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The Consumer Bankruptcy Panel: Hot Consumer Bankruptcy Plan Issues

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CONSUMER BANKRUPTCY PANEL

HOT CONSUMER BANKRUPTCY PLAN ISSUES

Brian Cahn[*]
Adam Goodman[**]
Karen Visser[***]
Melissa Youngman[****]

MR. ZISHOLTZ: We're going to start our final panel. This panel will be moderated by Ms. Karen Visser, who was gracious enough to volunteer as our moderator. Karen has served as a law clerk to the Honorable W. H. Drake, Jr., Bankruptcy Judge for the Northern District of Georgia, since 2001. She graduated *summa cum laude* from Georgia State University College of Law in 2000. Karen is a co-author of *Bankruptcy for the General Practitioner*. She is also an adjunct professor at Mercer University's Walter F. George School of Law. Thank you for participating with us today, Karen.

MS. VISSER: Thank you, Jeremy. It's my pleasure to introduce the rest of our awesome consumer panel. To my immediate right, we have Melissa Youngman. Melissa is a managing attorney of McCalla Raymer's bankruptcy practice in Florida. She focuses on representation of secured creditors in consumer bankruptcy practice. She also represents creditors in all aspects of insolvency, including workouts, bankruptcy, reorganizations, and assignment for the benefit of creditors. She received her J.D. from St. John's University School of Law in 2002 and her B.A. from the University of Florida in 1998. While in law school, she served as an editor of the *American Bankruptcy Institute Law Review*. She also serves currently as a board member of the Central Florida Bankruptcy Law Association and is a former board member of the New York chapter of IWIRC. Welcome to Atlanta, Melissa.

Next to Melissa we have Adam Goodman. The Office of Adam M. Goodman, Standing Chapter 13 Trustee, is responsible for administering chapter 13 bankruptcy plans here in the Northern District of Georgia for cases

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assigned to Judge Drake, Judge Murphy and Judge Sacca. Adam is the co-author of *Chapter 13 Practice and Procedure*.

MR. GOODMAN: Go out and buy a copy.

MS. VISSER: And at the end we have Brian Cahn, who is a partner with Perrotta, Cahn & Prieto, P.C. Mr. Cahn received his bachelor's degree from the University of Georgia in 1991 and his J.D. from Sanford University's Cumberland School of Law in 1994. He is a member of the National Association of Consumer Bankruptcy Attorneys and the ABI. Welcome, Brian.

MR. CAHN: Thank you.

MS. VISSER: We're very glad to have you as our debtor attorney on the panel.

So what we've done today in order to frame our discussion is give you a typical but hypothetical fact pattern involving a married couple who have two young kids and they've come into our office today seeking bankruptcy relief. If you wouldn't mind taking about three minutes to go ahead and read through the hypothetical, we'll jump into Issue 1. So just stop when you get to the part that says, "Issues."

All right. I know that you all are speed readers, so I'm going to go ahead and throw our first issue out to Brian. Basically, our first issue is that Donna Debtor has a student loan debt. And as you all know that under 11 U.S.C. § 523(a)(8),[1] the debt is presumptively non-dischargeable. And to get that debt discharged, the debtor is going to have to get a determination that failure to discharge the debt would impose an undue hardship on her and her family. So under Rule 7001(6),[2] we're supposed to file an adversary proceeding to get that determination. But Brian says that he has a friend who told him that the Supreme Court recently ruled that all you have to do is put language in the plan that says it's discharged and get your plan confirmed. So, Brian, is that really what the Supreme Court said? And if so, can we just go ahead? It seems really easy to do that.

MR. CAHN: Well, if you just look at the holding at the ruling,[3] you're going to miss the essence of the opinion. You don't want to make the mistake of

[1] 11 U.S.C § 523(a)(8) (2006).

[2] FED. R. BANK. P. 7001(6).

[3] Mr. Cahn refers to the *United Student Aid Funds, Inc. v. Espinosa* case. United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367 (2010).

overreaching with plan provisions. They call it "discharge-by-declaration." Now, when I first read the case and I saw that this debtor was able to discharge the student loan debt by virtue of a plan provision, this sounded great to me because the last adversary that I filed for a client that was clearly disabled was very much contested. It involved a two-day trial, doctors' depositions, and it seemed like a cut-and-dried case to me. But after all the evidence, the judge said it was a close call and ultimately did give my client a discharge on his student loan. But these are very difficult cases to prove. The *Brunner* test[4] is pretty much the universal standard. The debtor in *Espinosa* was able to avoid all of that. The debtor did not have to go to a trial. The debtor did not have to prove the elements under the *Brunner* test. He did it the easy way.

Now, if you look at the opinion, the Supreme Court decided this case on very narrow procedural grounds. That was more of a due process issue. Because United Student Aid Funds did receive notice of the plan and, for whatever reason, chose not to object to it, they had waived their rights, even though the way the debtor did it was illegal. But the opinion warned debtors' attorneys about doing it this way. Debtors' attorneys could be looking at the possibility of sanctions under Rule 11[5] or Rule 9011,[6] and that could be considered a bad faith litigation tactic.

So for a student loan case, I wouldn't touch it with a plan provision. I wouldn't want to risk being on the other end of a Rule 11 or 9011 motion for sanctions. It's just in practice not something that I would risk doing. But there are other options that may be available, may be appropriate, and those options I would consider.

MS. VISSER: For example, you would perhaps try to strip a second lien through a plan provision without filing a motion or an adversary proceeding?

MR. CAHN: I wouldn't do that.

MS. VISSER: Why?

