

Bankruptcy

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Since last year's article, the courts in the Eleventh Circuit have issued—with a few exceptions—mostly routine bankruptcy opinions. The United States Supreme Court, however, has been very busy, deciding six bankruptcy-related cases. It makes sense to begin with one of the most anticipated of those opinions.

I. SOVEREIGN IMMUNITY

The Supreme Court held in *Tennessee Student Assistance Corp. v. Hood*¹ that a student loan dischargeability proceeding under § 523(a)(8) of the Bankruptcy Code² is not a suit within the meaning of the Eleventh Amendment³ and is, thus, not subject to a defense of sovereign immunity.⁴ Rather, it comes within the scope of the bankruptcy court's *in rem* jurisdiction.⁵ In so holding, the Court avoided the question of whether Congress has the power to abrogate state sovereign immunity in bankruptcy.⁶

Writing for a 7-2 majority, Chief Justice Rehnquist explained, "Bankruptcy Courts have exclusive jurisdiction over a debtor's property,

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1. 124 S. Ct. 1905 (2004).
2. 11 U.S.C. § 523(a)(8). Unless otherwise stated, all statutory references are to the Bankruptcy Code, which is codified at Title 11 of the United States Code, and all rule references are to the Federal Rules of Bankruptcy Procedure.
3. U.S. CONST. amend. XI.
4. 124 S. Ct. at 1909.
5. *Id.* at 1910.
6. *Id.* at 1914-15.

wherever located, and over the estate.”⁷ In a footnote, he indicated that there may be some instances in which the court’s *in rem* jurisdiction intrudes upon state sovereignty.⁸ However, in the case of student loan dischargeability, “[a] debtor does not seek monetary damages or any affirmative relief from a State by seeking to discharge a debt; nor does he subject an unwilling State to a coercive judicial process.”⁹ Therefore, the state’s sovereignty is not offended.¹⁰

The dissent, after first asserting that “Congress lacks authority to abrogate state sovereign immunity under the Bankruptcy Clause,”¹¹ argued that while the *in rem* exception to sovereign immunity may be appropriate for matters initiated by motion, it should not apply to adversary proceedings, which are similar to civil litigation.¹² Unlike motion practice, adversary proceedings require, among other things, a complaint, service of process, and an answer.¹³ It is a coercive process subject to the Eleventh Amendment because “[i]n order to preserve its rights, the State is compelled either to subject itself to the Bankruptcy Court’s jurisdiction or to forfeit its rights.”¹⁴

The majority countered that the dissent is elevating form over substance.¹⁵ The granting of a discharge is an *in rem* proceeding, and the requirement of service of process does not change its essential nature, nor does it effect an exercise of personal jurisdiction over the state.¹⁶

While *Hood* represents a victory for the debtor, its scope is uncertain. For example, the majority opinion is unclear as to the extent of the bankruptcy court’s *in rem* jurisdiction. After claiming that it covers all estate property, “wherever located,”¹⁷ the majority later suggests that a trustee’s effort to recover estate property through a preference action is not within the court’s *in rem* jurisdiction.¹⁸ Time will tell what, if any, new issues *Hood* creates. But, one old issue remains in play: that

7. *Id.* at 1910 (citing 28 U.S.C. § 1334(e)).

8. *Id.* at 1913 n.5.

9. *Id.* at 1912.

10. *Id.*

11. *Id.* at 1915 (Thomas, J., dissenting).

12. *Id.* at 1917.

13. *Id.*

14. *Id.*

15. *Id.* at 1913-14.

16. *Id.* at 1914.

17. *Id.* at 1910.

18. *Id.* at 1914.

is the constitutionality of § 106(a),¹⁹ which purports to abrogate state sovereign immunity.²⁰

II. PROCEDURE

A. Deadlines

In a unanimous opinion, the United States Supreme Court in *Kontrick v. Ryan*²¹ decided that the deadline provided by Federal Rule of Bankruptcy Procedure 4004²² for filing a complaint objecting to discharge is not jurisdictional in nature.²³ Rather, it is merely a claim-processing rule.²⁴ Thus, a debtor cannot challenge the timeliness of the complaint after the adversary proceeding has been decided on the merits.²⁵

In *Kontrick* one count in the creditor's complaint objecting to discharge was filed after the filing deadline, but the debtor did not raise untimeliness of the complaint until after the bankruptcy court granted summary

19. 11 U.S.C. § 106(a).

20. The majority of courts in the Eleventh Circuit have held that § 106(a) of the Bankruptcy Code is unconstitutional as applied to states. *See, e.g.*, *Skandalakis v. Geeslin*, 303 B.R. 533, 538 (Bankr. M.D. Ga. 2004); *Ala. Dep't of Human Res. v. Lewis*, 279 B.R. 308, 319 (Bankr. S.D. Ala. 2002); *Monseratt v. Student Loan Fin. Corp. (In re Monseratt)*, 289 B.R. 183, 187 (Bankr. M.D. Fla. 2002); *Venable v. Acosta (In re Venable)*, 280 B.R. 916, 918 (Bankr. M.D. Fla. 2002); *Levin v. New York (In re Levin)*, 284 B.R. 308, 311 (Bankr. S.D. Fla. 2002); *King v. Florida (In re King)*, 280 B.R. 767, 777 (Bankr. S.D. Ga. 2002); *Taylor v. Georgia (In re Taylor)*, 249 B.R. 571, 573-74 (Bankr. N.D. Ga. 2000).

Georgia courts, in some cases, have held that states do not retain sovereign immunity in bankruptcy. *See, e.g.*, *Georgia v. Burke (In re Burke)*, No. 92-11482, 1997 WL 33125720, *3 (S.D. Ga. July 23, 1997) (state sovereign immunity was properly abrogated pursuant to Congress's power to enforce privileges and immunities clause of the 14th Amendment), *aff'd on other grounds*, 146 F.3d 1313 (11th Cir. 1998); *Frazier v. Georgia (In re Frazier)*, No. 02-41136, Adv. Proc. No. 02-4133, slip op. at 12 (Bankr. S.D. Ga. June 12, 2003); *Smith v. Goode (In re Smith)*, 301 B.R. 96, 100 (Bankr. M.D. Ga. 2003) (states surrendered immunity in bankruptcy by ratifying the Constitution), *questioned by Geeslin*, 303 B.R. at 538; *Wilson v. S.C. State Educ. Assistance Auth. (In re Wilson)*, 258 B.R. 303, 306 (Bankr. S.D. Ga. 2001) (state sovereign immunity was properly abrogated pursuant to Congress's power to enforce privileges and immunities clause of the 14th Amendment).

21. 124 S. Ct. 906 (2004).

22. FED. R. BANKR. P. 4004. Rule 4004(a) provides that "a complaint objecting to the debtor's discharge under § 727(a) of the Code shall be filed no later than 60 days after the first date set for the meeting of creditors." FED. R. BANKR. P. 4004(a). Pursuant to Rule 4004(b), the court can, for cause, grant an extension of time to file such a complaint only if the request for extension is made prior to the expiration of the filing deadline. FED. R. BANKR. P. 4004(b). According to Rule 9006(b)(3), an extension can be granted only in the circumstances outlined above. FED. R. BANKR. P. 9006(b)(3).

23. 124 S. Ct. at 914.

24. *Id.*

25. *Id.* at 918.

judgment for the creditor.²⁶ The debtor argued that, like subject matter jurisdiction, untimeliness of a complaint objecting to discharge could be raised “any time in the proceedings, even initially on appeal or certiorari.”²⁷ The Court rejected this argument, distinguishing between subject matter jurisdiction, which “cannot be expanded to account for the parties’ litigation conduct,” and a claim-processing rule, which can “be forfeited if the party asserting the rule waits too long to raise the point.”²⁸ The Court held that the Rule 4004 deadline created an affirmative defense.²⁹ “Ordinarily, under the Bankruptcy Rules as under the Civil Rules, a defense is lost if it is not included in the answer or amended answer Only lack of subject-matter jurisdiction is preserved post-trial.”³⁰ Thus, because the filing deadline was not jurisdictional in nature, untimeliness of filing could not be raised after a judgment on the merits.³¹

The Court specifically left open the question of whether equitable doctrines, such as equitable tolling, may apply to the Rule 4004 deadline, but noted a split on the issue among the lower courts.³² In other words, if the debtor does raise untimeliness of the complaint in his answer, can the creditor rely on equity to save his complaint? A Georgia bankruptcy court said yes, holding that the deadline to file a complaint to determine dischargeability of a debt was in the nature of a statute of limitations and, thus, was subject to equitable tolling.³³

B. *Judicial Estoppel*

Judicial estoppel prevents a litigant from asserting a position that is inconsistent with one he successfully asserted in a prior judicial proceeding. Applying judicial estoppel in state courts based on a debtor’s action in bankruptcy courts was fertile ground for legal developments in 2003. The Supreme Court of Alabama weighed in and transformed its

26. *Id.* at 911-12.

