

# Bankruptcy

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## I. INTRODUCTION

Never underestimate the persistence of the credit lobby. In the most significant development in bankruptcy law since last year's Article,<sup>1</sup> Congress finally, after eight years of trying, enacted bankruptcy reform legislation in the form of the Bankruptcy Abuse Prevention and Consumer Protection Act<sup>2</sup> ("BAPCPA" or the "Act"). At least one judge has stated that "to call the Act a 'consumer protection' Act is the grossest of misnomers."<sup>3</sup> Indeed, the Act creates new roadblocks for entrance into bankruptcy, such as the pre-petition credit counseling requirement and Chapter 7 means testing; limiting or eliminating the protection of the automatic stay for repeat filers; substantially reducing the super discharge for Chapter 13 debtors; and limiting the availability of a discharge for repeat filers. As that same judge said in reference to some of these new provisions, "[i]t should be obvious to the reader at this point how truly concerned Congress is for the individual consumers of this country."<sup>4</sup>

All sarcasm aside, whether or not individual judges approve of the Act, they must apply its provisions. This Article will examine the BAPCPA cases decided by courts in the Eleventh Circuit, pertinent non-BAPCPA

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1. See James D. Walker, Jr. & Amber Nickell, *Bankruptcy*, 56 MERCER L. REV. 1199 (2004).

2. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

3. *In re Sosa*, 336 B.R. 113, 114 (Bankr. W.D. Tex. 2005).

4. *Id.* at 115.

cases decided from early 2005 through early 2006, and a somewhat surprising decision from the Supreme Court.

## II. BAPCPA CASES

### A. *Debt Relief Agencies*

On the same date the bulk of BAPCPA<sup>5</sup> provisions became effective, one judge issued an opinion *sua sponte* holding that debtors' attorneys practicing in the Southern District of Georgia are not debt relief agencies.<sup>6</sup> Chief Judge Davis came to this conclusion after applying a "plain meaning" standard to sections 101(12A), 101(4A), 526, 527, and 528 of the Bankruptcy Code.<sup>7</sup> Most bankruptcy practitioners should be intimately acquainted with those provisions, which impose "significant restrictions on the activities of debt relief agencies" as well as significant duties when such debt relief agencies are interacting with assisted persons.<sup>8</sup>

A "debt relief agency" is defined by section 101(12A) as "any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer . . . ."<sup>9</sup> Under this definition, an attorney arguably falls within the purview of providing bankruptcy assistance.<sup>10</sup> Additionally, a petition preparer also seems to fit within the definition.<sup>11</sup> Because Congress put petition preparers in a separate category, the scope of "bankruptcy assistance" must be narrower than it first appears.<sup>12</sup> "[I]t is instructive that Congress saw the necessity of expressly including 'bankruptcy petition preparers' (who clearly provide 'bankruptcy assistance') in the definition of debt relief agency, yet omitted any express inclusion of attorneys."<sup>13</sup> The court further reasoned that the inclusion of "providing legal representation" within the

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5. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

6. *In re Attorneys at Law & Debt Relief Agencies*, 332 B.R. 66, 71 (Bankr. S.D. Ga. 2005).

7. *Id.* at 69. See 11 U.S.C. §§ 101(12A), 101(4A), 526, 527, 528 (2005). Unless otherwise stated, all statutory references are to the Bankruptcy Code, which is codified at Title 11 of the United States Code.

8. *Attorneys at Law*, 332 B.R. at 67.

9. 11 U.S.C. § 101(12A).

10. See *Attorneys at Law*, 332 B.R. at 67.

11. *Id.*

12. *Id.* at 69.

13. *Id.* (citing 11 U.S.C. § 101(4A)).

definition of bankruptcy assistance actually refers to the unauthorized practice of law by a debt relief agency.<sup>14</sup>

Moving from the definitional sections to the regulatory sections, the court again concluded that the Act targets non-attorneys.<sup>15</sup> “Congress intended to establish regulation of entities who interface with debtors in shadowy, gray areas not already covered by bankruptcy petition preparer regulations and to bolster the existing regulation of bankruptcy petition preparers, but it did not intend to regulate attorneys.”<sup>16</sup> In addition, the Act does not preempt states’ power to regulate attorneys because the provisions are silent regarding Congress’s intent.<sup>17</sup> “It would be a breathtakingly expansive interpretation of federal law to usurp state regulation of the practice of law via the ambiguous provisions of this Act, which in no clear fashion lay claim to the right to do any such thing.”<sup>18</sup> In conclusion, the court noted that if Congress wanted to regulate bankruptcy attorneys, it would have done so expressly rather than using the term “debt relief agency.”<sup>19</sup> For those reasons, the court held that attorneys practicing before it “are excused from compliance with” any provision covering debt relief agencies “so long as their activities fall within the scope of the practice of law and do not constitute a separate commercial enterprise.”<sup>20</sup>

Perhaps emboldened by Judge Davis’s opinion, a debtor’s attorney in the Middle District of Georgia filed a motion to determine attorney status, seeking a similar ruling applicable to that district.<sup>21</sup> His efforts were fruitless because of a jurisdictional problem.<sup>22</sup> The United States Constitution only allows courts to hear cases and controversies.<sup>23</sup> A case or controversy only exists if the plaintiff has suffered actual harm or such harm is imminent.<sup>24</sup> The attorney in *McCartney* could show no actual or imminent harm because “no party has threatened to enforce against [the Plaintiff] the debt relief agency provisions of BAPCPA.”<sup>25</sup>

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14. *Id.* at 70.

