. § 46.2-622 (Repl. Vol. 2005 & Cum. Supp. 2008); *id.* § 55-20.2(A) (Repl. Vol. 2007 & Supp. 2008)).
122. *Id.* at 710–11.

bankruptcy court.[123] The bankruptcy court had determined that when a car was purchased within 910 days of the filing of the bankruptcy case, the debtor may surrender that car back to the secured creditor in full satisfaction of the debt.[124] The importance of this ruling stems from the depreciating value of vehicles—often more is owed than the vehicle is worth, and the creditor is secured to the extent of the fair market value but unsecured for the balance.[125] Allowing surrender in full satisfaction eliminated the ability of the creditor to file a deficiency claim for the unsecured portion.[126]

Under BAPCPA, Congress revised § 1325 of the Code to provide that a debtor may not bifurcate the claim secured by a vehicle that was purchased for the personal use of the debtor within 910 days of the filing, rendering § 506 inapplicable for so-called 910 cars.[127]

The court reasoned that once Congress removed the § 506 valuation method from the equation for 910 cars, debtors and creditors are left to their rights as determined by state law.[128] Citing *Butner v. United States*,[129] the court stated that it was a well-recognized principle that state law controls when the Bankruptcy Code fails to provide a remedy.[130] The court further reasoned that regardless of the fact that § 506 is not applicable under these circumstances, it is actually § 502 that determines whether a claim is allowed.[131] The creditor was allowed to file a deficiency claim for the unsecured portion.[132]

b. *In re Walker*

In *In re Walker*, the debtor had filed her third petition for bankruptcy protection in two years.[133] In the third case, the debtor proposed to bifurcate the claim of her car lender, as the car had been

123. 531 F.3d 312, 314 (4th Cir. 2008).
124. *Id.* at 315 & n.2.
125. *See* 11 U.S.C. § 506 (2006).
126. *See Tidewater Fin. Co.*, 531 F.3d at 318.
127. 11 U.S.C. § 1325 (2006).
128. *Tidewater Fin. Co.*, 531 F.3d at 320.
129. 440 U.S. 48, 55 (1979).
130. *Tidewater Fin. Co.*, 531 F.3d at 319.
131. *Id.* (quoting *In re* Wright, 492 F.3d 829, 833 (7th Cir. 2007)); *see* 11 U.S.C. §§ 502, 506 (2006).
132. *Tidewater Fin. Co.*, 531 F.3d at 321.
133. No. 07-11819, 2008 WL 2559420, at *1 (Bankr. M.D.N.C. June 23, 2008).

purchased outside of the 910-day window prescribed by the hanging paragraph in § 1325.[134] The lender objected to the plan as having been filed in bad faith because the two previous plans had provided for the creditor to be paid as a fully secured claim.[135] The debtor purchased the car within 910 days of filing those previous cases. [136]

The court reviewed the standards for determining good faith as set forth in *Deans v. O'Donnell*[137] and *Neufeld v. Freeman*.[138] The court also discussed a similar case, *In re Robinson*, in which the debtor miscalculated the time between the car purchase and the filing of the case.[139] The debtor in that case was off by a few days and was required to pay the car in full because of the hanging paragraph.[140] The case was then dismissed, and the debtor filed another case, to which the creditor objected.[141] The debtor admitted that she let the first case be dismissed because she would realize a substantial savings by filing a new case.[142] The court in *In re Robinson* found that the filing of the new case did not rise to the level of bad faith merely because the debtor filed it to realize substantial savings.[143]

In *In re Walker*, the debtor's first case was dismissed because she lost her job and was unable to make the payments required.[144] The second case was dismissed because the debtor was out of work for a week with sick children, and she incurred medical bills from which she could not catch up.[145] The court found that these were reasons beyond the control of the debtor and did not rise to the level of behavior exhibited in *In re Robinson*, which was still found to be in good faith.[146] The court overruled the objection and confirmed the plan in the third case.[147]

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134. *Id.* at *2; *see* 11 U.S.C. § 1325(a) (2006).

135. *In re* Walker, 2008 WL 2559420, at *1–2.

136. *Id.* at *2.

137. *Id.* at *3 (citing Deans v. O'Donnell, 692 F.2d 968, 970 (4th Cir. 1982)).

138. *Id.* (citing Neufeld v. Freeman, 794 F.2d 149, 150 (4th Cir. 1986)).

139. *Id.* at *4 (citing *In re* Robinson, No. 07-41562-13, 2008 WL 2095349, at *1 (Bankr. D. Kan. May 16, 2008)).

140. *See In re* Robinson, 2008 WL 2095349, at *1.

141. *Id.*

142. *Id.* at *2.

143. *Id.* at *7.

144. 2008 WL 2559420, at *1.

145. *Id.* at *2.

146. *Id.* at *5; *see In re* Robinson, 2008 WL 2095349, at *7.

147. *In re* Walker, 2008 WL 2559420, at *5.

3. Negative Equity

In *GMAC v. Horne*, the district court consolidated the appeals of bankruptcy court decisions in the cases of *In re Pajot* and *In re Lavigne*.[148] In these cases, the debtors had purchased vehicles for which the total amount financed included (1) the purchase price of the new vehicles; (2) negative equity from loan balances attached to vehicles that the debtors traded in at the time of the new vehicle purchase; and (3) other costs, such as extended warranties and gap insurance.[149] The debtors were attempting to bifurcate the creditors' claims in their Chapter 13 plans, proposing to pay the secured claims to the extent of the cash purchase price of the new vehicle and the unsecured claims to the extent of the negative equity, extended warranty, gap insurance, and fees.[150]

In *In re Pajot*, the debtor attempted to bifurcate the secured claim of a creditor by reducing the amount secured to the retail value of the vehicle and treating the negative equity portion of the note as an unsecured claim.[151] The court held that negative equity was neither part of the price of the car, nor was it part of the value given or used to obtain rights in the collateral.[152] In instances where the debt is not entirely purchase-money security, the Uniform Commercial Code ("UCC") uses two different approaches to determine how the debt is treated.[153]

> The "[t]ransformation rule" holds that a security interest that is part purchase-money and part non-purchase-money completely loses its purchase-money character and is entirely transformed into a non-purchase-money security interest. The "dual status rule" allows the court to treat the portion that is purchase-money (essentially the purchase price) as purchase-money, whereas the non-purchase-money portion remains non-purchase-money and is treated accordingly.[154]

The bankruptcy court held that the negative equity portion of the transaction was not a purchase-money debt and could be bifur-

148. 390 B.R. 191, 194 (E.D. Va. 2008) (citing *In re* Lavigne, No. 07-30192, 2007 Bankr. LEXIS 4187 (Bankr. E.D. Va. 2007); *In re* Pagot, 371 B.R. 139 (Bankr. E.D. Va. 2007)).

149. *Id.*

150. *Id.* at 195.

151. 371 B.R. at 144.

152. *Id.* at 151.

153. *Id.* at 157.

154. *Id.* (citations omitted).

cated based on the dual status rule.[155] In *In re Lavigne*, the bankruptcy court went further and held that creditors did not have a purchase-money security interest in extended warranty contracts or any insurance policies such as gap insurance.[156]

On appeal to the district court, the creditors argued that the "package deal" the debtors agreed to for the purchase of the vehicles included the negative equity, extended warranty contracts, and the insurance policies, plus the cash purchase price of the new vehicles—so the entire amount financed was a purchase-money obligation.[157] As a purchase-money obligation, the debtors should be required to pay the entire balance in full as a secured claim in their Chapter 13 plan.[158]

The district court found that "state law controls what constitutes a purchase money security interest" and held that the creditors had a purchase-money security interest in amounts advanced to debtors to pay off negative equity on the trade-in vehicles.[159] The court held that these amounts "may be considered as a component of the 'price' and of the 'value given to enable,' and, consequently, that the creditors maintain purchase money security interests in the negative equity financing."[160] However, the court held that gap insurance and other insurance and warranties do not possess the requisite close nexus with the collateral and therefore cannot be considered as part of the purchase-money obligation.[161]

The Fourth Circuit recently addressed this same issue in *In re Price*, holding that negative equity along with gap insurance and other warranties are included with the new car purchase price in the purchase-money security interest.[162] The court explained:

> [I]nterpreting "purchase-money obligation" to include debt relating to negative equity is unlikely to cause endless bundling of various obligations with the purchase of a car. And we therefore see no need to create artificial distinctions between negative equity financing and the other common components of motor vehicle transactions to ward off that implausible result. Rather, our recognition of the wide-

155. *Id.* at 154, 157–58.
156. 2007 Bankr. LEXIS 4187, at *43.
157. GMAC v. Horne, 390 B.R. at 196–97.
158. *See id.* at 205.
159. *Id.* at 197, 205.
160. *Id.* at 205.
161. *Id.* at 205–06.
162. 562 F.3d 618, 628 n.5 (4th Cir. 2009) (interpreting North Carolina law).

spread inclusion of negative equity financing in new motor vehicle contracts is faithful to the UCC's own guidance on interpreting its provisions.[163]

E. *The Chapter 7 Discharge*

1. *Smith v. Jordan (In re Jordan)*

In *Smith v. Jordan (In re Jordan)*, the trustee filed an adversary complaint seeking revocation of the debtor's discharge after learning the debtor had refinanced her home without the knowledge and consent of the trustee or court.[164] Because revocation of a Chapter 7 discharge under § 727(d)(3) is an extraordinary remedy and contrary to the policy of the "fresh start" in bankruptcy, § 727(d) is "'construed strictly against the party seeking the revocation and liberally in the debtor's favor.'"[165] The court must find a willful and intentional lack of compliance with a relevant court order.[166]

In this case, debtor's lack of compliance was not willful. The court order at issue—the standard administrative order issued to all debtors in bankruptcy informing them of their duties under the Code—did not specifically prohibit "refinancing" but, instead, prohibited the "selling, transferring, removing, destroying, mutilating or concealing" of property.[167] It is not likely apparent to the average debtor that refinancing may technically involve a transfer in connection with the execution of the deed of trust.[168] The burden to clarify such restrictions is not on the debtor, but on the "business-savvy drafters of the administrative order."[169] "Simply put, the administrative order drafters should have anticipated—and specifically prohibited—such action because refinancing is one of the most common methods by which a homeowner may affect the equity in his or her home."[170]

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163. *Id.* at 627.

164. 521 F.3d 430, 432–33 (4th Cir. 2008).

165. *Id.* at 433 (quoting Pierce v. Fuller (*In re* Fuller), 356 B.R. 493, 495 (Bankr. D.S.D. 2006)); *see* 11 U.S.C. § 727(d)(3) (2006).

166. *In re* Jordan, 521 F.3d at 433; *see* 11 U.S.C. § 727(d)(3) (discussing revocation of a discharge for refusal to obey a lawful court order).

167. *In re* Jordan, 521 F.3d at 435.

168. *Id.*

169. *Id.*

170. *Id.*

2. *Tidewater Finance Co. v. Williams*

In *Tidewater Finance Co. v. Williams*, the debtor received a discharge under Chapter 7 in 1996, and then filed another Chapter 7 case in March 2004—before BAPCPA.[171] Between these two filings, the debtor also filed three Chapter 13 cases, each of which was dismissed.[172] In 2001, Tidewater Finance Company ("Tidewater") obtained a judgment against the debtor.[173]

Tidewater filed a motion objecting to the debtor's discharge (accompanied by the appropriate adversary proceeding) in the debtor's new case.[174] Tidewater argued that the debtor was ineligible for discharge under § 727(a)(8).[175] The motion acknowledged that the pre-BAPCPA Bankruptcy Code, which governed all of the debtor's cases, required the debtor to wait six years between Chapter 7 discharges, and that more than seven years had passed since the debtor's first discharge.[176] However, Tidewater argued that the period was equitably tolled for the duration of each Chapter 13 case, and as a result, the debtor was not eligible for a discharge.[177]

The Court of Appeals for the Fourth Circuit affirmed the judgment of the bankruptcy court, which held that "'[e]quitable tolling is not applicable here because § 727(a)(8) does not define a limitations period for Tidewater, a creditor, to assert its claim,'" but instead "'defines a condition that [the Debtor] was required to satisfy in order to qualify for . . . a discharge of her debts.'"[178]

3. *Nabso, Inc. v. Holmes (In re Holmes)*

In *Nabso, Inc. v. Holmes (In re Holmes)*, the creditor filed a motion objecting to the debtor's Chapter 7 discharge prior to the expiration period for filing objections to discharge and subsequently filed an adversary proceeding.[179] The time period had twice been ex-

171. 498 F.3d 249, 253 (4th Cir. 2007).
172. *Id.*
173. *Id.*
174. *Id.*
175. *Id.*; *see* 11 U.S.C. § 727(a)(8) (2006).
176. *Tidewater Fin. Co.*, 498 F.3d at 253.
177. *Id.*
178. *Id.* at 254 (quoting Tidewater Fin. Co. v. Williams (*In re* Williams), 333 B.R. 68, 73 (Bankr. D. Md. 2005).
179. 393 B.R. 95, 97 (Bankr. M.D.N.C. 2008).

tended by the creditor's motions, but the adversary proceeding was filed two months after the last extension.[180]

The bankruptcy court held that the creditor's motion objecting to discharge did not satisfy the timeliness requirements of the Federal Rules of Bankruptcy Procedure.[181] The creditor should have filed a third extension of time within the time provided by the prior motions.