MR. CAHN: The reason I wouldn't do that is because Rules 3012 and 7001[7] require, respectively, either a motion or an adversary proceeding. So this is very much like the *Espinosa* situation where you are at risk of employing a bad

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[4] Brunner v. N.Y. State Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987) (articulating a three-part test for a finding of "undue hardship").

[5] FED. R. CIV. P. 11.

[6] FED. R. BANKR. P. 9011.

[7] *Id.* 3012, 7001.

faith litigation tactic by trying to strip a second lien by virtue of a plan provision. So I wouldn't suggest doing that. But there are other options that are less aggressive, but more common.

One provision that I've incorporated into plans has been a situation where a client has a pawned vehicle. This is very common now with this economy. We're seeing more and more clients come in with vehicles subject to a title pawn. Most of the times you don't know whether that client is still within the redemption period, and you don't really know what it takes to appropriately redeem that vehicle through a chapter 13 plan. There are a couple of cases out there that indicate that the debtor must take adequate affirmative steps in the plan to redeem that vehicle. So I hate to risk the probability of filing a plan that doesn't take those appropriate affirmative steps.

On page 130 of the materials, I incorporated a plan provision that said that the debtor is going to retain this vehicle by paying the title lienholder in full, and that confirmation of the plan shall constitute an affirmative finding that the grace period for redemption has not expired, that the vehicle is property of the estate, and that the payments in the plan to the title pawn lender do constitute affirmative appropriate steps to redeem that vehicle. I think that shifts the burden to the title pawn lender to object and tell me that these are not appropriate steps.

MS. VISSER: In fact, the title pawn holder didn't come to court, more than likely in that case, but someone else did.

MR. CAHN: Yes. I believe that is a function of the *Espinosa* opinion. The *Espinosa* opinion shifts the burden of policing these provisions, not only to the debtor and the debtor's attorney, but to the chapter 13 trustee and judges as well. So the creditor has to protect itself, and everybody else has to be proactive in policing these provisions.

I don't think that two years ago I would've had to argue this provision because it wouldn't have come before the judge, but now our chapter 13 trustees have been instructed by the Supreme Court to police plan provisions that are unconventional or off the menu. So it does add more work, not only to the trustees but to the judges and the creditors.

MR. GOODMAN: I actually look a little bit further back than *Espinosa*. I look to the Eleventh Circuit's *Bateman* decision[8] which preceded *Espinosa* by,

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[8] Universal Am. Mortg. Co. v. Bateman (*In re* Bateman), 331 F.3d 821 (11th Cir. 2003).

I think, at least ten years. In that case, it was a case that emanated out of Miami regarding mortgage arrearage cures and the fact that the debtor's plan did not properly address a nonmodifiable mortgage and did not propose to cure what the proof of claim actually provided for. The case went past confirmation and was actually, by the time the Eleventh Circuit decided the case, near that five-year mark if it hadn't already passed it. In that case, the Eleventh Circuit crafted relief to all the parties but instructed all the parties, pointing to the court, to the trustee, to the debtor's attorney, and to the creditor, that everybody had a responsibility under the Code and needed to honor what the Code provided for. So I think the *Bateman* case really to me is where I'm looking towards, and certainly *Espinosa* supports obviously that same logic.

So, as long as I've been trustee, I look at it as though we've got a model plan, we've got certain things we expect, but at the same time, if you're going to, I guess, leave what we know is standard, I want to make sure that the court is aware of something that's different and that we're not accustomed to because I don't want to come back in the case a year or two later, even if *Espinosa* stands in place and the party was properly served, and they've got no defense, and even if it should've been a void judgment. The fact of the matter is, it sticks and they were properly served. To me, I don't want any judge looking at me and saying, "Hey, how did you let this case get confirmed with this provision in there that clearly should not have been confirmed?"

Certainly in the Northern District [of Georgia], a very high volume district in this country, probably one of the highest, I can look every week and see anywhere from 80 to 200 cases up for confirmation. Obviously, the judge isn't going to hear every one of those cases. And so I view it as my role to make sure that the plan complies with the Code in every way that we can make sure, certainly as the case would get to the § 341 meeting,[9] and as we look at amendments getting towards confirmation. So we put a very heavy eye on the plan.

MS. VISSER: And, Melissa, from the creditor's perspective, do you see clients paying more attention to the plan provisions to ensure that they're not violating § 1322(b)(5)?[10]

MS. YOUNGMAN: We do. Before these cases, we always had that obligation anyway. The problem is, as has already been mentioned, when you have a

9 *See generally* 11 U.S.C. § 341 (2006).
10 *See generally id.* § 1322(b)(5).

district that uses model plans, sometimes it just gets slipped in there and it may be that it'll go by us. We absolutely have an affirmative responsibility to review that plan and make an objection if one is warranted. But as Brian mentioned, I think if a debtor's counsel doesn't do anything to demarcate that language in there so that it sticks out to the court, the trustee, and the creditor, then maybe they might have an ethical obligation that they're violating. That's my perspective, but we've always had that obligation, and now we even have it more because of the *Espinosa* decision.

MS. VISSER: Before we leave Issue 1, do we have any questions from the audience? If so, if you wouldn't mind moving to a microphone so we can hear you. All right, we can move on to Issue 2.

This issue, we're talking now about trying to figure out how much money our debtors are going to have to pay to their unsecured creditors. Of course, you are all familiar with BAPCPA[11] and the addition of the means test, which resulted in the projected disposable income test to tell us how much to go to unsecured creditors, and it also tells us how long the debtors have to stay in their plan, three years versus five years, otherwise known as the applicable commitment period.[12] So, Adam, would you mind starting us off to walk us through some of the more recent issues you've seen in the means testing field?