15. *Id.*

16. *Id.*

17. *See id.* at 70-71.

18. *Id.* at 71.

19. *Id.*

20. *Id.*

21. *See In re McCartney*, 336 B.R. 588, 589 (Bankr. M.D. Ga. 2006).

22. *See id.* at 592.

23. *Id.* at 590 (citing U.S. CONST. art. III, § 2).

24. *Id.* at 590-91.

25. *Id.* at 592.

Consequently, the court dismissed the motion due to lack of jurisdiction.<sup>26</sup>

The same jurisdictional problem may eventually derail Judge Davis's opinion in *Attorneys at Law*. The United States Trustee filed an appeal, arguing that the court lacked jurisdiction and that the decision was incorrect as a matter of law.<sup>27</sup> At the time of this writing, the appeal was still pending.

### B. Credit Counseling

Section 109 of the Bankruptcy Code<sup>28</sup> sets forth the debtor eligibility requirements. The BAPCPA added a new requirement for individuals: they must receive credit counseling within 180 days prior to filing a petition, with a few very narrow exceptions.<sup>29</sup> The court in *In re Davenport*,<sup>30</sup> recognized waiver as one of the narrow exceptions.<sup>31</sup> Waiver is available if "(1) exigent circumstances merit a waiver of pre-petition credit counseling; (2) the individual requested, but was unable to receive, credit counseling within five days of the request; and (3) the court is satisfied" with the debtor's request for waiver.<sup>32</sup> In *Davenport*, the court was satisfied that the imminent repossession of the debtor's car constituted exigent circumstances.<sup>33</sup> However, the debtor did not request counseling prior to filing, although she did obtain counseling two days after filing.<sup>34</sup> "The statute is clear: the Court can only excuse compliance if the debtor satisfies all three requirements of Section 109(h)(3)."<sup>35</sup> Consequently, the court dismissed the case.<sup>36</sup>

*Davenport* did not address the effect of its dismissal on a subsequent case filed by the debtor, with respect to new provisions of section 362<sup>37</sup>

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26. *Id.*

27. *In re Attorneys at Law & Debt Relief Agencies v. Turner*, No. 4:05-CV-00206-WTM (S.D. Ga. filed Sept. 3, 2005). Briefs in the appeal are available on PACER.

28. 11 U.S.C. § 109 (2005).

29. *Id.* § 109(h)(1).

30. 335 B.R. 218 (Bankr. M.D. Fla. 2005).

31. *Id.* at 220.

32. *Id.*

33. *Id.* at 220-21.

34. *Id.* at 221.

35. *Id.*

36. *Id.* The debtor argued that dismissal was futile because, having obtained credit counseling, she would likely file a new petition. *Id.* However, if she immediately refiles, she will have had two prior cases pending and dismissed during the previous one-year period. Consequently, she would not receive the benefit of the automatic stay, and her creditor could proceed with repossession of her car notwithstanding the bankruptcy filing. See 11 U.S.C. § 362(c)(4) (2005)).

37. 11 U.S.C. § 362 (2005).

that limit or eliminate the automatic stay for repeat filers.<sup>38</sup> In *In re Valdez*,<sup>39</sup> the court dismissed the debtor's petition for failure to satisfy the credit counseling requirement.<sup>40</sup> However, the court stated that because it considers section 109 jurisdictional, the dismissal would not be treated as a dismissal for purposes of section 362(c) if the debtor filed a subsequent case.<sup>41</sup> Courts in other circuits have reached a similar result by striking the petition and treating the case as *void ab initio* rather than dismissing the case.<sup>42</sup>

On the other hand, the court in *In re Ross*<sup>43</sup> concluded that section 109 is not jurisdictional.<sup>44</sup> Thus, the court reasoned that failure to complete credit counseling requirements results in a dismissal of the case—a dismissal that counts as a dismissal for purposes of section 362(c).<sup>45</sup> The court relied on cases considering other eligibility requirements to determine that eligibility is not jurisdictional.<sup>46</sup> It also noted that the protection afforded a debtor by treating the case as *void ab initio* may be illusory.<sup>47</sup> In order to protect the automatic stay in a later case, the court must void the original case, meaning no stay was in effect.<sup>48</sup> Thus, any actions taken by a creditor in violation or ignorance of the stay in the original case cannot be remedied.<sup>49</sup> In addition, treating a case as void for failure to receive credit counseling creates uncertainty for all nondebtor parties with an interest in the case, and would require them to engage in a level of due diligence not presently necessary.<sup>50</sup>

It is important to note that the automatic stay problems caused in subsequent cases by a section 109(h) dismissal will probably disappear for all debtors except *pro se* debtors. Debtors' attorneys will likely

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38. Pursuant to 11 U.S.C. § 362(c)(3), a debtor who had one case pending and dismissed during the one-year period prior to filing his current case loses the benefit of the automatic stay after thirty days. Also, pursuant to 11 U.S.C. § 362(c)(4), a debtor with more than one case pending and dismissed in the prior year receives no automatic stay.