27. *Id.* at 915.

28. *Id.* at 916.

29. *Id.*

30. *Id.* at 917-18.

31. *Id.* at 918.

32. *Id.* at 917 n.11.

33. *In re Phillips*, 288 B.R. 585, 593 (Bankr. M.D. Ga. 2002). Rule 4007 governs the deadline for filing a complaint to determine dischargeability with language identical to that used in Rule 4004(a)-(b). *See* FED. R. BANKR. P. 4007. *Cf. In re Gilley*, 288 B.R. 901, 905-07 (Bankr. M.D. Fla. 2002) (court would not rely on equity to allow late proof of claim); *Zich v. Wheeler Wolf Attorneys (In re Zich)*, 291 B.R. 883, 885 (Bankr. M.D. Ga. 2003) (court cannot use its general equity powers to extend deadline for filing proof of claim).

test for judicial estoppel. In *Ex parte First Alabama Bank*,³⁴ plaintiff sued the bank for allowing his wife to remove \$500,000 from a safe deposit box. The bank raised judicial estoppel as a defense because in a prior bankruptcy proceeding, plaintiff had claimed that the money did not exist.³⁵ Under existing Alabama law, judicial estoppel required, among other things, that “the parties and questions [in both judicial proceedings] be the same” (privity) and that “the party claiming estoppel [was] misled and . . . changed his position.”³⁶ In this case, the bank lacked both privity and reliance; thus, judicial estoppel should have been unavailable.³⁷ However, the court decided to reconsider its test because “[t]he conscience and feeling of justice of the overwhelming majority whose obedience is required to a rule that would permit [the debtor] to play fast and loose with the court would be, quite simply, shocked.”³⁸ Because judicial estoppel “protects the integrity of the judicial system, not the litigants,” reliance and privity “should not be essential elements of the doctrine of judicial estoppel.”³⁹ Consequently, the court adopted a new test for judicial estoppel, relying on the standards set forth by the Supreme Court in *New Hampshire v. Maine*.⁴⁰

(1) “a party’s later position must be ‘clearly inconsistent’ with its earlier position;” (2) the party must have been successful in the prior proceeding so that “judicial acceptance of an inconsistent position in a later proceeding would create ‘the perception that either the first or second court was misled;” and (3) the party seeking to assert an inconsistent position must “derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped.”⁴¹

34. *Ex parte First Ala. Bank*, No. 1020855, 2003 WL 22113920 (Ala. Sept. 12, 2003).

35. *Id.* at *1-2.

36. *Id.* at *4 (quoting *Jinright v. Paulk*, 758 So. 2d 553, 555 (Ala. 2000)). The court articulated the full test as follows:

“(1) The inconsistent position first asserted must have been successfully maintained; (2) a judgment must have been rendered; (3) the positions must be clearly inconsistent; (4) the parties and questions must be the same; (5) the party claiming estoppel must have been misled and have changed his position; and (6) it must appear unjust to one party to permit the other to change.”

Id. (quoting *Jinright*, 758 So. 2d at 555).

37. *Id.* at *5.

38. *Id.* at *8.

39. *Id.* at *6 (citing *Burnes v. Pemco Aeroplex, Inc.*, 291 F.3d 1282, 1286 (11th Cir. 2002)).

40. 532 U.S. 742 (2001).

41. *Ex parte First Ala. Bank*, 2003 WL 22113920, at *7 (quoting *New Hampshire*, 532 U.S. at 750-51) (internal citations omitted).

The Eleventh Circuit Court of Appeals also added to its catalog of bankruptcy-related judicial estoppel cases. *Barger v. Cartersville*⁴² appears to deal a blow to debtors' efforts to avoid judicial estoppel by adding a previously undisclosed cause of action to their bankruptcy schedules.⁴³ In *Barger* the debtor was pursuing an employment discrimination claim for damages and reinstatement of employment when she filed a no-asset Chapter 7 case. She did not list the claim on her bankruptcy schedules. At the meeting of creditors, she told her attorney and the trustee about the claim, but indicated to the trustee that she was only seeking injunctive relief. During discovery in the discrimination case, she failed to disclose her bankruptcy when asked whether she was involved in any legal proceedings. The debtor was ultimately granted a discharge, and her creditors received no distribution. The defendant in the discrimination case learned of the discharge and raised judicial estoppel as a defense. In response, the debtor reopened her bankruptcy case and added the employment discrimination claim to her schedules. Nevertheless, her discrimination case was dismissed based on judicial estoppel and she appealed that decision.⁴⁴ The Eleventh Circuit affirmed.⁴⁵

Under the Eleventh Circuit's test for judicial estoppel, "a party's allegedly inconsistent positions must have been 'made under oath in a prior proceeding'" and "the 'inconsistencies must be shown to have been calculated to make a mockery of the judicial system.'"⁴⁶ In this case, the court focused on the debtor's intent to manipulate the system, which can be inferred when "the debtor has knowledge of the undisclosed claims and has motive for concealment."⁴⁷ It was undisputed that the debtor knew of the claim. However, she argued that her disclosure of the claim to her attorney and the trustee, and her attempt to amend her schedules, weighed against a finding of intent to manipulate.⁴⁸ The court disagreed.⁴⁹

Any error by the debtor's bankruptcy attorney should not be charged against the defendant in the nonbankruptcy case.⁵⁰ Rather, the

42. 348 F.3d 1289 (11th Cir. 2003).

43. *Id.* at 1297. The issue of judicial estoppel typically is raised in bankruptcy courts when debtors attempt to amend their schedules to add a previously omitted cause of action.

44. *Id.* at 1291-92.

45. *Id.* at 1297.

46. *Id.* at 1293-94 (quoting *Burnes*, 291 F.3d at 1284).

47. *Id.* at 1294 (citing *Burnes*, 291 F.3d at 1287).

48. *Id.* at 1294-95.

49. *Id.* at 1295.

50. *Id.*

debtor's remedy is to sue her attorney for malpractice.⁵¹ In addition, a debtor's omission can only be considered inadvertent if there is no motive to conceal the claim.⁵² In this case, the nondisclosure allowed the debtor to shield the proceeds of her cause of action from her creditors, which unquestionably provided the debtor with a motive to conceal.⁵³

The debtor's disclosure to the trustee did not save her claim because she told the trustee only about the claim for injunctive relief and failed to tell the trustee about the claim for damages.⁵⁴ This limited disclosure strengthened the inference that the debtor was engaged in intentional manipulation of the system.⁵⁵ Finally, the debtor's attempt to amend her schedules only upon the threat of judicial estoppel further weakened her position.⁵⁶ As a result, the court barred the debtor's employment discrimination claim for damages.⁵⁷ But the debtor's claim for reinstatement was allowed to go forward because it had no effect on her bankruptcy estate.⁵⁸

A different panel of the court of appeals reached a different result in *Parker v. Wendy's International, Inc.*⁵⁹ *Parker* also involved a Chapter 7 debtor who had a prepetition employment discrimination claim but did not list that claim on her bankruptcy schedules. After the debtor received a discharge, her attorney in the nonbankruptcy case alerted the court to the debtor's omission and sought a continuance so the bankruptcy case could be reopened and the claim added as an asset. At that time, the Chapter 7 trustee, who is charged with administering the assets of the bankruptcy estate, intervened as a plaintiff in the employment discrimination case. Later, the defendant successfully raised judicial estoppel as a defense, and the case was dismissed.⁶⁰ The court of appeals reversed the dismissal.⁶¹

As in *Barger*, the court relied on a two-part inquiry: (1) the assertion of inconsistent positions that (2) were intended to "make a mockery of

51. *Id.*

52. *Id.*

53. *Id.* at 1296.

54. *Id.*

55. *Id.*

56. *Id.* at 1297.

57. *Id.* Compare *In re Haskett*, 297 B.R. 637, 644 (Bankr. N.D. Ala. 2003) (no bad motive when debtor attempted to remedy nondisclosure before judicial estoppel was raised).

58. 348 F.3d at 1297.

59. No. 02-16185, 2004 WL 813174 (11th Cir. April 15, 2004).

60. *Id.* at *1-2.