MR. GOODMAN: Well, certainly, you've got *Hamilton v. Lanning* and the *Ransom* case coming from the Supreme Court, *Lanning*[13] dealing with the income side of the equation. And then you've got *Ransom*[14] dealing with the expense side. You could find cases all over the country that support whatever position you want to take regarding the means test. The cases are really all over the place. Certainly what I've experienced is that the means test does not work so well all the time in chapter 13 in determining what the unsecureds can receive or what they should receive according to the means test.

Now I look also to the Eleventh Circuit's *Tennyson*[15] decision which determined that, even if the debtor's means test analysis comes up to be a negative number, they are still required to be in the case for the sixty-month commitment period. I think as I look at other circuit courts that have addressed cases since *Lanning* and *Ransom*, they seem to be linking onto the idea that the

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[11] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23.
[12] *See* 11 U.S.C. §§ 707(b), 1325(b).
[13] Hamilton v. Lanning, 130 S. Ct. 2464 (2010).
[14] Ransom v. FIA Card Servs., N.A., 131 S. Ct. 716 (2011).
[15] Whaley v. Tennyson (*In re* Tennyson), 611 F.3d 873 (11th Cir. 2010).

circuit court followed that ultimately BAPCPA was about having debtors who can pay, and that they do pay what they can afford to pay.

So as I look at the mix between *Lanning* and *Ransom*, and then in *Tennyson*, in our circuit, I view it as though really the big thing to me is determining what is the debtor's current monthly income, and you look at the definition under § 101(10A),[16] and what has their income been for the last six months. Maybe not exactly the best way of looking at what the debtor should project forward to pay to their creditors when you look at the last six months, in most cases probably the worst six months of that person's life financially, but that's what we have. So I'm looking at that current monthly income, because that current monthly income is going to determine what that applicable commitment period is, whether it's a thirty-six-month plan or a sixty-month plan.

Also I think an important part of that equation is the household size. I know that we're still living in the era of "Leave It To Beaver" and the very simple household sizes, and there's a lot of—

MS. VISSER: Half-children?

MR. GOODMAN: So you've got a lot of flux in regard to that. But I think those two pieces are a very big part in determining how long the debtor's case is going to last, at least, I should say, as a minimum period of time, whether it's the thirty-six- or sixty-month commitment period. So in this scenario, as with the example, you've got, for example, the idea that maybe there was this $20,000 settlement, and is that part of the CMI. I think that falls right into the *Lanning* situation, where Ms. Lanning had received a severance package from her previous employer. She gets into the case, and that severance package very much skews what her current monthly income is to the point that, when you look at the numbers of her actual income versus what the means test provided, she just could not afford even remotely what that means test required. So when you're looking at a $20,000 settlement, that's going to be a problem for the debtor if you're going to try to follow the form mathematically. There is one court that said early on, "you just do the math."

MR. CAHN: Let me switch the hypothetical up a little bit on that *Lanning* issue. Let's assume that Donna had not yet settled her personal injury case. She disclosed it as an asset in her petition. She had her personal injury lawyer

[16] 11 U.S.C. § 101(10A).

appointed as special counsel, and her plan was confirmed. What happens down the road, postconfirmation when she settles that claim? Can I argue that that $20,000 is not disposable income? And I have seen some cases that answer that question.

MR. GOODMAN: Are you looking at that case out of Michigan?

MR. CAHN: Yes. I can give you a cite to that case. It just came out on January the 23rd. It's *In re Connor*.[17] This was a win for the debtor. It was a bankruptcy court opinion. Excuse me, it was a district court opinion. Basically what the opinion said is that BAPCPA significantly changed the definition of disposable income, and § 1325(b)(2) is now a very mechanical approach, and it defines disposable income as current monthly income minus these amounts that are reasonably necessary to be deducted from that income. But current monthly income is that six-month average.

When you look at that holding in conjunction with the *Lanning* holding, *Lanning* said that you have to look at factors or additional income that was known or virtually certain at the time of confirmation. So three courts, including the *Connor* court, have looked at this issue as to whether this personal injury settlement postconfirmation fits the definition of disposable income, and it depends on whether that amount was known or virtually certain in the future. All three courts that have looked at it have opined that it is impossible to know, first of all, whether that settlement is ever going to come to fruition, or how much it's going to be. And since it is relatively unknown under the *Lanning* opinion, it is not disposable income and doesn't have to be paid into the plan.

Now there may be other problems with it. It may be nonexempt, etc., but I see this as a win for the debtor. I think it creates a strong argument, not only to this scenario but other scenarios where the chapter 13 debtor comes into property postconfirmation. It's going to be interesting to see how it plays out.

MR. GOODMAN: I look at that, I guess, in a couple of different ways. One, are we going to narrowly determine known or virtually certain? If the person comes into the case and there is a cause of action that is known, you're never always going to know whether it's going to settle in the debtor's favor or in one way or another resolve in the debtor's favor. Attorneys take things on contingency, and they're hoping they're going to win; otherwise, they

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[17] *In re* Connor, 463 B.R. 14 (E.D. Mich. 2012).

wouldn't take the case. So I think there's a certain expectation that the debtor will be successful. So I think it's not as much narrowly interpreting what is known as much as the fact as when the debtor comes into the case, there is this known aspect out there.