39. 335 B.R. 801 (Bankr. S.D. Fla. 2005).

40. *Id.* at 804.

41. *Id.* at 803-04.

42. See *In re Rios*, 336 B.R. 177, 178 (Bankr. S.D.N.Y. 2005); *In re Hubbard*, 333 B.R. 377, 388 (Bankr. S.D. Tex. 2005).

43. No. 05-86669-PWB, 2006 WL 349654 (Bankr. N.D. Ga. Feb. 8, 2006).

44. *Id.* at \*2.

45. *Id.* at \*2, \*4, \*6.

46. See *id.* at \*3.

47. *Id.* at \*4.

48. *Id.*

49. *Id.*

50. *Id.* at \*5.

establish procedures to obtain immediate credit counseling for debtors in imminent danger of foreclosure or other financial distress.

### C. Homestead Exemption Cap

The BAPCPA is not all gloom and doom for debtors. Wealthy debtors who have lived for a substantial time in a state with a generous homestead exemption, Florida<sup>51</sup> for example, can still shelter enormous sums from their creditors. BAPCPA limits the available homestead exemption to \$125,000 for debtors who acquired their residences within 1,215 days prior to filing their bankruptcy petitions.<sup>52</sup> However, this new provision has some tricky language in that it applies when the debtor has “elect[ed] under subsection (b)(3)(A) to exempt property under State or local law.”<sup>53</sup> Here’s the problem: some states allow a debtor to choose (or to elect) either state or federal exemptions. Other states, such as Florida, require the debtor to use state exemptions; thus, the debtor makes no election.

It did not take Florida debtors long—at least those with fewer than 1,215 days in residence—to grasp the significance of these circumstances.<sup>54</sup> Florida debtors argued that because they made no election, the cap on the homestead exemption should not apply to them.<sup>55</sup> The debtors relied on an Arizona bankruptcy case<sup>56</sup> to support their view; however, the Florida bankruptcy courts were not persuaded.<sup>57</sup>

Acknowledging that a strict, plain reading of the statute would render the exemption cap ineffective in Florida, the courts determined that principles of statutory construction required them to look to congressional intent.<sup>58</sup> In *Kaplan*, the court found that section 522(p)(1) was ambiguous and turned to congressional intent to resolve the ambiguity.<sup>59</sup> In *Wayrynen*, the court found that a plain reading would render the provision “inconsequential” in a manner inconsistent with congressio-

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51. Florida offers its residents an unlimited homestead exemption. See *In Re Wayrynen*, 332 B.R. 479, 482 n.1.

52. 11 U.S.C. § 522(p)(1) (2005).

53. *Id.*

54. See *In re Wayrynen*, 332 B.R. 479 (Bankr. S.D. Fla. 2005); *In re Kaplan*, 331 B.R. 483 (Bankr. S.D. Fla. 2005).

55. *Wayrynen*, 332 B.R. at 482; *Kaplan*, 331 B.R. at 485.

56. *In re McNabb*, 326 B.R. 785 (Bankr. D. Ariz. 2005).

57. *Wayrynen*, 332 B.R. at 484; *Kaplan*, 331 B.R. at 488.

58. See *Wayrynen*, 332 B.R. at 483; *Kaplan*, 331 B.R. at 484.

59. *Kaplan*, 331 B.R. at 487. The alternative meaning suggested by the court is that the provision applies to any debtor using state law exemptions, “whether they have a choice or not.” *Id.*

nal intent.<sup>60</sup> Both courts relied on a House report accompanying a prior version of the Act, which stated:

The Bill also restricts the so-called “mansion loophole.” Under current bankruptcy law, debtors living in certain states can shield from their creditors virtually all of the equity in their homes. In light of this, some debtors actually relocate to these states just to take advantage of their “mansion loophole” laws.<sup>61</sup>

Relying on this legislative history, both courts concluded that when a debtor files for bankruptcy in Florida, he is “electing” to take advantage of the exemptions available to Florida debtors.<sup>62</sup> Thus, the BAPCPA limits on the homestead exemption apply in Florida.

### III. STATE SOVEREIGN IMMUNITY

States’ efforts to claim sovereign immunity in bankruptcy proceedings have been seriously undermined, if not completely eviscerated, by the Supreme Court’s 5-4 decision in *Central Virginia Community College v. Katz*.<sup>63</sup> Two years earlier, the Court held, in *Tennessee Student Assistance Corp. v. Hood*,<sup>64</sup> that bankruptcy courts had in rem jurisdiction in a student loan dischargeability proceeding against a state.<sup>65</sup> However, the Court stated that *Hood* was “unlike an adversary proceeding by the bankruptcy trustee seeking to recover property in the hands of State on the grounds that the transfer was a voidable preference.”<sup>66</sup> That statement suggests that a court might not have in rem jurisdiction over a preference claim. The Court in *Katz* directly addressed this issue.