The bankruptcy court held that it lacked authority to extend the time period for filing an adversary proceeding once the time expired, and therefore it dismissed the complaint.[182]

F. *Claims*

The district court in *Branch Banking & Trust Co. v. McDow (In re Garriock)* was asked to review "whether 'the legal rate' of interest owed to claimants under 11 U.S.C. § 726(a)(5) refers only to the federal judgment rate or whether it encompasses prepetition contracts between a claimant and the debtor."[183]

The district court affirmed the bankruptcy court's judgment that "the legal rate" of § 726(a)(5) is the federal judgment rate as determined by 28 U.S.C. § 1961(a).[184] Citing *In re Cardelucci*, the district court concluded that "[b]y awarding interest at 'the legal rate' rather than at 'a legal rate,' Congress signaled that a single source should be used to calculate post-petition interest."[185] The awarding of post-petition interest should affect all creditors equally because "[t]he cost of delay affects all creditors equally, and the federal judgment rate accurately reflects the time value of each creditor's claims."[186]

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180. *Id.* at 96–97.

181. *Id.* at 97–98; *see* FED. R. BANKR. P. 4004(a)–(b).

182. *In re* Holmes, 393 B.R. at 98.

183. 373 B.R. 814, 815 (E.D. Va. 2007); *see* 11 U.S.C. § 226(a)(5) (2006).

184. *In re* Garriock, 373 B.R. at 817; *see* 11 U.S.C. § 726(a)(5); 28 U.S.C. § 1961(a).

185. *In re* Garriock, 373 B.R. at 816 (citing *In re* Cardelucci, 285 F.3d 1231, 1234 (9th Cir. 2002)).

186. *Id.* (citing *In re* Godsey, 134 B.R. 865, 867 (Bankr. M.D. Tenn. 1991)).

G. *Dischargeability*

The ultimate goal of any consumer bankruptcy is for the debtor to receive a discharge. Discharges in consumer bankruptcy are governed by 11 U.S.C. §§ 727 and 1328 and are the pinnacle of completion of any case.[187] However, there are certain instances where the debtor is not entitled to a discharge for particular debts. Section 523 of the Bankruptcy Code lists the exceptions to discharge.[188] Some of the most recently litigated dischargeability issues include those of student loans, false pretenses, willful and malicious injury, fraud or defalcation in a fiduciary capacity, larceny, and debts arising from domestic support obligations.[189] The party seeking to except the debt from discharge bears the burden of proof by preponderance of the evidence.[190]

Government-issued or -backed student loans are generally not dischargeable unless the debtor can prove that repayment of such debt would be detrimental to the debtor or the debtor's dependents.[191] The Fourth Circuit ruled in two recent cases that student loan debt is non-dischargeable if the debtor is unable to satisfy the undue hardship test adopted by the Second Circuit in *Brunner v. New York State Higher Education Services Corp.*[192] The *Brunner* factors include a showing

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for [the debtor and the debtor's dependents] if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.[193]

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187. *See* 11 U.S.C. §§ 727, 1328.

188. 11 U.S.C. § 523.

189. *See generally* 10 NORTON BANKR. L. & PRAC. 3d 11 U.S.C. § 523 (2009).

190. *See* Grogan v. Garner, 498 U.S. 279, 291 (1991).

191. *See* 11 U.S.C. § 523(a)(8).

192. *See* Spence v. Educ. Credit Mgmt. Corp. (*In re* Spence), 541 F.3d 538, 544 (4th Cir. 2008); Educ. Credit Mgmt. Corp. v. Frushour (*In re* Frushour), 433 F.3d 393, 400 (4th Cir. 2005); *see generally* Brunner v. New York State Higher Educ. Servs. Corp., 831 F.2d 395, 396 (2d Cir. 1987).

193. *Brunner*, 831 F.2d at 396.

The debtor must prove these factors by a preponderance of the evidence.[194]

In *In re Spence*, the Fourth Circuit affirmed the district court's judgment that the student loan debt was non-dischargeable.[195] The court applied the three-part *Brunner* test and found that the debtor failed to satisfy parts two and three.[196] Despite her education and ability to attain a higher paying job, the court found that the debtor did not attempt to improve her financial situation and that her current situation was not indicative of what the future held.[197] In addition, the court concluded that the debtor failed the third part of the test for failing to maximize her income by pursuing a higher paying line of work and by not attempting to pay or explore the options for repayment of the student loans, including loan consolidation.[198]

The Fourth Circuit in *Educational Credit Management Corp. v. Mosko (In re Mosko)* reversed the district court's affirmation of the bankruptcy court's holding, granting the debtors discharge of their student loans.[199] As in *In re Spence*, the court held that the debtors failed to show efforts to obtain employment, maximize income, and minimize expenses, thereby not satisfying the third prong of the *Brunner* test.[200] Lastly, the court found that the debtors did not put forth any effort to repay their student loan obligation when there was a surplus in their budget, nor did they seek alternative payment arrangements like loan consolidation.[201]

In the Western District of Virginia, the bankruptcy court denied discharge of student debt in *Hooker v. Educational Credit Management Corp.* to a Chapter 7 debtor who had a history of making very nominal income, had been diagnosed as a paranoid schizophrenic, and was HIV-positive, stating that the debtor failed to satisfy the third prong of the *Brunner* test because he did not seek partici-

194. *See In re* Frushour, 433 F.3d at 400 (citing O'Hearn v. Educ. Credit Mgmt. Corp. (*In re* O'Hearn), 339 F.3d 559, 565 (7th Cir. 2003); Brightful v. Pa. Higher Educ. Assistance Agency (*In re* Brightful), 267 F.3d 324, 327 (3d Cir. 2001)).

195. 541 F.3d at 545.

196. *Id.* at 544–45.

197. *Id.* at 544.

198. *Id.* at 545.

199. 515 F.3d 319, 327 (4th Cir. 2008).

200. *Id.* at 324–25. The court decided not to consider whether the debtors satisfied the other two prongs of the test after it found that they failed to satisfy the "good-faith effort" portion. *Id.* at 324.

201. *Id.* at 326.

pation in an income contingent repayment plan.[202] On appeal, the district court remanded the case to the bankruptcy court for a more dispositive factual basis to deny the discharge.[203]

Similarly, the bankruptcy court in *Shank v. Educational Credit Management Corp. (In re Shank)* denied the discharge of student loan debt because the debtor failed to satisfy the third prong of the *Brunner* test.[204] The debtor filed a Chapter 7 case, receiving her discharge in October 2005, and the case was closed in November 2005.[205] Thereafter, in August 2007, the debtor moved the court to reopen her case so that she could request the discharge of her student loan debt under § 523(a)(8).[206] The court found that the debtor failed to prove that she acted in good faith to repay her student loans.[207] Specifically, the debtor admitted that she did not seek employment, relied solely on Social Security income, and did not reduce expenses or attempt to participate in the repayment plan offered by the lender.[208]

Vujovic v. Direct Loans (In re Vujovic) is of particular interest because the court deferred its ruling on the discharge of student debt for two years to determine whether the second prong of the *Brunner* test could be satisfied.[209] The debtor in this case was a forty-one-year-old consumer bankruptcy attorney who incurred a substantial amount of student loan debt from pursuing his law degree and license to practice.[210] The court held that the debtor satisfied prongs one and three of the *Brunner* test,[211] but because the debtor could not show by a preponderance of the evidence that his current financial state would persist throughout the repayment period, the court exercised its equitable power under § 105(a) to defer its ruling and

202. 368 B.R. 502, 503 (W.D. Va. 2007).
203. *Id.* at 505.
204. No. 05-73943-FJS, 2008 WL 3166492, at *7 (Bankr. E.D. Va. 2008).
205. *Id.* at *1.
206. *Id.*; *see* 11 U.S.C. § 523(a)(8)(B) (2006).
207. *In re* Shank, 2008 WL 3166492, at *10.
208. *Id.* at *4–6.
209. 388 B.R. 684, 688 (Bankr. E.D.N.C. 2008).
210. *Id.* at 687.
211. *Id.* at 688.

enjoin any collection efforts from the lenders for two years.[212] The court explained that

> [w]hat is needed here, is time. Although [the debtor] cannot at this moment demonstrate a "certainty of hopelessness," it is not fair to the debtor to make a premature assessment of his prospects and to permanently deny him the relief he seeks. A better solution is to deny his request on an interim basis, and to re-evaluate his situation two years from now.[213]

1. Nondischargeability Under § 523(a)(4) for Fraud or Defalcation in a Fiduciary Capacity

In *Kubota Tractor Corp. v. Strack (In re Strack)*, the Fourth Circuit established a two-part test for a creditor seeking nondischargeability under 11 U.S.C. § 523(a)(4), which requires the creditor to show "(1) that the debt in issue arose while the debtor was acting in a fiduciary capacity; and (2) that the debt arose from the debtor's fraud or defalcation."[214] In *In re Strack*, the creditor also had to establish that the corporation's actions could be imputed to the debtor to prevent him from receiving a discharge for a debt he guaranteed for the corporation.[215] The court relied on Virginia law to define "express trust" and to impute a fiduciary duty on Strack as an officer of the corporation.[216] The court held that the debt was nondischargeable because (1) the debtor personally guaranteed the indebtedness; (2) the indebtedness arose due to defalcation or the breach of a fiduciary relationship by the corporation; (3) the debtor, as an officer of the company, was personally responsible for the conduct that gave rise to the corporation's breach or defalcation; and (4) the debtor's conduct rose to the level of a breach of his fiduciary duty to the corporation as its president.[217]

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212. *Id.* at 692–94 ("[11 U.S.C.] section 105(a) provides that the court 'may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.'") (quoting 11 U.S.C. § 105(a) (2006))).

213. *Id.* at 692.

214. 524 F.3d 493, 497 (4th Cir. 2008) (citing Pahlavi v. Ansari (*In re* Ansari), 113 F.3d 17, 20 (4th Cir. 1997)); *see* 11 U.S.C. § 523(a)(4).

215. *In re* Strack, 524 F.3d at 498 (citing Airlines Reporting Corp. v. Ellison (*In re* Ellison), 296 F.3d 266, 270–71 (4th Cir. 2002)).

216. *Id.*

217. *Id.* at 500 (citing *In re* Ellison, 296 F.3d at 271).

Although the Fourth Circuit resorted to state law in *In re Strack* to help determine whether to except the discharge under § 523(a)(4), in *In re Shreve*, the bankruptcy court rejected the expansive definition codified by Virginia and relied on federal common law for the definition of larceny.[218] In *In re Streve* , the creditor, who was one of the debtor's suppliers, brought an adversary proceeding to determine the dischargeability of money loaned and allegedly misused according to state law.[219] The court agreed that while the debtor's actions may have met the state law definition of larceny, the definition of larceny for purposes of applying § 523(a)(4) is a matter of federal common law.[220] The violation of a state statute does not automatically preclude the discharge of the debt owed to the creditor.[221]

2. Nondischargeability of Domestic Support Obligations and the Doctrine of Res Judicata

Generally, domestic support obligations are not dischargeable.[222] The usual question is whether the debt is a domestic support obligation as defined in 11 U.S.C § 101(14A).[223] In *Monsour v. Monsour (In re Monsour)*, the bankruptcy court denied discharge of a lump sum owed to the debtor's ex-wife after their divorce because it was a domestic support obligation.[224] The Chapter 7 debtor had filed a motion to reopen his previous bankruptcy case, and filed an adversary proceeding on the same day, to determine the dischargeability of the lump sum award to his ex-wife.[225] The question was whether the lump sum was a domestic support obligation or a debt owed under a property settlement agreement—the former is not dischargeable while the latter is.[226] Although whether or not the lump sum obligation is in the nature of support is a matter of federal bankruptcy law rather than state law, "[b]ankruptcy courts and state courts

218. Smith Mtn. Bldg. Suppy, LLC v. Shreve (*In re* Shreve), 386 B.R. 602, 605 (Bankr. W.D. Va. 2008).

219. *Id.* at 603.

220. *Id.* at 606; *see also* Nat'l Agents Serv. Co. v. Duiser (*In re* Duiser), 12 B.R. 538, 539–40 (Bankr. W.D. Va. 1981) (stating that a state's determination that certain conduct is criminal is not determinative of the issue of dischargeability in bankruptcy).

221. *See In re* Shreve, 386 B.R. at 606.

222. 11 U.S.C. § 523(a)(5) (2006).

223. *See* 11 U.S.C. § 101(14A) (defining "domestic support obligation").

224. 372 B.R. 272, 282 (Bankr. W.D. Va. 2007).

225. *See id.* at 276.