61. *Id.* at *4.

the judicial system.”⁶² But, where *Barger* focused on intent, *Parker* focused on the assertion of inconsistent positions.⁶³ Because the trustee was the real party in interest and the trustee had not asserted any inconsistent positions, judicial estoppel could not prevent the trustee from pursuing the employment discrimination claim.⁶⁴

This result appears to be in direct opposition to *Barger*. In *Barger*, the trustee was substituted as the real party in interest.⁶⁵ Nevertheless, the inconsistent positions taken by the debtor were sufficient to satisfy the first prong of the judicial estoppel inquiry against the trustee.⁶⁶ Interestingly, the court’s initial opinion in *Parker*, which was subsequently vacated and replaced, held that the trustee *was* charged with the debtor’s inconsistent assertions.⁶⁷ In its revised opinion, the court in *Parker* indicated that judicial estoppel could only be asserted against the trustee if it would have been available as a defense against the debtor in the absence of bankruptcy.⁶⁸

III. CASE ADMINISTRATION

A. Attorney Compensation

Chapter 7 debtors’ attorneys cannot be paid out of the bankruptcy estate, according to the Supreme Court in *Lamie v. United States Trustee*.⁶⁹ The Court was asked to interpret § 330(a)(1) of the Bankruptcy Code, which provides for compensation for the services of certain professionals.⁷⁰ The previous version of the statute expressly provided for payment to the debtor’s attorney.⁷¹ When the provision was amended in 1994, the reference to the debtor’s attorney was deleted in what appears to be a “legislative drafting error,” rather than the intent of Congress, resulting in some grammatical peculiarities.⁷² Conse-

62. *Id.* at *3 (quoting *Burnes*, 291 F.3d at 1285).

63. *Id.*

64. *Id.* at *4.

65. 348 F.3d at 1292-93.

66. *Id.* at 1294.

67. *Parker v. Wendy’s Int’l*, No. 02-16185, slip op. at 1598 (11th Cir. March 31, 2003 [sic]) (vacated by *Parker*, 2004 WL 813174, at *1). Although the slip opinion is dated 2003, it was actually entered on March 31, 2004. See *Parker*, 2004 WL 813174, at *1.

68. *Parker*, 2004 WL 813174, at *4 n.3.

69. 124 S. Ct. 1023, 1027 (2004).

70. *Id.*; 11 U.S.C. § 330(a)(1) (2000).

71. 124 S. Ct. at 1027-28; 11 U.S.C. § 330(a) (1988), amended by 11 U.S.C. § 330(a)(1) (2000).

72. 124 S. Ct. at 1028. Prior to the amendment, § 330(a) provided in relevant part: “[T]he court may award to a trustee, to an examiner, to a professional person employed

quently, courts divided into two camps: those (including the Eleventh Circuit) that adhered to the plain language of the statute to deny payment to Chapter 7 debtors' attorneys from estate funds, and those that relied on legislative history to discern congressional intent to allow payment of the attorneys.⁷³

Not surprisingly, the Supreme Court took the plain language approach.⁷⁴ The Court began its analysis by intoning its mantra that "when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms."⁷⁵ Although the statute's amendment makes it ungrammatical and nonparallel, the Court stated that these problems do not result in ambiguity.⁷⁶ The statute clearly sets out the type of people eligible for compensation and the type of compensation available.⁷⁷

In the absence of ambiguity, the Court cannot deviate from the plain meaning unless doing so leads to an absurd result.⁷⁸ In this case, the Court noted that debtors' attorneys have other paths available for compensation, such as receiving payment prior to filing the petition or obtaining approval for post-petition employment by the Chapter 7 trustee.⁷⁹ Furthermore, those circuits that follow the plain language approach are apparently functioning smoothly.⁸⁰ Consequently, no

under section 327 or 1103 of this title, or to the debtor's attorney—(1) reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional person, or attorney" *Id.* Section 330(a) now provides: "[T]he court may award to a trustee, an examiner, a professional person employed under section 327 or 1103—(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney." *Id.*

The amendment left § 330(a)(1) "with a missing 'or' that infects its grammar Furthermore, the Act's inclusion of the word 'attorney' in § 330(a)(1)(A) defeats the neat parallelism that otherwise marks the relationship between [current] §§ 330(a)(1) and 330(a)(1)(A)." *Id.*

73. *Id.*

74. *Id.* at 1030.

75. *Id.* (quoting *Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 U.S. 1, 6 (2000)).

76. *Id.*

77. *Id.*

78. *Id.* at 1031.

79. *Id.* at 1031-32.

80. *Id.* at 1032. The Court noted that even if it were to examine the legislative history, that history "creates more confusion than clarity about the congressional intent." *Id.* at 1033.

absurd result flows from the application of the plain language of the statute, so the statute must be applied as written.⁸¹

B. Dismissal

Does Chapter 7 have a good faith filing requirement? One court has said no.⁸² A creditor of a corporate Chapter 7 debtor sought to have the case dismissed on the ground that it was filed in bad faith.⁸³ Pursuant to Section 707(a) of the Bankruptcy Code, a Chapter 7 case may be dismissed “for cause.”⁸⁴ The Code provides a list of circumstances that constitute cause for dismissal.⁸⁵ Although lack of good faith filing is not among the circumstances listed, the list is not exclusive.⁸⁶

In its analysis of “cause,” the court turned to case law that developed three lines of reasoning.⁸⁷ First, some courts hold that debtors are not required to file a Chapter 7 petition in good faith.⁸⁸ Second, other courts allow dismissal for lack of good faith filing only when the circumstances are egregious, such as in the case of “concealed or misrepresented assets and/or sources of income, and excessive and continued expenditures, lavish life-style, and intention to avoid a large single debt based on conduct akin to fraud, misconduct, or gross negligence.”⁸⁹ Finally, some courts refuse to characterize the problem as lack of good faith, but instead consider whether “the debtor’s motives for filing the [C]hapter 7 petition are inconsistent with the established purpose of the Bankruptcy Code.”⁹⁰ The court agreed with the first line of cases, noting that “Chapter 7 makes no mention of a good faith requirement” and that unlike debtors in Chapters 13 and 11, Chapter 7 debtors do not “continue in possession of their assets [or] alter their contractual relationships with their creditors.”⁹¹ As long as the debtor

81. *Id.* at 1034. Justices Stevens, Souter, and Breyer concurred, but stated that when “there is such a plausible basis for believing that a significant change in statutory law resulted from a scrivener’s error, [the Court has] a duty to examine legislative history.” *Id.* at 1035 (Stevens, J., concurring).

82. *In re* RIS Investment Group, Inc., 298 B.R. 848, 851 (Bankr. S.D. Fla. 2003).

83. *Id.* at 850-51.

84. 11 U.S.C. § 707(a) (2000).

85. *Id.*

86. 298 B.R. at 851.

87. *Id.*

88. *Id.*

89. *Id.* (quoting *Indus. Ins. Servs., Inc. v. Zick (In re Zick)*, 931 F.2d 1124, 1129 (6th Cir. 1991)).

90. *Id.*

91. *Id.* at 851-52.

is willing to give up the benefits of Chapters 11 and 13, his motives in filing Chapter 7 are irrelevant.⁹²

Despite its holding, the court acknowledged that certain circumstances, not present in this case, could give rise to cause for dismissal of a Chapter 7 corporate debtor, including “a severe threat to public health, an abuse of the legal process, or some comparable extraordinary circumstances.”⁹³

IV. DEBTOR PROTECTIONS

A. Automatic Stay

1. Violations. The manner in which a creditor allocates payments does not, by itself, violate the automatic stay.⁹⁴ In *Smith v. Fairbanks Capital Corp. (In re Smith)*, the debtor alleged that the creditor was collecting attorney fees in violation of the automatic stay by allocating the debtor’s payments to attorney fees rather than to the debt.⁹⁵ The court held that so long as the creditor did not collect money in excess of its allowed claim, which did not include an amount for attorney fees, it could allocate the payments in any manner without violating the automatic stay.⁹⁶ Because the allocation was merely a product of the creditor’s internal recordkeeping and the creditor made no overt act to collect an amount in excess of the claim, there was no stay violation.⁹⁷

In *Ford v. A.C. Loftin (In re Ford)*,⁹⁸ the court found that a foreclosure sale of a residence in which the debtor had a beneficial interest violated the automatic stay.⁹⁹ The creditor raised § 549(c) as a defense that provides that a post-petition transfer of real estate to a good faith purchaser who was without knowledge of the bankruptcy cannot be avoided by the trustee.¹⁰⁰

The court recognized a split of authority on the issue of “whether § 549(c) applies to protect a purchaser at a postpetition foreclosure or tax sale conducted in violation of the automatic stay.”¹⁰¹ The court noted

92. *Id.* at 852.

93. *Id.* at 854.

94. *Smith v. Fairbanks Capital Corp. (In re Smith)*, 299 B.R. 687, 693 (Bankr. S.D. Ga. 2003).

95. *Id.*

96. *Id.*

97. *Id.*

98. 296 B.R. 537 (Bankr. N.D. Ga. 2003).

99. *Id.* at 543.

100. *Id.* at 544 (citing 11 U.S.C. § 549(c) (2000)).