In *Katz* the liquidating agent for the debtor sought to recover preferential transfers made to Central Virginia Community College (“CVCC”), an arm of the state. CVCC moved for dismissal based on sovereign immunity. The bankruptcy court denied the motion. The

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60. *Wayrynen*, 332 B.R. at 483-84. Under a strict reading of the statute, the cap would apply only in Minnesota and Texas. See *Kaplan* 331 B.R. at 484.

61. *Wayrynen*, 332 B.R. at 483; *Kaplan*, 331 B.R. at 487-88 (both citing H.R. REP. NO. 109-31, at 15-16 (2005), reprinted in 2005 U.S.C.C.A.N., 88, 102).

62. *Wayrynen*, 332 B.R. at 484; *Kaplan*, 331 B.R. at 488. In *Wayrynen*, the court found in favor of the debtor on other grounds (transfer of interest from a prior Florida residence to his present Florida residence). 332 B.R. at 484-86.

63. 126 S. Ct. 990 (2006).

64. 541 U.S. 440 (2004).

65. *Id.* at 454.

66. *Id.*

district and circuit courts affirmed.<sup>67</sup> The issue before the Court was whether Congress effectively abrogated state sovereign immunity through section 106(a) of the Bankruptcy Code,<sup>68</sup> which provides that “[n]otwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit . . . with respect to” specific sections of the Code.<sup>69</sup>

The Court concluded that the validity of abrogation was irrelevant because historical analysis revealed that States have agreed not to assert their immunity.<sup>70</sup> The Court reached this conclusion after an extensive review of the history of bankruptcy generally, colonial and state bankruptcy laws and their discrepancies, and the earliest federal bankruptcy laws.<sup>71</sup>

Originally, the bankruptcy discharge served not only to rid the debtor of his debts, but also to release him from prison. This bankruptcy discharge worked in England, which had a single sovereign, but when the practice of imprisoning debtors began in the colonies, the existence of multiple sovereigns created a problem for debtors. While one colony or state might grant a debtor a discharge, nothing prevented the debtor from being imprisoned for the same debts when he crossed state lines.<sup>72</sup> Against this backdrop, the bankruptcy clause was inserted into the Constitution with little debate.<sup>73</sup>

The Court also focused on the historical understanding that bankruptcy jurisdiction was a limited type of in rem jurisdiction.<sup>74</sup> Nevertheless, the framers of the Constitution understood, as evidenced by the early federal bankruptcy laws, that the jurisdiction extended to issuing ancillary orders enforcing in rem adjudications.<sup>75</sup> In preference actions, which may have an in personam component, “those who crafted the Bankruptcy Clause would have understood it to give Congress the power to authorize courts to avoid preferential transfers and to recover the transferred property.”<sup>76</sup> To the extent a turnover order implicates state sovereign immunity, “the States agreed in the plan of the Convention not to assert that immunity.”<sup>77</sup>

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67. *Katz*, 126 S. Ct. at 994-95.

68. 11 U.S.C. § 106(a) (2005).

69. *Katz*, 126 S. Ct. at 995 (quoting 11 U.S.C. § 106(a)).

70. *Id.* at 1002.

71. *Id.* at 995-96.

72. *Id.* at 997-99.

73. *Id.* at 999-1000.

74. *Id.* at 1000.

75. *Id.* at 1000-01.

76. *Id.* at 1001-02.

77. *Id.* at 1002.

The dissent challenged the majority's conclusion that "the States' consent to suit can be ascertained from the history of the Bankruptcy Clause."<sup>78</sup> Instead, the dissent examined the history and concluded that it "confirms that the adoption of the Constitution merely established federal power to legislate in the area of bankruptcy law, and did not manifest an additional intention to waive the States' sovereign immunity against suit."<sup>79</sup>

#### IV. BANKRUPTCY ESTATE

In 2005 an Alabama bankruptcy court, in *In re Pigott*,<sup>80</sup> departed from prior rulings and held that a debtor's overpayment of federal income taxes is not necessarily property of the estate.<sup>81</sup> The debtors owed several years of back taxes, dischargeable in part and nondischargeable in part. Nevertheless, they anticipated a refund from their 2004 taxes and claimed an exemption of \$5125 in the refund. The Internal Revenue Service ("IRS") argued that it was entitled to offset the dischargeable tax debt against any overpayment prior to issuing a refund.<sup>82</sup> The court noted in its analysis that other courts have framed this issue as a conflict between section 553,<sup>83</sup> which preserves any right of setoff available under nonbankruptcy law, and section 522(c),<sup>84</sup> which protects exempt property from liability for pre-petition debts with some exceptions, including *nondischargeable* tax debt.<sup>85</sup> The majority position, followed by courts in Georgia and Alabama, held that the IRS could not offset an overpayment against dischargeable tax debt because: (1) to hold otherwise prevents the debtor from exempting property from the claims of creditors holding a right to setoff; (2) it furthers the fresh-start policy; and (3) Congress rejected a version of section 522(c) that provided for valid setoff by the IRS.<sup>86</sup>

Although the court considered these assertions persuasive, it took a different position based on new arguments relating to the definitions of "overpayment" and "refund."<sup>87</sup> Under this approach, the court held

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78. *Id.* at 1006 (Thomas, J., dissenting).