226. *Id.* at 277.

maintain concurrent jurisdiction to decide . . . exceptions to discharge arising under . . . Section 523(a)(5), which excepts from discharge any debt to a spouse for alimony, support or maintenance made in connection with a divorce decree."[227] The court found that the debtor was barred from bringing the adversary proceeding based on the doctrine of res judicata because the state court divorce decree constituted a final judgment, an identity of the cause of action existed because the debtor argued to the state court that he had received a discharge of the lump sum obligation, and the same parties would be in both sets of litigation.[228]

Even though the court disposed of the case with its holding on res judicata, it went on to reiterate that the intent of the parties at the time they enter into the agreement is critical in determining the classification of indebtedness.[229] "Factors relevant to a determination of intent include the language and substance of the judgment, the financial circumstances of the parties, and the role of the obligation."[230]

3. False Pretenses, Willful and Malicious Injury

Sections 523(a)(2) and (a)(6) are designed to protect creditors who are manipulated into giving money or property to debtors and creditors injured by the torts of debtors.[231]

In order to except a debt from discharge under § 523(a)(2)(A), a creditor must prove that the debtor obtained money by fraud, specifically that (1) the debtor made a fraudulent misrepresentation, (2) that induced the creditor to act or refrain from acting, (3) that caused harm to the creditor, and (4) that was justifiably relied upon

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227. *Id.* at 278 (citing *In re* Crawford, 183 B.R. 103, 107 (Bankr. W.D. Va. 1995)); *see* 11 U.S.C. § 523(a)(5).

228. *In re* Monsour, 372 B.R. at 277–78.

229. *Id.* at 281 (citing Tilley v. Jessee, 789 F.2d 1074, 1078 & n.4 (4th Cir. 1986) ("Intent clearly remains the threshold that must be crossed before any other concerns become relevant.")).

230. *Id.* at 281 (citing Catron v. Catron (*In re* Catron), 164 B.R. 912, 919 (E.D. Va. 1994)).

231. 11 U.S.C. §§ 523(a)(2), (a)(6); *see also* Nunnery v. Rountree, (*In re* Rountree), 478 F.3d 215, 219–20 (4th Cir. 2007) ("Congress intended § 523(a)(2) to protect creditors who were tricked by debtors into loaning them money . . . through fraudulent means."); Harrold v. Raeder (*In re* Raeder), 399 B.R. 432, 440 (Bankr. N.D. W. Va. 2009) ("Section 523(a)(6) of the Bankruptcy Code provides that a discharge in bankruptcy does not apply to any debt that arises from the 'willful and malicious injury by the debtor to another entity or to the property of another entity.'" (quoting 11 U.S.C. § 523(a)(6) (2008)).

by the creditor.[232] For a creditor to prevail under § 523(a)(6) for a willful and malicious injury, the court must find that the debtor intended both the act and the injury that resulted.[233]

In *Haas v. Trammell (In re Trammell)*, the debtor's former boyfriend brought an adversary proceeding to except from discharge a debt based on fraud and willful and malicious injury.[234] The court found that the ex-boyfriend failed to prove that the debtor maliciously prosecuted him in a child abuse case or that he was fraudulently induced to make a loan to the debtor.[235] The court held that the debts were not excepted from discharge.[236]

In *El-Yacoubi v. Hetrick (In re Hetrick)*, the plaintiff brought an adversary proceeding seeking to quiet title to real estate and seeking relief against the debtors for slander of title and trespass.[237] Additionally, the plaintiff sought to except the indebtedness resulting from the husband-debtor's actions from discharge as a willful and malicious injury under § 523(a)(6).[238] The court, finding that the deed in question was a forgery, entered summary judgment against the debtors and the holder of a mortgage on the property and quieted title to the real estate.[239] The court also entered default judgment on nondischargeability against the husband-debtor based upon his willful and malicious actions in transferring the property.[240]

H. *Exemptions*

1. *In re Price*

In *In re Price*, after eighteen months of extensive discovery, the Chapter 7 trustee found that the joint debtors failed to report a to-

232. *See* 11 U.S.C. § 523(a)(2)(A).

233. *See* Kawaauhau v. Geiger, 523 U.S. 57, 61 (1998) ("The word 'willful' in [§ 523](a)(6) modifies the word injury, indicating that nondischargeability takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury.").

234. 388 B.R. 182, 186, 188 (Bankr. E.D. Va. 2008).

235. *Id.* at 194–95.

236. *Id.* at 195.

237. 379 B.R. 612, 614 (Bankr. E.D. Va. 2007).

238. *Id.* at 620.

239. *Id.* at 617–18.

240. *Id.* at 620–21.

tal of more than $428,000 in various assets.[241] These undisclosed assets were non-exempt property of the estate that the trustee had the ability to use, sell, or lease.[242]

The court held that the trustee could set off any exempt funds against the debtors' liability to the estate for failing to turn over the undisclosed assets.[243] Alternatively, the trustee could surcharge their exemption, by taking would-be exempt assets to compensate the estate for the property that the debtors concealed or refused to surrender.[244]

When the debtors deprive the estate of assets and cause significant administrative expenses, such a result is necessary "'to protect the integrity of the bankruptcy process and to ensure that [debtors] exempt an amount no greater than what is permitted by the exemption scheme of the Bankruptcy Code.'"[245] The amount of the set-off can be any portion of the value of the undisclosed assets, plus administrative expenses incurred by the trustee as a result of the debtor's failure to comply or the amount necessary to pay all claims, whichever is less.[246]

2. *Logan v. Williams (In re Williams)*

In *Logan v. Williams (In re Williams)*, the Chapter 7 trustee objected to the tenancy by entireties exemption claimed by the debtor for property owned with his estranged spouse, whom he eventually divorced, and sought to set aside a refinancing agreement as an unauthorized post-petition transfer.[247]

Under the Federal Rules of Bankruptcy Procedure, a party in interest must file any objections to claimed exemptions "within 30 days after the meeting of creditors . . . or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later."[248] When an objection is filed after thirty days, regardless of the propriety of the exemption claimed, the objection is not consi-

241. 384 B.R. 407, 408–09 (Bankr. E.D. Va. 2008).
242. *Id.* at 409; *see* 11 U.S.C. § 363(b)(1) (2006).
243. *In re* Price, 384 B.R. at 410.
244. *Id.* at 412.
245. *Id.* at 411–12 (quoting Latman v. Burdette, 366 F.3d 774, 786 (9th Cir. 2004)).
246. *See id.* at 412.
247. 400 B.R. 479, 483–86 (Bankr. D. Md. 2008).
248. FED. R. BANKR. P. 4003(b).

dered by the court, and the exemption is allowed up to the full amount declared.[249] In *In re Williams*, the court denied the trustee's objection, explaining that the trustee's indefinite continuance of the § 341 meeting of creditors, his failure to announce a new date to reschedule the meeting, and his failure to object to the exemption for almost ten months after the last § 341 meeting was unreasonable.[250] The court did not give the trustee an extension of time to object to the debtor's claimed exemption.[251] As such, the tenancy by entireties property owned with the non-debtor spouse was properly claimed as exempt and removed from the bankruptcy estate.[252] Therefore, the refinancing did not run afoul of the automatic stay.[253]

I. *Credit Counseling & Financial Management*

1. *In re Lilliefors*

In *In re Lilliefors*, a pro se debtor filed a voluntary Chapter 7 without including a copy of the credit counseling certificate in Exhibit D, but certified under penalty of perjury that he had completed the required credit counseling.[254] He failed to file a completed certificate and failed to appear at the § 341 meeting of creditors.[255] Both the Chapter 7 trustee and United States trustee filed motions to prevent the case from being dismissed due to the significant assets that would be distributed to creditors and the lack of assurance that creditors would be paid if the case were dismissed.[256]

The court held that an individual is judicially estopped from disavowing his own sworn statement, and under the circumstances, the debtor was deemed to have satisfied the credit counseling requirement even without any further documentation.[257] The motions were granted, and the case was not dismissed.[258]

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249. *See* Taylor v. Freeland & Kronz, 503 U.S. 638, 642 (1992).
250. 400 B.R. at 489–91.
251. *Id.* at 491.
252. *Id.* at 493–94.
253. *Id.* at 495–96.
254. 379 B.R. 608, 610 (Bankr. E.D. Va. 2007).
255. *Id.*; *see* 11 U.S.C. § 341 (2006).
256. *In re* Lilliefors, 379 B.R. at 610–11.
257. *Id.* at 611.
258. *Id.* at 612.

2. *In re Taing*

The debtor in *In re Taing* failed to file a certificate of completion of the financial management course required by § 727(a)(11) of the Bankruptcy Code.[259] Upon the debtor's motion to reopen the case in order to file the certificate, the court explained that certain requirements must be met in order for the motion to be granted: "[T]here must be a reasonable explanation for the debtor's failure to comply with the requirement and counsel's failure to monitor the debtor's compliance; no prejudice to creditors; and a timely request for relief."[260] In addition, the debtor's ignorance of the requirement was not a reasonable excuse given the court's written notice of the requirements to every debtor, as well as counsel's responsibility to advise the debtor of the credit counseling requirement.[261] Similarly, counsel's failure to timely recognize the noncompliance was also not a reasonable excuse, as counsel was well aware of the requirement and deadline and had twenty-four hour Internet access to the court's electronic filing system.[262] Without satisfying the requirements, a case could not be reopened.[263]

J. *Special Issues in Chapter 13*

1. Co-Debtor Stay

The issue in *Morris v. Zabu Holding Co. (In re Morris)* on appeal to the district court was "whether the bankruptcy court abused its discretion when it determined that a balancing of the equities favored retroactive annulment of the co-debtor stay" imposed by 11 U.S.C. § 1301.[264]

In this case, the creditor obtained relief from the stay as to the debtor, but not as to the co-debtor, and foreclosed on the debtor's real property.[265] The debtor's counsel moved the court to set aside

259. No. 07-13776-RGM, 2008 Bankr. LEXIS 1528, at *1 (Bankr. E.D. Va. May 14, 2008); *see* 11 U.S.C. § 727(a)(11).

260. *In re* Taing, 2008 Bankr. LEXIS 1528, at *1–2.

261. *Id.* at *2.

262. *Id.* at *2–3.

263. *Id.* at *3–4.

264. 385 B.R. 823, 828 (E.D. Va. 2008); *see* 11 U.S.C. § 1301 (2006).

265. *In re* Morris, 385 B.R. at 826.

the foreclosure and reimpose the stay.[266] The purchaser of the real property had already obtained a mortgage on the property and was unaware that relief as to any co-debtor had not been obtained.[267] In balancing the equities, the bankruptcy court retroactively granted relief from the co-debtor stay, thus validating the foreclosure sale.[268] The parties agreed that the balancing of the equities test was appropriate, so the district court was left to consider whether the bankruptcy court had abused its discretion by retroactively annulling the co-debtor stay.[269] Because the bankruptcy court would have granted relief as to the co-debtor if it had been so moved by the creditor, and because the mortgage company who financed the purchase after the foreclosure lacked knowledge as to the lack of relief from the co-debtor stay, the district court held that the bankruptcy court did not abuse its discretion and had correctly applied the balancing of the equities test.[270] The bankruptcy court's judgment was therefore affirmed.[271]

2. The Chapter 13 Plan

a. *Murphy v. O'Donnell (In re Murphy)*

Pursuant to 11 U.S.C. § 1329, the terms of a confirmed Chapter 13 plan may be modified upon request by the debtor, the Chapter 13 trustee, or unsecured creditors at any time before the completion of payments.[272] Courts have held that the doctrine of res judicata prevents modification of the confirmed plan unless there is a showing by the moving party of substantial and unanticipated changes in the debtor's financial condition.[273]

In *Murphy v. O'Donnell (In re Murphy)*, the debtor filed a Chapter 13 bankruptcy, and the court confirmed the debtor's plan, which proposed to pay a 37% dividend to all unsecured creditors.[274] Less than eight months after confirmation, the debtor filed a mo-

266. *Id.*
267. *Id.* at 826–27.
268. *Id.* at 827–28.
269. *Id.*
270. *Id.* at 830–31.
271. *Id.* at 831.
272. 11 U.S.C. § 1329 (2006).
273. *See, e.g.*, Murphy v. O'Donnell (*In re* Murphy), 474 F.3d 143, 149 (4th Cir. 2007); Arnold v. Weast (*In re* Arnold), 869 F.2d 240, 243 (4th Cir. 1989).
274. *In re* Murphy, 474 F.3d at 147.

tion to sell real property.[275] Due to the fair market appreciation of the debtor's real property, he would receive more than $80,000.00 in net proceeds from the sale.[276] The Chapter 13 trustee moved the court to modify the debtor's confirmed plan to pay all unsecured creditors 100% of their claims filed in the case, requiring that approximately $30,000 of the proceeds from the sale be paid to the trustee.[277] Based on this evidence, the bankruptcy court found that there was a substantial and unanticipated change in the debtor's financial condition and, therefore, it granted the trustee's motion to modify the confirmed plan to pay 100% to all unsecured creditors.[278] On appeal, both the district court and the Fourth Circuit concluded that the bankruptcy court did not abuse its discretion in granting the trustee's motion to modify the confirmed plan.[279] Even though property of the estate revests in the debtor upon confirmation under 11 U.S.C. § 1327, that did not preclude the court from granting the trustee's motion to modify the confirmed plan.[280]

b. *In re McLain*

In *In re McLain*, the issue was whether the court could confirm a Chapter 13 plan that proposed to modify a secured creditor's claim when the debt was secured by a mobile home that was also the debtor's principal place of residence.[281]