101. *Id.*

that courts that allowed the defense to apply to a stay violation generally did so without analysis.¹⁰² Exceptions to the stay are listed in § 362, and § 549(c) is not among them.¹⁰³ Furthermore, the text of § 549(c) indicates that it may only be used as a defense to an avoidance action initiated pursuant to § 549(a).¹⁰⁴ Thus, the court concluded that there is no basis for allowing § 549(c) to be used as a defense to a stay violation.¹⁰⁵

2. Liability of Third Parties. The assignor of a claim is not liable for the assignee's stay violation, according to the Eleventh Circuit Court of Appeals in *Commodore Holdings, Inc. v. Exxon Mobil Corp.*¹⁰⁶ After the debtor filed for bankruptcy, the initial creditor, Esso Nederland B.V., assigned its claim to Pied Rich B.V. for consideration. Pied Rich then violated the stay by placing a lien on certain property of the bankruptcy estate. The debtor sought sanctions against Esso and other creditors due to Pied Rich's stay violation.¹⁰⁷ The bankruptcy court refused to sanction Esso, and the circuit court affirmed, stating that "[t]he fact of the assignment, made for consideration, is not in itself an unlawful collection practice or an act encouraging or assisting Pied Rich in engaging in an unlawful practice."¹⁰⁸

3. Sanctions. In two cases, courts indicated a willingness to award various sanctions for stay violations even though the debtors suffered no compensable financial damages. For example, in *Bishop v. U.S. Bank/Firststar Bank, N.A. (In re Bishop)*,¹⁰⁹ the court held that § 362(h) authorizes damages for emotional distress even in the absence of financial damages.¹¹⁰ The court stated, "[a]n award of damages for emotional distress due to a violation of the stay is appropriate where a natural and powerful emotional distress is readily apparent from the nature or extent of the wrongful conduct under the particular circumstances surrounding the stay violation."¹¹¹ Because § 362(h) provides

102. *Id.*

103. *Id.* at 546.

104. *Id.*

105. *Id.* at 550. The court also explained that even if § 549(c) were an applicable defense, the creditor failed to satisfy the proof requirements. *Id.* at 556.

106. 331 F.3d 1257, 1259 (11th Cir. 2003).

107. *Id.* at 1258-59.

108. *Id.* at 1259.

109. 296 B.R. 890 (Bankr. S.D. Ga. 2003).

110. *Id.* at 897; 11 U.S.C. § 362(h) (2000).

111. 296 B.R. at 895.

for “actual damages”¹¹² and emotional distress damages are actual damages, “there appears to be no reason to question their statutory authorization.”¹¹³ In reaching its decision, the court disagreed with a Seventh Circuit Court of Appeals case that requires the debtor to have some monetary loss on which to “piggyback” the emotional distress damages.¹¹⁴

Similarly, in *In re Hedetneimi*,¹¹⁵ the court held that even though the debtor had not suffered any damages compensable under § 362(h), he could still be awarded attorney fees under that section.¹¹⁶ Hence, the court rejected the creditor’s argument that attorney fees “are awarded only to embellish actual damages.”¹¹⁷

B. Discrimination

A debtor’s offer-in-compromise to the Internal Revenue Service (“IRS”) to settle a tax debt “is not a license, permit, charter, franchise, or other similar grant” within the meaning of § 525(a) of the Bankruptcy Code,¹¹⁸ according to the court in *Holmes v. United States (In re Holmes)*.¹¹⁹ Section 525(a) prohibits a governmental unit from denying such grants solely because a person is a debtor in bankruptcy.¹²⁰ The debtor’s tax liability in this case exceeded \$9 million. After filing for bankruptcy, he submitted an offer-in-compromise for the taxes owed. The IRS had a written policy not to consider such offers from a bankruptcy debtor until his case was either discharged or dismissed.¹²¹ The court rejected the debtor’s argument that the policy constituted improper discrimination pursuant to § 525(a).¹²² According to the court, an offer-in-compromise does not fit within the ordinary meaning of “license,” and if Congress wanted to target a broader range of

112. 11 U.S.C. § 362(h).

113. 296 B.R. at 897.

114. *Id.* (citing *Aiello v. Providian Fin. Corp.*, 239 F.3d 876, 880 (7th Cir. 2001)). In *Bishop* the debtor did have a monetary loss, so he would have been entitled to emotional distress damages even under the Seventh Circuit rule. *Id.*

115. 297 B.R. 837 (Bankr. M.D. Fla. 2003).

116. *Id.* at 842.

117. *Id.* This case also considered the question of emotional distress damages, but the court declined to award any such damages because of insufficient evidence to establish emotional distress. *Id.*

118. 11 U.S.C. § 525(a) (2000).

119. 298 B.R. 477, 483 (Bankr. M.D. Ga. 2003).

120. *Id.* at 480 (citing 11 U.S.C. § 525(a) (Supp. 2003)).

121. *Id.* at 479-80 (citing INTERNAL REVENUE MANUAL §§ 5.8.3.2.1(1)(b) & 5.17.4.7 (1998)).

122. *Id.* at 483.

discrimination, it could have done so.¹²³ But the court relied on its § 105(a)¹²⁴ power to order the IRS to consider the debtor's offer-in-compromise.¹²⁵ The IRS's internal policy "does not have the force and effect of law," and it "frustrates the basic principles of the Bankruptcy Code" and the Tax Code.¹²⁶ Thus, the IRS was obligated to consider the offer.¹²⁷

V. BANKRUPTCY ESTATE

A. *Property of the Estate*

1. Use of Estate Property. In *McGlockling v. Chrysler Financial Co., LLC (In re McGlockling)*,¹²⁸ the court considered whether a Chapter 13 debtor's car remained property of the bankruptcy estate after plan confirmation.¹²⁹ The debtor, who served in the United States Army, was transferred to Germany. Relying on its sales contract, Chrysler refused to allow the debtor to take the car out of the country.¹³⁰ However, if the car were estate property, then the debtor would be entitled to use it pursuant to §§ 363(b) and 1303.¹³¹

In the Eleventh Circuit, only that property necessary to carry out the Chapter 13 plan remains in the bankruptcy estate after confirmation.¹³² The court determined that the appropriate test for necessary property "is to examine the individual debtor to determine what is necessary, under the particular facts and circumstances, to complete a successful plan."¹³³ In this case, reliable transportation was necessary to the successful completion of the debtor's plan.¹³⁴ As a result, the car was property of the estate that the debtor was entitled to use, even if it meant taking the car to Germany.¹³⁵

123. *Id.* at 482-83.

124. 11 U.S.C. § 105(a) (2000).

125. 298 B.R. at 486 (citing 11 U.S.C. § 105(a)).

126. *Id.*

127. *Id.*

128. 296 B.R. 884 (Bankr. S.D. Ga. 2003).

129. *Id.* at 887.

130. *Id.* at 886-87.

131. *Id.* at 887 (citing 11 U.S.C. § 363(b) (2000) and 11 U.S.C. § 1303 (2000)).

132. *Id.* (citing *Telfair v. First Union Mortgage Corp.*, 216 F.3d 1333, 1340 (11th Cir. 2000)).

133. *Id.*

134. *Id.* at 888.

135. *Id.* The court noted that Chrysler was adequately protected because the car was insured and the debtor had stable employment. *Id.* at 889.

2. Distribution of Estate Property. Deciding an issue of first impression in the Eleventh Circuit, a Florida bankruptcy court held that when a Chapter 7 trustee holds estate property for distribution to creditors, she may be subject to garnishment by a creditor's creditor.¹³⁶ The court rejected the reasoning of the sole case on point decided under the current Bankruptcy Code, which prohibited such garnishment of the trustee on the grounds that it impedes administration of the estate and that the proper procedure is to seek substitution under Bankruptcy Rule 3001(e)(2).¹³⁷ The court stated that "where the claims against the estate creditor have been reduced to final judgment and a garnishment judgment has been issued prior to bankruptcy distribution, the sole burden on the trustee is the substitution of one creditor's name and address for that of another."¹³⁸ Thus, the burden on the trustee is slight and is certainly no greater than the burden imposed by substitution under Rule 3001(e).¹³⁹ Furthermore, the purpose of that rule is to establish the authenticity of the transfer of a claim.¹⁴⁰ In other words, it is merely a safeguard.¹⁴¹ In the case of a garnishment, that purpose has been served by the court issuing the garnishment.¹⁴² Thus, there is no reason to prohibit garnishment, particularly when the trustee does not object.¹⁴³

B. Turnover

The issue of whether a debtor may obtain turnover of a vehicle that was repossessed prepetition continues to work its way through the courts in Georgia.¹⁴⁴ In 2002 a bankruptcy court held that the debtor is entitled to turnover so long as the repossessed vehicle has not been resold.¹⁴⁵ The district court affirmed.¹⁴⁶ The case is pending before

136. *In re Brickell*, 292 B.R. 705, 709 (Bankr. S.D. Fla. 2003).

137. *Id.* at 708-09 (citing *NVLand, Inc. v. Vogel (In re Ocean Downs Racing Ass'n)*, 164 B.R. 249, 254-55 (Bankr. D. Md. 1993)).

138. *Id.* at 709.