79. *Id.* (Thomas, J., dissenting).

80. 330 B.R. 797 (Bankr. S.D. Ala. 2005).

81. *Id.* at 802.

82. *Id.* at 798-99.

83. 11 U.S.C. § 553 (2005).

84. 11 U.S.C. § 522(c) (2005).

85. *Pigott*, 330 B.R. at 799-800.

86. *Id.* at 801 (citing *In re Jones*, 230 B.R. 875, 880-81 (M.D. Ala. 1999)).

87. *Id.* at 802.

that a taxpayer is not entitled to a refund until any overpayment has been applied to unpaid taxes.<sup>88</sup> “Since an overpayment is not credited to the debtor until after offsets have occurred, if the IRS chooses to make such an offset, there is no property interest in a debtor until the refund has been declared.”<sup>89</sup> Thus, so long as the IRS has yet to declare a refund, any tax overpayment is not property of the estate and consequently cannot be claimed as exempt.<sup>90</sup>

## V. CLAIMS

### A. *Mortgage on a Principal Residence*

In Chapter 13,<sup>91</sup> the loan date, rather than the petition date, determines whether a mortgage creditor’s claim is protected from modification under section 1322(b)(2).<sup>92</sup> In *United States Department of Agriculture v. Jackson*,<sup>93</sup> the debtor applied for a home loan in January 1983 and indicated that she would reside in the house, which she did for some time after receiving the loan. Subsequently, she gave the creditor a security interest in the house. However, when the debtor filed her bankruptcy petition in August 2003, her stepfather lived in the house and she resided elsewhere. The creditor filed a secured claim for \$32,888.58. The debtor and creditor agreed the house was worth at least \$9000, and the debtor, in her Chapter 13 plan, proposed to treat the claim in excess of \$9000 as unsecured. The bankruptcy court allowed the modification on the ground that the house was not the debtor’s principal residence on the petition date.<sup>94</sup> The creditor appealed, and the district court reversed.<sup>95</sup> The court examined the statutory language and decided it was unclear “whether the critical phrase, ‘real property that is the debtor’s principal residence’ modifies the remotely antecedent term, ‘claim,’ or the more immediate antecedent term, ‘security interest.’”<sup>96</sup> Thus, the court turned to the legislative history to determine that Congress intended to give residential mortgages

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88. *Id.*

89. *Id.*

90. *Id.*

91. 11 U.S.C. §§ 1301-1330 (2000).

92. 11 U.S.C. § 1322(b)(2) (2005).

93. No. 5:05-CV-20, 2005 WL 1563529 (M.D. Ga. July 1, 2005).

94. *Id.* at \*1-2.

95. *Id.* at \*2, \*4.

96. *Id.* at \*4 (quoting 11 U.S.C. § 1332(b)(2)).

favorable treatment to encourage such lending.<sup>97</sup> Using the petition date rather than the agreement date undermines Congress's purpose by creating additional risk for the mortgage lender—risk that the loan may be modified in bankruptcy if the debtor simply moves out of the house.<sup>98</sup> Thus, the court held that the loan date is the appropriate date for determining whether real property subject to a mortgage is the debtor's principal residence.<sup>99</sup>

*B. Discharge of Debt Absent Proof of Claim*

The debtors in *In re Lowthorp*<sup>100</sup> sought to hold the IRS in contempt for attempting to collect a discharged debt. The debtors owed the IRS for two pre-petition debts: a priority debt and a claim for trust fund penalties. The IRS filed a proof of claim for the priority debt, but not for the trust fund taxes. The IRS received notice of the confirmation hearing in the debtors' case and of the order confirming the plan, however, it withheld the debtors' tax return to offset the trust fund tax debt. The IRS returned the money only after the debtors filed a motion to impose sanctions, and then proceeded to send the debtors demand letters for the trust fund tax debt. The debtors again sought sanctions. In response, the IRS argued that the claim for trust fund taxes was never discharged because it was not provided for in the debtors' Chapter 13 plan.<sup>101</sup> The court disagreed, noting that "a [p]lan cannot and will not 'provide for' a claim that was not timely filed for the simple reason that it cannot be allowed under Section 502 . . . ."<sup>102</sup>

In reviewing the case law on the issue, the court concluded that cases requiring the plan to provide for a debt, in the absence of a filed claim, generally concerned post-petition debt.<sup>103</sup> The court refused to accept the reasoning of those cases because to do so "would open the door to enable a creditor to escape the consequences of the debtor's pending bankruptcy by not filing a proof of claim thus preserving the non-dischargeability of the claim . . . ."<sup>104</sup> Instead, the court held that "an unfiled claim is discharged even when the plan makes no reference to

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97. *Id.*

98. *See id.*

99. *Id.*

100. 325 B.R. 470 (Bankr. M.D. Fla. 2005).

