ABI Webinar: The Judges' Perspective on BAPCPA
September 22, 2005
Judge James Starzynski Notes[1]

Utility payments:
STARZYNSKI, HOUSER

§ 366 has been modified in a major way by the addition of subsection (c). Basically that section provides that:
1) to keep service in place the utility must be provided "adequate assurance of payment", which essentially is cash (and explicitly is not an administrative priority claim), unless the utility agrees otherwise;
2) essentially the utility gets to say how much cash constitutes "adequate assurance of payment", unless the debtor gets the court to order otherwise. If there is a postpetition dispute about how much needs to be paid, the debtor probably has to get a court hearing and a decision extremely quickly, given that the utility can cut off service within 20 or 30 days (compare (b) with (c)(2)). (This will be another one of those situations where the court will be required to act quickly, although there is no statutory provision on this similar to § 1112(b), which mandates a hearing on a motion to convert or dismiss a chapter 11 case within 30 days of the filing of the motion.) Nothing in the statute limits the utility's right to cut off service after thirty days in a chapter 11 case (see item (4) below) simply because the trustee or the debtor in possession is in the process of getting the adequate assurance payment lowered;
3) in a hearing on the issue of "adequate assurance of

[1] Author's notes: I prepared the following notes for the topics I addressed. They do not include the thoughts (except as noted) of other speakers; for that, you need to listen to the broadcast. The notes are arranged in the order in which the topics were addressed or were listed to be addressed during the Webinar. The names accompanying the topics identify the judges primarily responsible for addressing the issues. The reader (or listener) is welcome to quote back to me anything in these notes or my presentation; just be aware that I reserve the right to disagree with myself (and you), especially if further study of the law and a close examination of the pertinent facts suggests I got it wrong this first time around. Judge James Starzynski

payment", the court is not allowed to consider as even a temporary remedy the availability of an administrative expense priority, or the debtor having been a model customer prepetition;

4) in a chapter 11 case, if the utility does not receive "adequate assurance of payment" during the first 30 days of the case, the utility can cut off service, without notice and without a stay order (no mention of this in § 362). Individuals doing business in a chapter 13 will not face this problem, and in the larger chapter 11 cases the debtor in possession will undoubtedly have anticipated this threat; on the other hand, the small chapter 11 debtor in possession may well get taken by surprise if it does not think of and specifically address this problem. Of course, nothing in the statute purports to overrule any state laws or regulations that govern utilities, including any requirements that a utility give notice before cutting off service; and

5) the utility can set off a prepetition deposit, without notice and without a stay order (no mention of this in § 362).

Clearly this statute puts the utility in a better position than perhaps any other entity in the case, including secured creditors.

Small dollar preference cases:
STARZYNSKI, RHODES

The applicable statutes are 11 USC § 547 and 28 USC § 1409.

Congress effected several changes, but three main ones that we are concerned with: DePrizio reform revisited, ordinary course of business defense made easier for defendants, and limitations on the collection of small debts.

New § 547(i) fixes definitively the **Deprizio** "problem" by making clear that if a preferential payment to an "outsider" for the period from 91 days to one year is avoided because of benefit to the insider, only the insider is liable to pay the trustee. This section seems pretty clear. And it became effective on April 20, 2005, including as to all pending cases.

§ 547(c)(2) – the **ordinary course of business defense** – has been modified to considerably ease the defendant's burden. Previously the statute required the defendant to prove all three elements of the defense: (A) the debt was incurred in the ordinary course of business of the debtor and the defendant (this one is usually easily proved and is therefore seldom litigated), (B) the repayment was in the ordinary course of business or financial affairs as between the two parties ("subjective test") <u>and</u> (C) the repayment was in the ordinary course of business for that industry ("made according to ordinary business terms") ("objective test"). Now, the creditor needs to prove (A) and <u>either</u> (B) <u>or</u> (C). This section also seems pretty clear.