I think also I would look to the idea that you're looking in the chapter 13 context that it's property of the estate still, when you're looking at § 1306.[18] If you're in a district where property of the estate does not re-vest, and I'm not sure in this particular case whether or not—I don't remember if the court even got into that aspect—but if the property re-vests in the debtor at confirmation, that could be a different story. In that scenario, it may be one where the trustee would want a plan provision that specifically references the fact that there is this potential asset out there and it is still part of the estate. That's certainly something that may need to be considered in doing that.

Another thing I look at, maybe just a little broadly. We're looking at a case that's coming from the Sixth Circuit. I don't know if any party is appealing that case. But when I look at cases post-*Lanning*, the Sixth Circuit has been rather active in looking at chapter 13 cases. I've got it in the material. You've got most recently the *Seafort* case regarding a 401(k) loan.[19] Certainly not identical to this scenario, but the Sixth Circuit indicated that when the debtor's 401(k) loan is done, that money goes toward paying the unsecured creditors. It cannot be used by the debtor to basically restart the 401(k). I thought it was interesting in footnote 7, the court states that the trustee had conceded that the debtor can continue to make voluntary retirement contributions. The court said that they didn't agree with that assertion but, however, their view didn't matter because that wasn't an issue presently before the court.

You've got the *Darrohn* case[20] out of the Sixth Circuit also that reversed confirmation that was following the mechanical approach. You also have the *Baud* case[21] that dealt with the debtor, following with *Tennyson,* that if the debtor's disposable income is negative under the means test, that they're still in a sixty-month commitment period. So I'd be interested to see, if that goes on appeal, whether it is affirmed.

[18] 11 U.S.C. § 1306.

[19] Seafort v. Burden (*In re* Seafort), No. 10-6248, 2012 U.S. App. LEXIS (6th Cir. Feb. 15, 2012).

[20] Darrohn v. Hildebrand (*In re* Darrohn), 615 F.3d 470 (6th Cir. 2010).

[21] Baud v. Carroll, No. 09-2164, U.S. App. LEXIS 2182 (6th Cir. Feb. 4, 2011).

MR. CAHN: Another question. This is the B22C. It's the means test form that we file in chapter 13 cases. Do you anticipate this form being modified or changed at all in light of the *Lanning* opinion? Where on this form do we put these significant changes or anomalies in the six-month history that *Lanning* was talking about? It seems to me that Donna's income was artificially inflated by $20,000 within that six-month period of time. I don't see a place on the form to reduce the CMI by that component.

MR. GOODMAN: Unless you put it under the special circumstance, and then you've got another whole issue of whether the debtor's situation falls into a special circumstance. But I think ultimately part of the problem, when you're looking at the reality of somebody's budget in comparison to the means test form is coming up with the number the unsecured creditors are going to receive if you're going to follow a mechanical approach under the form, because remember, you're looking at someone whose income on this side of the equation is based on their last six months' history. You've got an expense side that deals with certain IRS standards as well as certain actual expenses, and then you get down to the bottom and come up with a number. I've seen plenty of folks who have tried to reconcile how this bottom line number should match up with what the bottom of I and J are on their schedules for income and expenses, I being the actual income they're receiving at the time, and their actual expenses on J. It's just not designed to be that identical. So I think ultimately you've got to look at it from a holistic standpoint when you've got someone who's got such a variance that the form creates a comparison to reality and come to an agreement.

Now, I think part of it when you're looking at, for example with *Tennyson* and the idea that the debtor is in the case for sixty months if you're above median, even if the form comes out with a negative number, in our district we use a base if the debtor is not paying their unsecured creditors in full. So effectively what you're looking at is the plan payment times thirty-six if it's a below-median debtor, or sixty times your plan payment for someone who is above-median.

So in that scenario, ultimately it may not be the dividend the debtor proposes that is what the unsecureds receive. It may not even be the pool that the debtor puts in the plan, even if they can afford the number that ends up being in the bottom of 22C. It ultimately could be that base amount. After the debtor has paid the attorneys fees, the trustee's fee, the secured creditors and the priority creditors, everything that's left goes to the unsecured creditors. So

if the debtor ends up paying those other four items, say for example in month forty, there's another twenty months that are available to pay the unsecured creditors, and that number could be different than what the plan provides. Our local form provides that the pool or the dividend can be adjusted to account for the applicable commitment period.

To a great extent, that may ultimately be reality as to what you're looking at, as to what the debtor can afford. Am I ultimately going to push the form if the debtor can't afford that number?

MR. CAHN: The problem that I see with putting the anomaly on line 57 is that we're still filling out the entire form and it appears to push my client into a sixty-month commitment period. So I'm trying to reconcile filling out the entire form, which would imply a sixty-month commitment period with *Lanning*, which suggests that if there is an anomaly, we can exclude that and go for a thirty-six-month.

MR. GOODMAN: And that's, I guess, the tough thing. When you look at the definition of § 101(10A), it could be interpreted rather broadly as to what that income is in dealing with that aspect. So I think that's a bit of a problem, I guess, for the debtor in looking at it, whether it's a debtor who has a business, whether it's a debtor who has additional income. And then, what if the debtor files this: you've got a single debtor in the case and she's married and her husband doesn't file with her—how does his income fall into the equation? Is it part of her CMI? There's plenty of cases that say that the non-filing spouse's income is not CMI according to the definition under § 101(10A). But at the same time, then you're looking at the idea of how much is the debtor spouse actually contributing to the household. It's very, very rarely that I see a debtor who does not commingle her income with her spouse and all their money is pooled together to pay the household expenses. So ultimately, even if it is a single filer who's married, she is still, I think, reality-wise, going to have the spouse's income as part of the equation for CMI.