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.*

144. Under the laws of both Florida and Alabama, a debtor does not retain sufficient ownership interest in a vehicle repossessed prepetition to seek turnover. *Bell-Tel Fed. Credit Union v. Kalter (In re Kalter)*, 292 F.3d 1350, 1354 (11th Cir. 2002); *Lewis v. Charles R. Hall Motors, Inc. (In re Lewis)*, 137 F.3d 1280, 1285 (11th Cir. 1998).

145. *Rozier v. Motors Acceptance Corp. (In re Rozier)*, 283 B.R. 810, 813 (Bankr. M.D. Ga. 2002).

146. *Motors Acceptance Corp. v. Rozier*, 290 B.R. 910, 913 (M.D. Ga. 2003).

the Eleventh Circuit Court of Appeals, which certified the following question to the Supreme Court of Georgia:

Does legal title, or any other ownership interest that would give a right of possession, pass to that creditor under Georgia law upon repossession of an automobile subsequent to a debtor's default on an automobile installment loan contract, or does such legal title or other ownership interest remain in the debtor?¹⁴⁷

The Eleventh Circuit already ruled that under Alabama and Florida laws, a debtor retains only a right of redemption in a repossessed vehicle, which is not sufficient to bring the vehicle into the bankruptcy estate.¹⁴⁸ Nevertheless, Florida debtors attempted to compel turnover of their repossessed car by proposing to redeem it through their Chapter 13 plan.¹⁴⁹ First, the court determined that redemption requires a lump sum payment of all obligations owed.¹⁵⁰ Neither an intention to propose a plan nor an actual filed plan that pays the full redemption amount over time fulfills the lump sum requirement.¹⁵¹ Second, the court relied on a circuit court case to determine that a "debtor [may] not modify [a] statutory right of redemption under a Chapter 13 plan."¹⁵² As a result, the debtors' effort to obtain turnover failed.¹⁵³

C. Exemptions

The post-petition appreciation of exempt property benefits the debtor, not the bankruptcy estate.¹⁵⁴ The debtor in *Tidwell v. Leskosky (In re Leskosky)*¹⁵⁵ sought to exempt certain stock under Georgia's wildcard exemption.¹⁵⁶ The debtor valued the stock at ten dollars. The trustee argued that any increase in the value of the stock should accrue to the benefit of the estate.¹⁵⁷ The court disagreed.¹⁵⁸ The Bankruptcy

147. *Motors Acceptance Corp. v. Rozier (In re Rozier)*, 348 F.3d 1305, 1307 (11th Cir. 2003) (emphasis omitted).

148. *Kalter*, 292 F.3d at 1356; *Lewis*, 137 F.3d at 1284.

149. *In re Menasche*, 301 B.R. 757, 758 (Bankr. S.D. Fla. 2003).

150. *Id.* at 762.

151. *Id.*

152. *Id.* (citing *Commercial Fed. Mortgage Corp. v. Smith (In re Smith)*, 85 F.3d 1555, 1560 (11th Cir. 1996)). In *Smith* the court of appeals held that the right of redemption could not be modified through a Chapter 13 plan after a foreclosure sale had terminated the debtor's interest in real property. 85 F.3d at 1559.

153. 301 B.R. at 763.

154. *Tidwell v. Leskosky (In re Leskosky)*, 287 B.R. 295, 296 (Bankr. M.D. Ga. 2002).

155. 287 B.R. 295 (Bankr. M.D. Ga. 2002).

156. O.C.G.A. § 44-13-100(a)(6) (2002).

157. 287 B.R. at 296.

158. *Id.*

Code requires the value of an exemption to be determined on the date of filing.¹⁵⁹ Although this may ultimately lead to a windfall for the debtor, the “alternative would be to keep the bankruptcy proceeding open indefinitely; the objections are self-evident.”¹⁶⁰ Additionally, the court explained that a local rule stating that “[e]xemptions will be limited to the dollar amount claimed as exempt even if the asset exempted is later discovered to have had a greater value than the amount listed in the schedules” merely sets the value of the exemption on the date of filing unless an objection is raised.¹⁶¹ The court’s decision is consistent with the Eleventh Circuit’s decision in *Allen v. Green (In re Green)*,¹⁶² in which the court stated, “an unstated premise of the [United States Supreme] Court’s holding [in *Taylor v. Freeland & Kronz*] was that a debtor who exempts the entire reported value of an asset is claiming the ‘full amount,’ whatever it turns out to be.”¹⁶³

VI. CLAIMS

If a debtor owns collateral for a debt but is not personally liable on the debt, the debtor may pay it through a Chapter 13 plan.¹⁶⁴ In *In re Curinton*,¹⁶⁵ a corporation borrowed money from the creditor to purchase real estate.¹⁶⁶ The corporation later transferred title in the property to the debtor, and then the corporation was administratively dissolved. The debtor never became obligated on the mortgage. The creditor accepted payments from the debtor for three years and allowed the debtor to cure a default. After a subsequent default, the creditor initiated foreclosure proceedings. The proceedings were halted when the debtor filed for bankruptcy and proposed to pay the creditor’s claim through a Chapter 13 plan. The creditor argued that because no privity

159. *Id.* at 297 (citing *Polis v. Getaways, Inc. (In re Polis)*, 217 F.3d 899, 902 (7th Cir. 2000)).

160. *Id.* (quoting *Polis*, 217 F.3d at 903).

161. *Id.* (citing LBR 4003-1(a)(3)).

162. 31 F.3d 1098 (11th Cir. 1994).

163. *Id.* at 1100 (citing *Taylor v. Freeland & Kronz*, 503 U.S. 638, 641-44 (1992)). In *Green* the debtor scheduled a lawsuit as an asset valued at one dollar and claimed the lawsuit as exempt, valuing the exemption at one dollar. *Id.* at 1098. When she settled the lawsuit for \$15,000, the court found the proceeds to be fully exempt. *Id.* at 1099. *See also In re Ferretti*, 203 B.R. 796, 799 (Bankr. S.D. Fla. 1996) (because claimed value of lawsuit and claimed value of exemption were the same, one dollar, and trustee had not timely objected to that valuation, debtor was entitled to all proceeds when lawsuit settled for \$70,000).

164. *In re Curinton*, 300 B.R. 78, 84 (Bankr. M.D. Fla. 2003).

165. 300 B.R. 78 (Bankr. M.D. Fla. 2003).

166. *Id.* at 84.

of contract existed between it and the debtor, the creditor had no claim that could be paid through the plan.¹⁶⁷ The court disagreed.¹⁶⁸ While noting a split of authority, the court relied on the United States Supreme Court case of *Johnson v. Home State Bank*¹⁶⁹ to conclude that “a claim against the debtor need not be against the debtor personally (*in personam*), but could consist solely of a claim against the debtor’s property (*in rem*).”¹⁷⁰ Thus, the creditor had a claim that the debtor could pay through a Chapter 13 plan.¹⁷¹

*United States v. Galletti*¹⁷² raised the issue of whether the Internal Revenue Service could assert a claim for taxes in the debtors’ bankruptcy cases. Under tax law, the IRS has ten years to collect taxes that have been timely assessed. In this case, the IRS timely assessed taxes against the partnership but not against the general partners, the debtors. After the general partners filed bankruptcy, the IRS filed claims in their cases. The debtors objected to the claims on the ground that the IRS never assessed taxes against them as general partners. The bankruptcy court sustained the objection, and was affirmed by the district and circuit courts.¹⁷³ The Supreme Court reversed and remanded.¹⁷⁴ The Court’s decision turned on an interpretation of the Internal Revenue Code that a tax, not a taxpayer, is assessed.¹⁷⁵ Once the tax has been timely assessed, the IRS has ten years to collect from anyone who is liable, including the debtors.¹⁷⁶

VII. AVOIDANCE

Payments for services provided in furtherance of a *Ponzi* scheme are not per se avoidable as fraudulent transfers, according to *Orlick v. Kozyak (In re Financial Federated Title & Trust, Inc.)*.¹⁷⁷ Defendant provided certain administrative and managerial assistance to the debtor, a company engaged in a *Ponzi* scheme for eighteen months, and was compensated by more than \$1 million. The bankruptcy trustee sought to avoid payment of the full amount of the compensation as a fraudulent

167. *Id.* at 79-80.

168. *Id.* at 84.

169. 501 U.S. 78 (1991).

170. 300 B.R. at 80-81 (citing *Johnson*, 501 U.S. at 85).

171. *Id.* at 85.

172. 124 S. Ct. 1548 (2004).

173. *Id.* at 1551.

174. *Id.* at 1555.

175. *Id.* at 1554.