This is a huge benefit for defendants, obviously. An additional benefit to defendants is that proving the industry standards often required an expert witness, not just an employee who described how his or her company does business or an employee who describes what his or her conversations have been with other people in the industry (hearsay). Most of the current case law will still be useful, including particularly those cases that define the standards that vary so significantly from circuit to circuit on what it takes to meet each of the two tests. That is especially the case for the objective test (former § 547(c)(2)(C), now contained in § 547(c)(2)(B)).

Taking all the cases in which these two tests have been litigated over the last 15-20 years, far fewer of them would likely have been litigated under this new standard. So maybe we can look forward to less litigation where ordinary course of business is a defense. On the other hand, there may be a number of cases that will now be litigated because the defendants think they might be able to make a showing on at least one of the two tests (subjective or objective) where before they would have thought the odds were too long to prevail on all three tests.

The **small debt** provisions.

§547(h) forbids a trustee from avoiding a payment that is part of an alternative repayment plan worked out with the help of an approved non-profit budget and credit counseling agency.

28 USC § 1409(b) formerly limited a trustee to suing a defendant in the district in which the defendant resided if the trustee sought recovery of a money judgment or property of <$1m or a consumer debt of <$5m. The $1m limit for recovery of a money judgment or for property remains. However, the consumer debt collection limit has now been raised from <$5m to <$15m in the statute. And a trustee must now sue a defendant in the defendant's home district if the debt is non-consumer and is <$10m and if the defendant is not an insider.

Note that § 328(a) now allows the trustee to hire professionals "on a fixed or percentage fee basis", which exactly describes how many collection attorneys work. Already we see a number of alleged credit card fraud cases brought by collection attorneys; there is no reason to think that those attorneys and others will not be available to pursue these collection actions around the country. In consequence, the number of out-of-district collections actions by the trustee, attributable to the limitations on amounts and venue, may not decrease, or may decrease less than anticipated.

§547(c)(9) has a new defense in a case filed by a debtor "whose debts are not primarily consumer debts" if "the aggregate value of all property that constitutes or is affected by such transfer is less than $5m." The language tracks (c)(8), which has been there for a while, that provided a defense in individual consumer cases for $600, so that case law ought to be instructive. Because this is a defense, the defendant has the obligation to prove the amount owed is less than $5m, although when trustee proves up the case in chief, there will obviously have to be some proof of the amount owed.

This provision squarely raises the issue of the trustee's obligation to take into account "obvious" affirmative defenses before filing the complaint and to account for those obvious affirmative defenses when filing the complaint; e.g., the obligation to not just add up all the payments within 90 days and sue on that figure but to also take into account, as an example subsequent new value for product supplied within 90 days – 547(c)(4). If you don't do that in the Tenth Circuit, you may well be in violation of Rule 9011. See White v. General Motors Corp, Inc., 908 F.2d 675, 682 (10th Cir. 1990), cert. denied 498 U.S. 1069 (1991): "Part of a reasonable attorney's prefiling investigation must include determining whether any obvious affirmative defenses bar the case." (In this case, it was the refusal to investigate whether there was a release when the company's lawyer told the plaintiff's attorney ahead of time there was one.) (The White v. GMC standard has been adopted in other jurisdictions: FDIC v. Calhoun, 34 F.3d 1291, 1299 (5th Cir. 1994) (Rule 11); Matter of Excello Press, Inc., 967 F.2d 1109, 1113 (7th Cir. 1992) (Rule 9011); Smyth v. City of Oakland (In re Brooks-Hamilton), 329 B.R. 270 (9th Cir. BAP 2005) (citing FDIC v. Calhoun) (Rule 9011); Matsushita Electronics Corp. v. Loral Corp., 974 F. Supp. 345, 358 (S.D.N.Y. 1997) (Rule 11); Berger Industries, Inc. v. Artwork Products, Inc. (In re Berger Industries, Inc.), 298 B.R. 37, 42 (Bankr. E.D.N.Y. 2003) (Rule 9011).)

The generally effective date of the new legislation is October 17, 2005, but if you have a case filed, say, October 2, 2005 and a preference action brought October 1, 2007, do the current Code provisions or the "new" Code provisions apply? The lead article in the June 2005 ABI Journal sets out the arguments on each side.