MR. CAHN: A lot of these discrepancies create absurd results. One of them, if we can go back to the *Ransom* case, involves the ownership cost that's on the means test, the B22. There was a split amongst the circuits as to whether or not a debtor who has an unencumbered vehicle can take that $496 ownership cost. The Supreme Court last year ultimately decided that, and really looked at the purpose of BAPCPA to squeeze out as much money as they could, and said, this is a category of expense that was earmarked for debtors that owe money against their vehicles. So now I cannot take that deduction for a debtor that

maybe was more responsible than another debtor. So this is an absurd result in some regards because the more responsible debtor that doesn't owe any money against his vehicle gets punished. What would happen, and this scenario does come up fairly often, if I do the means test for this debtor and the end result is that he's got $400 left over? That would require a significant pool to the unsecured creditors. If that debtor only knew that he had to go borrow $100 against his vehicle, he could do a chapter 7 and he wouldn't have—

MR. GOODMAN: As long as you didn't tell him beforehand to do that.

MR. CAHN: Well, that's the—

MR. GOODMAN: And now we're getting to *Milavetz*.[22]

MR. CAHN: What would you do? That's the interesting issue. That debtor has three options. That debtor can file a chapter 13, try to force some disposable income out of the budget and tough it out for sixty months. Another option is to do nothing. I basically tell that debtor, "I can't help you. If you can't afford this chapter 13 payment, you're going to have to fight them on your own." And the third option is that ethical quandary. If that debtor borrows $100 against his vehicle, all of a sudden he gets another $496 on his means test and he qualifies.

The Supreme Court actually wrote an opinion, the *Milavetz* opinion. It comes close to telling me that I can advise that client to do that, but you've got to reconcile a couple of things. First of all, you've got Rule 1.3 of the Georgia Rules of Professional Responsibility.[23] That tells me that I may take whatever legal and ethical measures that are required to vindicate a client's cause and I've got to represent that client with zeal and advocacy.

On the other hand, I'm looking at § 526(a)(4)[24] because I'm a debt relief agent. I've even got a badge that says I am.

MR. GOODMAN: Do you wear that when your clients are there?

MR. CAHN: I haven't. But because I am a debt relief agent, that Code section says that I shall not advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title. The *Milavetz* case was the result of several opinions that were out there. Some of the opinions said that the entire concept of debt relief agents was

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[22] Milavetz, Gallop & Milavetz, P.A. v. United States, 130 S. Ct. 1324 (2010).

[23] GA. RULES OF PROF'L RESPONSIBILITY 1.3 (2011).

[24] 11 U.S.C. § 526(a)(4) (2006).

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unconstitutional. Other cases said that § 526 restricted free speech between a lawyer and his client. So the *Milavetz* case basically prohibited a certain type of communication between a lawyer and his client. The way I read it is that it is meant to restrict advice to a debtor to incur additional debt when such advice is tantamount to a specific type of misconduct, namely incurring debt and not intending to repay it. And that's the way I read it, but still something seems fundamentally wrong about the whole process. Something seems wrong about borrowing money to qualify for chapter 13.

MR. GOODMAN: Now, you're talking about the process as far as the means test?

MR. CAHN: Yes.

MR. GOODMAN: Then I'll flip it to the other way. Now you're talking about the frugal debtor who was trying to do the best they could and didn't buy a new car, didn't buy the expensive house. And because they didn't have all these expenses, their means test showed that they had a lot of money to be able to pay their creditors back, assuming they had a decent stream of income, and obviously they're above median to get to the back end of the form. Then I see cases with the flip of the debtor who bought the $300,000–400,000 house, who bought the new Mercedes and the new BMW. Then when that debtor fills out this form, even if they have the same amount of income that Brian suggests—we don't know exactly what that is, but with the same amount of income as the debtor who was frugal—that debtor's number is going to come up negative on the form.

MR. CAHN: Every time.

MR. GOODMAN: Every single time. And so now you do have this problem of two different people who have the same income and one of them comes up with a very huge number because they were trying to be fiscally responsible and maybe they had a medical issue and incurred $100,000 in medical debt, didn't have insurance, and they've got this big problem. Then you've got someone who was spending on credit cards and buying new expensive cars and buying the expensive house. Same income, and if you're going to follow the mechanical approach, the guy who is spending is going to get away without having to pay his unsecureds. While the guy Brian points out has got a form that says he's got to pay.

MR. CAHN: It's a frustrating situation.

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MS. VISSER: On that note, maybe we should ask for some questions about the means test. Do we have any in the audience?

MR. GOODMAN: Because everybody knows everything about the means test.

MS. VISSER: That's right. And everyone agrees that it's an unworkable test and frustrating. And since we can't fix all the problems today, then we'll move on to Issue 3, which basically deals with how we decide what our debtors are going to be able to exempt from the property in a chapter 7 case, and keep away from the trustee. Or if they're filing a chapter 13 case, how much that will reduce the amount by which they have to pay unsecured creditors under the liquidation test. So, in our case, Brian, what do you think you would advise our debtors to do about this real estate that Donna inherited that turns out might be worth more than it was on the petition date?

MR. CAHN: The fact pattern was modeled to raise a scenario that would involve the *Schwab v. Reilly* holding.[25] In that opinion, the Supreme Court gave the debtor's attorneys an election to choose to exempt a certain dollar value of property. Or if the intent is to exempt the interest in the property itself, there is actually a way on my software where I can click that the exemption is 100% of the fair market value of that property. There seems to be a trend over the last couple of years. Opinions were coming out suggesting that, in chapter 7 cases, postpetition appreciation in value belonged to the trustee. That might create an awkward incentive for the trustee to sit around, wait, see what happens with that property, and if it appreciates, then that appreciation would inure to the benefit of the estate and creditors.