Section 1322(b)(2) provides that a Chapter 13 plan may not modify the rights of a secured creditor with a security interest in real property that is the debtor's principal residence.[282] Section 101(13A) defines a debtor's principal residence to include a mobile home.[283] In *In re McLain*, the secured creditor, objecting to confirmation of the debtor's plan, argued that reading § 1322(b)(2) in conjunction with § 101(13A) created an ambiguity.[284] Therefore, the creditor argued that the debtor should not be allowed to modify the

275. *Id.*
276. *See id.* at 147 & n.5.
277. *Id.* at 147.
278. *In re* Murphy, 327 B.R. 760, 772 (Bankr. E.D. Va. 2005).
279. *In re* Murphy, 474 F.3d at 147, 154.
280. *Id.* at 153–54 (quoting 11 U.S.C. § 1327(b) (2006)).
281. 376 B.R. 492, 493 (Bankr. D.S.C. 2007).
282. 11 U.S.C. § 1322(b)(2); *In re* McLain, 376 B.R. at 493.
283. 11 U.S.C. § 101(13A).
284. *In re* McLain, 376 B.R. at 494.

creditor's claim secured by the mobile home.[285] The debtor argued that there was no ambiguity between the two code sections as § 1322(b)(2) applies only when the debtor's principal residence is also real property.[286] The court agreed with the debtor that there was no ambiguity, and it held that the debtor could modify the creditor's rights.[287] The mobile home was personal property, and the restriction on modification of a loan secured by real property did not apply.[288]

c. *In re Poole*

In *In re Poole*, a divorce decree provided that Mr. Poole would maintain payments for two credit card accounts, pay half of Ms. Poole's attorney's fees, and execute a note in favor of Ms. Poole, with monthly payments due until paid in full.[289] Mr. Poole executed the required note on March 1, 2007 and filed for Chapter 13 relief on June 6, 2007.[290] Ms. Poole filed a proof of claim for the amount of the note as a priority domestic support obligation and attached a copy of the divorce decree.[291] The note was scheduled as an unsecured debt in the case.[292]

Ms. Poole objected to the plan confirmation, arguing that each of the obligations set forth in the divorce decree were domestic support obligations as defined by § 101(14A), and as such, they were entitled to full priority under § 507(a)(1)(A) and were non-discharge-able pursuant to § 523(a)(5).[293] Additionally, Ms. Poole raised allegations of bad faith, arguing that Mr. Poole filed for bankruptcy shortly after the divorce and that he had previously filed for bankruptcy.[294]

The court first addressed bad faith. Mr. Poole testified that the previous case was due to medical bills from an accident.[295] Without

285. *Id.*
286. *Id.*
287. *Id.* at 494, 496.
288. *See id.* at 495–96.
289. 383 B.R. 308, 310 (Bankr. D.S.C. 2007).
290. *Id.*
291. *Id.*
292. *See id.* at 311.
293. *Id.* at 312; *see* 11 U.S.C. §§ 101(14A), 507(a)(1)(A), 523(a)(5) (2006).
294. *In re* Poole, 383 B.R. at 312.
295. *Id.*

further evidence showing a lack of good faith, and after considering the plan, which included a provision to pay his portion of the debt at issue, the court could not find any reason to conclude that Mr. Poole was proceeding in bad faith.[296]

In addressing claim treatment, the court explained that a "domestic support obligation," as defined in § 101(14A), is a debt "'owed to or recoverable by . . . a spouse [or] former spouse,'" or a debt "'in the nature of alimony, maintenance or support . . . of such spouse [or] former spouse.'"[297] In determining whether the debt is in the nature of alimony, maintenance, or support, the court must look to federal law and must consider whether the obligation was intended to be for support.[298] Here, the agreement between Mr. and Ms. Poole did not label or indicate any obligation in the nature of alimony, maintenance, or support.[299] In family court, Ms. Poole's attorney stated that the agreement was in the nature of debt allocation.[300] The record in the family court gave little insight into the intent behind the agreement other than as debt allocation.[301]

After weighing all of the relevant factors and considering all of the evidence, the court could not find that the debts in question qualified as a "domestic support obligation," and accordingly, they were not entitled to priority treatment under § 507(a)(1)(A).[302] Mr. Poole met his burden of proof, and Ms. Poole's objection to the plan on these grounds was overruled.[303]

d. *IRS v. White (In re White)*

In *IRS v. White (In re White)*, the IRS held a claim secured by personal property of the debtors.[304] The plan treatment of a secured claim is governed by § 1325(a)(5), providing that if the secured creditor does not accept the plan, a debtor may either invoke a

296. *Id.*
297. *Id.* at 312–13 (quoting 11 U.S.C. § 101 (14A)).
298. *See id.* at 314 (citing *In re* Davis, No. 06-10581-DHW, 2007 Bankr. LEXIS 953, at *6–7 (Bankr. M.D. Ala. Mar. 15, 2007)).
299. *Id.* at 315.
300. *Id.*
301. *Id.*
302. *Id.* at 316.
303. *Id.*
304. 487 F.3d 199 (4th Cir. 2007).

"cram-down" or surrender the property subject to the lien.[305] The debtors' plan in *In re White* proposed to satisfy the IRS's secured claim in part by a partial cram-down and partial surrender of the personal property securing the claim, with the remaining secured value to be paid through the plan.[306] The IRS objected to confirmation on several grounds, among which was that the debtors were not surrendering property because the property in question was exempt from administrative levy.[307] The bankruptcy court overruled the objection, finding that the partial surrender was appropriate and that, because the property was exempt from levy, the IRS's claim was unsecured.[308] On appeal, the district court reversed the bankruptcy court, holding that the IRS's claim was not rendered unsecured by the inability of the IRS to levy on the property, and also that under the circumstances of the case, the debtors "could not be said 'to have "surrendered" their property in any meaningful fashion.'"[309]

On further appeal of the surrender issue by the debtors, the Fourth Circuit affirmed the district court, explaining that the debtors' retention of property that is legally insulated from collection was inconsistent with surrender.[310]

3. The Chapter 13 Discharge

In *Branigan v. Bateman (In re Bateman)*, which consolidated appeals from two bankruptcy cases, the Chapter 13 trustee argued that because the debtors were ineligible for discharges under 11 U.S.C. § 1328(f), they were not permitted to file a Chapter 13 petition.[311]

The Code provides that

> the court shall not grant a discharge of all debts provided for in the plan . . . if the debtor has received a discharge—(1) in a case filed under chapter 7, 11, or 12 of this title during the 4-year period preceding the date of the order for relief under this chapter, or (2) in a

305. *See id.* at 202–03 (citing 11 U.S.C. §§ 1325(a)(5)(B), (C) (2006)).
306. *See id.* at 203.
307. *Id.*
308. *Id.*
309. *Id.* at 204 (citing United States v. White, 340 B.R. 761, 765–67 (E.D.N.C. 2006)).
310. *Id.* at 207–08; *see* 11 U.S.C. § 1325(a)(5)(C).
311. 515 F.3d 272, 275 (4th Cir. 2008); *see* 11 U.S.C. § 1328(f).

> case filed under chapter 13 of this title during the 2-year period preceding the date of such order.[312]

One of the debtors, Bateman, previously filed for Chapter 7 bankruptcy protection on March 25, 2005, and received a discharge on June 29, 2005.[313] He filed for Chapter 13 relief on December 12, 2005, in order to stop a pending foreclosure on his residence.[314] If confirmed, his Chapter 13 plan would have paid all claims in full.[315]

The other debtors, the Graveses, filed a joint Chapter 13 bankruptcy petition on January 4, 1999, and received a discharge on June 16, 2004.[316] Similarly, they filed a joint Chapter 13 case on February 7, 2006, to prevent a foreclosure.[317]

The Chapter 13 trustee argued that the Graveses were ineligible to file because § 1328(f)(2) prohibits a discharge in a Chapter 13 case filed within two years of the date of discharge of a previous bankruptcy.[318] The United States Trustee filed a motion in opposition to the Chapter 13 trustee's motion, "arguing that the Graveses were indeed eligible for a discharge under § 1328(f) because the period during which a discharge is prohibited runs from the date of filing in the prior bankruptcy case to the date of filing in the present Chapter 13 case."[319]

The bankruptcy court adopted the "'filing date to filing date' interpretation" and therefore concluded that the Graveses were eligible for discharge because their filings were more than seven years apart.[320] The bankruptcy court thus confirmed the Graveses' plan.[321]

To resolve the Bateman's case, the Fourth Circuit had to "decide whether an individual may file a Chapter 13 petition if he is ineligible for a discharge under § 1328(f)."[322] In that section, the Code

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312. 11 U.S.C. § 1328(f).
313. *In re* Bateman, 515 F.3d at 275.
314. *Id.*
315. *Id.*
316. *Id.* at 276.
317. *Id.*
318. *Id.*
319. *Id.*
320. *Id.* (citing *In re* Graves, No. 06-10634-TJC, 2007 Bankr. LEXIS 1274 at *7–9 (Bankr. D. Md. Jan. 19, 2007)).
321. *Id.* (citing *In re* Graves, 2007 Bankr. LEXIS 1274 at *22–23).
322. *Id.* at 277.

never uses the word "filing"—only "discharge"—and it does not appear to limit the eligibility provisions of § 109(e).[323] As such, "the plain language of § 1328(f) does not prohibit a debtor who is ineligible for a discharge from filing a Chapter 13 petition."[324]

Bateman's case provided for full payment of all allowed claims.[325] The court therefore held that the Chapter 13 filing was in good faith, and it affirmed the district and bankruptcy court's orders denying the trustee's motion to dismiss and confirming Bateman's Chapter 13 plan.[326]

III. BUSINESS BANKRUPTCY CASES

A. *Bad Faith in Chapter 11*

The debtor in *In re Premier Automotive Services, Inc.* filed its Chapter 11 bankruptcy case only two days before the expiration of its holdover, at-will tenancy on land it previously leased from the State of Maryland.[327] The court dismissed the case because it was not filed in good faith, for various reasons.[328] First, because the lease had expired, the debtor did not have any interest in the property at the time the case was filed; hence, it was not property of the bankruptcy estate.[329] Second, the debtor was solvent and was seeking only to delay its eviction from the land, rather than to use the bankruptcy process to reorganize its debts.[330] Third, because the expired lease was not property of the bankruptcy estate, the automatic stay did not apply.[331] Finally, even though the debtor claimed that negotiations with the state would lead to a renewed lease, this unilateral belief did not give rise to a protected property interest under the Due Process Clause.[332] The court made short shrift of the debtor's weak constitutional arguments when it explained:

323. *See id.* at 281; 11 U.S.C. §§ 109(e), 1328(f) (2006).
324. *In re* Bateman, 515 F.3d at 281.
325. *Id.* at 283.
326. *Id.* at 283–84.
327. 492 F.3d 274, 278 (4th Cir. 2007).
328. *Id.* at 277.
329. *Id.* at 280, 282.
330. *Id.* at 280–81.
331. *Id.* at 281.
332. *Id.* at 282.

> Above and beyond all that, Premier's various constitutional claims are not only tenuous at best, but carry us far afield from the purposes of bankruptcy law in general and Chapter 11 petitions in particular. "The purpose of Chapter 11 reorganization is to assist financially distressed business enterprises by providing them with breathing space in which to return to a viable state." To allow resort to the bankruptcy process for plainly meritless constitutional claims advanced solely to thwart lawful eviction would do nothing but subvert the purposes of a Chapter 11 reorganization.[333]

B. *Employee Retirement Income Security Act*

The Supreme Court of the United States, in *Beck v. PACE International Union*, found that the debtor had not breached its fiduciary duties when it failed to consider a union's proposal regarding the debtor's pension plan.[334] The union wanted the debtor to terminate its single-employer defined-benefit pension plan under the Employee Retirement Income Security Act ("ERISA") by merging it with the union's multi-employer plan.[335] The debtor's directors did not accept the union's proposal, and the union sued, claiming that the debtor's directors breached their fiduciary duties by not seriously considering the union's proposal.[336] The Pension Benefit Guaranty Corporation ("PBGC") argued to the Court that the union's proposal was not an accepted method of termination under ERISA.[337] The Court agreed with the PBGC and concluded that the debtor did not breach its fiduciary duties, explaining:

> Even from a policy standpoint, the PBGC's choice is an eminently reasonable one, since termination by merger could have detrimental consequences for plan beneficiaries and plan sponsors alike. When a single-employer plan is merged into a multiemployer plan, the original participants and beneficiaries become dependent upon the financial well-being of the multiemployer plan and its contributing members. Assets of the single-employer plan (which in this case were capable of fully funding plan liabilities) may be used to satisfy commitments owed to *other* participants and beneficiaries of the (possibly underfunded) multiemployer plan. The PBGC believes that this arrangement creates added risk for participants and beneficiaries of

333. *Id.* at 284–85 (quoting *In re* Little Creek Dev. Co., 779 F.2d 1068, 1073 (5th Cir. 1986)) (internal citations omitted).

334. 551 U.S. 96, 110 (2007).

335. *Id.* at 99.

336. *Id.* at 100.

337. *Id.* at 104.