101. *Id.* at 471-72.

102. *Id.* at 473.

103. *Id.* at 474.

104. *Id.*

the claim . . . .”<sup>105</sup> Thus, the trust fund taxes were discharged and the IRS was subject to sanctions for trying to collect them.<sup>106</sup>

#### VI. AVOIDANCE

In *Reily v. Kapila (In re International Management Associates)*,<sup>107</sup> the Eleventh Circuit Court of Appeals considered whether a transferee received a benefit from a transfer sufficient to make him liable in a fraudulent transfer case.<sup>108</sup> The facts of the case are somewhat complex but can be summarized in relevant part as follows: Reily and Gichon both owned shares in an assisted living facility management company. To obtain financing to purchase additional facilities, the lender required Reily to become the sole shareholder. Consequently, Reily obtained Gichon’s shares for \$100,000. After the management company filed for bankruptcy, the trustee sought to recover the money, alleging the transfer was fraudulent. The bankruptcy court found Reily and Gichon jointly and severally liable. Thus, the trustee could recover the money from either or both of them. On appeal, the district court held that Reily was liable but Gichon was not.<sup>109</sup> The issue on appeal in the circuit court was whether Reily was liable.<sup>110</sup>

Section 550(a)(1)<sup>111</sup> of the Bankruptcy Code allows a trustee to recover a fraudulent transfer from “the entity for whose benefit such transfer was made . . . .”<sup>112</sup> In *Reily*, the purpose of the transfer of stock was to facilitate financing.<sup>113</sup> The trustee argued that “Reily was ‘benefitted’ . . . when he obtained complete control” of the management company.<sup>114</sup> The circuit court rejected this argument stating that, “this sort of unquantifiable advantage is not the sort of ‘benefit’ contemplated by 11 U.S.C. § 550(a).”<sup>115</sup> The court further explained that Reily did not benefit “in a transaction that reduced the assets under his control by \$100,000 but increased to an unquantifiable extent the concentration of his control or ownership of that shrunken asset base,”

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105. *Id.*

106. *Id.*

107. 399 F.3d 1288 (11th Cir. 2005).

108. *Id.* at 1291-92.

109. *Id.* at 1289-91.

110. *Id.* at 1292.

111. 11 U.S.C. § 550(a)(1) (2000).

112. *Id.*

113. 399 F.3d at 1290.

114. *Id.* at 1292.

115. *Id.*

and as a result concluded that Reily was not liable for the fraudulent transfer.<sup>116</sup>

The circuit court dealt with a similar issue in *IBT International, Inc. v. Northern (In re International Administrative Services, Inc.)*.<sup>117</sup> At issue in *IBT International* was whether, in a fraudulent conveyance avoidance case, “an action must first be brought against the initial transferee as a prerequisite to seeking recovery against other parties who may be liable.”<sup>118</sup> Section 550(a) provides for recovery of a transfer “to the extent that a transfer is avoided under section 544 . . . .”<sup>119</sup> The court first rejected the defendants’ argument that the plain language of section 550(a) requires the actual avoidance of the initial transfer before any subsequent transferees can be sued.<sup>120</sup> Such an interpretation of section 550(a) “produces a harsh and inflexible result that runs counterintuitive to the nature of avoidance actions.”<sup>121</sup> The court instead opted for a rule under which the trustee may simultaneously pursue an avoidance action under section 544<sup>122</sup> and seek a recovery under section 550.<sup>123</sup> The court adopted this approach because it “allows a more pragmatic and flexible approach to avoiding transfers; for if the Bankruptcy Code conceives of a plaintiff suing independently to avoid and recover, then bringing the two actions together only advances the efficiency of the process and furthers the ‘protections and forgiveness inherent in the bankruptcy laws.’”<sup>124</sup>

## VII. DISCHARGE

Although it is hard to believe, after so many courts have refused to grant a hardship discharge on very sympathetic facts, it is still possible for a debtor to obtain a discharge of student loans. In *Mosley v. General Revenue Corp. (In re Mosley)*,<sup>125</sup> the *pro se* debtor was unable to maintain employment due to “chronic lower back pain with radicular

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116. *Id.* at 1293.

117. 408 F.3d 689 (11th Cir. 2005).

118. *Id.* at 704.

119. 11 U.S.C. § 550(a).

120. *IBT Int’l*, 408 F.3d at 704.

121. *Id.*

122. U.S.C. § 544 (2000).

123. *IBT Int’l*, 408 F.3d at 706.