Schwab suggested that the debtor may elect to exempt 100% of the fair market value of the property, whatever that value was at the time of filing, and if the trustee doesn't object to it, then the appreciation belongs to the debtor. So I have seen more and more petitions in general include 100% FMV as opposed to a dollar figure on the schedules. I don't know if you see it as much in chapter 13 cases.

MR. GOODMAN: Actually I have seen it several times. It's interesting you point out that the software lets you make that selection, because when I get to the § 341 creditor meeting and I ask why they selected that, they say, "Really, oh, I don't know." And so I think that I guess the software vendor has decided

[25] *See* Schwab v. Reilly, 130 S. Ct. 2652 (2010).

that is a viable option. Every opinion I've seen since *Schwab* has ruled against the debtor and has required them to amend the exemptions, especially if you're dealing in a place where it's a dollar amount, which is what the state or the federal exemption provides for.

MR. CAHN: Right. It doesn't feel right clicking 100% FMV because we're used to just a mathematical computation of fitting these exemptions within the dollar amounts allowed.

One thing that I think the 100% FMV does is it actually gives a little bit more meaning to uncontested orders avoiding judicial liens. I know in my division, when an order is entered uncontested on a § 522 motion to avoid a judicial lien,[26] it doesn't have teeth. You don't really know what it says. In fact, I looked at one of the orders that was issued in one of my cases yesterday, and this is what the order says: "Because the [§] 522 motion to avoid the judicial lien is unopposed, it is hereby ORDERED, ADJUDGED and DECREED that the lien held by the Respondent upon exempt property of the above-named movant is avoided to the extent that such lien impairs an exemption to which the Movant would have been entitled under [§] 522(b)."

Now what does that mean? If I'm a real estate closing attorney and this is post-discharge, and I see a judgment recorded but I'm handed this order, am I convinced that that lien is extinguished?

MS. VISSER: To the extent it's avoidable.

MR. CAHN: Yes, but to what extent? So I think if you have indicated on your Schedule C that you have exempted 100% of the FMV of your real estate, that gives some clarity, and I do think that that's an advantage at least in one respect.

MS. VISSER: And we don't have, obviously, a chapter 7 trustee here to take up the position of the trustee.

MR. GOODMAN: I think ultimately what you're really looking at, though, at least from my standpoint in a chapter 13 is the debtor properly disclosing what the value of the property is? Because now I've got § 1325(a)(4).[27] I've got the liquidation test, and I've got to make sure the debtor is paying at least as much in a chapter 13 as what they would pay in a chapter 7. So it immediately strikes

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[26] 11 U.S.C. § 522.
[27] *Id.* § 1325(a)(4).

me as, hey, wait a second. The debtor has a $10,000 exemption on the house, $600 additional on the wild card, possibly the non-filing spouse if they're not on title, another ten.

Now I may go out and look at the value on the real property, and that may be a little bit of an easier analysis in looking at it, but the debtor's household goods, I'm not going out to the debtor's house and doing an inventory of everything they have. I've got anywhere from 12,000 to 13,000 cases, so unless I get a sense at the § 341 meeting, and after doing this for a number of years, I sometimes get a sense when someone's not giving me the whole story, that I'm not going to go out and investigate everything. I think ultimately the debtor has to properly disclose all their assets and it just kind of raises a concern when the debtor says, "I'm exempting everything," when the Georgia exemptions are a dollar amount.

It'd be another thing if we were in Florida and it's based upon acreage, whether you're in the city or not. Then the issue there might be whether it's the homestead, but Georgia is a different place. So, to me, I want to make sure the debtor is fully and properly disclosing things. Ultimately, as these cases come down after *Schwab*, the debtor has to provide it. I think if somebody is going to raise it as an issue, I'm going to ask them, "Provide me an appraisal of all your property and show me what everything you have is worth." If you're going to tell me you're exempting everything, I want to know everything you have, and give me an appraisal. I have a duty to make sure under § 1325 that this case is confirmable and it meets all the elements.[28]

MS. VISSER: Do we have any questions about any of the exemption issues? There were quite a few in there that we didn't necessarily cover, but if anyone has a question about one of those, we could take a crack at it. What to do with proceeds of the exempt property if it's been deposited into a bank account or converted into another type of asset.

MR. CAHN: I would like to touch briefly on the new O.C.G.A. sections dealing with life insurance cash value and annuities. There's been a great deal of buzz in the consumer bankruptcy attorney community about whether this statute creates an additional exemption. It's printed in the materials. I didn't write down the page number.

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[28] *See id.* § 1325.

In 2006, the General Assembly enacted O.C.G.A. § 33-25-11(c)[29] and two other companion statutes. Section 33-25-11(c) applies to the cash surrender values and proceeds of life insurance policies. This is a situation that I see fairly often. A client will come in to see me, and they do have some cash value in excess of the $2,000 exemption that's provided under the bankruptcy exemption statute, under § 522.[30]

When you read O.C.G.A. § 33-25-11(c), it provides an unlimited exemption to the residents of Georgia in the cash value of their life insurance. So the question is whether that creates an additional exemption to those in § 44-13-100,[31] or whether it only applies to non-bankrupt individuals.

There was reason to be excited about this because of Judge Davis' opinion in the Southern District in *Fullwood*.[32] That case is in the materials. It's not a published opinion I do not believe.