> the original plan, particularly in view of the lesser guarantees that the PBGC provides to multiemployer plans . . . .[338]

C. *Use, Sale, or Lease of Property*

In the Chapter 11 case of *In re The Holladay House*, the district court affirmed the bankruptcy court's judgment that D.M. Reid Associates, an inventory supplier, had a perfected security interest only in the inventory it had conveyed to the debtor under a consignment agreement, not in the debtor's entire inventory.[339]

In the bankruptcy case, the debtor asked the court for authority to use the cash collateral generated from the sale of its nonconsigned inventory.[340] D.M. Reid and another secured creditor with a lien on the debtor's inventory objected to the debtor's motion to allow use of its cash collateral.[341] As to the other secured creditor, the bankruptcy court found that the inventory was valued at $623,145.07, the amount owed to the creditor was $86,070, and that the debtor was paying adequate protection payments in the amount of $3,500 per month.[342] The bankruptcy court granted the debtor's motion as it related to the other creditor because of the equity cushion and the adequate protection payments—allowing the debtor to use the cash collateral generated from the sale of its inventory would not prejudice the other creditor.[343]

Regarding D.M. Reid's purported security interest in the debtor's entire inventory, the bankruptcy court's analysis was more complicated. D.M. Reid claimed that it had a security interest in all inventory because the security agreement executed between it and the debtor granted such a security interest.[344] However, the bankruptcy court found that the financing statement more narrowly defined the collateral as only the inventory that was conveyed to the debtor on consignment.[345] D.M. Reid recorded the financing

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338. *Id.* at 110.

339. *In re* The Holladay House, Inc., No. 3:08cv286, 2008 U.S. Dist. LEXIS 84405, at *1 (E.D. Va. Oct. 21, 2008).

340. *In re* The Holladay House, Inc., 387 B.R. 689, 690–91, 692–93 (Bankr. E.D. Va. 2008).

341. *Id.* at 691.

342. *Id.* at 691–92.

343. *Id.* at 692.

344. *Id.* at 693.

345. *Id.*

statement along with the security agreement, but the financing statement did not incorporate the broader security agreement.[346] The bankruptcy court concluded that the more narrow financing statement was therefore binding, and the court limited D.M. Reid's lien to only the collateral conveyed to the debtor on consignment.[347]

The bankruptcy court reasoned that when a secured creditor chooses to limit the description of its collateral in the financing statement, and when the financing statement in turn describes that particular property as the subject collateral, that limitation overrides a more general collateral description that would be permitted by the UCC.[348] Therefore, although the general description in the security agreement would allow a lien over "inventory," the financing statement in *In re The Holladay House* limited the collateral to "consigned goods," and so the financing statement controlled.[349] If the financing statement had incorporated the security agreement with the broad UCC description of "inventory," a title examiner would have seen that in the record.[350] But because it was not attached to the financing statement, the security agreement did not create a perfected security interest in all inventory.[351] D.M. Reid's perfected security interest therefore attached only to collateral conveyed to the debtor on consignment.[352] Because the debtor's motion related just to non-consigned inventory, the bankruptcy court overruled D.M. Reid's objection to the debtor's use of cash collateral.[353]

Often in bankruptcy cases, a debtor's reorganization depends upon a successful sale of its assets. What happens when a deal is struck but the buyer backs out? The Bankruptcy Court for the Eastern District of Virginia addressed this issue recently in *Wood v. Cumulus Broadcasting LLC (In re Wood)*, where the debtor filed a motion to sell assets of the estate under an asset purchase agreement for the sale of some radio stations it owned.[354] Cumulus

346. *Id.*
347. *Id.* at 695–96.
348. *Id.* at 695 (citing Nw. Acceptance Corp. v. Lynnwood Equip., Inc., 841 F.2d 918, 921 (9th Cir. 1988)).
349. *Id.* at 697.
350. *See id.* at 696.
351. *Id.* at 695–96.
352. *Id.* at 697.
353. *Id.* at 698.
354. No. 00-14460-RGM, 2008 WL 2244972, at *1 (Bankr. E.D. Va. May 30, 2008).

Broadcasting LLC ("Cumulus"), as a competing bidder, filed an objection to the sale and claimed it was willing to pay $1 million more than the bidder chosen by the debtor.[355] The debtor's motion to sell was therefore denied, and Cumulus and the debtor executed a written agreement for the sale of the radio stations.[356] However, this new deal was never brought before the court.[357] Cumulus thereafter declined to close the sale, and the debtor filed an adversary proceeding against Cumulus for breach of contract.[358] Cumulus filed a motion for judgment on the pleadings, arguing that the written agreement conditioned its obligation on court approval.[359] Until the court approved the deal, Cumulus argued that the written agreement was merely a non-binding letter of intent.[360]

The court disagreed with Cumulus and denied its motion for judgment.[361] In doing so, the court applied a three-step analysis: First, is there a contract? Second, may one party to an otherwise valid and enforceable contract unilaterally withdraw from the agreement merely because the bankruptcy court had not yet approved the agreement? Third, should the contract be approved by the bankruptcy court?[362] The court explained, "[w]hat is particularly important is that the determination of whether there was an agreement is separate and distinct from the court's approval of the agreement. The reasons for approving an agreement are different from determining whether there is an agreement."[363] The court very aptly explained that bankruptcy changes the landscape—the bankruptcy process brings third parties into the mix:

> Bankruptcy is a community, multi-party proceeding seeking to adjust the obligations of the parties fairly among all the creditors and interested parties. The purpose of court approval is to protect all of the creditors and interested parties of the estate and to assure that the proposed agreement is fair and reasonable under the circumstances. Outside bankruptcy, this determination is made by the parties to the agreement and is effective upon acceptance of an offer. The parties to a non-bankruptcy agreement are not generally

355. *Id.*
356. *Id.*
357. *Id.*
358. *Id.*
359. *Id.*
360. *Id.*
361. *Id.* at *3.
362. *Id.* at *2 (citing *In re* Frye, 216 B.R. 166, 170–75 (Bankr. E.D. Va. 1997).
363. *Id.* (citing *In re* Frye, 216 B.R. at 174).

> charged with protecting third-party interests. Approval by the bankruptcy court is not the last step in creating a valid contract, [sic] it is a necessary step to assure that the agreement reached by the parties is fair and reasonable to the entire creditor community. A contrary result undermines the bankruptcy process. Mischief can arise if a party to a contract can simply withdraw from it at any time before the court approves the agreement.[364]

The "mischief" referred to by the court is that once the debtor chooses a buyer among competing bidders, the losing bidders will move on while the court approval process is underway, which can take time.[365] The court spelled out the mischievous result of adopting Cumulus' view of things: "If at this point the successful purchaser has the unilateral right to walk away from the deal, he has effectively eliminated his competition and may threaten to walk away unless the terms are changed more favorably to himself."[366]

In this case, all of the material terms of the deal were included in the written agreement.[367] Even if the court has to approve the deal before the debtor can close on the sale of assets under the contract, the parties are bound by the agreement as soon as it is formed.[368] The court retains the discretion to disapprove the deal even though the parties are bound upon formation.[369] The debtor need not first obtain court approval before commencing its breach of contract action, but it may have to prove that the court would have approved the contract to recover on its breach of contract action.[370]

D. *Property of the Estate*

The Bankruptcy Court for the Eastern District of Virginia recently issued opinions that define "property of the estate" under various circumstances.[371] In *Millard Refrigerated Services, Inc. v.*

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364. *Id.*
365. *See id.*
366. *Id.*
367. *Id.* at *1.
368. *Id.* at *3.
369. *See id.*
370. *Id.*
371. *See* Frontier Pepper's Ferry, L.L.C. v. LandAmerica 1031 Exchange Servs., Inc. (*In re* LandAmerica Fin. Group, Inc.), No. 08-03148, 2009 WL 1269578, at *1 (Bankr. E.D. Va. May 7, 2009); Millard Refrigerated Servs., Inc. v. LandAmerica 1031 Exchange Servs., Inc. (*In re* LandAmerica Fin. Group, Inc. II), No. 08-03147-KRH, 2009 WL 1011647, at *1 (Bankr. E.D. Va. Apr. 15, 2009).

Land America 1031 Exchange Services, Inc., the bankruptcy court concluded that funds held by the debtor in its bank accounts on the petition date as part of "1031 exchanges" were not trust funds and, therefore, were property of LandAmerica 1031's bankruptcy estate.[372] This holding impacted the distribution of those funds—if the funds were held in trust, then the claimant would be entitled to the return of his funds, and the funds would not be subject to the claims of other creditors. If the funds were property of the estate, as the bankruptcy court held, then the distribution of the funds would follow the normal course in bankruptcy cases and the claimant would only hold a general unsecured claim against the debtor. This, of course, means that the exchanger would receive only his pro rata share along with all the other unsecured creditors of the debtor.

Relying on cases holding that parol evidence may not be offered to prove a term that was not expressly stated in an integrated contract,[373] the court in *Millard* found that the exchange agreement between Millard and the debtor did not create a trust by its express terms.[374] Therefore, Millard only held a claim for breach of contract, an unsecured claim, against the debtor.[375]

E. *Utilities and Section 366*

As a national big-box retailer, Circuit City received utility service from various utility companies at its 712 retail stores and nine outlet stores throughout the country at the time it filed Chapter 11 bankruptcy.[376] The Bankruptcy Code contains a provision that prevents utility companies from cutting off service for a period of thirty days to a debtor that files a bankruptcy case.[377] Importantly, the general rule in subsection (a) of § 366 prohibiting the termination

372. *In re* LandAmerica Fin. Group, Inc. II, 2009 WL 1011647, at *11–12.

373. Lysk v. Criswell (*In re* Criswell), 52 B.R. 184, 197 (Bankr. E.D. Va. 1985); Robinette v. Robinette, 4 Va. App. 123, 127, 354 S.E.2d 808, 810 (Ct. App. 1987).

374. *Millard*, 2009 WL 1011647, at *12.

375. *See id.*

376. *In re* Circuit City Stores, Inc., No. 08-35653, 2009 Bankr. LEXIS 237, at *2, *7–8 (Bankr. E.D. Va. Jan. 14, 2009).

377. *See id.* at *12; 11 U.S.C. § 366(a) (2006) ("Except as provided in subsections (b) and (c) of this section, a utility may not alter, refuse, or discontinue service to, or discriminate against, the trustee or the debtor solely on the basis of the commencement of a case under this title or that a debt owed by the debtor to such utility for service rendered before the order for relief was not paid when due.").

of utility service "is subject to two exceptions—the exception contained in subsection (b) and the exception contained in subsection (c)."[378] Subsection (b) provides that the "debtor must furnish what it considers to be adequate assurance of payment within twenty days after the petition date in the form of a deposit or other security for postpetition service."[379] In this case, Circuit City furnished a blocked account that the court found to be the equivalent of a letter of credit, which constitutes an assurance of payment as required by § 366.[380]

The second exception, in subsection (c), provides that "a utility company may discontinue service in a Chapter 11 case if it does not receive 'during the 30-day period beginning on the date of the filing of the petition . . . adequate assurance of payment for utility service that is *satisfactory* to the utility.'"[381] The court explained that this subsection is susceptible to a strange interpretation:

> Conceivably, under § 366(c)(2), the Debtors could receive a demand from a utility company at the end of such thirty-day period and be compelled to accede to the demand immediately or face termination of critical utility services. On the other hand, the Debtors could receive no demand at all and nonetheless be subject to the same fate.[382]

Circuit City, in an attempt to foreclose this strange result and "impose order on an otherwise disorganized and haphazard process," asked the court on the first day of its case to enter an order to establish procedures that would effectively implement the provisions of § 366.[383] The court held that it had the discretion, even after BAPCPA, to modify the amount of adequate assurance and adopt the procedures set forth in Circuit City's proposed order without first waiting for the utility company to make a demand under subsection (c).[384] As the court explained, "[t]he first clause of § 366(c)(2)

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378. *In re* Circuit City Stores, Inc., 2009 Bankr. LEXIS 237, at *12.

379. *Id.* at *13. This requirement does not equal an absolute guarantee of payment. *Id.*; *see* 11 U.S.C. § 366(b) (2006).

380. *In re* Circuit City Stores, Inc., 2009 Bankr. LEXIS 237, at *13.

381. *Id.* at *15 (quoting 11 U.S.C. § 366(c)(2)).