124. *Id.* at 707 (quoting *In re Waldron*, 785 F.2d 936, 941 (11th Cir. 1986)). The court acknowledged that its interpretation departed from a plain reading of § 550(a). *Id.* However, it justified doing so because the statute is both ambiguous and leads to an absurd result if strictly construed. *Id.*

125. 330 B.R. 832 (Bankr. N.D. Ga. 2005).

component, depression, anxiety, hypertension, and high blood pressure and adjustment disorder with anxiety and dysthymia.<sup>126</sup> The debtor had not earned more than \$7,770 since 1994, stayed with different friends or family every night, owned no property, and had been in default on his student loans since July 1996.<sup>127</sup>

The court analyzed the debtor's undue hardship claim under the three-prong test established in *Brunner v. New York Higher Educational Services Corp.*,<sup>128</sup> which requires the debtor to show: (1) that he would be unable to maintain a minimal standard of living if required to repay his student loans; (2) that additional circumstances indicate this state of affairs will persist for a significant portion of the loan repayment period; and (3) that he has made a good faith effort to repay the loans.<sup>129</sup> After noting that the debtor easily satisfied the first prong because he lived in "abject poverty," the court stated that "the Brunner test is often strictly interpreted, thereby denying deserving debtors, who are honest and unfortunate, much-needed relief and frustrating the fresh start policy of the Bankruptcy Code."<sup>130</sup> Furthermore, because an "unduly rigid" application of the second and third prongs could prejudice destitute debtors, "flexibility with regard to the last prongs of Brunner may be equitable."<sup>131</sup>

With respect to prong two of the *Brunner* test, the court explained that medical problems, such as those suffered by the debtor, served as the necessary "additional circumstances" satisfying the second prong.<sup>132</sup> However, the court noted that "it is difficult, if not impossible, for *pro se* debtors to overcome evidentiary challenges (such as objections to admissibility)" when trying to prove mental or physical disability.<sup>133</sup> For that reason, the court held that "the Debtor's testimony regarding his physical and emotional ailments was sufficient to show that these conditions have prevented him from being gainfully employed and will interfere with employment for a significant portion of the repayment period."<sup>134</sup>

Turning to prong three of the *Brunner* test, the court reiterated that the debtor lived in poverty and was unable to maintain employment due

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126. *Id.* at 837.

127. *Id.* at 838.

128. 831 F.2d 395 (2d Cir. 1987).

129. *Mosley*, 330 B.R. at 840.

130. *Id.* at 841 (citing *Educ. Credit Mgmt. Corp. v. Polleys*, 356 F.3d 1302, 1308 (10th Cir. 2004)).

131. *Id.* at 842.

132. *Id.*

133. *Id.* at 843.

134. *Id.* at 846-47.

to his medical conditions.<sup>135</sup> Furthermore, he had “endeavored to resolve his student loan obligations through inquiries with the United States Department of Education, the Georgia Student Finance Commission, the V.A., and his congressman, Senator Zell Miller.”<sup>136</sup> Considering these facts, the court held that being poor and unable to make student loan payments did not constitute bad faith.<sup>137</sup> Because the debtor proved that repayment of his student loan debt constituted an undue burden, the court held that the debt was discharged.<sup>138</sup>

#### VIII. CHAPTER 11: ABSOLUTE PRIORITY RULE

In *In re Henderson*,<sup>139</sup> an individual Chapter 11 debtor proposed a plan that included four classes of impaired unsecured creditors.<sup>140</sup> Because the debtor proposed to retain exempt property with a total value exceeding \$5.5 million, the court was faced with the issue of whether the plan violated the absolute priority rule.<sup>141</sup> The absolute priority rule provides as follows: “With respect to a class of unsecured claims . . . the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.”<sup>142</sup> The court found no violation of the rule because exempt property is not retained on account of the debtor’s interest in property of the estate.<sup>143</sup> Rather, “he retains it as a matter of right by virtue of recognition of his right to exemptions.”<sup>144</sup> Thus, the court concluded that the debtor’s interest in exempt property was not junior to the interest of dissenting unsecured creditors “because unsecured creditors could never reach exempt property outside of bankruptcy, and such properties are immune and not subject to liquidation under any of the operating Chapters of the Code.”<sup>145</sup> Consequently, the court found that the plan did not violate the absolute priority rule.<sup>146</sup>

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135. *Id.* at 847.

136. *Id.*

137. *Id.*

138. *Id.* at 847-48.

139. 321 B.R. 550 (Bankr. M.D. Fla. 2005).

140. *Id.* at 553.

141. *Id.* at 557.

142. 11 U.S.C. § 1129(b)(2)(B)(ii) (2000).

143. *Henderson*, 321 B.R. at 559.

144. *Id.*

145. *Id.* at 560.

146. *Id.* But see *In re Gosman*, 282 B.R. 45, 48-49 (Bankr. S.D. Fla. 2002) (holding that because Congress used the word “property” rather than “property of the estate” in the absolute priority rule, that exempt property is subject to the rule).