MS. VISSER: It may be mis-cited in your hypothetical as a Southern District of Florida case. It's 07-41115, Southern District of Georgia, March 17, 2010.

MR. CAHN: That's right. And what Judge Davis was looking at was a different statute that was outside of the four corners of § 44-13-100. He was looking at a workers compensation statute under § 34-9-84.[33] That statute basically says that workers compensation benefits are not assignable or attachable to or by creditors. So it appears to be exempt, but it's not within the four corners of § 44-13-100. Judge Davis looked at this, and I'm quoting from his opinion. He says, "Not all of Georgia's exemptions are within the four corners of O.C.G.A. § 44-13-100."[34] So that seemed to open up the door to bring in this new statute with regard to cash surrender value of life insurance.

But I think the excitement was short-lived, almost like the surrender in full satisfaction of vehicles' nine-tenths claims, because as case law has progressed, the cases have been more restrictive on exemptions outside of § 44-13-100. Specifically, the first case that looked at it was *In re Allen*.[35] That dealt with an annuity. The *Allen* case was out of the Middle District of Georgia. The debtor had $25,000 from a personal injury settlement, used that

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[29] GA. CODE ANN. § 33-25-11(c) (2011).
[30] *See* 11 U.S.C. § 522(d)(5).
[31] GA. CODE ANN. § 44-13-100.
[32] *In re* Fullwood, 446 B.R. 634 (Bankr. S.D. Ga. 2010).
[33] GA. CODE ANN. § 34-9-84.
[34] *In re Fullwood*, 446 B.R. at 637.
[35] *In re* Allen, No. 10-50827 JPS, 2010 WL 3958171 (Bankr. M.D. Ga. Oct. 4, 2010).

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money to purchase an annuity policy, and O.C.G.A. § 33-28-7 seems to fully exempt that. The debtor argued that based on the application of the *Fullwood* case, that should be exempt, too. The court sided with the creditor and disallowed the debtor's claim of exemption. Basically the court in that opinion looked at the intent of the legislature in enacting that. It said in the opinion that for purposes of statutory construction, a specific statute will prevail over a general statute, and the court rejected repeal by implication. So if the legislature had intended to add this as an exemption to § 44-13-100, it could've done so and it would've done so, and that exemption was disallowed.

The matter came back before Judge Davis in the Southern District of Georgia on the exact issue of the cash surrender value of insurance. Judge Davis distinguished his earlier holding in *Fullwood*—this is the case of *In re Ryan*[36]—and said that this new statute was in derogation of the exemption statute and distinguished the workers comp statute as preexisting the bankruptcy statutes, and they were for different purposes. In that case, Judge Davis said that that unlimited exemption did not apply. So it's going to be interesting to see how these play out, but the trend hasn't been as good as we had hoped it would be.

MS. VISSER: Are you aware of any in the Northern District? Any decisions?

MR. CAHN: I don't know if there are any opinions out of the Northern District yet. This is a relatively new statute. It was enacted only about five or six years ago.

MS. VISSER: Any questions on exemption? You guys are so talkative. We're going to skip over Issue 4 and jump down to Issue 5, which will kind of combine with Issue 6 since we're running a little short here. We're going to talk about lien stripping. This is obviously a new issue that many of us who started in the 2000 time frame didn't really understand or expect to see, because when we started, houses had value in excess of the first mortgage, and now largely they don't. So now we have second liens that are completely underwater and completely unsecured. Brian's going to explain to us what we might need to do in order to address that second lien.

MR. CAHN: First of all, how do you accomplish a lien stripping action? Do you do it by plan provision? I think we've already decided that's not a good idea. The question is whether to do it by a motion or by an adversary. It's a lot

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[36] Roach v. Ryan (*In re* Ryan), No. 11-40712, 2012 WL 423854 (Bankr. S.D. Ga. Jan. 19, 2012).

easier to do it by a motion. The key element here is complying with due process, making sure that service is proper. That is just critical. An adversary may be the safest way to go, but it is a drawn-out process. It's a lot more difficult to obtain a default judgment in an adversary than it is to obtain an unopposed order in connection with a motion, so you have to balance these issues.

MS. VISSER: And, Melissa, on your end, what kinds of issues have you begun seeing on your end in the mortgage industry with regard to the lien stripping?

MS. YOUNGMAN: The main issues that I deal with on a daily basis are where a debtor is trying to modify or strip the first on the debtor's principal residence. Just to take a step back, under § 506(a), a debtor can bifurcate a secured creditor's claim into a secured and unsecured portion.[37] So that means that the secured portion is going to be limited to the value of the collateral. Anything left over is going to be treated as unsecured. Section 1322(b) is the anti-modification provision in chapter 13, which states that if the claim is secured only by the debtor's principal residence, then the debtor cannot modify that lien.[38]

What happened in *Nobelman*,[39] which was a Supreme Court decision, the Court said a debtor can't bifurcate under § 506(a) a lien on a debtor's principal residence, which would be a strip-down, not a strip-off, because that would violate § 1322(b).

Then *Tanner* came along in 2000[40] and the court said that if there's a junior lien that's wholly unsecured, then it's permissible for the debtor to strip off that lien because § 1322(b) only protects claims where there's some security to protect.