382. *Id.*

383. *Id.*

384. *Id.* at *15–17.

clearly renders the entire section subject to the court's authority outlined in § 366(c)(3)."[385]

The "court's authority" is summarized as follows:

> Section 366(c)(3)(A) provides that "[o]n request of a party in interest and after notice and a hearing, the court may order modification of the amount of an assurance of payment under paragraph (2)." Assurance of payment is defined in § 366(c)(1), and upon a request for a hearing under § 366(c)(3)(A), the court must determine whether the assurance of payment is adequate, operating within the restrictions outlined in § 366(c)(3)(B). In sum, the court is authorized to modify the assurance of payment pursuant to § 366(c)(3)(A) after notice and a hearing, and a debtor is not required to first pay a demand that is unilaterally satisfactory to the utility company.[386]

Therefore, because the court found that the blocked account-*cum*-letter of credit provided adequate assurance to the utility companies as required by § 366, the court extended the thirty-day injunction against disruption of utility service.[387] Doing so "avoid[ed] a haphazard and chaotic process whereby each utility could make extortionate, last-minute demands for adequate assurance which the Debtors would be pressured to pay under the threat of losing critical utility service."[388]

F. *Claims*

The case of *In re J.A. Jones, Inc.* arose out of a tragic car accident in North Carolina.[389] In January 2003 Laura Dunnagan died after spending eighty-three days in the burn unit of the University of North Carolina Hospital as a result of severe burns and other injuries she sustained in a car accident that occurred in a construction zone on a North Carolina interstate highway.[390] The general contractor, Rea Construction Company ("Rea"), eventually became one of the debtors in the *In re J.A. Jones* bankruptcy case.[391] The evidence showed that Rea knew about the accident shortly after it occurred and that Rea notified Zurich American Insurance Com-

385. *Id.* at *17 (citations omitted).
386. *Id.* at *18; 11 U.S.C. § 366(c) (2006).
387. *In re* Circuit City Stores, Inc., 2009 Bankr. LEXIS 237, at *21–22.
388. *Id.* at *22–23.
389. 492 F.3d 242, 245 (4th Cir. 2007).
390. *Id.* at 245–46.
391. *Id.* at 245.

pany ("Zurich") in accordance with the provision of its liability insurance policy that required Rea to report any occurrence which may result in a claim.[392] The insurance company undertook extensive investigation of the accident, expecting to be sued by Dunnagan and other victims involved in the accident.[393] The accident was widely covered in the local media, and

> [o]ne newspaper article, in particular, contained a photograph of Dunnagan and reported the details of the Dunnagan Accident, as well [sic] Dunnagan's death on January 22, 2003. [The Rea project manager] cut this article out of the newspaper and kept it in his office in a location where it could readily be observed as a continuing reminder of the importance of safety in Rea's work.[394]

About a year after the accident, J.A. Jones, Inc., and various subsidiaries, including Rea, filed for Chapter 11 bankruptcy.[395] The bankruptcy court set the bar date for creditors to file prepetition claims against the estate at February 2, 2004.[396] Notice of the filing of the bankruptcy case and the claims bar date was served on "certain known creditors" of the debtors, but Dunnagan's estate did not receive such notice.[397] Notice was also published in *The Wall Street Journal* and *The Charlotte Observer*.[398] Later, in the summer of 2004, the debtors served notice of the August 18, 2004, confirmation hearing on the debtors' Chapter 11 plan to certain known creditors and published the notice in the same newspapers, but again Dunnagan's estate did not receive such notice or see the published notices.[399] The estate did not know about the bankruptcy

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392. *Id.* at 246.

393. *Id.* The court exhaustively listed the measures undertaken by Rea and Zurich in the accident investigation:

> Among the documents Rea assembled were accident reports prepared by the State Highway Patrol disclosing Dunnagan's name, address and date of birth; newspaper articles regarding the I-77 accidents; press releases regarding the I-77 construction project; photographs; roadway diagrams; project diaries; project supervisor diaries; and other documents concerning Rea's potential liability for the I-77 construction zone accidents, including specifically the Dunnagan Accident. Cheek [,the Rea project manager,] also prepared a timeline of critical events pertaining to the I-77 accidents. A copy of this timeline, together with approximately 250 pages of assembled relevant documents, was sent by Cheek to the Rea Claims Department, as well as to Zurich.

Id.

394. *Id.* at 246–47.

395. *Id.* at 247.

396. *Id.*

397. *Id.* at 247–48.

398. *Id.* at 248.

399. *Id.*

case until late October 2004, long after the bar date had passed, and over a month after the bankruptcy court had approved the debtors' Chapter 11 plan.[400]

On December 9, 2004, the administrator of Dunnagan's estate filed a motion in the bankruptcy court for an extension of time to file a claim against the bankruptcy estate and a determination that Dunnagan's estate was not bound by the confirmed plan because it was a known creditor that did not receive actual notice of the debtors' bankruptcy case and the applicable deadlines.[401] Zurich opposed the administrator's motion, and the court held several hearings on the claims bar date issue and ancillary issues such as granting relief from the automatic stay so that the estate could sue Rea in state court before the statute of limitations period ran out under state law.[402] Almost a year after the administrator filed the motion for an extension, the bankruptcy court granted the motion by final order on December 20, 2005, and allowed the late filing of a prepetition claim against the bankruptcy estate.[403] The bankruptcy court also found that Dunnagan's estate was not bound by the liquidation plan because it was a known creditor of Rea and did not receive actual notice of the filing of the bankruptcy case, the claims bar date, the confirmation hearing date, or the deadline for filing objections to the debtors' Chapter 11 plan.[404] Zurich appealed the final order of the bankruptcy court to the district court, which affirmed the judgment of the bankruptcy court on June 20, 2006.[405] Zurich then appealed to the Court of Appeals for the Fourth Circuit.[406]

The Fourth Circuit stated that the appeal turned on whether Dunnagan's estate was a known or unknown creditor:

> In this regard, to achieve a constitutionally permissible discharge of a known creditor's claim against a debtor, actual notice of the bankruptcy filing and applicable bar date is required. By contrast, where a creditor is unknown to the debtor, constructive notice—typically in

400. *Id.*
401. *Id.*
402. *Id.*
403. *Id.*
404. *Id.*
405. *Id.* at 249.
406. *Id.*

> the form of publication—is generally sufficient to pass constitutional muster.[407]

In this case, because of the personal knowledge of Rea's employees, the coverage of the accident in the local media, the reporting of the accident to Rea's insurer, and the investigation of the accident which was conducted by Rea and Zurich jointly, the Fourth Circuit held that Dunnagan's estate was a known creditor of the debtor and was therefore entitled to actual notice.[408] To explain the rule, the court wrote:

> What is reasonable depends on the particular facts of each case. A debtor need not be omnipotent or clairvoyant. A debtor is obligated, however, to undertake more than a cursory review of its records and files to ascertain its known creditors. Thus, stated succinctly, a known creditor or claim arises from facts that would alert a reasonable debtor, based on a careful examination of its own books and records, to the possibility that a claim might reasonably be filed against it by a particular individual or entity.[409]

In *In re Rowe Furniture, Inc.*, a creditor filed proofs of claim in the Chapter 11 case of the debtor's parent company, but not in the debtor's case, because the creditor mistakenly believed the parent was liable for the debt rather than the debtor.[410] The creditor also filed an objection to the sale of the debtor's assets in the debtor's case while the debtor was still in Chapter 11, but before the conversion to Chapter 7, asserting that it was the holder of claims against the debtor.[411] After the bar date for filing claims in the debtor's case passed, the creditor realized its mistake—it had filed its proofs of claims in the parent company's case and not the debtor's.[412] The creditor asked the court to allow the claims in the debtor's Chapter 7 case as amendments to the claims that had been timely filed in the parent's case.[413] The court held that those proofs of claims filed in the parent company's case could not be informal proofs of claim in the debtor's Chapter 7 case, but the creditor's ob-

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407. *Id.* at 249–50 (footnotes omitted).

408. *Id.* at 251–52.

409. *Id.* at 251 (quoting *In re* Drexel Burnham Lambert Group, Inc., 151 B.R. 674, 681 (Bankr. S.D.N.Y. 1993)) (citation omitted); *see also* Bosiger v. U.S. Airways, Inc., 510 F.3d 442, 451–52 (4th Cir. 2007); *In re* U.S. Airways, Inc., No. 04-13819-SSM, 2008 WL 850659, at *5–6 (Bankr. E.D. Va. Mar. 27, 2008).

410. 384 B.R. 732, 734–35 (Bankr. E.D. Va. 2008).

411. *Id.*

412. *Id.*

413. *Id.* at 735.

jection to the sale of the debtor's assets could be treated as an amendable proof of claim.[414] The court relied on the Fourth Circuit's liberal allowance of informal claims.[415]

1. Administrative Expenses

The Bankruptcy Court for the Eastern District of Virginia held in *In re Circuit City Stores, Inc.* that the debtor, Circuit City, did not have to immediately pay "stub rent" for the month in which it filed for bankruptcy.[416] "Stub rent" is the portion of rent due for the post-petition period of occupancy from the date of the petition through the end of the month.[417] For example, Circuit City filed its case on November 10, 2008, and the "stub rent" was the rent due for occupancy during November 10–November 30.[418] At the time Circuit City filed its bankruptcy petition it had not paid any rent to the lessors at issue.[419] A complicating fact was that there were two types of leases—arrears leases and advance leases.[420] Arrears leases are those lease agreements where the rent for November is due on November 30th; i.e., the rent for the month is paid in arrears.[421] Advance leases are those lease agreements where the rent for November is due on November 1st; i.e., the rent for the month is paid in advance.[422] In bankruptcy, the date the petition is filed generally cuts off prepetition debts from post-petition debts.[423]

The lessors filed motions to compel Circuit City to immediately pay the stub rent, arguing that § 365(d)(3) requires the debtor to do so.[424] Section 365(d)(3) provides in relevant part that

> [t]he trustee shall *timely* perform all the *obligations* of the debtor [except certain obligations not applicable in this case] *arising from and after the order for relief* under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, not-

414. *Id.* at 738.

415. *Id.*; *see* Davis v. Columbia Constr. Co. (*In re* Davis), 936 F.2d 771, 775–76 (4th Cir. 1991); *Fyne v. Atlas Supply Co.*, 245 F.2d 107, 109 (4th Cir. 1957).

416. No. 08-35653, 2009 Bankr. LEXIS 672, at *24–25 (Bankr. E.D. Va. Feb. 12, 2009).

417. *See id.* at *4.

418. *Id.*

419. *Id.* at *3.

420. *Id.*

421. *See id.*

422. *See id.*

423. *See id.* at *11.

424. *Id.* at *3–4; *see* 11 U.S.C. § 365(d)(3) (2006).

> withstanding section 503(b)(1) of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period.[425]

So the question in this case was whether the obligation to pay rent under these leases arose "from and after" the order for relief (the petition date in this case.[426] The court described two different methods for answering that question—the "accrual method" and the "billing method."[427] The accrual method means that the obligation arises day by day, and so the filing of the petition cuts off prepetition rent from post-petition rent.[428] The billing method means that the obligation arises when the payment is due under the terms of the lease, so using this method would lead to different results depending on whether the lease is advance or arrears.[429] Under the billing method, an advance lease in this case would result in the rent for November being a prepetition claim, no matter that the debtor would have occupied the premises post-petition and thereby gained a post-petition benefit.[430] Conversely, an arrears lease would result in the rent for November being an entirely post-petition claim, elevating such a lessor's position over similarly situated lessors who happen to hold advance leases.[431] The court followed the decision in *In re Trak Auto Corp.* and held that the accrual method applies in the Fourth Circuit.[432]

The next question was when stub rent must be paid, since stub rent is paid as an administrative expense because the obligation arises post-petition.[433] Section 365(d)(3) uses the term "timely," but does not define when "timely" payment occurs.[434] The court held that "timely" means whatever the lease term says it means—an arrears lease says timely performance is at the end of the month,

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425. *In re* Circuit City Stores, Inc., 2009 Bankr. LEXIS 672, at *7 (quoting 11 U.S.C. § 365(d)(3) (2006)).

426. *Id.* at *9.

427. *Id.* at *10; *see In re* Trak Auto Corp., 277 B.R. 655, 662 (Bankr. E.D. Va. 2002), *rev'd on other grounds*, 367 F.3d 237 (4th Cir. 2004) (noting that a minority of courts have adopted the "billing method" while the majority of courts have adopted the "accrual method").

428. *See In re* Circuit City Stores, Inc., 2009 Bankr. LEXIS 672, at *11.

429. *Id.* at *10–12.

430. *Id.*

431. *Id.* at *11–12.

432. *Id.* at *12 (citing *In re* Trak Auto Corp., 277 B.R. at 663 n.2).

433. *Id.* at *17.