Increased cash needs:
STARZYNSKI, HOUSER

The need to pay for **utility service** with cash, coupled with the utility's huge advantages in saying how much cash it will require, and the consequences of not paying all the cash required, means the debtor or trustee likely needs to have a lot more cash available (whether through DIP financing or otherwise) on the petition date or shortly thereafter than before. This requirement will vary with the debtor: a family filing a chapter 13 case most likely won't need to worry about it; a mining company will need to deal with this problem front and center, and probably before filing the petition, so that it will know how much money it is likely to need from the lender in order to keep the utilities on.

To the extent that the revised **reclamation** standards result in a more than theoretical benefit to reclamation creditors (given the priority of the secured creditor's lien over any competing rights of the reclamation creditor), the estate may need more cash. And if the debtor had hoped to put confirmation and **lease assumption** payments more than twenty months into the future, it may have to have the cash sooner.

There may also be the need for more **attorney fees**, especially in small cases, to deal with emergency utility motions, motions to dismiss which the U.S. Trustee is required to file when a monthly operating report is late, etc.

Curbing KERPs:
STARZYNSKI, HOUSER

The particularly relevant provisions are in §§ 503(c) and 548(a).

A KERP is a key employee retention plan. The idea behind the addition of **subsection (c)** to § 503 was to make it very unlikely that the estate would be able to retain certain management employees by means of a bonus or extra payments of some sort. Congress certainly accomplished that goal, by preventing administrative expense payments to any member of management beyond what was the usual compensation (or lower, depending on what non-management personnel are getting paid), either prepetition or postpetition. Some form of bonus can be paid if certain extremely rigorous conditions are met, including apparently a bona fide offer from some other entity to go work for that company at equal or better rates of compensation. The same applies to severance pay for the key employee.

Add to the foregoing the new parts of **§ 548(a)**, which allows the trustee to go after prepetition payments to the key employee as fraudulent transfers, and the effective date of this provision to all cases filed on or after April 20, 2005, and it is clear that Congress has painted on the back of debtor's management a big bull's eye.

Attorney requirements re "**debt relief agency**".
RHODES, STARZYNSKI

The applicable Code sections are §§ 101(3),(4A),(12A), and (41); 526; 527 and 528.

"Debt relief agency" ("DRA") is defined in §101(12A) as

any person [§101(41) defines to "person" to include "individual, partnership or corporation"]

who provides any bankruptcy assistance [§ 101(4A) defines "bankruptcy assistance" as "any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors' meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title"]

to an assisted person [§ 101(3) defines "assisted person" as "any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than $150m]; the 'consumer debts' limitation probably means that, practically speaking, only individuals will be assisted persons. Congress clearly intended the term 'assisted person' to include debtors, but reading the language literally or "plainly" (as in <u>Lamie v. UST</u>), **the definition of 'assisted person' also describes certain creditors.** So if an attorney, for compensation, provides advice to a creditor who is an individual with mostly consumer debts and not too much property, that attorney becomes a DRA. And it is probably the case that a thousand-lawyer law firm with offices around the world who has one attorney that provides advice to a recently divorced person about the ex-spouse's threat to file bankruptcy (a likely creditor that would qualify as an 'assisted person', as Judge Rhodes notes), and accepts a $100 fee for the advice, is also a DRA. On the other hand, an attorney presumably could avoid being a DRA if the attorney only deals with "high-end" debtors; i.e., debtors whose nonexempt property exceeds $150m or whose obligations consist primarily of business debts. Note that, literally, the property of a corporation or partnership is "nonexempt", and in any event neither are likely to have much consumer debt. Note also that "nonexempt property" does not mean "equity", so that if the individual owns a $250m home with a $240m mortgage against it in a state where the maximum homestead exemption is $60m, the individual is not an "assisted person" and therefore providing advice, etc. to that person would not by itself require designation of the attorney as a DRA. (Maybe the lesson here is that if you deal with poor or lower middle-class people, whether they be debtors or creditors, you have to call yourself a DRA.)

in return for the payment of money or other valuable consideration,

or who is a bankruptcy petition preparer under section 110, but does not include [501(c)(3) entities, Colliers, the local bank or credit union and its subsidiaries and affiliates, et al.].