176. *Id.*

177. 309 F.3d 1325, 1333 (11th Cir. 2002).

transfer pursuant to § 548.¹⁷⁸ Both the bankruptcy and district courts held, as a matter of law, that defendant could not raise a “for value and in good faith” defense because she “assisted in perpetuating [a *Ponzi*] scheme, [and] therefore ‘no value was or could be legally given.’”¹⁷⁹

The court of appeals reversed.¹⁸⁰ The case relied upon by the lower courts ignored the question of culpability; in other words, it did not consider whether defendant intended to further an illegal scheme.¹⁸¹ By removing the culpability issue, any party, including landlords, utilities, etc., whose services were used in the course of a *Ponzi* scheme, would be deprived of the “for value and in good faith” defense to a fraudulent transfer suit.¹⁸² The court concluded that defendant should have an opportunity at trial to prove that, despite the fact that her services were used in furtherance of a *Ponzi* scheme, the debtor received value for her services and she acted in good faith.¹⁸³

In another fraudulent transfer case, *Jensen v. Captiva Limousine Service, Inc. (In re Rajkovic)*,¹⁸⁴ the court considered the implications when the transferred funds, prior to the transfer, were of a type that could be exempted in a bankruptcy case.¹⁸⁵ In *Jensen* the debtor received \$100,000 from a worker’s compensation claim.¹⁸⁶ He transferred nearly \$66,000 of that money to his corporation before filing for bankruptcy. The trustee sought to recover the money on the ground that it was a fraudulent transfer. The debtor argued that because worker’s compensation is exempt under Florida law, the transfer could not be avoided.¹⁸⁷ The court ruled in favor of the trustee.¹⁸⁸

The court first noted that the transfer of “exempt *homestead* property could not be set aside as fraudulent.”¹⁸⁹ But unlike the homestead exemption, which is granted by the state constitution, the worker’s compensation exemption is granted by statute and, therefore, can be

178. *Id.* at 1327-28; 11 U.S.C. § 548 (2000).

179. 309 F.3d at 1331 (quoting *Martino v. Edison Worldwide Capital (In re Randy)*, 189 B.R. 425, 442 (Bankr. N.D. Ill. 1995)).

180. *Id.*

181. *Id.*

182. *Id.* at 1332 (citing *Merrill v. Allen (In re Universal Clearing House Co.)*, 60 B.R. 985, 999 (D. Utah 1986)).

183. *Id.* at 1332-33.

184. 289 B.R. 197 (Bankr. M.D. Fla. 2002).

185. *Id.* at 198.

186. *Id.* at 199.

187. *Id.* at 199-200.

188. *Id.* at 201.

189. *Id.* at 200-01 (citing *Kapila v. Fornabaio (In re Fornabaio)*, 187 B.R. 780, 782 (Bankr. S.D. Fla. 1995)) (emphasis added).

distinguished.¹⁹⁰ Furthermore, the purpose of worker's compensation "is rehabilitation of the man and not the payment of his debts."¹⁹¹ Once the funds in this case were transferred to the corporation, they could no longer be used for their intended purpose.¹⁹² The court refused to allow the exemption as a defense to the fraudulent transfer because to allow the corporation "to immunize the monies it received would be a perversion of the very purpose of the Statute designed to assist an injured worker to achieve rehabilitation."¹⁹³

In *Yates v. Hendon*,¹⁹⁴ the Supreme Court decided an ERISA (Employee Retirement Income Security Act of 1974) issue. However, the issue was raised in a bankruptcy case, and is thus, worth mentioning. The debtor had set up and was the trustee for a profit-sharing plan for a corporation that he wholly owned. The debtor took a loan from the plan, but failed to make payments according to the terms of the loan. Nevertheless, he eventually repaid the outstanding principal and interest with two payments. Three weeks after the payments, he became the subject of an involuntary bankruptcy petition, and the trustee sought to recover the payments as preferential transfers.¹⁹⁵ At issue was "whether a working owner may qualify as a participant in an employee benefit plan covered by ERISA."¹⁹⁶ The Court answered in the affirmative, relying on congressional intent as revealed by "multiple indications" in the text of ERISA, and remanded the case for consideration of the avoidance issue.¹⁹⁷

VIII. LEASES AND EXECUTORY CONTRACTS

A debtor must cure both monetary and nonmonetary defaults to assume an executory contract, according to the court in *In re Williams*.¹⁹⁸ The debtor leased a truck from his employer. According to the terms of the lease, the truck could not be used for any other company's work. Nevertheless, the debtor changed jobs and continued using the truck. He later filed a Chapter 13 petition and sought to assume the lease. The debtor was able to cure a monetary default, but he argued that he did not need to cure the nonmonetary default that

190. *Id.* at 201.

191. *Id.* (citing *Surace v. Danna*, 161 N.E. 315, 315-16 (N.Y. 1928)).

192. *Id.*

193. *Id.*

194. *Yates v. Hendon*, 124 S. Ct. 1330 (2004).

195. *Id.* at 1336-38.

196. *Id.* at 1338.

197. *Id.* at 1339, 1345.

198. 299 B.R. 684, 686 (Bankr. S.D. Ga. 2003).

resulted from his use of the truck in the course of his employment with a company other than the lessee.¹⁹⁹

Generally, a debtor must cure defaults to assume a lease.²⁰⁰ However, § 365(b)(2) sets out certain exceptions to the cure requirement, including “the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract”²⁰¹ The court rejected the argument that this subsection “articulat[es] two distinct exceptions to the cure requirement: (1) penalty rate obligations and (2) nonmonetary obligations.”²⁰² Instead, the court adopted the view that the provision merely excludes certain penalties: penalty rates and penalty provisions relating to nonmonetary defaults.²⁰³ The nonmonetary default itself is not excluded from the cure requirement.²⁰⁴ Because the debtor’s nonmonetary default was an incurable historical fact, he could not assume the lease.²⁰⁵

IX. CONSUMER ISSUES

A. Discharge

1. Willful and Malicious Injury—§ 523(a)(6). *NBA Properties, Inc. v. Moir (In re Moir)*²⁰⁶ raised the issue of whether a judgment for conversion has a collateral estoppel effect on a nondischargeability action for willful and malicious injury.²⁰⁷ In the pre-petition conversion case, a nonbankruptcy court awarded plaintiff compensatory damages, attorney fees, and punitive damages against the debtor.²⁰⁸ In considering the first element of collateral estoppel, similarity of the issues,²⁰⁹

199. *Id.* at 684-85.

200. *Id.* at 685 (citing 11 U.S.C. § 365(b)(1) (2000)).

201. *Id.* at 686 (quoting 11 U.S.C. § 365(b)(2)(D) (2000)).

202. *Id.* (citing *In re GP Express Airlines, Inc.*, 200 B.R. 222, 233-34 (Bankr. D. Neb. 1996)).

203. *Id.* at 686-87 (citing *Worthington v. Gen. Motors Corp. (In re Claremont Acquisition Corp.)*, 113 F.3d 1029, 1034 (9th Cir. 1997)).

204. *Id.* at 686.

205. *Id.* at 687. The First Circuit Court of Appeals recently rejected this approach, holding that debtors need not cure nonmonetary defaults. *Eagle Ins. Co. v. Bankvest Capital Corp. (In re Bankvest Capital Corp.)*, 360 F.3d 291, 301 (1st Cir. 2004).

206. 291 B.R. 887 (Bankr. S.D. Ga. 2003).

207. *Id.* at 891.

208. *Id.* at 890.

209. Collateral estoppel for bankruptcy purposes requires the following four elements:

(a) the issue in the prior action and the issue in the bankruptcy court are identical, (b) the bankruptcy issue was actually litigated in the prior action, (c) the

the court determined that conversion is a type of wrongful conduct within the scope of the definition of "malicious."²¹⁰ But a conversion is not always willful; rather it "can arise from reckless or negligent acts."²¹¹ In this case, the bankruptcy court relied on the award of punitive damages to determine that the nonbankruptcy court had found the requisite intent for willfulness and, thus, that the issues were sufficiently identical to satisfy the first element of collateral estoppel.²¹² Finding that all the other elements of collateral estoppel were satisfied, the court held that the debt was nondischargeable.²¹³

2. Student Loans—§ 523(a)(8). The Eleventh Circuit formally adopted the *Brunner* test²¹⁴ for analyzing the dischargeability of student loans, but it avoided the question of partial discharges in *Hemar Insurance Corp. of America v. Cox (In re Cox)*.²¹⁵ The debtor had earned several degrees, including two law degrees, and was licensed to practice in two states. Nevertheless, his law practice was unprofitable, so he began working for a landscaping company. Eventually he filed for bankruptcy and sought to discharge more than \$114,000 in student loans. The bankruptcy court found that the debtor failed to prove undue hardship, but due to the size of the loans, the court ordered a partial discharge and left the debtor liable for only \$50,000.²¹⁶

The circuit court began its analysis by joining the Second, Third, Fourth, Seventh, and Ninth Circuit Courts in adopting the *Brunner* test for determining whether a debtor satisfies the "undue hardship" requirement for discharging student loans.²¹⁷ Thus, in this circuit, the debtor must now prove the following:

"(1) that the debtor cannot maintain, based on current income and expenses, a 'minimal' standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist

determination of the issue in the prior action was a critical and necessary part of the judgment in that litigation, and (d) the burden of persuasion in the discharge proceeding must not be significantly heavier than the burden of persuasion in the initial action.