## IX. PROCEDURE

A. *Jurisdiction*

In *Justice Cometh, Ltd. v. Lambert*,<sup>147</sup> the circuit court concluded that district courts have jurisdiction to hear a complaint for violation of the automatic stay.<sup>148</sup> In *Lambert* the district court dismissed the case due to lack of subject matter jurisdiction.<sup>149</sup> On appeal, in a short and succinct opinion, the circuit court noted that pursuant to 28 U.S.C. § 1334,<sup>150</sup> “the district courts have original jurisdiction over all cases under Title 11.”<sup>151</sup> Because the grant is of “original” jurisdiction, there can be no valid argument that the district court lacks jurisdiction.<sup>152</sup>

B. *Garnishment*

In *Brickell v. Dunn (In re Brickell)*,<sup>153</sup> Brickell’s ex-husband filed a Chapter 7 petition, naming Brickell as a creditor. Brickell hired a law firm to assist her with her claim. The firm later obtained a judgment against Brickell for unpaid legal fees. The firm then obtained a garnishment against Brickell, which it served on the Chapter 7 trustee. Brickell’s ex-husband also obtained a judgment against her for frivolous litigation, and he obtained a garnishment and served it on the Chapter 7 trustee. The trustee received permission from the bankruptcy court to pay the garnishments from funds that would otherwise be distributed to Brickell. She challenged that decision, and after an initial remand, the district court affirmed and the plaintiff appealed to the circuit court.<sup>154</sup>

The circuit court began by noting that both the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure “are silent about whether a trustee is subject to garnishment.”<sup>155</sup> Only one case decided after enactment of the Code considered the issue, and it held that a trustee was not subject to garnishment because such a garnishment would

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147. 426 F.3d 1342 (11th Cir. 2005).

148. *Id.* at 1343.

149. *Id.* at 1342.

150. 28 U.S.C. § 1334 (2000).

151. *Lambert*, 426 F.3d at 1343.

152. *Id.* However, the court recognized that the Second Circuit Court of Appeals reached a different conclusion. *Id.* at 1343 n.2.

153. 142 F.App’x 385 (11th Cir. 2005).

154. *Id.* at 387-88.

155. *Id.* at 389.

impede the bankruptcy process.<sup>156</sup> The circuit court was unpersuaded by this reasoning, especially because the opinion failed to identify any actual impediment caused by garnishment.<sup>157</sup> The court held that in Brickell's case, garnishment was permissible because "the only burden on the trustee in this case was the substitution of one creditor's name and address for another."<sup>158</sup> However, the court cautioned that "garnishment should not be allowed if it unnecessarily complicates the administration of the bankruptcy estate . . . ."<sup>159</sup>

#### X. PROFESSIONALS

*In re Oliver*<sup>160</sup> is notable because it offers guidance in applying certain BAPCPA amendments. In *Oliver*, the court imposed sanctions on the debtor's attorney after the attorney filed what turned out to be the debtor's seventh bankruptcy case.<sup>161</sup> Furthermore, the filing was made in violation of a 180-day injunction against refiling that had been imposed upon dismissal of the sixth case.<sup>162</sup> Although the debtor had used different attorneys for the prior cases and had not been completely honest with his current attorney about his bankruptcy history, the current attorney still had an obligation "to conduct a reasonable investigation to make sure that petitions are filed in good faith and not for improper purposes."<sup>163</sup> At a minimum, such an investigation requires the attorney to search PACER for previous bankruptcy filings by the debtor.<sup>164</sup>

Since *Oliver* was decided, BAPCPA added section 527<sup>165</sup> to the Bankruptcy Code. Under that section, a debt relief agency is required to engage in a "reasonably diligent inquiry of the assisted person or others so as to obtain such information reasonably accurately for inclusion on the petition, schedules or statement of financial affairs . . . ."<sup>166</sup> Based on *Oliver*, a wise debtor's attorney will include a PACER search in their "reasonably diligent inquiry."

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156. *Id.* at 390 (citing NVLand, Inc. v. Vogel (*In re Ocean Downs Racing Ass'n*), 164 B.R. 249, 254 (Bankr. D. Md. 1993)).

157. *Id.*

158. *Id.*

159. *Id.*

160. 323 B.R. 769 (Bankr. M.D. Ala. 2005).

161. *Id.* at 771.

162. *Id.*

163. *Id.* at 773.

164. *Id.*

165. 11 U.S.C.A. § 5257 (2005).

166. *Id.* § 527(c).

## XI. CONCLUSION

Currently the body of case law addressing BAPCPA amendments is relatively small—too small to suggest any specific trends in the Eleventh Circuit. It could take years before any such trends emerge.

Meanwhile, the Supreme Court occasionally grants certiorari in bankruptcy cases. At the time of this writing, the Court had two bankruptcy cases under consideration. First, the case of *Marshall v. Marshall*<sup>167</sup> has become something of a novelty, not because of the issues involved, but because the debtor, Vickie Lynn Marshall, is better known as Anna Nicole Smith. The issue in *Marshall* is whether the federal bankruptcy and district courts exceeded their jurisdiction by awarding the debtor a tort judgment that, according to the defendant, would interfere with the probate of her late husband's estate.<sup>168</sup> Second, in *Howard Delivery Service, Inc. v. Zurich American Insurance Co.*,<sup>169</sup> the Court will decide whether a claim for unpaid worker's compensation insurance premiums is entitled to a fourth level priority.<sup>170</sup> Opinions in both cases should be available in 2006.

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167. 392 F.3d 1118 (9th Cir. 2004), *cert. granted*, 126 S. Ct. 35 (2005).

168. *Id.* at 1121.

169. 403 F.3d 228 (4th Cir. 2005), *cert. granted*, 126 S. Ct. 621 (2005).

170. *Id.* at 229-30.