§ 526 imposes duties and restrictions on DRAs, including to exercise reasonable care to ensure that the debtor makes no untrue or misleading statement. (This is probably a requirement already.) Another obligation is not to advise the client to incur more debt in order to pay fees to the attorney or a petition preparer to file the case (on its face what everyone's expectation is now, except what if the debtor planned to borrow the fees from a relative, which is one of Judge Rhodes' examples) or "incur more debt in contemplation of [the prospective debtor] filing a case under this title". (What of bankruptcy planning as allowed by the legislative history of § 522 by taking out a mortgage for the nonexempt equity in a home to put into an exempt IRA?). § 526(c) has penalties for "intentionally or negligently" violating §§ 526, 527 and 528 or for failing to file any required document, particularly if the result is that the case is dismissed or converted. For example, the debtor can recover the lost fees, actual damages and attorney fees and costs, which essentially makes the process a quick legal malpractice action. In addition, the DRA can be subject to an injunction or payment of damages in an action brought by, among others, the state attorney general, and the U.S. District Court would have concurrent jurisdiction (with a state court, or tribal court, or the Bankruptcy Court?) to entertain such an action.

§ 527 sets out the disclosures a DRA must make, and § 528 imposes various obligations on the DRA if it is going to charge for services to an assisted person, including the requirement of a written contract and advertising requirements.

Debtor attorney certification requirements:
STARZYNSKI, RHODES

The applicable provisions are in new § 707(b)(4) and (5), and in § 524(k) and (m).

The "**abusive filing**" provisions are in § 707(b)(4) and (5), which means it applies in chapter 7 cases. And (b)(4), for debtors, appears to apply to attorneys only, not the debtor – compare to Rule 9011 that applies to unrepresented parties as well.

Addressing **misbehaving creditors** first, § 707(b)(5) provides for sanctions for a "party in interest" that files a motion to dismiss or convert which is denied and the court finds a violation of Rule 9011. (This specific provision concerning Rule 9011 does not apply to a small business creditor with a claim of less than $1m.) The court can also award sanctions if it denies the creditor's motion but does not find a violation of Rule 9011, but the limitations imposed on the award of sanctions against creditor counsel in that circumstance are so numerous and strict that very seldom will creditor counsel be sanctioned without having violated Rule 9011.

Concerning **debtor attorney conduct**:

(A) The court may, on its own motion or the motion of a party in interest, order the debtor's attorney (but not the debtor – to its credit, the statute departs from the traditional approach of visiting the sins of the lawyer on the client) to reimburse the trustee for costs and attorney fees in prosecuting a 707(b) motion if (1) trustee files a motion to dismiss or convert under 707(b), (2) the court grants the motion, and (3) the court finds that the action of the attorney in filing the chapter 7 case violated Rule 9011. The assessment of a sanction must be done in accordance with the procedural protections of Rule 9011(c).

(B) The court can also, on its own motion or the motion of a party in interest, assess an appropriate civil penalty to be paid to the UST or Bankruptcy Administrator, if the court finds a violation of Rule 9011. This assessment is in addition to, not as an alternative to, the award of costs and attorneys fees permitted by the preceding paragraph (A). There is no requirement of compliance with Rule 9011(c).

(C) This section applies when an attorney signs a "petition, pleading or written motion" (as both are defined in Rule 7007 presumably – so what about filing a <u>response</u> to a motion for stay relief or filing a claim objection? – those are not part of § 707(b), but perhaps the "pleadings" that a chapter 7 attorney files in the case as such arise out of Rule 9014?), and it sets out requirements that somewhat resemble portions of Rule 9011 but are clearly not the same. Case law for both Rule 11 and Rule 9011 may be generally relevant, but the differences in language between the two rules on the one hand and the statute on the other hand may also turn out to be significant: <u>e.g.</u>, the statute requires a "reasonable investigation" vs. the rules' requirements of a "reasonable investigation under the circumstances"; and the statute requires that the pleading be "well grounded in fact" vs. the rules' requirement that "the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery." The statute seems to impose a tougher or least less nuanced standard.