Id. at 891 (citing *Bush v. Balfour Beatty Bahamas, Ltd. (In re Bush)*, 62 F.3d 1319, 1322 (11th Cir. 1995)).

210. *Id.* at 892.

211. *Id.* (citing *Kawaauhau v. Geiger*, 523 U.S. 57, 61-62 (1998)).

212. *Id.*

213. *Id.* at 892-94.

214. See *Brunner v. N.Y. State Higher Educ. Servs. Corp.*, 831 F.2d 395 (2d Cir. 1987).

215. 338 F.3d 1238, 1241 (11th Cir. 2003).

216. *Id.* at 1240-41.

217. *Id.* at 1241.

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.”²¹⁸

In the absence of a finding of undue hardship, the court held that no discharge of student loans, partial or otherwise, may be ordered.²¹⁹ The court noted that a string of amendments that made student loan discharges successively harder to obtain is evidence of Congress’s intent to leave “undue hardship’ as the only possible avenue for a debtor to obtain a discharge of student loan indebtedness.”²²⁰

The court was silent as to whether partial discharges would be permissible in conjunction with a finding of undue hardship.²²¹ This silence leaves the creditors’ attorneys free to argue for some continuing liability. However, they may face some difficulty with that argument in the Middle District of Georgia because the debtor may cite to the district court decision in *Educational Credit Management Corp. v. Carter*,²²² which recently rejected the possibility of partial discharge in dicta.²²³

B. Chapter 13 Plans

1. Claims Modification. A debtor cannot alter an allowed secured claim via her Chapter 13 plan.²²⁴ In *Universal American Mortgage Co. v. Bateman (In re Bateman)*,²²⁵ the debtor’s mortgage company filed a proof of claim evidencing a secured arrearage debt of \$49,178.80.²²⁶ The debtor did not object, and the claim was allowed. The debtor’s Chapter 13 plan proposed to pay Universal \$21,600 and listed that amount as disputed. Universal did not object to confirmation of the plan. More than a year after confirmation, when the trustee noticed and alerted the debtor to the discrepancy between Universal’s proof of claim and the plan, the debtor objected to the proof of claim. In response, Universal filed a motion to dismiss the debtor’s case because her plan

218. *Id.* (quoting *Brunner*, 831 F.2d at 396).

219. *Id.* at 1241-42.

220. *Id.* at 1242-43.

221. *Id.*

222. 279 B.R. 872 (M.D. Ga. 2002).

223. *Id.* at 877.

224. *Universal Am. Mortgage Co. v. Bateman (In re Bateman)*, 331 F.3d 821, 822 (11th Cir. 2003). A claim secured by a first mortgage in a residence cannot be modified in Chapter 13. *Id.* at 826 (citing 11 U.S.C. § 1322(b)(2) (2000)). However, a debtor can cure an arrearage in such a mortgage without violating § 1322(b)(2). *Id.* at 826 n.5 (citing 11 U.S.C. § 1322(b)(5) (2000)).

225. 331 F.3d 821 (11th Cir. 2003).

226. *Id.* at 823.

failed to comply with the confirmation requirement that secured claims be provided for in full.²²⁷

The bankruptcy court sided with the debtor, sustaining her objection and holding that plan confirmation was *res judicata* as to the amount of Universal's claim. While its lien survived bankruptcy, it could not pursue its arrearage claim beyond the \$21,600 listed in the plan. Furthermore, the court denied Universal's motion to dismiss; because Universal had not objected to the plan, it could not now collaterally attack the plan.²²⁸ The district court affirmed.²²⁹

First, with respect to the amount of Universal's claim, the circuit court reversed the lower courts.²³⁰ Because the debtor had raised no objection to Universal's proof of claim, it was deemed allowed.²³¹ With an appropriate procedure for objecting to claims spelled out in the Bankruptcy Code and Rules, the court

refuse[d] to permit an inconsistent plan provision to constitute a constructive objection by reason of the Plan's notation of dispute alone, especially where a bankruptcy court does not consider an objection until over a year after the Plan's confirmation That the Plan states an amount in conflict with the proof of claim demands a resolution of the inconsistency, but a debtor's post-confirmation objection is not the appropriate vehicle by which to do so.²³²

Thus, in addition to survival of the lien, the debtor would remain liable for any amount of the claim not paid under the plan.²³³ Furthermore, Universal's rights would be controlled by the mortgage and not any contradictory plan provisions.²³⁴

Second, the court refused to grant Universal's motion to dismiss because it was not raised until three years into the plan.²³⁵ Universal failed to protect its rights in the early stages of the Chapter 13 process and had to bear "some responsibility for letting the discrepancy go this far unchallenged."²³⁶ At such a late point in the proceedings, the

227. *Id.* at 822-23.

228. *Id.* at 823-24.

229. *Id.* at 824.

230. *Id.* at 829.

231. *Id.* at 827-28 (citing 11 U.S.C. § 502(a) (2000); FED. R. BANKR. P. 3001(f)).

232. *Id.* at 828.

233. *Id.* at 831.

234. *Id.* at 834.

235. *Id.* at 833-34.

236. *Id.* at 833.

prejudicial effect of dismissal on the debtor and other creditors would be severe.²³⁷

2. Plan Modification. Rejecting the approach taken by numerous bankruptcy courts in the Eleventh Circuit, the court in *In re Thomas*²³⁸ held that a trustee need not show an extraordinary change in circumstances to modify a Chapter 13 plan.²³⁹ The court relied on the plain language of § 1329, which provides that the trustee may request modification of the plan at any time between confirmation and completion for one of three reasons, including to increase the amount of payments.²⁴⁰

The debtor's bankruptcy schedules indicated that she had only \$4000 equity in her home, which she claimed as exempt. However, when her home was destroyed by fire, more than \$25,000 in insurance proceeds remained after the mortgage was satisfied. The trustee sought to modify the plan to apply those excess proceeds to the claims of unsecured creditors.²⁴¹ The court noted a split of authority, with one line of cases requiring a showing of substantial or unanticipated change in circumstances to modify a plan, and a second line of cases imposing no such requirement.²⁴² The court determined that it was obligated to follow the plain language of the statute.²⁴³ It could "not engraft the 'substantial' or 'unanticipated' conditions over the plain language of the Code" because the plain language did not lead to an absurd result.²⁴⁴ On the contrary, the Code generally does not permit a debtor to receive and keep a payment of \$25,000 to the detriment of her creditors.²⁴⁵ Thus, the court allowed modification so the proceeds could be distributed to creditors.²⁴⁶

Some tension exists between this case and *In re Leskosky*,²⁴⁷ which held that appreciation of exempt property accrues to the benefit of debtors.²⁴⁸ Relying on *Leskosky*, a debtor could argue that the value

237. *Id.*

238. 291 B.R. 189 (Bankr. M.D. Ala. 2003).

239. *Id.* at 193.

240. *Id.* at 192 (citing 11 U.S.C. § 1329(a)(1) (2000)).

241. *Id.* at 191-92.

242. *Id.* at 192-93.

243. *Id.* at 193-94.

244. *Id.* at 194.

245. *Id.* at 194, 196-97. The court also rejected the debtor's argument that *res judicata* precluded modification. *Id.* at 197-98.

246. *Id.* at 198.

247. 287 B.R. 295 (Bankr. M.D. Ga. 2002).

248. *Id.* at 298.

of her exempt property had merely appreciated since the date she filed for bankruptcy and that she should retain the benefit of that appreciation. However, that argument might be difficult to make when the property was never fully exempt. A better argument might be to allocate the appreciation between the nonexempt portion of the residence and the exempt portion.

3. Cram Down Rate. To confirm a Chapter 13 plan over a secured creditor's objection, the debtor must either surrender the creditor's collateral or propose to "cram down" the creditor's secured claim.²⁴⁹ Cram down requires that the creditor retain its lien and receive plan payments equivalent to the present value of its claim.²⁵⁰ Generally, debtors satisfy the cram down requirements by proposing plan payments that total the amount of the secured claim plus interest.²⁵¹ Courts are split over how to determine the appropriate interest rate.²⁵² The Supreme Court's recent plurality decision in *Till v. SCS Credit Corp.*²⁵³ offers no resolution.

Justice Stevens, joined by three colleagues, authored the plurality opinion, which announced the judgment of the Court.²⁵⁴ He advocated a "prime plus" or "formula" method, which relies on the prime rate plus a risk factor based on the possibility of default. The bankruptcy court accepted this approach when it was used by the debtors to propose a 9.5 percent rate on a claim secured by their truck, despite the fact that the contract rate on the truck loan had been 21 percent.²⁵⁵

Under the formula approach, the bankruptcy court would begin with the prime rate and adjust it upward according to risk of default.²⁵⁶

249. 11 U.S.C. § 1325(a)(5).