My clients, though, if we have a second and a motion to value gets filed and we really don't think that there's any possibility that we're ever going to recover on that second lien, it's really a business judgment whether we're going to respond to that motion. So even though it might not technically be correct, I see a lot of debtors filing those motions. I see a lot of the time

37 11 U.S.C. § 506(a) (2006).
38 *Id.* § 1322(b).
39 Nobelman v. Am. Sav. Bank, 508 U.S. 324 (1993).
40 Tanner v. FirstPlus Fin., Inc. (*In re* Tanner), 217 F.3d 1357 (11th Cir. 2000).

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mortgage companies aren't responding to them because their clients aren't willing to pay for it, even though maybe we have a valid defense to it.

The other thing we see is in chapter 20 cases. For those of you who don't know what a chapter 20 case is, there's no chapter 20 in the Code, but what it means is a debtor who has filed a chapter 13 in the last four years prior to the filing of that case received a 7, 11, or 12 discharge, or in the two years preceding received a chapter 13 discharge. So chapter 20 comes from 7 followed by a 13. That's where we see it most commonly. Whether a debtor can strip a junior lien under that has been treated differently by different courts. There's really three different lines of cases. Basically the answer is no, no, or in some circumstances.

Under one line of cases, the court reviewed it and said, "Well, if we allow a bankruptcy debtor who's not eligible for a discharge because of § 1328(f)[41] because they received a prior discharge in either the four- or two-year time period, that would be a de facto discharge of the debt, and we're not going to do that, so we're not going to allow debtors to strip this lien."

Some cases reach the same conclusion, but the reason that they did wasn't really a de facto discharge issue; it was because they said it would be tantamount to allowing a debtor in chapter 7 to strip a lien, which we know you can't do. The Supreme Court has expressly said you can't do that under the *Dewsnup* decision.[42]

Then there's a third line of cases. They say, "Well, in some circumstances there might be a legitimate reason for the debtor to file a subsequent chapter 13. And if there is, if it appears that this case was filed in good faith and it looks like the debtor is going to be able to complete their plan payments, then we're going to allow them to do that."

So it's sort of up in the air whether, in a chapter 20 case, it's permissible for the debtor to strip a junior lien. I can tell you in Florida, most of our courts have said, "No, it's a de facto discharge basically and we're not going to let that happen."

MR. CAHN: Melissa, let me ask you a question. Let's assume that you and I are on opposite ends of a case. I represent a debtor who is entitled to a discharge, who has filed a motion or adversary to strip off your client's wholly

[41] *See* 11 U.S.C. § 1328(f).
[42] Dewsnup v. Timm, 502 U.S. 410 (1992).

unsecured second mortgage, but it's a close call. It would be my appraiser versus your appraiser, and we don't know who is going to win, and we decide let's make a deal. Can we even do that? Let's say we decide to fund your client's $50,000 unsecured creditor to the extent of $10,000 through the plan. Since the *Tanner* opinion says that the debtor can strip off a wholly unsecured second mortgage, would that be even a legal consent judgment? I don't know. I've never had one issued or kicked back. It's an interesting issue that I haven't seen come up.

MS. YOUNGMAN: It is an interesting issue. I haven't litigated it, but I can tell you that I have reached deals like that where we've reached a deal on a second lien where it was questionable, and the court didn't really dispute it, I guess because we had a deal and it was going to benefit the debtor. But I haven't seen it litigated yet.

MR. GOODMAN: Now, I wonder. If Brian's appraisal is a good one, and I wanted to ask you a question about what if the debtor is using Zillow or some internet website, whether your client has an issue. But just to get back to this settlement agreement. Now, what if this lien could be stripped off and your client doesn't fully disagree with it but is willing to make a deal just to get something, and all of a sudden that could negatively impact the other unsecured creditors because there's this money that could go to them. So now do I interject myself into the situation because now you're negatively impacting the other creditors of this estate?

MR. CAHN: These issues have all really come to the forefront with the decline of the real estate market. I'm filing ten times as many motions to strip an unsecured second lien as opposed to a few years ago, so these issues are really starting to come to the forefront.

MS. YOUNGMAN: Definitely. I would say in seven out of my ten chapter 13 cases we have these motions filed, so it's very common.

MR. GOODMAN: Let me get back to the idea because, Brian, you were talking about a battle of the appraisers. I occasionally see that but not very often. A lot of times, I see the county's tax assessment attached to the motion or I see they're referencing Zillow or they're referencing Eppraisal or some other website. Does the mortgage company take that into consideration? What do they think when they see not a good, hard appraisal attached to that motion?

MS. YOUNGMAN: It is extremely common for us to see either a Zillow or a county tax appraisal, or the debtor just attaches an affidavit saying, "In my

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opinion, I believe that the fair market value of my property is three dollars." Courts in the Middle District have said the debtor can rely on that. Is that credible evidence when I come in with an actual appraisal? No. So I'm probably going to win. What usually happens is the motion gets filed, there's a Zillow or just the debtor saying, "This is what I believe the value to be." I file a response. If there's enough time, I'll file a response with an actual appraisal attached, and then we settle. It hardly ever goes to an evidentiary hearing. If it does, the court has to then make a decision about whose appraisal is more credible, and that's going to come down to what comparable sales they looked at, how recent were those sales, and how realistic is the actual appraisal.

MS. VISSER: Great. Do we have any questions before we wrap up on lien stripping? We did also include some information in the materials about new Rule 3002(1).[43] So if anyone has a burning question about application of the rule or how the creditors are handling that, for Melissa, we could take that as well. And apparently that is not as interesting as lunch. It looks like we're done.

MS. MIKHAIL: Please join me in giving a hand to our Consumer Panel.

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[43] FED. R. BANKR. P. 3002.1.

https://scholarlycommons.law.emory.edu/ebdj/vol28/iss2/5