And the last part of subsection (b)(4)(C) says that the attorney's signature is a certification that the attorney has determined that the petition "does not constitute an abuse under paragraph 1 [dismissal for abuse]."

(D) The signature of the attorney on the petition constitutes "a certification that the attorney has no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect." This portion of the statute presents a host of questions: What about schedules filed after the petition is filed? What if the attorney enters the case for the debtor after the petition is filed? What about unbundling services, an increasingly common phenomenon? What is the duty of inquiry – to visit the house of the debtor and look at (and perhaps evaluate) the gun collection? – since when is an attorney necessarily competent to do that? Will there be a cottage industry of real estate agents doing $50 windshield appraisals, pawn shop owners doubling as jewelry and electronic gear appraisers, etc.? And will all this lead to higher attorney fees for chapter 7 filings and therefore more pro se cases?

There has been a problem with some debtors' attorneys, clearly, not doing their jobs. But the people mostly getting hurt by those attorneys were debtors, not creditors, and in any event, there could have been a more targeted solution had Congress taken the time and some advice from those folks in the trenches.

The debtor's attorney certification provisions for **reaffirmations** are in § 524(k) and (m). The attorney must certify, among other things, that the reaffirmation "does not impose an undue hardship on the debtor or any dependent of the debtor". § 524(k)(5). "Undue hardship" is presumed (although the presumption can be rebutted) if the debtor's monthly budget shows that income does not exceed expenses by at least the amount of the monthly payment being reaffirmed. § 524(m). If undue hardship is presumed, the attorney must also certify that in the opinion of the attorney, the debtor is able to make the payment. § 524(k)(5). (The "undue hardship" provisions don't apply to debts owed to credit unions.)

In some ways, this is a good provision; it might get the attorneys who willy nilly approve reaffirmations to think a bit more before they sign off on the debtor's reaffirmation of the $63m debt for the girlfriend's Lincoln Navigator. (Real example taken from actual case file.) On the other hand, what happens when the payments are not made? Can the attorney be sued on a claim of fraud, negligence, strict liability, contract, a Rule 9011 violation or perhaps the same basis of liability that parties rely on when they obtain an opinion letter from the attorney on the other side of a transaction? Will the action against the attorney be brought in the bankruptcy court or in state court, before a state court judge who works without a clerk, is swamped with cases and understands little of the Code? And the issue is not just winning or losing, of course, but the threat of having to defend the case and incur those costs. Will debtor attorney malpractice premiums go up? Will there be fewer competent debtor attorneys in practice as a result?

Personal property options, or the "fourth option" (retention only) and secured loans.
BUFFORD, STARZYNSKI

The operative sections are §§ 521, 524(k) and 362(h).

The requirement of electing treatment of secured loans is now not limited to "consumer" debts, so it can include, for example, business debts for equipment. One result of this change may be that the "fourth option" may get raised more often now. It is limited to individuals, but, for the most part, it is not limited to chapter 7 cases.

Given what Congress was apparently trying to do and how the statute ended up, Lamie v. UST (2005) would seem to be the Supreme Court case most on point for interpreting the statute.

To begin with, Congress did not change § 521(a)(2)(A). That subsection still gives three options to the debtor who does not surrender the collateral: retain, redeem or reaffirm. So by the literal terms of the statute the debtor can retain the collateral without doing either of the other two options. It would therefore seem that the prior cases such as In re Boodrow, 126 F.3d 43 (2^{nd} Cir. 1997), Price v. Delaware State Police Fed. Credit Union (In re Price), 370 F.3d 362 (3^{rd} Cir. 2004), In re Belanger, 962 F.2d 345 (4^{th} Cir. 1992), McClellan Fed. Credit Union v. Parker (In re Parker), 139 F.3d 668 (9^{th} Cir. 1998) and Lowry Fed. Credit Union v. West, 882 F.2d 1543 (10^{th} Cir. 1989), which allowed the "fourth option", are still good at least as far as the results they reached. Interestingly the proposed new form allows this election to be made: it provides four choices, in a horizontal line: surrender, retain, redeem, reaffirm. (Of course, the form cannot govern the statute.)