434. *Id.* at *17–18; *see* 11 U.S.C. § 365(d)(3) (2006).

and advance leases say timely performance is at the beginning of the month.[435] Because the time for timely performance on advance leases expired prepetition, the stub rent on those leases should be paid as an administrative expense along with all other administrative expenses—upon plan confirmation.[436] Because the time for timely performance on arrears leases had not yet expired, the time for performance was at the end of the month, and § 365(d)(3) compels the debtor to pay such stub rent at the end of the month.[437] However, the remedy for the debtor not complying with this requirement is not immediate payment of the stub rent.[438] For example, the court held that the debtor must pay stub rent at the end of the month for its arrears leases.[439] If the debtor does not do so, the court may not order immediate payment because to do so would elevate the claim for stub rent to superpriority status, which is not allowed under the Code.[440] The only remedy is that stub rent shall in any event be paid upon plan confirmation if the debtor does not pay it before then.[441]

2. Voting Rights

Simon, of *In re Simon*, was the owner of a medical practice and filed a Chapter 13 bankruptcy case, but then converted it to Chapter 11.[442] Three former patients filed unliquidated medical malpractice tort claims that exceeded $13 million.[443] Simon objected to the three claims, arguing that they should all be classified separately from the liquidated, undisputed, nonpriority unsecured claims filed in his case.[444] These other unsecured claims totaled approximately $627,000.[445] Simon also wanted to estimate the amount of the med-

435. *In re* Circuit City Stores, Inc., 2009 Bankr. LEXIS 672, at *22.
436. *Id.* at *22–23.
437. *Id.* at *22; *see* 11 U.S.C. § 365(d)(3).
438. *Id.* at *24–25.
439. *Id.* at *25.
440. *Id.* at *24; *see also In re* Va. Packaging Supply Co., 122 B.R. 491, 494–95 (Bankr. E.D. Va. 1990).
441. *Id.* at *25.
442. No. 07-31414-KRH, 2008 Bankr. LEXIS 2787, at *2 (Bankr. E.D. Va. July 29, 2008).
443. *Id.* at *3.
444. *Id.* at *4.
445. *Id.* at *2–3.

ical malpractice tort claims for voting purposes.[446] The former patients objected to Simon's proposed treatment of their claims.[447]

The court agreed with Simon that the medical malpractice claims should be separately classified and estimated at $1.00 each for voting purposes.[448] The Code provides that a Chapter 11 plan cannot be confirmed unless at least one-half of the creditors, representing two-thirds of the amount of allowed claims in a particular class, vote in favor of the plan.[449] The former patients argued that Simon's proposal improperly reclassified their claims in an attempt to limit the impact of their vote.[450] They stated that their claims were substantially similar to all the other general, nonpriority unsecured claims.[451] Section 1122(a) allows for substantially similar claims to be placed in different classes only if the debtor (or plan proponent, if different from the debtor) can articulate legitimate differences between the two proposed classes and the separate classification is in the best interests of creditors in general.[452]

The court did not agree with the former patients for several reasons. First, it would not be expedient to administer Simon's case with the tort claims outstanding.[453] Liquidation of personal injury tort claims is not a "core" matter appropriately decided by a bankruptcy court, and so the district court would have jurisdiction over the medical malpractice lawsuits.[454] Determining the exact amount of damages for each of the medical malpractice tort claims could take years in the district court.[455] If the tort claims were not separately classified and estimated for voting purposes, Simon would have to wait years for the district court judgments before he could propose a confirmable plan. Second, the court held that the medical malpractice claims were unliquidated and disputed—very different from the unsecured claims that were liquidated and undis-

446. *Id.* at *4.
447. *Id.* at 4–5.
448. *Id.* at *22.
449. *Id.* at *6 (citing 11 U.S.C. § 1126(c) (2006)).
450. *Id.* at *11.
451. *Id.* at *10.
452. 11 U.S.C. § 1122(a).
453. *In re* Simon, 2008 Bankr. LEXIS 2787, at *16–17.
454. *Id.* at *17.
455. *Id.*

puted.[456] Separate classification of the malpractice claims made sense given their fundamentally different nature. Finally, only "allowed" claims give rise to the right to vote on a plan. Section 502(a) of the Code says that an allowed claim is one to which no objection has been made.[457] Here, Simon objected to the claims.[458] Rule 3018(a) of the Federal Rules of Bankruptcy Procedure provides for the temporary allowance of claims just for voting purposes, and § 502(c) allows the court to estimate claims that are temporarily allowed for voting purposes.[459] The court noted that $1.00 is recognized as a reasonable estimation of tort claims, so the former patients could determine their relative voting power—each of the three tort claimants would have equal weight within their new separate class.[460]

G. *Professionals and Petition Preparers*

1. *In re Rennie Petroleum Corp.*

In *In re Rennie Petroleum Corp.*, the bankruptcy court denied retroactive employment under § 327 of a business analyst for the debtor, and also denied the alternative request for compensation for the business analyst under § 503(b)(4) for having made a "substantial contribution" to the debtor's case.[461] Without filing an application to employ the analyst as a professional for the debtor, the analyst nonetheless began providing services to the debtor shortly after the case was filed.[462] During the course of the analyst's work for the debtor, the debtor alternately considered retaining him as a consultant, a CFO, or as an investment banker.[463] The debtor had already filed applications to employ its counsel, as well as an accountant and financial advisor.[464] A few months after the case was filed, the debtor filed an application to employ a different entity as investment banker to assist in the marketing and sale of the entire

456. *Id.* at *17–18.
457. 11 U.S.C. § 502(a) (2006).
458. *In re* Simon, 2008 Bankr. LEXIS 2787, at *14.
459. 11 U.S.C. § 502(c); FED. R. BANKR. P. 3018(a).
460. *In re* Simon, 2008 Bankr. LEXIS 2787, at *21–22.
461. 384 B.R. 412, 414, 417–18 (Bankr. E.D. Va. 2008); *see* 11 U.S.C. §§ 327, 503(b)(4).
462. *In re* Rennie Petroleum Corp., 384 B.R. at 414.
463. *Id.* at 414–15.
464. *Id.* at 414.

business.[465] Only after the analyst was not selected for the position of investment banker did the debtor file its application to employ the analyst as a professional person under § 327 retroactive to the time when he began providing services to the debtor.[466] Alternatively, the debtor argued that the analyst should be compensated under § 503(b)(4) because he had provided a "substantial contribution" to the debtor's bankruptcy case.[467] The Official Committee of Unsecured Creditors objected to the retroactive employment and to the request for compensation under § 503(b)(4).[468]

The bankruptcy court explained that "[a] professional person may be compensated from the bankruptcy estate in a Chapter 11 case only if that professional's employment was properly authorized by the court pursuant to 11 U.S.C. §§ 327 or 1103."[469] A professional person who performs services without first getting his employment approved by the court "will be treated as a volunteer notwithstanding that the services rendered may have been beneficial to the bankruptcy estate."[470] The reason behind this rule is that "[r]equiring prior court authorization of employment affords the Court as well as the parties in the case the opportunity to assess the wisdom or propriety of using estate assets in the manner proposed. It is a means by which the Court can control administrative expenses."[471] There is an exception to this hard-and-fast rule for extraordinary circumstances, and the movant bears the burden of proof on two elements: "(1) the professional [must] satisfactorily explain the failure to obtain prior approval of employment and (2) the professional [must] meet the requirements set forth in § 327 and Rule 2014(a), aside from that of obtaining timely court appointment."[472] In this case, the debtor was unable to explain the failure to obtain prior court approval.[473] The court explained:

> The Debtor initially planned to hire [the analyst] as a salaried officer. Later the Debtor considered employing [the analyst] to oversee

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465. *Id.* at 415.

466. *Id.*

467. *Id.* at 414; *see* 11 U.S.C. § 503(b)(4) (2006).

468. *In re* Rennie Petroleum Corp., 384 B.R. at 414.

469. *Id.* at 415 (citing *In re* Hagan, 145 B.R. 515, 518 (Bankr. E.D. Va. 1992); *see* 11 U.S.C. §§ 327, 1103 (2006).

470. *In re* Rennie Petroleum Corp., 384 B.R. at 415 (citing *In re* Fountain Bay Mining Co., 46 B.R. 122, 124 (Bankr. W.D. Va. 1985)).

471. *Id.* at 416.

472. *Id.*; *see* 11 U.S.C. § 327; FED. R. BANKR. P. 2014(a).

473. *In re* Rennie Petroleum Corp., 384 B.R. at 416.

> the sale of its business pursuant to § 363 of the Bankruptcy Code. Both of these situations would have required the prior approval of the Court. The competing roles in which it had been contemplated that [the analyst] might serve the estate were mutually exclusive. It appears that the parties elected to delay the submission of the initial employment application so as not to preclude [the analyst] from consideration for engagement as the Debtor's investment banker. While the Court is sympathetic to [the analyst]'s situation . . . the Code requires, and proper functioning of bankruptcy cases demands, that the procedures in the Code and the Bankruptcy Rules be followed as they relate to the employment and compensation of professionals. The process is designed so as to permit parties in interest to understand (as a result of the notice and disclosure required by those procedures) the extent to which the estate may be depleted by the employment of the proposed professional.[474]

The court sustained the committee's objection to the retroactive employment.[475] Turning next to the debtor's "substantial contribution" argument under § 503(b)(4), the court rejected that argument because § 503(b)(4) is applicable only to an entity whose expenses are allowable under § 503(b)(3).[476] The analyst in this case provided services to the debtor, not to one of the six categories of entities under § 503(b)(3), and therefore, § 503(b)(4) was inapplicable to the analyst's request for compensation under that Code section—"no matter how substantial his contribution may have been to this case."[477]

2. *McDow v. Mayton*

Under the Code, a "bankruptcy petition preparer" is a "person, other than an attorney for the debtor or an employee of such attorney under the direct supervision of such attorney, who prepares for compensation a document for filing," which includes "a petition or any other document prepared for filing by a debtor in a United States bankruptcy court."[478] Because these persons are not attorneys bound by professional standards, the Code places several restrictions and penalties upon bankruptcy petition preparers for

474. *Id.* at 416–17; *see* 11 U.S.C. § 363.
475. *In re* Rennie Petroleum Corp., 384 B.R. at 417–18.
476. *Id.* at 417; *see* 11 U.S.C. § 503(b)(3), (4).
477. *In re* Rennie Petroleum Corp., 384 B.R. at 417.
478. 11 U.S.C. § 110(a).

negligent or fraudulent preparation of documents and for the unauthorized practice of law.[479]

In *McDow v. Mayton*, the United States Trustee filed a complaint against such a person, who was not a licensed attorney but had prepared several documents for a debtor in a North Carolina bankruptcy case, and obtained a default judgment when the defendant petition preparer failed to respond to the complaint.[480] The District Court for the Eastern District of Virginia found that the defendant violated numerous subsections of § 110 because he provided legal advice to the Chapter 11 debtor, did not disclose his social security number, and implied that he was a licensed attorney.[481] The court permanently enjoined him from acting as a bankruptcy petition preparer in any bankruptcy court or district court of the United States, from using a computer, Internet website, or other electronic means to violate § 110, and from the unauthorized practice of law.[482]

H. *Taxation:* Florida Department of Revenue v. Piccadilly Cafeterias, Inc.

In a 7-2 decision, the Supreme Court of the United States ruled that the stamp-tax exemption contained in 11 U.S.C. § 1146(a)[483] applies only to post-confirmation transfers made under the authority of a confirmed plan—not to transfers made after the Chapter 11

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479. *See* 11 U.S.C. § 110(b).

480. 379 B.R. 601, 602–03 (E.D. Va. 2007).

481. *Id.* at 604–05; *see* 11 U.S.C. § 110. The court elaborated that this person

> distributed bankruptcy advice under the name "John Hall" via an internet website known as "*www.allexperts.com.*" On this website, [the defendant] advertised that he has the following "Expertise": "Law school graduate (J.D.) Degree; Over 25 years of experience throughout the United States in bankruptcy law matters (Chapters 7, 11, and 13 of the United States Bankruptcy Code) primarily representing individual debtors with consumer debt or small businesses; Experience has included all aspects of debtor/creditor relations." [The defendant] offered "FREE BANKRUPTCY HELP." He stated, "I will not charge you just to talk on the phone" and listed his phone number and personal email address at which potential clients could contact him.

McDow v. Mayton, 379 B.R. at 604.

482. *Id.* at 608.

483. Section 1146(a) provides that "[t]he issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax." 11 U.S.C. § 1146(a).

case is filed but before the plan is confirmed.[484] The importance of the opinion is not necessarily just the result—especially in the Fourth Circuit because the Court adopted the prior rule in the Fourth Circuit—but also the method the Court used to interpret the Bankruptcy Code.

In general, stamp taxes

> share the following common elements: (1) they are imposed only at the time of transfer or sale of the item at issue; (2) the amount due is determined by the consideration for, par value of, or value of the item being transferred; (3) the tax rate is a relatively small percentage of the consideration, par value or value of the property; (4) the tax is imposed irrespective of whether the transferor enjoyed a gain or suffered a loss on the underlying sale or transfer; and (5) in the case of state documentary transfer taxes, the tax must be paid as a prerequisite to recording.[485]

Before the *Piccadilly* case, the federal circuit courts of appeals were split on the question of whether the plan already had to be confirmed at the time of the transfer for the exemption from stamp taxes to apply.[486] The Third and Fourth Circuits ruled that the "under a plan confirmed" language in Section 1146(a) is read to mean under a plan *that has been confirmed.*[487] After the Eleventh Circuit ruled in *Piccadilly* that preconfirmation transfers are exempt from stamp taxes, the Supreme Court of the United States granted certiorari to resolve the question.[488] The Court first noted that "Florida and Piccadilly base[d] their competing readings of § 1146(a) on the provision's text, on inferences drawn from other Code provisions, and on substantive canons of statutory construction. We consider each of their arguments in turn."[489]

The provision's text. When the Court analyzed the text of § 1146(a), it discussed the parties' arguments about whether the word "under" renders the statute facially ambiguous.[490] Florida as-

484. Fla. Dep't of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. __, 128 S. Ct. 2326, 2330 (2008).

485. 995 Fifth Ave. Assocs., L.P. v. N.Y. State Dep't of Taxation & Fin. (*In re* 995 Fifth Ave. Assocs., L.P.), 963 F.2d 503, 512 (2d Cir. 1992).

486. *See* Lorenzo Marinuzzi & Jordan A. Wishnew, Piccadilly Cafeterias: *Congress Should Revisit Supreme Court's Bright-Line Test*, 27-6 AM. BANKR. INST. J. 1, 55 (2008).

487. *See In re* Hechinger Inv. Co. of Del., 335 F.3d 243, 246 (3d Cir. 2003); *In re* NVR, LP, 189 F.3d 442, 458 (4th Cir. 1999).

488. *Piccadilly*, 128 S. Ct. at 2331.