250. *Id.* § 1325(a)(5)(B).

251. *Till v. SCS Credit Corp.*, 124 S. Ct. 1951, 1955-56 (2004) (plurality opinion).

252. *Id.* at 1956. The Eleventh Circuit Court of Appeals has not addressed this question.

253. 124 S. Ct. 1951 (2004) (plurality opinion).

254. *Id.* at 1955 (Stevens, J.).

255. *Id.* at 1956-57. The district court reversed, endorsing a "coerced loan" approach, in which the rate is determined by the rate "the creditor could have obtained if it had foreclosed on the loan, sold the collateral, and reinvested the proceeds in loans of equivalent duration and risk." *Id.* at 1957. The majority in the court of appeals took a presumptive contract rate approach, in which the contract rate is deemed the appropriate rate unless challenged by one of the parties. *Id.* at 1957-58. The dissent in the court of appeals urged the formula approach or a "cost of funds" approach, which is based on "what it would cost the creditor to obtain the cash equivalent of the collateral from an alternative source." *Id.* at 1958 (quoting *In re Till*, 301 F.3d 583, 595-96 (7th Cir. 2002) (Rovner, J., dissenting)).

256. *Id.* at 1961.

The court would determine the risk enhancement—which generally has been in the range of 1 to 3 percent—by considering relevant factors, such as “the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan.”²⁵⁷

In a concurring opinion, Justice Thomas endorsed a “risk-free” rate.²⁵⁸ He agreed that some interest may be necessary, but that rate should be dictated by the time value of money and not any risk factors related to the debtor.²⁵⁹ Thomas argued that by considering risk factors, the Court is actually valuing the debtor’s promise to pay rather than valuing “the property to be distributed” as required by the statute.²⁶⁰

Justice Thomas never explains how the appropriate rate should be determined, although he states that “[t]he prime rate is [t]he interest rate most closely approximating the riskless or pure rate for money.”²⁶¹ He concurred in judgment with the plurality because the 9.5 percent rate proposed by the debtor “is higher than the risk-free rate.”²⁶² Thus, it is sufficient to satisfy § 1325(a)(5)(B)(ii).²⁶³

Justice Scalia was joined by three colleagues in dissenting.²⁶⁴ He preferred the “presumed contract rate” approach, in which the contract rate is the presumptive rate, but could be altered as necessary upon motion of a party.²⁶⁵ This approach prevents the creditor from being undercompensated “for the true risks of default.”²⁶⁶ And it relies on the assumptions that “the contract rate reasonably reflects actual risk at the time of borrowing” and that “this risk persists when the debtor files for Chapter 13.”²⁶⁷ Furthermore, the contract rate approach is more efficient than the prime plus formula, because the risk need not be calculated by the court unless disputed by one of the parties; it has already been determined by the market.²⁶⁸

257. *Id.* at 1961-62.

258. 124 S. Ct. at 1965 (Thomas, J., concurring).

259. *Id.*

260. *Id.* at 1966 (quoting 11 U.S.C. § 1325(a)(5)(B)(ii)).

261. *Id.* n.2 (quoting *ENCYCLOPEDIA OF BANKING & FINANCE* 830 (9th ed. 1991)). *But see* 124 S. Ct. at 172 n.6 (Scalia, J., dissenting) (indicating that the treasury rate, which is two percent lower than the prime rate, is a risk-free rate).

262. *Id.* at 1968.

263. *Id.*

264. 124 S. Ct. at 1968 (Scalia, J., dissenting).

265. *Id.*

266. *Id.*

267. *Id.* at 1970.

268. *Id.* at 1973.

The lack of a majority opinion raises the question of whether *Till* is binding precedent. The Supreme Court has said that “[w]hen a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of five Justices, ‘the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds.’”²⁶⁹ The Court has since acknowledged that this test has been difficult to apply.²⁷⁰ In this case, as the dissent stated, “[e]ight Justices are in agreement that the rate of interest set forth in the debtor’s approved plan must include a premium for risk.”²⁷¹ The difference is that the majority would require creditors to prove any risk in addition to that contained in the prime rate, while the dissent would presume that the creditor’s calculation of risk at the time it lent the money is correct. Whether or not the courts will be able to find some narrow grounds of agreement on which to base future decisions remains to be seen.

X. THE SERVICEMEMBERS CIVIL RELIEF ACT OF 2003

The Servicemembers Civil Relief Act of 2003 (the “Act”)²⁷² amended the Soldiers and Sailors Civil Relief Act (“SSCRA”)²⁷³ and was signed into law in December 2003. The Act provides for “the temporary suspension of judicial and administrative proceedings and transactions that may adversely affect the civil rights of servicemembers during their military service.”²⁷⁴ Bankruptcy is not excluded from the Act; on the contrary, it is specifically invoked in one section.²⁷⁵ Payment of an active duty servicemember’s life insurance policy premiums is guaranteed by the United States.²⁷⁶ If the United States is obligated to act on that guarantee, the servicemember will become indebted to the United States.²⁷⁷ “Such debt payable to the United States is not dischargeable in bankruptcy proceedings.”²⁷⁸

Another provision of the Act that may arise in the bankruptcy context is the interest rate reduction. That provision became an issue in *Baxter*

269. *Marks v. United States*, 430 U.S. 188, 193 (1977) (quoting *Gregg v. Georgia*, 428 U.S. 153, 169 n.15 (1976)).

270. *Grutter v. Bollinger*, 539 U.S. 306, 325 (2003).

271. 124 S. Ct. at 1978.

272. Pub. L. No. 108-189, 117 Stat. 2835 (2003).

273. 50 App. U.S.C. §§ 501-596 (1990 & Supp. 2003).

274. 117 Stat. at 2836, § 2(2).

275. *Id.* at 2854, § 407(b)(3).

276. *Id.* § 407(a)(1).

277. *Id.* § 407(b)(1).

278. *Id.* § 407(b)(3).

v. Watson (In re Watson).²⁷⁹ The Chapter 13 debtor had two secured claims to be paid at twelve percent interest. He was a member of the Army National Guard and was called to active duty after his plan was confirmed. The trustee sought a reduction in the interest rates under the SSCRA (the predecessor to the Act).²⁸⁰ The SSCRA provided that the obligations of active duty servicemembers shall not accrue interest at a rate greater than six percent unless the servicemember's ability to pay a greater rate is unaffected by his military service.²⁸¹ After determining that the debtor was covered by the SSCRA and that the SSCRA applied to bankruptcy proceedings, the court concluded that the rate reduction is mandatory unless the creditor proves "that the serviceman is capable of paying the higher rate."²⁸² In this case, the creditor failed to meet its burden.²⁸³ The court ordered reduction of the interest rate on the secured claims, with the proviso that the rate would return to twelve percent "immediately upon the Debtor[']s release from active duty."²⁸⁴

Bankruptcy practitioners should also be aware of an affidavit requirement for default judgments. Pursuant to the Act, before a plaintiff can receive a default judgment, he must submit an affidavit to the court "stating whether or not the defendant is in military service and showing necessary facts to support the affidavit; or . . . stating that the

279. 292 B.R. 441, 442 (Bankr. S.D. Ga. 2003).

280. *Id.* at 442-43.

281. *Id.* at 443 (quoting 50 App. U.S.C. § 526). The amendments made some changes to this provision. It now provides,

[a]n obligation or liability bearing interest at a rate in excess of 6 percent per year that is incurred by a servicemember . . . before the servicemember enters military service shall not bear interest at a rate in excess of 6 percent per year during the period of military service A court may grant a creditor relief from the limitations of this section if, in the opinion of the court, the ability of the servicemember to pay interest upon the obligation or liability at a rate in excess of 6 percent is not materially affected by reason of the servicemember's military service.

117 Stat. 2835, 2844, § 207(a)(1), (c).

282. 292 B.R. at 445. While the amendment did not appear to make significant alterations to the language of the "interest rate" section, creditors may still rely on the changes to argue that it is no longer clear who bears the burden of proof. Under the SSCRA, the court only considered the debtor's ability to pay the higher interest rate "upon application thereto by the obligee." 50 App. U.S.C. § 526. The amendment removed that language. *See supra* note 281. However, such a requirement may be implicit in the new statute.

283. 292 B.R. at 445.

284. *Id.*

plaintiff is unable to determine whether or not the defendant is in military service.²⁸⁵

XI. CONCLUSION

It is difficult to draw any broad themes from the cases decided over the past year. And, notably, the Supreme Court has probably created more questions than answers in the bankruptcy arena during its 2003-2004 term. Moreover, Congress is once again attempting to pass bankruptcy reform legislation.²⁸⁶ So, interesting changes may be in store for the future.

285. 117 Stat. at 2840 § 201(b)(1).

286. Bankruptcy Abuse Prevention and Consumer Protection Act of 2003, H.R. 975, 108th Cong. (2003).