§ 521(a)(2)(B) merely changes the time in which the debtor must perform the announced intention.

§ 521(a)(2)(C) is also unchanged except that it refers to § 362(h).

§ 521(a)(6) is new. It is limited to individuals in a chapter 7 and to creditors with an "allowed" claim for the "purchase price" secured in whole or in part by personal property, and says the debtor "shall ... not retain" if the debtor does not redeem or reaffirm. But the (presumably exclusive) penalty for failing to redeem or reaffirm is specified in the statute, and that penalty is a modification of stay (with the exception that if trustee sees value in the asset, he or she can file a motion, provide adequate protection to the creditor, etc.).

§ 362(h) is new. It is limited to individuals but unlike § 521(a)(6) there is no limit on the chapter. § 362(h) terminates the stay as to personal property securing a claim in whole or in part (without the qualifiers of the claim being "allowed" or for the purchase price), if the debtor retains the property and does not redeem or reaffirm (unless the debtor offers to reaffirm on the original terms and creditor refuses).

§ 521(d) is new; Congress provided the extra incentive (or punishment) that if the debtor does not comply with §§ 521(a)(6) or 362(h)(1) or (2) by reaffirming or redeeming, the ipso facto clauses of the underlying agreement become effective again.

Finally, a portion of the required reaffirmation disclosures recites "Even if you do not reaffirm and your personal liability on the debt is discharged, because of the lien your creditor may still have the right to take the security property if you do not pay the debt or default on it." § 524(k)(3) (toward the very end of the subsection).

In summary, the statute explicitly provides for the "retention only" option, and then sets out a set of consequences for electing that option. The "fourth option" is clearly still there in the jurisdictions where it existed before, and it may now be there for jurisdictions that did not previously allow it. And although it is probably the case that the days of issuing an order which in effect told the creditor to keep hands off the vehicle as long as the debtor was current on payments and insurance, are gone, the required language of § 524(k)(3) quoted in the preceding paragraph suggests maybe those days have not altogether disappeared. In any event, what happens when the stay is terminated as to the property is probably no longer the business of the bankruptcy court but likely falls into the lap of the repo man and the state court judge.

"Chef's choice" -- what will be the biggest change resulting from the new law: STARZYNSKI view

A. What the District of New Mexico is **considering** doing about automatic dismissals under § 521(i): The clerk's office will review the file and determine if all the documents are there, not necessarily the sufficiency of one or more of the documents (e.g., the case manager will not look to see if the debtor has filled in the bottom of new Schedule I and J about any anticipated changes in income or expenses in the future). The clerk's office may send a notice to the debtor of the possibility of a dismissal of the case due to deficient filing 10-15 days before day 46. If the deficiency still exists on day 46, an order over a judge's signature will be entered on that day (or maybe day 47), just like the order of discharge in a chapter 7 case; it will be an actual order that concludes the case and not merely a docket or bookkeeping entry.

B. As a result of the increasing fees that debtors' counsel will have to charge, the percentage of pro se filers will increase substantially, and the courts, and represented parties, will find court dockets considerably more congested. The work of the clerk's office and the judges will increase substantially relative to the number of cases that are filed. Court personnel, judges, attorneys, and trustees will have to exercise considerable patience and maintain considerable respect for the increased numbers of pro se parties.

C. The court already faced a number of situations where it had to conduct hearings quickly. The number of those hearings, and the requirement of decisions within specified short times, has increased: the requirement that the court not only hear but also decide a stay motion within sixty days (§ 362(e)(2)) (although this was already largely being done), the need to conduct and make a decision shortly after conducting an emergency hearing on adequate assurance of payment to a utility (§ 366), the requirement to conduct a hearing on a motion to dismiss a chapter 11 case and decide within fifteen days thereafter (§ 1112(b), the potential need to conduct a hearing in order to issue (or not issue) an order declaring that the case has been dismissed pursuant to § 521(i), and other provisions that, for example, deal with the small business limitations.