489. *Id.*

490. *Id.* at 2332–33.

serted that "under" means "subject to" and that "plan confirmed" means "confirmed plan"; thus, the stamp tax exemption would apply only to transfers that are "subject to a plan that has been confirmed subject to § 1129," and transfers made preconfirmation "cannot be subject to, or under the authority of, something that did not exist at the time of the transfer."[491] Piccadilly asserted that the language is ambiguous and could be read to mean "in agreement with a plan confirmed" so long as the transfers had "some nexus" with a plan that is eventually confirmed.[492] But the Court held:

> Although we agree with Florida that the more natural reading of § 1146(a) is that the exemption applies only to postconfirmation transfers, ultimately we need not decide whether the statute is unambiguous on its face. Even assuming, *arguendo*, that the language of § 1146(a) is facially ambiguous, the ambiguity must be resolved in Florida's favor.[493]

Even though the Court did not decide whether the language of § 1146(a) is or is not ambiguous, it nonetheless concluded:

> While both sides present credible interpretations of § 1146(a), Florida has the better one. To be sure, Congress could have used more precise language—*i.e.*, "under a plan *that has been* confirmed"—and thus removed all ambiguity. But the two readings of the language that Congress chose are not equally plausible: Of the two, Florida's is clearly the more natural.[494]

Inferences drawn from other Code provisions. The Court discussed the parties' competing arguments about other Code provisions that do unambiguously place a temporal limitation on their provisions.[495] Piccadilly argued that, for example, § 1127 states that the proponent of a plan may modify it "at any time before confirmation"; § 1104(a) states "[a]t any time after the commencement of the case but before confirmation of a plan . . ."; § 1104(c) states "[a]t any time before the confirmation of a plan . . . ."[496] Therefore, Piccadilly argued that Congress clearly did not intend for § 1146(a) to include a temporal limitation because it did not clearly include one.[497] Furthermore, Piccadilly "buttresse[d] its conclusion by

491. *Id.* at 2332; *see* 11 U.S.C. § 1129 (2006).
492. *Piccadilly*, 128 S. Ct. at 2332–33.
493. *Id.* at 2333.
494. *Id.* at 2332.
495. *Id.* at 2333.
496. *Id.*; 11 U.S.C. § 1104(a), (c), 1127.
497. *Piccadilly*, 128 S. Ct. at 2333.

pointing out that § 1146(b)—the subsection immediately following § 1146(a)—includes an express temporal limitation."[498] Piccadilly pointed to still other Code sections to illustrate the folly of reading the word "under" in § 1146(a) to mean "subject to" or "authorized by."[499] On the other hand, Florida argued that "the subchapter in which § 1146(a) appears is entitled 'POSTCONFIRMATION MATTERS,'" and that, "while not dispositive, the placement of a provision in a particular subchapter suggests that its terms should be interpreted consistent with that subchapter."[500] Florida argued that "it would have been superfluous for Congress to add any further limitations to § 1146(a)'s already unambiguous temporal element."[501]

The Court was again persuaded by Florida's argument. The Court concluded that "[i]t was unnecessary for Congress to include in § 1146(a) a phrase such as 'at any time after confirmation of such plan' because the phrase 'under a plan confirmed' is most naturally read to require that there be a confirmed plan at the time of the transfer."[502] Rejecting Piccadilly's "curious interpretation" of § 1146, the Court reasoned that

> [t]o read the statute as Piccadilly proposes would make § 1146(a)'s exemption turn on whether a debtor-in-possession's actions are consistent with a legal instrument that does not exist—and indeed may not even be conceived of—at the time of the sale. Reading § 1146(a) in context with other relevant Code provisions, we find nothing justifying such a curious interpretation of what is a straightforward exemption.[503]

More curious is the Court's failure to discuss in this context what it acknowledged earlier in the opinion—"On January 26, 2004, as a precondition to the sale, Piccadilly entered into a global settlement agreement with committees of senior secured noteholders and unsecured creditors. The settlement agreement dictated the priority of distribution of the sale proceeds among Piccadilly's creditors. . . . The sale closed on March 16, 2004."[504] At the time the

498. *Id.* (citing 11 U.S.C. § 1146(b) (2006)).

499. *Piccadilly*, 128 S. Ct. at 2334 (discussing 11 U.S.C. §§ 303(a), 365(g)(1), 1123(b)(2)).

500. *Id.* at 2334–35.

501. *Id.* at 2335.

502. *Id.*

503. *Id.*

504. *Id.* at 2330.

sale closed, the plan had not been submitted to the bankruptcy court.[505] But the Court did not mention the global settlement agreement—which in this case served many of the same functions of a plan, such as dictating the priority of distribution of sale proceeds—when it said that the plan was a legal instrument that did not exist and may not even have been conceived of. How could Congress have intended the words "under a plan confirmed" to refer to a legal instrument that may not exist? As Justice Breyer noted in the dissent, "[t]he absence of a clear answer in text or canons, however, should not lead us to judicial despair. Consistent with Court precedent, we can and should ask a further question: *Why* would Congress have insisted upon temporal limits? What reasonable *purpose* might such limits serve?"[506]

The Court determined that "one major reason why a transfer may take place *before* rather than *after* a plan is confirmed is that the preconfirmation bankruptcy process takes time."[507] If the statutory objectives set forth in the Bankruptcy Code are to preserve the value of the business as a going concern and to maximize creditors' recovery by providing tax relief to debtors for the facilitation of bankruptcy asset sales, then how, Justice Breyer asks, "would the majority's temporal limitation further these statutory objectives? It would not do so in any way," and "[i]n fact, the majority's reading of temporal limits in § 1146(a) serves *no reasonable congressional purpose at all*."[508] Justice Breyer argues that the statutory objectives are clear—"turn[ ] over to the estate (for the use of creditors or to facilitate reorganization) funds that otherwise would go to pay state stamp taxes on plan-related transferred assets"—and that the temporal limitation actually undermines those objectives.[509] Justice Breyer explains the congressional purpose behind the "under a plan confirmed" language as "provid[ing] the bankruptcy judge's assurance that the transfer meets with creditor approval and the requirements laid out in § 1129."[510]

Justice Breyer concluded: "[I]nsofar as the Court's interpretation of the statute reduces the funds made available, that interpreta-

505. *Id.*
506. *Id.* at 2341 (Breyer, J., dissenting).
507. *Id.* at 2342 (Breyer, J., dissenting).
508. *Id.* at 2341–42.
509. *Id.*
510. *Id.* at 2342; *see* 11 U.S.C. § 1129 (2006).

tion inhibits the statute's efforts to achieve its basic objectives," and even "[w]orse than that, if the potential loss of stamp tax revenue threatens delay in implementing any such decision to sell, then creditors (or the remaining reorganized enterprise) could suffer far more serious harm. They could lose the extra revenues that a speedy sale might otherwise produce."[511]

Substantive canons of statutory construction. Before the Court turned to the third part of its analysis—substantive canons of statutory construction—it summed up the first two parts:

> [E]ven if we were fully to accept Piccadilly's textual and contextual arguments, they would establish at most that the statutory language is ambiguous. They do not—and largely are not intended to—demonstrate that § 1146(a)'s purported ambiguity should be resolved in Piccadilly's favor. Florida argues that various nontextual canons of construction require us to resolve any ambiguity in its favor. Piccadilly responds with substantive canons of its own. It is to these dueling canons of construction that we now turn.[512]

Florida's argument began with the *Lorillard* canon—that "'Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change.'"[513] The "under a plan confirmed" language

> has remained unchanged since 1978 despite several revisions of the Bankruptcy Code. The most recent revision in 2005 occurred after the Fourth Circuit's decision in *NVR* and the Third Circuit's decision in *Hechinger* but before the Eleventh Circuit's decision below. Florida asserts that Congress ratified this longstanding interpretation when, in its most recent amendments to the Code, it "readopted" the stamp-tax provision verbatim as § 1146(a).[514]

Next, Florida invoked the *Sierra Summit* canon—"that courts should 'proceed carefully when asked to recognize an exemption from state taxation that Congress has not clearly expressed.'"[515] Florida used the *Sierra Summit* canon to argue that the stamp tax exemption in § 1146(a) should not apply to preconfirmation transfers because Congress did not clearly express such an ex-

511. *Piccadilly*, 128 S. Ct. at 2342.

512. *Id.* at 2336.

513. *Id.* (quoting Lorillard v. Pons, 434 U.S. 575, 580 (1978)).

514. *Piccadilly*, 128 S. Ct. at 2336.

515. *Id.* at 2336–37 (quoting *In re* Hechinger Inv. Co. of Del., 335 F.3d 243, 254 (3d Cir. 2003)).

emption and because to do so would interfere with the administration of its taxation scheme.[516]

Piccadilly countered Florida's argument regarding the *Sierra Summit* canon by asserting that the exemption is clearly expressed in § 1146(a).[517] Also, Piccadilly pointed out that taxes like Florida's stamp tax are post-petition claims, which are paid (absent an exemption) as an administrative expense with priority over the prepetition claims of other creditors.[518] Such administrative expenses are analogous to preferences, and provisions of the Code allowing preferences "should not be construed to diminish other claimants' recoveries."[519] Piccadilly argued that the clearly expressed purpose of § 1146(a) is tax relief, and any ambiguity in its text must be construed in its favor to avoid frustrating Congress's goal of maximizing the distribution to creditors.[520]

The Court chose to follow the *Sierra Summit* canon rather than the *Howard Delivery Service* canon because it was not persuaded that allowing the stamp tax on prepetition transfers is tantamount to a preference.[521] The Court explained that

> Piccadilly's effort to evade the canon falls well short of the mark because reading § 1146(a) in the manner Piccadilly proposes would require us to do exactly what the [*Sierra Summit*] canon counsels against. If we recognized an exemption for preconfirmation transfers, we would in effect be "recogniz[ing] an exemption from state taxation that Congress has not clearly expressed"—namely, an exemption for preconfirmation transfers.[522]

To reach this conclusion, the Court assumed that "clearly" equals "unambiguous." The Court did not ask whether Congress could have clearly expressed the exemption in ambiguous language.

In sum, the Court wrote:

> The most natural reading of § 1146(a)'s text, the provision's placement within the Code, and applicable substantive canons all lead to the same conclusion: Section 1146(a) affords a stamp-tax ex-

516. *Id.* at 2337.

517. *Id.*

518. *Id.*

519. *Id.* (citing Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 667 (2006)).

520. *Id.* at 2338.

521. *Id.*

522. *Id.* at 2338 (quoting Cal. State Bd. of Equalization v. Sierra Summit, Inc., 490 U.S. 844, at 851–52 (1989)).

> emption only to transfers made pursuant to a Chapter 11 plan that has been confirmed. Because Piccadilly transferred its assets before its Chapter 11 plan was confirmed by the Bankruptcy Court, it may not rely on § 1146(a) to avoid Florida's stamp taxes.[523]

IV. CONCLUSION

As convoluted as BAPCPA sometimes turned out to be, one can see in it a clear reflection of the historic tug-of-war between creditors' rights and mercy for honest, but unfortunate, debtors. A recent magazine article called the United States "the most bankrupt nation on Earth.... We are the Michael Phelps of debt liquidation."[524] While commentators continue to hammer out a consensus on BAPCPA's specific effect,[525] most people understand the common sense notion that

> [i]f you're the kind of person who buys now and worries later, the idea that government is making your inevitable bankruptcy filing slightly more annoying won't discourage you. Actually, a higher hurdle to bankruptcy will make things worse, because banks will offer to lend you more money if getting the debt discharged is harder for you—money that you will happily, and irresponsibly, borrow and spend. The people who are most likely to be deterred from borrowing are the people who are taking the rationally contemplated risk of starting a company or buying their first home.[526]

While bankruptcy courts must myopically examine BAPCPA for its plain meaning, the Supreme Court of the United States has recently reminded the profession of the need to back away from the details and "keep purposes of bankruptcy law in the foreground" as practitioners and jurists continue to interpret the new Code and discover "multiple, conflicting plain meanings for the same language, when meaning is obviously debatable."[527]

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523. *Id.* at 2339.

524. Megan McArdle, *Sink and Swim: Bankruptcy Helps the Undeserving—And That's the Way It Should Be*, THE ATLANTIC, June 2009, at 30.

525. *See, e.g.*, Rafael I. Pardo, *Failing to Answer Whether Bankruptcy Reform Failed: A Critique of the First Report from the 2007 Consumer Bankruptcy Project*, 83 AM. BANKR. L.J. 27 (2009); *cf.* Robert M. Lawless et al., *Interpreting Data: A Reply to Professor Pardo*, 83 AM. BANKR. L.J. 47 (2009).

526. McArdle, *supra* note 524, at 32.

527. Jean Braucher, A *Guide to Interpretation of the 2005 Bankruptcy Law*, 16 AM. BANKR. INST. 349, 350, & n.10 (2008) (discussing *Marrama* and *Piccadilly Cafeterias*); *see also* Thomas F. Waldron & Neil M. Berman, *Principled Principles of Statutory Interpretation: A Judicial Perspective After Two Years of BAPCPA*, 81 AM. BANKR. L.J. 195, 213 (2007) ("[C]ourts should no longer feel compelled to engage in the fiction of finding plain meaning.").

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